The Law and Practice of Contractual Receivership

Volume I

by

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Thesis submitted to The University of Nottingham for the degree of Doctor of Philosophy

October 2000

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Abstract

The law of contractual receivership has evolved quietly over a period of one hundred and fifty years or so. The institution of receivership started out as a mortgagee's remedy, but has proved remarkably adaptable to the commercial needs of large financial organisations, so much so that it has enjoyed ascendancy as a method of debt enforcement for the latter half of the twentieth century. This thesis attempts to chart the developmental process of receivership law, and to evaluate both judicial and legislative responses to the particular issues of policy it raises. In particular, it investigates the impact of receivership, both in legal and practical terms, on the various parties interested, in their various capacities, in the corporate entity. The main body of the thesis addresses this question from a number of perspectives.

Corporate insolvency affects a wide variety of constituents. Receivership, as an insolvency regime, is frequently criticised as overly biased in favour of powerful financial institutions at the expense of both the corporation itself and its other stakeholders. By affording a contractually appointed receiver dominion over the entirety of the company's property, and by sanctioning the proposition that his decisions be informed *exclusively* by his appointor's interests, this censure of the law might appear justified. Alternatively, proponents of receivership have promoted the institution as a 'rescue' mechanism, a means by which viable companies, *or viable sectors of their businesses*, may be nurtured back to productivity and profitability. These two conflicting views will be examined in the final Chapter, in the light of recent reform initiatives which appear to envisage at least some minor modification to the existing 'balance of power'.

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INTRODUCTION

Preface: What is receivership?[1]

1. The perception of contractual receivership

Even the uninitiated have some (albeit perhaps imperfect) understanding of the phrase 'the receivers have been called in', and this information is usually imparted in the kind of hushed tones that accompany the news that a medical prognosis is less than promising. Indeed, the analogy may not be inappropriate[2]. Receivership of a company generally signals the fact that all is not well with that company. Whilst the precise nature of the problem may not be transparent, it is commonly assumed to be serious, so serious as, in the majority of cases, to be terminal. It is not fanciful to suggest that the most widely held perception of receivership is a pessimistic one. Far from being seen as company doctors, or trouble-shooters on a mission to rescue an ailing enterprise, receivers are viewed as harbingers of its ultimate demise, descending upon it only to administer the last rites.

Of course, the perceived wisdom will not always reflect the reality and an inauspicious reputation may be undeserved. This is, to some extent, the case where receivership is concerned. There exists something of an early nineties 'hangover' which still taints it as an institution in the eyes of the public, and it is the misfortune of receivers that much of the negativity attaching to their position emanates from an era of unsettled economic conditions and unprecedented corporate failure. Recessions do not make for spectacular rescues, but that truism has been overlooked, and the most visible candidate for hostility in this regard is usually the receiver. His

[1] This introductory section is intended, firstly, to provide a skeleton description of receivership and, secondly, to sketch out the aims, scope and emphases of the thesis as a whole. For the sake of brevity footnotes are kept to a minimum, and certain assertions made which will be amplified upon and supported in the main body of the work.

[2] Nor, indeed, original.

is the classic case of shooting the messenger.

Furthermore, as many would vigorously assert, the beneficial aspects of receivership have been woefully under-publicised. The demise of a company is not necessarily accompanied by the demise of the enterprise carried on by it, nor are its employees inevitably rendered jobless. The timely intervention of a receiver may be instrumental in salvaging worthwhile sections of the corporation that might otherwise have been jeopardised by ongoing incompetence on the part of management. The appointment of a receiver may 'stop the rot', as it were, in that directors who might have continued to incur liabilities are divested of their control of the enterprise. The receiver, in such circumstances, acts as a buffer between the company and those who, but for his appointment, would have found themselves to be unsecured creditors[3].

Nonetheless, it remains the case that the institution of receivership continues to engender suspicion, and even hostility. This is hardly surprising, given that bad news reaches the public more speedily and frequently than good news. Further, those with grievances will often find themselves with an opportunity to air them, whereas receivers themselves appear unwilling to engage in validation exercises. This is particularly noticeable at the local level, where some receiverships become front-page news[4]. Folklore, then, is perpetuated at the expense of a genuine understanding of what it is that receivers actually do, why they do it, on whose behalf, and under

[3] Receivership is not the only mechanism to achieve this result. Liquidation and administration provide a direct bar to management incurring further debt, and the prospect of wrongful trading proceedings under s 214 Insolvency Act 1986 acts as an indirect (perhaps psychological) bar.

[4] At the time of writing there are frequent reports in local newspapers concerning the receivership of a Speedway club. The members of the club express disappointment at the refusal of the receivers to lease the grounds to them so that racing can continue in the short term. The reason for this refusal is said to be the receivers' determination to sell the land with planning permission and vacant possession. The receivers, perhaps understandably, have remained tight-lipped.

what factual and legal constraints. The question is whether, by exploring popular myths, it becomes possible to explode them.

2. Receivership as a debt enforcement mechanism: an overview

As a starting point, it is important to identify the *function* of a contractual receiver. Notwithstanding that certain 'rescue-orientated' roles have been claimed for receivers, it remains the case that receivership began as, and continues to be, primarily a method of enforcing a secured debt. Advancing credit to a company necessarily entails acceptance of the risk that the advance will not be repaid. Such risk can be diminished by the taking of security, the means of which are manifold, but in the present context usually comprise the making of the loan conditional upon the creditor obtaining a proprietary right in the present and future assets of the company. If the company cannot repay, the creditor has recourse to its property, which can be sold and the proceeds used to discharge the debt.

The *taking* of security is only the first step in reducing the risk of furnishing credit facilities. If the worst happens, and the company defaults, it then becomes necessary to *enforce* the security, to sell the collateral and apply the proceeds as described above. This process not straightforward, either in legal or practical terms. At one time a creditor taking enforcement steps found himself under considerable legal disabilities[5], and, as will be seen, receivership provided a way around these. The practical problems of enforcing security remained, however. The value to the creditor of having security cannot be measured solely by the monetary value of the collateral, for this takes no account of the costs of taking possession and selling that collateral. To the extent that enforcement requires a creditor to expend time and money, the

[5] Specifically, the equitable rules relating to mortgagees in possession; see Chapter 1.

value of having security is reduced. The interposition of a receiver between debtor and creditor provides a supremely effective solution to this dilemma.

How does receivership work to achieve this benefit? This is probably best illustrated by example[6]. Suppose Company X has an overdraft with Bank Y[7] of £100,000 and has repeatedly failed to respond to the bank's request to reduce the amount outstanding. Bank Y reaches the conclusion that Company X will not, in the future, be in a position to discharge the debt. Bank Y has, however, a fixed charge over Company X's land, plant, book debts and goodwill, and a floating charge over its stock and work-in-progress. It estimates the value of these assets at £30,000 on a forced sale basis and £120,000 if the business can be sold as a going concern. Theoretically, therefore, the bank's security should protect it from loss, but only if it can be enforced at little or no cost.

Leaving aside the legal position, Bank Y would be ill-equipped to carry out the enforcement task. The situation demands expert intervention *in sitû*: someone must be moved into the company's premises to safeguard the assets and assess how best to proceed, and this is not what bankers do. Outside intervention is called for, but such is likely to be expensive. The net result is that what appears to be perfectly adequate security is found wanting, *unless* a quick, cheap and effective method of enforcement is available. Receivership is that method.

Receivers can be appointed with the minimum of ceremony: once a valid demand for repayment has been made and not met, the appointment can follow without delay[8].

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[6] The example is basic in the extreme and does not purport to typify the course of a receivership.
[7] Receivers are usually appointed by banks, although it is technically possible for *any* creditor to contract for the right to make an appointment. This right will be dependent upon the creditor having some form of proprietary interest in some, or all, of the company's property, since the receiver enforces the debt by recourse to that property. For the sake of convenience, references to 'the bank', 'the secured creditor', 'the debenture-holder' and 'the appointor' will be used interchangeably throughout the thesis.
[8] *Bank of Baroda v Panessar* [1987] Ch 335; *Lloyds Bank plc v Lampert* [1999] BCC 507.

The receiver's professional fees, as well as any costs he incurs during the receivership, will invariably be met by the defaulting company. Further, the bank can rest assured that its appointee has the expertise to perform his task efficiently. This is particularly so in light of the fact that the Insolvency Act 1986 now prescribes minimum qualifications for those acting as insolvency practitioner in relation to a company[9]. These factors combine to create a potent enforcement mechanism, almost tailor-made to meet the needs of the bank, and it is little wonder that receivership has proved so popular over time. The bank can, in effect, simply make its appointment and await payment in due course.

As an added bonus, the bank's legal position is made more favourable by the use of a receiver. The spectre of extensive liability as mortgagee in possession is exorcised by the simple ploy of deeming the receiver to be agent of the mortgagor/company[10]. This sleight of hand shields the bank from responsibility for its receiver's actions, without prejudicing its interests, since the receiver's main focus throughout his time in office will be those very interests.

Debt enforcement, therefore, is the primary concern and function of receivership, and its extraordinary success in this regard is demonstrated by the fact that for over a century loan contracts have, as a matter of course, made provision for the appointment of a receiver. However, the above description is incomplete as to the nature and significance of receivership, and an analysis of the institution would be inadequate without an examination of its impact outside the debtor/creditor relationship of company and bank. The next stage of the enquiry, therefore, is to

[9] Section 390(2) Insolvency Act 1986. The definition of 'insolvency practitioner' includes an administrative receiver.

[10] This strategy is further investigated in Chapter 1.

identify other 'corporate stakeholders' who have an immediate interest in the workings and outcomes of receivership.

3. The process of receivership: implications

As a method of debt enforcement, receivership functions by removing control of secured assets from the company's management and placing it in the hands of the receiver. He[11] then makes certain deployment decisions in respect of those assets, with a view to discharging the outstanding debt. The process appears deceptively simple: the receiver sells whatever he can for the best price he can get. The reality is infinitely more complex, influenced by variables which will rarely be predictable or, indeed, predicted. It is, however, possible to identify a few common features of corporate insolvency that may inform the receiver's eventual deployment decisions. Contemporaneously one can see how such decisions bear upon the interests of those outside the tripartite debtor/creditor/receiver relationship.

It is trite to state that receivers are appointed over companies in crisis. It follows that the likelihood of the appointor being the only major creditor of the company is infinitesimal, and there will invariably be a variety of other parties seeking payment. These may include those who have supplied goods or services to the company[12], various organs of the State[13], customers who have ordered goods from the company and paid for them in advance, and, not least, the company's employees, who may be owed wages or other benefits. In the vast majority of cases, the assets of the company being finite, they will not be sufficient to meet all outstanding claims.

Perhaps the first incident of the appointment of a receiver is that it amounts to a

[11] In time honoured fashion, 'he' will be employed throughout to denote 'he/she'.
[12] Usually designated 'trade creditors'.
[13] Most notably the Inland Revenue and Customs and Excise.

reference point from which priorities are determined. At the moment of appointment it becomes possible to line creditors up into the sequence in which they will be paid. This sequence may be contractually preordained, so that those who have bargained for proprietary rights will be towards the top of the list, or prescribed by statute[14]. Whilst the priority position remains static throughout receivership[15], the value of assets may not, in that the actions of the receiver may enhance, or even diminish that value, thus altering the actual amount each creditor eventually receives.

How does this occur? Given the company's likely parlous financial circumstances at the onset of receivership, it will often be the case that a break-up sale of assets will not realise sufficient to discharge the debt owed to the bank, let alone the claims of other creditors. If, however, the underlying *business* of the company is potentially sound, then prospects improve, as it is a truism to state that the value of any enterprise is multiplied considerably if it can be sold as a going concern. Even if the business is unsaleable, it will usually make sense to continue operations in order to complete work-in-progress and to fill existing orders, for the value of the goods produced will invariably exceed that of their component parts in their raw state. Thus, even by the simple expedient of continuing production on a short-term basis, a receiver can generate more cash than he started with.

Where it is deemed appropriate, a receiver will seek to sell the company, or its business, as a going concern. Any sale will usually be preceded by a period of trading, as the receiver seeks to stabilise the enterprise and assess its strengths and weaknesses. This can be a subtle process. The company's 'business' may consist of several 'projects', each distinct and identifiable, each attaining different degrees of

[14] See, e.g., s 40(1) Insolvency Act 1986.

[15] Subject to the possibility of proceedings for non-registration of a registrable charge (see s 395(1) Companies Act 1985) or an avoidance action under s 245(2) Insolvency Act 1986.

profitability, and each a potential candidate for sale in its own right. The receiver must decide which parts of the company are most viable, whether or not these can be packaged and marketed, and in what form they are to be presented to potential purchasers.

The company will also have entered into contracts prior to the appointment, and it falls to the receiver to choose whether or not these should be performed[16]. The possibility of obtaining supplies more cheaply elsewhere, or selling finished products at a better price, will be assessed and the appropriate steps taken. The company's workforce will also be an issue. Initially, a receiver will have to decide how many, and which staff to retain in order to achieve his short- and long-term aims. It may also transpire that a sale of the whole or part of the business will entail a concurrent transfer of some employees' contracts of employment[17].

The above 'pocket' version of receivership aims to illustrate how decisions made, or stratagems determined upon, will have multiple effects. A receiver's initial aim is to raise sufficient cash to satisfy the claims of the appointor, but each means to this end may have a 'knock-on' effect for those standing outside the core relationship. The decision to complete a particular contract means that the other contracting party gets what he has bargained for (and probably paid for), and saves him from the unenviable status of unsecured creditor. It also promises a period of further employment for certain of the workforce. On the other hand, the decision to repudiate a contract leaves the other party with an empty damages remedy against the company.

The jettisoning of an unprofitable sector of the company's business will have adverse effects on those employed in that sector, whilst the successful sale of another may

[16] See Chapter 3.
[17] See Chapter 4.

preserve employment. If the receiver need only sell fixed charge assets to discharge the secured debt, then those who would have been paid as preferential creditors in the event of a sale of floating charge assets have only their remedy against the company, and, if liquidation follows, the monetary value of their claim will also be altered.

In pursuit of a specific goal, the repayment of a secured debt, a receiver has significant power to enhance or to jeopardise the future prospects, economic or otherwise, of a whole range of interest groups who had no involvement in his appointment and who appear to have little control over his actions. A favourable outcome for the appointing bank may have, as a spin-off, an equally favourable outcome for some stakeholders, but may contemporaneously consign others to a worse position. This process might therefore be accused of being arbitrary, although it is to some extent caused by the fact of insolvency, rather than receivership. In the words of one eminent member of the judiciary:

> "Of course it is true that insolvency always causes loss and that perfect fairness is unattainable."[18]

Stating the obvious, though, is cold comfort to those prejudiced by receivership, and, in any event, they might reasonably enquire why an inevitable loss had to fall their way. Some might even question the presumption that there will inevitably *be* a loss: after all, if a receiver can improve the company's position sufficiently to pay one creditor, does not justice require that his endeavours be more evenly directed? If receivership, with its present narrow focus, is capable of producing beneficial incidents, could these not be augmented by a broadening of the focus? The question conveniently introduces the next theme.

[18] *Neste Oy v Lloyds Bank plc* [1983] 2 Lloyds Rep 658, 666, *per* Bingham J.

4. Receivership as a facilitator of corporate rescue: a shift in emphasis?

In recent years the concept of corporate rescue has gained ground as a worthy aspiration. Much attention has been paid to the adverse consequences of the complete failure of a company[19], such as the attendant job losses, the waste of enterprise and resources, the devastation it may cause to a local community, and the economic hardship suffered by its creditors. The perceived wisdom is that, where feasible, some attempt should be made to achieve at the very least a partial rescue.

Precisely where receivership slots into this ideology is difficult to depict. Some considerable thought has, in the past, been given to the idea of receivership as a 'rescue mechanism', most visibly by the Review Committee into Insolvency Law and Practice chaired by Sir Kenneth Cork, a body charged by the then Conservative Government with investigating insolvency law (both individual and corporate) and recommending reforms. The Cork Committee embraced the philosophy of corporate rescue enthusiastically, asserting that one of the basic objectives of insolvency law should be:

> "...to provide means for the preservation of viable commercial enterprises capable of making a useful contribution to the economic life of the country..."[20]

Furthermore, receivership was identified as one means of achieving this aim; indeed, the fact that it facilitated the appointment of a receiver and manager was advanced as one of the saving graces of the much maligned floating charge:

> "Such receivers and managers are normally given extensive powers to manage and carry on the business of the company. In some cases, they have been able to restore an ailing enterprise to profitability, and return it to its former owners. In others, they have been able to dispose of the whole or part of the business as a going concern. In either case,

[19] I.e., its liquidation.

[20] *Insolvency Law and Practice: Report of the Review Committee* (hereinafter the Cork Report), Cmnd. 8558 (1982 : HMSO : London), para. 197.

> the preservation of the profitable parts of the enterprise has been of advantage to the employees, the commercial community, and the general public."[21]

Rehabilitation was unmistakably perceived as a possible *result* of receivership, even though it may not be the aim *behind* it, in as much as the appointor's chief interest (perhaps *only* interest) would be the discharge of the debt, and the receiver's focus would be raising enough cash to procure that discharge. That the company in receivership might emerge at least partly intact might be fortuitous, but that possibility impressed the Cork Committee, so much so that it decided upon receivership as the prototype for its more overt rescue mechanism, the administration order.

The idea of receivership as a rescue mechanism is important, in that it goes some way towards answering the criticism that the process is excessively one-sided, favouring the appointor to the unwarranted detriment of other interested parties. Deliverance of the company, or of the enterprise that it carries on, even if entirely incidental, can be seen as a pay-off for the monopoly enjoyed by the appointor in the area of debt enforcement. This, however, assumes that receivership in its current form does indeed attain positive outcomes: that it saves worthwhile projects and jobs, that it maximises returns in an even-handed manner and that it promotes an overall constructive consequence. How far such a proposition can be supported is open to dispute. A close examination of the legal regime underpinning receivership might equally lead to the conclusion that the institution is, at best, rescue-neutral, at worst counter-productive to this objective. If this is the case, the most urgent enquiry must concern the appropriate legal response.

[21] *The Cork Report, supra* n 20, para. 495.

The Objectives and Scope of the Thesis

1. The law of receivership: a focused analysis

The process and impact of receivership are briefly outlined above. It would be astonishing to discover that such a regime, with its capacity to affect a wide array of interests, was not subject to some form of 'public' regulation, notwithstanding its 'private' origins. There is, of course, a body of law specifically concerned with receivership. It is comprised in a raft of provisions in the Insolvency Act 1986, but the underlying common law continues to inform in this area, and to a meaningful degree.

Law does not evolve in a vacuum. It should, and does, take account of the driving policy of the age, and as one travels along the continuum one discerns how policies, and, as a corollary, law, change to accommodate the mutable demands of society. In the context of receivership this process of development is discernible from an examination of both common law and statutory innovations. For law to accurately reflect a given ideology, however, presupposes that such has been clearly enunciated. The progress of the law of contractual receivership has been bedevilled by a dearth of transparent debate into its function. Given receivership's fluid history, this is not surprising. Its origins are firmly fixed in the law of mortgages, but its success in that area led to it being transplanted *in toto* into more general commercial debtor/creditor relationships. This development, in turn, has allowed 'receivership law' to be permeated by a variety of influences, the result being that it sometimes uncomfortably straddles such areas as contract, company and insolvency law, with a seasoning of equity and agency for good measure[22].

[22] See also to this effect, in the context of appointment validity considerations, Doyle, *Administrative Receivership: Law and Practice* (1995 : FT Law and Tax : London), 1, where the author aptly describes administrative receivership as "a true legal *maelström*".

There now exists a distinct branch of law dealing with receivership. No attempt will be made to comprehensively describe it. Rather, this thesis takes as its focal point the theme of *relationships.* The receiver finds himself in a number of different relationships during the course of his office. The obvious one is that which exists between himself and the company over whose assets he is appointed, closely followed by that of receiver/appointor. But there are others, perhaps less instantly recognisable but no less important. To the extent that the receiver has power to affect, directly or indirectly, the interests of any given group it is suggested that he has some form of *relationship* with that group. In this regard, the thesis will investigate the impact of receivership upon such diverse stakeholders as the directors of the receivership company, its owners, its employees, and its preferential and unsecured creditors.

This relational nexus presents, it is submitted, the law's first major dilemma. Each group confronting the receiver will have an interest in the manner in which he performs his functions. These interests will, almost inevitably, *conflict*, and such conflicts represent a further theme of the thesis. The prioritisation of one group's welfare will often be potentially injurious to that of another, so how is a receiver to choose between competing interests? More specifically, how does the law intervene to inform his choice, and on what basis?

A consideration of *relationships*, and the *conflicts* arising therefrom, serves as the foundation of the thesis. It attempts to discern and evaluate the prevailing legal response to both, to chart the manner in which the law prescribes the resolution of conflicts and the prioritisation of certain relationships, and to examine the extent to which the receiver's freedom of action is enhanced or restricted by this edict. This enables an extrapolation of certain value judgments inherent in the law's responses, and the extent to which these are valid rejoinders to the underlying legislative framework.

Finally, the legislative framework itself warrants some comment. Is it specific enough to enable those called upon to implement it to do so properly? Is the policy behind legislation openly identifiable, or does it offer some interpretative leeway? If the latter, how are the arbiters to fill the gaps in a manner which accords with the causal aim? The thesis, therefore, looks very much to the law's responses to a series of difficult contests which will inescapably impinge on the rights and interests of a variety of corporate stakeholders. If such rejoinders are unequal to the particular issues raised by receivership, and reform of the law necessary, the substance of such reforms is also a fertile source of enquiry, and one which the final Chapter of the thesis addresses in some detail.

Finally, whilst legal rules have a significant bearing on how receivership operates, they provide little more than guidelines, and an examination of the Law Reports alone cannot hope to inform as to the practical nature of the institution. In this regard the thesis, wherever possible, attempts to identify and to illustrate those extra-legal concerns that may in some way influence the course of a receivership. In particular, the final Chapter makes substantial reference to anecdotal evidence gleaned from insolvency practitioners with considerable experience of insolvency regimes, including, of course, receivership. Their views as to the effectiveness of the law, and, indeed, the practical constraints which confront receivers on a day-to-day basis, are valuable in that they allow a rather more holistic analysis of receivership law, and, as a corollary, contribute to the critical question of whether reform is either necessary or desirable.

CHAPTER 1

THE AGENCY OF THE RECEIVER

Introduction

An exploration of *relationships* in the context of receivership necessitates an initial intimation of what that term connotes. It was proposed earlier[1] to treat any party upon whom the receiver's actions or decisions will have some impact as being in a *relationship* with the receiver. Law has a tendency to pigeonhole. It compartmentalises in order to treat like in like manner, to establish general principles that will apply to given situations, transactions and relationships that display a sufficient degree of similarity. This means that the particular *designation* afforded a relationship has legal consequences for the parties to it.

When an individual assumes a certain *status* in relation to another, the mere invocation of that status can, to a certain extent, amplify the rights and duties transferred and undertaken without further enquiry. The labelling of a relationship becomes convenient legal shorthand; the label reflects expectations, how each party is required to behave within the relationship. Labels will only infrequently define rights and duties comprehensively, but if the parties have failed to precisely specify what sort of performance is called for, they may operate to fill gaps.

An example of a status entailing legal incidents is that of *agent.* As a rule, those identified as agents are subject to a legal regime which ordains a standard of conduct as far as dealings with the *principal*, the other party to the relationship, are concerned, and the agent is expected to act according to this template[2]. Contractual

[1] See Introduction.
[2] The universality of this proposition is tested later in the Chapter.

receivers are agents, and they are almost invariably agents of the company over whose assets they are appointed[3]. This is because the parties to a contract have decreed in that contract that this shall be so. One might therefore expect that the receiver's status as agent will be instrumental in determining the manner in which he is to act, or, more correctly, the interests he is to prefer in so acting. Reality, however, departs dramatically from expectation in this regard, with unique results for the parties concerned. This Chapter attempts to negotiate the convolutions of the receiver's agency in order to conclude, first, whether it can properly be designated an agency at all, and, secondly, to assess its practical effects.

Agency and Receivership: Some Preliminary Observations

1. A brief history of the agency of receivers

Receivership has long been established as a mortgagee's remedy. The institution itself predates the modern practice of appointing a receiver as agent of the mortgagor[4] by a couple of centuries at least, that strategy arising out of the prejudicial incidents of another mortgagee's remedy, that of taking possession of the mortgaged property. The right to possession was usually exercised so as to intercept any profits generated by the mortgaged property or as a preliminary to its sale. It was not uncommon for a mortgagee faced with a defaulting mortgagor to appoint an agent to receive any profits or to arrange a sale, simply as a matter of convenience. Whether the mortgagee exercised his entitlement to possession personally or vicariously, he faced the considerable disadvantage of having his

[3] Although a contractual oversight may result in the receiver being the agent of his appointor; see *In re Vimbos Ltd* [1900] 1 Ch 470.
[4] In the present context, the company. The terms will be used interchangeably when appropriate.

conduct whilst in possession subjected to the scrutiny of equity. Specifically, he might find himself liable to the mortgagor *on the footing of wilful default.*

Liability to account for wilful default is of ancient origin[5], arising out of the account jurisdiction of the Courts of Equity. On a suit for redemption a Chancery Master took an account, whereby the mortgagee's principal, interest and costs were set against the amount received from the mortgaged property. Where the mortgagee had previously taken possession, this last item included not only what *had been* received, but what *might have been received but for his wilful default*[6]. The kind of conduct attracting such liability included the refusal to accept tenants[7], the disadvantageous letting of the property[8], and failing to receive the purchase price on a sale of the property[9].

The remedy of possession was, therefore, fraught with pitfalls. A means of avoiding these was concocted early in the 19th century, and it has served mortgagees remarkably well ever since. It had long been the practice to insert in the mortgage deed a clause entitling the mortgagee to appoint a receiver to take possession of the mortgaged property: by the simple expedient of appointing that receiver *as agent of the mortgagor*, the hazard of wilful default liability was neutralised. An incomparable account of this development is to be found in the judgment of Rigby LJ in *Gaskell v Gosling*[10], and it is not proposed to examine it further here. It suffices to note from the outset that the agency status of contractually appointed receivers arose simply as a protective device, and in an era in which land was the

[5] See Frisby, *Making a Silk Purse out of a Pig's Ear*, (2000) 63 MLR 413, 416.
[6] See, e.g., *Harnard v Webster* (1725) Cas. Temp. King 53; *Beare v Prior* (1843) 6 Beav. 183.
[7] *Anonymous* (1682) 1 Vern. 45; *Hughes v Williams* (1806) 12 Ves Jun 493; *Brandon v Brandon* (1862) 10 WR 287.
[8] *Shepard v Jones* (1882) 21 Ch D 469; *White v City of London Brewery* (1889) 42 Ch D 237.
[9] *Mayer v Murray* (1878) 8 Ch D 424. For a fuller treatment of the substance of wilful default liability see Frisby, *supra* n 5; Stannard, *Wilful Default*, [1979] Conv. 345.
[10] [1896] 1 QB 669, 692.

only realistic candidate for mortgage collateral. Whilst mortgage transactions in relation to land remain widespread, the practice of financing commercial enterprises via agreements that are, essentially, mortgages, is similarly extensive. It is perhaps surprising that a manufactured agency convenient and appropriate to the social conditions of an earlier epoch should survive to the present day. The following sections examine how this ostensible anomaly came about.

2. A description of agency

> "Agency is the fiduciary relationship which exists between two persons, one of whom expressly or impliedly consents that the other should act on his behalf so as to affect his relations with third parties, and the other of whom similarly consents so to act or so acts."[11]

The above conveys a basic idea of what agency involves. It is a facilitative relationship, the employment of an agent reflecting the fact that individuals can rarely attend to all their affairs at once, so that circumstances demand that another person be charged with the performance of some task, or related tasks. This performance may involve the agent in the creation of a legal relationship between his principal and a third party[12], and it frequently entails the principal ceding control of his property to the agent, albeit with instructions on how that property is to be dealt with.

Agents can enter into contracts *on behalf of* their principals, and while it is the agent who does the 'contracting' it is the principal who is bound by the contract. The agent acts as a conduit between the contracting parties almost as though he has

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[11] *Bowstead and Reynolds on Agency*, 16th ed (hereinafter Bowstead), (1996 : Sweet & Maxwell : London), 1-001.

[12] Fridman emphasises the ability of an agent to affect his principal's *legal* position in relation to third parties as fundamental to agency: Fridman, *Law of Agency*, 7th ed (1996 : Butterworths : London), 11.

no legal identity of his own. The ability of an agent to bind his principal and third parties contractually is commonly referred to as the *external* dimension of agency. The *internal* dimension signifies the typical incidents of the relationship between agent and principal. This Chapter is primarily concerned with the manner in which the *receiver's agency* parts company with the orthodox understanding of the consequences of both.

3. Judicial and academic explanations: troubled waters?

Courts and commentators alike have struggled with the nature of the contractual receiver's agency throughout its history. A perusal of the case law reveals some adjectival prestidigitation in an attempt to explain how the standard incidents of agency are avoided when the agent in question is a receiver. Thus, to select a few examples, the receiver has been described as "a peculiar sort of agent, but nevertheless an agent"[13], or as "occupying a very special position"[14], and even as "wearing two hats"[15]. The agency itself is dubbed "not an ordinary one"[16], "rather unusual"[17], or "little more than an administrative convenience"[18]. On a wider view, this aspect of the law is acknowledged as "somewhat anomalous"[19], and giving rise to some "logical difficulty"[20].

[13] *Smiths Ltd v Middleton* [1979] 3 All ER 842, 846, *per* Blackett-Ord VC. The epithet of 'peculiar but real' is popular amongst the judiciary: see *Woolston v Ross* [1900] 1 Ch 788, 791, *per* Cozens-Hardy J; *Ratford v Northaven District Council* [1987] QB 357, 372, *per* Slade LJ; *Rhodes v Allied Dunbar (Pension) Services* [1989] 1 WLR 800, 807, *per* Nicholls LJ.
[14] *Visbord v Federal Commissioner of Taxation* (1943) 68 CLR 354, 382 *per* Williams J.
[15] *Peat Marwick Ltd v Consumer's Gas Co.* (1981) 113 DLR 3d 754, 762, *per* Houlden JA.
[16] *Re Sobam BV (In Receivership)* [1996] 1 BCLC 446, 452, *per* Arden J. "Not ordinary" comes a close second to "peculiar": see *Gomba Holdings UK Ltd v Minories Finance Ltd* (1989) 5 BCC 27, 29 *per* Fox LJ.
[17] *Telemetrix plc v Modern Engineers of Bristol (Holdings) plc* [1985] BCLC 213, 217, *per* Peter Gibson J.
[18] *Re Aveling Barford Ltd* [1989] BCLC 122, 127, *per* Hoffmann J.
[19] *Gaskell v Gosling* [1896] 1 QB 669, 678, *per* Lord Esher MR.
[20] *Sowman v David Samuel Trust Ltd* [1978] 1 WLR 22, 28, *per* Goulding J.

Academics have been rather more aesthetic in their terminology. Goode compares the administrative receiver with "the Roman God Janus" and describes him as a "protean character"[21]. O'Donovan remarks upon the receiver's "schizophrenic status" and points out that the law governing his duties and liabilities "ignores the biblical dictum that a man cannot serve two masters..."[22]. Stewart dubs the agency "somewhat artificial"[23], whilst Milman and Rushworth advert to "a *fiction* of agency"[24].

There is, then, a consensus roughly to the effect that the receiver's agency is non-conformist. Whilst accepting the status of agent, he is able to escape the full application of canons of agency law. This is uncontroversial, in the sense that it is widely acknowledged, but leads to practical uncertainty and conceptual difficulty. That an expressly appointed agent is not subject to a body of law designed to regulate his conduct appears anomalous, and to dismiss the anomaly by asserting that his situation is 'peculiar' smacks of sweeping the problem under the carpet. Admittedly, the fact that the law in this area has developed in a piecemeal fashion compounds the obscurity.

The next sections attempt, firstly, to compare and contrast "pure" agents[25] with receiver/agents, which primarily involves identifying those rules generally applying to the former and examining whether they apply to the latter. This exercise has already been proficiently performed by Milman[26], but bears repetition if only to reflect the impact or otherwise of the Insolvency Act 1986 and subsequent case law

[21] *Principles of Corporate Insolvency Law*, 2nd ed (1997 : Sweet & Maxwell : London), 216.
[22] (1979) 12 MULR 52, 52
[23] *Administrative Receivers and Administrators*, (1987 : CCH Editions : London), ¶ 402.
[24] *Receivers and Receiverships*, (1987 : Jordans : Bristol), 19.
[25] A term used by Peter Gibson J in the *Telemetrix* case, *supra* n 17, and gratefully adopted hereafter in relation to agents other than receivers.
[26] *Receivers as Agents* (1981) 44 MLR 658.

developments. Once any points of departure have been identified, legal explanations as to how such divergences are accomplished can be sought. If none present themselves, extra-legal clarification must be located.

Contractual Duties of Agents

1. A preliminary stumbling block: finding the contract

Agency is commonly contractual in origin, and the scope and content of an agent's duties will therefore be found in the terms of the contract between agent and principal. Immediately, one encounters difficulties where receivers are concerned, as locating the contract creating the agency relationship between receiver and company is hardly straightforward. The documentary basis of the receiver's appointment is the debenture agreement between company and debenture-holder. The *power* to appoint, the terms upon which an appointment can be made, and the powers of the appointee are all contained in a contract to which the receiver himself is not a party. The document of *appointment*, to which the receiver must respond before an appointment is valid[27], is usually a brief article, making no mention of the purpose of the appointment or the powers of the appointee, except by reference to the debenture[28]. Moreover, the appointment is made by the debenture-holder rather than the company. Where, then, is any contract between receiver and company?

The key to this question is found in the debenture, which will invariably contain an irrevocable power of attorney in favour of the debenture-holder. This, in effect, allows it to act as the company's agent when making an appointment[29]. As the appointor acts as agent for the company in this regard, in accordance with basic

[27] Insolvency Act 1986 s 33 (hereinafter 'IA').
[28] See Lingard, *Bank Security Documents*, 3rd ed (1993 : Butterworths : London), 11.11
[29] *Ibid.* 8.01. See also *Gaskell v Gosling* [1896] 1 QB 669, 692.

principles of agency law, he is able to establish privity of contract between the company, his principal, and the receiver. Thus it is, in law, *the company* that appoints the receiver as its own agent, and on all those terms contained in the debenture.

It is worth noting that this represents an interesting deviation from the normal understanding of how an agency relationship is created. Agency is thought of as *consensual*[30], suggesting a degree of autonomy on the part of both principal and agent. The relationship cannot be forced upon either party except, perhaps, by operation of law[31]. As far as receivers are concerned this tenet holds true. Before his appointment takes effect he must accept it, otherwise no agency relationship arises. The company/principal, on the other hand, has no input into the appointment exercise[32], and the decision to appoint the agent, the time of appointment and the identity of the agent are matters for the bank to determine. The company finds itself thrust into the agency relationship, and the notion of consent is dispensed with. That there is an element of coercion here is indisputable, and this is not a routine characteristic of agency. From the outset, therefore, there is a dichotomy between pure agency and the agency of receivers.

[30] See, e.g., Bowstead's description of agency, *supra* 18; Seavey, *The Rationale of Agency* (1920) 29 Yale LJ 859, 868; *Garnac Grain Co. Inc. v HMF Faure and Fairclough Ltd* [1967] 2 All ER 353, 358.

[31] Fridman discusses this process, and the distinction between consensual agency and that arising from estoppel in some detail: see *Law of Agency, supra* n 12, 15.

[32] Its directors may request the bank to appoint a receiver, but in general the appointment decision is exclusively the preserve of the debenture-holder.

2. The next hurdle: finding the duties

Debentures are lengthy documents, but notably terse as far as the duties of any receiver are concerned. They will usually contain an express term that the receiver shall be agent of the company, and an expansive list of powers that he may exercise[33], but are strangely silent as to the nature of his performance. Indeed, debentures do not in terms specify what the receiver's *task* is; it appears that the fact that he is to deal with the secured assets in order to discharge the company's indebtedness to the bank is left to be implied from his status as receiver[34]. In order to perform this function the receiver is endowed with an array of discretionary powers, but given no guidance as to *how* he is to exercise them. As regards itemising the receiver's *duties* the contract is deficient[35].

As noted earlier, this need not be problematic if regard can be had to the *status* of the receiver in order to define his duties and the manner of his performance. In other words, once a *task* is identified, the status or capacity in which the actor carries out that task should resolve questions of how he is to perform it: whose interests he is to prioritise in the event of a conflict, which of alternative courses he should take towards the fulfilment of the task, and so on. The choice of status in this regard saves the parties from engaging in an expensive and time-consuming drafting exercise, there being no need to exhaustively detail every incident of the relationship created because the status does this implicitly. In the context of receivership, the proposition that the receiver is to deploy the secured assets so as to

[33] Debentures are deemed to include the equally comprehensive list of powers specified in Schedule 1 IA, unless such are inconsistent with the provisions of the debenture; IA s 42(1).

[34] The courts generally acknowledge that the *purpose* of the appointment is the satisfaction of the appointee's claim; see, e.g., *Bank of New Zealand v Essington* [1991] ACLC 1039; *Downsview Nominees Ltd v First City Corporation* [1993] AC 295.

[35] Certain duties are prescribed by statute, but these are generally concerned with matters other than the principal/agent relationship between receiver and company. They will be examined later.

discharge the company's debt, and that he is to do so *as agent of the company*, ought to direct his *modus operandi.* What follows attempts to illustrate that this is hardly ever the case.

Performing the Task: Pure Agents and Receivers Compared[36]

1. Obedience

Pure agents are invariably subject to a duty of obedience. If a principal issues instructions that are lawful and reasonable then the agent must comply with them, or be liable for breach of contract. Bowstead describes this proposition as "almost self-evident"[37]. It is not so where the agent is a receiver[38].

Firstly, it is arguable that, on the appointment of a receiver, the principal/company loses its capacity to issue instructions to *any* of its agents, let alone to the receiver. Companies can only instruct through those empowered to do so, and it is usually the board of directors who are so empowered. It now seems well established that the management powers of the board cease, or are at least suspended, whilst the receiver is in office[39]. This is not an unqualified statement, in that the board may retain residual management powers, or, indeed, may be authorised by the receiver to act on behalf of the company[40]. As a general proposition, however, it is correct to assert that the power of the company to command, via its board, enters a period of cold storage on the receiver's appointment, so that that principal's usual instructional organ is disabled from operating.

36 The following does not describe the *minutiae* of a receiver's duties, these being considered in later Chapters.
37 *Supra* n 11, 6-008.
38 See Milman, *supra* n 26, 660.
39 *Moss Steamship Co. Ltd v Whinney* [1912] AC 254, 263, *per* Lord Atkinson; *Hawkesbury Development Co. Ltd v Landmark Finance Pty Ltd* [1969] 2 NSWR 782, 790, *per* Street J.
40 The impact of receivership on the internal management of the company is considered in detail in the next Chapter.

Should the board presume to give orders to the receiver he is under no duty to obey, and suggestions to the contrary have been robustly dismissed by the courts:

> "...[the receiver] was appointed, not to receive directions from the directors, but to give directions ... It may, indeed, be said with accuracy, I think, that he took the place of the directors and was responsible in their stead for the management of the affairs and business of the company..."[41]

The position is, therefore, that the company/principal, far from being entitled to expect obedience, may find itself dancing to its agent's tune.

2. Reasonable Dispatch

Bowstead observes agents are typically obliged to perform with reasonable dispatch, and that such a duty exists as an implied term of the agency contract[42]. As regards receivers, the position has yet to be tested in the courts, but a few observations can be made.

What would amount to reasonable dispatch in this context is difficult to quantify. The receiver's core assignment is to discharge the secured debt by deploying the secured assets, and this could be achieved in a number of ways, including trading on, selling the assets, and selling the business. It is the receiver who has the entire conduct of this exercise, and it would be a remarkably assured court that would attempt to assess whether or not he was acting with due expedition[43]. Secondly, this may be one duty the company would rather was not owed to it. Depending upon how much is owed to the bank, it may be that the quickest way to complete the task

[41] *Meigh v Wickenden* [1942] 2 KB 160, 166, *per* Viscount Caldecote.
[42] *Supra* n 11, 6-012.
[43] Protracted receiverships are not unknown. The Handley Page receivership has lasted some fifteen years, and that seen in *Re Joshua Shaw & Sons Ltd* (1989) 5 BCC 188 took nine years to complete.

is to sell the assets on a break-up basis[44]. Reasonable dispatch, in such circumstances, would be fatal to the company.

Without the benefit of judicial authority it is difficult to determine whether or not a duty to act promptly is owed, although it is tentatively submitted that were a court to be presented with incontrovertible evidence of inertia on the part of a receiver, it might well consider this a breach of duty[45]. In practice, however, such a scenario is implausible, as receivers work with half an eye to their appointor banks, who would not appreciate dilatoriness. The practical result is that receivers are generally not known for sitting on their hands[46].

3. Skill, care and diligence

3.1 Pure agency: the jurisprudential basis of the duty

> "Every agent acting for reward is bound to exercise such skill, care and diligence in the performance of his undertaking as is usual or necessary in or for the ordinary or proper conduct of the profession or business in which he is employed, or is reasonably necessary for the proper performance of the duties undertaken by him."[47]

Failure by an agent to exercise skill, care and diligence in the performance of his functions will be a breach of an implied term of the agency contract. Where the agent is in a position to exercise discretion, again, proper care and skill must be exercised. If the breach amounts to negligence it is established that the principal

[44] Whether a receiver could legitimately follow such a course is examined throughout the thesis.
[45] Such conduct might be a breach of the equitable duty of skill and care, to be examined in detail in the next Chapter.
[46] On the contrary, those detailing the practical side of receivership emphasise that speed is of the essence: see Samwell, *Corporate Receiverships* (1981 : ICAEW : London), Chapter 7; Stewart, *supra* n 23, ¶ 501.
[47] Bowstead, *supra* n 11, 6-015.

may sue in tort[48]. As well as concurrent tortious and contractual duties, it now appears that those who stand in a fiduciary position to another will owe an *equitable* duty of skill and care[49]. As agents are almost universally acknowledged as fiduciaries[50] this rule will apply to them. As to how the principal chooses to frame his action, the courts have recently displayed a tendency to assimilate the potential outcomes, so that there will be no advantage in suing in negligence over contract, or in eschewing both in order to sue in equity[51].

Where what is alleged is the breach of the equitable duty of skill and care, it has been stated authoritatively that such does not amount to a breach of fiduciary duty and, although it might attract an award of equitable compensation, such an award:

> "...resembles common law damages in that it is awarded by way of compensation to the plaintiff for his loss. There is no reason in principle why common law rules of causation, remoteness of damage and measure of damages should not be applied by analogy in such a case."[52]

It would therefore appear that at least one avenue to fiduciary forum shopping has been effectively barred.

3.1.1 The standard of care

The degree of skill and care expected of an agent will vary from case to case. Bowstead notes that it is "similar in principle to the normal duty of care in negligence"[53]. Where the agent in question is a professional, the level of skill

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48 *Midland Bank Trust Co. Ltd v Hett, Stubbs and Kemp* [1979] Ch 384; *Central Trust Co. v Rafuse* (1987) 31 DLR (4th) 481; *Hendersen v Merrett Syndicates Ltd* [1994] 3 WLR 761. See also Fridman, *supra* n 12, 160, and cases there noted.

49 *Bristol & West Building Society v Mothew* [1996] 4 All ER 698, 701, *per* Millett LJ.

50 See *infra* 36

51 Except, perhaps, where limitation periods are concerned.

52 *Bristol and West Building Society v Mothew*, *supra* n 49, 711, *per* Millett LJ.

53 *Supra* n 11, 6-017.

expected will be higher, and will normally conform to that which a reasonable professional acting in the same area would display[54]. Where the agent holds himself out as having special skills or expertise he will be expected to exercise that level of competence, and will be liable if he does not[55].

3.2 Skill and care: receivers

This is a vexed question and will be examined exhaustively in following Chapters. For comparison purposes the law can be stated briefly as follows. First, no action lies against a receiver in the tort of negligence[56]. Secondly, the receiver's agency does not appear to give rise to an implied contractual duty to exercise skill and care. Earlier cases suggested otherwise. In *Nelson Bros. Ltd v Nagle*[57] Myers CJ based his conclusion that a receiver owed a duty of skill and care squarely upon the footing that the receiver was expressed to be agent of the company and that such a duty was a normal incident of agency. There are echoes of this approach in *Standard Chartered Bank v Walker*[58], where Lord Denning MR adverted to the receiver's agency as a source of duty[59], although whether this was in order to establish sufficient proximity to ground liability in tort, rather than to identify a contractual duty is unclear. Certainly his Lordship framed much of his speech in the language of negligence, and to this extent the decision can no longer stand in the light of *Downsview Nominees Ltd v First City Corporation* [60].

[54] *Lamphier v Phipos* (1838) 8 C & P 475, 479.
[55] See, e.g., *Duchess of Argyll v Beuselinck* [1972] 2 Lloyd's Rep. 172, 183.
[56] *Downsview Nominees Ltd v First City Corporation* [1993] AC 295; *Medforth v Blake* [1999] 3 All ER 97.
[57] [1940] GLR 507.
[58] [1982] 3 All ER 938.
[59] *Ibid.*, 942.
[60] *Supra* n 56 (hereinafter *Downsview*). Nor presumably, can *American Express International Banking Corporation v Hurley* [1985] 3 All ER 564, *Knight v Lawrence* [1993] BCLC 215.

Indeed, *Downsview* has rather muddied the waters as far as any contractual duties of skill and care are concerned. Lord Templeman, in that case, wholly ignored the receiver's position as agent, instead equating his duties with those of a mortgagee and stating them as comprising a duty to act in good faith and for proper purposes, which, in turn, incorporates an obligation to take reasonable steps to obtain a proper price on a sale of the mortgaged property. It is therefore difficult to sustain an argument that a receiver is *contractually* bound to exercise skill and care.

The equitable position is, perhaps, even more opaque. As noted above, those in *fiduciary* positions owe an *equitable* duty of skill and care, but *Downsview*, by assimilating the positions of mortgagee and receiver, vetoes any attribution of a fiduciary character to a receiver simply because the general law does not view mortgagees as fiduciaries[61]. It is now unequivocally established, however, that receivers, in exercising their powers of sale and management do indeed owe an *equitable* duty of skill and care, which arises not so much out of any fiduciary status, but rather because of their status as *receiver*[62]. The position as regards fiduciary law is both fascinating and perplexing, and will be discussed shortly. For the present it suffices to note that whilst a receiver owes an equitable duty, its source is not his agency position, nor contractual.

[61] At least not in English law: see Chapter 2. The position may be different in the United States: see *Murphy v Financial Development Corporation* 495 A.2d 1245, 1985 (Supreme Court of New Hampshire.

[62] *Medforth v Blake, supra* n 56 (hereinafter *Medforth*). This enigma will be examined at length in the next Chapter.

3.2.1 The standard of care

Following the *Medforth* case it appears that that standard of care expected of a receiver is that which a reasonably competent receiver would exercise. This requires some amplification, not least because receivership has, for some time, been the exclusive domain of the professional. Since 1986 only qualified insolvency practitioners may act as an administrative receiver in relation to a company[63], and even before this enactment the practice of appointing banks was to select appointees from the ranks of chartered accountants[64]. Even where an appointee is a non-administrative receiver there will be a duty incumbent upon the bank not to appoint an incompetent[65]. These requirements reflect the acknowledgement of the legislature and the courts that receivership is a demanding office and should not be left to happy amateurs[66].

An interesting question is whether the 'professionalisation' of insolvency practice raises the appropriate standard of care to be expected from receivers. In particular, do administrative receivers hold themselves out as possessing a special skill or expertise, simply by reason of their qualification? Certainly, the law of negligence demands a greater level of skill from those engaging in specialised activities[67], and has recognised that those holding themselves out as experts must exercise an expert's skill[68]. Perhaps more pertinently, the standard of care required of a company director has been held to be that prescribed in s 214 of the Insolvency Act

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[63] IA s 390(2).

[64] And Chartered Surveyors if the nature of the security so demanded.

[65] *Shamji v Johnson Matthey Bankers Co. Ltd* [1991] BCLC 36, 42, *per* Oliver LJ, affirming the statement to this effect made at first instance by Hoffmann J, [1986] BCLC 278, 283.

[66] See the comments of the Cork Committee, *Insolvency Law and Practice: Report of the Review Committee*, Cmnd. 8558 (1982 : HMSO : London), para. 105.

[67] See, e.g., *Bolam v Friern Hospital Management Committee* [1957] 2 All ER 118.

[68] *Wilsher v Essex Area Health Authority* [1986] 3 All ER 801.

1986[69]. This states, first, that a director should conform to the standard of a reasonably diligent person occupying his position in relation to the company[70], and, secondly, that he should exercise any special skills and experience that he actually has[71]. Given that a receiver will take over most of the functions of the company's board, it might be considered suitable that the s 214 standard of care be applicable. In this regard, further amplification of the *Medforth* duty is awaited.

4. Duty to keep the principal informed

This duty is again an implied term of agency contracts, Bowstead giving the example of a solicitor who must inform his client of any overtures made[72]. It is heavily qualified in receivership. Pure agents must proffer any information that is of legitimate concern to the principal voluntarily, the duty being a positive one and calling for action on the part of the agent. Receivers, by contrast, need not periodically report to the company about the progress of the receivership[73], and if the board requires information it must make the initial approach itself.

Furthermore, if a request is made, the receiver is under no duty to comply with it, and may withhold anything the revelation of which might be damaging to the debenture-holder[74]. It is the receiver's judgment which prevails in assessing this matter. Finally, there is a positive onus on the board to show that the information requested is in some way 'necessary' for it to perform a particular function or make a particular decision. Mere curiosity will not suffice, and the circumstances in

69 *Norman v Theodore Goddard* [1991] BCLC 1028; *Re D'Jan of London Ltd* [1994] 1 BCLC 561.
70 The *objective* standard: s 214(4)(a).
71 The *subjective* standard: s 214(4)(b).
72 *Supra* n 11, 6-019.
73 *Gomba Holdings (UK) Ltd v Homan* [1986] 3 All ER 94.
74 *Ibid.*

which production will be forthcoming are likely to be limited in practice[75]. One is, therefore, confronted with the extraordinary prospect of a supplicant principal begging his agent's indulgence, and this example serves to reiterate the impotence of the company/principal as against its receiver/agent.

5. Contractual duties: some final thoughts

5.1 Explaining the receiver's contractual position

The above compendium of pure agency duties is contractual in origin. They exist as *implied terms* of an agency contract and will operate to the extent that they are not expressly excluded. That they *can* be excluded is unquestionable. The receiver's agency contract does not, however, expressly exclude them, which leads to the enquiry as to whether such terms can be, or are, *impliedly excluded.* At this stage the position becomes cryptic: the question 'can an implied term be impliedly excluded' assumes a certain unreality, and does not sit easily within the framework of implied term theory of contract law.

An agent's contractual duties appear to exist as terms implied in law, in that they apply as "a necessary incident of a definable category of contractual relationship"[76]. Such terms will only be implied by the courts in narrowly defined circumstances, and will be "as the nature of the contract itself implicitly requires, no more, no less: a test, in other words, of necessity"[77]. It appears that there is a general acceptance that duties of obedience, dispatch, skill and care, and the imparting of information are all 'necessary and appropriate' to the agent/principal relationship. If they are to

[75] See, for example, *Routestone v Minories Finance* [1997] BCC 180, which applies a 'need to know' test.
[76] *Scally v Southern Health and Social Services Board* [1992] 1 AC 294, 307, *per* Lord Bridge of Harwich.
[77] *Liverpool City Council v Irwin* [1977] AC 239, 254, *per* Lord Wilberforce.

be impliedly excluded it can only be because they are *not* 'necessary and appropriate' to the relationship at all.

The solution to this conundrum is self-evident. The receiver's agency relationship with the company is *different*, so different that an entire catalogue of terms necessary to a typical agency contract is routinely disapplied, not merely because they are unnecessary but because they would be *counter-productive* to the operation of receivership. The contract creating an agency relationship between receiver and company falls to be construed in a manner which will facilitate the proper working of that relationship, which in turn is determined by the task the receiver is to perform. In other words, the courts have moved from the general (agency) to the particular (receivership). There is no need to impliedly *exclude* the normal duties implied into agency contracts because they never arise.

The courts, instead, look to the context, and imply terms appropriate to that context. In this regard, the case of *Gomba Holdings (UK) Ltd v Homan*[78] is of interest, in that it provides an express endorsement of this approach. Hoffmann J overtly acknowledges that the receiver's agency is of only marginal consequence to a determination of his duties:

> "...his status as agent provides a starting point for the inquiry rather than its solution. It cannot simply be assumed that his obligations are the same as those of an ordinary agent who owes a duty of undivided loyalty to his principal. They must depend on *the express or implied terms of the bargain between the debenture-holder and the company* under which he was appointed. In this case *we are really concerned with implied terms...*"[79]

In other words, while implication takes place, it does so on the basis that the

[78] [1986] 3 All ER 94.
[79] *Ibid.* 98 (italics added).

contract in question relates to receivership rather than agency, and that any terms implied will be those necessary for the receivership, rather than the agency, to be effective.

5.2 The nature of implied terms

Are such terms implied 'in law' or 'in fact'[80]? It is tempting to suggest the former, although no case has expressly stated as much, and the conclusion is one of impression only. An examination of the case law suggests that the courts look to the commercial purpose of the relationship between receiver and company, that being to realise the security for the benefit of the secured creditor. Such a purpose will be characteristic of all appointments, and to the extent that a term of, say, independence of action is necessary to one receivership it will be necessary to all. It has, however, been observed that "any implication on loan documentation will be an implication of fact: not law, as a loan contract is a commercial contract to be construed according to its terms"[81]. This statement is concerned with implied terms affecting the debtor/creditor relationship, and so may be taken as inapplicable to that part of the loan contract which creates the receiver/company agency relationship.

The question may be of more than academic interest, in that terms implied in law may be subject to a slightly more lenient test than those implied in fact, although it has been emphasised that the test is not one of reasonableness[82]. Nonetheless, it

[80] The possibility that they might be implied by custom is examined later.
[81] Parker Hood, *Lender Liability Under English Law*, in *Banks, Liability and Risk*, Cranston, 2nd ed (1995 : LLP : London). The case of *Williams and Glyn's Bank Ltd v Barnes* [1981] Com. LR 205 is cited in support.
[82] *Liverpool City Council v Irwin*, *supra* n 77; *Scally v Southern Health and Social Services Board*, *supra* n 76; *Reid v Rush & Tompkins Group plc* [1990] 1 WLR 212.

appears that the implication of a term in law may be based on wider considerations than the unspoken intentions of the parties, which form the basis of terms implied in fact[83]. Certainly there are difficulties with the notion that the contract between receiver and company contains terms implied in fact, not least that implied terms such as 'no duty to obey' are inconsistent with the express agency status, which imports a duty of obedience[84].

It is submitted that the better view is that the courts view the debenture contract as having the potential to create a particular relationship, the purpose of which dictates those terms that are to be incorporated into it as a matter of law. Thus the receiver/company relationship is treated, for the purposes of implied terms, similarly to that of, for instance, employer/employee[85] or landlord/tenant[86], and terms can be implied *in law* in order that the receiver can better perform his functions.

If the above analysis is accurate, what purpose does it serve? The courts' observations on the unusual nature of the receiver's agency were observed earlier, and a casual observer might conclude that this 'oddness' is inherent in the agency contract itself. In fact it is the result of a process of implication embarked upon by the courts, with a view to facilitating the achievement of a certain end. If the receiver's agency is unusual it is because the courts themselves have cultivated this outcome. The peculiarity is of their own making, and stems from their decisions to disapply terms *habitually implied* into contracts of agency. This may be entirely legitimate, but the courts' insistence that the agency is a 'real' one begins to ring

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[83] *The Moorcock* (1889) 14 PD 64; *Shirlaw v Southern Foundries Ltd* [1939] 2 KB 206.

[84] Attempts to imply such inconsistent terms have uniformly failed: see, e.g., *Duke of Westminster v Guild* [1995] QB 688.

[85] *Lister v Romford Ice & Cold Storage Ltd* [1957] AC 555.

[86] *Liverpool City Council v Irwin, supra* n 77.

hollow. This impression is compounded by an examination of a further typical feature of agency law which appears extensively modified in the context of the receiver's agency, so much so that the courts' avowal as to its authenticity appears almost spurious.

The Fiduciary Dimension

1. Agents as fiduciaries

> "An agent owes to his principal fiduciary duties (duties of loyalty)"[87]

That agents act towards their principals in a fiduciary capacity is widely recognised[88]. The proposition has, however, been the subject of some judicial reservation and its indiscriminate application to agency questioned by the courts, so that it might be asked whether all agents are, as a matter of law, fiduciaries. It is submitted that, for the most part, the assertion holds true, but the following section suggests that the proposition is not wholly unqualified.

1.1 Incursions into the fiduciary principle of agency?

Whereas the general fiduciary character of the agency status is incontrovertible, there may be occasions when its full implications are somehow modified. The Privy Council decision of *Kelly v Cooper*[89] (hereinafter *Kelly*) is important in this regard, and merits detailed consideration, both at this point and later, for several reasons. First, it may mark the advent of a fiduciary 'backlash' on the part of the judiciary

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[87] Bowstead, *supra* n 11, 6-032. See also Fridman, *supra* n 12

[88] *Hospital Products Ltd v United States Surgical Corp.* (1984-1985) 156 CLR 41; *LAC Minerals Ltd v International Corona Resources Ltd* (1989) 61 DLR (4th) 14; *Artifakts Design Group Ltd v N P Rigg Ltd* [1993] 1 NZLR 197; *Yasuda Fire and Marine Insurance Co. of Europe Ltd v Orion Marine Insurance Underwriting Agency Ltd* [1995] QB 174. This selection of authorities reflects recent acceptance of the proposition, and its universality across the Commonwealth.

[89] [1993] AC 205.

similar to that witnessed in relation to the expansive use of the 'duty of care' concept in the tort of negligence[90]. The imprecision of fiduciary doctrines has stimulated their invocation in aid of some rather dubious causes, and the *Kelly* case, amongst others[91], suggests that the courts are now prepared to apply the brakes. Secondly, the speech of Lord Browne-Wilkinson in *Kelly* reasserts the primacy of contract in determining rights and duties, at the expense of customary, but inconsistent fiduciary duties. Thirdly, and perhaps most germane, is the deference of the Privy Council to the perceived *purpose* of the agency in question, evidenced by a willingness to reject fiduciary obligations which would obstruct that purpose. The main thrust of *Kelly* is encapsulated in the following extract from the judgment of Lord Browne-Wilkinson:

> "...first ... agency is a contract made between principal and agent; second, like every other contract, the rights and duties of the principal and agent are dependent upon the terms of the contract between them, whether express or implied. It is not possible to say that all agents owe the same duties to their principals; it is always necessary to have regard to the express or implied terms of the contract."[92]

The facts involved estate agents accepting commissions for sale from two vendors. In the event, both properties were sold to the same purchaser, giving rise to an allegation of breach of fiduciary duty, that breach consisting of acting for two principals with potentially conflicting interests without obtaining the fully informed consent of both. In essence, the complaint was of non-disclosure, an archetypal breach of an agent's fiduciary duty[93]. In construing the relevant contract Lord Browne-Wilkinson noted:

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[90] See *Murphy v Brentwood District Council* [1990] 2 All ER 908; *Caparo Industries plc v Dickman* [1989] 1 All ER 568.
[91] See, especially, *Hospital Products Ltd v United States Surgical Corp*, *supra* n 88.
[92] [1993] AC 205, 213-214.
[93] *Fullwood v Hurley* [1928] 1 KB 499, 502, *per* Scrutton LJ.

"In a case where a principal instructs as selling agent for his property or goods a person who to his knowledge acts or intends to act for other principals selling property or goods of the same description, the terms to be implied into such agency contract must differ from those to be implied where an agent is not carrying on such general agency business ... estate agents must be free to act for several competing principals otherwise *they will be unable to perform their function.*"[94]

It would seem, then, that his Lordship was not concerned with a *particular* contract, but rather with contracts of a particular *type.* This much is emphasised by his conclusion that:

"Accordingly in such cases there must be an implied term of the contract with such an agent that he is entitled to act for other principals selling competing properties and to keep confidential the information obtained from each of his principals."[95]

If the matter had rested there it could be confidently stated that the case merely carves out a single instance of agency, estate agency, from the whole and, because of its commercial purpose, as recognised and accepted *by both parties*, applies an atypical rule, or, rather, *disapplies* a *typical* rule. However, Lord Browne-Wilkinson went on to address the fiduciary duties of agents in general terms:

"Similar considerations apply to the fiduciary duties of agents. The existence and scope of these duties depends upon the terms on which they are acting."[96]

In support of this assertion he cited dictum of Mason J in *Hospital Products Ltd v United States Surgical Corps*:

"...it is the contractual foundation which is all important because it is the contract that regulates the basic rights and liabilities of the parties. The fiduciary relationship, if it is to exist at all, must accommodate itself to the terms of the contract so that it is consistent with, and conforms to, them. The fiduciary relationship cannot be

[94] [1993] AC 205, 214 (italics added).
[95] *Ibid.*
[96] *Ibid.*

superimposed upon the contract in such a way as to alter the operation which the contract was intended to have according to its true construction."[97]

The implication is unmistakable: to the extent that an agency contract envisages performance to which a fiduciary obligation would be anathema, then none attaches. The express or implied terms of the contract dictate the manner of performance, and if they do not admit of the importation of fiduciary duties then such do not arise. *Kelly* clearly intimates that the status of agent may no longer be coterminous with that of fiduciary.

The decision is not uncontroversial. It has been pointed out that not all agency relationships are contractual[98]. Moreover:

> "Even where the relationship is contractual (as it normally will be), the matter is too important to be left entirely to the agreement of the parties and the interpretation of that agreement. This is an area where the unequal standing of the contracting parties has for more than a century been recognised as requiring relief. The relief is principally given by the application of fiduciary duties..."[99]

The predominant objection to the decision has been its preoccupation with contractual terms at the expense of fiduciary duties. It represents an attack on the previous wisdom that the acceptance of agency status entails a concomitant acceptance of the fiduciary standard of performance. In exchange for the potent capacity to affect his principal's legal and practical position, the agent is burdened with an obligation to exercise his powers in a manner designed to enhance that position. The contract of agency dictates what the agent is to do, but the manner of performance is determined by criteria independent of that contract. *Kelly* potentially

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[97] (1984-1985) 156 CLR 41, 87.

[98] Brown notes that at the time of the alleged breach in *Kelly*, vendor and estate agent would not have been parties to any contract, so that the Privy Council implied a term into a non-existent contract: *Divided Loyalties in the Law of Agency* (1993) 109 LQR, 206.

[99] Bowstead, *supra* n 11, 6-034.

undermines the reflexive imposition of the fiduciary standard upon agents and concentrates instead upon contract as the primary source of the *substance* of the obligation. As Brown graphically puts it:

> "The Privy Council's hypothesis appears to let the tail of contract wag the dog of duty."[100]

The importance of the *Kelly* case to the present enquiry will be further examined later. It suffices to note here that it may be indicative that to attribute fiduciary duties to all agents may be premature, and that a detailed scrutiny of the contractual basis of the relationship may be appropriate. Reynolds has strongly advocated that the decision should be confined to its especial facts[101], although it is interesting to note that the High Court of Australia has at least partially followed Lord Browne-Wilkinson's lead:

> "Nevertheless, even here [where the status in question would normally bring about fiduciary duties] to say that the appellants stood as fiduciaries to the respondents calls for ascertainment of the particular obligations owed to the respondents and a consideration of what acts or omissions amounted to a failure to discharge those obligations."[102]

This may be symptomatic of a growing reluctance on the part of the courts to affix the fiduciary label as a matter of course, or to treat every obligation owed as fiduciary in character[103]. For present purposes, however, it is proposed to treat agency as *prima facie* giving rise to fiduciary duties. This has been accepted practice for too long to be overturned wholesale by recent decisions which appear to kick against the traces.

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[100] *Divided Loyalties in the Law of Agency, supra* n 98, 100

[101] *Fiduciary Duties of Estate Agents* [1994] JBL, 147, 149.

[102] *Maguire v Makaronis* (1996) 188 CLR 449, 464. The case involved a solicitor/client relationship, the alleged breach of duty comprising the grant of a mortgage to the client by the solicitor without disclosure of the latter's interest.

[103] See, for example, *Bristol & West Building Society v Mothew, supra* n 49.

2. The Content and Scope of an Agent's Fiduciary Duties[104]

> "If a person is a status-based fiduciary it would appear that his fiduciary obligations apply to all activities that occur within the scope of that relationship, and any opportunities that arise as a result of that relationship."[105]

Since agents are, customarily, fiduciaries, it is relatively simple to identify what that status entails. The essence of the fiduciary ideal is loyalty: the agent must at all times have regard to the principal's interests over and above his own or, indeed, any other party's[106]. This extensive expression has been refined by the courts into a series of specific rules which cumulatively encompass the central idea. It is proposed to here adopt the approach of the Law Commission in identifying four paramount themes which compress the fiduciary norm into a digestible form. These are:

> "(i) <u>the "no conflict" rule</u> - A fiduciary must not place himself in a position where his own interest conflicts with that of his [principal]. There must be a "real sensible possibility of conflict";
>
> (ii) <u>the "no profit" rule</u> - A fiduciary must not profit from his position at the expense of his [principal];
>
> (iii) <u>the undivided loyalty rule</u> - A fiduciary owes undivided loyalty to his [principal], and therefore must not place himself in a position where his duty towards one [party] conflicts with the duty he owes to his [principal]. A consequence of this duty is that a fiduciary must make available to [the principal] all information that is relevant to [the principal's] affairs;

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[104] This section presents no more than an outline, with brief illustrations, of the basic substance of the fiduciary relationship between principal and agent so that a comparison with the agency of receivers can be drawn. For a fuller treatment the reader is referred to specialist agency works, such as Bowstead, *supra* n 11, and Fridman, *supra* n 12.
[105] Law Commission Consultation Paper No. 124: *Fiduciary Duties and Regulatory Rules* (1992 : HMSO : London) para. 2.4.9.
[106] See Bowstead, *supra* n 11, 6-038.

(iv) the duty of confidentiality - A fiduciary must use information obtained in confidence from his [principal] for the benefit of [the principal] and must not use it for his own advantage or for the benefit of any other person."[107]

To these might be added that an agent may not delegate the performance of his duties or the exercise of his discretion unless his principal expressly or impliedly consents to such[108]. Whilst the maxim *delegatus non potest delegare* might also be classified as of *contractual* origin, it is suggested that because it applies as between principal and agent because of the confidential nature of that relationship, it sits appropriately amongst the agent's fiduciary obligations. There is, further, a fiduciary duty to account for the conduct of the agency[109].

The application of the above rules is best illustrated by the kind of conduct they proscribe. An agent who purchases his principal's property is potentially in breach of the "no conflict" rule, since his own interest dictates that he acquires the property at the lowest possible price, whereas that of his principal requires the highest to be obtained[110]. The same could be said of an agent selling his own property to his principal: again a conflict arises[111]. The paradigm violation of the "no profit" rule is the making of a secret profit through the agency position[112], which may include the taking of a secret commission or a bribe.

The undivided loyalty rule prevents an agent from acting for two parties with conflicting interests, as he may find himself in the position of being unable to fulfil his duty to one principal without breaching that owed to the other[113]. The

[107] Law Commission, *supra* n 105, para. 2.4.9.
[108] *De Bussche v Alt* (1878) 8 Ch D 286.
[109] Bowstead, *supra* n 11, 6-088; *Chedworth v Edwards* (1802) 8 Ves. 46.
[110] See, e.g., *Dunne v English* (1874) LR 18 Eq. 524; *Lowther v Lowther* (1806) 13 Ves. 95.
[111] *Tetley v Shand* (1872) 25 LT 658; *Massey v Davies* (1794) 2 Ves. Jun. 317.
[112] *Boston v Deep Sea Fishing and Ice Co. v Ansell* (1888) 39 Ch D 339; *Parker v McKenna* (1874) LR 10 Ch 96.
[113] *Fullwood v Hurley* [1928] 1 KB 499; *Moody v Cox and Hatt* [1917] 2 Ch 71.

confidentiality rule is most conspicuous in cases of directors taking advantage of information gained through their position to further their own ends, rather than those of their companies[114], although the principle is of general application[115].

The above illustrations are subject to one overriding qualification. The conduct is only proscribed in the absence of the principal's fully informed consent. Thus an agent may act contrary to any of the above rules *provided that* he has disclosed all material facts to his principal, and his principal has consented to the act which would otherwise be a breach of duty[116]. As to precisely what must be disclosed, the courts have preferred not to lay down precise formulae, having regard instead to the circumstances of each case. It is, however, clear that the mere divulgence of a second commission will not suffice, so that an agent acting in a "double-agency" position must:

> "...make the fullest disclosure on the second contract of all the benefit he is getting out of it..."[117]

The circumstances may even demand that the fiduciary recommend that independent advice be taken, and any consent given will be defective if no such recommendation is made[118].

Before moving on to a survey of the fiduciary duties of receivers, some final points concerning the fiduciary position should be made. As noted earlier, agents will find themselves subject to fiduciary duties almost as a matter of course because of their

[114] *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134; *Industrial Development Consultants Ltd v Cooley* [1972] 1 WLR 443. A particular transaction may fall outside the scope of the director's fiduciary duties: *Island Export Finance Ltd v Umunna* [1986] BCLC 460; *Queensland Mines Ltd v Hudson* [1978] ALR 1; *Peso Silver Mines Ltd v Cropper* (1966) 58 DLR (2d) 1; *Balston Ltd v Headline Filters Ltd* [1990] FSR 385.
[115] See, e.g., *Phipps v Boardman* [1967] 2 AC 46 (solicitor acting as agent for trust).
[116] Authority for this proposition can be found in the cases in nn 111-115 above.
[117] *Fullwood v Hurley, supra* n 110, 503, *per* Scrutton LJ. See also *Dunne v English, supra* n 116, 536 *per* Jessell MR; agent must make "full disclosure of all he knows".
[118] *Farrington v Rowe McBride & Partners* [1985] 1 NZLR 83; *Commonwealth Bank of Australia v Smith* (1991) 102 ALR 453.

status. The status attracts the obligation, and once it is accepted the obligation attaches to any actions performed. The Law Commission put the matter thus:

> "If a person is a status-based fiduciary it would appear that his fiduciary obligations apply to all activities that occur within the scope of the relationship, and any opportunities that arise as a result of that relationship."[119]

Examples of status-based fiduciary relationships include trustee and beneficiary, partner and partner, director and company, solicitor and client, doctor and patient, and, of course, agent and principal.

Other relationships may be of fiduciary character, giving rise to a category of 'fact-based' fiduciaries. Because the attribution of the fiduciary standard imposes onerous burdens the courts have been cautious in declaring a relationship fiduciary when such responsibility has not been expressly accepted by the assumption of a particular status. Nonetheless, it is generally agreed that the categories of fiduciary relationship are not closed[120], and a careful examination of the circumstances of a relationship, its purpose, and the reasonable expectations of the parties to it as to the manner in which obligations are to be performed may result in it being characterised as fiduciary, notwithstanding the absence of a particular status. In this regard the courts abandon the general in favour of the particular, and sweeping statements of principle are shunned, to be replaced by a microscopic analysis of a single transaction.

So, whilst a receiver might be expected to owe fiduciary duties to a company because he is its agent, such could also arise out of the nature of the receiver/company relationship, without reference to agency at all. Moreover, and especially in the case of fact-based fiduciaries, only certain aspects of the

[119] *Supra* n 105, para. 2.4.2.
[120] See, e.g., *LAC Minerals Ltd v International Corona Resources Ltd*, *supra* n 88.

relationship may attract fiduciary consequences. Put simply, a relationship may be fiduciary in part[121], and this should be borne in mind when examining the fiduciary composition of receivership.

3. Receivers as fiduciaries

3.1 The various views

A survey of the cases and commentary in this area discloses a certain ambivalence towards the question of whether receivers stand in a fiduciary post in relation to the company. Some statements are unequivocal, describing the receiver's agency as:

> "...the only genuinely non-fiduciary agency"[122]

Lingard, on the other hand, asserts that " the receiver is in a fiduciary relationship to the company and owes it duties similar to those owed by a mortgagee."[123] A receiver was described as occupying a fiduciary position in *Visbord v The Federal Commission of Taxation*[124], and the Cork Committee stated that:

> "Under the present law a receiver owes fiduciary duties to the debenture-holder for whom he holds and manages the property charged, *and to the company debtor for whom he is almost always deemed to be acting as agent.*"[125]

Others are more circumspect. Picarda suggests that:

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[121] *New Zealand Netherlands Society 'Oranje' Inc. v Kuys* [1973] 2 All ER 1222. See also the conclusion of Mason J in *Hospital Products, supra* n 95, that specific activities can be isolated within a non-fiduciary relationship to which fiduciary consequences attach.

[122] Meagher, Gummow and Lehane, *Equity: Doctrines and Remedies* (1992 : Butterworths : Sydney), [2845]. See also *Ostrander v Niagara Helicopters Ltd* (1974) 40 DLR (3d) 161.

[123] *Bank Security Documents*, 3rd ed (1993 : Butterworths : London), para. 11.23. This statement should perhaps be handled with care. It would seem that if a receiver is indeed a fiduciary, the duties owed to the company should be pitched at a much higher level than those owed by a mortgagee.

[124] (1943) 68 CLR 354, 389, *per* Starke J.

[125] *Insolvency Law and Practice: Report of the Review Committee*, (hereinafter the Cork Report), Cmnd 8558 (1982 : HMSO : London), para. 444 (italics added).

"The middle way is to concede a fiduciary element in *some* of the duties, but to reject any all-pervading fiduciary element."[126]

Milman notes that "the full range of fiduciary duties normally expected to be fulfilled by an agent does not apply"[127], whilst Stevenson suggests that fiduciary duties "are not therefore lightly to be read into this relationship between receiver and company"[128]. O'Donovan also counsels wariness:

"With respect, it seems preferable to discard this much abused [fiduciary] label and to concentrate upon the duties which attend the office. While it is true that a private appointee is subject to fiduciary obligations in some contexts it is misleading to classify him as a fiduciary lest it be thought that all the usual fiduciary obligations apply to him."[129]

Three possibilities present themselves: the receiver may be a non-fiduciary actor, he may be a fiduciary, or he may owe fiduciary duties in relation to the performance of some of his functions, but not all. If the second or third are accurate, one might expect fiduciary duties to stem from the receiver's agency position. The next sections examine to what extent the receiver is subject to the normal range of fiduciary duties owed by agents to principals. It is, however, salutary to note that a particular duty may bear a close resemblance to its fiduciary counterpart, without actually being fiduciary in origin.

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[126] *The Law Relating to Receivers, Managers and Administrators*, 2nd ed (1990 : Butterworths : London), 86.

[127] *Corporate Insolvency: Law and Practice*, 2nd ed (1999 : Sweet & Maxwell : London), para. 4.45. See also Milman and Rushworth, *Receivers and Receiverships, supra* n 24, 21-22.

[128] (1973) 47 ALJ 438, 441

[129] *The Duties and Liabilities of a Receiver and Manager Appointed out of Court* (1979) 12 MULR 52, 53, n 4.

3.2 Receivers and the "no-conflict" rule

This rule prevents agents selling to, or purchasing from, their principals without first having obtained fully informed consent. Given the circumstances of receivership, purchase from the company is a more likely occurrence. Receivers are in an unusually favourable position here, in that they have control of any sale that might take place. Can a receiver, therefore, purchase for himself?

There is no case directly in point[130], but three deal with a related matter, and are of considerable interest. In *Ostrander v Niagara Helicopters Ltd*[131] a privately appointed receiver sought a buyer for the shares of the company over whose assets he had been appointed. Whilst acting as receiver, he purchased 2% ($20,000 worth) of the total issued shares of a second company, and eventually sold the debtor company's shares to that company. The former had not been informed of the receiver's interest in the latter, let alone consented to the sale. Starke J expressed reservations as to the propriety of this conduct, but refused to rule the sale void or to award damages, stating that the receiver was not acting in a fiduciary capacity[132]. There are certain difficulties with this case. It is not at all clear in what capacity the receiver had been appointed, but the learned judge throughout treated him as agent for the *appointor* rather than the company, and, indeed, appeared to consider that this was the typical status of a contractually appointed receiver. The decision is therefore explicable on the basis that an agent of a mortgagee in possession made the sale, and the rules relating to sales by mortgagees to companies in which they have an interest applied. Those rules allow such a sale if the mortgagee can show

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[130] *In re Magadi Soda Co. Ltd* (1925) 94 LJ Ch 217 deals with the case of a receiver appointed by trustees for debenture-holders purchasing those debentures from their holders, and so does not concern the particular point, a purchase from *the company*, in issue here.

[131] (1974) 40 DLR (3d) 161.

[132] *Ibid.* 167.

that he acted *bona fide* and obtained a proper price for the property[133]. The particular status of this receiver might also explain Starke J's remark that he was not a fiduciary, but, again, confusion arises from the learned judge's failure to differentiate between receivers as agents of debenture-holders and as agents of companies.

In *Royal Bank of Canada v First Pioneer Investments*[134] the receiver was in an even more invidious position. A debenture-holder company (of which he was vice-president and director) appointed him over the assets of a second company (of which he was, again, vice-president and director). He proceeded to sell the assets of the second company to a wholly-owned subsidiary of the debenture-holder[135]. Again, it is not clear whether the receiver was appointed as agent of the debenture-holder or the company, although Parker ACJHC, like Starke J in *Ostrander*, appeared to regard nothing as turning on this point. He observed:

> "In the instant case, it appears on the evidence that [the receiver] sold [the company's] assets for what he believed to be a fair price and exercised his power as receiver-manager in a fair and proper manner. Indeed, the debenture-holder voiced no complaints[136] ... Furthermore, there is no evidence before the Court that the value of [the company's] franchises or office equipment was greater than the amount received. Even if selling assets to a related company amounted to suspicious circumstances ... which I do not find to be the case, the defendant has, by virtue of the above noted facts, satisfied the onus of then proving that [its receiver] acted in good faith and without fraud."[137]

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[133] *Farrar v Farrars Ltd* (1888) 40 Ch D 395; *Tse Kwong Lam v Wong Chit Sen* [1983] 1 WLR 1349. The onus is on the mortgagee to prove these two requirements satisfied.
[134] (1980) 106 DLR (3d) 330.
[135] Whether he was vice-president and director of the subsidiary is not revealed in the report.
[136] Given the circumstances, why on earth should it?
[137] (1980) 106 DLR (3d) 330, 333-334.

Again, this appears to be an application of the 'mortgagee in possession' standard of conduct. Parker ACJHC followed Starke J in *Ostrander* in holding that the transaction could stand providing that it had been entered into in good faith and that a proper price had been obtained. The question of any conflict of interest was given short shrift, to the extent that it was dealt with at all, and these two cases are therefore of little assistance in determining whether the "no conflict" rule applies to receivers.

Perhaps the most illuminating case in this area is *Watts v Midland Bank*[138]. The allegation was that a sale by a receiver was tainted by the fact that it was made to a solicitor acting for him. Whilst this claim was rejected on the evidence, Peter Gibson J had this to say:

> "A fiduciary who sells to a person in which he is interested comes within the fair dealing rule, and the sale is liable to be set aside at the suit of the beneficiary unless the fiduciary can discharge the onus on him of showing that the sale was made in good faith and that the fiduciary took reasonable precautions to obtain the best price reasonably obtainable at that time ... Counsel for the receivers very properly accepted that a mortgagee or receiver selling to a solicitor acting for him would come within the fair dealing rule. So too in my judgment would a sale by a receiver to a purchaser in which the solicitor acting for the receiver was financially interested."[139]

At first glance, the learned judge appears to treat receivers as fiduciaries in applying the "fair-dealing" rule to them. With respect, this is misleading. To begin with, he treats the *content* of the rule as requiring a receiver to demonstrate good faith and the taking of reasonable precautions to obtain a proper price. This does not equate to what is required of fiduciaries if they are to escape the consequences of the

[138] [1986] BCLC 15.
[139] *Ibid.* 21.

fair dealing rule. A fiduciary must obtain the fully informed consent of his beneficiary, and it has consistently been held that the *bona fides* of a transaction of this nature are irrelevant if no consent has been obtained[140].

Bowstead suggests that a sale by an agent to a company in which he is interested may be a breach of his fiduciary duty, and that only fully informed consent of the principal will neutralise the breach[141], and this is the case where the sale is by a trustee to a company in which he is interested[142]. Furthermore, company directors, who are classically fiduciaries and, indeed, agents of their companies, remain subject to a disclosure onus in cases where they have an interest in a contract of the company[143].

Peter Gibson J cited *Tse Kwong Lam v Wong Chit Sen*[144] in support of his application of a "fair-dealing" rule. Certainly this case is authority for the proposition that a mortgagee exercising a power of sale in favour of a company in which he is interested must show that he acted in good faith and took precautions to obtain a proper price, but the source of this obligation is far from fiduciary. On the contrary, in *Farrar v Farrars Ltd*[145], a case extensively cited in *Tse Kwong Lam*, Lindley LJ was at pains to point out that a mortgagee is in a different position to a trustee as far as an exercise of a power of sale is concerned[146].

Both these decisions appear to be based upon a rule exclusive to the

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140 E.g., *Ex parte James* (1803) 8 Ves. 337, 344, *per* Lord Eldon; but *c.f. Holder v Holder* [1968] Ch 353.

141 *Supra* n 11, 6-056, 6-057.

142 *Tito v Waddell (No 2)* [1977] 3 All ER 129; *Silkstone & Haigh Moor Coal Co v Edey* [1900] 1 Ch 167.

143 In this context the fiduciary standard is watered down. Fully informed consent of the *principal* is not required, but disclosure must be made to the board; see Companies Act 1985 s 317; Companies (Tables A to F) Regulations 1985, SI 1985/805, Table A regulation 85.

144 *Supra* n 133.

145 *Supra* n 133.

146 *Ibid.* 410.

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[144] *Supra* n 133.

[145] *Supra* n 133.

[146] *Ibid.* 410.

mortgagor/mortgagee relationship, which, whilst it arises in equity, differs from that pertaining to relationships of a fiduciary character. It is aimed at conduct which is similarly proscribed in relation to fiduciaries, but its content and operation are entirely novel. Fully informed consent *enables* an agent to purchase his principal's property. A mortgagee need not obtain fully informed consent, but need only show good faith. What was applied in *Watts v Midland Bank* was not the fair-dealing rule relating to agents but, at most, a version of it associated with mortgagees, and the use of fiduciary language was therefore unnecessary and deceptive.

In conclusion, it is suggested that as far as receivers are concerned the "no-conflict" rule does not apply to them in any meaningful sense, notwithstanding their agency relationship with the company. The only three cases remotely in point implement a cognate but discrete principle, which has its origin in a relationship that is not fiduciary and so not subject to fiduciary standards.

Finally, in this regard, it is interesting to consider the *Guide to Professional Conduct and Ethics*[147], which states:

> "Save in circumstances which clearly do not impair his or her objectivity, a member appointed to an insolvency appointment in relation to a company or debtor should not himself or herself acquire directly or indirectly any of the assets of the company or debtor nor knowingly permit any principal or employee of his or her practice ... directly or indirectly to do so."[148]

How far this reproduces the legal rule relating to fiduciaries is difficult to ascertain. The first sentence may refer to a situation where something akin to fully informed consent has been obtained, or it may emphasise the necessity of paying a fair price for assets purchased. It appears implicit that an acquisition of this nature is not to be

[147] Produced by the Society of Practitioners of Insolvency (now the Association of Business Recovery Professionals) (1993) and distributed to insolvency practitioners.
[148] *Ibid.*

taken lightly[149]. However, to the extent that this guideline reflects the "no-conflict" rule at all, it remains a self-imposed standard rather than a legal one, and it is with the latter that this section is concerned.

3.3 Receivers and the "no-profit" rule

No case law on this question exists, but Milman suggests that the rule applies to receivers. He adds, however:

> "...where such a secret profit is made [a receiver] would have to account for it either to the debenture-holders, if the company's assets had proved insufficient to satisfy them, or alternatively to the company, his principal."[150]

This departs from the usual agency position, in that the *principal's* entitlement to demand any profit is relegated to that of the debenture-holder. This raises the question of to whom, if anyone, is 'no-profit' duty owed? Milman's explanation for the debenture-holder's superior position is that the right to sue the receiver is a post-crystallisation asset of the company vested in the debenture-holder under its charge[151]. Therefore the duty is owed to the company, but its fruits devolve upon the debenture-holder by operation of property law, the company being a residuary beneficiary.

A different construction is that no such duty owed is owed to the company, but it *is* owed solely and directly to the debenture-holder, because the receiver stands in a fiduciary position to him[152]. If this is correct, the company would be unable to claim any secret profit made by a receiver, notwithstanding that he is its agent.

[149] Although see *Insolvent Abuse: Regulating the Insolvency Industry*, Cousins, Mitchell, Sikka, Cooper and Arnold (2000 : Association for Accountancy and Business Affairs : Basildon), Chapter 5.
[150] *Receivers as Agents*, *supra* n 26, 662.
[151] *Ibid.* 662, n 33.
[152] See Chapter 2.

In either event, the debenture-holder would have a priority claim to any illegitimate profit made by a receiver, so it might be questioned why the location of the duty is significant. It will be recalled that it is not the making of a *profit* that is prohibited, but rather the making of a *secret* profit[153], and that fully informed consent negatives the breach. The question of the *recipient* of the duty therefore assumes importance for all three parties to the arrangement. The receiver will need to know from whom to seek consent in the (admittedly unlikely) event that he wishes to profit, other than via remuneration, from his position.

There remains the possibility that the duty is owed to both company and debenture-holder, and in the absence of authority the position is obscure. If regard were to be had to the agency status of the receiver, the natural assumption would be that the company could claim any secret profit made by him, if such were likely to prove surplus to the claim of the debenture-holder. The courts, however, have thus far had little regard for that status in other contexts, so to take it at face value in this regard would represent something of a change of approach.

3.4 The receiver and undivided loyalty

This pure agency rule has no application to receivers. To the extent that the rule requires an agent to prefer the interests of his principal to those of other parties, a receiver is under no such duty, and, indeed, is under a positive duty to prioritise the interests of his appointor. This proposition appears to hold true in relation to the entirety of the receiver's actions. Whether he is selling property of the company or managing its business, the welfare of the company informs his decisions only to a

[153] Such conduct would almost certainly breach ethical guidelines and, it is submitted, a duty of good faith (see Chapter 2).

limited extent.

The first case to address this question in detail was *Re B Johnson & Co. (Builders) Ltd*[154]. The case makes interesting reading, not least because of the pains the members of the Court of Appeal took to emphasise where the receiver's duties lay, especially when this was not necessary for the disposal of the case. Evershed MR noted that:

> "...it is quite plain that a person appointed as receiver and manager is concerned, *not for the benefit of the company but to realise the security for the benefit of the mortgagee bank; that is the whole purpose of his appointment...*"[155]

The result of this was, according to the learned judge, that the receiver owed no duty to preserve the goodwill or business of the company. Jenkins LJ was of similar mind:

> "The primary duty of the receiver is to the debenture-holders and not to the company ... *the whole purpose of the receiver and manager's appointment would obviously be stultified if the company could claim that a receiver and manager owed it any duty comparable to the duty owed to a company by its directors and managers.*"[156]

No authority was cited in support of these views, which appear inspired by the Court of Appeal's conception of the purpose of the appointment as contemplated by both bank and company.

Other cases display some ambiguity as to whom any duty is owed. In *R v Board of Trade, ex parte St Martins Preserving Co. Ltd*[157] Phillimore J hinted quite strongly at an obligation to have regard to the interests of the company[158], and in *Lawson (Inspector of Taxes) v Hosemaster Co. Ltd*[159] Danckwerts LJ considered the

[154] [1955] 1 Ch 634 (hereinafter *Re B Johnson*).
[155] *Ibid.* 644-645 (italics added).
[156] *Ibid.* 661 (italics added).
[157] [1965] 1 QB 603.
[158] *Ibid.*, 613-614. Note though, that Winn J did not agree.
[159] [1966] 1 WLR 1300.

receiver's mission to be to act "to the best advantage of the company, *and, therefore, the debenture-holders.*"[160]. This reverses the orthodox position that the incidental beneficiary of the receiver's efforts is the company. Further, Edmund Davies LJ has suggested that a receiver's duty in carrying on the business of the company is to preserve its goodwill[161].

Contemporary courts have not followed these dicta, and the orthodoxy of *Re B Johnson* has been strongly asserted of late. Some judges have advanced a form of two-tier, or hierarchical duty system, albeit without much amplification as to how such operates in practice. In *Lathia v Dronsfield Bros. Ltd*[162] Sir Neil Lawson noted that the primary duty is owed to the bank, but that a duty is also owed, as agent, to the company, this latter being characterised as one of good faith[163]. In *Gomba Holdings (UK) Ltd v Minories Finance Ltd* it was stated that:

> "Whilst the receiver is the agent of the mortgagor he is the appointee of the debenture-holder and, in practical terms, has a close association with him. Moreover, he owes fiduciary duties to the debenture-holder..."[164]

The 'dual duty' hypothesis was noted and approved, but without exegesis as to its effect.

Downsview Nominees v First City Corporation Ltd[165] provides some enlightenment as to the nature of the receiver's duties to the company. They are, according to Lord Templeman, to exercise his powers in good faith and for proper purposes. They do not include the preference of the company's welfare:

[160] [1966] 1 WLR 1300, 1315.
[161] *George Barker (Transport) Ltd v Eynon* [1974] 1 All ER 900, 905.
[162] [1987] BCLC 321.
[163] *Ibid.*, 324, 326.
[164] (1989) 5 BCC 27, 29, *per* Fox LJ .
[165] [1993] AC 295.

"The decisions of the receiver and manager whether to continue the business or close down the business and sell assets chosen by him cannot be impeached if those decisions are taken in good faith *while protecting the interests of the debenture-holder* in recovering the moneys due under the debenture, *even though the decisions of the receiver and manager may be disadvantageous for the company.*"[166]

This surely dispels any doubts as to whether the receiver owes the fiduciary duty of undivided loyalty to the company. He patently does not. He is at liberty, and, indeed, constrained to act at all times in the interests of the appointing debenture-holder. If even more recent corroboration of this is required it can be found in the High Court of Australia and the bald statement of Brennan CJ:

"The receiver is appointed not for the benefit of the company but for the benefit of the mortgagee."[167]

Technically, a receiver in these circumstances is not in a situation of 'double agency'. On the contrary, his agency relationship with the company is intended to counteract any allegation that he acts in that character for the appointor. Rather he is, in fiduciary language, placed in a position of conflict of duty and duty. Terminology aside, however, it remains the case that a pure agent, in preferring the interests of another party to whom he owes a duty to those of his principal will breach his fiduciary duty to the latter, whether or not his relationship with the other party is one of agency. The core of the duty is the advancement of the principal's position, and unless the principal consents, with full knowledge, to his agent acting in the interests of a third party, then the duty is breached.

[166] [1993] AC 295, 312-313. The effect on this proposition of the decision of the Court of Appeal in *Medforth v Blake* [1999] 3 All ER 97 will be examined in Chapter 2.
[167] *Sheahan v Carrier Air Conditioning Pty Ltd* (1997) 71 ALJR 1223, 1227. See also the statements of Dawson, Gaudron and Gummow JJ at 1234, 1236.

Contrast this with the receiver's position, as described by the courts. Not only is he entitled to prefer the interests of his appointor, he is compelled to do so. If, in the performance of his functions, he favours the company over the appointor he will be in breach of his duty to the latter[168]. Moreover, if *Downsview* is correct and the receiver's duty *to the company* is breached by an improper use of his powers, one might come to the extraordinary conclusion that, in prioritising the company's interests, he is in breach of his duty *to the company.*

Does the company's consent to this ostensible breach of the duty of loyalty explain this anomalous position? It might be argued that implied consent could be inferred from the debenture itself, in that the company expressly grants a number of powers to the receiver and impliedly consents to their use primarily in the interests of the debenture-holder. Such an approach is reminiscent of that of the Privy Council in *Kelly v Cooper*[169], and, as will be discussed further on, is probably the most feasible explanation of the receiver's remarkable position. Nevertheless, it sits uncomfortably with the usual understanding of what constitutes fully informed consent for the purposes of agency law. As far as trustees are concerned, it has been held that advance notice of a breach of trust, coupled with inertia by the beneficiary, does not relieve the errant trustee from liability[170], and that effective consent requires full information regarding all material facts and circumstances. Implied consent to *future* breaches of the duty of loyalty, therefore, is hardly a satisfactory response to the receiver's apparent ability to breach this duty with impunity, at least as far as his agency status it taken at face value.

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[168] This issue is considered at length in the next Chapter.

[169] *Supra* n 89, and see the discussion at 62 *infra.*

[170] *Life Association of Scotland v Siddal* (1861) 3 De G. F. & J. 58.

3.5 Receivers and the duty of confidentiality

This duty might be breached in a number of ways. First, a receiver might use the company's confidential information to advance his own interests, in which case the discussion above as to the making of a secret profit is relevant. Secondly, he might divulge such information to his appointor, although it will usually be the case that the bank, under the debenture agreement, is contractually entitled to it[171]. Thirdly, the receiver might divulge it to a third party, and it appears that he is entitled to do so in certain circumstances.

In *Re Neon Signs (Australasia) Ltd*[172] a receiver proposed to reveal the terms of a company's forward contracts to its only competitor. He was negotiating a sale of the company's business to that competitor, and the company sought an injunction preventing disclosure of customer lists and contracts. Adams J refused to grant an injunction, notwithstanding that if the sale did not go ahead the competitor would be in a position to use the information to the detriment of the company. He said this:

> "It follows that save in exceptional cases the court will not interfere with the exercise by debenture-holders or their trustees or receivers acting on their behalf and with their authority of such powers as are given to them by a company as incident to their security. That the company or its unsecured creditors or shareholders may be prejudiced because the debenture-holders or those acting on their behalf and with their authority choose in their discretion to exercise their undoubted powers in a manner which may be less favourable to them than some other is not to the point."[173]

[171] See Lingard, *supra* n 123, para. 4.02(b).
[172] [1965] VR 125.
[173] *Ibid.* 127.

The power in question was that of realising the company's property, and the disclosure of the confidential information in the exercise of that power was therefore not an abuse of it.

This is not to say that the making of *indiscriminate* disclosures would not amount to a breach of duty, although whether it would be a breach of the agency duty of confidentiality or the *Downsview* duty of good faith is debatable. Where, however, information is disclosed in the pursuit of the appointor's well being, no breach of duty is committed. Another agency-related fiduciary duty is therefore ruled out of the range of duties owed by a receiver.

3.6 Receivers and non-delegation

This point can be dealt with shortly. Receivers do delegate their functions, both to members of their own staff and, in certain cases, to directors or employees of the company, and such delegation is usually expressly authorised in standard form debentures[174]. Moreover, administrative receivers are empowered to appoint agents to do business on their behalf pursuant to Schedule 1 of the Insolvency Act 1986[175].

3.7 Receivers and the duty to account

Receivers are under a statutory duty to deliver accounts to the Registrar of Companies, these comprising an abstract of receipts and payments over each twelve-month period in office[176]. Further, under the Insolvency Rules 1986, an abstract of receipts and payments over the same period is to be delivered to the Registrar, the company, the appointor and to members of any creditors'

[174] See Lingard, *supra* n 123, para. 7.01(g).
[175] Power no. 11.
[176] IA s 38.

committee[177]. In *Smiths Ltd v Middleton*[178] Blackett-Ord VC held that the similar statutory duty under a previous enactment[179] was not exhaustive of the receiver's accounting obligation. His conclusion was prompted by two factors, the first being the receiver's agency relationship with the company:

> "...he is the mortgagor's agent, a peculiar sort of agent of course, but nevertheless an agent, and an agent is *prima facie* an accountable party..."[180]

The learned judge also had regard to s 109 of the Law of Property Act 1925, which requires a receiver to pay any surplus remaining after the satisfaction of other matters to the person entitled, in this case the mortgagor[181]. Accounts were therefore required in order that the receiver be able to demonstrate the amount of the surplus.

The case provides a rare example of a pure agency duty being held to apply, seemingly without qualification, to a receiver *as a result of* the latter's agency position[182]. The duty only arises once the receivership, and so the agency, has come to an end and so does not impose anything resembling a duty to keep the principal/company informed. The decision is also faintly reminiscent, albeit obliquely, of certain comments of Williams J in *Visbord v The Federal Commissioner of Taxation* in which he suggested that a receiver occupies a fiduciary position[183]. This was noted and explained in *Expo International Pty Ltd v Chant*, where Needham J considered the fiduciary obligation attached to a receiver merely in his capacity as fundholder:

177 SI 1986/1925, Rule 3.32.
178 [1979] 3 All ER 842.
179 Companies Act 1948 s 372(2).
180 [1979] 3 All ER 842, 846.
181 The case involved a company, "unusually" in the words of Blackett-Ord VC, surviving receivership.
182 *C.f.* the decision of Slade J in *J P Filhol Ltd v Haigh* (unreported, 8 December 1977).
183 (1943) 68 CLR 354, 384.

"Of course, once the mortgagee has sold, he holds surplus money in trust for subsequent encumbrancers and, ultimately, for the mortgagor. It appears to me that Williams J [in *Visbord*] is equating with that situation the case of a receiver who has acquired money either by sale of the mortgaged assets or receipt of income thereon."[184]

This is in accord with the alternative ground for the decision in *Smiths Ltd v Middleton*, although its basis is equitable rather than statutory.

One should enquire how far Blackett-Ord VC's judgment survives *Downsview*, which seems to abjure any duties on a receiver originating from his agency status. Indeed, Lord Templeman equated the position of a receiver with that of a mortgagee. This approach would not disturb the actual *duty* to account, since a mortgagee, with whom the receiver's position is said to correspond, is an accounting party[185]. *Downsview* does, however, cast doubt on the attribution of the duty to the receiver's agency status, and its fiduciary origin. The *mortgagee's* duty to account is not fiduciary, but stems from his particular relationship with the mortgagor and the assertion of his strict legal rights in the taking of possession of the mortgagor's property[186]. Whilst *Smiths Ltd v Middleton* remains accurate in identifying *a* duty, it is at least arguable that *Downsview* relocates its source from agency to mortgage law.

[184] [1979] 2 NSWLR 820, 830.
[185] *Quarrell v Beckford* (1816) 1 Madd. 269.
[186] *Parkinson v Hanbury* (1876) L.R. 2 H.L. 1, 1, *per* Lord Westbury.

4. The non-applicability of fiduciary duties: a contractual explanation?

The above survey indicates that the usual fiduciary incidents of pure agency have no application to receivers. It does not *necessarily* follow that this is because the receiver's agency is counterfeit, and it remains to be considered whether those duties which would normally arise from the status of agent have in some way been excluded. The fully informed consent of a principal to what would otherwise be a breach of duty negatives that breach, but this does not explain the apparent subjugation of any fiduciary duties that a receiver might owe. Fully informed consent, in this regard, would require at least consent of the company's board[187], or even an ordinary resolution of the company in general meeting, and this patently does not occur. There are, however, other means by which fiduciary duties may be sidestepped.

4.1 Exclusion by contract

The avoidance of fiduciary duties might be achieved in two ways. Firstly, they might be excluded in the contract creating the ostensibly fiduciary relationship. Secondly, that contract might contain provisions which define the extent of any duty owed, and, if this is the case, such provision will be conclusive. This is because fiduciary duties "cannot be prayed in aid to enlarge the scope of contractual duties."[188] The decision in *Kelly v Cooper*[189] gives credence to the proposal that regard should be had to the express and implied terms of the contract in order to ascertain the extent of any fiduciary duties. The question remains, however, how far these decisions can be taken as conferring *carte blanche* on

[187] As in the Companies Act 1985 s 317.
[188] *Clark Boyce v Mouat* [1994] 1 AC 428, 437, *per* Lord Jauncey of Tullichettle.
[189] *Supra* n 89.

contracting parties to configure a status-based relationship so as to exclude its usual consequences. It has been argued that *Kelly*, as a matter of policy, represents a retrograde step in sanctioning the contractual veto of fiduciary duties, in that it ignores the crucial rationale behind their imposition and fails to distinguish between contractual duties and those imposed by law[190]. A differently constituted Privy Council has acknowledged that such a distinction exists since *Kelly* was decided:

> "...the essence of a fiduciary relationship is that it creates obligations of a different character from those deriving from the contract itself..."[191]

A broad reading of *Kelly*, however, would allow the courts to have regard to the particular *function* the agent is to perform and to imply a term negating a fiduciary repercussion which would impede that performance.

There is no express exclusion of the fiduciary agency duties in the debenture agreement which constitutes the contract between receiver and company. Standard form debentures exonerate receivers from the liability for default which would attach to a mortgagee in possession[192], but are silent on the question of liability for breach of duty *as agent for the company*. If the *nature* of the receiver's agency duties is to be established by recourse to the contract, it can only be through *implied terms* that such a determination can be made. Following *Kelly*, the receiver's function, the enforcement of his appointor's security, informs his duties in relation to the company, and not his agency status. Thus, where fiduciary duties would be inimical to the accomplishment of this function, a term is implied to the effect that such do not apply.

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[190] See *supra* 40.
[191] *Re Goldcorp Exchange Ltd* [1994] 2 All ER 806, 821, *per* Lord Mustill.
[192] See, e.g., Lingard, *supra* n 123.

This is entirely consonant with the approach of Hoffmann J in *Gomba Holdings (UK) Ltd v Homan*[193] in relation to the receiver's purely contractual duties[194]. The receiver does not owe the usual fiduciary duties of an agent because they would inevitably detract from his performance as debt-enforcer. If, for example, he was to owe a duty of undivided loyalty to the company the interests of the appointor would be subjugated. Such a construction is not conducive to enforcement (albeit that it is entirely conducive to agency), and the courts have chosen to suppress it. In the *Kelly* sense, they have implied a term to the effect that no fiduciary duties shall be owed by receiver to company.

Does the *Kelly* 'principle' provide a satisfactory solution to the perplexity of the receiver's agency? There are two objections to such a proposition. First, the decision does not necessarily allow an implication of a *blanket exclusion* of those fiduciary duties which would normally attach to a particular status. Such goes far beyond the parameters of *Kelly*, and would appear to rob an express status of any internal legal effect. The choice of status must have some connotation, for *both* parties, and to emasculate it in such a manner would be unprecedented and, it is submitted, unprincipled.

Secondly, no court has yet explained the oddities of the receiver's agency in these terms. Hoffmann J, in *Gomba Holdings*, comes close to identifying implied terms as the source of the receiver's duties, but his comments were directed to contractual rather than fiduciary duties, and he does not explain in any detail *why* the normal incidents of agency do not apply. That they might impede the *function* of

[193] *Supra* n 73.
[194] See the discussion at 33 *supra*.

receivership is, at best, tacit in his judgment.

The 'contractual implication' explanation is therefore found wanting. It fails to elucidate *how*, rather than *why*, the receiver escapes liability for breaches of his agency duties, and does not address the question of whether it is in law possible to constitute an agency relationship to which no agency duties attach.

4.2. Exclusion as a matter of custom

Contracts of a certain type may be subject to terms implied by custom, or usage. It is well established that 'incorporation by custom' may modify or alter the nature of one or both parties' performance. For a custom to be incorporated into a contract it must be proved that it exists, that it is certain and uniform, that it is notorious and that it is considered to be of a legally binding nature. These are all questions of fact. There is a further requirement that the custom be reasonable, and this is a question of law[195].

The fact that a receiver does not owe those fiduciary duties usually ascribed to agents might therefore be explicable by reference to custom. Again, though, there are problems with this hypothesis. Whilst such a custom could be described as notorious it does not satisfy the requirement of certainty and uniformity. A brief survey of some of the customs recognised by the courts demonstrates that they are usually extremely precise: they involve a specific action or pattern of conduct which is described in exact terms. Thus, recognised customs have included: the right of a buyer to elect to take timber in bond[196]; the taking of crops on land at

[195] See Law Commission Consultation Paper No. 124, *supra* n 105, para. 3.2.3.
[196] *Clark v Smallfield* (1861) 4 LT 405.

valuation by incoming tenants[197]; that "1000" in relation to rabbits in Sussex means "1200"[198]; the entitlement of a domestic servant to a certain period of notice[199]; that a c.i.f. seller may validly appropriate a cargo by passing on a copy of the original shipper's appropriation without delay, notwithstanding that the cargo is already lost[200]. A custom along the lines of 'no fiduciary duties shall be owed' or 'a receiver owes no duty of loyalty' seems altogether too nebulous to be described as certain and uniform.

A more fundamental drawback to the trade custom approach is the fact that the courts have consistently held that customs which purport to modify fiduciary duties are, as a matter of law, unreasonable. Of particular significance is the decision of Megaw J in *Anglo-African Merchants Ltd v Bayley*[201], in which a custom allowing an agent to act for both assured and insurer was held to be unreasonable. Megaw J stated that:

> "...a custom will not be upheld by the courts of this country if it contradicts the vital principle that an agent may not at the same time serve two masters - two principals - in actual or potential opposition to one another..."[202]

Even if, therefore, it were accepted that a custom allowing a receiver to prefer the interests of his appointor to those of the company/principal existed the above case, and others, suggest that it would be held to be unreasonable. In any event, this explanation has never formed the basis of any decision on receivers' duties.

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[197] *Wilkins v Wood* (1848) 17 LJQB 319.
[198] *Smith v Wilson* (1832) 3 B. & Ad. 728.
[199] *Hoult v Halliday* [1898] 1 QB 125.
[200] *Produce Brokers Co. Ltd v Olympia Oil and Cake Co. Ltd* [1916] 2 KB 296.
[201] [1970] 1 QB 311.
[202] *Ibid.*, 324. See also *North and South Trust Co. v Berkeley* [1971] 1 WLR 470; *Robinson v Mollett* (1874) LR 7 HL 802.

5. The receiver's agency and the fiduciary dimension - an overview

The above sections illustrate that receivers, whilst they might owe duties to the company, do not owe those fiduciary duties typically associated with the agent/principal relationship. Their absence from the receiver/company nexus is not explained by reference to those rules which may allow for their modification or exclusion in the agency context. The traditional duties are not merely tempered in precisely defined circumstances, as was the case in *Kelly.* They are not adapted by trade custom or usage, and a receiver may act in a manner which would constitute a breach of fiduciary duty without obtaining fully informed consent.

In short, as was seen in the case of contractual duties, the receiver's status as agent does not act as a determinant of his duties. The effect of the various decisions considered above is to renounce its relevance to the question of duties owed[203]. This is so even though that status is the contract's only express device for measuring what a receiver's duties might actually comprise. We appear, therefore, to be presented with a process of implication that flies in the face of the express terms of the contract. Such an approach is not readily squared with the courts' insistence on the authenticity of the receiver's agency.

[203] *Smiths Ltd v Middleton, supra* n 178, is the exception, but must now be reconsidered in the light of *Downsview.*

The Company's Side of the Bargain: Duties as Principal

1. Rights of agents

The foregoing sections have focused on one side of the agency relationship, that concerned with the *agent's* contractual and fiduciary duties. It is a well-established feature of agency law that the *principal* owes certain duties to his agent or, to put it another way, agents have rights as against their principals. It therefore falls to be determined whether this aspect of agency law applies in the case of receivership.

The most fundamental of an agent's entitlements is that of remuneration. Such will usually be express in the agency contract but in its absence the courts have readily implied terms conferring a right to reasonable remuneration, what is reasonable being determined by reference to all the circumstances of the case. Where the agent is a professional, there is a presumption that remuneration was intended[204], and the fact that the principal does not actually benefit from the agent's performance does not detract from the latter's entitlement[205]. This right is not unqualified. Where an agent acts outside his authority, or in serious breach of duty, his principal may be able to repudiate any liability to pay remuneration[206].

An agent may also claim reimbursement of expenses incurred in the performance of his duties from his principal, again as a result of an express or implied term of the agency contract. He will also be entitled to an indemnity against losses or liabilities[207], such right usually being implied. This right is subject to the agent acting within his authority, and reimbursement and indemnity cannot be claimed where the expense or liability is incurred as a result of the agent's own default.

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[204] *Miller v Beale* (1879) 27 WR 403.
[205] *Fisher v Drewett* (1878) 48 LJ QB 32.
[206] See Bowstead, *supra* n 11, para. 7-047.
[207] *Ibid.*, para. 7-056. See also Fridman, *supra* n 12, 210.

2. The receiver's rights as against the company

2.1 Remuneration

The receiver's right to remuneration is not, strictly speaking, conferred as a result of his agency, but rather originates from an express term of the debenture agreement. Such terms are standard[208], providing that the level of remuneration is to be fixed by reference to the charging practices of the receiver's firm. The company therefore has no control over how much its agent earns. In the unlikely event that no provision for remuneration is made, recourse to the Law of Property Act 1925 may be had. By s 109(6) a receiver will be entitled to retain a commission not exceeding 5% of gross realisations to satisfy his costs, charges and expenses. He is entitled to such as of right, and need only apply to court of he wishes to receive a commission in excess of 5%[209]. Where no express provision for remuneration is made, and where s 109(6) does not apply, it is likely that the courts would imply both the entitlement to be paid, and the rate at which payment should be made, in a manner similar to that applicable to pure agents[210].

Thus far, the receiver's right to remuneration appears akin to that of a pure agent, in that it will usually be express, and that otherwise the courts will imply such a right. A variance from the usual position is that the *level* of remuneration may, in the receiver's case, be fixed by the court at the behest of a liquidator under Insolvency Act 1986, s 36. Any order made by the court may have retrospective effect[211], so as to require the receiver to account for remuneration already paid. However, it has

[208] See Lingard, *supra* n 123, para. 7-04.
[209] *Marshall v Cottingham* [1982] Ch 82.
[210] See, to this effect, Picarda, *supra* n 126, 240-241.
[211] *In re Potters Oils Ltd* [1986] 1 WLR 210, in relation to Companies Act 1948, s 371(1) (the predecessor to s 36 IA). No retrospective effect existed in relation to Companies 1929, s 309; *In re Greycaine Ltd* [1946] Ch 269.

been held that the court will only exploit this strong power in a case where the level of remuneration as fixed by the debenture is plainly excessive[212], and there is no reported case in which a court has so interfered.

Nor have the courts had occasion to address the question of disentitlement to remuneration. Such deprivation may result from the negligent performance of an agent's functions, but the case law on receivers has focused rather more on the question of whether the company can claim *damages* in such circumstances. The question of the forfeiture of remuneration has, therefore, been neglected. Given that the decision in *Medforth v Blake*[213] establishes that an equitable duty of skill and care is owed by a receiver, there is, in principle, no reason why the agency rule *should not* apply, and Picarda assumes that a receiver acting for improper purposes or in bad faith would fall within its ambit[214].

2.2 Indemnity and reimbursement

Much of what has been stated above in relation to remuneration applies *mutatis mutandi* to the question of indemnity and reimbursement. The debenture agreement usually compels the company to indemnify a receiver and to reimburse expenses incurred in the performance of his task. In the absence of express provision, such entitlement would almost certainly be implied, although whether such might be forfeit for breach of duty remains unclear. Section 36 of the Insolvency Act 1986 appears to have no application to the matters of indemnity and reimbursement.

A feature which sets the receiver's agency apart from that of a pure agent is the priority position he enjoys in relation to his remuneration, and any reimbursement

212 *In Re Potters Oils Ltd* [1986] 1 WLR 210.
213 [1999] 3 All ER 97.
214 *Supra* n 126, 243-244.

of expenses. To the extent that realisations are insufficient to satisfy all claims against the company, a receiver may discharge his remuneration, expenses and indemnity ahead of any amount owing to his appointor under s 45(3) Insolvency Act 1986. These claims are similarly prioritised over those of preferential creditors and, *a priori*, unsecured creditors[215].

3. The internal position: a conclusion

The company's position as principal is remarkably similar to that of a traditional principal. It is contractually bound to provide remuneration and to indemnify and reimburse its agent, the receiver. The only question mark in this area is the extent to which the company can impeach the receiver's contractual entitlements in the event of his breach of duty.

As far as the *internal* consequences of this particular agency are concerned, therefore, a singular picture emerges. The receiver's agency, in terms of mutual rights and duties, appears wholly one-sided. The company/principal must perform in the manner expected of a traditional principal. The receiver/agent may render a performance entirely unconstrained by the usual incidents of that status. In essence, the company is subject to all the burdens of the agent/principal relationship without being able to claim any of the benefits. This is not merely unusual, it is entirely unprecedented, and provokes the enquiry as to whether this departure from the norm is so profound as to invalidate the designation of the relationship absolutely. Before responding, though, a further aspect of agency law, and the conformity of the receiver's agency with it, should be examined.

[215] *Re Glyncorrwg Colliery Co.* [1926] Ch 951.

The External Consequences of the Receiver's Agency

1. The agent's authority

It is customary to speak of the parameters within which an agent may act as his *authority.* As Bowstead notes:

> "An agent who is appointed by contract is bound to act in accordance with the terms of that contract and not to exceed his authority."[216]

Authority simply refers to whatever it is that the principal has directed his agent to do. To take a simple example, if an agent is directed to purchase timber on his principal's behalf he will exceed his authority by buying coal. As far as the *internal* aspect of the agency relationship is concerned, an agent acting outside the scope of his authority is liable in damages to his principal for breach of contract.

The extent of the agent's authority has *external* ramifications. Third parties dealing with agents will not know whether authority to enter into the transaction in question has been conferred, and in order to protect them the law has devised a number of categories of authority. To the extent that the agent acts within these categories he will bind his principal[217].

Actual authority is self-explanatory. It comprises those actions that the principal has in fact authorised the agent to carry out, and, further, any actions incidental to the activity expressly authorised[218]. *Usual* or *implied authority* is that stemming from the particular position occupied by the agent. The 'office' to which he is appointed may be one which usually carries with it authority to perform certain actions, so that the agent is "impliedly authorised to do what is *usual* in his trade, profession or

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[216] *Supra* n 11, 6-002.

[217] What follows does not purport to explain the intricacies of the concept of authority. For a more detailed exposition the reader is referred to the specialist works on agency referred to throughout the Chapter.

[218] Referred to as *incidental authority* by Bowstead, *supra* n 11, 3-003.

business for the purpose of carrying out his authority…"[219]. *Apparent* or *ostensible authority* is that which derives from a *representation* by the principal that the agent has authority to do a certain thing. If a third party relies on that representation when contracting with the agent, then the principal is bound. Apparent authority and implied authority are based upon *appearances*[220], so that a principal, having expressly or impliedly represented that his agent has authority in certain areas, cannot then deny that authority once it has been exercised[221].

1.1. Agents of companies

Whilst companies have their own corporate personality, they can only contract by writing under common seal or via agents[222]. Where it is the directors of a company who enter into contracts on its behalf their authority to do so is typically found in the company's articles of association. These may contain restrictions on the authority of the board, but such will not affect a third party dealing with the company in good faith, by virtue of s 35A Companies Act 1985. Whilst the provision has no bearing on the ability if the company's *members* to restrain an unauthorised act[223] it protects a third party dealing with the company via its board where that board exceeded its authority. The common law rules as to usual and apparent authority remain relevant where, say, a single member of the board transacts without authority, or the third party deals with some other person

[219] Fridman, *supra* n 12, 69.
[220] See Morse, *Partnership Law*, 4th ed (1998 : Blackstone Press : London), 87.
[221] Fridman uses the language of estoppel in this regard, *supra* n 12, 111.
[222] Companies Act 1985 s 36.
[223] Except to the extent that such act has already rendered the company subject to a legal obligation; *ibid.* s 35A(4).

purporting to act for the company but without authority to do so.

2. The receiver's authority

Actual authority will be found in the debenture agreement. A receiver will have actual authority to exercise any of the powers contained in the debenture, and if he is an *administrative receiver*, these will be deemed to include those listed in Schedule 1 to the Insolvency Act 1986, to the extent that they are not inconsistent with the debenture[224]. It is at least arguable that the Schedule 1 powers constitute the administrative receiver's *usual authority* also. Whilst debentures will not usually curtail the operation of s 42(1), if they did a third party would be unaware of this fact, and might successfully argue that a receiver exercising powers contained in Schedule 1, but excluded by the debenture, is acting within his usual authority. In any event, such a third party would be protected by s 42(3) Insolvency Act 1986, which provides:

> "A person dealing with an administrative receiver in good faith and for value is not concerned to inquire whether the receiver is acting within his powers."

This is roughly equivalent to s 35B Companies Act 1985, which relieves a party to a transaction with the company from enquiring into the capacity of the company, or the authority of its board.

The position of receivers other than administrative receivers is different. Section 42 has no application to them, and so the combined protection of the importation of the Schedule 1 powers and the relief offered by s 42(3) is unavailable. In practice, however, it is more than likely that the *actual authority* of such a receiver conferred

[224] IA s 42(1).

by the debenture will be ample to validate any transaction entered into by him[225]. Even where it does not, it may be possible for a contracting party to invoke the concept of usual authority, especially if the unauthorised act would be authorised were the receiver an administrative receiver. Under s 39 Insolvency Act 1986 every invoice, order for goods, or business letter issued by or on behalf of the company or its receiver must state that a receiver has been appointed. There is no requirement that such statement specify the *type* of receiver. Even where a non-administrative receiver is in office, and even where his actual authority would not allow entry into the contract in question, it is therefore conceivable that the other party might point to the s 39 statement as conferring usual authority on the receiver, consisting of the Schedule 1 powers. There is no case law on this matter, but if the common law agency rules on authority apply, and there is no reason to suppose that they do not, such a result is plausible.

How far the concept of *apparent authority* applies in receivership is difficult to gauge. It seems that the requisite representation must be made by an agent of the company with the relevant authority[226], and since the powers of the board of directors are abridged in receivership, they appear to have no authority to make a representation as to the receiver's authority. On the other hand, the obligatory s 39 statement might be taken as a representation of authority, but such will generally be issued by the receiver, and the usual rule is that the other party is unable to rely upon a representation made by the agent himself[227]. These queries have never come before a court, and in practice are unlikely to, since third parties will virtually

[225] See, to this effect, Milman, *supra* n 26, 664.
[226] *Bank of the Middle East v Sun Life Assurance of Canada (UK) Ltd* [1983] BCLC 78.
[227] See *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd* [1964] 2 QB 480; *Hely-Hutchinson v Brayhead Ltd* [1968] 1 QB 549.

always have the blanket protection offered by any receiver's actual authority.

In conclusion, this appears to be one area in which the agency of the receiver closely resembles that of pure agents. A couple of final points are, however, worth making. First, regardless of the position of third parties, it appears that, compatible with 'ordinary' agency law, a receiver acting outside his authority will be liable to the company for any damage that his actions cause[228]. The basis of this liability, however, has been stated to be 'abuse of power', a wide-ranging doctrine which applies outside the field of agency law[229]. Secondly, it may be that a receiver acting outside his authority would be liable to a third party for breach of warranty of authority, if the principle in *Collen v Wright*[230] could be extended to encompass such circumstances.

3. Liability on contracts: a departure from convention

3.1 Pure agents and liability

> "There is no doubt whatever as to the general rule as regards an agent, that where a person contracts as agent for a principal, the contract is the contract of the principal and not that of the agent; and, *prima facie*, at common law the only person who may sue is the principal and the only person who can be sued is the principal."[231]

This is a general rule, and admits of exceptions. It is open to the parties to provide that an agent shall be personally liable on any contract he enters into on behalf of his principal, or to decree that an agent shall be jointly and severally liable with the principal. However, there exists something in the nature of a presumption that an

[228] *Downsview Nominees Ltd v First City Corporation* [1993] AC 295.
[229] *Ibid.* This topic is examined in the next Chapter.
[230] (1857) 8 El. & Bl. 647.
[231] *Montgomerie v UK Mutual S.S. Association Ltd* [1891] 1 QB 370, 371, *per* Wright J.

agent contracting for his principal assumes no liability; he is simply the means by which the contract is effected.

3.2 The receiver's position

Prior to 1948 a receiver was in the same position as a pure agent. In entering into contracts for the company he incurred no personal liability, except to the extent that the contract could be construed as providing otherwise[232]: the liability remained that of the company. That such liability was unlikely to be met gave the legislature pause for thought. The Cohen Committee noted:

> "A receiver appointed out of Court is as a rule the agent of the company and ... is not personally liable unless he pledges his own credit. In some cases receivers appointed out of Court have ordered goods and have not paid for them but the proceeds of realisation have been applied for the benefit of the debenture-holders, the seller of goods being left to sue the company which has no assets. We consider that a receiver, however appointed, should be made personally liable (without prejudice to his right to an indemnity out of the assets) on any contracts entered into by him subsequent to his appointment, except where the contract expressly excludes him from personal liability."[233]

This recommendation was enacted in s 369(2) Companies Act 1948. Its effect is reproduced ss 37(1)(a) and 44(1)(b) Insolvency Act 1986[234]. These enactments reverse the presumption of non-liability that attaches to pure agents. If the receiver wishes to avoid personal liability he must actively provide for such in any contract into which he enters, otherwise it will be an automatic result. It is clear that such liability can be excluded, and it seems equally likely that, notwithstanding s

[232] *Telsen Electric Co Ltd v J. J. Eastick & Sons* [1936] 3 All ER 266.
[233] *Report of the Committee on Company Law Amendment*, Cmnd. 6659 (1945 : HMSO : London), para. 68.
[234] In relation to non-administrative and administrative receivers respectively.

44(1)(b), the company, as principal, will also be liable on any contract entered into on its behalf by its receiver, although this is not spelt out in the legislation[235]. Thus, a fundamental principle of agency law is statutorily excluded in receivership.

4. Miscellaneous fragments of agency law and their application to receivers

4.1 Tortious liability of agent and principal

An agent will be personally liable for torts committed by him whether acting within or without authority[236], although his principal may be held jointly and severally liable for tortious acts committed with authority[237]. The position of a receiver is similar, although this is subject to the question of whether the receiver's liability to third parties can be excluded in the debenture. The one qualification to this proposition is the position in relation to the tort of inducement of a breach of contract, for which receivers are not liable[238], and which is considered in detail in Chapter 3.

4.2 Agents' actions causing a principal to commit a criminal or similar offence

As with tortious liability, there will be circumstances where a principal may incur criminal liability through his agent's actions. This is the case even where the principal in question is a company, although it should be noted that, under 'alter-ego' or 'attribution' theory, a company principal may be directly, rather than vicariously liable[239].

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[235] The company's liability will be valueless to the contracting party. Common sense dictates that he will pursue the receiver.
[236] Bowstead, *supra* n 11, para. 9-109.
[237] Fridman, *supra* n 12, 315.
[238] *Welsh Development Agency Ltd v Export Finance Co.* [1992] BCC 270.
[239] This is a complex subject and confines of space do not allow for a full treatment. The reader is directed to the useful discussion in Charlesworth and Morse, *Company Law*, 16th ed (1999: Sweet & Maxwell : London), 21-23.

This principle has been applied equally to receivers. It has been held that a receiver may, by his actions, cause the company to commit a criminal offence[240], or render it in contempt of court[241]. This is so even though the company has no control over its receiver's actions. In this respect, the courts have displayed a degree of sympathy, and have usually managed to avoid the detrimental consequences to the company. In the *John Willment* case, for example, Brightman J, whilst acknowledging that a receiver might have a discretion as to whether to pay over VAT collected for the company, ruled that that discretion could only be exercised in favour of the Customs and Excise Commissioners, thus saving the company from criminal liability[242]. Similarly, in the *MacLeod* case[243], a decree of specific performance against the company was refused for fear that its receiver would ignore it and thus place the company in contempt of court. These cases give full effect to the receiver's agency position, but assuage its potentially harsh consequences.

A different approach can be seen in *Sheahan v Carrier Air Conditioning Pty Ltd*[244]. Here the question was whether a payment made by the receiver to a contracting party of the company could amount to a preference for the purposes of s 122 of the Bankruptcy Act 1966 (Cth) and s 565(1) Corporations Law. By a bare majority it was held that the agency of the receiver did not mean that the payment was effected by the company. The majority[245], having noted the unusual nature of the receiver's agency, stated:

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240 *Re John Willment (Ashford) Ltd* [1980] 1 WLR 73.
241 *Macleod v Alexander Sutherland Ltd* 1977 SLT (Notes) 44.
242 *Supra* n 240. See also *Sargent v Commissioners of Customs and Excise* [1995] 2 BCLC 34.
243 *Supra* n 241.
244 (1997) 71 ALJR 123.
245 Dawson, Gaudron and Gummow JJ.

"Reliance, in this question of characterisation, by the liquidator of TOC upon the particular agency created by the Debenture as a step to controverting what would otherwise be the legal nature and practical effects of the steps involved, extends that notion of agency beyond its true character."[246]

It remains to be seen whether this technique would be followed by an English court[247]. It clearly departs from earlier English authorities, and, indeed, from the usual position under agency law, but whether this amounts to an attempt to protect the company, as in *John Willment* and *Macleod*, or to facilitate the progress of the receivership is debatable.

The Agency of the Receiver: Some Conclusions

1. Is the agency 'real'?

This perhaps begs the question of what a 'real' agency amounts to. Certainly, some principles of agency law have relevance to the receiver's position, most notably the obligation of the company/principal to remunerate and indemnify the receiver/agent. It also appears that the legislature has chosen a form of protection for third parties dealing with receivers similar to that seen in relation to company agents acting outside their authority. But do these contractual and statutory interventions give the receiver's agency the stamp of authenticity?

It was noted at the beginning of this Chapter that agency is essentially a mutually beneficial arrangement. Thus, agency can be characterised as a bilateral exchange of rights and duties, those of each party being circumscribed by law in order that the integrity of the relationship be maintained. One of the hallmarks of agency law

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[246] (1997) 71 AJLR 1231, 1236.

[247] It was not where the question of whether a sale of company assets to a connected party of one of its directors fell within s 320 Companies Act 1985: *Demite Ltd v Protec Health Ltd* [1998] BCC 638. See Frisby, *Receivers and the Companies Act 1985, s 320: A Very Real Agency* [1999] CFILR 143.

is, therefore, the construction of a series of checks and balances, in the form of rights and duties, inspired by a desire to safeguard a valuable and serviceable arrangement. These rights and duties represent a concatenation of components that, when viewed as a whole, amount to a discrete and unmistakable association. The question arises as to how many of these constituent parts can be removed before the alliance ceases to be aptly demarcated as agency and becomes something else. This is at the heart of the interrogation in hand.

What emerges from the case law can be summarised as follows. As far as the internal aspects of the receiver's agency are concerned, it is entirely one-sided. The company/principal appears subject to the usual range of obligations imposed upon principals, but does not benefit from the concomitant duties owed by agents. Those duties that *are* owed are atypical: they are not informed by the receiver's agency status, but owe their existence to his position as a kind of surrogate mortgagee in possession. The skeleton upon which the courts have fleshed out the receiver's obligations is his *function* as debt enforcer, and the courts have concluded that such necessarily excludes virtually the entire compass of a pure agent's duties.

The external dimension of the agency is also robbed of certain of its idiosyncratic features. Most notably, the receiver is fixed with personal liability which would not, under agency law, arise. What remains is the receiver's ability to commit the company to legal obligations, and this is, admittedly, entirely consonant with pure agency.

In the final analysis, the 'reality' of the agency comes down to a matter of impression. It is submitted that one feasible analysis of the receiver's position is that it lacks so many of the characteristics of agency as to be undeserving of that label. The reality is that the performance of the receiver's function, and the manner of that performance, lends itself more appropriately to the conclusion that he is *acting* in the manner of agent *for the appointor* rather than the company[248]. That this is the *substance* of the arrangement is irrefutable. Consider the position where the agency clause is inadvertently omitted. In such circumstances it has consistently been held that the receiver acts as agent *for the debenture-holder*, with all the consequences that entails[249]. This is, having regard to the agreement as comprised in the debenture, the *natural* conclusion. What the receiver does, and his focus in doing it, leads inexorably to that verdict. And yet it is smoothly circumvented by the cosmetic device of the agency clause, a clause which adds nothing to what is actually to be done and does not affect the manner of performance, even vestigially. That such a technicality should be afforded credence merits further comment.

2. A triumph of form over substance?

The artificiality of the receiver's agency position has been expressly adverted to by the courts, but has gone virtually unchallenged. Whilst acknowledging its 'oddness' they have been prepared to take it at face value, *but only* to the extent that it facilitates the performance of the debt collection service and protects the appointor from liability. Commentators have noted this phenomenon and drawn their own conclusions. Lord Millet, writing extra-judicially, remarks:

> "The true principal appears to be that the so-called "agency" of the receiver is not a true agency, but merely a formula for making the company, rather than the debenture-holders, liable for his acts..."[250]

[248] See Ziegel, *Current Developments in International and Comparative Corporate Insolvency Law*, Ziegel ed (1994 : Clarendon Press : Oxford), 457.
[249] See *Re Vimbos Ltd* [1900] 1 Ch 123; *Robinson Printing Co. Ltd v Chic* [1905] 2 Ch 123; *Deyes v Wood* [1911] 1 KB 806.
[250] *The Conveyancing Powers of Receivers After Liquidation* (1977) 41 Conv. 83, 88.

Ziegel refers to a "fictitious use of agency concepts"[251]. The Law Commission, in what appears to be its only excursion into the area of receivership, has commented as follows:

> "A notable example of the artificiality of mortgage law is the agency of a receiver."[252]

It is clear that the true beneficiary of this device is the debenture-holder. The agency relieves him from the consequences of being a mortgagee in possession, it protects him from liability to third parties, and it affords the utmost efficacy to the recovery of his claim against the company. For all intents and purposes the receiver acts on his behalf, and, *in substance*, as his agent. Yet the *form* of the agreement prevails emphatically. The intention, as evinced by the agency clause, is that the receiver is to be the agent of the company, and the deference of the courts to contractually expressed intentions is an accepted feature of interpretative techniques.

However, across a whole range of legal areas, the courts have been alert to the use of labels to disguise the true effect of transactions. The detection of illusory designations, where such are employed to give one party an unwarranted advantage, has been a feature of the courts' role for centuries. Thus, equity was quick to turn its powerful spotlight onto the mortgage transaction and to intervene to give effect to its *substance*: the arrangement was structured as a sale, but in substance was a security, and equity would allow it to take effect *only* as a security. This predilection is at the root of the creation of the equity of redemption. Other examples are readily available, and a few are noted here to demonstrate the universality of the courts' adherence to 'reality'.

[251] *Supra* n 248, 452.
[252] Working Paper No. 99: *Land Mortgages* (1986 : HMSO : London), para. 3.49.

In *Ex parte Delhasse*[253] the Court of Appeal disregarded the use of loan language in an agreement as an attempt to avoid partnership liability. James LJ was trenchant in this regard:

> "...the use of the word "loan" and the reference to the Act are, in my opinion, a mere sham - a mere contrivance to evade the law of partnership. The Loan is a mere pretence, its object being to enable the so-called lender to be, not only a dormant partner, but the real and substantial owner of the business, for whom and on whose behalf it is to be carried on, and yet to provide that he shall not be liable for loss, in case loss shall be incurred ... the law of England does not allow this to be done..."[254]

To the same effect are the words of Cozens-Hardy MR in *Weiner v Harris*:

> ""It is quite plain that by the mere use of a well-known legal phrase you cannot constitute a transaction that which you attempt to describe by that phrase."[255]

Similarly, the courts have disregarded labels attached to employment-type contracts where they do not reflect the reality of the arrangement between the parties[256], and have construed purported liquidated damages clauses as penalties when this is their true tenor:

> "It is well settled that, when a court of law finds that the words the parties have used in their written agreement are not genuine and are not designed to express the real nature of the transaction but for some ulterior motive to disguise it, a court will go behind a sham front and get at the reality."[257]

Finally, and perhaps most prominently, the House of Lords examined the use of 'labels' in the landlord/tenant domain and unhesitatingly refused to give effect to an

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253 (1877) 7 Ch 511.
254 *Ibid.*, 526.
255 [1910] 1 KB 285, 290.
256 *Ferguson v John Dawson & Partners (Contractors) Ltd* [1976] 1 WLR 1213; *Massey v Crown Life Insurance Co.* [1978] ICR 590; *Calder v H Kitson Vickers & Sons (Engineers) Ltd* [1988] ICR 233.
257 *Bridge v Campbell Discount Co Ltd* [1962] 1 All ER 385, 402, *per* Lord Devlin.

agreement terming itself a licence where the rights and obligations of the parties indicated that a lease had been created. In the words of Lord Templeman:

> "If the agreement satisfied all the requirements of a tenancy, then the agreement produced a tenancy and the parties cannot alter the effect of the agreement by insisting that they only created a licence."[258]

The above cases reveal that the use of labels in order to 'steal a march' will be given short shrift. Yet the agency label in receivership works in precisely this manner for the debenture-holder. He is allowed to appoint a receiver who acts *as though he were his agent*: the nominal principal sustains all the burdens of that position, without enjoying the corollary benefits. Full force is given to the receiver's agency as far as it protects the appointor, but where such protection is jeopardised by virtue of the agency, such as where the company's position ought to be given primacy, the legal response has been to deny the agency this effect.

How to explain this aberration? Much elucidation and evaluation is left to the following Chapter, but this much can be presently noted. The courts appear to have resolved, at least implicitly, that a fully-fledged agency relationship is inappropriate to the status of *receiver*. Although there is nothing in the debenture agreement creating that arrangement to suggest that it should not operate according to its terms, they have construed the position with half an eye to the task that the receiver is to perform and structured a duty framework around that task. In doing so, what emerges is a relationship that is perhaps *sui generis*. A new status is created, that of *receiver*, which attracts a bundle of rights and obligations unique and tailored to the circumstances. The process is, as yet, incomplete, and whether the last word on this abnormal agency has been spoken remains to be seen. The following Chapter

[258] *Street v Mountford* [1985] AC 809, 819.

moves on to consider the ramifications of the courts' approach in this regard, and attempts to elucidate further the policy considerations informing their conception of the appropriate response to the receiver/company/debenture-holder nexus.

CHAPTER 2

THE TRIPARTITE RELATIONSHIP: RECEIVER, COMPANY AND DEBENTURE-HOLDER

Introduction

> "The appointment of a receiver seems to me to involve an inherent conflict of interest. The purpose of the power is to enable the mortgagee to take the management of the company's property out of the hands of the directors and entrust it to a person of the mortgagee's choice. That power is granted to the mortgagee by the security documents in completely unqualified terms."[1]

The above neatly encapsulates receivership. Of all the relationships in which the receiver finds himself, two stand out as being particularly important, those which exist, on the one hand, between receiver and company and, on the other, between receiver and appointing debenture-holder. Given that the interests of company and debenture-holder are likely to diverge sharply during receivership, some means of resolving this conflict must be available to the receiver. His position would be untenable if, by prioritising the welfare of one party, he became legally accountable to the other for the inevitable damage caused to it.

This Chapter attempts to illustrate the manner in which the law intervenes to ensure that the receiver faces no such dilemma. By prescribing a duty-based hierarchy it ensures that the irresistible force and the immovable object never actually meet: to use fiduciary language, no conflict of duty and duty arises. Such a result could be most easily achieved by an 'all or nothing' route, whereby the receiver would be legally compelled to have regard to only one set of interests. In fact the law has

[1] *Shamji v Johnson Matthey Bankers Ltd* (1986) 2 BCC 98,910 *per* Oliver J at 98,915 (adopting the words of Hoffmann J at first instance).

developed in a subtler fashion. Whilst acknowledging the sovereignty of the debenture-holder's claims, it has nevertheless asserted that the well-being of the company is not completely irrelevant in informing the receiver's conduct, and in doing so has consummated a balance of sorts, if not a reconciliation. Whether or not this balance is sensibly or fairly weighted is a recurring theme in this, and other Chapters.

The technique employed by law to regulate the receiver's performance of his functions is to attribute *duties*, which may be owed to either the debenture-holder or the company. The twin origins of these duties, as far as the *company* is concerned, are contract and status[2]. The contract in question is that between the company and the debenture-holder, to which the receiver is not a party but which nonetheless represents a significant source of power, if not obligation. As for status, the previous Chapter suggests that the receiver's identification as agent of the company is fictitious, at least as far as it dictates how he must behave towards the company, his purported principal. Nevertheless, it will be suggested that the status of *receiver* (as opposed to agent) has some consequence, especially in terms of the relationship between the receiver and his appointor. And, according to more recent case law, the status of *mortgagee* is similarly meaningful, in that it is pivotal in determining those duties owed by receiver to company[3].

This Chapter will examine the nature of the receiver's duties to the company and to the debenture-holder in tandem. This is not because their content or derivation is in

[2] Although statutory duties are owed to both debenture-holder and company, as to which see *infra*126.

[3] Even though the receiver is not a mortgagee of the company's property. This enigma is explored in depth further on.

any way similar, indeed, the case law graphically depicts that this is not the case. However, an examination of the way in which the courts have developed and refined the law in this area suggests that the respective duties are inextricably intertwined, the one delineated by the other. As was observed in relation to the receiver's agency, at the centre of this construct is the notion of *function*, with primacy afforded to the achievement of the commercial purpose (as perceived by the courts) of receivership. This approach acknowledges what the legal structure of receivership seeks to avoid, it concedes that for all intents and purposes the nucleus of the institution is composed of three, rather than two parties. As Fox LJ puts it:

> "The relationship set up by the debenture, and the appointment of a receiver, however, is not simply between mortgagor and receiver. It is tripartite, and it involves the mortgagor, the receiver and the debenture-holder."[4]

Thus, although the interposition of the receiver is legally effective to fence off the debenture-holder from the company, the relationship between receiver and debenture-holder is instrumental in determining the workings of the relationship between receiver and company. From the outset, it is the initial contract between debenture-holder and company that spawns the subsequent receiver/company nexus. What emerges is a *ménage à trois* of considerable intricacy, in that on the one hand it endeavours to exclude any such denomination, whilst, on the other, it accepts that the rights and duties of each party to it are circumscribed by reference to each other. Form and substance branch off again, as they do in relation to the agency of the receiver. The tripartite relationship, and the duty configuration within it, warrant close attention if the true legal nature of receivership is to be assessed.

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[4] *Gomba Holdings UK Ltd v Minories Finance Ltd* (1989) 5 BCC 27, 29.

Why Duties Arise: The Practical Effect of Receivership

1. Introduction: Receiver and Company

Before exploring the nature and content of the receiver's duties, the practical consequences of the appointment of a receiver over the charged assets of a company merit attention. This may help to elucidate why a receiver should owe duties to the company at all, and also support the submission that these duties should not necessarily owe their existence to somewhat specious comparisons with the law of mortgages. Further, a survey of the case law relating to the position of the company in receivership reveals, it is submitted, an embryonic endorsement of the uniqueness of the situation and an attempt to address that singularity with *ad hoc* solutions.

2. A transfer of powers

The appointment of an administrative receiver is, by definition, over the whole or substantially the whole of the company's property[5]. That appointment is underpinned by the bestowal upon the receiver of a parcel of powers, deemed to emanate from the debentures under which he is appointed, unless inconsistent with the provisions of those debentures[6]. Armed with these considerable powers the receiver is able to effectively usurp the management of the company from its board, and to deploy the charged assets in whatever manner he thinks fit in order to achieve his goal of discharging the debt owed to the debenture-holder. Goode has classified the Schedule 1 powers as *in rem* and personal:

[5] Insolvency Act s 29(1)(a)(b) (hereinafter 'IA').
[6] IA s 42(1) and Schedule 1.

> "[The receiver's] *in rem* powers are held in right of the debenture-holder and derive from the security created by the debenture. They include the power to collect in the assets comprising the security, to possess, control and use those assets and to deal with and dispose of them, whether by way of sale, lease, charge or otherwise. His personal powers are those vested in him by virtue of his position as deemed agent to manage the company's business."[7]

A scrutiny of these powers reveals a compelling likeness to those usually possessed by the company's directors, and, *en bloc*, they comprise an unfettered authority in relation to both the assets included in the charge (*in rem* powers) and the ability to commit the company to obligations and to direct its future trading course (personal powers). Further, it would appear to be the law that, subject to one interesting and difficult exception[8], the receiver wields these powers exclusively, so that the usual managerial functions of the company's board evaporate upon his appointment. As a consequence, the company is emasculated as far as its power of self-determination is concerned.

This proposition is not particularly surprising. If directors were able to continue to exercise powers commensurate to those of the receiver, and over the same assets, the resulting tug of war would lead to chaos, especially for third parties, and the achievement of the receiver's *purpose* gravely undermined. Common sense dictates that, for the most part, only one actor can have dominion, and the courts have come down almost unconditionally on the side of the receiver. There is nothing express in the contract between debenture-holder and company that would have this effect: whilst the receiver is given powers, these are not stated to be to the exclusion of the

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[7] *Principles of Corporate Insolvency Law*, 2nd ed (1997 : Sweet and Maxwell : London), 237.
[8] See *infra* 99.

board's powers[9], even where concurrent exercise would lead to inconsistencies and unworkability. Instead, this conclusion is reached almost as a matter of impression, and, in some cases, by recourse to the implied term theory of contract.

Rigby LJ, in *Gaskell v Gosling*[10], hinted as much. In tracing the foundations of the peculiarities of the agency of the receiver, and locating them in the contract between debtor and creditor, he noted:

> "For valuable consideration he [the mortgagor] *has committed the management of his property to an attorney whose appointment he cannot interfere with...*"[11]

Not only is the dismissal of the attorney contractually prohibited, but, it might be inferred, so is any interference with his actions or any attempt to pre-empt them by the taking of action by the mortgagor. This was confirmed in *Woolston v Ross*[12], where a disgruntled mortgagor attempted to distrain for unpaid rent, without the authority and against the better judgment of a receiver appointed over the lease in question. Cozens-Hardy J asserted:

> "In my opinion, so long as the receivership is in force and the notice to the tenant is not withdrawn, no valid distress can be levied except by the receiver or by some person, including the mortgagor authorised by him ... It is a fallacy to suggest that the mortgagor, as principal, can exercise the statutory power vested in his agent, the receiver."[13]

How the statutory power to levy distress came to 'vest' in the receiver was left unexplained by the learned judge. Property of the company does not vest in a receiver, if a power to distrain can be described as property. It would perhaps be

[9] Nor does the Insolvency Act have this effect.
[10] [1896] 1 QB 669.
[11] *Ibid.* 692 (italics added).
[12] [1900] 1 Ch 788.
[13] *Ibid.* 791.

more accurate to say that the statutory power to levy distress is only exercisable by the receiver, in lieu and to the exclusion of the mortgagor landlord. Nonetheless, it is clear that he considered that the receiver, having chosen not to exploit this power, had debarred the mortgagor from dealing with it inconsistently. Not only is the receiver given 'first refusal' on the deployment of an 'asset', his refusal operates to sterilise the productive capacity of that asset in the hands of the mortgagor unless he so authorises.

The impotence of the company's managerial organs during receivership was proclaimed by Lord Atkinson in *Moss Steamship Co. Ltd v Whinney*:

> "[The] appointment of a receiver and manager over the assets and business of a company does not dissolve or alienate the company, any more than the taking of possession by the mortgagee of the fee of land let to tenants alienates the mortgagor. Both continue to exist; but it entirely supersedes the company in all the conduct of its business, deprives it of all power to enter into contracts in relation to that business, or to sell, pledge, or otherwise dispose of the property put into the possession, or under the control of the receiver and manager. Its powers in these respects are entirely in abeyance."[14]

One point that is occasionally overlooked about this dictum is that his Lordship was dealing with a receiver appointed by the court, and not a privately appointed receiver of the kind here under discussion. One of the several differences between court appointed and private receivers is that the former is an officer of the court, so that any interference with his functions amounts to a contempt of court[15]. This is not

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[14] [1912] AC 254, 263.

[15] See, for example, *Ames v Birkenhead Docks Trustees* (1855) 20 Beav. 332 (dispossession of property under receiver's control); *Langford v Langford* (1835) 5 LJ Ch 60 (attempting to collect rents); *Re Derwent Rolling Mills Co Ltd* (1904) 21 TLR 81 (attachment of debts after appointment of receiver); *Re Sutton's Estate* (1863) 8 LT 343 (levying distress after appointment of receiver).

the case where private receivers are concerned[16]. Furthermore, the powers of a court-appointed receiver are entirely a matter of the order under which he is appointed, whereas those of the private receiver flow out of the debenture contract, so it should not be assumed that the *effect* of each is identical. If, on the other hand, regard to the *function* of each type of receiver is had, the analogous treatment of such effect is not inappropriate. Both are appointed over property with a view to managing it for a particular beneficiary or beneficiaries, and both would be severely hampered in this task if outside intervention were countenanced[17]. Thus a choice has to be made as to who may exercise management powers. In the case of the court appointee, the answer is obvious, in the case of the contractual receiver, the same result ought to follow as a matter of contract.

3. How the transfer is effected: the contractual resolution

As has been noted, debenture agreements do not, in terms, stipulate for a suspension of the powers of the company's board, during receivership, but this appears to be the effect of any appointment. The *Whinney* case[18] establishes that a receiver appointed by the court takes over certain of the board's powers and functions, and this proposition has been adopted in relation to privately appointed receivers. There ought, therefore, to be some contractual basis for this result, and it is submitted that

[16] Although it is open to the receiver, under s 35 IA, to obtain injunctive relief against interference. His appointor has no such facility; *Bose v Harris* (1942) SJ 376.
[17] Weinrib considers that court and privately appointed receivers are "functionally identical": *The Fiduciary Obligation* [1975] UTLJ 1, 7, n 16.
[18] *Supra* n 14.

such an analysis is substantially correct, although its niceties have been engulfed by rather sweeping statements in the past[19].

To return to the classification of the receiver's powers as *in rem* and personal, as far as the former are concerned one explanation of his ability to exclude outside exercise would run as follows. In the first place, his appointment will crystallise a floating charge over the assets of the company[20]. At that point the company's freedom to deal with those assets is terminated, and any attempt to dispose of them, by whatever means, would require the permission of the chargee[21]. The company, by granting the fixed or floating charge, has contractually accepted a shackle on its freedom to deal with its assets during receivership which may only be loosened by the debenture-holder's sanction, and such sanction is not requested or given.

Further, and again as a matter of contract, the company has agreed to the debenture-holder acting as its agent in the matter of the receiver's appointment. On making that appointment, a form of permission to deal is granted, but that licence is 'vested' in a single agent of the company, *viz.* the receiver. Its other agents, the directors, are disabled from any form of disposition by virtue of the pre-existent fixed charge or newly crystallised floating charge, as the company has contractually acceded that they should be.

The proprietary analysis is more difficult to apply where the power in question is 'personal'. Personal powers may be described as general management powers, and

[19] See, e.g., *Meigh v Wickenden* [1942] 2 KB 160, 168; *Lawson v Hosemaster Machine Tool Co Ltd* [1966] 1 WLR 1300, 1315; *Griffiths v Secretary of State for Social Services* [1973] 3 All ER 1184, 1199. All of these state the fact, rather than the legal basis, of the receiver's control.

[20] *Re Panama, New Zealand and Australian Royal Mail Co* (1870) 5 Ch App 318; *Evans v Rival Granite Quarries Ltd* [1910] 2 KB 979; *George Barker (Transport) Ltd v Eynon* [1974] 1 WLR 650.

[21] As would a disposal of fixed charge assets whether a receiver was in office or not.

whilst they may relate to charged assets, in the sense that the receiver decides how to *deploy* those assets, they may also concern the running of the company without reference to its assets[22]. The Schedule 1 powers include: appointing solicitors or accountants; bringing or defending legal proceedings in the name and on behalf of the company; appointing other agents or dismissing employees; establishing subsidiaries of the company; making arrangements or compromises; proving in bankruptcy; bringing or defending a winding up petition, and; changing the situation of the company's registered office[23]. These correspond very closely with the kind of powers bestowed upon and exercised by the company's board, but they have no immediately obvious proprietary base, stemming rather from the agency status of the board on the one hand and the receiver on the other. Again, neither the debenture contract nor the Insolvency Act expressly exclude the board's exercise of those powers which are also possessed by the receiver, and, of course, their concurrent exercise by both parties would render receivership impractical.

This impasse is avoided by the implication of a contractual term to the effect that the directors of the company may not exercise managerial powers whilst the receiver is in office. This was recognised by Hoffmann J in *Gomba Holdings UK Ltd v Homan*[24] where, having expressly adverted to the importance of implied terms in the "bargain between the debenture-holder and the company", he continued:

> "There are, I think, certain principles which can be deduced from what the parties may be supposed to have contemplated as *the commercial purpose of the power to appoint a receiver and manager*. The first is that the receiver and manager should

[22] Although, as Goode notes, there may be some overlap between *in rem* and personal powers; *supra* n 7.
[23] IA Schedule 1, items 4, 5, 11, 15, 18, 20, 21 and 22 respectively.
[24] [1986] 3 All ER 94.

have the power to carry on the day-to-day process of realisation *and management of the company's property* without interference from the board."[25]

Interference, it is submitted, must encompass any attempt to exercise management powers which have been granted, by the debenture, to the receiver. Further, this principle may extend to management powers beyond those directly associated with the charged property to any action of a commercially significant nature. In *Independent Pension Trustees Ltd v L.A.W. Construction Co Ltd*[26] it was held that the board had no power over assets in the possession or control of the receiver, and that assets, in this respect, included rights and powers of the company which were of value in the commercial sense[27]. One point of interest is Lord Hamilton's view that rights and powers of this nature would be caught by a global floating charge[28]. If this is correct, the proprietary analysis described above could be applied to divest the board of its powers of management whenever those powers could be described as 'commercially significant', a benchmark which is potentially extremely wide and could conceivably absorb the majority, if not all, of managerial discretion[29]. If this proposition is considered to be too broad, in that it blurs the distinction between *in rem* and personal powers, it remains the case that the courts may have resort to the implied contractual term to prevent directors acting in conjunction with the receiver and so defeating the commercial purpose of the appointment.

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[25] [1986] 3 All ER 94, 98, relying on *Moss Steamship Co Ltd v Whinney* (italics added).
[26] 1997 SLT 1105.
[27] The right in question was that of appointing an independent trustee of an occupational pension scheme.
[28] I.e., one over the entire undertaking of the company.
[29] 1997 SLT 1105, 1110. His Lordship envisaged as commercially significant any right or power the exercise of which could have some bearing on the value of exploitable assets, including goodwill. All-encompassing indeed.

3.1 The validity of 'divestment theory'

Two modes of divesting directors of their general management powers have been suggested, the first based on the proprietary effect of the debenture contract, the second on an implied contractual term. Both are entirely orthodox. Whilst the courts may, in relation to other aspects of receivership, have used implied term theory somewhat inconsistently[30], in this regard their approach appears both doctrinally legitimate and eminently sensible. Such terms may be implied as a matter of law or of fact, but, it is generally stated, only as a matter of necessity. In these circumstances, and given the courts' deference to the receiver's function, it is arguable that such a term is implied in law, but it could equally emerge from a strict application of the business efficacy test. Clearly there can be no question but that the directors of a company in receivership abdicate their managerial powers to the appointee. As Meagher, Gummow and Lehane put it:

> "A receiver obviously could not manage effectively if the directors retained concurrent power to manage. Nor, it is suggested, could a receiver effectively deal with the property of the company if the directors retained a concurrent power to deal with it ... if a receiver is given power to manage, that power must be exclusive of the directors' powers; if he is given power to convey the legal title to an asset of the company, that power equally must be exclusive of the directors' powers."[31]

This is absolutely appropriate to the *commercial purpose* of the particular relationship in question, and, further, it satisfies the test of necessity proposed in *Liverpool City Council v Irwin*[32]. Whilst a man may not serve two masters, nor may

[30] See Chapter 1.
[31] *Equity: Doctrines and Remedies*, 2nd ed (1992 : Butterworths : Sydney) [2849].
[32] [1977] AC 239, 266.

two masters preside over the affairs of the company in the circumstances envisaged by receivership. Such a situation simply would not work, and both parties to the debenture contract must be taken to have adverted to this[33].

4. The extent of 'divestment theory'

The above analysis has the attraction of simplicity. Once a receiver is appointed, the managerial powers of the company's board are suspended. Commercial certainty, on which a premium is placed, is delivered and the receivership can run smoothly without niggling impediments. Or so it would seem. In fact it appears that 'divestment theory' is subject to qualification, and that the unique flavour of receivership inspires this inroad. This may be symptomatic of a recognition that there should exist a discrete body of receivership law, untrammelled by strict proprietary or contractual construction and tailored instead to reaching a solution that acknowledges the several interests at stake and reconciles them in a measured and thoughtful manner. If so, it is to be welcomed.

4.1 The bringing of proceedings:an exception to divestment theory?

A receiver has power "...to bring or defend any action or other legal proceedings in the name and on behalf of the company"[34]. Outside of receivership, so do the board of directors. The question of whether the board, against the wishes of the receiver, may sue on behalf of the company has given rise to a cluster of cases at least two of which can only be rather contrivedly reconciled.

[33] Although the *company* might suppress the officious bystander not so much with a testy 'Oh, of course' as with a resigned 'Oh, well, I suppose so'.
[34] IA Schedule 1, item 5.

The starting point in the UK is *Newhart Developments Ltd v Co-operative Commercial Bank Ltd*[35]. In that case the plaintiff company sought to pursue the debenture-holder bank, which had already appointed a receiver, for an alleged breach of contract. The receiver had chosen to ignore the cause of action[36], and it was argued that the company's writ should be set aside as issued without the receiver's consent. In the Court of Appeal, Shaw LJ held that the directors remained at liberty to bring proceedings in the name of the company, notwithstanding that a similar power could be exercised by the receiver. He pointed out that:

> "...the provisions of the debenture trust deed giving him that power is an enabling provision which invests him with the capacity to bring an action in the name of the company. It does not divest the directors of the company of their power, as the governing body of the company, of instituting proceedings in a situation where doing so *does not in any way impinge prejudicially upon the position of the debenture-holders by threatening or imperilling the assets which are subject to the charge.*"[37]

The directors in question had agreed to indemnify the company against liability for a hostile costs order against it, thus such an award would not have to be met out of the charged assets and so those assets would not be 'threatened or imperilled'.

The decision is of interest for a number of reasons. First, Shaw LJ noted in passing that the appointment of a liquidator has the statutory effect of curtailing the powers of the directors, whereas the appointment of a receiver does not. He did not explore the possibility that such a result could be achieved contractually or as a matter of property law. Secondly, *Moss Steamship Co Ltd v Whinney*[38] was relied on in

[35] [1978] 2 WLR 636.
[36] Hardly surprisingly.
[37] [1978] 2 WLR 636, 641 (italics added).
[38] *Supra* n 14.

support of the proposition that not all of the directors' powers are in abeyance during receivership[39]. As suggested earlier, a decision relating to the effects of a court-appointed receiver should not automatically be treated as authoritative as far as privately appointed receivers are concerned. Thirdly, the fact that the cause of action in question would have been caught by the debenture-holder's charge was not adverted to. Finally, Shaw LJ acknowledged that the directors were not in a position to "dispose of assets within the debenture charge without the assent or concurrence of the receiver..."[40].

A diametrically opposed view of this matter was taken in *Imperial Hotel (Aberdeen) Ltd v Vaux Breweries Ltd*[41] on similar facts, except that the proceedings in question were purported to be brought against a third party. Lord Grieve, having stated that "in England the directors powers are in abeyance during the receivership"[42], referred to the Floating Charges and Receivers (Scotland) Act 1972 and continued:

> "It would be quite contrary to the object of the Act if a company, all of whose assets were attached to the receiver because all were covered by a floating charge or floating charges, could interfere, through its directors, with the exercise by the receiver of his discretion by, for instance, raising actions that the receiver did not consider should be raised.[43]

This dichotomy of approach has been noted by Campbell[44] and Wilson[45], the former

[39] See also Doyle, *Administrative Receivership: Law and Practice* (1995 : FT Law & Tax : London), 262 (hereinafter *Doyle*).
[40] [1978] 2 WLR 636, 642.
[41] [1978] SLT 113.
[42] *Ibid.* 115.
[43] *Ibid.* 116.
[44] *Powers of Directors and Receivers* (1979) 129 NLJ 261.
[45] *Receivers (Scotland)* [1979] JBL 61.

preferring the thinking of the Court of Appeal:

> "The test of whether the proposed action of the directors could harm the charge holders as such in any given case seems to be a fair one. It attaches due importance to the security of the charge holder and yet recognises that the board of directors is still in existence and still owes duties to the members and other creditors of the company."[46]

Newhart has since been preferred in Scotland in *Shanks v Central Regional Council*[47], where Lord Weir noted, as had Shaw LJ, that the company's directors continued to owe duties to the company during receivership and that it might therefore be "appropriate or even necessary" for them to institute proceedings in such circumstances[48]. Further, the 1972 Act did not preclude this conclusion, as had been assumed to be the case in *Imperial Hotel (Aberdeen) Ltd.* Finally, his Lordship, whilst accepting that the views expressed by Lord Grieve in that case might be "applicable to most situations", was of the opinion that they were not universally sound. Instead a more searching enquiry on a case-by-case basis should be conducted[49].

The Commonwealth courts were some way ahead of their UK counterparts on this question, the matter first being addressed in *Hawkesbury Development Co Ltd v Landmark Finance Pty Ltd*[50]. Street J was called upon to decide whether the directors of the company could bring proceedings to challenge the security under which a receiver had been appointed, and had this to say:

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46 (1979) 129 NLJ, 262.
47 [1987] SLT 410.
48 *Ibid.* 413.
49 *Ibid.*
50 [1969] 2 NSWR 782.

> "[Receivership] does not permeate the company's internal domestic structure. That structure continues to exist notwithstanding that the directors no longer have authority to exercise their ordinary business management functions. A valid receivership and management will ordinarily supersede, but not destroy, the company's own organs through which it conducts its affairs. The capacity of those organs to function bears an inverse relationship to the validity and scope of the receivership and management."[51]

The emphasis here seems distinct from that seen in *Newhart.* It concedes that a central issue is the *validity* of the appointment. To the extent that it is valid, and to the extent that the receiver is given powers of management, then the directors' powers are to some degree suspended, and the fuller the receiver's powers the more extensive that suspension. This is entirely in accord with the proprietary/contractual analysis set out earlier. *Newhart*, however, was approved in *Paramount Acceptance Co Ltd v Souster*[52], where the validity of the debenture contract was relegated to the status of "a further consideration"[53], although Davison CJ was clear that:

> "...the company must have the right, independently of the receiver, to take such action as it thinks fit on all matters in dispute in respect of the *alleged* contract with the debenture-holder."[54]

Newhart has since come under overt attack in *Tudor Grange Holdings Ltd v Citibank NA*[55], the facts of which were on all fours with it, except that no offer was made to indemnify the company against costs. Browne-Wilkinson J pointed out that the causes of action in issue were caught by the bank's charges, that the receivers

[51] [1969] 2 NSWR 782, 790.
[52] [1981] 2 NZLR 38.
[53] *Ibid.* 43.
[54] *Ibid.* (italics added). This seems to go to the validity of the contract in question, rather than its purported breach by the debenture-holder, as considered in *Newhart.*
[55] [1992] Ch 53.

had the right to bring proceedings based on those causes of action and, therefore, that:

> "...it is ... surprising if the directors ... also have power to bring proceedings to enforce such causes of action ... I have substantial doubts whether the *Newhart* case was correctly decided in any event. That may have to be looked at again in the future. The decision seems to ignore the difficulty which arises if two different sets of people, the directors and the receivers, who may have widely differing views and interests, both have power to bring proceedings on the same cause of action. The position is exacerbated where, as here, the persons who have been sued by the directors bring a counterclaim against the company. Who is to have the conduct of that counterclaim which directly attacks the property of the company?"[56]

Browne-Wilkinson VC was patently anxious to avoid applying *Newhart* and mustered sufficient distinguishing factors to do just that. His emphasis on the absence of any indemnity against costs seems legitimate, and he is clearly correct in stating that the indemnity in the *Newhart* case was a matter which "impressed" the Court of Appeal. His observation that the Court was equally impressed by the receiver's "invidious" position in having to decide whether or not to sue his appointor is less convincing. It merited a brief mention in the judgment of Stephenson LJ[57] and appeared not to trouble Shaw LJ in the slightest. Moreover, it overstates the case to suggest that this dilemma is solved by recourse to s 35 Insolvency Act, since, as Goode points out, the receiver cannot be compelled to seek directions from the court[58] and so may neutralise any potential embarrassment by simply ignoring the cause of action[59].

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[56] [1992] Ch 53, 63
[57] [1978] 2 WLR 636, 643-644.
[58] *Principles of Corporate Insolvency* Law, supra n 7, 232.
[59] See also *Lascomme Ltd v United Dominions Trust* [1993] 3 IR 412.

The most recent word on this issue comes from the Irish High Court. In *Lascomme Ltd v United Dominions Trust*[60] Keane J approved *Newhart* and distinguished *Tudor Grange*, once again on the indemnity point. He relied on the unreported decision of *Wymes v Crowley*[61] for the proposition that:

> "...when a receiver is appointed by a debenture-holder under the powers in that behalf in the debenture, the powers vested by law in the directors of the company are not thereby terminated. They may not, however, be exercised in such a manner as to inhibit the receiver in dealing with and disposing of the assets charged by the debenture or in a manner which would adversely affect the position of the debenture-holder by threatening or imperilling the assets which are subject to the charge. Subject to that important qualification, the powers vested by law in the directors remain exercisable by them and include the power to maintain and institute proceedings in the name of the company where to do so would be in the interests of the company or its creditors."[62]

Given the existence of an indemnity, no charged assets would be threatened or imperilled.

The above cases may be technically distinguishable but, it is suggested, reveal a fundamental difference of opinion between courts as to the effect of the appointment of a receiver on the directors' powers to bring actions in the company's name. Commentators, too, disagree. Doyle prefers the *Newhart* approach, and in doing so rejects the notion that the problem is resolved via the contractual or proprietary route:

> "...the real question in issue appears not to be whether a right of action is subject to

[60] [1993] 3 IR 412.
[61] High Court, 27 February, 1987.
[62] [1993] 3 IR 412, 416-417.

any particular security interests but, rather, whether that right of action is exercisable by the company with or without the interference or consent of the administrative receiver."[63]

The critical factor, he propounds, is prejudice to the charged property should the action be brought, and any such threat will usually be offset by the indemnification of the company against costs. In answer to Browne Wilkinson VC's rhetorical question in the *Tudor Grange* case as to who would have the conduct of any counterclaim, he points out, correctly it is submitted, that this difficulty is less real than imagined and that the only practical candidate is the debenture-holder.

Goode similarly favours this approach, considering that the *Newhart* decision is "clearly correct"[64]. Picarda, writing before the *Tudor Grange* decision, is more cautious, noting that the absence of prejudice to the debenture-holders was "crucial" in *Newhart* and admonishing that the existence of prejudice or otherwise may be a matter of contention between receiver and directors[65]. Lightman and Moss, on the other hand, advance a more juristically orthodox view, proposing that:

> "...the relevant relationship is not between the directors and the company and the receiver and the company, but between the rights of the company and the debenture holder respectively or mortgagor and mortgagee of the relevant chose in action. After the assignment has been effected by the charge, the assignee alone can seek to enforce the assigned right. Accordingly in respect of any cause of action charged to the debenture-holder, only the debenture-holder can sue."[66]

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[63] *Administrative Receivership: Law and Practice, supra* n 39, 264; see also *The Residual Status of Directors in Receivership* (1996) 17 Co Law 131, 136-137.

[64] *Supra* n 7, 232.

[65] *The Law Relating to Receivers, Managers and Administrators* 2nd ed. (1990 : Butterworths : London) 89.

[66] *The Law of Receivers of Companies* 2nd ed (1994: Sweet & Maxwell: London), para. 2-08, (hereinafter *Lightman and Moss*).

This appears indisputable in strict property law terms, but, it is submitted, it fails to acknowledge those considerations which inspired the Court of Appeal in *Newhart* to reach a decision which, whilst not technically impeccable, was legitimate in spirit. The following sections consider how far that decision can, and should be taken if receivership law in this area is to develop with due regard to its especial circumstances.

4.1.1 The limits of co-extensive power: actions between company and debenture-holder

It is suggested that two different situations should be considered in this regard. First, where the company, through its directors, wishes to sue in order to challenge the validity of the debenture under which the receiver is appointed, then no question as to its ability to do so should arise. To allow the debenture-holder to point to a purported equitable assignment of a *chose in action* that could only take place under a *valid* charge would be permitting him to pull himself up by his own bootstraps. Secondly, where, as in *Newhart* and *Tudor Grange*, the cause of action is *against* the debenture-holder, again it is suggested that proceedings by the company are properly admitted. This is so notwithstanding that the *chose in action* is caught by the charge. To deny the company any redress in such circumstances would foster substantial injustice. For instance, the very institution of receivership blocks off one potential route to recovery for the company, that of equitable set-off. Precisely *because* the debenture-holder can enforce his security via an appointment, and need not sue for the debt, the ability to impeach his claim is lost. This result supervenes, it would seem, even with regard to insolvency set-off, which only operates "between the company and any creditor of the company *proving or claiming to* *prove* for a debt in liquidation"[67]. Again, it seems arguable that the ability to enforce the debenture-holder's claim via receivership, and so without having to prove[68], excludes the operation of a rule that is intended to effect justice between debtor and creditor.

Further, should the directors be unable to pursue any such claim, value which may have accrued for the benefit of other creditors will be lost. If liquidation follows receivership, and the claim remains an asset of the company, there is no guarantee that the liquidator will have the funds or the inclination to exploit it. The scarcity of 'fighting funds' in liquidation is well documented, and the hazards of litigation might dissuade any liquidator from pursuing a potentially successful suit. Receivership, then, provides the debenture-holder with not so much a windfall as a windbreak, in that he may be able to escape the consequences of a breach of contract. The fact that any damages awarded to the company could be claimed by the receiver for the benefit of the debenture-holder has been, rightly it is submitted, dismissed by the courts as a red herring. The effect of such an award is simply to achieve a sort of *de facto* set-off, so that there is no 'circular' transfer of money, and the exercise is far from academic.

A further advantage of this approach is that it frees the receiver from the impossible situation of having to weigh the interests of the company and his appointor in deciding whether to exploit a right of action against the latter. This is not a judgment the receiver ought to be called upon to make. Whilst his duty is towards the debenture-holder *qua* debenture-holder only, so that, technically, no conflict

[67] Insolvency Rules 1986, Rule 4.90 (italics added).
[68] Except to the extent that the security is insufficient to meet the debenture-holder's claim.

arises, the reality must be that most receivers would consider the positive exploitation of a suit against the very person who appointed them unthinkable. By allowing the directors to bring the action in the name of the company, and without reference to the receiver's wishes, this dilemma is resolved.

4.1.2 Actions against third parties

It is suggested that two separate situations should be considered, the first being where the cause of action is against the receiver himself. It was decided in *Watts v Midland Bank*[69] that an argument that a derivative action under the rule in *Foss v Harbottle*[70] would be allowed as against a receiver was misconceived - the company itself was able to sue:

> "...I can see no reason in principle why the court should not allow the company to sue the receiver in respect of an improper exercise of his powers."[71]

One reason is that identified by Lightman and Moss, namely that the cause of action against the receiver will, as after-acquired property, be caught by the debenture-holder's fixed or floating charge[72], and the fact that the action is against the receiver ought not to make a difference. Again, were the courts to take a rigidly technical view of the matter it would seem that the company in such circumstances would be left without a remedy no matter how flagrant the wrong. In *Watts*, Peter Gibson J took a vigorously pragmatic approach and concluded:

> "...[it is] common sense that there must be some redress obtainable by a company in receivership against a receiver who acts improperly and in breach of his duties to the

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[69] [1986] BCLC 15.
[70] (1843) 2 Hare 461.
[71] [1986] BCLC 15, 22, *per* Peter Gibson J.
[72] *N. W. Robbie & Co v Witney Warehouse Co* [1963] 3 All ER 613; *Ferrier v Bottomer* (1972) 126 CLR 597.

company to the detriment of the company. It is also common ground that the liquidator of a company in receivership can sue the receiver. Why should a company in receivership have to go into liquidation before the receiver could be sued by the company?"[73]

Returning to the *Newhart* question, one might also ask why a company in receivership should have to go into liquidation before the appointor could be sued. The considerations are the same, and there is no reason to take an overly protective attitude to either potential defendant.

Different factors enter the equation when it is sought to sue third parties other than the receiver. Here the fears of Browne Wilkinson VC in *Tudor Grange* appear justified, namely that to admit of a right of action capable of exploitation by parties with, potentially, conflicting interests may lead to an indirect disordering of the receivership. A receiver may wish to eschew a particular cause of action in order to maintain a good trading relationship with the potential defendant. The directors of the company might not be so constrained. In these circumstances it is appropriate that the receiver's commercial judgment should prevail and that he should be able to prevent the directors from pursuing the third party.

The receiver might, however, choose inactivity for other than purely commercial reasons. For example, the debenture-holder might prefer the action not to go ahead because of *its* relationship with the third party, and might prevail upon the receiver to remain passive. If this is the case it is arguable that he breaches his duty of good faith[74]. Whilst the receiver is entitled, and, indeed, duty bound, to prefer the interests of the debenture-holder, this should only hold true to the extent those

[73] [1986] BCLC 15, 22.
[74] That duty being discussed fully *infra*, 158.

interests are represented by and relate to the secured assets of the company. In other words, the receiver can prioritise the claims of the debenture-holder, but only *qua* debenture-holder. The wider interests of the debenture-holder as, say, banker, are outside the scope of the receiver's protectionist role, and to prioritise them by preventing the directors from bringing an action in the name of the company would confer upon the debenture-holder an unbargained for and unwarranted advantage.

This is really no more than an echo of the sentiments expressed in *Newhart.* The criterion for assessing whether proceedings may be instituted by the company's directors should be the effect upon the security that such a course might have. Thus, if there is in place a sufficient indemnity against all costs that might be incurred, the secured assets are safe from attack and the directors cannot be said to be speculating at the debenture-holder's risk. Where the security might be devalued other than by an award of costs, as, for example, where the action would have a detrimental outcome on goodwill, it should be open to receiver or debenture-holder to restrain proceedings, with the onus being on the directors to show no potential prejudice to the debenture-holder *in that capacity.* This may involve the courts in a more involved investigation than the 'all or nothing' approach advocated by *Tudor Grange*, but, it is submitted, is unlikely to give rise to a plethora of litigious directors. The requirement of indemnification should provide an adequate safeguard against vexatious proceedings[75].

Further, this blueprint is eminently even-handed, upholding the interests of the

[75] Although note the views of the Cork Committee that the practice of requiring security to be given by directors is overly burdensome and should be replaced by an application to the Court for directions as to costs: *Insolvency Law and Practice : Report of the Review Committee*, Cmnd 8558 (1982 : HMSO : London), para. 1730 (hereinafter the Cork Report).

company (and, perhaps, its other creditors) in those circumstances where the ruthless advancement of the debenture-holder would be ungrounded in principle. Finally, the benefits in terms of costs should be taken into account. Litigation is notoriously expensive, and receivers' time likewise. If the conduct of an action is left with the directors at least the latter are saved, and these may have amounted to a substantial sum which would have fallen to have been paid ahead of debenture-holder, preferential creditors and unsecured creditors. Such a bonus should not be dismissed lightly.

4.2 The position of the directors

In *Newhart* Shaw LJ considered directors to be under a positive duty to exploit 'assets' disregarded by the receiver:

> "Indeed, in my view, it would be incumbent on them to do so, because notwithstanding that the debenture-holders have got the right to be satisfied out of the assets subject to the charge, other creditors are entitled to expect that those concerned with the management of the company should exercise their best efforts to ensure that, when the time comes, they too will find themselves in the position that there is a fund available to pay them, if not in full, at least something of what they are owed."[76]

This might appear unduly burdensome on directors. Given the conflicting case law in this area, they might reasonably take the view that they are effectively disabled during receivership, or at best only able to act with the receiver's sanction. To expect a proactive stance is somewhat stringent, particularly when the directors will know that it is within the receiver's power to dismiss them.

The courts may, of course, take a realistic view of the impediments under which

[76] [1978] 2 WLR 636, 642.

directors operate during receivership and so not be too hasty in upholding allegations of breach of duty. Certainly in *Re Joshua Shaw and Sons Ltd* Hoffmann J had this to say:

> "I do not think that it is seriously arguable that in a case in which the management of the company's assets has been taken out of the hands of the directors by the appointment of a receiver, the directors' residual powers create a duty on their part to the creditors to ensure that a resolution for a winding up is passed in sufficient time to prevent the claims of some or all of those creditors from becoming statute-barred."[77]

This case concerned a very precise point, but it is feasible that the approach of the learned judge might be adopted in relation to the directors' residual powers over those assets of the company that the receiver has chosen not to take advantage of.

Finally, as far as the directors' *statutory* duties are concerned, whilst these appear to continue in force during receivership and the directors remain under a duty to prepare accounts and a directors' report and to lay each before the company, and to deliver copies of each to the Registrar of Companies[78], the provisions in question allow of defences against default. Further, the directors may require from the receiver the necessary information to enable them to discharge these duties[79]. What steps the directors need take to avail themselves of the statutory defences is obscure, and Doyle propounds a solution similar to that which supervenes on administration, namely a computer 'stop' at Companies House on the pursuit of defaults[80].

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[77] (1989) 5 BCC 188, 190.
[78] Companies Act 1985, ss 226, 234, 241 and 242.
[79] *Gomba Holdings v Homan* [1986] 1 All ER 94. They cannot demand that he disgorge the funds to ensure compliance though.
[80] *The Residual Status of Directors in Receivership*, *supra* n 70, 131. See also the Cork Report, *supra* n 75, for an alternative recommendation that was not enacted in the IA.

5. The End Result - Vulnerability

The above exposition illustrates the extent to which the company is divested of the power to manage its own affairs on the appointment of a receiver. The courts have consistently emphasised this point: the receiver has been variously described as exercising "supervision and control of the way in which the company's business is run"[81], and as "the complete master of the affairs of the company"[82]. Thus an entity which has previously been governed on a co-operative and delegatory basis by a hierarchical command structure is suddenly under the sole direction of a single[83] independent contractor who has assumed this potentate position in order to marshal its entire value for the benefit of a single creditor.

To mechanically repeat the mantra that the company has contractually agreed to this upheaval is all very well and good, but it must nonetheless come as a considerable trauma to its various stakeholders to discover the factual extent to which the company finds itself at the mercy of its receiver. Moreover, there are participants standing outside the immediate contractual nexus who are in an equally precarious position, and whose welfare is therefore threatened by an approach that is overly-solicitous of the debenture-holder's interests. Their position is considered in the next Chapter. For the present, further aspects of the tripartite relationship should be examined.

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[81] *Griffiths v Secretary of State for Social Services* [1973] 3 All ER 1184, 1199, *per* Lawson J.
[82] *Meigh v Wickenden* [1942] 2 KB 160, 168, *per* Viscount Caldecote CJ.
[83] Unless the appointment is a joint one.

Receiver and Debenture-holder

1. Ensuring Independence of Action

In assessing the practical effect of receivership on a company, one is struck by the impotence of that company once the receiver is in office. To a certain extent the same is true of the debenture-holder appointor, although his plight is nowhere near as pronounced. Receivership affects the appointor's jurisdiction in relation to the assets over which the appointment is made. By making an appointment the debenture-holder is, in effect surrendering his own opportunity to gain ascendancy over them and trusting a third party to make the best possible use of them, albeit for his benefit. This abdication is made complete by s 45 Insolvency Act 1986, which alters the pre-existing law in that it removes the debenture-holder's ability to remove his appointee[84]. Such an innovation was seen as desirable by the Cork Committee:

> "In order to strengthen the independence of the receiver we consider that the present rule whereby a receiver may be removed without notice by the holder of the charge should be amended. We recommend that such removal should be only by the Court on cause shown."[85]

In this respect there is, perhaps ironically, an analogy between company and appointor in that both lose their control (although the latter's is inchoate) over the charged assets upon receivership. The manner of the receiver's performance of his function has some bearing on the economic well-being of the debenture-holder and is in many cases decisive of the future of the company. For the debenture-holder,

[84] The section only applies to administrative receivers. An LPA receiver may still be dismissed by his appointor if provision for such is made in the debenture.
[85] *Supra* n 75, para. 492.

though, this loss of control is a satisfactory trade-off for the privileges receivership offers. The debenture-holder is cushioned against the (allegedly) apocalyptic consequences of being a mortgagee in possession, and may rest assured that the estate in question is being administered for his benefit by an individual who has undergone rigorous training. Moreover, if his trust turns out to be misplaced, he may comfort himself with the knowledge that he has available to him an arsenal of remedies disproportionate (in comparison with the position of the company) to the degree of autonomy he has relinquished.

2. The trade-off upheld: *Amex v Hurley*

Legally, receivership presents few dangers for the appointor, but a potential pitfall was identified in *American Express International Banking Corp. v Hurley*[86]. In that case Mann J, recalling a similar sentiment of Lord Denning in *Standard Chartered Bank Ltd v Walker*[87], stated the law in the following terms:

> "The mortgagee is not responsible for what a receiver does whilst he is the mortgagor's agent, unless the mortgagee directs or interferes with the receiver's activities."[88]

The jurisprudential basis of this assertion is a little shadowy. Mann J was entitled to follow Lord Denning's dicta, but that judge's declaration was characteristically capacious and, on this occasion, unsupported by authority. Earlier case law establishes that the receiver *may* become the agent of his appointor on the winding up of the company. The effect of a winding up is to deprive the company of its

[86] [1985] 3 All ER 564.
[87] [1982] 3 All ER 938, 942.
[88] *Supra* n 86, 571.

capacity to carry on its business, and it is a well-established canon of agency law that a principal may not confer a greater authority upon his agent than he himself possesses[89].

Thus, the receiver's agency *for the company* ceases upon its winding up, whether compulsory[90] or voluntary[91], although his *in rem* powers remain operative[92]. The cessation of that agency, however, does not automatically constitute the receiver agent for his appointor[93], and unless the debenture-holder proceeds to treat the receiver as his agent then the receiver, to the extent that he continues to exercise personal powers, does so as principal[94].

It appears that some positive act on the part of the debenture-holder is required in order to defeat a seemingly rebuttable presumption that, on winding up, the receiver may only continue to exercise personal powers as principal. In *Hurley* the fact that receiver and bank were in constant communication and that the former sought the latter's approval before taking action were held to be sufficient to constitute the receiver agent of the appointor bank. This is roughly reconcilable with general agency law, although it cannot be seriously suggested that the bank held the receiver out as its agent. The mere fact of the receiver continuing to act cannot constitute a 'holding out', otherwise every winding up would result in an appointee/appointor agency relationship, which has been expressly held not to be

[89] *Drew v Nunn* (1879) 4 QBD 661.
[90] *Gosling v Gaskell* [1897] AC 575.
[91] *Thomas v Todd* [1926] 2 KB 511.
[92] *Sowman v David Samuel Trust Ltd* [1978] 1 All ER 616. On the effect of winding up generally, see Goode, supra n 7, 261-263; Doyle, *supra* n 39, 234-235; Lightman and Moss, *supra* n 66, Chapter 11.
[93] *In Re Wood's Application* [1941] Ch 112; *American Express v* Hurley, *supra* n 86; *Cf. In re S Brown & Co (General Warehousemen) Ltd* [1940] 1 Ch. 961.
[94] *American Express v Hurley*, *supra* n 86, 568.

the case. Nor does the agency in question arise out of an express contract, so we are thrown back onto a process of implication, the hypothesis being that both parties impliedly consent to the relationship of agency arising between them. This consent can only be inferred from something tangible, and here it appears to be the giving and taking of instructions, or the entering into of close communication, and such might be interpreted as the conferring of an authority on the receiver to act *on behalf of* the debenture-holder.

Outside of winding up, the proposition in *Hurley* that a debenture-holder might be held responsible for the receiver's activities is on shakier ground, to the extent that it is based on an alleged agency relationship between debenture-holder and receiver. It might be thought that Mann J was asserting only the narrower conception that such responsibility arises outside of any formal relationship, and, indeed, this seems to be the position taken by Lord Denning in *Standard Chartered Bank v Walker* when he stated:

> "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."[95]

His Lordship, it is submitted, based this assertion on the burgeoning principles of tortious liability prevalent at that time, rather than on an agency relationship between debenture-holder and receiver, spawned by 'directions and interference' and giving rise to the appointor/principal's vicarious liability for the acts of his agent. The relevance of such directions and interference would be to constitute a

[95] *Supra* n 87, 942.

relationship of proximity between debenture-holder and *company* (or guarantor), so that the liability of the former would be direct rather than vicarious. The relationship between debenture-holder and *receiver* (or non-relationship to be precise) remains unaffected.

Mann J, in *Hurley*, appeared to prefer the vicarious route to liability:

> "I add that when a receiver is in breach of his duty of care to the guarantor *whilst acting as agent of the mortgagee*, then, in so far as the mortgagee is liable to the guarantor and in the absence of any express exclusion *in the contract of agency*, the mortgagee would be entitled to an indemnity from the receiver under an implied term *of the agency agreement.*"[96]

That an agent impliedly indemnifies his principal against the consequences of his own negligence is a well established principle of agency law and unexceptional. What is unclear is whether Mann J was confining his remarks to the *post*-liquidation situation or intended them to be of wider application, so that an implied agency can arise during the pre-liquidation period by the giving of instructions and directions[97]. The tenor of the latter part of his judgment indicates that he considered this to be the law, and most commentators have interpreted the case as supportive of such a contention. Thus Goode writes that:

> "The debenture-holder is not entitled to instruct the receiver in the performance of his duties; indeed, it is dangerous to attempt to do so, *for the receiver will then become the de facto agent of the debenture-holder...*"[98]

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[96] *Supra* n 86, 571 (italics added).

[97] In *Hurley* liquidation had in fact intervened. Moreover, the appointor had virtually conceded that the receiver in question had become its agent.

[98] *Supra* n 7, 266 (italics added). See, to similar effect, Lightman and Moss, *supra* n 66, para. 8-11.

Whilst the creation of such an agency is tenable after winding up, the notion is problematic during the subsistence of the receiver's agency with the company. That very agency is intended to thwart a similar relationship arising between appointor and appointee, and, as noted in the previous Chapter, the courts have been perfectly amenable to allowing it that effect. The notion that the bank, in giving instructions to its receiver, impliedly consents to him becoming its agent is difficult to sustain in the face of the express terms of the contract between bank and company. To put it another way, is it conceptually possible for an agent to have concurrently identical authority over identical property emanating from two different principals, and, if not, who is the genuine principal? Surely that identified contractually?

This is an instance of the courts having regard to the *substance* of the tripartite relationship, and, it is submitted, represents a rule of receivership law that operates independently of the underlying agency. *Hurley* personifies a healthy dose of realism in that it illustrates that the agency device is not impenetrable and that the debenture-holder can take it a step too far. By assuming to control his appointee he abuses an advantage which, whilst it will for the most part be upheld, is not unassailable and will be closely scrutinised by the courts should the circumstances so warrant.

This seems justifiable on several counts. First, and especially following the Cork Report, it is clear that a premium is placed on the independence of receivers, their freedom of action and decision being seen as socially desirable. To the extent that *Hurley* facilitates such freedom it anticipates the Insolvency Act itself. Secondly, it emphatically elevates substance over form. A debenture-holder meddling in the conduct of the receivership is a *de facto* mortgagee in possession and should be treated in law as such. Thirdly it promotes a balance between debenture-holder and company. One trade-off for the validity of the agency device is *control*, and should that control be reasserted by the simple expediency of treating the receiver as a ministerial agent without autonomy then the agency's protective mantle should be withdrawn. Baldly stated, the debenture-holder cannot expect to have his cake and eat it.

In policy terms *Hurley* is a consummate decision, acknowledging the singular circumstances of receivership and fashioning a model that does substantial justice to all parties to the tripartite relationship. It is, however, unsupported by authority. Indeed, authority to the opposite effect exists, as evinced by dictum of Latham CJ, in the High Court of Australia in *Visbord v The Federal Commissioner of Taxation*:

> "In my opinion the fact that the mortgagee assumed to give directions to the receiver could not affect the fact that the receiver was the agent of the mortgagor or the legal consequences of that fact."[99]

That a contemporary court would prefer the *Hurley* approach is not a foregone conclusion[100], although given the emphasis of the Cork Committee and the subsequent Insolvency Act on the value of the receiver's independence such a result might be tentatively predicted. *Hurley* was, however, either overlooked or ignored in the Scottish case of *Inverness District Council v Highland Universal Fabrications Ltd*[101]. In that case Lord Murray, whilst concluding that the *statutory* agency of a debenture-holder's receiver is rebuttable, did not see fit to hold it

[99] (1943) 68 CLR 354, 370.

[100] Although see *National Bank of Greece v Pinios* [1990] 1 AC 637 which might provide implicit support for the *Hurley* principle (active intervention on the part of the debenture-holder might attract liability for a receiver's default, 648 -649, *per* Lloyd LJ).

[101] 1986 SLT 556.

rebutted by documentary evidence that the receiver had consistently requested and acted upon his appointor's instructions. The issue in question was whether the receiver was personally liable for rent due from the company to the plaintiff Council, and the potential liability of the debenture-holder was not argued, nor was *Hurley* cited.

A puzzle raised by *Hurley* is the precise nature of the inter-meddling said to constitute a receiver his debenture-holder's agent. In *Hurley* itself the fact of constant communication between the two parties and the receiver's seeking of approval for his actions was held to be sufficient in the face of a concession by the debenture-holder. This, however, falls some way short of the giving of directions or interference referred to later in the judgment, so some doubt must exist as to when a debenture-holder will cross the line between merely taking an interest in the receivership's progress and actively encroaching upon the receiver's legitimate territory[102].

Too prescriptive an approach in this regard might in fact be damaging to the interests of all parties. Consultation between receiver and debenture-holder will in some circumstances prove extremely valuable to the company's chances of survival (or at least to a more profitable realisation of the assets). Certainly receivers should be in a position to approach the latter with a view to obtaining overdraft facilities with which to continue trading, and debenture-holders should be able to request and receive information without the threat of constituting the receiver their agent. It is a fact of commercial life that a close relationship exists between receiver and

[102] *National Bank of Greece v Pinios*, *supra* n 101, supports the view that active intervention is necessary.

appointor[103], and the process of negotiation and discussion that inevitably takes place should not be lightly inhibited. Nothing short of an assumption of *de facto* control should be curbed.

A further flaw in *Hurley* is that it fails to develop its own theme. What is the precise effect of the receiver becoming agent of the debenture-holder and to what extent does that agency operate? Does it relate only to those transactions in which the debenture-holder has interfered, or does interference *per se* reverse the presumption that the receiver is agent of the company and constitute him agent of the debenture-holder for the duration and entirety of the receivership? If, as has been propounded, the proper rationale for the *Hurley* approach is the debenture-holder's usurpation of control from the receiver, then it makes no sense to 'penalise' him beyond the ambit of his intervention.

It has been acknowledged that a receiver may act as agent for the debenture-holder in relation to a part of the conduct of the receivership[104], so there would seem to be no conceptual obstacle to treating the receiver as agent of the debenture-holder only in relation to those assets or transactions which the latter attempts to control. This would seem to be an appropriate response to the particular 'mischief' the *Hurley* decision is aimed at.

The final point concerning *Hurley* is that the principle may prove of narrow

[103] See, e.g., Iredale and Hughes, *Tolley's Receivership Manual*, 3rd ed (1987 : Tolleys : London), 18-19, 36 -37.

[104] See *Cretanor Maritime Co Ltd v Irish Marine Management Ltd* [1978] 1 WLR 966 (receiver could have been authorised to act on behalf of debenture-holder to apply for the lifting of a *Mareva* injunction); see also the approach of Houlden J to this effect in *Peat Marwick Ltd v Consumers' Gas Co* (1981) 113 DLR (3d) 754.

practical application from the enforcement point of view. The evidential burden being on an aggrieved company, it may be difficult to demonstrate any actual interference on the part of the debenture-holder. Whilst it may be the perceived wisdom that receiver and debenture-holder fraternise to a greater or lesser extent, establishing such conduct to the satisfaction of a court is likely to prove difficult. From the debenture-holder's perspective forewarned is forearmed, and he is unlikely, after *Hurley*, to commit any instructions he might wish to give to paper.

3. The receiver ascendant and the law's response

From the foregoing discussion it should be apparent that a distinctive feature of receivership is that it creates a certain vulnerability in both company and debenture-holder. Whilst the incapacity of the former is prodigious in comparison to that of the latter, it is submitted that it is this fundamental handicap implicit in receivership which elicits a legal response to the enormity of the receiver's practical powers. One method of restraining an unwarranted use of power, of illustrious vintage, is the imposition of concomitant duties. This is traditionally the response of equity to the pragmatism of the common law, and is most conspicuous in relation to the institution of the trust. The employment of the fiduciary obligation as a means of curbing power operates in a similar manner.

One might expect to find that the greater the disadvantage engendered, the more stringent the duties owed, but in receivership this turns out to be a mistaken assumption and, indeed, the converse appears to be true. The following section attempts to illustrate how this surprising state of affairs has come about and to assess whether the current legal position is justifiable from both a jurisprudential and a political perspective.

The Duty Configuration Within the Tripartite Relationship

1. Introduction: Sources of obligation

Within any given relationship the duties incumbent upon the parties may derive from different roots. They may be contractual, devised by the parties themselves, or they may be imposed by law, as, for example, the duty of care in the tort of negligence, the fiduciary duty of loyalty, or other duties which transpire from the receipt of a specific status. Statute, too, may prescribe a particular duty or obligation. Where the receiver is concerned, he is given a task, that of dealing with the charged property of the company in order to discharge the debt owed to the debenture-holder. He is given powers to facilitate this task, and such powers are accompanied by the imposition of duties.

Whilst there is perfect identity between company and debenture-holder over what the receiver is to do (his task) the manner in which he is to carry it out (roughly speaking, his duty) differs starkly in relation to each. The origins and the content of this 'duty' are diverse and individual to both parties, but this is not to say that a schism exists. Quite the contrary, the law's scheme has been to consider the tripartite relationship and its aim, and to extrapolate from that a composite edifice of 'duty' which most effectively promotes that aim.

By examining separately the various constituents of each affiliation (receiver/company and receiver/debenture-holder) this symbiotic process is exposed, and its calibre can be evaluated. Most imperatively, one can discern the attitude of the courts to the competing and conflicting demands of company and debenture-holder on receiver: the congenital strife of the tripartite relationship exacts a response from the law, a determination of which exigency is to be accorded priority if, as is frequently the case in receivership, reconciliation proves hopeless.

2. Statutory obligations

These are simply and shortly stated. By s 46(1) of the Insolvency Act 1986 an administrative receiver 'shall forthwith send to the company a notice of his appointment'[105]. By s 48 he must send a report of certain matters, including the events leading up to his appointment, his plans for disposals or trading, amounts due to the debenture-holder and preferential creditors and the likelihood of any surplus, to the company's secured creditors[106]. The Insolvency Rules 1986 provide that an administrative receiver shall, at certain points during his office, send an abstract of receipts and payments to both company and appointor[107], that he shall give 7 days notice to each of his intention to resign[108], and that he shall notify the company on his vacation of office[109].

This would seem to be the extent of the receiver's statutory duties to company and debenture-holder[110]. They are really little more than tasks ancillary to the main goal, that of the discharge of the debt. Perhaps the most arresting feature of the legislation in this context is its silence on what is arguably the most pressing controversy of receivership, *viz.*, the *mode* of the receiver's performance of his task. That is left entirely to other instruments of the legal process.

105 There is no such provision in relation to non-administrative receivers.
106 The section does not require the report to be sent to the company itself.
107 Rule 3.32.
108 Rule 3.33.
109 Rule 3.35.
110 Statutory duties to other parties are considered in the next Chapter.

3. The Equitable Dimension: Receiver as Fiduciary?

In the previous Chapter it was argued that the receiver's agency status lacks one of the most notable features of a pure agency relationship, that of its fiduciary character. And yet, as also noted, the cases and commentary continue to assert to a greater or lesser degree that the receiver occupies a fiduciary position, the origin and scope of which, however, remain perplexing. Two relationships are presently considered, and one or the other, although probably not both, might correctly be classified as fiduciary. Moreover, attributes or aspects of each relationship might or might not attract fiduciary burdens[111]. Exactitude has proved to be an elusive goal in the fiduciary domain and in the tripartite relationship here in question it is no less simple to track down.

3.1. Characteristics of fiduciary relationships

The following does not attempt to dissect the notion of the fiduciary principle, but rather to take uncontroversial elements of it and apply them to the receiver/company/debenture-holder association. To this end, it is appropriate to start with the 'when' enquiry, that is to say when and in what circumstances have fiduciary obligations been held to arise within a particular relationship. The methodology of the courts in this respect has been a little haphazard, but one approach is to identify a certain *quality* of the relationship in question which will, most commonly in combination with other features, stamp the relationship as a fiduciary one. No effort is made here to evaluate the credibility or otherwise of this approach. Rather the aim is to take acknowledged aspects of fiduciary relationships

[111] *New Zealand Netherlands Society 'Oranje' Inc. v Kuys* [1971] 2 All ER 1222.

and to assess their prominence and relevance to the tripartite relationship.

A common theme amongst the cases and literature is that of *undertaking*. Whenever one party undertakes to act in the interests of another he is said to assume a fiduciary responsibility towards that other. This is well expressed by Lord Browne-Wilkinson in *White v Jones*:

> "The paradigm of the circumstances in which equity will find a fiduciary relationship is where one party, A, has *assumed* to act in relation to the property or affairs of another, B. A, having *assumed* responsibility, *pro tanto*, for B's affairs, is taken to have *assumed* certain duties in relation to the conduct of those affairs ... thus a trustee *assumes* responsibility for the management of the property of the beneficiary, a company director for the affairs of the company and an agent for those of his principal. By so *assuming* to act in B's affairs, A comes under fiduciary duties to B."[112]

The 'undertaking' basis for fiduciary responsibility seems a nod in the direction of the 'voluntary assumption of responsibility' ground for liability in tort[113], but it exacts a far more stringent mode of performance. It is also of greater vintage, and has been posited as an appropriate basis for a fiduciary finding on a number of occasions[114]. The undertaking in question need not be express, but may be implied

[112] [1995] 2 AC 207, 271 (italics added). One might question the extent to which this is at odds with the learned judge's statements in *Kelly v Cooper* [1993] AC 205 (see the discussion in Chapter 1).

[113] See, e.g., *Hedley Byrne & Co v Heller & Partners* [1964] AC 465 and, more recently, *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145.

[114] See *Nocton v Lord Ashburton* [1914] AC 932 , 969, *per* Lord Shaw; *Woods v Martins Bank* [1959] 1 QB 55, 72-73, *per* Salmon J; *Hospital Products Ltd v United States Surgical Corp.* (1984 - 1985) 156 CLR 41; *Commonwealth Bank of Australia v Smith* (1991) 102 ALR 453. See also Law Commission Consultation Paper No. 124: *Fiduciary Duties and Regulatory Rules* (1992 : HMSO : London), para. 2.4.6; Scott, *The Fiduciary Principle* (1949) 37 Calif. L. Rev. 521, 540; Finn, *Fiduciary Obligations* (1977: The Law Book Co : Sydney), 9; Sealy: *The Fiduciary Relationship* [1962] CLJ 73; Mason, *The Place of Equity and Equitable Remedies in a Contemporary Common Law World* (1994) 110 LQR 238, 246 (emphasising also the vulnerability of the other party).

from the circumstances of the relationship, which suggests that the courts, if of the opinion that the justice of the case demands it, may proceed upon the basis that since the purported fiduciary *ought* to have assumed responsibility or given the necessary undertaking then, by implication, he did so.

A second recognised characteristic of the fiduciary relationship is the *transfer of power or discretion.* When one party confers upon the other capacity to affect his legal or practical position that other is in possession of a fiduciary power and must exercise it accordingly. Again this circumstance has been conspicuous in case law and other writings[115]. A third is *vulnerability,* although care must be taken in distinguishing between the vulnerability that results from a transfer of power, such as that described above, and that which is inherent in the relationship in question because of one party's dominion or influence over the other. This characteristic has also been widely promoted as a significant factor[116].

Closely allied to the notions of a transfer of power or discretion and vulnerability is that of *entrustment of property.* The *de facto* ability to control the property of another brands the entrusted party a fiduciary. What constitutes property for this purpose remains a hotly debated matter, and the elasticity of the concept is such that it could explain fiduciary inferences in cases such as *Phipps v Boardman*[117] and

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[115] *Lac Minerals Ltd v International Corona Resources Ltd* (1989) 61 DLR (4th) Forest J); *Hospital Products Ltd v United States Surgical Corp, supra* n 114; Law Commission, *supra* n 114; *Bowstead and Reynolds on Agency,* 16th ed (London : Sweet & Maxwell: 1996), 6-034; Finn: *Contract and the Fiduciary Principal* [1989] UNSWLJ 76; Weinrib: *The Fiduciary Obligation* (1975) 25 UTLJ 1; Brown, *Franchising - A Fiduciary Relationship* (1971) 49 Tex. L.R. 650; Flannigan: *The Fiduciary Obligation* (1989) 9 OJLS 304.

[116] *Lac Minerals, supra* n 115 (but see *per* La Forest J at 40) ; *Hospital Products, supra* n 114; *Burns v Kelly Peters & Associates Ltd* (1988) 41 DLR (4th) 577; *Lloyds Bank v Bundy* [1975] 1 QB 326 (Lord Denning, at 329, focusing on inequality of bargaining power as giving rise to vulnerability); Law Commission, *supra* n 114, para. 2.4.6.

[117] [1967] 2 AC 46 (information relating to trust property).

those relating to misuse of corporate opportunities[118]. Further, it has been pressed into service to impose a fiduciary obligation on one party to a franchising agreement[119], and achieves prominence in the eyes of Professor Waters[120], as well as amongst those analysing the economic implications of the fiduciary principle[121]. A final illustrative feature of the archetypal fiduciary relationship is that it is said to be based on *trust and confidence*, and, once more, there is ample authority to support the moment of this trait[122].

There is considerable potential for overlap amongst these various attributes. For example, the entrustment of property gives rise to vulnerability, as may an undertaking to act in another's interests, in that it causes one party to relax his usual self-interested alertness. Further, a relationship of trust and confidence may result in the conferral of the capacity to exercise power or discretion, which, in turn, occasions vulnerability. Indeed, most fiduciary relationships display an admixture of these qualities and attempts to identify one as definitive have been unfruitful. One might imagine, however, that more representative features present in a particular relationship, the stronger the claim that it should attract fiduciary repercussions. Such a 'pick and mix' approach is somewhat simplistic, but when applied to the tripartite relationship it yields a noteworthy outcome.

[118] *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134;*Peso Silver Mines Ltd v Cropper* (1966) 58 DLR (2d) 1; *Industrial Development Consultants Ltd v Cooley* [1972] 1 WLR 443; *Queensland Mines Ltd v Hudson* (1978) 18 ALR 1; *Island Export Finance Ltd v Umunna* [1986] BCLC 460.
[119] *Lac Minerals*, *supra* n 115, 16, *per* Wilson J.
[120] *Law of Trusts in Canada*, 2nd ed (1984 : Carswell Co. Ltd : Toronto), 32.
[121] See, e.g., Flannigan, *supra* n 115, 308; Cooter & Freedman: *The Fiduciary Relationship: Its Economic Character and Legal Consequences*, (1991) 66 NYULR 1047.
[122] *Lac Minerals*, *supra* n 115; *Hospital Products*, *supra* n 114; *Lloyds Bank v Bundy*, *supra* n 117; Flannigan, *supra* n 115.

3.2 Fiduciary characteristics and the tripartite relationship

Consider the position of company and receiver. The very institution of receivership renders the company *vulnerable*, for reasons enumerated above. Further, the entire estate of the company (or virtually the whole of it) is *entrusted* to the receiver, and at the same time he obtains competence to *exercise power or discretion* over it. However, it is nonsensical to describe the relationship as one of *trust and confidence.* It is thrust upon the company, frequently against its wishes. The company does not select its receiver, and whilst the receiver is a highly qualified individual the particular *brand* of trust and confidence in issue in the fiduciary setting, the conviction that one's welfare is uppermost in the trusted party's consciousness, is absent. This is because there is no *undertaking* on the part of the receiver to favour the company's cause. To the contrary, his possession of and powers over its property are conferred in order that the *debenture-holder's* claim be afforded precedence, and this is implicit in the scheme of the tripartite relationship. The company's 'score' in terms of fiduciary pointers, is a respectable if not overwhelming three out of five[123].

The debenture-holder, though, manages a clean sweep. His vulnerability lies in the fact that he has ceded representation of his interests in relation to the charged property to the receiver. Central to this cession is the entrustment of property, that of the company in which the debenture-holder has a superior interest, and correspondingly, the grant of power and discretion. Trust and confidence, both in the orthodox and fiduciary senses, is a significant feature of the debenture-

[123] As will be illustrated later, equal weight does not attach to each factor.

holder/receiver compact, and again this springs out of the receiver's undertaking to act in the interests of the debenture-holder. If, as will be argued later, a full-blown fiduciary relationship cannot contemporaneously exist between receiver and debenture-holder and receiver and company, this simple method of 'tallying' suggests that the debenture-holder has the better claim to the onerous standard of service that a fiduciary status exacts. Indeed, this clearly represents the current state of the law.

Several points should be made. First, this particular enquiry is unlike that usually made in relation to the fiduciary or non-fiduciary status of any given actor. The cases cited have all involved bilateral rather than tripartite relationships, the central dispute being not so much who has the better right, but whether any right exists at all. Further, the attachment of the fiduciary label has most commonly been sought in order to gain access to the remedial benefits that accrue from such. Here, the parties' stake in a fiduciary finding is more visceral: it settles the crucial matter of the competing interests of debenture-holder and company, it determines which is to have priority *at the expense of* the other. The possibility of the receiver according supremacy to *his own interests* is really not in issue, the conflict being between (potential) duty and (potential) duty rather than duty and interest.

Thirdly, the rough and ready method above may produce an accurate account of the state of the law, but it fails to acknowledge that the debenture-holder's better score results from the fact that the presence of those characteristics within his relationship with the receiver that are absent from that between receiver and company is self-fulfilling. In other words, the one necessarily excludes the other, and this is due to the *nature* of the characteristics in question.

Those features present in both associations, *viz.,* vulnerability, entrustment of property and the conferral of powers and discretion, are essentially *objective* in that they exist regardless of the state of mind of 'fiduciary and beneficiary'. Trust and confidence and belief in an undertaking, though, are *subjective* features. Something triggers them, and whilst in many circumstances it may be the existence of those other objective properties, in the tripartite relationship this cannot be case. What is at stake is the location of the core of the fiduciary principle, the duty of loyalty, the covenant that a particular interest will be advanced at the expense of all others, including, in the orthodox situation, the fiduciary's. As between debenture-holder and company, whoever legitimately lays claim to that duty inevitably precludes it fastening elsewhere.

Why, then, does the debenture-holder win? At this stage it is possible to identify the one factor that should be accorded the greatest weight in the fiduciary enquiry, that of an *undertaking*[124], and if such is present, both *objectively*[125] and *subjectively*[126], then there must be a very strong presumption of fiduciary responsibility.

In the tripartite relationship no such undertaking is explicit, unless it is in the form of the receiver's acceptance of the status of agent *for the company.* Ostensibly the company has the stronger petition via the receiver's status, but, as illustrated in the previous Chapter, this status can be ignored for the purpose of finding a fiduciary duty of loyalty. Even so, discounting it does not settle the question in favour of the debenture-holder since it remains the case that he himself cannot point to an express

[124] Because this will give rise to trust and confidence in the fiduciary sense, it may lead to the entrustment of property and the conferral of power and discretion and, hence, to vulnerability.
[125] In the sense that it is actually given.
[126] In the sense that the recipient *is aware* of it.

undertaking to prefer his interests on the part of the receiver. How, then, is the conundrum to be resolved?

3.3 The policy interpolation

The solution, it is submitted, lies in an acknowledgement of the fact that, in certain relationships, factors extrinsic to the connection itself are determinative. In an endeavour to identify a unitary theory of fiduciary responsibility Shepherd offers the following:

> "A fiduciary relationship exists whenever any person acquires a power of any type on condition that he also receive with it a duty to utilise that power in the best interests of another, and the recipient of the power uses that power."[127]

In the context of the tripartite relationship the 'acquisition of power' requirement is present from the point of view of both company and debenture-holder, but only one may realistically 'encumber' that power with the relevant duty to utilise it in his best interests. A further echelon of Shepherd's thesis is a judgment as to *when* a transferred power may be so encumbered, and here is found a cogent clue to the reasons behind the destination of fiduciary responsibility within the tripartite relationship. Shepherd asserts that:

> "There are a number of considerations in determining whether a duty should exist in any given fact situation, *all of them rooted in policy* - social, legal and economic. The overall force is a policy favouring individual responsibility, the necessary complement to the fundamental freedom of individuals to enter into private transactions with each other."[128]

[127] *Law of Fiduciaries* (1981: Carswell: Toronto), 93. Shepherd designates this the 'transfer of encumbered power' theory.
[128] *Ibid.* 228 (italics added).

Thus, the extrinsic here is *policy*, and policy concludes when the transferor of a power is *entitled* to encumber it with fiduciary incidents. To cite Shepherd again:

> "On the basis of the theoretical framework, it is clear that policy limits the ability of the beneficiary to encumber *de facto* powers. Thus, the thrust of the policy analysis should be directed at considerations of [the weaker party's] position, and whether his purported encumbrance was *fair, reasonable, or necessary.*"[129]

This discussion takes place in the context of fiduciary relationships arising from situations of inequality of bargaining power, and focuses on when the weaker party to a relationship can and should be able to fix the stronger with fiduciary responsibility. It is submitted that it can properly apply to the matter in hand. Indeed, the policy issues in question enter the equation long before the receiver takes the stage, and fall to be considered at the earliest stage of the tripartite relationship, namely the initial contract between company and debenture-holder. It is at this point that a potential appointment is agreed, and at this point that the ramifications of such an appointment, in terms of the prioritising of one party's interests, should be conclusively determined by recourse to policy factors. The actual appointment brings into play no new policy considerations. In other words, if the company is to be able to encumber the receiver's powers with a fiduciary standard, it must be politically expedient for it to so do.

3.5 The outcome

In the final analysis, therefore, the debenture-holder wins not so much because of any special feature of the relationship between himself and the receiver, but rather because, in the contest for the receiver's fealty, his interests are deemed more

[129] *Law of Fiduciaries, supra* n 127, 231.

worthy of protection then the company's. With regard to this particular enquiry, it is his relationship with *the company* that matters. The ultimate arbiters, the courts, have made a value judgment as to how the receiver should carry out his task, and in locating the duty of loyalty with the debenture-holder, have simultaneously aborted the embryonic possibility of such being owed to the company. This explains to a significant degree the peculiarities of the receiver's agency. This deference to the welfare of the debenture-holder, emerging from policy, totally represses the fiduciary incidents of pure agency, so that the receiver's agency is only operative to the extent that it furthers the debenture-holder's cause. Strict legal principle, in this respect, yields to expediency, the balance of which is perceived to lie with the appointor.

3.6 Receiver, debenture-holder, and the suitability of the fiduciary standard

The above analysis has focused on the battle between debenture-holder and company for the receiver's allegiance, in which the former triumphs resoundingly. That he does so is largely a result of the courts' view of his relationship with the *company* rather than that with the receiver. Only one can lay claim to the duty of loyalty, and considerations of policy dictate that it comes to rest with the debenture-holder. However, it could be contended that this dissection puts the cart before the horse in that it proceeds from an assumption that the receiver is a fiduciary to one or other party when such is unestablished in law. Whilst the receiver is clearly duty bound to prefer the interests of the debenture-holder to those of the company, is this because he is in a fiduciary post in relation to the former or does the 'duty of loyalty' owed fall short of full fiduciary accountability? Certainly there are no cases in which the fiduciary status of the receiver has been explained in any detail, and the nearest *re Magadi Soda Co Ltd* where Eve J stated:

> "The receiver not only fills a fiduciary position to the debenture-holders, but his appointment to an office of such responsibility presupposes that he will discharge his duties with punctilious rectitude."[130]

More recent case law takes the same view, and without amplification[131].

Behind this dearth of authority is the fact that the superior remedial opportunities that a fiduciary finding attracts have never been pursued in the courts by appointing debenture-holders. Should, however, the unthinkable occur and the receiver abuse his control of the charged assets to make an illicit profit from them, it seems apt that the courts' response would be to compel him to account for that profit to the debenture-holder. Such a result would be entirely apposite, and in harmony with various theories as to *why* the fiduciary standard of behaviour is imposed in certain circumstances. The hallmark of the fiduciary relationship, as identified by Finn, is:

> "...[a relationship] in which one party has in fact relaxed, or is justified in believing he can relax, his self-interested vigilance or independent judgment because, in the circumstances of the relationship, he reasonably believes or is entitled to assume that the other is acting or will act in his (or their joint) interests."[132]

In the relationship between debenture-holder and receiver these conditions are met. The opportunity for self-interested exploitation is evidently available to the receiver, either through self-dealing or the making of a secret profit. The law's response to such activity, the ordering of an account of any such profit, serves to deter what is perceived to be undesirable behaviour on the part of the fiduciary.

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130 (1925) 94 LJ Ch 217, 219.

131 *Gomba Holdings UK Ltd v Minories Finance Ltd* (1989) 5 BCC 27, 29, *per* Fox LJ.

132 *Contract and the Fiduciary Principle* [1989] UNSWLJ 76, 94.

This retort has been lauded as economically efficient in that it counters agency costs deriving from the necessity to monitor closely the behaviour of the trusted party or to resort to elaborate and lengthy contractual terms to achieve the disgorgement of 'secret' benefits[133].

A further impetus towards fixing the receiver with fiduciary responsibility towards the debenture-holder is that such ought to afford indirect protection to the company itself. The same result would be achieved by allowing for a limited fiduciary status between receiver and company, giving rise the latter's right to call for an account of any secret profit made by the former *if* the debenture-holder chose to forego his own right in that respect[134]. In any event, it is submitted that the 'no conflict' rule is a wholly befitting one as far as receivers are concerned, and that the courts, should they ever be called upon to apply it, would do so without hesitation.

4. Contractual sources of duty.

4.1. Introduction

> "...It is quite plain that a person appointed receiver and manager is concerned, not for the benefit of the company but for the benefit of the mortgagee bank, to realise the security; that is the whole purpose of his appointment..."[135]

In determining the duties of the receiver to both debenture-holder and company the courts have assiduously emphasised that behind every appointment there is a particular *purpose*. It is inherent that the charged assets at the disposal of the

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[133] See, Flannigan, *supra* n 115, 289; *Cooter and Freedman, supra* n 121, 1053.
[134] *Quaere* whether the debenture-holder, by failing to pursue his receiver in such circumstances, breaches his own duty of good faith to the company?
[135] *Re B Johnson & Co (Builders) Ltd* [1955] 1 Ch 634, 644, *per* Evershed MR.

receiver are to be deployed towards a specific end, the discharge of the company's indebtedness to the debenture-holder. To this extent, Evershed MR's statement rings resoundingly true: receivership signals an end to the debenture-holder's clemency towards the company, at least as far as the outstanding sum is concerned, and represents an intervention spurred by self-interest. The realisation of a security interest, by whatever means, is provoked by a recognition that a situation of conflict exists, and that if one set of interests is to be adequately protected then another will have to be prejudiced, or even entirely sacrificed. In the context of receivership, the protection of the debenture-holder's position is cardinal.

An initial observation, then, is that those cases referring to the receiver's *primary* duty[136] towards the debenture-holder are doing no more than stating that which is inherent in the debenture contract. The power to appoint is a term inserted for the benefit of the debenture-holder and any appointment will be made on a similar understanding.

What is frequently left tacit is the contractual origin of this primary duty. It does not spring into being independently of the agreement between debenture-holder and company, although given its notable absence as an express term of the debenture contract the casual observer might be forgiven for thinking that this is the case. Instead it falls to be implied from the commercial circumstances of receivership, which, acknowledging the secured creditor's contractual right to enforce his security, similarly admit of his power to do so in the manner which best promotes

[136] See, e.g., *Latchford v Bierne* [1981] 3 All ER 705, 708, *per* Milmo J; *R A Price Securities Ltd v Henderson* [1989] NZLR 257, 261-262, *per* Somers J; *Gomba Holdings UK Ltd v Homan* [1986] 3 All ER 94, 98, *per* Hoffmann J; *Lathia v Dronsfield Bros. Ltd* [1987] BCLC 321, 324, *per* Sir Neil Lawson.

his economic well-being. Once that first right is established and endorsed, the second inexorably supervenes.

In this respect the debenture agreement resembles a trust, with the company as settlor, the receiver as trustee and the debenture-holder as beneficiary. It is the company, via the debenture-holder's agency, that contracts with the receiver on terms contained in the original debenture deed, those terms comprising the express grant of a series of powers on the implicit cognisance that these will be exercised towards a given end. The trust analogy is fortified by the fact that it would at first appear that the debenture-holder never enters into contractual relations with his appointee at all[137], and yet is able, as are beneficiaries, to enforce the terms of the 'trust'. But the parallel is an imperfect one. The core of the trust concept is composed of a bilateral relationship, that which exists between trustee and beneficiary, whereas at the heart of receivership is the tripartite relationship, which allows that the company is something more than a bit-part player.

The company has a vested and continuing interest in the receiver's actions. It is not concerned only that the debenture-holder/beneficiary profits by the exercise of the receiver/trustee's powers. On the contrary, too ardent a regard for the appointor's advantage could result in its total destruction. This suggests that the company, presupposing it contracts as a rational actor, would agree that the power to appoint is for the benefit of the debenture-holder, but would qualify the manner in which the appointee will subsequently pursue his end. It is one thing to accede to the primacy of a third party's interests over one's own, quite another to blithely accept

[137] This issue is examined immediately below.

that one's own interests are to be totally discounted at some future point. What follows attempts to unravel the contractual structure of the tripartite relationship, to illustrate how the demands of its parts dictate the effect of the whole, to chart a move from contract to status and, finally, to evaluate whether the outcome is justified in terms of legal principle and policy.

4.2 The contractual foundation

Contractual relations between receiver and company are created by the latter's appointment. There appears to be a minor dispute as to whether contractual relations are ever constituted between receiver and debenture-holder. Lightman and Moss suggest that:

> "The offer and acceptance of the appointment as receiver constitutes a contract between the appointor and the appointee."[138]

This statement was approved by the New Zealand Court of Appeal in *R. A Price Securities v Henderson*[139]. Lange and Hartwig, however, affirm:

> "The appointment does not create contractual relations between administrative receiver and debenture-holder. The right of the debenture-holder to appoint a receiver arises from the contractual relationship between creditor and debtor. The creditor has, in making the appointment, acted as agent of the debtor."[140]

For this, *Bose v Harris*[141] is cited in support, although that case decides only that a debenture-holder has no cause of action against the company debtor for interference with a receiver who is agent of the company. The reasoning behind the decision is

[138] *Supra* n. 66, 7-32.
[139] [1989] 2 NZLR 257, 261 *per* Somers J.
[140] *The Law and Practice of Administrative Receivership and Associated Remedies* (1989: Sweet & Maxwell : London), para. 3.32.
[141] (1942) SJ 376.

unclear, the report being little more than a summary, but it would appear that the determinative consideration was not so much a want of contractual relations between debenture-holder and receiver as the fact of the agency for the *company.* It might be argued that an action in tort for interference with contractual relations was not available because, due to the agency, no contractual relations were in fact established, but, given the brevity of the report this would be a considerable leap of faith. The aggrieved debenture-holder appears to have been seeking an injunction against the company, and the question of an action in tort was not argued.

Notwithstanding the ambivalence of the *Bose* case, Lange and Hartwig's opinion is not without some force. It has already been noted that, as a general rule, an agent contracting for his principal does not become a party to the contract made. Thus, it is feasible to speculate that the appointment does no more than create contractual relations between receiver and *company.* On the other hand, it is similarly clear that the general rule is no more than a presumption, rebuttable by evidence that the parties intended the agent to be a party to the contract in question. Whether such a conclusion could be inferred from the standard form of appointment, which is succinct in the extreme, might be open to question. In any event, and as will be discussed later, the absence of contractual relations between debenture-holder and receiver is unlikely to be a source of any great anxiety for the former since the intervention of equity and tort provide him with more than adequate protection.

4.3 Contractual terms as a duty source

The receiver's task of marshalling the charged assets of the company in order to satisfy the debt owed to the debenture-holder is referred to only concisely in standard form debentures. Such documents, having catalogued the receiver's powers, go on to provide that:

> "All money received by the Bank or by any receiver appointed by the Bank in the exercise of any powers conferred by this Debenture shall be applied ... in or towards satisfaction of such of the moneys obligations and liabilities hereby secured..."[142]

The manner of the exercise of such powers is left entirely to the discretion of the receiver. Nowhere in this contract, which is the hub of the tripartite relationship, is the receiver given any guidance as to the foremost informant of the exercise of his discretion, namely, whose interests are to be prioritised, those of the company or those of the debenture-holder. Powers, rather than duties, are the focus of the debenture.

It follows that the contract has nothing express to say about the manner of performance. One might select all manner of situations where such direction will be necessary. For example, the sale of a fixed charge asset will realise sufficient to pay off the debt, but will leave the company without the wherewithal to continue its business, whereas the sale of floating charge assets would leave a shortfall but would allow the company to keep up operations. A going concern sale might achieve the best of both worlds[143], but will require additional finance and a lengthy period of trading and negotiation. The appropriate course, in these circumstances, is dictated by the accommodation of only one set of interests, and in the absence of categorical command some means of resolving potential conflicts must be discerned from the agreement between the parties. Enter the implied term.

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[142] Lingard, *Bank Security Documents*, 3rd ed (1993 : Butterworths : London), 7.02.
[143] In that the company's *vocation* will be preserved, and perhaps the jobs of its employees, albeit under new ownership.

The courts have been somewhat inconsistent in their explanations of the source of the duty hierarchy within the tripartite relationship. Frequently, it is difficult to ascertain whether they impute the duty in question to an implied term of the debenture contract, to the fact of the status of the receiver, or, indeed, whether they consider the two derivations to amount to the same thing. In the first case to consider the question of the receiver's duties to the company, though, the contractual context was explicitly afforded weight:

> "...a receiver and manager for debenture-holders is a person appointed by debenture-holders to whom the company has given powers of management *pursuant to the contract of loan constituted by the debenture*, and as a condition of obtaining the loan, to enable him to preserve and realise the assets comprised in the security for the benefit of the debenture-holders. *The company gets the loan on terms that* the lenders shall be entitled, for the purpose of making their security effective, to appoint a receiver with powers of sale and of management pending sale, and with full discretion as to the exercise and mode of exercising those powers. The primary duty of the receiver is to the debenture-holders and not to the company..."[144]

This passage is instructive in two respects. First, it identifies the debenture contract as the root of the receiver's obligations and, secondly, it locates the beneficiary of the receiver's efforts, the party to whom he owes his *primary* duty. Considering these two elements together, and although Jenkins LJ did not expressly so state, it is clear that the duty to prefer the welfare of the debenture-holder is an implied term of the contract of loan. What remains ambiguous is the use of the term 'primary', in relation to the receiver's duty, indicating the existence of secondary duties. What *Re*

[144] *Re B Johnson, supra* n 135, 661-662, *per* Jenkins LJ.

B Johnson omits to develop is the nature of any such residual duty and to whom it is owed, apart from an acknowledgement that the company may impeach an improper use of power or discretion by the receiver.

Further examples of the use of implied terms in this respect have been documented earlier. For instance, a receiver's usurpation of the management powers of the company's board is explicable by reference to such a process. Likewise, it was held by Hoffmann J in *Gomba Holdings UK Ltd v Homan*[145] that the company's right to demand and receive information from its receiver was subject to the receiver's determination that the divulgence of such would not prejudice the interests of the debenture-holder, and that this right arose as a matter of implication from the debenture contract. However, no case has satisfactorily explained the incidents of the elusive 'secondary duty', or at least not in the language of implied terms. The question of when it operates, and what it requires the receiver to actually *do*, remains a matter of conjecture, unless one has regard to another, probably separate source of obligation.

4.4 Implied terms and the 'secondary' duty

4.4.1 Terms implied in law and in fact

That a receiver owes some form of obligation to the company over whose assets he is appointed is well established. The *Gomba Holdings* case appears to suggest that its origin is the debenture contract, and, more specifically, the implied terms of that contract. Where circumstances dictate that the debenture-holder's advantage can

[145] *Supra* n 136.

only be promoted by inevitably impairing that of the company, then there can be no question that the former must prevail. However, in less straightforward situations, implied term theory might lead to a different result. For example, where a receiver is presented with two possible courses of action, neither of which would be detrimental to the debenture-holder but one of which would be advantageous to the company, it seems unarguable that he should be duty bound to the company to look after its interests. One element of the secondary duty would require the receiver at all times to *consider* the effect of his decisions on the company and, wherever his primary duty to the debenture-holder allows, to act in a manner which best serves the company.

A different situation is where a particular action would improve the company's prospects but would not represent a consummate advancement of the debenture-holder's. It may be that an immediate shut-down and forced sale would raise sufficient funds to discharge the debt, whereas continued trading would almost inevitably result in a going concern sale[146] for a substantially larger amount, but would involve the debenture-holder waiting for his money. Having regard to the manner in which the courts have developed and utilised implied terms, what would be the result here?

The difficulty with implying a term *in fact* is that it is not immediately obvious that either party would accede to a particular outcome. Just as it is impossible to say that the debenture-holder would have intended, in such a situation, a degree of benevolence towards the company, it is similarly unfeasible to suggest that the

[146] It may be objected that such a sale is of no benefit to the company, since it will cease to own its 'enterprise'. Such a sale might, however, leave a surplus available to the company's *owners*.

company would expect its own stake in any surplus to be forfeited simply in order that the debenture-holder could be paid off a little earlier. The '*fact*' test, in these circumstances, does not work, it does not yield of a justiciable norm.

What of terms implied in law? A significant distinction between these and terms implied in fact is that it is almost universally acknowledged that the courts' input here is to a greater or lesser extent policy driven, notwithstanding their insistence that the test is one of necessity. Treitel states that:

> "...in determining what amounts to necessity the courts do not, in the present context, look for evidence of common intention. They determine the existence, scope and content of terms implied in law rather by citation of authorities and by reference to general considerations of policy ... In such cases the courts are really laying down, as a matter of law, how the parties to the contract ought to behave..."[147]

This approach, it is submitted, is both workable and appropriate as far as a determination of the receiver's duty to the company is concerned, not least because it allows the courts to home in on the precise issue in hand. Where the test for implication of contractual terms *in fact* founders is at its focal point. It looks not to what the *receiver* would consider he ought to do in any given situation but rather at what two parties with conflicting interests would assert he *should* do, and each will necessarily give a different answer. In short, no common can possibly exist.

Further, it is critical to bear in mind the contextual background. A debenture contract is first and foremost an agreement for a loan, and, at least as far as the company is concerned, provisions relating to security and its potential enforcement are almost an irrelevance. It seems fair to postulate that the company only considers

[147] *An Outline of the Law of Contract*, 5th ed (1995 : Butterworths : London), 70 -71.

them as a contingency against a remote possibility, and included as a 'comforter' for the bank. The company is hardly likely, *at the point of execution of the debenture*, to be contemplating its own failure so that receivership provisions and their potential effect are unlikely to be seriously adverted to. As Samwell puts it:

> "From the borrower's viewpoint the debenture is frequently executed without a full appreciation of the power that is being conveyed, or at least the possibility of a receiver being appointed is frequently considered to be so remote as to be disregarded for all intents and purposes."[148]

Terms implied in fact are wholly unsuited to resolving the question of the receiver's obligations to the company in the situation detailed above. Terms implied in law are a different matter. Because they are not ascertained by reference to a common intention, there is a certain flexibility available to the courts in determining their existence. This allows them to scrutinise the *circumstances* rather than the contract, and to propose a result which *objectively* accommodates both the expectations of each party and the demands of fairness and policy. Such an approach would allow for the gradual development of receivership law, in that it acknowledges the fact of the relationship between *receiver and company* as a singular yet constituent part of the tripartite relationship.

In other words, it operates *ex post facto* on an appointment being made and thus is better able to localise the substance of the question, namely, how far can the *receiver* go towards the attainment of his task without unjustifiably injuring the company. In reaching a conclusion the court can and should consider not only the commercial purpose of his appointment but also the extent to which this purpose

[148] *Corporate Receiverships* (1981 : ICAEW : London), 25.

calls for the subjugation of the company's welfare and the degree of subordination necessary if that purpose is not to be defeated.

4.4.2. Implied terms - a model

To recapitulate, *Gomba Holdings (UK) Ltd v Homan*[149] establishes that the company's right to call upon the receiver to produce information relating to the receivership is subject to the proviso that he may decline production where, in his opinion, such would be prejudicial to the debenture-holder. This proposition can be broadened into one of more general application. Where a certain action would benefit the company but harm the debenture-holder the receiver must refrain from choosing that course. If faced with a straight choice between the interests of one or the other where that choice will inevitably result in injury to one, the receiver must favour his debenture-holder.

Where, however, a particular action is result neutral for the debenture-holder, it is elementary that the receiver should act in a way which best protects or promotes the company. In either set of circumstances it is submitted that, as a bare minimum, the courts would, if asked, imply a term to the effect that the receiver should take into account the likely effect of his decisions on the company and strive to accommodate its interests wherever the commercial purpose of his appointment allows.

What of the more contentious situation where a particular course would be beneficial to the company but would mean the debenture-holder receiving his money later rather then sooner? At this stage the enquiry becomes more complex in

[149] *Supra* n 136.

that the court, in formulating an implied term, would have to make an overt value judgment. However, the following considerations might foreseeably enter the equation. First, the commercial purpose of receivership would not be overthrown if the receiver were enabled (or even bound) to take a long-term view of circumstances. Assuming that it is virtually certain that a better level of realisations will accrue if a going concern sale is pursued, then *a fortiori* that purpose will be achieved.

Secondly, one effect of receivership is the acceleration of repayment of the debt. Since the debenture-holder has contractually agreed to 'wait' for repayment, it would seem capricious to hold that his interest *demands* an immediate discharge[150]. Thirdly, an increased level of realisations would inure to the benefit of those parties outside the tripartite relationship, in particular the company's unsecured and preferential creditors. Fourthly, should the receiver's judgment as to the value of delaying payment in order to trade on turn out to be misconceived, the debenture-holder will have a remedy against him, either in the tort of negligence or as a matter of contract.

The above suggest that the weight of political and practical factors would be in favour of implying a term to the effect that a receiver may choose to solicit a potentially higher level of realisations even where the outcome is that the fulfilment of his function is deferred. The court would have to be convinced that the eventual discharge was a realistic prospect, but if that condition is satisfied there would seem to be no reason in principle or policy to incite it to shirk from such an implication.

[150] Although the precise timescale would have to be examined. A matter of a few weeks, or even months, of delay might seem justified whereas a much longer period would be less acceptable.

Very broadly, in terms of the receiver's duty to the company, one might expect to find that this encompasses an obligation to take the step most likely to *maximise realisations* where there is no (or a *de minimis*) perceived risk to the value of the security. This duty would be an ongoing one, *unless* the receiver or his debenture-holder could evidence that its fulfilment would result in an excessive delay in attaining the commercial purpose of the receivership. What would amount to excessive would probably be treated as a question of fact, and it ought not to be beyond the ability of the courts to reach a determination of that matter.

The above rather reverses the content of the primary and secondary duties, in that it elevates the company's long-term interest in maximum realisations over the debenture-holder's short-term interest in immediate repayment, but this variation is only temporary, as the debenture-holder will get paid in the end. What of a more permanent deviation, where the company's interests are *irreversibly* preferred? Suppose, for example, the company operates from a valuable piece of land which could be sold for a sum adequate to discharge its debt, but that a going concern sale, perhaps to the company's own management, would ensure the continuation of its enterprise whilst leaving a small shortfall? Should the receiver's duty to the company prevail in such circumstances or should the orthodoxy that his primary duty is to the debenture-holder triumph? What sort of term would be implied in law to deal with this situation?

In such circumstances it would always be open to the debenture-holder to sanction a course that would be superficially detrimental to his position. In some cases, and especially if the amount at risk is only small, he might prefer to forego its recovery in the name of public relations or in order to retain a customer[151]. In the face of the debenture-holder's objection, though, and bearing in mind that a term implied in law reflects the court's appraisal of how the parties *ought* to behave, what should be its response? Clearly the policy considerations in this scenario are distinct from those itemised in the 'short term/long term' situation dealt with above. There is an identifiable loss to the debenture-holder by the prioritising of the company's interests, so that requiring the receiver to prefer the latter precludes the full attainment of the commercial purpose of receivership.

Further, its unsecured creditors will similarly suffer in that the possibility of a share in the surplus on the liquidation of the company will evaporate. On the other hand, the preferential creditors ought theoretically to be placed in a healthier position[152], as they will receive nothing from the realisation of a fixed charge asset (the land) and so be left to chase the now inoperational company. Moreover, since the amount of their claim will now be determined by reference to the date of *winding up*[153], it will usually be the case, especially in a non-trading receivership, that such an amount will have shrunk considerably. Preferential creditors, then, would do better out of a going concern sale, and this is likely to be at the expense of the debenture-holder. Finally, the company's employees, regardless of their status as preferential creditors, may stand a chance of keeping their jobs if the enterprise continues.

The question of whether there are any circumstances in which a receiver is duty bound to prioritise interests in competition with those of the debenture-holder has

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[151] See *infra* Chapter 5

[152] For a fuller exposition see Chapter 3.

[153] The 'relevant date'; s 387(3) IA .

never been comprehensively addressed by the courts. However, there are numerous indications that they would categorically decline to imply such a term into the debenture contract, no matter how small the potential loss to the charge holder, and, indeed, would be indisposed to examine the particular facts to see whether such would be politically expedient. There has been an express acknowledgement that this question of 'balance' is a legitimate one, particular in the context of the ubiquitous battle between a company's secured and unsecured creditors. The Cork Committee noted:

> "One of the most difficult questions to which we have tried to find a solution is how best to reconcile the legitimate safeguards to those who are required to provide adequate finance to commerce and industry, with justice to the ordinary unsecured trade creditor who is an involuntary supplier of goods, materials or services on credit."[154]

One of the Committee's 'solutions' to this problem, the "10%" fund, foundered at the Parliamentary stage. Interestingly though, in relation to receivership, it came close to suggesting that the welfare of the debenture-holder need not always be paramount in the receiver's deliberations, in the following passage

> "The receiver should have freedom to act *in the best interests of all concerned, without having the necessity to look over his shoulder either at the holder of the charge or at other creditors......*"[155]

It would be overly ambitious to suggest that this amounts to a recommendation that, where the demands of the company or its other creditors are overwhelmingly more imperative than those of the debenture-holder, the former should take precedence.

[154] *Supra* n 75, para. 110.
[155] *Ibid*, para. 453 (italics added).

Nonetheless, to the extent that it invites the courts to scrutinise more closely the overall effect of a particular course of conduct, it has been largely overlooked. Rather, they have tended to emphasise the social value in according the utmost deference to the position of institutional lenders. This 'policy' finds its inspiration in the perception that any move toward a redistributive goal in an insolvency situation would do more overall harm than overall good, and is perhaps most overtly expressed by Lowry J in *Kernohan Estates Ltd v Boyd*:

> "...one must always have regard to the terms on which large sums of money are borrowed in order to finance a business, and to the power of the lender to realise his security. It seems to me that is one weakens the confidence of lenders one may end up doing a great deal of harm commercially."[156]

An assessment of the merits or otherwise of this solicitude towards secured lenders is left until later in the thesis, but for the moment it suffices to note its presence in the judicial consciousness.

The inevitable conclusion must be that it would be a complete *volte face*, for a court to imply a term to the effect that a receiver is at liberty to, or *should*, contemplate the proportionate detriment to company and debenture-holder that a given course of action would cause, and then favour the company's cause if its loss would be tremendously unequal to that of the debenture-holder. In other words, if a monetary loss to the debenture-holder can be avoided it is the receiver's duty to so avoid it, regardless of the consequences to the company and those others interested in its prospects. Further, such an approach avoids the courts becoming embroiled in a

[156] [1967] NI 27, 34. See, to similar effect, *Jones v Matthie* (1847) 16 LJ Ch 405, 407; *Re Sobam BV (In Receivership)* [1996] 1 BCLC 446, 459, *per* Arden J; House of Lords Weekly Hansard No. 1276, 4th-7th February 1985, col. 851, Lord Bruce of Donnington.

minute inquisition into the pros and cons of the entirety of the receiver's decisions and, perhaps even more importantly, thwarts the possibility of a glut of complex and expensive litigation embarked upon by the company at every turn.

A final question relating to the use of implied terms to elucidate the duty incidents of the tripartite relationship is whether the courts would imply an obligation on the part of the receiver, *owed to the company*, to exercise skill and care in the carrying out of his task. In the contractual nexus between receiver and company such a term is notable by its absence. It should be acknowledged that most of the cases have been argued not on the basis of a contractual duty of skill and care but rather on a tortious one[157], but one might expect, if the former existed, that the courts would have so averred before now.

A duty of skill and care in the contractual context seems so obvious as to go without saying. Judges occasionally choose to articulate its presence, though:

> "It is however my understanding that by law in this country contracts for services do contain an implied promise to exercise reasonable care and skill in the performance of the relevant services..."[158]

Nevertheless, and assuming that the receiver's connection with the company could be described as a contract for services, no case has yet asserted that a receiver is *contractually* bound to exercise skill and care in the performance of his functions. This is so even though s 13 of the Supply of Goods and Services Act 1982 provides:

[157] As to which see the following section.

[158] *Henderson v Merrett Syndicates* [1994] 3 All ER 506, 532, *per* Lord Goff.

> "In a contract for the supply of a service where the supplier is acting in the course of a business there is an implied term that the supplier will carry out the service with reasonable care and skill."

That an implied term to the above effect ought to be read into the receiver/company relationship would appear an inoffensive proposition, but it remains the case that there is no authority to this effect. The exegesis of this curious, and at first glance aberrant state of affairs lies in fact that whilst the question of a receiver's skill and care *has* been the subject of judicial attention, this debate has taken place largely outside the contractual arena. The next sections chart it more fully.

5. The primacy of status as a duty determinant

5.1. Status: an implied term by any other name?

The incidents of 'status' have already been examined at some length in Chapter One in relation to the receiver's agency. Whilst status-based duties are treated separately here, it should be observed that the process by which they are attributed bears a marked resemblance to that by which the courts determine those contractual terms which are to be implied as a matter of law. In particular, in both contexts, regard is had to the nature of the relationship in question, its purpose (commercial or otherwise), the relevant policy issues raised and, to some extent, the legitimate expectations of the parties to it. One potential distinction between the two mechanisms may be the extent to which parties are able to vary particular incidents that would otherwise arise in relation to the connection between them. As far as implied terms are concerned, it is clear that the courts cannot, even as a matter of law, imply a term inconsistent with the content of the contract. Status-based obligations, on the other hand, may override even the express terms of the contract, although the law remains obscure in this respect[159].

In the preceding section an attempt was made to assemble a 'prototype' of implied terms which would apply to the receiver/company association if it were closely examined by the courts. What follows is an account of the outcome of the status-based approach that has *actually* prevailed in the vast majority of cases, and a comparison of that outcome with the theoretical model based on implied term theory. This exercise aims to illustrate, first, the intrinsic view of the courts as to the predominant thrust of receivership and, secondly, the problems of a process that relies too heavily on status as a short-cut to determining the appropriate duty construct.

5.2.1 What status?

Receivership law, it might be thought, should be built around the 'rank' of *receiver*. That status is sufficiently unique to demand that its legal consequences for all parties be settled by reference to a thorough appraisal of how the institution works and the goals and policies, as determined by the exigency of the times, to which receivers should have regard. Case law reveals that this approach has only partially been adopted, and that, more often, the courts assume that receivers work under the same constraints as their appointors. In short, most of the duties that receivers owe, both to the company and its outside participants, flow from the status of *mortgagee*. This identity of obligation has been expressly approved on numerous occasions[160].

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159 See the discussion in Chapter 1.

160 The most authoritative versions of this view can be found in *Re B Johnson, supra* n 137, 662, *per* Jenkins LJ; *Expo International Pty Ltd v Chant* [1979] 2 NSWLR 820,834-835, *per* Needham J; *Downsview Nominees Ltd v First City Corporation Ltd* [1993] AC 295, *per* Lord Templeman.

It is therefore necessary to consider those incidents that attach to the status of mortgagee.

5.2 Duties of mortgagees owed to mortgagors: an overview.

The law relating to the obligations owed by mortgagee to mortgagor has had a troubled history. A full exposition of its development is beyond the scope of this work, but for present purposes certain irrefutable duties can be identified, although their content is less easily discernible. In *Expo International Pty Ltd v Chant*[161] Needham J described the duties of a receiver (which he considered identical to and derived from those of a mortgagee) as including:

> "...[a] duty to exercise his powers in good faith (including a duty not to sacrifice the mortgagor's interests recklessly); to act strictly within, and in accordance with, the conditions of his appointment; to account to the mortgagor after the mortgagee's security has been discharged, not only for surplus assets, but also for the conduct of the receivership."[162]

A further duty, and one that has received prominence in the English courts, is to take reasonable precautions to obtain the true market value of the property on the exercise of a power of sale. Such was initially denied in *Re B Johnson*[163], but is now widely acknowledged to exist[164]. In essence, up until very recently[165], the sum of a mortgagee's duties to a mortgagor is comprised of three, arguably independent, elements. Each warrants closer consideration.

[161] *Supra* n 160.
[162] *Ibid.* 834.
[163] *Supra* n 137, 651, *per* Evershed MR.
[164] See, most notably, *Cuckmere Brick Co Ltd v Mutual Finance Ltd* [1971] Ch. 949, 965, *per* Salmon LJ.
[165] An extremely interesting and welcome development in the law in this regard is discussed in the final section of this Chapter.

5.3 The duty to act in good faith

The content of a mortgagee's duty of good faith is elusive. Nevertheless, a degree of enlightenment is to be found in the cases. First, good faith encompasses an 'absence of fraud or *mala fides*'[166]. Further assistance is to be had from the House of Lords in *Kennedy v De Trafford*[167], where Lord Herschell, having intimated that the case did not call for an "exhaustive definition of the duties of a mortgagee to a mortgagor"[168], went on to say:

> "Of course, if [the mortgagee] *wilfully and recklessly deals with the property in such a manner that the interests of the mortgagor are sacrificed,* I should say that he had not been exercising his power of sale in good faith."[169]

The wilful or reckless sacrifice of the mortgagor's interests, then, will be a breach of the duty to act in good faith. This much has been confirmed in more recent authorities, albeit expressed in slightly different terms[170]. As to what amounts to a wilful or reckless sacrifice, the matter becomes opaque. It would seem that recklessness is to be distinguished from mere 'want of care and prudence'[171], but other than this the best that can be said is that a great deal will depend upon a particular court's view of the *facts.* Therefore there will always be a degree of uncertainty over whether a course of action will comply with the duty

[166] *Re B Johnson, supra* n 135, 662, *per* Jenkins LJ.
[167] [1897] AC 180.
[168] [1897] AC 180, 185.
[169] *Ibid.* (italics added).
[170] E.g., *Pendlebury v The Colonial Mutual Life Assurance Society Ltd* (1912) 13 CLR 676 ('reckless disregard of the mortgagor's interests', 692, *per* Griffith CJ); *Hartley v Humphris* [1928] St.R.Qd 83 (mortgagee 'not at liberty to look after his own interests alone', 89 *per* Woolcock J); *R. A. Price Securities Ltd v Henderson* [1989] 2 NZLR 257 (receiver to carry out duties 'with the interests of the company, its creditors and its shareholders in mind', 262, *per* Somers J); *Palk v Mortgage Services Funding plc* [1993] Ch 331 (mortgagee not entitled 'to conduct himself in a way which unfairly prejudices the mortgagor', 337, *per* Sir Donald Nicholls VC).
[171] *Pendlebury's Case, supra* n. 170, 703, *per* Isaacs J.

A good example of this uncertainty is the Australian case of *Forsyth v Blundell*[172]. A mortgagee seeking to sell land had received a firm offer from one party and a tentative suggestion from another that he would pay a price higher than that offered were the property to go to auction. Wilson and Mason JJ considered that the failure to bring the two potential purchasers into competition represented a 'sacrifice' or a 'reckless disregard' of the mortgagor's interests. Menzies J, dissenting, felt that the mortgagee should have been under no obligation to act in a manner which might jeopardise his chance to sell at a fair price[173]. Judicial subjectivity, therefore, may play a substantial role in determining whether the mortgagor has been unfairly prejudiced.

The duty to act in good faith has also spawned more precise obligations. It may account for the rather odd proposition that a receiver is under a duty to "protect the company against potential serious consequences to it", identified by Nourse LJ in *Sargent v Commissioners of Customs and Excise*[174]. Admittedly, the learned judge was labouring in the face of a potentially severe *lacuna* in the law, which on its face would allow a non-administrative receiver to choose whether or not to pay over VAT collected by him during the receivership. His decision, therefore, may be no more than an *ad hoc* response to an unusual problem, and likely, in future, to be confined to its facts.

A further aspect of the duty to have regard to the interests of the mortgagor is that it

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172 (1973) 129 CLR 477.

173 One can sympathise with this view. It seems clear that the firm offer was of limited duration, and likely to be withdrawn if the mortgagee delayed long enough to bring about an auction. The second party's interest amounted to no more than a testing of the water. The majority's opinion that the mortgagee had determined to sell only to the first offeror rather overstates the case.

174 [1995] 2 BCLC 34, 42.

requires the mortgagee not to run up unreasonable costs, as articulated by Scott LJ in *Gomba Holdings v Minories Finance (No 2)*[175]. This is an interesting development of the law, in that it seems to owe its existence to those cases relating to items of expenditure the mortgagee could add to his mortgage debt at the accounting stage, although Scott LJ did not expressly state this much. To the extent that it allows *the company* to challenge the receiver's remuneration under the guise of breach of duty, it introduces a novel dimension to receivership law[176].

As well as identifying positive facets of the duty of good faith it is possible to detect what it *does not* enjoin a mortgagee to do. First, the duty is not breached by a decision to sell any particular asset ahead of another, so that the order of realisation of the mortgagor's assets is at the discretion of a receiver. He is not duty bound to sell those assets crucial to the mortgagor's survival only as a last resort[177]. Moreover, the duty not to prejudice the mortgagee's interest has been held not to impose any "duty of care" on mortgagee or receiver in deciding whether to exercise a power of sale[178]. The correctness of these two decisions must be doubted, though[179]. The latter seems to ignore previous authority to the effect that the mortgagee may not recklessly sacrifice the mortgagor's interests[180], and, in any

[175] [1993] BCLC 7, 21. This would include the agreeing of excessive remuneration with a receiver (at 28). It might pertinently be added that receivership law owes a debt of gratitude to the proprietors of the Gomba Group for their zealous pursuit of litigation, much of which has proved illuminating.
[176] *Quaere* its compatibility with s 36 IA, which only envisages a challenge to the receiver's remuneration by a subsequent liquidator, and see the construction of this section by Hoffmann J in *Re Potters Oil Ltd (No 2)* [1986] 1 WLR 201.
[177] *Consolidated Traders Ltd v Downes* [1981] 2 NZLR 247.
[178] *Routestone Ltd v Minories Finance Ltd* [1997] BCC 180, 187, *per* Jacob J.
[179] *Consolidated Traders* was referred to in *Sullivan v Darkin* [1986] NZLR 214, where it was suggested that it did not decide the extent of a mortgagee's duty on the exercise of a power of sale.
[180] See the cases at n 170.

case, draws a specious distinction, especially where a receiver is concerned, between the exercise of a power of sale and the conduct leading up to it. It is submitted that at the very least, there is a duty to *consider* whether a sale is the most appropriate course of action. If the debenture-holder's interests can be served as effectively by some other method of realisation which would protect the *mortgagor's* interests, then that course should be taken. Otherwise the receiver is open to attack on the good faith ground, in that he has unfairly prejudiced the mortgagor.

Finally, there remains the question of whether the duty to act in good faith may be qualified, or even excluded altogether. In *Gomba Holdings (No 2)*[181] Scott LJ noted that if a mortgagee deed purported to allow a mortgagee to impose unreasonable costs on the mortgagor, the avoidance of which he regarded as a constituent of the duty of good faith, then "questions of public policy would arise"[182]. Lingard takes a similar view, but considers that equity, rather than public policy would deter such conduct:

> "The writer questions whether liability for breach of duty as mortgagee can effectively be limited by a clause in the debenture, because such a clause would be inequitable ... The law has seen fit to impose certain duties on mortgagees and may well consider it unconscionable for a mortgagee to attempt to obtain a waiver of these duties or an indemnity from the company against the consequences of a mortgagee or receiver breaching the duties imposed."[183]

[181] *Supra* n 175.
[182] *Ibid.* 21.
[183] *Bank Security Documents, supra* n 144, 11.26 See also Farrar, *Recent Developments in the Law of Receivership,* [1975] JBL 23, 27, supporting the view that a duty of good faith may not be excluded for reasons of public policy.

These opinions may be contrasted with that of the Privy Council in *Kelly v Cooper*[184] to the effect that equitable duties must take effect according to the terms of the contract. The issue therefore awaits further clarification.

5.4 The duty to take reasonable steps to obtain a proper price

This obligation is inextricably linked to the exercise of the mortgagee's power of sale. That its existence should have at one time have been doubted[185] seems extraordinary, given equity's traditionally protective stance towards the equity of redemption. Indeed, Lindley LJ referred to the duty in precisely these terms in *Farrar v Farrars Ltd*[186]. It is now widely accepted as attaching to the power of sale as exercised by a mortgagee[187] or by his receiver[188]. It is generally treated by the courts as an independent duty, although some would look upon it as an element of the wider obligation of good faith[189].

5.4.1 A duty to delay sale?

As with the duty of good faith, the content of this obligation is less than clear and has provoked certain discrepancies in the case law. The main dispute[190] has centred on whether the duty affects *when* the mortgagee may exercise a power of sale. More specifically, the question is whether he is under any obligation to refrain from selling when he is aware of an imminent rise in the market or, conversely, whether

[184] [1993] AC 205. See Chapter 2 for a fuller commentary of this case.
[185] See *Re B Johnson, supra* n 136.
[186] (1888) 40 Ch.D 395, 411, although see the earlier opinion of Kay J in *Warner v Jacob* (1882) 20 Ch.D 220, 224, which might be taken to militate against such a duty.
[187] *McHugh v Union Bank of Canada* [1913] AC 299 (PC); *Cuckmere Brick v Mutual Finance, supra* n 169; *Alexandre v NZ Breweries Ltd* [1974] 1 NZLR 497; *Tse Kwong Lam v Wong Chit Sen* [1983] 1 WLR 1349 (PC).
[188] *Standard Chartered Bank v Walker, supra* n 87; *American Express v Hurley, supra* n 86; *McGowan v Gannas* [1983] ILRM 516; *Downsview Nominees v First City Corporation, supra* n 160. See also the view of the Cork Committee, *supra* n 75, para. 444.
[189] *Moritzson Properties Ltd v McLachlan* [1994] 3 NZLR 250, 255, *per* Fraser J.
[190] Apart from that relating to the jurisprudential source of the duty; see *infra* 185.

he should sell quickly if he knows that the value of the security is about to fall. The traditional view stems from the fact that a mortgagee is not a *trustee* of the power of sale, and holds that the timing of the sale is a matter entirely at his discretion and subject to no duty to have regard to the mortgagor's position:

> "But every mortgage confers upon a mortgagee the right to realise his security and find a purchaser if he can, and if in the exercise of his power he acts bona fide and takes reasonable precautions to obtain a proper price, the mortgagor has no redress, even though more might have been obtained for the property if the sale had been postponed."[191]

This understanding was reaffirmed almost a century later by the Court of Appeal in the case that revived the underlying duty. In *Cuckmere Brick Co Ltd v Mutual Finance Ltd* Salmon LJ stated:

> "Once the power [of sale] has accrued the mortgagee is entitled to exercise it for his own purposes whenever he chooses to do so. It matters not that the moment may be unpropitious and that by waiting a higher price could be obtained ... if the mortgagee's interests, as he sees them, conflict with those of the mortgagor, the mortgagee can give preference to his own interests..."[192]

Nevertheless, the above has not escaped attempts at qualification. Lord Denning has suggested that a mortgagee may not be entitled to sell at "the worst possible time"[193], but this dictum must be doubted, not least because it locates the mortgagee's duties in tort, a position that has since been resoundingly rejected[194]. In *McGowan v Gannas*[195] Carrol J evinced some sympathy for the view that a receiver

[191] *Farrar v Farrars Ltd, supra* n 186, 411, *per* Lindley LJ.
[192] *Supra* n 164, 965.
[193] *Standard Chartered Bank Ltd v Walker, supra* n 87, 942.
[194] *Infra* 186-7.
[195] *Supra* n 188.

should avoid selling at a time when he knows the market is poor, although he expressed no decided opinion on the question. Doyle, whilst accepting the orthodox position, suggests that:

> "...the position will be different where it is clear that a higher price will be obtained following a delay, say where a prospective purchaser makes it clear that he is only able to complete the purchase on a stipulated date on funds becoming available to him particularly where the delay is relatively short and the price which may be obtained is significantly higher."[196]

Such an approach appears fair and sensible, and one might cautiously propound that it would commend itself to the courts, should they be asked to determine the issue in these terms. On the other hand, it would seem to be at odds with the various judicial statements to the effect that no such obligation is owed, the clearest of which can be found in the judgment of Millett J in *Re Charnley Davies Ltd (No 2)*:

> "A mortgagee is bound to have regard to the interests of the mortgagor, but he is entitled to give priority to his own interests and may insist on *an immediate sale whether or not that is calculated to realise the best price...*"[197]

Delay or otherwise will only be an issue where the debenture-holder is over-secured. If he is under-secured then self-interest will dictate a delayed sale in the circumstances described by Doyle. Further, a receiver will be bound by his duty *to the debenture-holder* to delay. In the final analysis, one might question whether a mortgagee or receiver who ruthlessly pursues a less than advantageous sale when a short stay would result in higher realisations is guilty of a needless sacrifice of the

[196] *Administrative Receivership: Law and Practice*, *supra* n 39, 274.
[197] [1990] BCLC 760, 775 (italics added).

mortgagor's interests. Without the benefit of authority no firm conclusion can be drawn, but it is hoped that the courts would baulk at sanctioning such conduct.

5.4.2 Duty to pursue a quick sale?

What of the situation where a mortgagee wishes to delay a sale of the property where such might be to the detriment of the mortgagor? In *China & South Sea Bank Ltd v Tan Soon Gin*[198] Lord Templeman categorically denied the existence of any duty on the part of the mortgagee to realise his security in the face of its imminent decline in value, even if his inactivity would result in a guarantor of the secured debt becoming liable. The case was argued on the basis of a duty of care in negligence, something of a *bête noire* as far as Lord Templeman is concerned, but he made no reference to the possible existence of any *equitable* duty in these circumstances. Recourse might be had to s 91(2) Law of Property Act 1925, by which the court may order a sale of mortgaged property at the suit of the mortgagor. In *Palk v Mortgage Services Funding Ltd*[199] Sir Donald Nicholls VC exercised his discretion to order a sale where the mortgagee's proposed letting of the property, whilst awaiting a rise in the market, would result in a disproportionate increase in the interest owing. The mortgagor would remain liable under her personal covenant for this amount. Of more immediate interest are his general comments on the duties owed by a mortgagor:

> "...[the] mortgagee does owe some duties to the mortgagor ... if he does take steps to exercise his rights over the security, common law and equity alike have set bounds to the extent to which he can look after himself and ignore the mortgagor's interests. In the exercise of his rights over his security a mortgagee must act fairly towards the

[198] [1990] 1 AC 536.

[199] [1993] Ch 331.

mortgagor ... he can protect his own interest but he is not entitled to conduct himself in a way which unfairly prejudices the mortgagor. If he takes possession he might prefer to do nothing and bide his time, waiting indefinitely for an improvement in the market, with the property empty meanwhile. That he cannot do. He is accountable for his actual receipts from the property ... I confess *I have difficulty in seeing why a mortgagee's duties in and about the exercise of his powers of sale and letting should be regarded as narrowly confined to these two duties.*"[200]

Clearly his Lordship considered it unfair that a mortgagee should be allowed to speculate at the expense of the mortgagor. One might ask whether he would find it similarly unfair that a mortgagee should refuse to delay a sale when such would be of benefit to the mortgagor whilst presenting no threat to his own interests. Given the unmistakable tenor of his closing remarks, the answer is not far to seek.

5.4.3 A proper price?

The question of what amounts to a proper price would appear to be one of fact, and has been expressed in various terms. Salmon LJ, in *Cuckmere Brick*, used the phraseology "the true market value", and this must be taken to mean the value at the time when the mortgagee chooses to sell if it is not to impose a more onerous burden than that which the courts have identified. In ascertaining whether or not a proper price has been realised the courts are unlikely to conceive the duty breached unless there is evidence of a substantial undervalue. This is apparent from *Cuckmere* itself, where his Lordship remarked:

"No doubt in deciding whether he has fallen short of that duty the facts must be looked at broadly, and he will not be adjudged to be in default unless he is plainly on the wrong side of the line."[201]

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[200] [1993] Ch 331, 337 (italics added).
[201] *Supra* n 169, 969.

This echoes the views of earlier courts[202]. Moreover, as Butt puts it:

> "In any case, the value of real estate is largely a matter of opinion, and it is to be expected that the mortgagor may have an inflated value of its worth, while a buyer naturally takes a conservative view of the value of what he is buying. Indeed, what is alleged to be an undervalue may merely be a difference in opinion of several valuers."[203]

The 'realistic' approach is *a fortiori* to be used where what is sold is not a particular piece of land or machinery but rather the whole business. Going concern sales, it is submitted, are unlikely to be open to attack on undervalue grounds except in the most extreme circumstances and it would be an intrepid court that chose to scrutinise the terms of such a sale unless the receiver had sold to other than the highest offeror. The idea that the value of a business in receivership is whatever is offered for it might well amount to an impenetrable defence to a charge that a proper price has not been obtained.

5.4.4 Reasonable steps?

A potentially more fruitful course for an aggrieved mortgagor is to allege that the mortgagee has not *taken reasonable steps* to obtain a proper price, as it is in this area that the courts have shown a certain willingness to scrutinise the latter's pre-sale conduct. Thus, the duty will be breached if the property in question is not accurately described in any advertising literature[204], if it is advertised for sale inappropriately[205], if specialist advice as to its value is not taken[206], or if an auction

[202] *Colson v Williams* (1889) 58 LJ Ch 539, 540, *per* Kekewich J.
[203] *The Mortgagee's Duty on Sale* (1979) 53 ALJ 172, 181-182.
[204] *Cuckmere Brick, supra* n 164.
[205] *American Express v Hurley, supra* n 86 (specialist equipment should have been advertised in the music press).
[206] *Ibid.*

is poorly advertised or proceeded with in inclement conditions[207]. In essence, these cases suggest that a mortgagee or receiver selling property should obtain independent valuations, should consider the nature of the property to be sold and advertise it appropriately and, perhaps, should at least have regard to the best *mode* of sale[208]. Doyle suggests that the duty extends to post-sale conduct, as where a mortgagee or receiver fails to *collect or receive* the agreed purchase price, and lists a number of terms that should properly be included in any contract for sale if liability is to be avoided[209]. The conduct he describes would almost certainly amount to wilful default in any event[210].

On occasion the courts have suggested that this duty demands a course of action involving a degree of risk to the mortgagee. In *Holohan v Friends Provident and Century Life Office*[211] Ó Dálaigh CJ, in the Supreme Court, considered that the mortgagees in question had breached the duty by refusing to consider whether a higher price would be obtained by a sale with vacant possession. In fairness, it is not clear whether he viewed the obligation as anything more than to *reflect upon* the possibility of such a sale[212]. Indeed, he made particular mention of the fact that the mortgagees had closed their minds to selling the property in anything other than its present state. Nonetheless, the tenor of his judgment is to the effect that the mortgagees should have taken steps to buy out the property's tenants in order to be

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207 *Standard Chartered Bank v Walker, supra* n 87.
208 In *Predeth v Castle Phillips Finance Co Ltd* [1986] 2 EGLR 144, the Court of Appeal held that the forced sale basis on which charged property was realised did not amount to the taking of reasonable precautions to obtain a proper price. The property should, in the court's opinion, have been exposed to the market for a sensible period. *C.f. Bank of Cyprus v Gill* [1980] 2 Lloyd's Rep. 51.
209 *The Receiver's Duties on a Sale of Charged Assets* (1997) 10 Insol. Intelligence 9,10.
210 *Mayer v Murray* (1878) 8 Ch D 424.
211 [1966] IR 1.
212 The mortgagees had been advised that such a sale would maximise the price obtained.

able to sell with vacant possession. Notably Budd J, at first instance, had felt this to be an unacceptable risk to expect the mortgagees to take.

A further example of a more demanding approach to mortgagees is the case of *Higton Enterprises Pty Ltd v BFC Finance Ltd*[213]. Fitzgerald P found a breach of the statutory duty to "take reasonable care to ensure that the property is sold at market value"[214] where the mortgagee entered into an "improvident" contract for sale. Completion of the contract in question never transpired, and in the (substantial) interim period the value of the property plummeted.

It is questionable whether an English court would take quite so vigorous an approach to the question of whether reasonable precautions have or have not been taken. In *AIB Finance Ltd v Debtors*[215] Carnwath J identified an obligation to take account of the effect of a sale on the value of the goodwill of a business. He further considered that an attempt to maintain that goodwill (i.e., by continuing the business) was incumbent upon the mortgagee where such would result in the obtaining of a higher price. On appeal[216] it was held that whilst a mortgagee *might* in certain circumstances come under a duty to co-operate with the mortgagor in selling the business as a going concern, no such duty arose prior to the taking of possession[217]. The destruction of the goodwill of the business had occurred before the mortgagees entered possession, and Carnwath J's ruling was overturned on the facts.

[213] [1997] 1 Qd R 168.
[214] Section 85 Property Law Act 1974.
[215] [1997] 2 BCLC 354.
[216] [1998] 1 BCLC 665.
[217] *Ibid.* 674-675, *per* Nourse LJ.

The Court of Appeal's decision is of interest in that both Nourse and Mummery LJJ were prepared to countenance the notion of a mortgagee coming under a duty to make attempts to preserve the goodwill of a business[218]. Such a duty was clearly not envisaged by Lord Templeman in *Downsview:*

> "The decisions of a receiver and manager whether to continue the business or close down the business and sell the assets chosen by him cannot be impeached if those decisions are taken in good faith while protecting the interests of the debenture-holder in recovering the moneys due under the debenture, even though the decisions of the receiver and manager may be disadvantageous for the company."[219]

On a note of caution, though, none of the judges in *AIB Finance* chose to describe the kinds of circumstances in which such a duty might arise. Lightman and Moss, addressing the question in terms of whether a duty to trade is owed, conclude that such should only arise where company funds are available, trading on will result in a going concern sale and a cessation of business would lead to a disadvantageous level of realisations[220]. Their view seems to preclude any expectation on the part of the courts that a mortgagee should be willing to risk the chance of an immediate sale in the hope of achieving a higher price on a going concern sale. This seems entirely in accordance with authority, and it should be noted that the Court of Appeal in *AIB Finance* made no intimation that they were purporting to change the law.

The duty to take reasonable precautions to obtain a proper price is easily stated but less easily demarcated. In particular, there is some scope for judicial inventiveness

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[218] See also *R v Board of Trade, ex p. St Martins Preserving Co Ltd* [1965] 1 QB 603, 615, *per* Phillimore J.
[219] *Supra* n 160, 312-313.
[220] *Supra* n 66, para. 8.14.

in the determination of whether reasonable precautions have or have not been taken, and, since the standard is an objective one, and the 'reasonable man' in this context is inevitably going to be a judge, opinion and personality enter the equation. Mortgagors will therefore hope for, and mortgagees fear, a debtor friendly bench.

5.5 The use of powers for their proper purpose

5.5.1 The origins of the duty

> "In my opinion, the contractual powers arising under the charge are subject to an implied qualification ... namely that they are exercisable only for the purpose of attaining the objectives for which the receiver was appointed. Those objectives, shortly stated, are the preservation, recovery and realisation of the assets subject to the charge in order to satisfy the debt secured by the charge."[221]

This obligation is of uncertain origin. Grantham suggests it is an "application of the wider doctrine of fraud on a power, a doctrine concerned with defining the scope of the power, not with controlling the manner of its exercise."[222] This would seem a reasonable inference, were it not for the fact that the fraud on a power doctrine was developed almost exclusively in the context of *trust powers*. One should, therefore, perhaps question whether the doctrine has any application, in its pure form, to the powers of a receiver. If it has not, what is the explanation for a version of it being adopted by the courts in this domain?

The mortgagee is not a trustee of his power of sale[223], and, therefore, neither is a receiver appointed by him. The power of sale is not conferred upon a mortgagee for the benefit of the mortgagor and in this respect it differs to those powers that might

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[221] *Bank of New Zealand v Essington Developments Pty Ltd* (1990) 9 ACLC 1039, *per* McClelland J.
[222] *The Purpose of a Company Receiver's Powers* [1993] Conv. 401, 401.
[223] *Farrar v Farrars Ltd, supra* n 186; *Tse Kwong Lam v Wong Chit Sen, supra* n 187.

properly be dubbed 'fiduciary' and to which the fraud on a power doctrine has been held to apply. Nonetheless the courts have frequently held that a power of sale may only be exercised for the 'purpose' for which it was granted, that purpose being to realise funds in order to satisfy the mortgage debt. In *Downes v Grazebrook*[224] Lord Eldon ruled that a mortgagee was, *on construction of the mortgage deed in question*, a trustee of the power of sale conferred upon him by that deed. Lord Cottenham, in *Re Bloye's Trust*[225], appeared to consider that Lord Eldon's comments applied generally, and whether or not the mortgage deed constituted the mortgagee a trustee. Stuart VC, in *Robertson v Norris*[226], referred to *Downes v Grazebrook* and continued:

> "That expression [that a mortgagee is trustee of his power of sale] is to be understood in this sense, that, the power being given to enable him to recover the mortgage money, this Court requires that he shall exercise the power of sale in a provident way, with a due regard to the rights and interests of the mortgagor in the surplus money to be produced by the sale. The legitimate purpose being to secure repayment of his mortgage money, if he uses the power for another purpose - from any ill motive to effect other purposes of his own, or to serve the purposes of other individuals - the Court considers that to be a fraud in the exercise of the power, because it is using the power for purposes foreign to that for which it was intended."[227]

The learned judge was not stating that a mortgagee is a trustee of his power of sale, rather he was refining that expression as leading to the application of the 'fraud on a power' doctrine. There is nothing particularly exorbitant about such an advance in

[224] (1817) 3 Mer 200.
[225] (1849) 1 Mac & G 488.
[226] (1858) 1 Giff 421.
[227] *Ibid.* 424.

the law, yet in *Nash v Eads*[228] Sir George Jessel MR launched a scathing attack on Stuart VC's reasoning, rejecting unconditionally the existence of a trust concept and asserting that the mortgagee's "motives" for exercising his power of sale were immaterial. The denial of any form of trust was similarly maintained in *Warner v Jacob*[229].

How, then, to explain the resurrection of the 'improper purposes' application to mortgagees and receivers in cases such as *Re B Johnson* and *Downsview*? None of the more recent decisions asserting that powers may only be so exercised have been concerned with a power of sale, focusing rather upon management powers of receivers. But to distinguish between these two types of power is nonsensical. Both are terms of the debenture contract and the improper exercise of both must surely be unacceptable on the same grounds, *viz.*, that neither would have been conferred had its use for a purpose other than the discharge of the debt been envisaged.

A better explanation is that the application of the doctrine is not reliant upon the power in question being a 'trust' or 'fiduciary' power. Rather, courts of equity have chosen to affix a principle originating in the law of trusts to the law of mortgages because of its suitability to the circumstances, and have done so in the exercise of their inherent jurisdiction to regulate mortgage transactions:

> "...a Court of Equity considers itself competent in this relation between mortgagor and mortgagee to go beyond the contract - to consider what is just and equitable between the parties standing in that relation."[230]

[228] (1880) 25 Sol Jo 95.
[229] (1882) 20 Ch D 220. See also *Martinson v Clowes* (1882) 21 Ch D 857; *Belton v Bass, Ratcliffe and Gretton Ltd* [1922] 2 Ch 449.
[230] *Quarrell v Beckford* (1816) 1 Madd 269, 282, *per* Sir Thomas Plumer VC.

The application of the 'fraud on a power' doctrine to mortgage law stems at least in part from implied term theory, in that it seems clear that the courts recognise that the conferral of wide powers on a mortgagee or receiver cannot be taken to be unqualified. This is really no more than a symptom of equity's adherence to the predominance of substance in the domain of mortgages, its insistence that the transaction is one of security and that all its terms must similarly be treated as devised with that substance in mind.

It comes down to this: the courts' insistence that a mortgagee or receiver may only use his powers with a view to discharging the secured debt does not necessarily stem from the fiduciary nature of those powers, but rather from equity's traditional scrutiny of mortgage transactions and its readiness to develop new principles, or apply established ones by analogy, as a means of policing the agreement. There is a similarity here with the manner in which the courts have cultivated safeguards against a mortgagee or receiver selling the mortgaged property to a connected party. Such conduct is scrutinised not because a *trust* power is being exercised but rather because the power itself is of such a nature that it may be abused by an unscrupulous mortgagee, and it is part of equity's vocation to forestall such abuse.

5.5.2 The substance of the duty

The duty to use powers for their proper purpose has been applied in a variety of situations. Examples include: the exercise of a power of sale in order that the mortgagee might gain *de facto* control of a mortgaged newspaper[231]; a receiver exercising management powers to trade a company on, at the behest of his

[231] *Robertson v Norris, supra* n 226.

debenture-holder and the Crown, as part of an employment protection policy[232]; a mortgagee's holding of an auction in order to ascertain the highest price likely to be offered, and the subsequent exercise of its power of sale to a subsidiary for a marginally higher sum, that conduct actuated by the mortgagee's desire to maintain the mortgaged hotel as a part of its own group[233], and; the appointment of and subsequent exercise of management powers by a receiver in order to prevent a second mortgagee from enforcing its own security[234].

The remedial consequences of the improper exercise of a power of sale are primarily the setting aside of the impugned transaction, although this appears to be subject to the rights of third parties. The improper exercise of other powers may give rise to a remedy in damages, and this was the route taken by Lord Templeman in *Downsview Nominees.* Grantham, however, cogently questions his reasoning in this respect, pointing out that the doctrine to which his Lordship had recourse is concerned not with the manner of exercise of a power but rather with its scope. After a review of the authorities he states:

> "In essence, therefore, the fraud on a power doctrine is a manifestation of the same principle that underlies the rules in agency that determine the scope of the agent's authority, and *ultra vires* in public law."[235]

Thus one must distinguish between an excess of power and an abuse of it, the latter seeming to roughly correspond with a want of good faith and the former relating to an exercise for an improper purpose. The remedial consequences are dissimilar, an abuse of power giving rise to rescission or damages, an excess of power simply

[232] *McKendrick Glass Co v Wilkinson* [1965] NZLR 721.
[233] *Latec Investments Ltd v Hotel Terrigal Pty (In Liquidation)* (1965) 113 CLR 265.
[234] *Downsview Nominees, supra* n 188.
[235] *The Purpose of a Company Receiver's Powers, supra* n 222, 406.

rendering the exercise void[236]. In the context of a mortgagee's use of power for an improper purpose the courts appear to have overlooked this potentially critical matter, their remedial response being an award of damages or the setting aside of the transaction in question. If Grantham is correct, and what the courts are applying here is the fraud on a power doctrine, it would therefore appear that they have done so imperfectly, and without due attention to the wider implications of the doctrine.

It is submitted that this anomaly can best be explained by acknowledging that what is being applied is something less than the fraud on a power doctrine in its unadulterated form. Whilst this particular rule may owe its origin to that principle, the version in operation views an exercise of power for improper purposes as an *abuse* rather than an *excess* of power,' with the consequence that the remedies available are those which would attach to the former rather than the latter. What the courts are applying is a rule of equity especially tailored to the control of the mortgagee/mortgagor relationship, which explicitly accepts that the mortgagee is not a trustee of his powers and that, as a corollary, it would be inappropriate that a tenet developed in relation to trust powers should take effect in its most stringent form. This distinctive principle treats an improper exercise of power as an abuse, so that the mortgagee's default gives rise to a remedy in recission or damages.

A final observation about this particular component of a mortgagee's or his receiver's duties to the company should be made, and that is that it roots the institution of receivership firmly in the debt enforcement camp so that, if strictly implemented, it could be severely deleterious to any 'rescue' function. For instance, should a receiver pursue a going concern sale in order to save jobs, and in doing so

236 *Ibid.* 408.

incur further debts on the company's behalf, it is at least theoretically possible that he has exercised his powers for an improper purpose. Should his strategy fail and leave the company in a worse position, the company can sue for breach of duty[237]. Further, if the debenture-holder has sanctioned this conduct it may be that he too is indirectly liable, for whilst the agency status of the receiver would ostensibly protect him from vicarious liability, the possibility of the company suing in tort for his inducement of a breach of contract should not be ruled out. As yet this possibility has not been fully explored in the courts, and may have escaped the attention of both receivers and their appointors. To the extent that it represents a practical check on the potential for a rescue goal in receivership, it must surely be considered aberrant.

5.6 Contract and status based duties - an evaluation.

> "Today, while it is necessary to look back before the Judicature Act to discover broad principles on which equity would grant relief, it may not be helpful to seek to find out from the cases what a Court of Equity would have done in a similar case. Application of that principle should be reached by a consideration of what today would be regarded as fair or just."[238]

It is difficult to discern where contract ends and status begins in the courts' determination of the duty configuration in the tripartite relationship. Their frequent resort to status may reflect the fact that the contract in question is largely silent on the duties that are owed by receiver to company and that statute has omitted to fill the gaps. On those occasions where a contractual analysis has been employed,

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[237] This was in effect what occurred *McKendrick Glass Co v Wilkinson, supra* n 237.

[238] *British Anzani (Felixstowe) Ltd v International Marine Management (UK) Ltd* [1979] 2 All ER 1063, 1076, *per* Forbes J.

implied term theory has had to be pressed into service, but more often the courts have preferred to invoke status as the conclusive factor.

This would not be unsatisfactory if the status in question were that of *receiver* and if, as the institution demands, the courts were prepared to conduct a detailed enquiry into the impact of receivership and the nature and varying modes of exercise of the receiver's powers. Such might well acknowledge the supremacy of the debenture-holder's claim but at the same time concede that there are occasions when policy demands that the interests of the company might expediently be served, even though this would not result in an out and out prioritisation of the debenture-holder. In the implied term model constructed above[239] it was tentatively suggested that a duty framework based on an investigation of policy issues of *receivership* might result in the following:

a) The receiver should at all times consider the impact of his choices and actions on the company. Where a particular course would benefit the company without prejudicing the debenture-holder the receiver is bound by his duty to the company to take that course;

b) Where a particular strategy would maximise realisations without permanently jeopardising the interests of the debenture-holder the receiver is duty-bound to adopt that strategy;

c) Where a particular strategy would result in a loss to the company excessively disproportionate to the debenture-holder's gain, the receiver's duty to the

[239] *Supra* 149.

debenture-holder demands that he nevertheless adopt that strategy, unless the debenture-holder agrees otherwise;

d) Whether the debenture-holder and company's interests conflict or coincide, the receiver is at all times under a duty to exercise skill and care in the carrying out of his task.

The status based approach would appear to result in a different outcome. The duty of good faith would correspond to proposition a) above, in that a failure to look to the interests of the company in such circumstances would amount to a wilful, reckless, or needless sacrifice of those interests. Good faith would *not* impose upon the receiver any duty similar to that suggested by proposition b), however, for it is inherent in the good faith standard that the mortgagee, and so his receiver, may look to his own interests first, and if he considers them to be best served by *immediate* repayment he is entitled to pursue that goal. Nor would the duty to take reasonable steps to obtain a proper price demand a temporary elevation of the company's welfare. The overwhelming weight of the case law supports the proposition that a mortgagee is under no duty to refrain from exercising a power of sale in pursuance of this duty. Further, it may be that the 'duty' to exercise powers only for their proper purpose might be breached where maximum realisations are solicited in order to benefit the company rather than discharge the debt, as would be the case here, although this is only likely to be an issue if the receiver's scheme fails.

Proposition c) is supported by a status based approach, as the latter is rooted in the understanding that the mortgagee's interests have priority notwithstanding that their prominence may result in the total disintegration of the mortgagor, and, again, the proper purpose qualification on the exercise of powers would militate against a course of action that was not designed to achieve maximum repayment. In relation to proposition d), recent developments suggest that such a duty is indeed owed. The decision of the Court of Appeal in *Medforth v Blake*[240] will be analysed in detail shortly. Prior to this decision, however, status made no allowance for a duty of skill and care, except to the extent that this was inherent in the duty to take reasonable steps to obtain a proper price.

Status, then, produces a duty structure far less exacting than the implied term model. The essential difference between the two origins is that the former takes as its basis the status of *mortgagee* whereas the latter assumes that the courts would proceed from a policy and impact based appraisal of *receivership.* Here we return to the ostensible dichotomy between debt enforcement and rescue. A mortgagee's duties were imposed by equity on the express understanding that they related to powers which were essentially enforcement driven. They were directed at protecting the mortgagor's equity of redemption from an overly ruthless promotion of the mortgagee's right to be repaid, but at no time contemplated any erosion of that right. Fundamentally, they are concerned with a bilateral relationship and admit of no consideration of a wider focus than who has first call on property and to what extent he can exploit that superior privilege without taking account of the residual claimant.

It is perhaps understandable that this approach should have been taken. The *commercial purpose* of receivership, a consideration to which the courts, rightly, have the utmost regard, is debt enforcement, the receiver's ultimate goal being precisely the same as that of the mortgagee entering into possession with a view to

[240] [1999] 3 All ER 97.

sale of the property or collection of the income from it. But it is there that the similarity ends. Mortgage law was developed and refined long before the limited liability company saw the light of day and equity conceived of the floating charge. Its foundation was predominantly concerned with transactions in land, and most often between individuals. The resemblance between the 18th and 19th century mortgagor and the contemporary company is faint to say the least, so too that between the mortgagee of those times and today's banks, to whom lending is a finely-tuned business operation.

Granted, the underlying concept is the same, but consider the manner in which mortgage law has been adapted to accommodate the needs of society in the context of home ownership. In this respect both the courts and the legislature have recognised and addressed the fact that expediency, in the form of social policy, demands that the legal approach of a century ago be discarded where such is clearly inappropriate to the calls of a more modern age. The Cork Report persistently emphasises that the wider questions raised by insolvency are no longer suitably solved by resort to the legislative response and judicial decisions of earlier times:

> "The answers given by English law today ... do not seem to us, or to many of those who gave evidence to us, to be in tune with modern needs, but to be responses to economic conditions and attitudes prevalent over 100 years ago ... We're convinced that the systems ... no longer work satisfactorily. They do not accomplish what is required of them; moreover, they no longer accord with what the general public conceive to be the demands of fairness and justice to all in modern society."[241]

[241] *The Cork Report, supra* n 75, paras. 8 - 9. See also, to similar effect, paras. 24, 25, 110, 195, 212, 777.

The Parliamentary rejoinder to that Report, in the Insolvency Act 1986, was the creation of the administrative receiver[242], an entity so far removed from the latter-day mortgagee that it seems bizarre that a comparison such as the courts have made should be drawn. The administrative receiver is a professional and suitably qualified individual. He is given powers of management of such scope that he is able to expropriate those of the company's directors. He is required to deal with the company's unsecured creditors, its preferential creditors and its employees. He is under an obligation to investigate the conduct of the company's directors and given broad investigatory powers in this respect. He may demand utility supplies. He can potentially sell property subject to a prior security interest if such is likely to result in an enhanced level of realisations. Yet in terms of those duties he owes to the company, he is treated by the courts as a mortgagee. Little wonder that Hogan considers such a position "antiquated" and "ludicrous"[243].

Receivership is an institution of such originality and import that it merits judicial consideration on its own terms, rather than by reference to mortgage law. This is especially the case after the Cork Report, with its emphasis on receivership as a potential rescue mechanism. The courts have done it a major disservice by viewing it in such narrow terms, and without regard to the rudimentary differences between a mortgagee selling a single piece of property to discharge a debt and a chargee appointing a professional as helmsman of a corporation. The two situations are incomparable. They should be treated as such.

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[242] Or, rather, the redesignation of the receiver and manager appointed under a floating charge.
[243] *Receivers Revisited*, (1996) 17 Co. Law 227, 230.

6. Duties of skill and care: a step in the right direction?

6.1. The legal background: all roads lead to Downsview

In *Re B Johnson & Co (Builders) Ltd*[244] the chairman of a company had the temerity to suggest that its receiver owed a duty to the company and its contributories to preserve its goodwill and business. This claim was peremptorily dismissed by the Court of Appeal:

> "In a word, in the absence of fraud or *mala fides* ... the company cannot complain of any act or omission of the receiver and manager, provided that he does nothing that he is not empowered to do, and omits nothing that he is enjoined to do by the terms of his appointment."[245]

These comments, albeit *obiter*, are unequivocal. The *only* duty owed by a receiver to the company over whose assets he is appointed are to act in good faith and to exercise his powers for a proper purpose, and the possibility of liability in the tort of negligence is implicitly rejected.

Tortious duties were similarly ruled out in *Expo International Pty Ltd v Chant*[246], and this time explicitly. Needham J condemned the illogicality of treating a receiver's duties as different depending upon whether powers of sale or management were being exercised, considered that the receiver's position was to be assimilated with that of a mortgagee and concluded:

> "...in the administration of the receivership, a receiver is not liable to answer to the mortgagor for losses caused by the negligent performance of *bona fide* acts."[247]

By this time the English courts had identified the existence of a duty to take

[244] [1955] Ch 634.
[245] *Ibid.* 663, *per* Jenkins LJ.
[246] [1979] 2 NSWLR 820.
[247] *Ibid.* 835.

reasonable steps to obtain a proper price incumbent upon a mortgagee when exercising his power of sale[248]. Furthermore, they had seemingly sourced this duty in the tort of negligence. Salmon LJ's judgment in the *Cuckmere* case is particularly redolent of the language of negligence:

> "The mortgagor is vitally affected by the result of the sale but its preparation and conduct are left entirely in the hands of the mortgagee. The *proximity between them could scarcely be closer. Surely they are "neighbours".*"[249]

Some have questioned whether the Court of Appeal in this case were doing no more than reviving a component of the *equitable* duty of good faith[250]. With respect, this seems untenable. Not only does the language of Salmon LJ smack unmistakably of tortious liability, but so does his formulation of the content of the obligation, that being to take *reasonable steps to obtain a proper price.* Moreover, the facts of the case support the proposition that the Court of Appeal envisaged liability being based on negligent conduct. The property was undersold because it had been inaccurately described in advertising material, and there is no hint in any of the judgments that this default was viewed as anything other than mere carelessness. Subsequent courts smoothly accepted the 'proper price' duty as tortious in origin. Furthermore, when the duties of a *receiver to the company* were in issue the same approach was adopted, both in relation to the exercise of sale and of management

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248 *Cuckmere Brick, supra* n 160.
249 *Ibid.* 966 (italics added).
250 See, especially, Bentley, *The Mortgagee's Duties on Sale - No Place for Tort?* [1990] Conv. 431.

powers[251]. A note of dissent was, however, sounded in *Parker-Tweedale v Dunbar Bank plc*[252]. Nourse LJ put the matter thus:

> "In my respectful opinion it is both unnecessary and confusing for the duties owed by a mortgagee to a mortgagor and surety ... to be expressed in terms of the tort of negligence ... the duty owed by a mortgagee to a mortgagor was recognised by equity as arising out of the particular relationship between them..."[253]

Considerable emphasis has since been placed upon this case, more, it is submitted, than it actually warrants. The somewhat neglected judgment of Purchas LJ can be read as at least partially supportive of tortious liability, albeit that such should be imported only after adequate regard to the contractual background. The learned judge certainly did not expressly rule out a duty of care between mortgagee and mortgagor, and made no determination upon whether the contractual basis of that relationship admitted of any such duty. Nevertheless, the approach of Nourse LJ was vigorously endorsed by Lord Templeman in *Downsview Nominees v First City Corporation*[254].

Downsview is, with respect, a troublesome decision. Briefly, the facts concerned the receivership of a motor dealer, the receiver in question engineering his own appointment by persuading an associate (Downsview) to take over a first debenture and so remove from office the receivers of a subsequent debenture-holder. The

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[251] It is not proposed to chronicle these developments in any detail. Support for negligence liability as concerns both mortgagees and receivers can be found in *Duke v Robson* [1973] 1 WLR 267; *Johnson v Ribbins* (1975) 235 EG 757; *Alexandre v NZ Breweries* [1974] 1 NZLR 497; *Bank of Cyprus (London) Ltd v Gill* [1980] 2 Lloyd's Rep. 51; *Standard Chartered Bank v Walker*, *supra* n 87; *American Express v Hurley*, *supra* n 86; *Predeth v Castle Phillips Finance Co Ltd* [1986] 2 EGLR 144; *Bishop v Bonham* [1988] 1 WLR 742 (holding that *negligence* liability may be excluded in the mortgage deed); *Palk v Mortgage* Services, *supra* n.204; *Rottenberg v Monjack* [1993] BCLC 374; *Knight v Lawrence* [1993] BCLC 215.

[252] [1990] 3 WLR 767.

[253] *Ibid.* 773.

[254] [1993] AC 295.

second defendant, now receiver, then proceeded with his scheme to trade the dealership out of its financial difficulties, a strategy that had been predetermined and was the motive behind the entire project. It failed spectacularly, the receiver running up trading debts to such a degree that the potential realisation value of the charged assets was easily outstripped by the amount owing on the first debenture. Not surprisingly, the second debenture-holder sued. In the New Zealand courts, both at first instance and on appeal, it was held that the second defendant was liable to the second mortgagee in negligence, in that he had failed to exercise reasonable care in his conduct of the receivership. The Privy Council raised no objection to the *outcome*, but Lord Templeman, entirely of his own volition, chose to realign the duties owed by receiver to company with the framework proposed for mortgagees by Nourse LJ in *Parker-Tweedale.* He did so in the following terms:

> "The general duty of care said to be owed by a mortgagee to subsequent encumbrancers and the mortgagor in negligence is entirely inconsistent with the right of a mortgagee and the duties which courts applying equitable principles have imposed on a mortgagee ... a receiver exercising his power of sale also owes the same specific duties as a mortgagee. But, that apart, the general duty of a receiver and manager appointed by a debenture-holder ... leaves no room for the imposition of a general duty to use reasonable care in dealing with the assets of the company. The duties imposed by equity on a mortgagee and on a receiver and manager would be quite unnecessary if there existed a general duty of care in negligence to take reasonable care in the exercise of powers and to take reasonable care in dealing with the assets of the mortgagor company."[255]

[255] [1993] AC 295, 315.

Whilst the decision may not be binding on an English court, and whilst Lord Templeman's comments are wholly *obiter*[256], *Downsview* has been followed in New Zealand in *Moritzson Properties Ltd v McLachlan*[257].

6.2. Downsview and downsides: reactions

Downsview has been variously described as 'amazing'[258], "a remarkable departure from the position recognised in previous authorities"[259], "flawed"[260], and "The most retrograde step in recent times..."[261]. Considering the force with which Lord Templeman delivered his opinion, his determination to focus on an issue that had not been raised in the pleadings, and his complete disregard of recent authority to the opposite effect, one might be forgiven for thinking that he had an agenda of his own. His reliance on *Re B Johnson* for the proposition that a receiver owes no duty other than that of good faith and to act for proper purposes seems odd when one reflects upon the tenor of the Cork Report to the effect that administrative receivers should be qualified and called upon to act competently[262].

One analysis of *Downsview* is that Lord Templeman's ruling was directed less at the appropriateness of the imposition of liability on receivers for failing to exercise skill and care, and rather more at restraining the expansion of negligence as a cause of action *per se.* As Hogan puts it:

> "...the chief justifications for the [decision] ... are clearly grounded in policy. It is part of the general retreat from grounding liability in the tort of negligence that has

[256] Liability attached to the receiver as a result of his exercise of power for an improper purpose.
[257] [1994] 3 NZLR 250.
[258] Milroy, *Receivers' Negligence* [1993] NZLJ 88, 88.
[259] Doyle, *supra* n 39, 271.
[260] Lightman and Moss, *supra* n 66, para. 7.13.
[261] Lightman J, *The Challenges Ahead : Address to the Insolvency Lawyers Association* [1996] JBL 113, 119.
[262] See the Cork Report, *supra* n 75, para. 788(b).

occurred over the last decade and from allowing an action in tort when it is believed that there is a perfectly adequate remedy in some other cause of action."[263]

There is some force in this contention. Certainly the case was decided at a time when the negligence 'backlash' would have still been fresh in the judicial memory, and Lord Templeman himself had evinced a healthy distaste for extensive tortious liability in relation to the liability of a mortgagee to a guarantor only three years earlier[264].

His Lordship, however, catalogued other basic objections to the imposition of tortious liability upon receivers. The first was that liability in negligence would result in detrimentally defensive practice on the part of receivers:

> "A receiver and manager liable in negligence will be tempted to sell assets as speedily as possible for the purpose of repaying the mortgage debt..."[265]

Secondly, he appeared to have recourse to a 'fusion-fallacy' argument: in essence, given that equity has defined the incidents of the mortgagee/mortgagor relationship, the super-imposition of common law principles would be both unnecessary and unwarranted:

> "The general duty of care said to be owed by a mortgagee ... in negligence is entirely inconsistent with the right of a mortgagee and the duties which courts applying equitable principles have imposed on a mortgagee..."[266]

Thirdly, Lord Templeman clearly considered that tortious liability would compromise the receiver's primary obligation to the debenture-holder[267]. Finally, he suggested that, in any event, adequate alternative remedies existed, and that an

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263 *Developments After Downsview* (1996) 12 Insol. Law and Practice 182, 183.
264 *China v South Sea Bank Ltd v Tan Soon Gin* [1990] 1 AC 191.
265 [1993] 1 AC 295, 316.
266 *Ibid.* 315
267 *Ibid.* and see Lightman and Moss, *supra* n 66, 7.13.

administration order would mitigate the "possible harsh consequences to a company of receivership."[268]

A number of rebuttals could be made to all four of these points. Confines of space do not allow for them to be propounded here. In fact, a more detailed analysis of Lord Templeman's reasoning is rendered unnecessary, as a recent decision of the Court of Appeal has 'rewritten the receivership manual' as it were, and, it is submitted, gone some way to redressing the potential injustices *Downsview* engendered. It is considered in the next section.

6.3 Medforth v Blake and the equitable duty of skill and care

6.3.1 Introduction

Following *Downsview*, it appeared established that a receiver who was careless in his management of the charged assets could not be held to account by the company. That Mr Medforth chose to challenge the conduct of the receivership of his pig farm might therefore be viewed as surprising. It is certainly fortuitous, as the outcome of that challenge is the imposition of an *equitable duty of skill and care* on receivers, and, indeed, on mortgagees in the unlikely event that they take possession of the mortgaged property.

In *Medforth v Blake*[269] the Court of Appeal was asked to determine whether the forfeiture of discounts on pig feed by receivers appointed over the farm in question amounted to a breach of duty on their part to the mortgagor/farmer. Whilst concurring with Lord Templeman's view in *Downsview* that receivers owe

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[268] [1993] 1 AC 295, 316.

[269] [1999] 3 All ER 97 (hereinafter *Medforth*).

equitable rather than tortious duties, Scott VC, giving the only judgment[270] concluded that a duty to manage charged property with *due diligence* is owed. This duty was later expressed in terms of an *equitable duty of care.*

The judgment of Scott VC is interesting in several respects[271]. Firstly, it resurrects the seemingly superannuated principle of wilful default liability[272] and applies it to receivers. This is notable in that it is consistent with the tendency of the courts to attribute the status-based duties of a mortgagee to a receiver, but, in this instance, Scott VC displayed admirable regard to the *context* in which the dispute arose. Secondly, the learned judge displayed some impatience with Lord Templeman's insistence on an adherence to the mantra that the regulation of the mortgage transaction is the sole territory of equity, whilst at the same time locating the receiver's duty in that very source. Thirdly, the judgment is commendable in that it strikes a balance between the primacy of the debenture-holder in the receiver's deliberations and the right of the company to see its affairs conducted with competence during the course of the receivership.

6.3.2 Determining duties with regard to context

> "The proposition that, in managing and carrying on the mortgaged business, the receiver owes the mortgagor no duty other than that of good faith offends, in my opinion, commercial sense ... if [the receiver] does decide to carry on the business why should he not be expected to do so with reasonable competence?"[273]

This rhetorical question underpins Scott VC's entire judgment, and, it is submitted, is an appropriately concise expression of the central difficulty with the position

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[270] Swinton Thomas and Tuckey LJJ concurring.

[271] See, generally, Frisby, *Making a Silk Purse out of a Pig's Ear* (2000) 63 MLR 413.

[272] See Chapter 1, 16

[273] *Medforth, supra* n 75, 103, *per* Scott VC.

enunciated in *Downsview.* A number of commentators have made the same enquiry in different terms[274], and the fact that a company in receivership would have no remedy against its receiver's incompetence is surely the basic flaw of Lord Templeman's judgment.

Essentially, Scott VC's question answers itself: there is *no* good reason why a receiver should not be expected to exercise skill and care in his administration of the company's estate. Much of the reasoning upon which *Downsview* is based falls by the wayside on close analysis. The idea that receivers would be detrimentally defensive in their actions in order to avoid liability is countered by an assertion that they *already* owe a duty of care *to their appointors*, as noted by Scott VC[275]. In other words, if careless conduct results in a reduced level of realisations that same conduct would be actionable at the suit of the debenture-holder. 'Shutting up shop' in order to avoid liability, as envisaged in *Downsview*, would be equally actionable to the extent that continuing the business would have resulted in a greater proportion of the secured debt being discharged.

Moreover, the supremacy of equity in the realm of mortgage law was vindicated by Scott VC's equation of the position of a receiver with that of a mortgagee. Thus, he was able to import the notion of liability for wilful default:

> "...a mortgagee in possession would be accountable to the mortgagor on the footing of wilful default – that is to say the mortgagee must be treated as having received sums that he would have received had he managed the property with due diligence."[276]

[274] See. e.g., Rajak, *Can a Receiver be Negligent?* in Rider (ed), *The Corporate Dimension* (1998 : Jordans : Bristol), 142-143; Lightman and Moss, *supra* n 66, 7-13; Goode, *supra* n 7, 242.
[275] *Supra* n 269, 102.
[276] *Ibid.* 102.

The learned judge went on, with inexorable logic, to invoke Lord Templeman's assertion in *Downsview* that a receiver owes the same specific duties as a mortgagee to endorse the former's liability for wilful default. Support for this proposition could be found in *Knight v Lawrence*[277], where conduct which would have amounted to wilful default by a mortgagee in possession resulted in a receiver being held liable, albeit mistakenly in negligence.

Thus a pristine doctrine is maintained, in that equity continues to be the sole regulator of a status-based relationship, only the relationship in question is that of *receiver/company* rather than mortgagee/mortgagor. In any event, Scott VC showed little concern for the purist attitude:

> "I do not, for my part, think it matters one jot whether [the receiver's] duty is expressed as a common law duty or as a duty in equity. The result is the same. The origin of the receiver's duty, like the mortgagee's duty, lies, however, in equity and we might as well continue to refer to it as a duty in equity."[278]

Moreover, the *Medforth* duty is in no way inconsistent with the receiver's cardinal obligation to promote his appointor's welfare. A duty, whether equitable or tortious, to exercise skill and care should not have any such effect. It does not enjoin a receiver to prefer the interests of the company to those of the appointor, it merely requires decisions to be competently taken. What is targeted is *careless* behaviour, rather than a deliberate course of conduct that will benefit the appointor whilst inevitably damaging the company. *Medforth* does not purport to alter the balance of power between debtor companies and debenture-holders.

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277 [1991] BCC 411.
278 *Supra* n 269, 111.

Scott VC had nothing to say on Lord Templeman's opinion in *Downsview* that adequate remedies existed to protect the debtor company. As far as proffering administration as such is concerned, Lightman and Moss pointedly observe that an administration order is not an option once a receiver has been appointed[279]. Moreover, the Cork Committee's recommendation that administrative receivers be suitably qualified and authorised[280] was prompted partly by a recognition that the company, and its constituents, may be vitally affected by the receiver's competence or otherwise[281]. Requiring a practitioner to attain a high level of proficiency and then absolving him from the consequences of failing to utilise it is aberrant. *Medforth* neutralises this anomaly admirably.

6.3.3 The law according to *Medforth*

According to Scott VC, principle and authority supported the following propositions as regards the duties owed by a receiver to the company/mortgagor:

> "(1) A receiver managing mortgaged property owes duties to the mortgagor and anyone with an interest in the equity of redemption.
>
> (2) The duties include, but are not necessarily confined to, a duty of good faith.
>
> (3) The extent and scope of any duty additional to that of good faith will depend upon the facts and circumstances of the particular case.
>
> (4) In exercising his powers of management the primary duty of the receiver is to try and bring about a situation in which interest on the secured debt can be paid and the debt itself repaid.
>
> (5) Subject to that primary duty, the receiver owes a duty to manage the property with due diligence.

[279] *Supra* n 66, 7-13.
[280] Subsequently enacted in Part XIII Insolvency Act.
[281] Cork Report, *supra* n 75, para. 189.

(6) Due diligence does not oblige the receiver to carry on the business on the mortgaged premises previously carried on by the mortgagor.

(7) If the receiver does carry on a business on the mortgaged premises, due diligence requires reasonable steps to be taken in order to try and do so profitably."[282]

How far does this statement of the law differ from those pronounced in earlier courts? Clearly, the most striking 'development' is the identification of what amounts to a tortious duty of care in all but name. A further, less conspicuous shift in emphasis relates to the duty of good faith. It was suggested earlier that the content of this duty cannot be stated with precision, and that much will depend upon the facts of the case, and the judicial view of those facts. Scott VC's remarks on this duty merit attention, not least because they would appear to 'narrow' the scope of the good faith duty to a considerable extent:

> "I do not think that the concept of good faith should be diluted by treating it as capable of being breached by conduct that is not dishonest or otherwise tainted by bad faith ... In my judgment, the breach of a duty of good faith should, in this area as in all others, require some dishonesty or improper motive, some element of bad faith, to be established."[283]

This is interesting, not least because, on the facts pleaded, the receivers in *Medforth* might, under the previous law, have been found to be in breach of their undoubted duty of good faith. They were aware of the possibility of discounts being available on the pig feed they ordered, but chose not to seek them: this smacks of 'recklessness', or a 'wilful sacrifice of the mortgagor's interests'[284]. The conduct was, however, characterised as a breach of the equitable duty of *diligence*, or *skill*

[282] [1999] 3 All ER 97, 110.
[283] [1999] 3 All ER 97, 112.
[284] See *Kennedy v De Trafford* [1897] AC 180.

and care, rather than good faith. The critical point is that the very identification of the former duty means that the scope of the latter need not be artificially extended in order to penalise conduct that would otherwise escape sanction. This is, it is submitted, a further advantage of the *Medforth* decision, in that it clearly demarcates two types of illegitimate action, dishonesty and carelessness, and, in delineating the good faith standard, will hopefully ensure that its integrity is maintained in future.

6.3.4 The equitable duty: some final thoughts

Perhaps the only weakness in the *Medforth* judgment is its failure to state with precision the substantive content of the equitable duty of skill and care. Scott VC stated that its extent and scope would depend upon the facts of a given case, and it is therefore difficult to predict the level of care required to discharge it. A comparison in this regard might be made with the duty to take reasonable steps to obtain a proper price on the sale of mortgaged assets[285]. Receivers taking over and running a mortgaged business might therefore be expected to familiarise themselves with the basic operations of that business, and to take advice where necessary, in much the same way as a 'selling' receiver is expected to investigate the value of and appropriate market for the property in question.

Beyond that it is difficult to second guess the kind of circumstances in which the equitable duty will be breached. It therefore has the benefit of flexibility but the affiliated drawback of uncertainty. The danger is that the identification of this 'new'

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[285] See *supra* 168.

duty will prompt its beneficiaries to test its limits through hopeless and expensive litigation which will serve only to further deplete an already overstretched estate[286]. This potential problem can be countered by a robust and pragmatic approach by future courts asked to apply the *Medforth* principle, and if a clearly defined obligation can be constructed through case law, then all parties will benefit. Receivers will be subjected to a practical duty that will not interfere with their business judgment, and those affected by receivership will be protected against obviously careless conduct, whilst not having their expectations elevated to a commercially unrealistic level.

In the final analysis, *Medforth* represents a major progressive step in 'receivership' law. Cases such as *Newhart Developments Ltd v Co-operative Commercial Bank*[287] and *American Express International Banking Corp. v Hurley*[288] address questions arising during receivership *by reference to the nature of the institution.* The formulaic application of technical rules of property or mortgage law underpinning, but no longer strictly relevant to, receivership is discarded in favour of a recognition that the regime is unique, and that its utility has outstripped its origins in recent times. Bespoke solutions are called for, and delivered, in *Newhart* and *Hurley. Medforth* proceeds in the same spirit, and Scott VC's judgment is to be commended on that basis alone.

It updates a useful but outmoded doctrine, that of wilful default liability, and fashions it into an obligation which should, if handled with care, achieve a

[286] Although it should be recalled that directors commencing actions may be required to give an indemnity against costs; see *supra* 105.
[287] [1978] 2 WLR 636.
[288] [1985] 3 All ER 564.

justifiable level of protection for companies in receivership whilst maintaining its commercial attractiveness for financial institutions. In this regard, if not in others, receivership is finally delivered into the twenty first century.

The Tripartite Relationship - Final Thoughts

The foregoing sections have attempted to illustrate the manner in which the courts have approached the question of the duty construct within the tripartite relationship. What emerges is an unfortunate preoccupation with the 'wrong' status - that of mortgagee - rather than a robust and policy driven attempt to reconcile the tensions produced by the relationship itself. The Insolvency Act was, at least in part, an attempt to take receivership law out of the nineteenth century, but one is left with the impression that nineteenth century law has yet to be taken out of receivership.

As an institution, it is still viewed as a debt enforcement mechanism. This is inevitable. The Insolvency Act itself contains no provisions that might persuade a court to pursue a more 'rescue propelled' approach when determining what duties the receiver owes to the company. Even the Cork Committee, who clearly envisaged the possibility of a 'rescue' role for receivership, hesitated at recommending any express erosion of the receiver's 'primary' duty to his appointor in order to achieve a more global apportionment of the receiver's obligations.

It is implicit in their Report that within the tripartite relationship the debenture-holder remains supreme in the receiver's deliberations. Nonetheless, that precedence need not always demand that the company's interests are of no consequence, and it is only in situations of obvious and irreconcilable conflict that they become irrelevant.

In the end, the categorisation of the receiver's duties as 'primary' and 'secondary' (as owed, respectively, to debenture-holder and company) is perhaps a little misleading, to the extent that it suggests the latter only operates when the former is not being pursued. It is more accurate to affirm that the receiver owes concurrent duties to both parties, but that the scope and content of his duty to the company is dependent upon and circumscribed by that owed to the debenture-holder. This is, roughly, the approach the courts have taken. What the receiver must do when pursuing his goal of discharging the secured debt is decided by reference to that goal, and his duty to preserve the welfare of the company cannot ever take precedence over it. Rescue, therefore, remains an incidental result of the main focus of receivership, and the courts have sanctioned this conclusion consistently enough to suggest that a change in emphasis in future is unlikely without legislative intervention[289].

This is unobjectionable, given the clear signal of the Cork Report and the Insolvency Act itself that the rights of secured creditors were not to be lightly interfered with. What *is* unsatisfactory with the present law is that it fails to explore, on a principled basis, the possibility of a receiver owing duties to the company which would require him to promote its interests where those of the debenture-holder are not, or are only marginally threatened. Thus it remains the law that he would appear to be under no obligation to pursue a going concern sale rather than an asset sale, even where the former would result in a better level of realisations, if the debenture-holder can be paid off by the latter. Similarly, he can pick and choose assets to sell without reference to their value to the company, and notwithstanding

[289] As to which see Chapter 5.

that the sale of several non-essential assets would realise sufficient to discharge the secured debt and allow the company to continue trading afterwards.

This position is surely untenable in today's economic climate. It is one thing for the law to uphold the rights of secured creditors in priority to those of debtor companies, quite another to make no attempt to ensure that such is achieved in a proportionate manner. The professional acumen of the modern receiver should at least be required to be utilised to best effect, given that his capacity to influence the outcome of a receivership impacts upon so many parties. Receivers have the skills, the knowledge and the expertise to achieve more than the law appears to require of them.

CHAPTER 3

RECEIVERS AND THIRD PARTIES: THE EXTERNAL DIMENSION

Introduction

The preceding two Chapters consider the 'internal' aspects of receivership. The agency relationship between receiver and company, and the tripartite relationship comprising receiver, company and debenture-holder, have as their basis a contractual foundation from which the courts, having regard to the *purpose* of that contract, have assembled a duty structure designed to aid the accomplishment of that purpose.

It emerges therefrom that the receiver's cardinal concern is the advantage of his appointor, and to the extent that the pursuit of this advantage necessitates impairment of the company as an economic entity the law's response is "so be it". This position is unqualified by considerations of the proportionate detriment and benefit to company and debenture-holder of a particular course of action. In any competition between company and appointor for the receiver's allegiance, the latter triumphs uncompromisingly.

There is perhaps a certain rough justice in this position. Receivership is, after all, a symptom of the company's failure to meet its obligations to the debenture-holder, obligations it freely incurred in an arm's length arrangement. To expect a solicitous response from either the law or the lender in these circumstances is unrealistic. Banks are commercial enterprises[1] and it is not the function of the courts to force

[1] See *National Westminster Bank plc v Morgan* [1985] 1 All ER 821, 825, *per* Lord Scarman.

them to behave otherwise, as to do so might have deleterious effects on the availability and cost of loan capital to non-defaulting companies, and so to the UK economy as a whole. Implicit in the jurisprudence of this area is a recognition that any erosion in the ability of lenders to recover money owed to them, especially if inspired by judicial tenderness towards the debtor, has repercussions outside the immediate transaction in question. The Cork Committee were resolute in this regard:

> "A sound banking and financial system is essential for the prosperity of the nation. It facilitates the exchange of goods and services and enables the most efficient use to be made of human and material resources. The provision of credit for trade and industry stimulates production and encourages enterprise as well as helping individuals and businesses over difficult economic times. These factors must in turn be matched by an acceptance by all involved that the sanctity of contract is fundamental to the existence of business relations and that unless businessmen maintain a sense of financial responsibility and integrity, trading will be drastically curtailed and the economy suffer accordingly."[2]

Moreover, there is a sense that defaulting borrowers, when left to the mercy of a receiver, get no more than their just desserts:

> "The foundation of the whole credit world and the maintenance of respect for the legal structure surrounding it, rests upon a belief in the sanctity of contract; the parties involved, as borrower, as guarantor, or in any other capacity, must clearly understand that a failure to repay can result in the application of some form of effective sanction."[3]

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[2] *Insolvency Law and Practice: Report of the Review Committee* Cmnd. 8558, (1982 : HMSO : London), para. 20 (hereinafter the Cork Report).
[3] *Ibid.* para. 21.

This deference to the contractual arrangements of company and debenture-holder provides an ostensibly credible rejoinder to the charge that receivership is 'unfair' to the former, since it is, in law, taken to have accepted the appointment of a receiver as a consequence of its failure to meet its obligations. Furthermore, the general good demands the primacy of the lender be upheld if other borrowers are not to find their access to finance impaired. Both on a microcosmic and a macrocosmic level, the debenture-holder has the "legal high ground"[4].

The apparent imbalance of the tripartite relationship at the core of receivership can be partially explained in the above manner. But that relationship, central as it may be, is not the entirety of receivership law. It is axiomatic that a company deals with a wide variety of parties. Clearly receivership, or more accurately the manner in which the receiver goes about achieving his aim of discharging the debt owed to his appointor, will have ramifications for those outside of the immediate receiver/company/debenture-holder nucleus. The initial contract between company and lender, once consummated by an appointment, has external effects.

It is with these that this Chapter and the next are concerned. Their focus is the extent to which the receiver can single-mindedly pursue his appointor's welfare, and whether or not the law circumscribes his freedom of action in this regard. It is unarguably the case that, as against the company, the debenture-holder's interests are prioritised, but can the same be said where they conflict with the interests of others, third parties whose subordination cannot be justified as a matter of contract? Or, as a corollary, in what circumstances does the law ordain that the welfare of a third party should take precedence to that of the debenture-holder, and on what

[4] *Receivers Revisited*, Andrew Hogan (1996) Co Law 226, 228.

political basis? This fascinating and abstruse pocket of law warrants close attention. It provides an insight into the policy considerations that have driven the development of 'receivership law' and, ironically, how frequently developments have occurred haphazardly and without reference to a unified conception of receivership.

1. *Dramatis Personae*

> "Often ... [in receivership] ... the interests of secured creditors, general creditors and shareholders do not coincide. For example, the debenture-holders might be better served by an immediate sale of the company's plant and equipment; on the other hand, the unsecured creditors and shareholders might prefer the company to retain this property with a view to the later sale of the business as a going concern."[5]

O'Donovan identifies the company's unsecured creditors and shareholders as two groups invariably sensitive to the conduct of the receivership. Others include the company's directors, employees, preferential creditors, customers, and those secured creditors both junior and senior to the appointing debenture-holder. He also identifies the classic case in which debenture-holder and others come into conflict, namely where the former is over-secured so that his receiver need not strive to maximise realisations from the assets under his control. It should be noted, though, that where the *external* dimension of receivership is concerned, the above classification of participants is simplistic in the extreme, and the archetypal conflict situation by no means the only one which may arise.

[5] O' Donovan, *The Duties of a Receiver and Manager Appointed Out of Court* (1979) 12 MULR 52.

First, some stakeholders[6] may occupy a sort of 'dual status' in a receivership situation. Employees, for example, may be preferential creditors, unsecured creditors or even, if a share ownership scheme is in force, shareholders. So too its directors, if the company is small, will very likely have a sizeable equity investment. They may also have executed personal guarantees of the company's debts with the appointing debenture-holder[7], placing them in a doubly precarious position if the receiver, for whatever reason, fails to realise sufficient from the charged assets to pay off his appointor.

Further, conflicts of interest do not only arise between the debenture-holder and external stakeholders. Where the latter are concerned, conflicts *inter se* are equally prevalent, the most obvious emerging from the legal priority afforded to preferential claimants, which inevitably diverts assets from the general body of creditors. This might be termed an organic conflict, inherent in the insolvency regime as a whole and separate from and unaffected by the receiver's strategy. More subtle are those conflicts spawned by his tactics during receivership, where one stakeholder benefits from a particular deployment decision at the expense of another. This outcome is particularly manifest where employees are concerned[8]. The point in question here is how, or whether the law provides guidance to the receiver on the resolution of such conflicts, whether they are between debenture-holder and other stakeholders, or between particular stakeholder subsets.

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[6] This convenient term is used henceforth to denote those parties or groups, other than the debenture-holder, with a financial interest in the conduct of the receivership.

[7] A likely scenario in the case of the small, owner-managed company.

[8] See Chapter 4.

1.2 The debenture-holder and external stakeholders: the basic position

1.2.1 Proprietary priority

The debenture's security confers upon him two separate but complementary 'rights'. First, his superior entitlement to the secured property, where this exists, confers upon him *proprietary priority.* Where a formal insolvency regime[9] is instituted, that priority accords him 'first' claim upon the assets or their proceeds, unless he agrees to forego that entitlement. The standard 'global' security package extends to the entirety of the company's undertaking, subjecting every asset to either a fixed or a floating charge. Thus the debenture-holder's position is ostensibly favourable to that of external stakeholders.

Proprietary priority, however, may not extend over the entirety of the undertaking. There may exist *senior* secured creditors, whose claim on a particular asset ranks ahead of that of the debenture-holder because it is prior in time or because the senior chargee and debenture-holder have negotiated to this effect. Moreover, statute intervenes to allocate a proportion of the asset pool to preferential creditors. Finally, the company may be *in possession* of assets which are not comprised in the debenture-holder's security, in that they are the subject of a valid retention of title clause or a hire-purchase or leasing arrangement.

1.2.2 Deployment decision priority

Where a receiver is appointed by the debenture-holder, the question arises as to whether, in devising a strategy, that receiver must prefer the interests of his

[9] In this context receivership, administration or liquidation.

appointor over those of external stakeholders. Theoretically, where the debenture-holder enjoys proprietary priority he should also enjoy *deployment decision priority.* Given that he has first claim upon the assets in question, his receiver should be able to make decisions as to how they are to be marshalled solely in the appointor's interests. As a corollary, where proprietary priority rests with another party, the question arises as to whether the receiver should prefer *that party's interests* by deploying the assets in question in a manner best designed to advance *that party's welfare.* This latter question will only be of practical importance if the interests of the external stakeholder and the appointor are in conflict.

In this Chapter, three stakeholder groups will be considered, namely the company's preferential creditors, its secured creditors (other then the appointing debenture-holder) and its guarantors, and its unsecured creditors. The treatment of employees is left to the next Chapter, largely because of the singular dilemmas their position raises and the possibility of amendments to the existing law. Within each group, the central question is the extent to which a receiver is compelled to modify a strategy he would otherwise have adopted in his appointor's interests.

This involves, in some cases, an explanation of the historical development of the law, and an exposition of the rationale behind the legal position. It then remains to determine whether the prioritisation of the stakeholder in question is justified from a *contemporary* policy perspective.

Preferential Creditors[10]

1. Introduction

Preferential creditors are not a group exclusive to receivership, but represent a feature of the insolvency law regime of considerable vintage. They comprise a body of creditors afforded 'special treatment' by an elevation of their claims above those of the general body of creditors and, to the extent that his claim relates to floating charge assets, the debenture-holder. One explanation of this favoured status is that, for the most part, preferential creditors are *involuntary*. Whilst the composition of this clique has altered over the years, a consistent member has been the Crown, in the form of various Revenue authorities, who have no choice but to extend credit to a trading company[11]. The same cannot be said, at least in theory, of other of the company's trading partners. Nor can it be said, again theoretically, of the company's employees, but their unpaid wages and salary have featured as a category of preferential debts since their inception.

1.2 Preferential Debts: Historical Overview

Preferential debts have marked the insolvency map since 1888 and the Preferential Payments in Bankruptcy Act of that year. Originally they were only payable in a winding up[12], and comprised certain claims for parochial rates and taxes[13] and for unpaid wages and salaries[14]. Such claims were, and remain, subject to the "costs of

[10] It is not proposed to embark upon a complete narration of the law in this area. This section focuses instead on how the existence of preferential creditors might influence the course of a receivership.
[11] For the simple reason that taxes are payable in arrears.
[12] Preferential Payments in Bankruptcy Act 1888 s 1(1).
[13] *Ibid.* s 1(1)(a).
[14] *Ibid.* s 1(1)(b)(c).

the administration" of the insolvent estate[15]. Although there is little documentation regarding the thinking behind this statute, it is easily inferred that it was a response to the recognition by the Court of Chancery of the floating charge[16], with its propensity to attach to future property of the debtor company, so leaving all other creditors, including the Crown and employees, behind the debenture-holder. As a means of ensuring that the favoured debts were paid, the 1888 Act was deficient in that it took no account of receivership, and this state of affairs was remedied by the Preferential Payments in Bankruptcy Act 1897, which applied to both winding up and receivership situations[17].

As species of taxation and worker protection evolved, a series of Companies Acts embodied each new form as a category of preferential debt. The preferred mode was to enact the basic duty of the receiver to make payment in one section, and then to catalogue the relevant debts in another. The Insolvency Act 1986 saw a sharp *volte face* in this tendency towards the augmentation of categories of preferential debts. This was largely due to the deliberations of the Cork Committee and its recognition that traditional justifications for preferential status required reappraisal. The Committee's chief anxiety was the diversion of funds from unsecured to preferential creditors inherent in the regime[18], which was seen to "militate against the principle of *pari passu*", and to operate "to the detriment of ordinary unsecured creditors"[19]:

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[15] Preferential Payments in Bankruptcy Act 1888 s 1(3).
[16] 18 years earlier in *Re Panama, New Zealand and Australian Royal Mail Co* (1870) 10 Ch App 318.
[17] Preferential Payments in Bankruptcy Act 1897 ss. 2, 3. This Act repealed its predecessor's categories of claimant.
[18] By s 40(3) IA and its predecessors, preferential payments can be recouped out of "assets of the company available for payment of general creditors."
[19] The Cork Report, *supra* n 2, para. 1398.

"We have received a considerable volume of evidence on this subject, most of it critical of the present law, and much of it deeply hostile to the retention of any system of preferential debts. We are left in no doubt that the elaborate system of priorities accorded by the present law is the cause of much public dissatisfaction, and that there is a widespread demand for a significant reduction, and even the complete elimination, of the categories of debts which are accorded priority in an insolvency."[20]

Whilst the Committee's sympathy seems obviously directed towards unsecured creditors, lending institutions similarly had a vested interest in the redistributional effects of the preferential regime[21] and, indeed, contributed vociferously to the debate at the consultation stage. In the face of such overwhelming opprobrium it should come as no surprise that the *Crown's*[22] priority position took something of a body blow in the Cork Report.

The Committee proceeded upon the basis that any priority should be justified "by reference to principles of fairness and equity which would be likely to command general public acceptance"[23]. Secondly, the fact that the Crown was an involuntary creditor in respect of unpaid taxes did not amount to sufficient justification for preferential status, largely because of the generous arsenal of remedies afforded revenue authorities by the State[24]. Thirdly, the Committee considered that no distinction should be drawn between the Crown's involuntariness and the *de facto*

[20] *Supra* n 2, para. 1397.
[21] Floating charge assets being available to preferential creditors; *supra* 213.
[22] No brave soul appears to have suggested that employee's preferential status be modified.
[23] *Supra* n 2, para. 1398.
[24] *Ibid.* para. 1413.

involuntariness of trade creditors:

> "Many suppliers of goods and services are constrained to extend credit facilities in accordance with the custom of the trade. In a practical sense they have no real choice in the matter, and are sometimes unable to exercise credit control."[25]

Finally, the abrogation of the Crown's preferential status would not produce a significant net loss. Tax would be at least partially recouped from those unsecured creditors expected to receive an enhanced dividend in insolvency, thus allowing for a net decrease in the amount of bad debts written-off against profits[26].

However, the preference accorded to taxes *collected by the company*[27] escaped the general recommendation for abolition:

> "We cannot think it right that statutory provisions enacted for the more convenient collection of revenue should enure to the benefit of private creditors. It would be commercially impractical to treat moneys collected for the Crown as impressed with a trust, and in these special circumstances we have formed the view that the retention of a measure of Crown preference is justified."[28]

The Committee was evidently following its own collective inclination, as well as acceding to the weight of the evidence presented to it, in recommending the abolition of Crown preferential status for all but collected taxes. But this proposal had yet to clear the Parliamentary hurdle, and some might have predicted a marked disinclination on the part of the Government to accept a measure that would strip, rather than line its pockets. As Goode elegantly observes:

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[25] *Supra* n 2, para. 1414.
[26] *Ibid.* para. 1416. The Committee's confidence that unsecured creditors would be the beneficiaries of an abolition of Crown preferences was perhaps misplaced, given the likely presence of a voracious floating charge.
[27] PAYE, National Insurance contributions and VAT: these categories reflect not so much the company's tax liability as that of someone else.
[28] *Supra* n 2, para. 1418.

"The priority of taxes has become so enshrined in the consciousness of tax authorities and their political masters that no amount of reasoning, however cogent, and no appeal on behalf of unsecured creditors, however compelling, seems to have the slightest effect upon those who rule over us."[29]

On this occasion, however, finding itself backed into a political corner, the executive relinquished its previous priority to the extent of the Committee's recommendations. The present law is to be found in Schedule 6 of the Insolvency Act 1986. The subset of 'collected taxes' continues to enjoy preferential status, as do employees' remuneration and certain of their pension scheme rights. Other 'escapees' are car tax and betting and bingo duty[30]. Ironically, additions to the 1986 catalogue have arisen in the form of insurance premium tax, excise duty, lottery duty, air passenger duty and levies on coal and steel production[31].

To complete the picture, it should be noted that preferential claims have always been subject to certain limits either in time or amount, so that a claimant falling into a relevant category might not be able to call for the entire amount of any debt due. It should further be noted that the status of preferential creditor is only germane in relation to debts incurred by the company *prior* to the appointment of a receiver.

[29] *Is the Law too Favourable to Secured Creditors?* (1983 - 1984) 8 Can. Bus. LJ 53, 75.
[30] Insolvency Act 1986, Schedule 6, paras. 4 and 5 respectively (hereinafter 'IA'). *Quaere* on what basis these items evaded abolition, since they appear not to be 'collected' taxes?
[31] *Ibid.* paras. 3A, 5A, 5B, 5C and 15A respectively.

2. Preferential debts - the basics of the law

> "In view of the fact that the priority of preferential debts over floating charges has been a feature of corporate insolvency law for almost one hundred years, and the practical significance of that priority, it is surprising that s. 40 [Insolvency Act 1986] and its predecessors have not given rise to more litigation."[32]

Anderson's surprise is not misplaced. He ascribes the relative paucity of case law on the matter to the fact that preferential creditors may lack information on which to base an action against a defaulting receiver and the liquidator's lack of *locus standi* under s 40. Given that elements of its operation remain unclear, it is only possible to state the law with certainty to a very limited extent. The ensuing propositions seem to be clearly established, and serve as a framework for the investigation that follows.

2.1 Assets available to meet preferential claims

Preferential creditors have priority over the company's unsecured creditors, and, to the extent that he is secured by a floating charge, the appointing debenture-holder. In spite of the wording of s 40 and its predecessors[33], it is unequivocally established that this priority is only conferred over *floating charge* assets. In *Re Lewis Merthyr Consolidated Collieries Ltd*[34] Tomlin J held that the proceeds of any fixed charge assets were unavailable to preferential creditors under s 78 Companies (Consolidation) Act 1908, rationalising the position thus:

[32] Hamish Anderson, *Receivership Preferential Creditors: Prior Floating Charges, Trading Receipts, Work in Progress and Allocation of Fees and Expenses* (1994) 15 Co Law 195.
[33] Preferential debts to be paid in priority to *any* claim for principal or interest.
[34] [1929] 1 Ch 498.

"I quite understand that in regard to a floating charge there may be a reason for giving the priority, because until the receiver is appointed or possession is taken, the charge does not crystallise, and it may well be said that this particular class of debts, which may perhaps have contributed to produce the very assets upon which the floating charge will crystallise, are proper to be paid out of those assets before the debenture-holder takes his principal and interest out of them. That seems to me to be a perfectly intelligible reason for the legislation..."[35]

Gough, citing the remarks to similar effect of Barwick CJ and Kitto J in *Stein v Saywell*[36], dubs this "value-added reasoning" and considers that:

"...[it] may have had some relevance in the context of employee remuneration but it hardly applied in relation to taxation and rating liabilities."[37]

With respect, it is submitted that the notion that unpaid taxes or rates add to the overall value of the floating charge in fact stands up to scrutiny. Just as the (unpaid) labour of the company's employees goes to produce benefit, so too does the amount of monies that should have been forwarded to the relevant revenue authority. In other words, the company may have been spending sums that should have been set aside for tax payments on assets that go to swell the floating charge.

A more persuasive objection to the "value-added" reasoning is that preferential debts do not include claims of trade creditors who have supplied floating charge assets to the company on credit, thus adding value, but who remain unsecured in a receivership. This seeming anomaly is in turn explained by the special 'involuntary' nature of those debts owing to taxation authorities, and the policy of employee protection favoured by successive legislatures.

[35] [1929] 1 Ch 498, 508. Tomlin J's judgment was upheld in the Court of Appeal.
[36] (1969) 121 CLR 529.
[37] W J Gough, *Company Charges* (1996 : Butterworths : London), 988.

2.1.1 'Clawing back' assets through contract

The past twenty five years or so have seen a marked erosion of the *categories of assets* that can be mustered under the 'floating' epithet. Preferential debts represent an overt assault on the ability of a lender to cordon off a company's property against outsiders in the event of insolvency. Perhaps not surprisingly, banks and other lenders have countered the consequences of the preferential regime by recourse to a number of contractual devices designed to defeat it.

One such contrivance was the 'automatic crystallisation clause'[38], whereby a floating charge would crystallise on the happening of a specified event, that event envisaged to take place before the appointment of a receiver. Upon that appointment, therefore, all the company's assets would be subject to a fixed charge and so unavailable to preferential creditors[39]. Whilst such clauses have been judicially recognised as effective[40] their usefulness in this regard has been largely neutralised by s 40(1) Insolvency Act 1986, which directs payment to be made out of assets subject to a charge "which, *as created*, was a floating charge"[41].

A more potent method of avoiding the devaluation of security inherent in the preferential regime is to subject as many 'asset groups' as possible to a fixed charge, thus reducing the overall proportion of the security to which preferential claimants may have recourse. This manoeuvre is most visible with regard to the practice of taking a fixed charge over the book debts of a company[42]. Book debts, as

[38] This matter is covered only briefly here. For a fuller treatment see Farrar (1976) 40 Conv. (N.S.) 397; Boyle [1979] JBL 231; Lingard, *Bank Security Documents*, 3rd ed. (1993 : Butterworths : London), paras. 9.20 - 9.31.
[39] See, e.g., *In re Griffin Hotel Co Ltd* [1941] Ch 129; *Re Brightlife Ltd* [1987] Ch 200.
[40] *Re Brightlife Ltd* [1987] Ch 200, 212 *per* Hoffmann J.
[41] Italics added.
[42] See *Siebe Gorman & Co v Barclays Bank* [1979] 2 Lloyd's Rep. 142.

a genus of property, ostensibly sit most comfortably under the 'floating charge' head, in that they display the three characteristics identified by Romer LJ in *Re Yorkshire Woolcombers Association Ltd*[43] as indicative of such a security. They are a) a class of assets of a company present or future, which b) will change from time to time in the ordinary course of business, and which c) the company may, until intervention, use in the ordinary course of business.

By compromising the ability of the company to deal with its book debts freely, lenders have been able to subject a remarkably fruitful species of property to a security invulnerable to preferential creditors. This position is largely achieved by the imposition of restrictions on the use to which book debts and their proceeds may be put by the debtor company. This in practice entails the lender requiring the company "to pay the proceeds of the book debts into a bank account either with or in the name of or to the order of or in trust for the chargee"[44].

The courts have upheld this stratagem, notwithstanding that it was concocted simply in order to divert assets away from those creditors the legislature had seen fit to accord priority. Indeed, in *Re New Bullas Trading Ltd*[45], the Court of Appeal acknowledged the parties' ability to subject 'book debts' to a fixed charge and their proceeds to a floating charge, thus removing the need to provide for the payment of book debts into a special account in order to preserve their fixed charge status[46].

It is arguable that the law has taken a wrong turn in this regard, and that the ease

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[43] [1903] 2 Ch 284, 295.
[44] Lightman and Moss, *The Law of Receivers of Companies*, 2nd ed. (1994 : Sweet & Maxwell : London), (hereinafter Lightman & Moss), para. 3-11.
[45] [1994] BCC 36.
[46] This case has prompted some stimulating academic debate, most notably Goode and Berg's exchange; see (1994) 110 LQR 592; [1995] JBL 433.

with which the parties to the original debenture can structure their contract deliberately to avoid the executively conferred rights of strangers to that contract is unfortunate. The likely reality is that contractual restraints on dealing with book debts are little more than window dressing, those restraints being lifted as soon as proceeds are paid into the designated account, thus allowing fixed charge assets to be treated by both lender and creditor as floating charge assets. Form masters substance blatantly in this area of law.

The courts willingness to allow lenders to draft their way out of a statutory initiative is perhaps symptomatic of the general aversion to which the entire system of preferential payments has been subject. However, unless and until the legislature sees fit to abolish them[47] it is reasonable to question how far this contractual freedom should be allowed to develop, and whether the present position is expedient. A brief survey of any standard form debenture reveals that freehold and leasehold property, fixtures, plant, machinery, vehicles, computers, office equipment, stocks, shares, bonds, other securities, book debts, uncalled capital, goodwill, patents, trademarks, copyrights and licenses all stand subject to a fixed charge[48].

It would be interesting to compare the proportions of fixed and floating charge assets in such a document to those in debentures from 1929, when *Re Lewis Merthyr Consolidated Collieries Ltd*[49] was decided. If, as Tomlin J suggests, "value-added reasoning" explains the preferential regime, that policy is severely undermined by permitting fixed charges to be taken over book debts, those debts

[47] As to which see Chapter 5.
[48] See, e.g., Lingard, *supra* n 38, 348.
[49] *Supra* n 34.

themselves being a product, at least in part, of floating charge assets. In the final analysis, given the continued existence of preferential debts, judicial affirmation that no questions of public policy are raised by such contractual machinations[50] must surely be dubious.

2.2 The receiver's duty to make preferential payments

Whilst endorsing the ability of chargees to drain the asset pool out of which preferential creditors are to be paid, the courts have remained resolute in their determination that a receiver has a positive duty to meet preferential claims. Thus a receiver will be liable in the tort of breach of statutory duty if he uses floating charge assets to pay other creditors ahead of preferential creditors[51]. The position is summed up by Danckwerts J in *Westminster Corp. v Haste*:

> "To my mind [s. 264(1) Companies Act 1929] is not simply a negative provision which means that the receiver is protected if he simply does not pay the debenture-holders: it is a provision which requires him to pay the preferential creditors out of any assets coming to the hands of him as receiver. Therefore, it seems to me that, if he has had any assets out of which this payment could have been made, he is under a liability in tort to the plaintiffs."[52]

Further, a receiver, on being removed from office, cannot hand over the proceeds of floating charge assets to his successor without accounting to the preferential creditors[53]. Goode suggests, correctly it is submitted, that a receiver who wrongfully pays his appointing debenture-holder will be entitled to an indemnity to the extent

[50] See, e.g., *Re Brightlife Ltd, supra* n 39; *Re New Bullas Trading Ltd, supra* n 45.
[51] *Woods v Winskill* [1913] 2 Ch 303; *Westminster City Council v Treby* [1936] 2 All ER 21.
[52] [1950] 1 Ch 442, 447.
[53] *IRC v Goldblatt* [1972] Ch 498, 505, *per* Goff J.

of the payment, and that the preferential creditors in such a case can sue the debenture-holder directly for procuring a breach of statutory duty or attempt to render him liable as constructive trustee[54]. It has also been held that *the company* can maintain an action against a receiver who fails to pay preferential debts[55].

In summary, therefore, the law prescribes that a receiver is under a statutory duty to discharge the claims of the company's preferential creditors out of assets the subject of a floating charge created as such, the *quantum* of those claims being determined at the date of appointment[56]. This seemingly plain proposition will now be examined in greater depth in an attempt to identify elements of its operation that remain unclear.

3. Assets available to meet preferential claims: further questions

3.1 The prior floating charge problem

There remains some doubt as to whether a receiver appointed under a junior floating charge may use assets subject to a senior floating charge to pay those preferential debts arising on his appointment. In *Griffiths v Yorkshire Bank plc*[57] Morritt J held that such were unavailable to preferential creditors, since the receiver's s 40 duty conferred priority only in respect of floating charge assets comprised in those debentures under which he was appointed. Anderson notes that a literal interpretation of the wording of s 40 appears to produce this result, but adds:

[54] *Some Aspects of Receivership Law* [1981] JBL 473, 476-477.
[55] *Westminster Corp. v Chapman* [1916] 1 Ch 161.
[56] Schedule 6 IA.
[57] [1994] 1 WLR 1427.

"...it must be acknowledged that such an interpretation would not be entirely consistent with what is ostensibly the scheme of the legislation."[58]

Furthermore, citing *In re Glyncorrwg Colliery Co Ltd*[59] and *Re Christonette International Ltd*[60], he notes that the scheme of payment of preferential debts in a receivership should equate to that in a liquidation, a principle from which the *Griffiths* case departs.

Anderson's misgivings were shared by Neuberger J in *Re H & K (Medway) Ltd*[61], and to such an extent that he declined to follow *Griffiths v Yorkshire Bank plc*, preferring a purposive approach to s 40. The learned judge appeared especially concerned at the likelihood of collusive avoidance techniques being adopted by secured creditors in order to thwart preferential claims:

"...a well-advised chargee or prospective chargee could effectively avoid the consequences of s 40 with ease ... an actual or prospective chargee [could require] the borrower to execute a second floating charge in favour of a nominee of the chargee, with a view to any receiver then being appointed by the nominee ... Further, in a case where the company is in difficulties and there are a number of chargees falling within s 40(1), those chargees would be able to get together and ensure that it is the lowest ranking chargee who appoints a receiver, so that the rest of the chargees are free from s 40."[62]

He therefore held that *any* assets subject to a floating charge were available to meet preferential claims, whether or not there existed floating charges prior to that under which the receiver was appointed.

58 *Receivership Preferential Creditors supra* n 32, 196.
59 [1926] Ch 951.
60 [1982] 3 All ER 225.
61 [1997] Ch 321.
62 *Ibid*, 326.

It is submitted that the reasoning in *Re H & K (Medway) Ltd* is to be preferred. In *IRC v Goldblatt*[63] a scheme to avoid making payment of preferential debts whereby one receiver was replaced by another was frustrated by Goff J, who considered such collaboration contrary to legislative intent. A *pre-receivership* stratagem designed to achieve the same effect should be treated similarly. However, given two conflicting first instance decisions and no higher authority on this matter an element of uncertainty must persist, and one which might cause receivers concern in future. If the *Griffiths v Yorkshire Bank* approach is correct a receiver paying over senior floating charge assets to preferential creditors might be open to an action in the tort of conversion by senior chargees. On the other hand, if a receiver pays the senior floating chargee on the authority of *Griffiths*, and if *Re H & K Medway* is preferred, the possibility of an action in the tort of breach of statutory duty at the behest of preferential creditors cannot be discounted. A resolution of this question from the Court of Appeal would be desirable.

3.2 The trading decision problem

> "...it is essential that the receiver earmarks funds for preferential claims as early as possible. He will then be able to consider what funds are available to him should he decide to trade on."[64]

A perennial quandary faced by receivers is the extent to which they may utilise assets subject to a floating charge in trading activities designed to enhance realisations. The Insolvency Act gives no guidance on this point, the precise content

[63] *Supra* n 53.
[64] Samwell, *Corporate Receiverships* (1981 : ICAEW : London), 68.

of the s 40 duty to pay preferential creditors remaining obscure. Anderson, in his accomplished article *Receivership Preferential Creditors*[65], identifies several unanswered questions raised by s 40 and is frequently compelled to second-guess the approach of the courts. Since the decision whether to trade or not is likely to be critical to the outcome of any receivership, the fact that the repercussions of s 40 on such decision have yet to be fully elucidated is something of an eccentricity in the receivership realm.

In the first place, it is necessary to decide whether a receiver is legally entitled to utilise floating charge assets in trading at all. In other words, does the s 40 duty require him to pay preferential claims immediately he is appointed, and so to realise any assets available for such claims without delay? Prior to the enactment of s 264(1) Companies Act 1929 a receiver was directed to make payment "forthwith", which might suggest that any use of floating charge assets other than in discharge of preferential debts was prohibited. The subsequent omission of the word "forthwith" may denote that immediate payment is no longer called for, thus offering the receiver some scope for the employment of such assets in trading activities. To the extent that the value of those assets[66] is depreciated by any dealings, the receiver would be personally liable to make up the difference[67] but the potential benefits of trading on might be assessed as neutralising such a risk.

Lightman and Moss, in considering whether a receiver may utilise stock and work in progress, offer the following:

[65] *Supra* n 32.
[66] As determined at the date of appointment.
[67] *Woods v Winskill, supra* n 51; *Westminster Corporation v Haste, supra* n 52.

> "The preferential creditors have first call on their realisable value. But their value if the receiver decides not to trade is likely to be very low indeed, and trading may be essential if any beneficial realisation is to be achieved. If the receiver decides that he should prudently trade on, he will inevitably use such assets, and this method of realisation should not ordinarily expose the receiver to liability if the initial decision can reasonably be justified in the interests of the preferential creditors, even if in fact (notwithstanding the exercise of all reasonable diligence and expertise) the endeavour fails to produce additional funds for them."[68]

This seems in principle correct, especially as preferential creditors are protected by the receiver's personal liability should trading diminish the assets available to them. It must also be open to a receiver to agree with such creditors that he will be able to conduct trading activities with 'their' assets, and such an agreement would surely shield him from any personal liability that might arise in the circumstances Lightman and Moss describe.

A closely linked question is whether a receiver is under any duty to realise floating charge assets at all if such a course is not necessary to discharge the debt due to the debenture-holder. If, for example, that debt can be repaid from fixed charge realisations, should the receiver nonetheless sell floating charge assets in order to satisfy preferential claims? Hatton and Cooke regard this matter as unclear[69], but since s 40(2) Insolvency Act refers to "assets coming to the hands of the receiver", rather than "the proceeds" of any such assets it must be implicit in the legislation that they are to be realised, whether the debenture-holder requires such realisations or not. This reasoning is supported by the decision of Carnwath J in *Re Pearl*

[68] *Supra* n 44, para. 8-08.
[69] *Fixed Charge Surplus - The Argument is Over* [1985] I L & P, 137, 139.

Maintenance Services Ltd[70], where the learned judge held that receivers should pay over book debts of the company collected after repayment of the appointing debenture-holder.

Finally, if a trading receivership is decided upon, it seems unarguable that any assets of a floating charge nature acquired post-appointment will be available to preferential creditors. Goode puts the matter thus:

> "It seems that all assets potentially within the scope of a floating charge are brought within s. 94 [Companies Act 1948] on the appointment of a receiver, even though those assets do not come into existence until after the charge has crystallised. So the appointment of a receiver or the occurrence of any earlier crystallising event does not limit the scope of s. 94 to assets in which the company then has an interest; future assets picked up under an after-acquired property clause are also caught, even though as to these the charge is fixed *ab initio.*"[71]

If this correctly reflects the position under s 94 Companies Act 1948, as it surely does, then the reasoning applies *a fortiori* to s 40 Insolvency Act, which directs payment out of assets subject to a charge which *as created* was a floating charge[72]. In effect, therefore, should a receiver buy in stock such acquisitions will be available to pay preferential creditors.

3.3 The apportionment problem

As noted above, costs, expenses and remuneration of the receiver in general rank ahead of both debenture-holder and preferential debts[73] These may be substantial[74].

[70] [1995] BCC 657.
[71] *Some Aspects of Receivership Law, supra* n 54, 475.
[72] Anderson reaches the same conclusion, *supra* n 32, 196-197.
[73] *In re Glyncorrwg Colliery Co Ltd* [1926] Ch 951.
[74] For example, the secured debt in *Re G L Saunders* [1986] BCLC 40 amounted to £302,000, receivership costs weighing in at £270,000.

It would obviously be in the interests of the debenture-holder that such costs be satisfied out of floating charge assets as far as possible, but the perceived wisdom is that they should be taken rateably out of both classes of asset[75].

A further 'apportionment' question relates to the value *to be attributed to different classes of assets* by the receiver. Doyle notes that:

> "It is of significant practical importance ... that an accurate and true allocation is made by the administrative receiver of the extent to which expenses of the receivership are to be met as between fixed and floating charges, since the greater the degree to which they are to be borne by any floating charge assets the less the amount available for discharging preferential debts."[76]

Where assets are sold on a break-up basis no problems should arise for preferential creditors, but a going concern sale represents a greater danger. It is feasible that the receiver's duty to take reasonable steps to obtain the true market value of property sold[77] will be discharged if the price *for the business* is viewed as realistic by the court. If a purchaser 'haggles' over stock and persuades the receiver to accept a lower than cost price, but nonetheless pays a sensible amount for the enterprise as a whole it must be arguable that no breach of duty occurs. In any event, it is unlikely that this particular duty is owed to preferential creditors as a group, the courts having confined its application to the company/mortgagor and those parties interested in the equity of redemption, a collection that does not readily admit of preferential creditors.

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[75] Lightman and Moss, *supra* n 44, para. 21-20 (conceding that the point is not free from doubt); Anderson, *supra* n 32, 202.

[76] Doyle, *Administrative Receivership: Law and Practice* (1995 : FT Law and Tax : London), 286-287.

[77] See Chapter 2.

A striking example of 'creative apportionment' can be seen from the facts of *Re The Real Meat Co Ltd (In Receivership)*:

"The consideration of £61,817 was apportioned to the assets purchased by RMP as follows: (i) goodwill - £1, (ii) plant, machinery and office equipment - £3,999, (iii) stock (comprising meat in the course of delivery) - £1, (iv) book debts - £57,815, (v) completed sales, customer records and all other assets - £1."[78]

Preferential creditors were in this case owed £10,792. If the company's book debts, goodwill and plant were subject to a fixed charge (as is usually the case), they would receive the princely sum of £2.

It is inordinately difficult to see how preferential creditors might attack such an allotment of consideration, especially if, as postulated above, a receiver owes them no duty in relation to the price obtained on a sale. The nature of the market for receivership companies is such that it will be the purchaser who is in a position to dictate terms, and a demand for such items as stock at a 'knock-down' price may be common. It is hardly realistic to expect a receiver to attempt to realise them separately, since the expense of such a strategy may not justify it being adopted, and, in any case, may jeopardise the sale of the business itself if the potential purchaser stands his ground.

Perhaps the best that can be said here is that the receiver should at least try to negotiate the price of floating charge assets upwards. To the extent that he does so, in the absence of fraud (which it is not suggested would be a serious proposition in these circumstances), he ought not to come under any liability to disappointed preferential creditors. The point remains undecided by the courts and so the

[78] [1996] BCC 254, 257, *per* Chadwick J.

legitimacy or otherwise of this procedure cannot be stated with any confidence. It may be the case that preferential creditors have hitherto been somewhat relaxed in their scrutiny of the allocation of going concern consideration. A more searching investigation on their part might in future give rise to some illuminating litigation.

4. The effect of preferential debts on receivership: proprietary and deployment decision priority

4.1 Proprietary priority

The interests of preferential creditors may clearly influence the conduct of a receivership. Their *proprietary priority* over a certain class of assets has the potential to prejudice the appointor to the extent that assets to which he could have recourse are redirected to such claimants. That priority, though, may be effectively corroded by pre-receivership contractual devices, such as subjecting as many asset groups as possible to a fixed charge invulnerable to the demands of preferential debts.

Moreover, a well-advised chargee considering the appointment of a receiver will pay close attention to the *content* of each class of his security, and may time any appointment to coincide with the moment when the fixed charge element is gravid with assets and the floating charge element correspondingly barren. This will most obviously be possible where the company in question has a seasonal factor to its production. To take a (perhaps) extreme example, the assets of a fireworks manufacturer will, from summer to autumn, be comprised largely of stock and work in progress (floating charge constituents), whereas after November 5th will chiefly consist of book debts (fixed charge constituents)[79]. Such tactical appointments are, from a legal point of view, unassailable.

The debenture-holder himself may therefore act to protect his security from being ravaged by preferential claims, but it would seem that a receiver may not. This is largely a result of his personal liability to the extent that he pays away or exhausts floating charge assets which were, on his appointment, notionally available to meet preferential debts. The s 40 duty is unqualified by the best interests of the debenture-holder in this respect. Proprietary priority remains with the preferential creditors and, whilst pre-receivership devices may serve to diminish it the receiver himself may not employ similar tactics, such as using floating charge assets for trading purposes, without running the risk of attracting personal liability.

4.2 Deployment decision priority

Deployment decision priority is a different matter. The preceding discussion suggests that the promotion of the best interests of the preferential creditors does not form part of the s 40 duty. Certainly, where the debenture-holder's welfare decrees a disposal of fixed charge assets only, whilst the receiver will arguably be under a duty to *realise* floating charge assets for the benefit of the preferential creditors, it is submitted that that duty does not enjoin him to *maximise* any realisations. In other words, he can dispose of such property as quickly as possible by the most convenient means and need not take the kind of trouble, or exercise the

[79] The author cannot take credit for this splendid example, which was provided by an insolvency practitioner with considerable experience of the timing of appointments.

professional expertise usually associated with his dealings in relation to assets being disposed of for the benefit of the debenture-holder.

It is doubtful whether the duty to take reasonable steps to obtain the true market value of the property is owed to preferential creditors, and in any event, on the authority of *Cuckmere Brick Co v Mutual Finance*[80], the receiver will be free to choose the appropriate mode of sale.

Further, there is the possibility that a going concern sale in the debenture-holder's interests may operate detrimentally to preferential creditors, in that the sum realised in relation to floating charge assets may be less than that which could be obtained if such were sold singly. Again, it is submitted that the selection of such a course ought not to subject the receiver to any personal liability. If asked to decide the point, the courts should have due regard to the market constraints under which receivers operate and the special nature of the sale in question. To require him to choose between the advantage of his appointor and that of preferential creditors, is simply untenable. Only the most blatant examples of false apportionment (for instance, where it can be shown that the receiver himself, without any prompting by the purchaser, has allocated a risibly low portion of the overall consideration to floating charge assets) should attract the attention of the courts, although on what basis remains unclear[81].

It should be acknowledged that the receiver's personal liability to preferential creditors may, *in practice*, have some bearing on deployment decision priority. In

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80 [1971] Ch 949.

81 *Quaere* whether the offence of cheating the public revenue would be committed here? See Ormerod, *Cheating the Public Revenue* [1998] Crim. LR 627.

the consultation process preceding the *Cork Report* the following observation was made:

> "...it seems unduly onerous that [a receiver] should be personally liable to pay preferential debts to the extent that assets had been available to pay them. The practical result is that the receiver sometimes decides to close the business, abandoning the possibility of selling it as a going concern, merely to protect himself against claims by preferential creditors."[82]

Such detrimentally defensive practice is most likely to be adopted where a trading strategy is viewed as being more than usually speculative. There is no empirical evidence that this is a widespread problem[83], and, indeed, may be resolved by agreement between receiver and debenture-holder that an indemnity will be provided against the former's personal liability should a scheme to trade on turn out badly. With respect, given that the completion and sale of work in progress will almost invariably enhance value, this predicament is probably more imagined than real, and the modern, professionally qualified receiver is more than capable of taking justified risks and deciding against unjustified ones. Personal liability, it is suggested, remains justified, if only as a brake on the arrogation of foolhardy tactics that may prejudice not only the company's preferential creditors but also all other stakeholders[84].

[82] *Memorandum by the Joint Working Party of the Law Reform Committees of the Senate of the Inns of Court and the Bar and the Law Society on Insolvency: The Law of Receivership*, 15.
[83] To the contrary, trading on seems to be the norm; see Chapter 5.
[84] In this respect it resembles liability for wrongful trading: see IA s 214.

The position of chargees senior to the appointing debenture-holder

1. Potential prejudice to productive receiverships?

> "...a sale by a mortgagee under a charge by way of legal mortgage overreaches the equity of redemption and all rights subsisting in the equity..."[85]

The rights subsisting in the equity of redemption are transferred into any surplus from the proceeds of such a sale. Thus a sale executed by a *debenture-holder*[86] will operate to transfer the property to a purchaser free of any junior mortgages. A mortgagee cannot overreach securities *senior* to his own in like manner. By s 104(1) Law of Property Act 1925 a mortgagee has power to convey the property sold free from all interests over which he has priority, but "...subject to all estates, interests, and rights which have priority to the mortgage".

The power to overreach junior secured creditors is eminently convenient in the context of enforcement of security. It allows a sale of charged property to take place without the need for the chargee to seek out holders of inferior charges and obtain a release of the property from those charges. It renders the property itself more attractive to a potential purchaser, who may acquire it safe in the knowledge that no hidden encumbrancer will later emerge to challenge his title. The inverse proposition is that the inability to overreach *senior* chargees is extremely bothersome. This is particularly so in a receivership situation, where it is sought to sell the business as a going concern and a strategic asset of that business is subject to a prior-ranking charge.

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[85] *Duke v Robson* [1973] 1 WLR 267, 272 *per* Plowman J.
[86] But not, *semble*, a receiver: see *infra* 234.

The Cork Committee were alive to this predicament, and addressed it in the following terms:

> "The fragmentation of security ... occasioned by the creation of a number of charges over different assets of the debtor in favour of several different creditors, makes it difficult and sometimes impossible for an insolvent's assets to be realised to their best advantage..."[87]

The Committee's response was as follows:

> "The introduction of necessary powers to stay and, if required, override the rights of certain secured creditors in appropriate circumstances and for a strictly limited period, is essential if our objective is to be attained."[88]

Interestingly, receivership and the newly conceived administration order procedure were treated in tandem, the Committee making the same recommendations in relation to both regimes. These were that:

a) for twelve months after the appointment of an administrator or an administrative receiver it should be unlawful for a secured creditor to seek to enforce his security without the officer's consent or leave of the court; and

b) both administrative receivers and administrators should be empowered, with the leave of the court and on such terms as the court saw fit, to dispose of the property of the company free from security. The owner of the charge would be entitled to the proceeds of such a sale, and, to the extent that they fell short of the court's valuation of the property, an amount necessary to make up that deficit[89].

Evidently these two powers were viewed as complementary, and their application in

[87] The Cork Report, *supra* n 2, para. 1506
[88] *Ibid.* para. 1507.
[89] *Ibid.* paras. 1508-1512.

receivership as a testament to that institution's potential as a corporate rescue mechanism.

2. The Government's response: s 43 Insolvency Act 1986.

In relation to receivers, only the second of the Cork Committee's 'package' of proposals was accepted by the Government. In the rather compact White Paper that succeeded the *Cork Report* the recommendation for a moratorium on enforcement proceedings was tersely rejected:

> "These proposals are not acceptable. The Government believes that only a court-appointed official, the administrator, whose duty will be to act in the interests of all creditors and shareholders, should enjoy such temporary protection."[90]

The recommendation that an *administrative receiver*[91] should potentially be able to dispose of property subject to a prior-ranking security was enacted in s 43 Insolvency Act 1986, which reads as follows:

> "Where, on an application by the administrative receiver, the court is satisfied that the disposal (with or without other assets) of any relevant property which is subject to a security would be likely to promote a more advantageous realisation of the company's assets than would otherwise be effected, the court may by order authorise the administrative receiver to dispose of the property as if it were not subject to the security."[92]

Section 43(1) applies only to securities held by persons other than the receiver's appointor, and only to securities senior to that of the appointor[93]. Doyle has argued that it also applies in relation to *junior charges*, notwithstanding, as he concedes,

[90] *A Revised Framework for Insolvency Law* (1984 : HMSO : London), para. 34.
[91] Non-administrative receivers do not enjoy the s. 43 power.
[92] IA s 43(1).
[93] *Ibid.* s. 43(2).

the clear wording of s 43(2), since otherwise a receiver has no means of disposing of such property without the co-operation of the chargee or his own debenture-holder[94]. Whilst such a construction would eliminate a minor inconvenience associated with receivership sales, it is submitted that the decision of Chadwick J in *Re the Real Meat Co Ltd (in receivership)* controverts it[95]. The proceeds of a disposal under s. 43(1) are to be applied towards the discharge of sums previously secured, and to the extent that those proceeds are less than the open market value of the property, as determined by the court, the deficiency is to be made good, presumably out of sums that would otherwise go to the debenture-holder[96].

The enactment of what was arguably one half of a rescue orientated whole is intriguing, the only clue to the Government's perspective on this matter being that an administrator, to whom the benefit of a stay on enforcement proceedings was granted, was said to be under a duty to act in the interests of all creditors and shareholders. It is therefore possible to infer that an enforcement embargo during receivership, where no such duty inures, was perceived as one step too far in favour of chargeholders. A fascinating insight into the executive's perception of receivership as a rescue mechanism is to be found tucked away in the White Paper:

> "It is hoped ... that the new insolvency mechanism, the administration procedure ... will go some way to replacing receivership where there is a reasonable prospect of a company, or part of a company, being maintained as a going concern."[97]

The enforcement prohibition exclusive to administration might, therefore, have been intended as bait to financial institutions understandably reluctant to cede the

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[94] *Administrative Receivership: Law and Practice*, *supra* n 76, 237.
[95] [1996] BCC 254, 262-263.
[96] IA s 43(3)(a)(b)
[97] *Supra* n 90, para. 24.

undoubted advantages of receivership. The extent to which the bait has been taken is examined later[98].

3. The operation of s 43: guesswork

The ability of an administrative receiver, with the sanction of the court, to override a senior secured creditor appears ostensibly attractive to a number of parties, most notably the appointor. Doyle remarks:

> "Potentially and practically, this power ... is an extremely useful one to an administrative receiver who is faced with an unco-operative prior-ranking charge holder. Section 43 also robs a prior-ranking chargee of the important rights of timing and conduct of the realisation of the prior-charged assets."[99]

The power might have been more useful still had it been coextensive with that of an administrator, whose disposal entitlement extends to hire-purchase agreements, which in turn comprise property subject to conditional sale agreements, chattel leasing agreements and retention of title agreements[100]. It seems that the additional empowerment of the administrator was intended as a 'selling point' for the administration regime. If this is correct, that object has been somewhat frustrated by judicial intervention which has the effect of assimilating, in this context, receivership with administration[101].

In the event, s 43 turns out to be something of a damp squib, there being no reported cases on it. Its most obvious utility would appear to be in circumstances where an administrative receiver is contemplating a going concern sale of the

[98] See Chapter 5.
[99] *Administrative Receivership: Law and Practice, supra* n 76, 28-29.
[100] IA s 15(1), (2)(b), (9).
[101] See *infra* 295.

company's entire undertaking, to which a senior chargee is opposed because of the possibility of a rising market in the property secured by his charge. Without the benefit of judicial consideration of s 43 it is difficult to predict how a court might approach a receiver's application.

The similar, but wider power of an administrator contained in s 15 Insolvency Act 1986 was considered by Knox J in *Re ARV Aviation Ltd*[102], where a secured creditor disputed the administrator's valuation of the property. Whilst the case is not precisely germane to the present discussion, some notable *obiter* observations were forthcoming. In relation to s 15(5) Knox J had this to say:

> "I accept that the intention of subs. (5) should be assumed to be the protection to the maximum practicable extent of the rights of the secured creditor and, without necessarily deciding the point ... it does seem to me that it was not the intention of s. 15(5)(b) to introduce as a figure for the amount which would be realised on a sale of the property in an open market by a willing vendor, anything which was significantly less than what one would anticipate the secured creditor could himself realise. That would seem to me to be an intention that it would be capricious to attribute to Parliament which, *a priori, would not be anxious to dilute the rights and security of a secured creditor.*"[103]

Further, his Lordship noted that:

> "....it appears to me that the court has to make a balancing exercise between the prejudice that would be felt by the secured creditor if the order is made against the prejudice that would be felt by those interested in the promotion of the purposes specified in the administration order."[104]

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[102] (1988) 4 BCC 708.
[103] *Ibid.* 712 (italics added).
[104] *Ibid*, 713.

Finally, it was suggested that valuation evidence should be presented by an administrator before a court would be willing to exercise its discretion under the section.[105]

Knox J's deference to the position of secured creditors may have some predictive value as far as a similar application by a receiver under s 43 is concerned. Whilst ss 15 and 43 both have the potential to 'overreach' senior chargees, the former specifies the circumstances in which an order favourable to the administrator may be made as being where such "would be likely to promote the purpose or one or more of the purposes specified in the administration order."[106] The "purpose" or "purposes" for which an administration order may be granted are those in s 8(3) Insolvency Act. By contrast, s 43 directs that authorisation for a disposal of secured property may be granted where such "would be likely to promote a more advantageous realisation of the company's assets than would otherwise be effected..."[107]. The 'protective' provisions of ss 15(5) and 43(3), however, are identically worded.

It is submitted that the pre-requisite for authorisation under s 43 will invariably be satisfied on any application. There would be no point in an administrative receiver seeking an order if the disposal of property subject to a prior-ranking security would not result in a more advantageous realisation of the company's assets. The question, then, would appear to be whether the words "a more advantageous realisation" should be qualified, so as to denote a more advantageous realisation *for all concerned.* In other words, is it necessary for an administrative receiver to show

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[105] (1988) 4 BCC 708, 713.
[106] IA s 15(2)
[107] *Ibid.* s 43(1).

that the benefit of a disposal will accrue to parties *other than* his appointor? This might not always turn out to be the case. If the debenture-holder is under-secured, the added value from a going concern sale would inure to his advantage, with other creditors being unaffected. The outcome would be that the priority position of two *secured* creditors would be effectively modified by a s 43 order.

The safeguard ostensibly provided by s 43(3) in such circumstances as these is, it is submitted, illusory if the senior creditor's concern is that the property is being sold at an inopportune time. To the extent that the consideration received is less than the amount secured, s 43(3)(b) appears to make no allowance for any *extra deficiency* resulting from a disposal at a time when the market is depressed. The critical question is therefore whether or not the courts would sanction a disposal by an administrative receiver which disturbed the senior creditor's *prima facie* claim to control of the property.

To return to Knox J's remarks in *Re ARV Aviation Ltd*[108], if the correct approach to s 15 Insolvency Act is to strike a balance between two courses potentially prejudicial to two different parties, and if the rights of secured creditors (or, in this case, a senior secured creditor) are not to be lightly impaired, there must be a presumption, where s 43 is concerned, that priorities are to be preserved. The Court of Appeal, in *Re Atlantic Computer Systems plc*[109], took this approach in relation to s 11 Insolvency Act 1986. It was noted there that where a secured creditor in an administration seeks to enforce his security a similar balancing procedure was appropriate, with proprietary rights being accorded great weight[110]. If such rights are

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[108] *Supra* n 102.
[109] [1992] Ch 505.
[110] *Ibid.* 542.

to be treated sensitively in an administration, where a wider range of interests tend to be considered than in receivership, *a fortiori* they should emerge ascendant where a receiver is in office and seeking only to further the interests of his appointor who, by definition, is a junior security holder.

Where the only *de facto* beneficiary of a going concern sale requiring the disposal of property subject to a senior charge is the appointor, the question is whether, if the senior chargee can show prejudice to his interests to more than a *de minimis* degree, discretion should be exercised in favour of an administrative receiver's s 43 application. The imperative element for that section's operation will exist, in that such a sale will promote a more advantageous realisation of the company's assets, but can it be utilised in so as to defeat a superior interest in order to inflate the monetary value of an inferior one? Quite what the courts will make of a s 43 application, if one ever comes before them, will make fascinating reading.

<u>4. Tactical avoidance of the loss of deployment decision priority</u>

Senior chargees have proprietary priority in a receivership. S 43 Insolvency Act strips them of deployment decision priority, in that an administrative receiver may, potentially, deal with 'their' charged property in a manner adverse to their interests. There are, though, certain manoeuvres open to a senior chargee which might render s 43 ineffective. Lingard suggests that:

> "...a chargee might decide to defeat s. 43 by procuring a rival offer for the asset with a view to buying it in for the full amount owing to him. If a receiver has an offer to buy in the asset at a price higher than the market value, his position will be far from easy ... A chargee might not only challenge valuations produced by the receiver or make a

rival offer, but also exercise the power of sale in his charge and sell the property at a higher price to a vehicle company formed for the purpose."[111]

Lightman and Moss also note this problem, but suggest that the resolution lies with the courts:

> "It may fairly be said that the open market value should reflect the premium value of the property to any particular purchaser willing to pay the price. But the premium value in this case does not reflect what the security-holder is willing to pay, but what he is willing to give credit for against a debt whose repayment is at least questionable. It is suggested that the court can discount such an offer as in substance an offer of credit rather than outright payment. It may also be possible to discount such offers, whether made by the security-holder or anyone else, as ransom demands which it is the scheme and policy of the Act to preclude: the security-holder is to be justly compensated, not unjustly enriched, for a loss of a security impeding an advantageous realisation."[112]

This may be the correct approach when a senior chargee is opportunistically aiming to inflate the value of his security, but where there is a genuine prospect of a rise in the market which will not be reflected in a payment under s 43(3)(a), one might equally dub the debenture-holder "unjustly enriched" if the chargee's offer is discounted.

Another ploy would be to reassert control over the asset by taking possession or appointing a fixed charge receiver. This revests deployment decision priority in the senior chargee. Quite how effective such a move would be is debatable. Taking possession, or the appointment of such a receiver, is usually a preliminary to sale. Installing a receiver simply to 'sit' on the charged property whilst the market

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[111] *Corporate Rescues and Insolvencies*, 2nd ed. (1989 : Butterworths : London), paras. 6.39-6.40.
[112] *Supra* n 44, para. 14-03.

improves might be frowned upon by the courts, particularly if, in the meantime, a rescue scheme has to be abandoned.

It might also be possible for junior and senior creditors to agree, *ex ante*, that any administrative receiver appointed will forego the use of the s 43 power, perhaps as a condition of the senior creditor injecting further cash into the company. Oditah suggests that such an arrangement is impermissible:

> "First, parties cannot contract out of s. 43 because that provision does not deal with private rights alone; it embodies the all-important policy of integrating administrative receivership into the mainstream of insolvency proceedings. Secondly, since an administrative receiver is an office-holder, any contract which excludes his s. 43 power is an attempt to fetter his discretion and on that basis contrary to the policy of the Insolvency Act. Put differently, the s. 43 power is not a result of contractual negotiations, but is incident to the receiver's status. So it cannot be excluded."[113]

With respect, the first proposition is not altogether convincing. Contracting around, if not out of, statutory provisions and the general law is a judicially accepted feature of this area of jurisprudence. As noted earlier, it is legislative policy that preferential creditors are to be paid out of floating charge assets ahead of the debenture-holder, and whilst s 40 Insolvency Act 1986 is mandatory, contractual devices to elude its repercussions have proved effective. If company and debenture-holder can contract in such a way as to prejudice third parties, it seems eccentric that that latter cannot agree with a senior chargee to waive his receiver's entitlement to utilise the s 43 power. Further, if s 43 represents an attempt to "integrate administrative receivership into the mainstream of insolvency proceedings" it is at

[113] *Lightweight Floating Charges* [1991] JBL 49, 56.

best a half-hearted endeavour. Receivership, in this regard, is a notably less potent institution than administration.

Oditah's second overture is more persuasive. In the first place, it is not entirely clear that a debenture-holder could prospectively bind a future appointee by means of an agreement with a senior chargee. Whilst it appears possible to confer the benefit of an exclusion clause in a debenture contract on a receiver[114], to restrict his freedom of action by the same method must be problematic. To the extent that the appointor attempts *ex post facto* to prevent his receiver having recourse to s 43 he can be viewed as interfering in the receivership, and so falling foul of the *American Express v Hurley* principle[115]. Given the policy of the Insolvency Act to champion the independence of administrative receivers, it is submitted that Oditah's analysis is probably correct, and that contracting out of s 43 is not feasible.

In conclusion s 43 is, perhaps, something of a misfit, an attempt to give a debt-enforcement regime the flavour of a rescue mechanism, but encumbered by the want of any device to prevent enforcement-based machinations that could rob it of its proficiency. It might be the case that receivers are able to come to acceptable compromises in this area without recourse to the section at all. Whatever the explanation for its neglect, it would be edifying to view how the forensic process deals with the balancing of competing interests inherent in a s 43 application.

[114] See Lightman and Moss, *supra* n 44, para. 7-15.

[115] See Chapter 2.

The position of chargees junior to the debenture-holder

1. Introduction

In practice, a junior chargee's interests will be best served by the receiver adopting a strategy designed to achieve maximum realisations from the company's assets. To the extent that this approach is successful enough to pay off both debenture-holder and preferential creditors, he will then have first call on the surplus. Where such tactics are unnecessary, because the appointor's interests are best served by a swift realisation programme, the junior chargee's position ordinarily languishes.

The developments in the law relating to a receiver's equitable duties of skill and care towards *the company*[116] will inevitably protect a junior chargee, not least because in *Medforth v Blake*[117] Scott VC expressly stated that the receiver's duties were owed to the mortgagor and "anyone else with an interest in the equity of redemption."[118] It might be questioned why a junior chargee should be 'lumped together' with the company in assessing the duties receiver's owe to external stakeholders, and this question is investigated in the following section.

In the event, since *Medforth*, the question is somewhat academic. The real prejudice to a junior chargee will stem not so much from a receiver's carelessness as his decision to realise the charged property expeditiously on a break-up basis, rather than seeking to maximise its value. The law in this area is therefore evaluated also.

[116] See Chapter 2.
[117] [1999] 3 All ER 97.
[118] *Ibid.* 111.

2. Receivers and junior chargees: status-based duties

> "[A receiver] must exercise his powers in good faith and for the purpose of obtaining repayment of the debt owing to his mortgagee. A receiver and manager owes these duties to the mortgagor and to all subsequent encumbrancers in whose favour the mortgaged property has been charged."[119]

There appears to be some doctrinal justification for his Lordship's conception that *the same set of duties* are owed to both mortgagor and junior encumbrancer by a mortgagee, and so a receiver. This theme will be explored first. Whether the position is politically vindicated is treated as a separate question.

2.1 Equitable intervention

Equity's prerogative over the mortgage transaction is of considerable vintage. Its cardinal protective apparatus, the equity of redemption, was designed to mitigate the asperity of the common law, which viewed a mortgagee as the outright owner of the mortgaged property. By the eighteenth century multiple mortgages over the same estate[120] were common, and since a junior mortgagee's interest was in effect in the mortgagor's equity of redemption it is hardly surprising that the Court of Chancery laid claim to the regulation of relations between senior and junior encumbrancer. It did so by extending those duties owed by a mortgagee to his mortgagor to subsequent mortgagees also.

The primary liability of such a mortgagee was to account:

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[119] *Downsview Nominees Ltd v First City Corporation* [1993] AC 295, 312 *per* Lord Templeman. Scott VC did not depart from this position in *Medforth v Blake*.
[120] Invariably land or reversionary interests in trust property.

"A mortgagee who enters into possession of, and sells part of the mortgaged property, and receives rents and purchase money, becomes liable to account to all persons entitled to the equity of redemption..."[121]

As in the case of a mortgagee in possession, the account was taken on the footing of wilful default, this principle being established from at least the end of the seventeenth century[122]. Thus, where a mortgagee entered into possession of the mortgaged property, allowed the mortgagor to receive the profits and prevented subsequent encumbrancers from entering, he was held liable to account to those encumbrancers on a wilful default footing[123]. Similarly, a mortgagee allowing the bankrupt mortgagor to remain in possession of the mortgaged property and resisting an ejectment brought by assignees was charged with the profits from that property as from the time of the ejectment[124]. On a puisne incumbrancer's suit for redemption, Sir John Stuart VC stated that:

"The true doctrine of this Court is that a mortgagee in possession of the mortgagor's property is bound to use it as carefully as if it were his own."[125]

The Court of Appeal confirmed this proposition in *In re Stockton Iron Furnace Company*[126], where James LJ noted that:

"They were mortgagees in possession liable to account in respect of this £5000 a year as against any second mortgagee or incumbrancer for what they had received or, but for their wilful default, might have received."[127]

[121] *Hinde v Blake* (1841) 11 LJ Ch 26, *per* Knight Bruce VC.
[122] See, e.g., *Maddocks v Wren* (1680) 2 Rep Ch 209.
[123] *Coppring v Cooke* (1684) 1 Vern. 270.
[124] *Chapman v Tanner* (1684) 1 Vern. 267.
[125] *Cocks v Gray* (1857) 1 Giff. 77, 80.
[126] (1878) 10 Ch 335.
[127] *Ibid.* 357.

Historically, therefore, equity has assimilated the position of a junior mortgagee with that of the mortgagor because the former has the same interest as the latter in the protection of the equity of redemption. By entering into possession and dealing with the mortgaged property the senior mortgagee was in a position to devalue that equity, and both mortgagor and junior encumbrancer would be financially damaged to precisely the same extent. Hence, logic dictates, the senior mortgagee should be co-extensively liable to both. It should be noted that this liability only extends to those third parties with a *proprietary interest* in the equity of redemption[128]. Thus it would not appear to extend to unsecured creditors, and in *Parker-Tweedale v Dunbar Bank plc*[129] the Court of Appeal held that a mortgagee's equitable duties were not owed to a beneficiary under a trust of the equity of redemption. Berg questions the authenticity of this approach, remarking that:

> "If *Parker-Tweedale* ... can be supported, this can only be done on the basis of the technical (but not inflexible) rule that the primary right to redeem is in the trustee, and can only be exercised by the beneficiary if the trustee improperly refuses to do so."[130]

With respect, subtlety of approach in this area has not proved a *forte* of the courts, their predilection for a broad-brush approach being all too conspicuous in the case law. This inclination has persisted into modern times.

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[128] See Bentley, *Mortgagee's Duties on Sale - No Place for Tort?* [1990] Conv. 431, 434-435; Lightman and Moss, *supra* n 44, 111 fn. 3.

[129] [1991] Ch 12.

[130] *Duties of a Mortgagee and a Receiver* [1991] JBL 230, 233.

2.2 The rise and fall of tort

The application of tortious liability to the relationship of mortgagee and mortgagor was discussed in Chapter 2. No authority prior to *Downsview* ever considered whether the *Cuckmere Brick* principle applied to the senior/junior encumbrancer connection. The potential for such an application is, however, implicit in the case of *Standard Chartered Bank Ltd v Walker*[131]. Lord Denning identified the appropriate test for the existence of a duty of care in negligence as "proximity"[132], and, in his usual tantalising style, hinted that that test might be satisfied in relation to general creditors of the company[133]. In New Zealand, Smellie J cited *Standard Chartered Bank* as authority for the proposition that:

> "The existence of a duty [owed by the mortgagee to subsequent encumbrancers] rests upon a straightforward application of the neighbour principle, the same approach having been taken on other occasions to mortgagors and guarantors."[134]

The same approach was taken in *Downsview* at first instance, and by Richardson J in the New Zealand Court of Appeal:

> "It is implicit [in the earlier case law] that the legal duties resting on a receiver and manager are not owed exclusively to the holder of the debenture under which the receiver was appointed. Inevitably, there are other interests involved. As agent for the company the receiver has some obligations to it. He cannot be oblivious to the interests of other secured creditors and even unsecured creditors who are directly affected by the commercial decisions he makes in receivership."[135]

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[131] [1982] 3 All ER 938.
[132] *Ibid.* 942.
[133] *Ibid.* 943.
[134] *National Westminster Finance Ltd v United Finance and Securities Ltd* [1988] 1 NZLR 226, 234.
[135] [1990] 3 NZLR 265, 274.

Prior to the Privy Council's deliberations in *Downsview*, then, negligence liability to a junior encumbrancer was orthodox law. In *Knight v Lawrence* Browne-Wilkinson VC considered the law to be as follows:

> "Though [a receiver] may be appointed by one party his function is to look after the property of which he is receiver *for the benefit of all those interested in it.*"[136]

In that case the receiver had failed to serve rent review notices on tenants of the mortgagor, resulting in the property yielding a lower rental value than might otherwise have been obtained. As noted in the previous Chapter, *Downsview* effectively ruled out a duty on the part of a receiver to exercise skill and care. *Medforth* reinstates it, locates it in equity, and confirms that it is owed to all those interested in the equity of redemption. The assimilation of junior chargee and company has, however, been attacked as illegitimate:

> "There is a conceptual gap between deciding that a first mortgagee owes a limited duty to the mortgagor in equity, that they owe a duty to a subsequent encumbrancer and, thus, the nature of the duty ought to be the same, limited equitable one."[137]

Hogan attacks the reasoning of the *Downsview* decision on the ground that it fails to distinguish between the differing interests of a mortgagor and a junior encumbrancer in the proper performance of a receiver's functions. At first instance in that case, Gault J similarly perceived a theoretical variance between a receiver's obligations to these two parties. Commenting on the question of a receiver's duties to the company, he observed:

> "It is sufficient to say that [*Re B Johnson & Co (Builders) Ltd*] was concerned with duties owed to a company in receivership. Statements made with reference to those

[136] [1993] BCLC 215, 223 (italics added).
[137] Andrew Hogan, *Receivers Revisited* (1996) 17 Co Law 226, 227 (written prior to *Medforth*).

duties do not necessarily apply to duties owed by a receiver to subsequent secured or unsecured creditors."[138]

Hogan's robust piece goes on to question Lord Templeman's "blithe assumption" that a receiver owes the same equitable duties to both mortgagor and junior encumbrancer by reference to the decision of the Court of Appeal in *Tomlin v Luce*[139]. That case was, like *Downsview*, concerned with the question of a mortgagee's duties to a second mortgagee, and the court found the former liable to compensate the latter when a sale of the mortgaged property realised less than it might have done. Hogan notes that:

> "Nowhere in this very brief judgment is mention made of an equitable duty between two mortgagees."[140]

He further considers that the liability of the mortgagee in *Tomlin* could be explained by reference to tortious principles in that "it focuses on loss traceable to the fault of the first mortgagee"[141]. A close perusal of the judgment of Cotton LJ, though, reveals that this is not the case. His Lordship based the finding of liability on the pleadings, which aver that the first mortgagees were answerable to the second for loss occasioned *by wilful default*[142]. Far from providing authority for the principle that a senior mortgagee is liable in negligence to a junior mortgagee, as Hogan suggests, *Tomlin v Luce* simply reasserts the proposition that the former party must account on the footing of wilful default to anyone interested in the equity of

[138] [1989] 3 NZLR 710, 739.
[139] (1890) 43 Ch D 191.
[140] *Supra* n 137, 228.
[141] *Ibid.*
[142] (1890) 43 Ch D 191, 194-195.

redemption. If it extends the law at all, it is through applying wilful default liability to the conduct of a sale[143].

Tomlin v Luce was cited in *Downsview* as authority for the proposition that a mortgagee owes a duty in equity to junior encumbrancers. Lord Templeman's interpretation of the case is, it is submitted, entirely correct in this respect. It has always been the position that a mortgagee in possession is under a duty to account on the footing of wilful default to all those parties having an interest in the equity of redemption, and Cotton LJ's judgment in *Tomlin* does no more than apply orthodox law. Confusion has arisen largely as a result of the reclassification of the mortgagee's duty to account as one of good faith seen in *Kennedy v de Trafford*[144], and the disunion of duties relating to sale and management of the mortgaged property.

Wilful default liability arguably applies to both activities, as evidenced by *Hinde v Blake* and *Tomlin v Luce*, the duty of good faith originally pertinent only to the former, but now occupying the entire field. But, in any event, it has always been the case that *any* liability or duty owed by a mortgagee is owed to both mortgagor and junior encumbrancer to precisely the same extent. *Downsview* does not introduce a new anomaly by assimilating the position of mortgagee and junior encumbrancer, it simply applies law that is three centuries old.

[143] This point seems to have escaped Lord Templeman in *Downsview*, who mentioned wilful default only in relation to the amount received by way of rent. *Hinde v Blake*, *supra* n 121, *may* apply the principle in relation to a sale.
[144] [1897] AC 180.

2.3 The case for limited deployment decision priority

The authorities dealing with the duty of a receiver to a junior encumbrancer converge almost exclusively on *breach of duty* situations, *viz.*, those occasions where the receiver has in some way damaged the position of the subsequent mortgagee. The courts have not been called upon to decide whether, in certain circumstances, a receiver should perform his task in a manner designed to *promote* the interests of secondary creditors. Such advancement may come about entirely serendipitously as a result of the receiver's efforts to maximise returns to his appointor. Where realisation maximisation is unnecessary, and sufficient can be raised by the sale of assets on a breakdown basis, as long as the receiver takes reasonable steps to obtain a proper price for individual assets he commits no breach of duty to junior creditors, notwithstanding that a going concern sale was both a practical proposition and would have appreciated the sums raised significantly.

The same point arises where delaying sale of one or more assets would enhance realisations, but is not obligatory in the interests of the debenture-holder. The issue is a temporal one, the crux of the matter being to what extent a receiver should be able to temporarily sideline the welfare of his appointor in order to advance that of some other party or parties. Where the only beneficiary of such an agenda would be the company, the implied term model proposed in Chapter 2 suggests that the courts could, or should, nonetheless sanction a transient displacement of deployment decision priority in favour of the company. *A fortiori* where a junior encumbrancer stands to benefit.

There is no contractual foundation for the unqualified subordination of a second to a first chargee. Indeed, in functional terms, the two are identifiable. Both have a 'moral' claim to protection by reason of their provision of finance to a commercial entity, and the mere fact that the former is prepared to lend money on an inherently more hazardous security suggests that his interests warrant at least some consideration. Where the only disadvantage to the senior creditor of the pursuit of a going concern sale, or a delay in disposal, would be that his debt would be discharged later rather than sooner, it makes eminent commercial sense that a receiver should be duty bound to prefer that course.

There is a powerful argument for allowing a junior encumbrancer deployment decision priority over the debenture-holder in the circumstances described above. Whether the courts would embrace it is a matter of speculation, and likely to remain so, since neither creditors nor receivers seem anxious to place the matter before a tribunal. The tenor of the *Downsview* judgment, though, is generally unsympathetic, with its emphasis on self-help remedies available to junior encumbrancers, such as their undoubted ability to redeem the first mortgage. If *Downsview* militates against the view that there is room, in defined circumstances, for a second mortgagee to enjoy limited deployment decision priority then it does such a creditor, and, indeed receivership, a notable disservice.

The position of guarantors of the company's indebtedness

1. Introduction

A receiver owes precisely the same duties to a guarantor of the company's indebtedness as are owed to the company itself, and to junior encumbrancers. He must exercise his powers in good faith and for proper purposes, he must take reasonable steps to obtain a proper price on any sale of the mortgaged property, and, under *Medforth*, exercise management functions with due care. According to *China and South Sea Bank Ltd v Tan Soon Gin*[145], no tortious duty of care is owed by mortgagee to guarantor, that relationship being regulated wholly by equity.

It was suggested above that a junior creditor has more in common with the appointing debenture-holder than with the company. A guarantor, on the other hand, may be aligned more comfortably with the latter. In the first place, there will be a contractual association between debenture-holder and guarantor springing directly from that between debenture-holder and company. Further:

> "The most important aspect of the nature of a guarantor's liability as a secondary liability is that it is co-extensive with the liability of the principal."[146]

Moreover, in the majority of cases where a guarantee of the company's debts is given, the surety will be director or owner (or both) of the enterprise. He may also have secured any potential liability under the guarantee by granting a mortgage over his personal assets, including his home. His 'profile', in this context, is rather more (contingent) debtor of the debenture-holder than creditor of the company, as is the case of a junior mortgagee.

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[145] [1990] 1 AC 536.

[146] *Law of Guarantees*, Andrews and Millett, 2nd ed. (1995 : FT Law and Tax : London), para. 6.2 (hereinafter *Law of Guarantees*).

It is perhaps not surprising, therefore, that in terms of the debenture-holder's obligations to each, company and guarantor should be considered as one. On the other hand their liabilities to the debenture-holder arise out of separate contracts, and it should also be noted that the law of guarantees forms a separate body to that of the law of mortgages, (although there is an unmistakable element of cross-pollination as regards the two). The appropriateness of the analogy of surety and company is hence debatable

For the most part a guarantor, like a junior mortgagee, will be protected by the receiver's duties to the company, especially now that *Medforth* introduces what amounts to a duty of care. There remains, however, one particular hazard for guarantors, that being where a receiver decides, quite deliberately, to 'speculate' on the value of the secured property. In these circumstances, should the speculation prove unsuccessful and the value of the property fall rather than rise, a guarantor is in an unfortunate position. It is this situation with which the following section is concerned.

2. Failing to safeguard the security: no remedy?

In *China & South Seas Bank Ltd v Tan Soon Gin*[147] Lord Templeman seized the opportunity to reassert the primacy of equitable duties as between creditor and guarantor. The guarantor's complaint was that the mortgagee bank had failed to realise a security, namely shares held by the company/principal debtor, at a time when a disposal would have raised enough to pay off the secured debt. Lord

[147] [1990] AC 536.

Templeman was adamant that these facts disclosed no breach of duty on the part of the bank. More precisely, he insisted that it was for the mortgagee to decide, in his own interests, if and when to exercise a power of sale:

> "The creditor had three sources of repayment. The creditor could sue the debtor, sell the mortgage securities or sue the surety. All these remedies could be exercised at any time or times simultaneously or contemporaneously or not at all. If the creditor chose to sue the surety and not pursue any other remedy, the creditor on being paid in full was bound to assign the mortgaged securities to the surety. If the creditor chose to exercise a power of sale over the mortgaged security he must sell for the current market value but the creditor must decide in his own interest if and when he should sell ... The creditor is not obliged to do anything..."[148]

The right of a mortgagee to decide upon the timing of the exercise of his remedies has been a consistent feature of mortgage law. Lord Templeman's judgment in *Tan Soon Gin* transplants that right into the law of guarantees, in what is arguably a novel move. It should be noted that the basic principle governing the guarantor's right to call upon a security held by the creditor was stated by Stuart VC as follows:

> "It is perfectly established in this court, that if *through any neglect on the part of the creditor*, a security to the benefit of which the surety's entitled is lost, or is not properly perfected, the surety is discharged."[149]

This passage was cited with approval by Quain J in *Wulff v Jay*[150], a case which Lord Templeman cited in support of his decision, and which prompted him to remark:

[148] *Supra* n 146, 545.
[149] *Strange v Fooks ?* 4 Giff. 412 (italics added).
[150] (1872) 7 LR QB 756, 766.

"In the present case the security was neither surrendered nor lost nor imperfect nor altered in condition by reason of what was done by the creditor."[151]

His Lordship's choice of *Wulff v Jay* to illustrate his point is somewhat unfortunate. In that case creditors held security over a business owned by the principal debtor, that security taking the form of a bill of sale which the creditors failed to register. Aware of the impending bankruptcy of the debtor they failed to take possession of the business, so that it fell into the hands of a trustee in bankruptcy. Cockburn CJ had this to say:

"Now I think there was twofold laches on the plaintiff's part - laches in the first place in not registering the bill of sale. If they had registered it the effect would have been that the fixtures would have been protected ... But then there was laches if possible *of a more serious description* affecting not only the moveables but the fixtures also. *The plaintiffs might have entered and taken possession upon the interest not being paid at the time when it became due.* Instead of doing this, however, they allow the mortgagors to remain in possession when they see that bankruptcy is impending and imminent. I cannot doubt myself that their intention was, that, being creditors ultra the amount thus secured, the goods in question should be available as assets under the bankruptcy, while they had the security of the defendant to come upon in order to get paid the debt of £300 secured by the bill of sale. *I think, looking at all the circumstances, it is impossible to say that the plaintiffs did what they ought to have done to realise the security they possessed.*"[152]

In effect, therefore, it would seem that the creditors in *Wulff v Jay* were penalised for failing to have recourse to one of their remedies. In *Tan Soon Gin*, however, Lord Templeman categorically denies that any such 'duty' exists. One might

[151] *Supra* n 146, 545.
[152] (1872) 7 LR QB 756, 762 (italics added).

justifiably enquire whether there is any conceptual difference between a failure to take possession of securities and a failure to exercise a power of sale expeditiously. Granted, the depreciation of the value of the shares in *Tan Soon Gin* was not the result of the mortgagee's conduct, but nor was the assumption of possession by a trustee in bankruptcy in *Wulff*. In neither case was the *security* lost due to the creditors' laches, but in both cases the *benefit of that security* became unavailable. In this respect the two cases are factually on all fours, yet the legal outcome of each is diametrically opposed.

It is submitted that if *Tan Soon Gin* is authority for the proposition that a creditor/mortgagee may sit back and observe the value of a perfectly sufficient security decline, safe in the knowledge that a guarantee will cover his indebtedness, then it is bad law and ought to be reassessed. Lord Templeman placed some emphasis on a surety's 'self-help' remedies, claiming that in such circumstances he could request the creditor to sell the security or pay off the debt and sell it himself. No such course of action recommended itself to the court in *Wulff v Jay*, and it is difficult to see why the onus to act should be placed on a surety, rather than a mortgagee, in such a situation. If nothing else, *Tan Soon Gin* represents an inefficient result in economic terms, in that valuable resources are to be allowed to become sterile. It also militates against fairness to a guarantor who may stand to lose his entire personal wealth through the capriciousness of a creditor.

3. The position of a receiver

> "A receiver, unlike the mortgagee, has no right to remain passive, even if so directed by his appointor. He owes duties to be active in the protection and preservation of the security over which he is appointed."[153]

At first sight, a guarantor should have little to fear once a receiver has been appointed, for his duty to the appointing debenture-holder would be breached were he to allow the value of a secured asset to deteriorate when a sale would be the expedient action. If the facts of *Tan Soon Gin* arose in a receivership, whether the benefit of the security was lost due to negligence or a calculated risk on the part of the receiver, it is incontestable that he would be liable to his appointor for the amount lost. Thus the debenture-holder could recover from his appointee, and the guarantor would be in no worse position and incur no increased liability. Or so the theory goes.

In practice, a guarantor may be at risk in two situations. The first is where the debenture-holder fails to pursue the errant receiver and instead falls back on the guarantee to discharge the debt. There appears to be nothing in the way of authority to suggest that this would not be a legitimate course. In *Tan Soon Gin* Lord Templeman affirmed that a mortgagee may exercise whichever of his remedies he deems appropriate, and in whatever order he deems appropriate, and that his choice can be informed purely by reference to his own interests. It is not entirely clear that this statement would encompass a remedy against a *receiver*, rather than a mortgagor or guarantor. Nonetheless, it would be far more convenient, and less expensive, to simply call in a guarantee than commence an action against a receiver,

[153] *Lightman and Moss*, *supra* n 44, para. 7.04.

and such a strategy would clearly have much to recommend it to a debenture-holder, both in financial and commercial terms.

If the omission to realise the property is due to pure carelessness the *equitable* duty to behave diligently protects the guarantor. If, however, the receiver reasonably believes he is acting in the best interests of the debenture-holder by holding on to the property in question he will, it is submitted, have a complete defence to any allegation of breach of duty. Thus, the second case in which a guarantor is under threat is where a receiver is predisposed to gamble on the chance of a rise in the market for the security. It may well be in his appointor's interests to do so, and, indeed, the debenture-holder himself may approve of such a scheme. A mortgagee's ability to speculate at the expense of a mortgagor was tentatively doubted by Sir Donald Nichols VC in *Palk v Mortgage Services Funding plc*, the learned judge observing:

> "Whether, in that situation, a mortgagee is at liberty to exercise his rights of leasing and sale in a way that in all likelihood will substantially increase the burden on the borrower *or guarantor* beyond what would otherwise be the case is not a question I need decide on this appeal ... That he can act in such a cavalier fashion is not a proposition I find attractive..."[154]

The *Palk* case was concerned with an application under s 91(2) Law of Property Act 1925, which enables the mortgagee or "any person interested either in the mortgage money or in the right of redemption" to ask the court to "direct a sale of the mortgaged property, on such terms as it thinks fit...". Nichols VC's observation was made with reference to the general law, apart from s 91(2), and would appear to

[154] [1993] Ch 331, 338.

fit the circumstances outlined above.

However, the mortgagor in *Palk* was faced with the prospect of a mortgagee leasing the mortgaged property at a rent that would not cover the interest accruing in the interim. Where a receiver or debenture-holder agrees that interest shall cease to arise[155] during the receivership period it might be argued that *Palk* becomes distinguishable, and that a decision to postpone sale does not "increase the burden on borrower or guarantor beyond what would otherwise be the case." In other words, the mortgage debt itself is not getting any larger, although the guarantor's contingent liability may in fact increase.

As to s 91(2), it would appear that a guarantor could have recourse to that section, as a person interested in the right of redemption[156]. In *Palk* it was asserted that s 91(2) gave rise to a wide equitable jurisdiction on the part of the court to make whatever order justice required, and that all the circumstances should be considered in this respect. On the facts, Sir Donald Nichols VC was especially concerned that the mortgagee in question was in effect speculating at the expense of the mortgagor, but at the same time acknowledged that there was no duty to exercise rights at any particular time[157]. Sir Michael Kerr, citing *Tan Soon Gin*, echoed this sentiment:

> "...the decision whether or not to realise his security by sale is undoubtedly the mortgagee's unfettered discretion, both in contract and in tort..."[158]

Whilst this discretion may be confined by the courts ordering a sale of the

[155] Agreements of this kind are not uncommon.
[156] *Quaere* whether a surety is entitled to redeem? *Swire v Redman* (1876) 1 QBD establishes the right to pay off the creditor and sue the principal debtor, and the right of a surety to marshalling is similarly clear; see *Law of Guarantees*, *supra* n 147, para. 11.15. The right of subrogation arises *ex post* (*ibid.* para. 11.17 *et seq.*), but it might be argued that in its embryonic form (i.e. before payment by the guarantor) it confers a right to redeem.
[157] *Supra* n 154, 337.
[158] *Ibid.* 343.

mortgaged property, the s 91(2) jurisdiction will only be exercised in exceptional circumstances. Whether a court would be amenable to the petition of a guarantor faced with a receiver proposing to delay sale in the hope of a rise in the market, *where such a delay would not increase the mortgage debt itself*, is debatable. If speculation *per se* is objectionable then one might conjecture that a sale would be ordered[159]. If the substantive misgiving is that delay imposes a *greater overall burden* on *both mortgagor and guarantor*, any incursion on a mortgagee's indisputable right to deal with the security in his own interests might appear unwarranted.

4. Conclusion

It appears a guarantor of the company's obligations enjoys no deployment decision priority, and is protected only to the same extent as the company itself. The sole qualification to this proposition may lie in the operation of s 91(2) Law of Property Act 1925. The courts thereunder could possibly override a plan of action that is in the best interests of the debenture-holder, *viz.*, a delay in the exercise of a power of sale, where such would potentially prejudice a guarantor. Without the benefit of authority directly in point, it is difficult to predict whether a court would be prepared to subjugate the potential advancement of a mortgagee out of clemency to a guarantor, who, after all, has contractually accepted that he may be made liable for the mortgagor's debt.

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[159] Perhaps with a rider that the mortgagee be allowed to buy the mortgaged property, as was ordered in *Palk*.

Where the depreciation of the value of secured property is explicable by dilatoriness, to the extent that this increases the guarantor's liability a receiver should be accountable, notwithstanding *Tan Soon Gin.* Such responsibility, if the orthodox view is followed, should arise out of an equitable duty to exercise diligence in the management of the mortgaged property[160]. Negligence apart, it is submitted that the *Tan Soon Gin* statement of the responsibilities of a mortgagee to a guarantor is unappealing. Whilst a guarantor may be identified with the company, in practice there is a separate interest to be considered. For a mortgagee, or receiver, to be able to make inefficient use of a security interest, without suffering any detriment because of the availability of a guarantee, seems aberrant. This is especially the case when one considers the typical profile of a surety in this context, who will usually be a director or owner of the company, and who will invariably have charged much of his personal wealth to secure his contingent liability. The enforcement of the guarantee, made necessary by carelessness or speculation, may tip the surety into bankruptcy. In *Tan Soon Gin* Lord Templeman sternly warned that:

> "No creditor could carry on the business of lending if he could become liable to the mortgagor and to the surety or to either of them for a decline in value of the mortgaged property, unless the creditor was personally responsible for the decline."[161]

One might add that no surety could confidently guarantee his company's debts if the law allows opportunism on the part of a mortgagee or receiver to effectively threaten his livelihood. The rout of the latter's interest in this regard goes too far.

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[160] *Medforth v Blake* [1999] 3 All ER 97.
[161] *Supra* n 146, 545.

The position of the company's unsecured creditors

Introduction

> "The law provides creditors with remedies, although it is a matter of everyday experience that in many cases creditors find the remedies yield no fruit. That, unhappily, is the creditors' misfortune: the law cannot produce money where none exists."[162]

The very fact of insolvency means that certain parties, having had dealings with the insolvent company, will be prejudiced. One class of constituents which invariably finds itself at the 'sharp end' is the company's unsecured creditors. It is no coincidence that this group has minimal proprietary priority, standing only one step ahead of the company's shareholders: indeed, that very deficit of security seals its fate under the current law, preoccupied as it is with property rights as a means of determining hierarchy over limited assets.

Unsecured creditors, as a class, usually comprise those parties who have entered into a trading relationship with the insolvent company. They will usually be its suppliers, delivering goods or providing services on credit terms, or its customers, paying in advance for goods to be delivered at a later date. It will usually be impracticable for such parties to bargain for a recognised security interest in any of the company's property[163], so that upon the crystallisation of a floating charge, usually on the appointment of a receiver, they are irrevocably located behind the holder of the charge in terms of their entitlement to the company's assets. If those assets prove insufficient to discharge both the debenture-holder's and preferential debts, the unsecured creditors will receive nothing.

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[162] *Re Kentish Homes Ltd* [1993] BCLC 1375, 1381, *per* Sir Donald Nicholls VC.

[163] Although see *infra* 287.

It should be noted at the outset that this predicament is not a product of receivership *per se*, but rather the law's recognition of the floating charge as an effective security interest. This monopoly of security, coupled with a similar monopoly of enforcement rights in the form of receivership, has inspired trenchant judicial comment for over a century. Remarking upon the ability of a debenture-holder to appoint a receiver and lay claim to the entirety of the company's property, Buckley J concluded, in 1905:

> "It is an injustice arising from the nature as defined by the authorities of a floating security. The mischief arises from the fact that the law allows a charge upon all future property. The subject, however, is one which, I think, urgently requires attention. It is not for me to say whether the matter requires the attention of the legislature."[164]

The learned judge's veiled solicitation of legislative intervention went unheeded in 1905. It was repeated, and accompanied by a cognate censure of the law, in 1977 by none other than Templeman J. His impatience with a system that consigns the interests of unsecured creditors to the back of the queue is transparent in the following passage, which is worth reproducing at length:

> "BCL's assets are about £1 million ... the preferential creditors take their fill of £300,000. The debenture-holders take the rest, about £700,000, in part discharge of bank loans, consisting no doubt of capital and interest at the crippling rates of between 10% and 20% which banks assert they are compelled to charge all and sundry. The trade creditors who perforce extended some credit to BCL in the ordinary course of business and other unsecured creditors claiming in all some £3 millions will get nothing. The question whether in this day and age it is necessary and desirable to permit the Crown and holders of future floating charges the totality of priorities which

[164] *In re London Pressed Hinge Co Ltd* [1905] 1 Ch 576, 581.

can be exercised under the existing law is not the subject of debate in this court, although I am inclined to think that it is at least debatable elsewhere."[165]

The debate called for by Templeman J was not long in coming. The Cork Committee, concerned at the inequities arising from the floating charge, remarked that its origin in a Court of Equity was "the matter for wonder"[166], and continued:

> "In a great number of cases, insolvency results in the distribution of assets among preferential creditors ... and the holders of floating charges (often though not invariably the banks) with little if anything for the ordinary unsecured creditors. We have received widespread complaints on this score. We have been left in no doubt that, as a result, there is a general disenchantment with the existing law of insolvency, and in the commercial community a feeling of anger at the barrenness of insolvency proceedings so far as the great majority of creditors are concerned. We believe that these criticisms are fully justified. Measures are urgently required to redress the balance before the whole system falls into even greater disrepute."[167]

Similar comments were made in the Parliamentary debates that followed the Cork Report:

> "The unsecured creditor almost always loses out because he is left with what remains after the holder of a floating charge has recovered his money, after preferential creditors such as the Government have taken their share, and after professional expenses have been paid. What is left to the unsecured creditor as a consequence is, in most cases, nothing."[168]

[165] *Business Computers Ltd v Anglo-African Leasing Ltd* [1977] 1 WLR 578, 580. The learned judge expressed the identical sentiment more laconically in *Borden (UK) Ltd v Scottish Timber Products* [1981] Ch 25, 42, where he described unsecured creditors as getting "a raw deal".
[166] *The Cork Report, supra* n 2, para. 107.
[167] *Ibid.* para. 233.
[168] *Hansard* (House of Commons), Vol. 78, 30 April 1985, col. 153, Mr Brian Gould.

Both Cork and Parliament observed that this injustice was perceived as exacerbated by the institution of receivership, the Review Committee reporting:

> "Another widely felt grievance is the belief that a receiver has too much regard for the interests of the holder of the charge, and that insufficient attention is paid to the interests of other creditors and shareholders."[169]

In the House of Lords the position was stated even more strongly:

> "Complaints were laid, and complaints continue, that very often receivers for debenture-holders apply themselves quite ruthlessly to the realisation of the assets in order to satisfy the charge comprising the debenture with, in some cases, scant regard either to the future of the business itself or even the plight in which creditors further down the line might find themselves..."[170]

The impetus for an overhaul of insolvency law in general, and receivership in particular, in favour of unsecured creditors was pronounced during this period. The quandary for the Cork Committee and the Government was the extent to which the balance between secured and unsecured creditors could be redressed without overly prejudicing the commercial well-being of the former. That the promotion of one group's cause would of necessity involve a subordination of the other's was acknowledged by Cork from the outset:

> "One of the most difficult questions to which we have tried to find a solution is how best to reconcile the legitimate safeguards of those who are required to provide adequate finance to commerce and industry, with justice to the ordinary unsecured creditor who is an involuntary supplier of goods, materials or services on credit."[171]

[169] *Supra* n 2, para. 438. See also, to similar effect, para. 436.
[170] *Hansard* (House of Lords), Vol. 1276, 4 Feb - 7 Feb 1985, col. 851, Lord Bruce of Donington.
[171] *Supra* n 2, para. 110.

Nonetheless, the Committee made a vigorous attempt to resolve the conflict with a package of proposals that, in some measure, was almost radical. The following section describes its eventual fate.

2. What might have been: Cork's recommendations and Parliament's response

2.1 A financial stake for unsecured creditors

The Committee identified two fundamental objections to the floating charge holders dominion in a receivership, the first, most obvious, being that it resulted in unsecured creditors benefiting not all from a receiver's management of the company and its assets. Having commented on the abundance of complaints to this effect, it concluded that:

> "We are convinced that no complete answer to the criticisms that have been levelled at the nature of a receiver's obligations can be made until unsecured creditors can be certain of having a financial interest in the proceeds of the receiver's realisations."[172]

This "financial interest" was to take the form of an entitlement to share in the "10% Fund"[173]. In essence, this fund was to consist of 10% of the net realisations from floating charge assets and would be divided *pari passu* between the debenture-holder, junior and senior floating charge holders and the company's unsecured creditors. The recommendation was of a clearly redistributive nature, and the Committee went to great pains to justify what it recognised was a controversial proposal. In the first place, it pointed out that the enactment of its recommendations *in their entirety* would offset any financial disadvantage suffered by the charge

[172] *Supra* n 2, para. 438.
[173] It is not proposed to consider the workings of the 10% Fund in detail. For a fuller exposition the reader is directed to Chapter 36 of the *Cork Report.*

holder by reason of the Fund. The reduction in the number and amount of preferential debts and the imposition of a temporary stay on enforcement proceedings were cited in this regard[174]. The Committee might have added that the 'downgrading' of the rights of utility suppliers[175] and the ability of a receiver to dispose of senior secured property would have a similar maximising effect on realisations. Given these cumulative gains to the debenture-holder:

> "It is neither inappropriate nor unfair to insist upon some concession in return for the benefit of the general body of creditors, particularly as former preferential creditors will be numbered among them."[176]

Whether or not the Government considered the extraction of such a compromise "inappropriate or unfair" is an unanswered question. The mechanics by which it was to be wrested, *viz.*, the 10% Fund, failed rather more because the executive were not convinced of its practical value, noting that chargees could avoid it simply by increasing the amount of fixed charge security taken:

> "Even if the proportion of the sums realised to be set aside for the unsecured creditors' fund were substantially greater than the proposed 10 per cent, this would serve only to reduce the value of the security conveyed by a floating charge and lead to additional reliance on fixed charges."[177]

No alternative initiative was advanced to counter the injustice perceived by the Review Committee. No doubt the Government, had they put their minds to it, might have addressed the problem in a variety of ways, one being to include in the 10% Fund realisations from fixed charge assets, or even just book debts.

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[174] *Supra* n 2, para. 1531.
[175] *Ibid.* Chapter 33.
[176] *Ibid.* para. 1531.
[177] *A Revised Framework for Insolvency Law* (1984 : HMSO : London), para. 26.

A more likely explanation for the Government's inaction is its sensitivity to pressure exerted by bankers during the consultative process. In a fascinating insight into the passage of the Insolvency Act 1986, Carruthers and Halliday describe the fierce lobbying of both the Cork Committee and the government by the banking institutions[178]. Individual clearing banks, the British Bankers Association, and the Committee of London Clearing Banks were all heavily involved, defending the floating charge in the face of criticism from such prominent contributors as Sir Peter Millett, Alfred Goldman, and Richie Penny[179], and, inevitably, opposing the introduction of the 10% Fund[180]. Given their ability to mobilise an extraordinarily potent lobbying machine, in terms of coherence and speed, and given the corresponding inability of unsecured creditors to put their case collectively through a representative organ, it is not surprising that charge holders emerged victorious in this particular debate. As Carruthers and Halliday put it:

> "With their considerable political resources, and their good relationship with the Tory party, banks successfully defeated what would have been a major blow to one of their preferred financial devices."[181]

How far the 10% Fund would have had a significant effect on returns to unsecured creditors in insolvency is a matter of conjecture. The Government's rationale for it's rejection *as a concept* is, frankly, unconvincing, and, with respect, appears to be a red herring. Even if the Fund would, as anticipated by the Government, comprise only a very small sum, a couple of pence in the pound is better than nothing. A Fund constituted over the entirety of the assets would have addressed that particular

[178] *Rescuing Business*, (1998 : Clarendon Press : Oxford), 194 -210.
[179] *Ibid.* 199.
[180] Of which they knew "well before" the publication of the Cork Report; *ibid.* 201.
[181] *Ibid.* 203.

shortcoming in any event. Lord Denning, during Parliamentary Debates in the House of Lords, noted the prestige of banking institutions in the Government's eyes, and took a side-swipe at their position:

> "I am afraid that the Government must have been much-influenced by those big bankers ... the banking community want every penny. They want the last 10%. As the Committee know, they always want their interest, right to the very top rate. The banking community do not need this 10% ... They ought to allow the unsecured creditors a little bit, just 10%, that is all."[182]

In the Commons, Mr Brian Gould described the maximisation of returns for unsecured creditors as "a light motif" (*sic.*) of the Cork Report[183], and his protest that the Bill in front of Parliament contained no reference to the 10% Fund was greeted by the retort that that fund:

> "...was intended as a fighting fund for the liquidator and not a dividend reserved for unsecured creditors, which would be a paltry sum in most cases."[184]

This seems a remarkable assertion, considering the Cork Committee's insistence that unsecured creditors should be offered the prospect of at least some financial return in insolvency. In the final analysis, one is left with the impression that a reasoned debate into the merits or otherwise of the 10% Fund was conspicuously absent during the legislative process, and that this was largely as a result of the executive's bias towards providers of debt capital. Whether this tacit partiality was justified in the political and economic climate of the time is an altogether separate question, and one on which the Government seemed notably reluctant to entertain discussion. The overall result, however, is that one of only two recommendations in

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182 *Supra* n 171, col. 1228.
183 *Supra* n 169, col. 157.
184 *Ibid.* col. 158, Mr Alex Fletcher.

the Cork Report directed towards improving the position of unsecured creditors was abandoned with the minimum of formality.

2.2 The provision of information and participation rights

> "The most frequent complaint which we have received is the lack of information once a receiver has been appointed. This is a complaint which we have received, not only from creditors, but also from shareholders."[185]

The Cork Committee addressed this problem by recommending that a receiver should be under a statutory duty to call a meeting of creditors, to prepare a report to be presented to creditors, and to appoint a 'receivership committee'[186]. These proposals were made with a view to "creating a relationship of accountability between the receiver and the unsecured creditors"[187], and their procedural operation described in some detail in Chapter 19 of the Cork Report. They were accepted by the Government and enacted in ss 48 and 49 Insolvency Act 1986.

By s 48, a receiver has three months to prepare and send to the company's creditors a report, detailing the events leading up to his appointment, the disposal of property or the carrying on of the business by him, the amounts payable to preferential creditors and to the debenture-holder, and the amount likely to be available for payment of other creditors. Further, and also within three months, a receiver is obliged to lay a copy of his report "before a meeting of the company's unsecured creditors summoned for the purpose on not less than 14 days' notice"[188]. It is open to a receiver to apply to the court for a direction that the calling of a meeting may

[185] *Cork Report, supra* n 2, para. 438.
[186] *Ibid.* paras. 477 - 481.
[187] *Ibid.* para. 481.
[188] IA s 48(2)

be dispensed with[189]. If the meeting is in fact called, it may establish a creditors' committee which may call upon the receiver to attend before it and provide it with "such information relating to the carrying out by him of his functions as it may reasonably require"[190].

The procedural aspects of ss. 48 and 49 are contained in the Insolvency Rules 1986[191]. It is not proposed to reproduce them here, except to note that they deal with such matters as venue, timing, chairman, voting rights, admission and rejection of claims, quorum, adjournment, and resolutions and minutes of the creditors meeting[192], and the constitution, establishment, functions and membership of the creditors' committee[193]. The *function* of the creditors' committee is to "assist the administrative receiver in discharging his functions, and act in relation to him in such manner as may be agreed from time to time"[194]. This final sentence is illuminating, in that it makes clear that the committee has no formal powers as against the receiver, and that its practical input into receivership will be entirely a matter of agreement.

The impressive construction of a set of procedural safeguards becomes somewhat less impressive when one considers the lack of any substantive capacity to direct the course of a receivership. Voting rights are all very well, but of little moment when what can be voted on is decided by the receiver himself. With respect, the Cork Committee's recommendations were well-meaning, but do little to improve

[189] IA s 48(2)(3).
[190] *Ibid.* s 49(1)(2).
[191] SI 1986/1925, Part 3, Chapters 3 and 4.
[192] Insolvency Rules 1986, rr 3.9-3.15.
[193] *Ibid.* rr 3.16-3.30A.
[194] *Ibid.* r 3.18(1).

the position of unsecured creditors in receivership. There seems little point in an administrative receiver gathering together creditors in order to tell them what they had already worked out for themselves, namely that their debts are unlikely to be satisfied. In any event, Stewart notes that ss 48 and 49 are hardly revolutionary:

> "The new legislation has ... given force of law to what was formerly merely good practice. A responsible receiver generally kept creditors of a company which was in receivership reasonably well informed."[195]

Doyle suggests that the requirement of a report to be provided to unsecured creditors does no more than pay "lip service to the idea of improving the position of unsecured creditors"[196], and suggests in many cases a receiver will propose dispensing with the creditors' meeting[197]. Further, and to emphasise the lack of teeth inherent in the s 49 regime, he contrasts the powers of the administrative receiver's committee with those of a liquidation committee, the latter being entitled to refuse to sanction the exercise of certain of the liquidator's powers[198].

It appears, therefore, that a receiver's involvement with unsecured creditors, via the mediums of a meeting and a committee, is of a cosmetic nature only. As Grier perceptively remarks:

> "...the creditors' committee (unlike a liquidation committee) appears to be merely advisory although some receivers who have practised for many years without such a committee might regard it as something of a statutory nuisance."[199]

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[195] *Administrative Receivers and Administrators* (1987 : CCH Edns Ltd) ¶ 421.
[196] *Administrative Receivership: Law and Practice, supra* n 76, 330.
[197] *Ibid*.332.
[198] *Ibid.* 337. Consider also the power of a meeting of creditors to disapprove the proposals of an administrator; IA s 24.
[199] *Voluntary Liquidation and Receivership*, 3rd ed (1991 : Longman : London), 184.

It would appear that the Cork Committee's aspiration to improve the lot of unsecured creditors in receivership was thwarted by the Government's refusal to enact its proposal for a 10% Fund, and by its own choice to leave the creditors' organs in receivership with no substantive powers. Any betterment of their position of unsecured creditors therefore required positive action by the courts or the development of self-help techniques. The following section examines the extent to which such initiatives have materialised.

3. The law's contribution to the position of unsecured creditors

3.1 A duty to have regard to the interests of unsecured creditors

> "...I doubt if as the law stands a receiver has any specific duties to pre-receivership unsecured creditors. If they are dissatisfied with his actions they have the remedy at any time of applying to the court to put the company into liquidation."[200]

Stevenson goes on to note that, in practice, most receivers will be "conscious of the interests of unsecured creditors", but the courts have confirmed that receivers are under no obligation to take account of those interests, let alone act to further them. This particular issue has not received much in the way of judicial attention, no doubt because its solution appears so obvious as to be not worth litigating. In any contest between debenture-holder and unsecured creditors for the receiver's allegiance, there can only be one winner. This was accepted without question by Goff J in *In re Northern Development (Holdings) Ltd*[201]:

> "It was argued, perfectly rightly, that the receivers are in duty bound to study the mortgagees, on whose behalf they were appointed, and that were they to delay sale or

[200] W R D Stevenson, *Receivers* (1973) 47 ALJ 438, 442.
[201] Unreported (1977)

refuse an offer good enough from the point of view of the debenture-holders, in the hope of getting something better for the unsecured creditors, they would incur personal liability."

Nor is the position any different once liquidation intervenes, as was pointed out in the same case by the Court of Appeal:

> "No liquidator could compel receivers, in their realisation of assets, to have regard to the interests of unsecured creditors."[202]

It should, however, be emphasised that unsecured creditors may be protected by the receiver's duty to *maximise realisations* for the benefit of the debenture-holder. The point bears repeating that it is only when the appointor's debt can be discharged without recourse to such a strategy that junior creditors are prejudiced *by receivership*. In such a situation it is abundantly clear that their welfare may not inform a receiver's decisions.

More recent case law fails to advance the cause of unsecured creditors, and, indeed, is notably meagre. Only one decided case addresses the issue of a receiver's relationship with unsecured creditors head on, and categorically dismisses the notion that he might he might be under any obligation to take account of their interests:

> "It is clear on the authorities, and no authority has been cited to the contrary, that receivers do not owe a duty to the general creditors of the company or to contributors."[203]

In the face of such an uncompromising statement, it is hardly surprising that the matter has not been litigated further. The question, therefore, of whether a receiver

[202] (1978) 128 NLJ 86.
[203] *Lathia v Dronsfield Bros.* [1987] BCLC 321, 324, *per* Sir Neil Lawson.

is under a duty to safeguard unsecured creditors *where to do so would involve no prejudice to the debenture-holder* remains unanswered.

In *Re Joshua Shaw & Sons Ltd*[204] Hoffmann J was asked whether a company's *directors* had breached their duty to its unsecured creditors by failing to advise them to petition for a winding up to shelter their entitlement to a dividend from the operation of the Limitation Act 1980. The receivers had conducted their receivership immaculately, turning a potential deficit to the debenture-holder into a surplus for all creditors, but this had taken them nine years, during which each unsecured creditor's debt became time-barred. Hoffman J, albeit reluctantly, concluded that the company's directors had been under no duty to protect its creditors via the provision of advice that might have prevented the eventual outcome. No argument was advanced to the effect that the *receivers* were subject to any such duty, and it is likely that it would have failed in any event. It has been held in relation to an administrator that the office holder owes no duty to advise a secured creditor on how best to protect his position[205]. The same conclusion would, it is submitted, be reached in the case of a receiver, who, unlike an administrator, owes no duty to consider the interests of the general body of creditors.

[204] (1989) 5 BCC 188.

[205] *Re Sabre International Products Ltd* [1991] BCC 694. Harman J, with splendid bluntness, asserted that an administrator could not be expected to "hold the hand" of the creditor.

3.2 Unsecured creditors and the duty of care

The case of *Medforth v Blake* unequivocally improves the position of unsecured creditors. If an equitable duty to take reasonable care is owed to the *company*, the company's unsecured creditors are indirectly protected to the extent that a receiver's want of diligence causes financial loss. If the company sues, any damages will go to swell its estate[206]. If the company, for whatever reason, chooses not to pursue the receiver, and is subsequently wound up, the aggrieved creditors are protected by statute. By s 212 Insolvency Act 1986, a court may penalise, *inter alia*, an administrative receiver who has been guilty of "any misfeasance or breach of any fiduciary *or other duty* in relation to the company"[207]. The court may order a defaulting receiver to make a contribution to the company's assets in whatever amount the court thinks just[208].

Berg suggests that s 212 was originally enacted on the assumption that a tortious duty of care was owed by receiver to company[209]. *Medforth* does not disturb the *Downsview* position that only *equitable* duties are owed, but it clearly offers scope to both company and unsecured creditors, the latter via s 212, to challenge careless conduct. It might, therefore, be a purely academic exercise to attempt to ascribe a *tortious* duty of care, owed by a receiver *directly* to the company's unsecured creditors. It is submitted, however, that there may be circumstances when such creditors would argue that that duty is owed to them.

206 Although such an award would have to be applied firstly in discharge of an unsatisfied floating charge.
207 IA s 212(1) (italics added). An administrative receiver falls within s 212(1)(b).
208 *Ibid.* s 212(3)(b).
209 *Duties of a Mortgagee and a Receiver* [1991] JBL 230, 233.

The utility of s 212 may, for instance, be circumscribed by an exclusion clause in the original debenture contract. Whether the equitable duty described in *Medforth* can be successfully excluded by contract has yet to be decided, as, indeed, has the question of whether such a clause would be subject to the provisions of the Unfair Contract Terms Act 1977[210]. To the extent that it can, recourse to s 212 becomes unavailable to both a liquidator and unsecured creditors, since the entire section is grounded in duties owed *to the company.* Further, s 212 only operates in the event of a winding up. Liquidation almost invariably succeeds receivership, but one can imagine circumstances where it might not. If, for example, sufficient is realised to repay the debenture-holder in full, and the residue is handed back to the company in circumstances where it can continue trading, a winding up may not take place. If the receiver has conducted the realisation process without due care, but the company, for whatever reason, is reluctant to pursue the receiver the unsecured creditors' would appear to be without a remedy unless they can point to an obligation owed directly to them. The obvious candidate is the tortious duty of care. Does the law, though, admit of such a remedy?

The short answer appears to be that it does not, although no principled rationale for this position has ever been advanced. Both *Downsview* and *Medforth* locate a receiver's duties in equity rather than tort, but it has consistently been asserted that the equitable duty is owed *to those interested in the equity of redemption.* Thus a junior mortgagee and, it would appear, a guarantor of the company's debts are entitled to enforce the equitable duty, but an unsecured creditor is not, because he

[210] It is suggested that it can: see Frisby, *Making a Silk Purse out of a Pig's Ear* (2000) 63 MLR 413, 421-422.

has no *proprietary interest* in the mortgagor's equity of redemption. One of the objections to negligence liability advanced by Lord Templeman in *Downsview* was that the relationship between mortgagor and mortgagee was already regulated by equity. Equity, though, has never occupied the field as far as the relationship between mortgagee and *unsecured creditors of the mortgagor* is concerned. The field is therefore ostensibly clear for the common law to make a dramatic entrance.

This contention is seductively simple, and, indeed, overly so. First, prior to *Medforth*, the equitable duty owed by receivers was clearly inferior to a tortious duty of care. For a court to hold, therefore, that a receiver could be liable to unsecured creditors in negligence would have left them better protected than, say, a junior encumbrancer. Such a position would be outlandish, given the deference accorded to property rights in insolvency, and the implicit precept that superior property rights attract superior protection. Thus the law's internal logic dictates that no tortious duty of care subsists as between receiver and unsecured creditors.

Secondly, it is by no means clear that *the law of tort* would apply to the receiver/unsecured creditor nexus. The main objection to the importation of a duty of care is that the latter suffers pure economic loss as a result of the former's carelessness. A full analysis of the stringent approach to this form of damage adopted in recent years is beyond this work, but a few observations may be made. Before recovery for pure economic loss will be countenanced the plaintiff must establish that he was a foreseeable and proximate victim of the defendant's negligence, and that it would be fair, just and reasonable that liability be imposed[211].

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[211] See, e.g., *Marc Rich & Co v Bishop Rock Marine Co Ltd* [1996] AC 211, 235e, *per* Lord Steyn.

Unsecured creditors are clearly foreseeable, but can they be said to be 'proximate' to a receiver? This term admits of no precise definition, and its meaning varies according to the context in which it is used. As far as economic loss is concerned, it appears that if a claimant can point to an assumption of responsibility on the part of the tortfeasor, and his own reliance on said tortfeasor, then he will be a sufficiently proximate victim[212]. Hogan, discussing the duties of a receiver, proposes the following:

> "It is submitted that by taking the role of receiver, a receiver is assuming responsibility to a degree necessary for the level of protection commensurate with tortious negligence to be applicable, however that is labelled, whether explicitly as tortious or in a reformulated equitable duty."[213]

Hogan cites *Hendersen v Merrett Syndicates Ltd* in support of this contention, but it is difficult to see how unsecured creditors can be said to *rely* upon a receiver in the sense that the Lloyds 'Names' in that case relied upon the managing agents interposed between themselves and the syndicate managers. Certainly, unsecured creditors do not authorise a receiver to act on their behalf or in their interests, and, indeed, have no choice in the matter of his management of assets in which they are residually interested.

In *Caparo v Dickman*[214] the House of Lords held that an auditor of a company owed no duty of care to its creditors, on the ground that the creditors were not sufficiently proximate victims of the carelessness in question, and it is at least arguable that the case of receiver and unsecured creditors is more analogous to this relationship than

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[212] *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145, 182, *per* Lord Goff.
[213] *Developments After Downsview* [1996] Insolvency Law and Practice 182, 187.
[214] [1990] 2 AC 605.

to that in the *Henderson* case.

On the other hand, *Caparo* is nowadays seen as the high water mark of the trend towards a restriction of negligence liability, and might be considered *passé*. Those wishing to impose tortious duties on a receiver could certainly cite more recent, less prohibitive House of Lords authority ostensibly supportive of their case. If reliance was considered important in *Henderson*, it was, as an element, relegated in *White v Jones*[215], where a solicitor who delayed in preparing a new will was found liable to the beneficiaries under that will. Clearly there was no *de facto* reliance in that case, and it arguably extends the scope of the interpretation of 'proximity' established in *Henderson*[216].

Further possible support for the proposition that unsecured creditors are proximate victims of a receiver's negligence is the case of *Spring v Guardian Assurance plc*[217], where a referee who provided a carelessly prepared and misleading reference was held liable to its subject. It might be maintained by analogy that a receiver acting primarily for a third party (the debenture-holder) is in a relationship of proximity to those who he foresees will be affected by the manner in which he performs his task, although the parallel is far from perfect.

Quite how the courts would decide this matter is uncommonly difficult to second guess. A further complication is the fact that questions of fairness, reasonableness and justice are routinely stated to be of relevance in the determination of whether tortious liability should be imposed. In this regard, Mackenzie states:

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[215] [1995] 2 AC 207.
[216] As pointed out by Lord Mustill in his dissenting judgment in *White v Jones* at 291.
[217] [1995] 2 AC 296.

"The extension of a general liability in negligence to all creditors would be undesirable, particularly since it might lead to a multiplicity of actions and a difficulty in finding receivers prepared to serve."[218]

This manifestation of the familiar 'floodgates' argument has some force in the receivership context, where a company's unsecured creditors might amount to a substantial number of individuals, all anxious to sue. The problem might be addressed at the legislative level by a provision that any action would take the form of a 'class action'[219]. This would not, however, address the problem of the costs run up by creditors prosecuting, and receivers defending actions, funds which can scarcely be spared out of an insolvent estate.

It is tentatively submitted that, if asked to decide the question, the courts would refuse to hold that a receiver owes a tortious duty of care to the company's unsecured creditors. On balance, this is probably the better approach, especially since *Medforth* now imposes an appropriately constructed equitable duty on a receiver. In those exceptional cases where unsecured creditors will not benefit from that duty it would seem that the only remedy available to unsecured creditors will be to petition the court for the removal of the receiver under s 45 Insolvency Act 1986. Both Doyle[220] and Berg[221] question whether a court would entertain such a petition, and conclude that in all likelihood it would be summarily dismissed.

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[218] *Duties Owed by Receivers to Third Parties*, (1982) 3 Co Law 80, 83.
[219] Analogous to those brought under exceptions to the rule in *Foss v Harbottle* (1843) 2 Hare 461.
[220] *Administrative Receivership: Law and Practice*, *supra* n 76, 343.
[221] *Duties of a Mortgagee and a Receiver*, *supra* n 210, 231.

3.3 Conclusion

Whilst unsecured creditors are indirectly protected against the carelessness of a receiver by *Medforth*, they remain disenfranchised in terms of their ability to influence the course of a receivership in any meaningful manner. No specific cause of action exists by which they might argue their case outside of winding up, and the value of their ability to participate in receivership via attendance of a creditors' meeting, or membership of a creditors' committee is dubious to say the least. Given the Cork Committee's anxiety that unsecured creditors should be given a greater stake in receivership, the position is open to criticism.

It can be contrasted with the position of creditors in an administration, who may, by s 27(1) Insolvency Act 1986, petition the court on the grounds that the administrator is carrying out his functions "in a manner which is unfairly prejudicial to the interests of ... creditors or members generally...". In Ireland, s 316 of the Companies Act 1963[222] allows a creditor of the company to apply to the court for directions "in relation to any matter in connection with the performance or otherwise by a receiver of his functions"[223], such an application to be supported by evidence of unfairly prejudicial conduct[224]. This would appear to reproduce the position during administration under UK law.

As it is, the existing law offers little comfort to unsecured creditors. Their lack of proprietary priority results in their interests being relegated to little more than an afterthought, and this impotence is exacerbated by the want of any meaningful participation rights in the receivership process. Little wonder that they have

[222] As amended by s 171 Companies (Amendment) Act 1990.
[223] *Ibid.* s 316(1)(a)(v).
[224] *Ibid.* s 316(1A).

responded by devising contractual solutions to their predicament, which have proved only partially successful but which serve nonetheless to make receivership law a more colourful and complex study. The following section considers the manner in which unsecured creditors have struggled to attain some level of protection against insolvency and receivership, and the extent to which they have prevailed.

4. Unsecured creditors in practice: wresting concessions during receivership

4.1 Introduction

The plight of unsecured creditors is usually represented by the fact that they are owed money which they are unlikely to receive. They are portrayed as having a 'one-off' interest in receivership, *viz.*, their only concern is whether or not they will be paid. In practice their interest is just as likely to be of a 'continuing' nature, in that it will extend to the company's trading activities during receivership and, indeed, its eventual fate. Iredale and Hughes explain the situation thus:

> "Despite the fact that they will not receive payment of past debts, an administrative receiver's dealings with trade creditors can often be relatively harmonious. If they co-operate, they may share in an increased realisation, and they can also hope to retain an outlet for their products through the new company."[225]

A receiver will often find himself called upon to harness the goodwill of unsecured creditors in order to pursue his appointor's advantage. In circumstances where the maximisation of assets can only be achieved by a period of trading and a going concern sale of the business, he will be dependent, to a greater or lesser

[225] *Tolley's Receivership Manual*, 3rd ed. (1987 : Tolleys : London), para. 11.2.

degree, on parties to whom the company owes money and who sense the opportunity to extract an advantage. On the other hand, such parties may be happy to cut their losses from pre-receivership contracts in the hope of securing orders during receivership trading. The circumstances of receivership give rise to a subtle and highly complex interaction between receiver and unsecured creditor, the outcome of which will often be decided by circumstances that are purely fortuitous.

4.2 Legal protection for receivership trading partners

> "The administrative receiver of a company -
>
> is personally liable on any contract entered into by him in the carrying out of his functions (except in so far as the contract otherwise provides) and...
>
> is entitled in respect of that liability to an indemnity out of the assets of the company."[226]

To the extent that a receiver orders supplies during receivership he is personally liable to pay for them, but is himself protected by his underlying indemnity. This provision has the effect of conferring upon post-receivership trading partners of the company a form of 'super-priority', in that a receiver's indemnity ranks for payment ahead of his appointor's security, whether fixed or floating[227]. Unsecured creditors whose products or services are *not* required in a trading receivership slip down a place in the payment 'league table' by reason of the fact that the receiver chooses to continue trading and incurring post-appointment liabilities. It appears, therefore, that both the debenture-holder and certain of the company's creditors are compelled to subsidise a trading strategy, but that only the former's interests dictate

[226] IA s 44(1)(b)(c).
[227] *Ibid.* s 45(3)(b).

whether such should be adopted. Further, to the extent that the eventual level of realisations is insufficient to discharge the whole of the secured debt, only the debenture-holder will reap any benefit from this 'investment'.

This does not mean that unsecured creditors are prejudiced to a greater extent by a trading receivership. Such will only be embarked upon if the debenture-holder's interests demand it, and this will only be the case where an immediate asset sale will result in a deficit for him. This being so, unsecured creditors would receive nothing anyway. The real risk-bearer in these circumstances is the debenture-holder, who, should the trading programme prove unsuccessful and ultimately realise less than an immediate sale would have done, will see the monetary value of his security diverted, via the receiver's indemnity, to parties who ostensibly rank below him in priority terms. Such an outcome seems unavoidable under the legislation, *unless* the super-priority position of receivership creditors can be avoided.

4.2.1 Contracting out of personal liability

In principle there is nothing objectionable about contracting out of s 44(1), since the section expressly provides for that possibility. If the receiver's personal liability is excluded, the practical effect is that the risk of post-appointment trading shifts from debenture-holder to contracting partners of the company. By contracting on such terms, the third party can be seen to consent to this displacement and so effectively waive his right to the protection offered by s 44. Lightman J suggested, in *Re*

Leyland DAF Ltd (No 2); Re Ferranti International plc[228], that a receiver might, in certain circumstances, be liable for fraudulent trading under s 213 Insolvency Act 1986. The circumstances he there described might be said to fit the case of a receivership contract entered into without personal liability. It is surely inconceivable that a contract consensually excluding such liability should expose a receiver to such strong sanction.

5. Unsecured creditors and self-help

5.1 Playing the bargaining chips

If post-appointment trading is contemplated, it will be because the welfare of the debenture-holder will be improved via the enhancement of realisations that such activities tend to generate. Thus a receiver will employ assets to generate income, or to render the company's business more saleable, and that decision will be informed by his appointor's requirements. If unsecured creditors benefit through the achievement of a surplus it will be by happy accident rather than design. Nonetheless, the fact that trading is necessary may prove advantageous to them by other routes. It may, in fortuitous circumstances, lead to the payment of *pre-receivership* (and so unsecured) debts, ahead of both debenture-holder and other unsecured creditors.

This is most likely to be the case where a pre-receivership supplier of the company is in a monopoly position. If the company cannot continue in business without his goods or services, such a party can refuse to furnish it further unless all indebtedness is discharged. This will even be the case where an instalment contract

[228] [1994] 2 BCLC 760.

envisages the supply of goods on credit but the company/buyer defaults before the contract is complete. In such circumstances the seller can simply refuse to perform his outstanding obligations[229].

A graphic illustration of this tactic is provided by the case of *Leyland DAF Ltd v Automotive Products plc*[230]. The continuation of Leyland DAF's business was impossible without Automotive's parts. Automotive were happily aware of this, and refused to fulfil outstanding supply contracts until they were paid for pre-appointment supplies. Leyland's administrative receivers, desperate to keep the business going, mounted a novel challenge, based in part on Art. 86 of the Treaty of Rome[231], which fell on stony ground both at first instance and in the Court of Appeal. Sir Donald Nicholls VC had this to say:

> "When an administrative receiver is appointed by a debenture-holder, and he seeks to carry on the customer's business with a view to selling it as a going concern, the person who primarily stands to benefit is the debenture-holder. There is no obvious reason why a supplier of goods should be expected to bear, for the benefit of the debenture-holder, the burden of an unpaid pre-receivership debt."[232]

This may be contrasted with the position of utility suppliers. Their ability to hold a receiver to ransom in this manner was circumscribed by s 233 if the Insolvency Act 1986, which entitles, *inter alia*, an administrative receiver to request a supply of gas, water, electricity or telecommunication services. Such supply may be made conditional upon the receiver personally guaranteeing charges in respect of that supply, but not conditional upon the discharge of pre-appointment liabilities[233].

229 *Re Edwards, ex parte Chalmers* (1873) 8 Ch App 289, *per* Mellish LJ at p. 291.
230 [1994] 1 BCLC 245.
231 Proscribing abuse of a dominant position in the marketplace.
232 [1994] 1 BCLC 245, 250-251.
233 IA s 233(2)(a)(b).

Prior to the Insolvency Act 1986 a supplier was statutorily entitled to cut off a supply for non-payment. A receiver, as agent of the company, was not a new 'occupier' similarly authorised to call for a new supply[234]. In practice, the only means by which power, water or communications services could be obtained was by the receiver discharging both pre- and post-appointment debts[235].

It is not surprising that statutory bodies, upon whom a *statutory* monopoly had been conferred in terms of utility supplies, should find their *de facto* power to obtain payment of an unsecured debt removed. Sir Kenneth Cork himself, during the consultation period preceding the Insolvency Act, described his own experience as receiver of a glass works, and his inability to persuade a power supplier not to cut off the supply, the result of which was the loss of valuable materials[236]. Carruthers and Halliday note:

> "If the Cork Committee had limited sympathy for any type of preference, it had none for these powerful utilities that impeded company rescue and muscled aside weaker creditors."[237]

Nonetheless, the might of the utility companies was uniquely vulnerable to the control of Government. In this regard, s 233 Insolvency Act is unusual in that it prevents one creditor from exercising the kind of commercial muscle that others are still perfectly free to employ.

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[234] This would appear to represent one of the very few disadvantages of the receiver's agency position.
[235] See, e.g., *Paterson v Gas, Light and Coke Co* [1896] 2 Ch 476; *Peat Marwick Ltd v Consumers' Gas Co* (1977) 83 DLR (3d) 161.
[236] *Rescuing Business* , *supra* n 179, 235.
[237] *Ibid.*

5.2 Contractual lienees

An unsecured trading partner of the company may escape the consequences of unsecured status by strength of bargaining power. Except in the case of utility suppliers, the law sanctions such tactics, and quite rightly. The debenture-holder's elevated position emanates from his own commercial strength, allowing him to extract advantageous property rights from the company. Many trading partners of the same company will be in no position to bargain for the kind of proprietary priority the debenture-holder enjoys. The tendency to survey unsecured creditors as a homogeneous group is, however, inappropriate in this context, as particular sub-species of the genus can escape the disadvantages of their status.

One such group is contractual lienees, having possession of property of the company and entitled to assert a *contractual* right to possession as defeating the debenture-holder's seemingly superior property rights. In *George Barker (Transport) Ltd v Eynon*[238] the Court of Appeal upheld the contractual right of a carrier to retain possession of the company's goods, notwithstanding that possession had been obtained *after* the appointment of a receiver. Farrar observes:

> "This seems to create new law. Formerly it was regarded as axiomatic that possession was essential to constitute a legal lien. The *Barker* case seems to distinguish between a legal lien and a contractual lien in a legal lien type of situation, possession being essential to the existence of the first but merely "preliminary to the exercise of the right claimed" in the case of the second."[239]

[238] [1974] 1 WLR 462.
[239] *Recent Developments in the Law of Receivers*, [1975] JBL 23, 32.

The *Barker* case, although unorthodox, was followed in relation to an equitable lien in *Re Diesels Components Pty Ltd*[240]. The principle also found favour in Northern Ireland, in the case of *De Lorean Motor Cars Ltd (In Receivership) v Northern Ireland Carriers Ltd*[241].

Whether the *Barker* decision survives the enactment of ss 234 and 236 Insolvency Act 1986 is an interesting and as yet unanswered question. The former provision allows an administrative receiver, as office-holder, to apply for a court order requiring any person who has possession or control of the company's property to surrender such to the administrative receiver[242]. The latter applies in circumstances where an office-holder is inquiring into the company's dealings, and gives the court power to require the production of "any books, papers or other records" relating to the company.

In *Re Aveling Barford Ltd*[243] Hoffman J ordered the production, under s 236, of documents of the company in the possession of its solicitor, notwithstanding that the solicitor had a lien over the documents in question. According to the learned judge, s 236 conferred a kind of "third party status" upon an administrative receiver[244], which meant that he was, in this context, in a different position to the company itself and so not subject to those 'equities' which bound the company. The outcome of an order for production was that the lien, whilst still enforceable[245], became virtually valueless.

[240] (1985) 9 ACLR 225.
[241] [1982] NI 163, and see Bell, *The Priority of General Liens*, (1986) 7 Co Law 164.
[242] IA s 234(2).
[243] [1989] 1 WLR 360.
[244] *Ibid.* 364-365.
[245] An administrative receiver cannot use s 246 Insolvency Act, which, in the case of administration or liquidation, renders a lien unenforceable.

The critical question is whether the "third party status" described by Hoffmann J is similarly conferred by s 234. If it is, then it is arguable that the *Barker* case is no longer good law, since it is implicit in that decisions, and essential to the judgment, that a contractual lien binds a receiver to precisely the same extent as it binds the company.

No case has decided this question, and it is perhaps odd that no administrative receiver has attempted to invoke s 234 in order to defeat a contractual lien. The section applies, as does s 236, only in relation to "office-holders". It is submitted, however, that s 236 has an entirely different emphasis to s 234, and to such an extent that decisions relating to the former are of no relevance to the latter. As its heading suggests, s 236 is concerned to ensure that an administrative receiver's investigation of the company's affairs and dealings may be conducted effectively. It serves to facilitate what is essentially a public service, and one which is entirely separate from a receiver's enforcement function.

No such element is present in s 234. Third party status may be considered necessary and justifiable in order to promote the policy initiative inherent in s 236, not so where its only effect is to destroy what the courts have already decided is a valid use of contractual rights, and to the advantage only of the debenture-holder. No guidance as to the manner in which the courts' s 234 power is to be exercised is given in the section itself. It is suggested that it should be used sparingly, and with the same deference to the rights of lienees as evinced in the *Barker* case. Their possessory rights are, in reality, conceptually similar to the debenture-holder's proprietary priority, in that both stem from contract. A contractual lienee is no less morally justified in asserting a judiciously bargained-for entitlement than is a debenture-holder.

5.3 Judicial ingenuity in the receivership cause: retention of title creditors

5.3.1 Ownership rights and the problems they create

The emergence of the retention of title clause in trading contracts is symptomatic of the disenchantment of ordinary trade creditors with a system of property and insolvency law that allows for the creation of a floating charge. By contractually retaining title to goods supplied to the company, such remain the property of the supplier and so are not caught by a floating charge. It is beyond the scope of this work to recount the chequered history of the retention of title clause[246]. It suffices to note here that before a retention of title clause will have the desired effect it must be validly incorporated into the contract of supply, it must not constitute an unregistered charge, and goods in the possession of the company must be shown to be the subject of that clause.

In the (perhaps unlikely) event that he is able to accomplish the above, a retention of title supplier should be fully protected against the crystallisation of a floating charge and the appointment of a receiver. Because the receiver only has jurisdiction over property covered by the charge he will have no power to deploy retention of title assets in his management of the company's business. If he wishes to use such assets he can always pay for them, but otherwise he may risk liability in conversion or trespass.

[246] See Gough, *Company Charges*, *supra* n 37.

Some protection in this regard might be offered by s 234(3) and (4) Insolvency Act 1986, which provides that a receiver will not be liable for any loss or damage arising from the disposal of property which he reasonably believes he is entitled to dispose of. But this provision does not divest the retention of title creditor of his ownership of the property, and so his entitlement to any proceeds of disposal. Nor, it is submitted, will a receiver be able to show that he had reasonable grounds for believing that he was entitled to dispose of such property. He will, as a matter of routine, have taken an inventory of goods in the possession of the company at the time of his appointment, and so become aware of the retention of title clause in the contract of supply. It is arguable that if a receiver remains blissfully unaware of the fact that goods are the subject of a retention of title clause and disposes of them in a manner causing loss or damage, he cannot claim the protection of s 234(4) by reason of his own negligence[247].

Prima facie, therefore, a retention of title creditor can assert his undoubted proprietary priority over the debenture-holder by simply repossessing his goods and an administrative receiver can do nothing to prevent this. This may cause particular problems where the goods in question are an essential part of a receiver's trading strategy. In extreme cases, the retention of title creditor may seriously jeopardise an attempt to sell the company as a going concern, or, indeed, an even more overt rescue plan. In the event, however, the position is less problematic than it might at first seem.

[247] See IA s 234(4)(a).

5.3.2 Taking the rescue initiative: *Lipe v Leyland DAF*

It was suggested earlier that the Government of the day, in enacting the Insolvency Act 1986, chose not to confer a moratorium and disposal powers on administrative receivers in order to 'sell' the more rescue-orientated administration procedure to financial institutions. If this is correct, they reckoned without the intervention of the courts, or, more accurately, the remarkable judgment of Hoffmann LJ in the case of *Lipe Ltd v Leyland DAF Ltd*[248]. The Leyland DAF receivership was one of the largest, and most economically significant of its time. Lipe was one of over 400 retention of title claimants demanding the return of its goods. The administrative receivers, who were continuing to fulfil the company's contracts and realising £300,000 to £400,000 per day in the process, refused to hand over those goods, offering instead their personal assurance that all *valid* claims would be met in due course[249]. Lipe commenced proceedings for possession and sought an injunction against the receivers. In the Court of Appeal, Hoffman LJ refused to grant one, applying the 'balance of convenience test' from *American Cyanamid Co v Ethicon Ltd*[250]. He said this:

> "If an injunction is granted, and in particular if others asserting an arguable claim to retention of title are encouraged to adopt similar tactics, the goods in question will be frozen and there will be a substantial risk of damaging the business which the receivers are trying to sell. The practical consequences are likely to be that the receivers will be forced to abandon their challenge to the retention of title clauses and pay suppliers immediately on the sale of the goods in dispute. To force a party to

[248] [1993] BCC 385.
[249] The validity of the clauses in question was being challenged by the receivers.
[250] [1975] AC 396.

> abandon a *bona fide* defence by this kind of commercial pressure seems to me an injustice which outweighs any risk which will have to be borne by Lipe."[251]

Lipe had argued that the risk to them that the receivers, faced with the possibility of having to meet many hundreds of thousands of pounds worth of claims and being unable to do so, outweighed that to the company. This contention was dismissed unceremoniously by Hoffmann J:

> "...receivers, as sensible professional men, will not lightly risk personal bankruptcy and will therefore not incur liabilities unless they are satisfied that there are sufficient assets to enable those liabilities, to say nothing of the receiver's personal expenses and remuneration, to be paid in full."[252]

This is a pioneering decision[253]. Its practical effect is to import into receivership a power similar to that in administration under s 15(2) Insolvency Act, entitling an administrator to apply to court for an order allowing the disposal of property subject to a retention of title clause. In practice, it may go further than the s 15(2) power. To the extent that a personal assurance is given by a receiver, and to the extent that *Lipe* is routinely followed, there will be little point in a retention of title claimant applying for an injunction to prevent disposal of the property in question. The principle of the case has since been applied in *Mayflower Foods Ltd v Barnard Bros.*[254], Judge Hegarty QC[255] lifting an injunction granted against receivers in relation to leased equipment which they claimed had become fixtures on the

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[251] [1993] BCC 385, 387-388.
[252] *Ibid.* 387.
[253] Swashbuckling almost!
[254] Unreported, 9 August 1996.
[255] Who, ironically, argued the case for Lipe in *Lipe v Leyland DAF*.

receivership company's premises. Again, the fact that a going concern sale was the receivers' ultimate objective was clearly influential to the eventual outcome[256].

The *Lipe* judgment was, it is suggested, driven to a great extent by Hoffmann LJ's desire to see an overall beneficial outcome in what was evidently an important receivership. There is also at least a hint of his disapproval at the 'tactics' adopted by Lipe, which contrasts sharply with the amenability of the Court of Appeal in *Leyland DAF v Automotive Products Ltd*[257] to the exertion of commercial pressure in the very same receivership.

The end result probably justifies the means by which the learned judge in *Lipe* managed to forestall what might otherwise have been a perfectly legitimate invocation of proprietary priority on the part of the retention of title claimants. Certainly, they stood to lose nothing if their claims turned out to be valid, as long as the receivers were able to back up their personal assurances with hard cash. On the other hand, it is arguable that receivers themselves might resort to opportunistic behaviour in the wake of the decision. Faced with a recalcitrant retention of title supplier, it would be expedient to challenge his clause, give the requisite personal assurance, and hope that he will agree to settle for a payment of less than the invoice value of the goods in question. Thus a seemingly utilitarian judgment may simply switch the opportunity to rely on bargaining power from one party to the other.

It is not clear from *Lipe* whether the suppliers could have framed their action purely in conversion, on the grounds that a demand for delivery up of the goods had been

[256] See (1997) 14(1) Building Law Monthly for a fuller treatment of the case.
[257] *Supra* n 231.

consistently ignored[258], and succeeded in that way. The remedy for conversion takes the form of a "forced judicial sale" of the property, and the practical effect of the *Lipe* case is precisely the same[259], except that payment would be delayed whilst the validity of the clauses was determined. It therefore appears that, in 'rescue policy' terms, retention of title claimants have nothing to lose, and other creditors everything to gain from the adoption of the decision in most cases. If, though, it appears that a useful bargaining chip has simply changed hands, and that valid claims are compromised out of an understandable desire to avoid litigation, there is something to be said for future courts treating the *Lipe* approach with caution.

5.4 Hire purchase and leasing transactions

Hire purchase contracts invariably contain a term conferring a right of repossession in the event of receivership. An administrator can apply to the courts for an order allowing him to dispose of property subject to a hire purchase agreement[260], and, further, repossession under such an agreement is subject to the permission of the administrator or the leave of the court[261]. Neither of these provisions operates in a receivership.

It will frequently be a matter of negotiation between receiver and hire purchase

[258] See Bridge, *Personal Property Law*, 2nd Ed. (1996 : Blackstone Press Ltd : London), 47 - 48.
[259] On the enforcement of the personal assurances, the suppliers would have received the invoice price of the goods in question, rather then their market value at the date of conversion: *General & Finance Facilities v Cooks Cars (Romford) Ltd* [1963] 1 WLR 644. It is submitted that the former is the more appropriate amount in the circumstances, since a retention of title creditor can hardly expect to receive more than he has contracted for.
[260] IA s 15(2)(b).
[261] *Ibid.* s 11(3)(c).

supplier as to whether the former can use or dispose of such assets. One problem encountered may be that the latter may be at a considerable bargaining advantage, being able to repossess goods the market value of which is well above the outstanding instalments due on the hire purchase contract. This will usually be the case towards the end of the hiring term, but a receiver is not altogether powerless to resist such commercial power. In *Transag Haulage Ltd v Leyland DAF Finance plc*[262] Knox J held that the court had an inherent jurisdiction to award relief against forfeiture under a hire purchase contract in circumstances where the company was in receivership and the contract had terminated. He contemplated that such jurisdiction would be exercised sparingly, and only in circumstances where a failure to do so would confer an unwarranted windfall on the owner. On the facts before him he was influenced by the receiver's offer to meet all outstanding instalments, by the prospect of a 30% windfall to the owner of the goods, and, notably, by the fact that "refusal of relief from forfeiture may cause significant loss to the company"[263]. Cumulatively, these considerations led him to believe that a grant of relief from forfeiture was appropriate in the circumstances[264].

A salutary warning to receivers to apply for relief expeditiously can be found in the case of *Alf Vaughan & Co Ltd v Royscot Trust plc*[265]. Assets were provided on hire purchase terms to the plaintiff company, the contract containing a term allowing for repossession on the appointment of an administrative receiver. Shortly before such appointment, the owner informed the company that the outstanding balance

[262] [1994] BCC 356; an interesting example of the boot being on the other foot as far as Leyland DAF were concerned.
[263] *Ibid.* 367-368.
[264] See also *On Demand Information plc v Michael Gerson (Finance) plc*, Unreported, 31 July 2000.
[265] Unreported, 15 March 1999.

amounted to £34,386. The receivers failed to apply for relief from forfeiture on their appointment, although they did request a statement of the outstanding balance on the hire purchase contracts. An offer for the business was made and the agreement was promptly terminated. The owner then offered to discharge its interest in the assets for a payment of £82,000, which the receivers agreed to pay when the owner's agents turned up to repossess the assets. After making this payment, and after the sale of the business, the company sought to recover the extra £47,613 payment as made under duress of goods.

HHJ Rich, sitting as a High Court Judge, dismissed the claim, on the ground that, although the payment was clearly an involuntary one, the threat to repossess was not wrongful purely because it was taking advantage of the receivers' failure to apply for relief from forfeiture. The subsequent negotiation of a price for release of the assets over double what had originally been due was not, according to the learned judge, obtained via the exertion of illegitimate pressure. Whether this decision accurately reflects what does, or should, constitute "illegitimate pressure" for the purposes of the law of economic duress is debatable. The owner, after all, obtained a windfall at the expense of the debenture-holder and, perhaps, the company's unsecured creditors, and it is submitted that the circumstances should have been examined in a rather more global manner. Nonetheless, to the extent that the case is good law, it behoves a receiver to examine all hire purchase contracts of the company immediately upon his appointment, and to make the appropriate applications for relief as soon after as possible.

Receivers and the company's contracts: opportunistic breach and its limits

1. Introduction

> "One of the critically important powers of a receiver is his ability effectively to repudiate pre-receivership contracts in the interests of a better realisation of the charge on the property."[266]

The nature of this power is best illustrated by example. Suppose Company X enters into a contract with Company Y. Prior to its performance, a receiver is appointed over Company Y's assets. He considers that he can make better use of the assets required for the performance of the contract with Company X and refuses to perform it. The receiver, as agent of Company Y, is not a party to the contract and cannot be personally liable on it. By causing Company Y to repudiate the contract he renders it liable in damages, but a damages award will represent an unsecured claim against Company Y, and is therefore unlikely to be met[267]. This section examines the extent to which the law protects Company Y in these circumstances, and, as a corollary, the extent to which it should circumscribe a receiver's freedom to consign a contracting partner of the company to unsecured status simply in order to benefit his debenture-holder.

2. Pursuit of the receiver in tort

A receiver will not be personally liable on a pre-receivership contract, but by causing the company to repudiate such an obligation it might be thought that he could be made liable in the tort of interference with contractual rights. The tort in

[266] Moss and Segal, *Trading by Administrative Receivers and Administrators* (1994) 7 Insolvency Intelligence 49.
[267] See Oditah, *Financing Trade Credit: Welsh Development Agency v Exfinco* [1992] JBL 541.

question is often described as an 'economic tort', and its *actus reus* is described thus:

> "Knowingly to procure, or as it is often put, to induce a third party to break his contract to the damage of the other contracting party without reasonable justification or excuse is a tort."[268]

Where a receiver refuses to utilise the company's assets to perform a pre-receivership contract it would seem that the elements of the above tort are made out[269]. The reality, however, is that a receiver is effectively immune from such tortious liability when his repudiation of a contractual obligation of the company is carried out *as agent of the company*[270].

This position originates in the case of *Said v Butt*[271]. The judgment of McCardie J was to the effect that an agent can never be liable in the tort of interference with contractual relations when the contract in question is one made between a third party and his principal. The learned judge's reasoning was based on the conceptual difficulty caused by the fact that an agent is his principal's alter ego, and a principal cannot be made liable for inducing or procuring *his own breach of contract.* Such syllogism is simplistic in the extreme, and has attracted cogent criticism, not least from the authors of *Bowstead on Agency,* who point out that an agent is concurrently liable with his principal for his (the agent's) own tortious acts[272]. A

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[268] *Clerk and Lindsell on Torts*, 17th Ed, (1995 : Sweet & Maxwell : London), para. 23-09.
[269] The defence of reasonable excuse or justification is discussed *infra* at 318-319.
[270] The loss of agency status on liquidation will, it is submitted, remove this immunity; see *infra* 320.
[271] [1920] 2 KB 497.
[272] *Bowstead and Reynolds on Agency*, 16th Ed (1996 : Sweet & Maxwell : London), para 9-115. See also *Welsh Development Agency v Export Finance Co Ltd* [1992] BCC 270, 289, where Dillon LJ confessed that he would find "no conceptual difficulty" in holding an agent liable in the tort of wrongful interference.

further objection to its application in a receivership situation is the technicality and artificiality of the receiver's agency for the company[273].

The question of the pertinence of the *Said v Butt* principle to receivership has only recently been authoritatively decided. In *Re Botibol (Deceased)*[274] Evershed J was prepared to contemplate that a *court-appointed receiver* might be liable in the tort of interference, but such a receiver has an independent status, is not an agent, and so an essential element of the *Said v Butt* reasoning was absent in that case. The first case to canvass the possibility of a *contractual receiver's* acts attracting tortious liability was *Telemetrix plc v Modern Engineers of Bristol (Holdings) plc*[275]. Peter Gibson J, without deciding the point, expressed strong doubts as to the relevance of *Said v Butt* to the agency of a privately appointed receiver. In *Lathia v Dronsfield Bros. Ltd*, however, Sir Neil Lawson had no such reservations:

> "The next point I have taken from the textbooks and authorities. A receiver can adopt or decline to adopt a contract which the company has entered into and which is unexecuted. It follows from this, and the agency clause, that an agent is personally immune from a claim for damages for a breach of contract or the procurement of a breach of contract. An agent has immunity from a claim for inducing a breach of contract unless he has not acted bona fide or acted outside the scope of his authority, i.e., had not acted as agent."[276]

The Court of Appeal confirmed this position in the case of *Welsh Development Agency v Export Finance Co Ltd*[277]. In spite of expressing some dissatisfaction with

[273] See Chapter 2.
[274] [1947] 1 All ER 26.
[275] [1985] BCLC 213.
[276] [1987] BCLC 321, 324.
[277] [1992] BCC 270.

the *Said v Butt* principle, Dillon LJ found himself constrained to apply it to a contractual receiver:

> "But the reasonings and conclusions of McCardie J have stood for so long and been so widely accepted that it is not for this court, in my judgment, to interfere with that."[278]

The law is therefore indisputably that a receiver, whilst his agency subsists, will be exempt from liability in the tort of interference with contractual relations.

<u>3. The alternative remedies: injunctive relief and specific performance</u>

<u>3.1 Court-appointed receivers</u>

In *In re Newdigate Colliery Ltd*[279] the Court of Appeal considered the question of whether a receiver appointed by the Court should be authorised to breach pre-receivership forward supply contracts entered into by the colliery company. The price for coal had risen sharply and the receiver wished to take advantage of that rise by seeking new purchasers at a higher price. All three Lords Justices[280] were adamant that authorisation should be withheld. This case, although clearly correctly decided, has befuddled the law on this question insofar as a contractual receiver is concerned, and its spectre continues to haunt the reasoning of judges asked to determine his freedom of action in the sphere of pre-receivership contracts.

Several factors may be identified which suggest that the *Newdigate* case should have no relevance to that of an administrative receiver. First, the receiver in question was compelled to seek a court order permitting him to breach the forward contracts, a position that a private receiver will not find himself in. Secondly, the

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[278] [1992] BCC 270, 290.
[279] [1912] 1 Ch 468.
[280] Cozens-Hardy MR and Buckley and Fletcher Moulton LJJ.

Court of Appeal correctly saw the receiver's obligations as being owed to two classes of constituent, the creditors and *the mortgagor company*.[281] It is axiomatic that a contractual receiver may, in his management of the company's assets, disregard the interests of the company in order to promote those of the debenture-holder. Such a requirement of even-handedness as is seen in relation to a court-appointed receiver is totally absent where privately appointed receivers are concerned.

Thirdly, Cozens-Hardy MR reached his conclusion on the basis that the receiver in question was under a duty to preserve the goodwill of the company. Again, it is clear that a contractual receiver owes no duty to preserve the goodwill of the business for the benefit of the mortgagor, except, perhaps, to the extent that he ought not to wilfully or carelessly sacrifice it. These three features of the *Newdigate* judgments are sufficient to suggest that the case is of little relevance to the question of when an administrative receiver should be free to repudiate pre-receivership contracts of the company.

Only two later decisions addressed the question of when a court-appointed receiver will be authorised by the court to disregard a contract. The Privy Council, in *Parsons v Sovereign Bank of Canada*[282], accepted without question that such a receiver was able to refuse to fulfil a pre-receivership contract. In *In re Great Cobar Ltd*[283] Warrington J focused on whether or not such a refusal would affect the value of the company's goodwill. Distinguishing the *Newdigate* case on the facts, he

[281] See Buckley LJ, [1912] 1 Ch 468, 478.
[282] [1913] AC 160.
[283] [1915] 1 Ch 682.

granted an order that the receiver should be at liberty to breach the agency agreement in question.

The institution of private receivership has proved much more attractive to debenture-holders in the years following *Newdigate*, and cases involving court-appointed receivers are now an endangered species. It remains the case, however, that that decision has influenced those on the same question in the private receivership arena, and one must question whether this is appropriate or helpful.

3.2 Contractual receivers: the cases

In *Ardmore Studios (Ireland) Ltd v Lynch*[284] a union representative sought an injunction to prevent a contractual receiver from repudiating an agreement that his members would provide services to the plaintiff company. With very little discussion of the principles involved, McLoughlin J concluded that the receiver was free to breach the agreement. It is clear from his judgment that he was influenced by the fact that the agreement in question was so disadvantageous to the company that it had precipitated the receivership[285]. Nonetheless he did observe that:

> "As agent for the Company, the Company is made fully responsible for [the receiver's] acts but it is not a corollary to this that he is bound by all company contracts and agreements entered into by the Company before the date of his appointment..."[286]

Lowry J, in *Kernohan Estates Ltd v Boyd*, explained the position by reference to authority and in a little more detail:

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[284] [1965] IR 1.
[285] *Ibid.* 40.
[286] *Ibid.*

"I think the key to the *Newdigate* case is that here was a receiver appointed who was seeking a special power *which he could not exercise without leave*, and who, in order to exercise the power, had to disregard existing obligations. I also consider that in the *Newdigate* case, unlike the [*Re B*] *Johnson* case, the court took the view ... that the mortgagor had a very definite interest in the future, and, I might say, the immediate future of the company."[287]

Newdigate was clearly considered relevant here, and particularly salient in the learned judge's view was the likelihood or otherwise of the mortgagor company having a realistic interest in the equity of redemption. It was this fact, and not any distinction between the duties of court-appointed and private receivers, that separated *Newdigate* from the case of *Re B Johnson (Builders) Ltd*[288].

The first opportunity for the Court of Chancery to consider the question was in the case of *Airlines Airspares Ltd v Handley Page Ltd*[289]. An enlightening insight into the background to this decision was candidly provided by Lightman J in 1996:

"I recall well in 1969 arguing the case of [*Airspares*] ... I, on behalf of the Plaintiff, applied for an injunction to restrain a receiver from proceeding with a sale on the ground that by doing so he would be procuring a breach of contract by Handley Page - he would be disabling Handley Page from selling aircraft and the Plaintiff from earning a Commission. The decision in the case was correct - my application was refused - but no credit due to any of those participating in the decision-making. The argument of counsel and reasoning in the judgment in that case were all vitiated by a failure to appreciate the fundamental difference in the role, responsibilities and powers of receivers appointed by the Court and of receivers appointed by debenture-holders. I was totally new to the law of receivership, and so I would suspect was my

[287] [1967] NI 27, 33 (italics added).
[288] [1955] Ch 634. It will be recalled that the *Johnson* case was not concerned with whether a receiver was legally able to breach company contracts.
[289] [1970] Ch 193 (hereinafter *Airspares*).

> opponent (though he is now a judge of the Chancery Division). The Law Reporter discretely omitted counsels' argument from the report. As regards the judge, need I say more than that he was a pure specialist patent judge unpolluted by any acquaintance with insolvency. We were all sleepwalkers in the dark - no light was shed on anything relevant by the only textbook available, namely *Kerr on Receivers.*"[290]

The learned judge's self-deprecation is both humorous and, it is submitted, to some extent undeserved. The law of contractual receivership was, in 1969, in its infancy and no authority on the question in hand existed. Moreover, little in the way of principle was available. Nonetheless, Graham J, in *Airspares*, made a valiant attempt, phrasing the central question thus:

> "...is a receiver and manager, appointed by debenture-holders, in a stronger position, from a legal point of view, than the company itself in respect of contracts between unsecured creditors and the company?[291]

Again, the question of whether the company could expect to re-assert control over the equity of redemption in any practical sense was considered germane. The learned judge also identified another relevant consideration, namely that if a receiver was compelled to perform pre-receivership contracts, "almost any unsecured creditor would be able to improve his position and prevent the receiver from carrying out, or at any rate carrying out as sensibly and as equitably as possible, the purpose for which he was appointed"[292].

This is a perceptive observation, and, it is submitted, more relevant than any

[290] *The Challenges Ahead: Address to the Insolvency Lawyers' Association* [1996] JBL 113, 114 - 115.
[291] [1970] Ch 193, 198.
[292] *Ibid.* 199.

contemplation of the company's activities post-receivership. Unfortunately, Graham J did not elaborate further, preferring instead to answer his own question by reference to a passage in *Buckley on the Companies Acts*[293], that passage reciting the position as regards court-appointed receivers and stressing the relevance of the effect of a repudiation on the goodwill of the company. In effect, therefore, *Airspares* departs hardly at all from the case law on court-appointed receivers, and proceeds on the basis that precisely the same considerations are determinative in the case of a contractual receiver. This is understandable, but nevertheless unfortunate in that it sets an inappropriate benchmark for following cases.

4. Developments after *Airspares* - towards a principled approach?

The academic commentary following *Airspares* was largely supportive[294]. O'Donovan, however, took a different view:

> "In retrospect it appears that his Lordship ... allowed the receiver and manager considerable latitude in attending to the interests of the secured creditor. By contrast, the interests of the unsecured creditors received scant attention. Moreover, while it could not be said that the appointee acted in bad faith, it seems that he spared little thought for the debtor company."[295]

The courts, when presented with the opportunity to apply the *Airspares* principle, chose instead to qualify it, and, in the Commonwealth, to do so almost out of existence. In *Schering Pty Ltd v Forrest Pharmaceutical Co Pty Ltd*, Helsham CJ was blunt:

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[293] 13th ed. (1957 : Butterworths : London), p. 244.
[294] See Henchman, *Remedies of the Secured Creditor* (1971-1972), 10 UWALR 20.
[295] *The Duties and Liabilities of a Receiver and Manager* (1979) 12 MULR 52, 58.

> "If [*Airspares*] purports to be a decision asserting a general principle such as is stated in the headnote ... then I think it is plainly wrong. What that would amount to is an assertion of principle that a receiver is entitled to avoid onerous contracts..."[296]

Having concluded that *Airspares* decided no such thing, he proceeded to infer that the Courts would, and should, be prepared to grant an injunction to prevent the company, by its servants and agents, acting in breach of an express negative stipulation in a contract. This case therefore contemplates that equitable remedies will be available against a company in receivership, the most obvious being an injunction or an order of specific performance.

This was confirmed in the case of *Re Diesels & Components Pty Ltd*[297]. McPherson J cited *Schering* as authority for the proposition that, where damages would be an inadequate remedy, the company's contracting partner "...may be entitled to either specific performance or an injunction that has the effect of obliging the company, and through it the receivers and chargee, to adhere to and to perform a pre-receivership contract"[298].

A consideration of equitable remedies, or rather their free availability to prevent a breach of a pre-receivership contract, appear to be very much *de rigeuer* in this respect. The first UK decision to embrace equitable intervention does so wholeheartedly. In *Freevale Ltd v Metrostore (Holdings) Ltd*[299] Judge Rattee QC set out his stall from the outset:

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[296] [1982] 1 NSWLR 286, 291.
[297] (1985) 9 ACLR 825.
[298] *Ibid.* 829.
[299] [1984] 1 Ch 199.

"Now, the first thing to note about the facts of [*Airspares*] is that the contract concerned was not one of which the court would, apart from receivership, grant specific performance."[300]

Having identified grounds upon which to distinguish *Airspares*, and having noted that the entry into a valid contract for the sale of land conferred upon the prospective purchaser an equitable interest in that land, the learned judge asked himself whether the appointment of a receiver somehow destroyed that equitable interest[301]. The focus of the enquiry, therefore, shifts from the rights of the debenture-holder and company *inter se*, as seen in *Newdigate* and *Airspares*, to the rights of the third party contractor, as espoused by the Australian cases noted above. Having reviewed existing authority and found it of no assistance, Judge Rattee chose instead to follow the approach of the courts to the similar question in a series of bankruptcy cases[302], and inferred from those decisions that the answer to the question he had earlier asked was "No". That being so:

"...it seems to me quite clear that the court ought to perfect the interests of the purchaser by calling upon the companies to transfer that legal estate in perfection of the equitable interest already vested in the plaintiff."[303]

Freevale was distinguished in the Irish case of *Tullow Engineering (Holdings) Ltd*[304], where one company in a group granted a floating charge over its shareholding in another company in the same group. It then granted an irrevocable option to purchase those shares to a third company in that group. A receiver was

300 [1984] 1 Ch 199, 202.
301 *Ibid.* p. 203.
302 *Pearce v Bastable's Trustee in Bankruptcy* [1901] 2 Ch 122; *In re Bastable, Ex parte the Trustee* [1901] 2 KB 518.
303 [1984] 1 Ch 199, 210.
304 [1990] 1 IR 452.

appointed and the third company purported to exercise its option. Blayney J held that in these circumstances the receiver was free to refuse to transfer the shares to the third company. *Freevale* concerned a *contract* for sale rather than an option to purchase, and so was distinguishable.

With respect, this reasoning is less than convincing. The existence of a *contract for sale* was only critical to the *Freevale* case because it served to create an equitable interest in the prospective purchaser. If *Freevale* was considered authoritative, as it must have been since the learned judge chose to distinguish it, he should instead have determined whether the grant of an irrevocable option to purchase shares creates a similar equitable interest. It is not clear whether such an option, where shares are concerned, does create *in rem* rights. In the case of land, an option to purchase has been held to confer a proprietary interest for the purposes of establishing an overriding interest under s. 70(1) Land Registration Act 1925[305]. It might, however, be argued that such cases have no relevance to options other then in relation to land.

Whilst ignoring the question of the third company's equitable interest (or otherwise), in the shares in question, Blayney J gave full consideration to the nature of the *debenture-holder's* rights. He considered these, by reason of the crystallisation of the floating charge, to amount to equitable ownership. That being so, the company was in no position to enter into a contract for sale in fulfilment of the option to purchase[306]. This only partially addresses the real issue, *viz.*, where two parties are claiming the right to have property deployed in a particular manner,

[305] *Webb v Pollmount* [1966] Ch 584; *Kling v Keston Properties Ltd* (1989) 49 P & CR. 212; *Ferrishurst v Wallcite Properties* [1999] 1 All ER 977.
[306] [1990] IR 452, 458.

which should prevail? In the event, it appears that the learned judge was especially influenced by the fact that the third company, if entitled to exercise its option, would be able to obtain the shares in question at roughly a third of their true value. Whilst this may be relevant in determining whether the equitable remedy of specific performance is available, it is submitted that it is an insufficient ground of itself on which to base a judgment.

A case expressly appreciating the importance of what resembles a contest between competing equities is *Astor Chemicals Ltd v Synthetic Technology Ltd*[307]. Vinelott J said this:

> "The question is one of priority. So a receiver will be restrained from acting in breach of an obligation entered into by the company if the consequences would be to deprive the plaintiff of an equitable interest *ranking ahead of the debenture ...or, I think, any other proprietary or contractual right binding on the debenture-holder.*"[308]

This, it is submitted, accurately identifies the essence of the enquiry. The learned judge, however, suggested that the *Newdigate* case was of continued relevance:

> "It does not follow that a receiver can otherwise act in disregard of contractual obligations binding on the company. He may not be entitled to do so if, for instance, there is a doubt as to whether there will be a surplus of assets available to the company and other creditors after meeting the debt due to the mortgagee and if the breach might seriously damage the reputation of the company and impair its goodwill, or if the charge does not extend to all the assets of the company and the breach might affect the ability of the company to continue to trade with its other assets."[309]

It appears from this that Vinelott J was not prepared to discount the question of *the*

[307] [1990] BCLC 1.
[308] *Ibid.* 11 (italics added).
[309] *Ibid.*

company's interest in deciding the point in question.

A further circumstance in which a court has been prepared to grant injunctive relief against a receivership company is where damages for breach of contract will be an inadequate remedy. Harman J, in a judgment that threatens to reverse the location of deployment decision priority altogether, made the following observation:

> "It is quite true that this contract [to grant a right of pre-emption over machinery] does not bind any third party, it is quite true that it does not give any equitable interest in the property, but it does not to my mind follow that there is no power in the court to grant any remedy or relief in respect of it other than damages. The prime remedy for breach of contract is, no doubt, damages, but a threatened breach of contract may be restrained by injunction even though there be no property rights arising under the contract."[310]

The learned judge upheld a pre-existing injunction against the breach of contract but varied it. The plaintiff was not to disclose his right of pre-emption, was to match any other offers made for the machinery, and was to accept or refuse the receiver's offer to sell to him promptly. This variation would ensure that the debenture-holder would not lose financially by his receiver's inability to sell the property other than to the plaintiff. Nonetheless, the judgment goes far further in favour of pre-receivership contracting partners of the company than any preceding it. It is unclear upon what principle it is based, other than a rather vaguely expressed inherent equitable jurisdiction to grant relief where damages would be an inadequate remedy[311].

[310] *Ash & Newman Ltd v Creative Devices Research Ltd* [1991] BCLC 403, 406.
[311] Which will virtually always be the case.

5. The breach of pre-receivership contracts : a coherent approach?

5.1 The cumulative effect of the authorities

From the preceding discussion it appears that the courts have identified several considerations relevant to the question of when a receiver may be restrained from disregarding pre-receivership obligations of the company. These include the effect of the breach on the company and/or its goodwill, the nature of the contracting partner's rights, the nature of the debenture-holder's rights, the adequacy of a damages remedy, and the elevation of an unsecured creditor over the debenture-holder and other unsecured creditors. Oditah, in reviewing the cases up until 1990, analyses the nature of the problem in great detail and concludes that the authorities go too far. In particular he notes that:

> "...the proposition deducible from [*Airspares* and *Astor Chemicals*] that a receiver appointed out of court cannot repudiate or refuse to perform the company's current contracts where there is a doubt whether there will be a surplus of assets for payment of other claims or where this will seriously affect the company's trading prospects or its goodwill is much too widely stated to be accepted as law. Secondly, the limitation suggested by the *Schering* case goes much too far and lacks grounding either in principle or precedent."[312]

To the extent that Oditah considers the position of *the company* as irrelevant to the enquiry, it is submitted that he is entirely correct. This particular consideration is no more than a judicial hangover from *Newdigate*, and should be dispensed with altogether as a factor which warrants attention. It is unconditionally established that deployment decision priority is located with the debenture-holder, so to suddenly

[312] *Financing Trade Credit: Welsh Development Agency v Exfinco* [1992] JBL 541, 563.

afford the company reflection where a receiver proposes, *in the interests of the debenture-holder*, to repudiate a pre-receivership contract belies existing law.

This proposition extends to a breach of contract that will effect a company's ability to trade with its free assets. Oditah suggests that:

> "...it cannot seriously be doubted that, as a receiver's powers are limited to charged assets, he must be careful not to allow a repudiation of contract to impair the company's ability to continue to trade with what are, at least so far as the receiver is concerned, the company's free assets."[313]

With respect, it is not immediately obvious why this should appear so self-evident. In practice, such a situation is unlikely in receivership, where a global floating charge will usually preclude the possibility of the company having free assets at all. But to the extent that it does, why should a receiver eschew the advantage that breaching a contractual obligation will give his appointor simply because the company may be prejudiced? This would appear to amount to a principle that a debenture-holder, through his receiver, may only exercise his rights over the charged assets in a reasonable way, a wholly novel overture as regards contract law. Oditah's criticism of the *Schering Pty* decision is wholly warranted, and applies to that in *Ash & Newman*. Damages will always be an inadequate remedy for the party on the receiving end of a breach of contract. To apply this principle routinely would amount to a blanket ban on the repudiation of pre-receivership contracts and have the effect of giving deployment decision priority to an unsecured creditor. This cannot be seriously contemplated.

[313] [1992] JBL 541, 563.

5.2 Breaching company contracts: the preferred approach

It bears repeating that the real issue here is a contest between the debenture-holder and the contracting partner of the company. A comparison of their respective rights, therefore, is wholly appropriate, and the approach of Vinelott J in *Astor Chemicals* is to be commended in this regard. If the third party is able to assert an equitable/proprietary interest in the property required to fulfil the contract in question, it is in accordance with the proprietary basis of receivership law as a whole that deployment decision priority should rest with him. One foreseeable problem here is in determining which of two equitable interests is the cardinal interest.

If the third party's equitable interest is in an asset which, prior to appointment of a receiver, was the subject of a floating charge, does the debenture-holder's temporal ascendancy give him the advantage[314]? Or does the 'freedom to deal' with floating charge assets inevitably render the debenture-holder's interest of a subordinate nature to that of the third party? In practice it is difficult to conceive of circumstances where such a determination would have to be made, since it is unlikely, given the nature of floating charge assets, that a third party would be able to acquire any proprietary interest of his own in them.

A further point to recommend this approach is that it answers the apparent injustice created by the receiver's immunity in the tort of interference with contractual relations. By weighing the relative rights of debenture-holder and third party, a court will effectively ask the question whether, had the *debenture-holder* caused the

[314] Under the principle that where equities are equal the first in time prevails.

company to breach its obligation, he would have been justified in doing so. The defence of justification is an effective answer to an allegation of a tortious interference with contractual relations. Whilst the scope and operation of this defence are far from transparent[315], the court may have regard to:

> "...the nature of the contract broken; the position of the parties to the contract; the grounds for the breach; the means employed to procure the breach; the relation of the person procuring the breach to the person who breaks the contract; and ... the object of the person in procuring the breach."[316]

Such an overview would, it is submitted, allow a court to take account of the *result* of any breach, and to assess whether the overall gain, in the form of enhanced realisations, is a sufficient answer to the plaintiff's loss. In *Edwin Hill & Partners v First National Finance Corp.*[317], a case very much in point, the Court of Appeal considered a debenture-holder's interference as justified because the interference in question was prompted by a desire to protect the debenture-holder's security[318]. It is equally feasible that a court could have regard to the likelihood of the breach releasing property that could be more profitably employed elsewhere, perhaps in pursuit of a going concern sale that might maximise realisations to such an extent that the company's unsecured creditors would benefit.

To the extent that the receiver's agency alone protects him from liability in tort, it seems assured that the onset of liquidation will remove that protection, since liquidation puts an end to the agency status[319]. In such circumstances a receiver will

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[315] See *Clerk and Lindsell on Torts*: "...it is impossible to lay down any general rule about the nature of the defence."; *supra* n 268, para. 23-09.
[316] *Glamorgan Coal Co v South Wales Miners' Federation* [1903] 2 KB 545, 573, *per* Romer LJ.
[317] [1989] BCLC 89.
[318] For an incisive and interesting critique of this decision, see O' Dair, *Justifying an Interference with Contractual Rights* (1991) 11 OJLS 227.
[319] See Doyle, *supra* n 76, 309.

presumably be vulnerable to an allegation of tortious interference with contractual relations, and will have to rely upon a defence of justification. That this should be the case only after liquidation seems artificial, and no good policy reason exists to explain why one particular unsecured creditor is better protected after liquidation, which is a collective procedure, than before it.

The *Astor Chemicals* approach is, it is submitted, the preferred one, to the extent that it focuses on the respective rights of debenture-holder and contracting partner. Considerations of the company's rights are superfluous, and the courts should avoid such. One final issue is whether an injunction restraining a threatened breach, or a decree of specific performance, should be denied when it would have the effect of elevating the party seeking the injunction or decree to a position above that of creditors who have no such opportunity. In other words, should the fact that one party has the benefit of a contract which confers upon him rights prior to those of the debenture-holder be sufficient to allow him to assert those rights to the detriment of creditors who are unsecured by reason of the fact that they have not been paid?

As seen earlier in relation to contractual lienees, the law on occasion allows one potentially unsecured creditor to steal a march upon both debenture-holder and other unsecured creditors via the assertion of contractual and quasi-proprietary rights. The likelihood of this position having a substantial effect on other unsecured creditors is probably very small, given that few creditors of the company will be in a position to assert possessory rights, and that their claims will be relatively small. Where a contracting partner is concerned, though, there may be circumstances where his right to have the contract performed will have a disastrous effect upon the level of realisations achievable. If the contract in question is for the sale of property central to the company's operations, and if a much higher price could be obtained for it if it were sold in a going concern sale, that difference will, potentially, be borne by the unsecured creditors. Moreover, without the asset in question a going concern sale may be unattainable.

In these circumstances it is arguable that the court should have regard to the question of proportionality. Whilst the third party may have rights superior to the debenture-holder, the exercise of those rights, where they will have a disproportionately detrimental effect on *all other creditors*, ought perhaps to be subordinated in pursuit of an optimal outcome for all concerned. As the law stands it is doubtful that such an approach could be sanctioned. If the question was framed in terms of a receiver's liability in tort, he might be able to invoke a justification defence[320], but under the present law tortious liability does not become an issue until liquidation.

In the final analysis, this entire area is in need of clarification. As the authorities stand, a discontented third party threatened with a repudiation of his contract by a receiver has every incentive to embark upon expensive litigation in the hope of obtaining injunctive relief or a decree of specific performance. This cannot be an acceptable state of affair. Insolvency litigation tends to benefit only insolvency lawyers. What is required, therefore, is a principled and policy driven discussion that takes in all the issues and attempts to find a solution based on the most advantageous outcome for all concerned.

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[320] See O'Dair's useful discussion of the proportionality question, *supra* n 318, 243.

The external dimension - some conclusions

The impact of third party rights forms an important part of receivership law. The position of external 'stakeholders' cannot be explained by reference to contract, and the courts have had to struggle to achieve a balance in an area where the debt enforcement function has traditionally been viewed as principal. For the most part, they have worked very much in the dark, falling back on the debenture-holder's proprietary priority position to explain some of the more overt disparities highlighted by receivership.

Clearly, the receiver's primary duty to the debenture-holder results in the demotion of the interests of third parties. Preferential creditors have proprietary priority over floating charge assets, but if the debenture-holder's advantage is best promoted by a course that does not involve the deployment of such assets, the receiver is duty bound to follow that course. Senior secured creditors may find their proprietary priority imperilled by a s 43 Insolvency Act application to court, made by an administrative receiver with his appointor's welfare in mind, although it is unclear how the court would respond to such an application. Junior secured creditors and guarantors have no place in the receiver's deliberations, except to the extent that he may not prejudice their position by failing to conduct his sale and management activities with due diligence. Unsecured creditors have even less of a stake in receivership, the law at present compelling them to wait until liquidation before mounting a challenge against a receiver, and even then such a challenge is dependent upon there having been a breach of duty owed to the company.

If the above seems to paint a bleak picture, it must always be borne in mind that, in certain circumstances, the receiver's duty to the debenture-holder will inure to the benefit of all of the above. Whenever he is compelled to deploy the company's assets to achieve maximum realisations, usually by attempting to sell the company's business as a going concern, there will always be a chance, albeit remote in some cases, of a surplus over the amount owed on the debenture. Receivership does not *per se* operate to the detriment of all but the debenture-holder; only where he is over-secured does the potential for this effect come into being. In those circumstances there is at least an argument that regard should be had to external stakeholders, at least where the only disadvantage to the appointor is temporal in nature.

It should also be noted that the case law on occasion reveals some ambivalence towards the supremacy of the debenture-holder. This is especially evident where contractual or quasi-proprietary rights have been held to take precedence over the appointor, notwithstanding that his proprietary priority is established. The contractual lienee authorities are a case in point, and perhaps are symptomatic of a certain judicial distaste for the plight of unsecured creditors in insolvency. In other areas, though, self-help techniques have been treated less gently, even where, ostensibly at least, proprietary priority rests with a third party. The decision in *Lipe v Leyland DAF*[321] is a good example of a court being prepared to elevate a cause, in this case the maximisation of realisations, over and above the immediate rights of a third party to property in the possession of the company. On its facts *Lipe* is a courageous, if unorthodox, decision. Whether it should be followed at every opportunity is debatable.

[321] *Supra* n 248.

In the final analysis, the courts appear to have achieved a workable balance with few legislative tools to hand. The majority of their decisions have been informed by the debenture-holder's proprietary priority over the charged property, and, in the absence of a clear executive policy of promoting the interests of other stakeholders, this is both understandable and legitimate. The clear rejection of the Cork Committee's proposals directed at awarding unsecured creditors a financial stake in receivership situations signals, if anything, Parliamentary acceptance that the debenture-holder remains the party deserving of primacy, and the courts have not departed from this position to any great extent.

The development of the law as regards the rights of third parties in receivership has been patchy and uninformed by any over-arching policy. This deficiency cannot be attributed to any laxity or lack of imagination on the part of the courts, but rather to the executive's inability to make up its mind over what the focal point of receivership should be. As far as external stakeholders are concerned, a more rescue-orientated regime for receivership, with less emphasis on the welfare of the debenture-holder, would ostensibly be preferable to the rather 'cut and paste' system that emerged from the Government's treatment of the Cork Report.

The final Chapter of this work will attempt to assess the *overall* performance of receivership as a regime, and the question of third party rights will be readdressed in the light of an evaluation of *practice*, as opposed to law. First, however, it is necessary to examine the impact on receivership law of one particular interest group, namely the company's employees.

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