England and Wales Court of Appeal (Civil Division) Decisions

IN THE SUPREME COURT OF JUDICATURE QBENF 98/1624/1
IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE HIGH COURT OF JUSTICE
QUEEN'S BENCH DIVISION
(His Honour Judge McGonigal
sitting as a Deputy High Court Judge)
Royal Courts of Justice
The Strand
London WC2

Wednesday 26th May, 1999
B e f o r e:

THE VICE-CHANCELLOR
(SIR RICHARD SCOTT)
LORD JUSTICE SWINTON THOMAS
LORD JUSTICE TUCKEY

- - - - - -

DOUGLAS MEDFORTH
Plaintiff/Respondent
- v -

JAMES PETER BLAKE & OTHERS
Defendants/Appellants
- - - - - -

- - - - - -
MR P SMITH QC and MISS L ANDERSON (Instructed by Messrs Dibb Lupton Alsop, Leeds LS1 5JX) appeared on behalf of the Appellant
MR P HAMLIN and MR T WATKIN (Instructed by Messrs Drivers, York YO1 8LR) appeared on behalf of the Respondent
- - - - - -
J U D G M E N T
(As approved by the Court)
- - - - - -

THE VICE-CHANCELLOR: The issue on this appeal is whether a receiver and manager of a pig farm, appointed by a mortgagee, owes any duty to the mortgagor, over and above a duty of good faith, as to the manner in which he conducts the pig farming business. The appeal is from the judgment of His Honour Judge McGonigal given on 20 November 1998 on a preliminary issue.

The proprietor of the pig farming business is Mr Medforth, plaintiff in the action and respondent in this Court. The judge described Mr Medforth as “a pig farmer on a very large scale”. In April 1982 Mr Medforth had 2,000 sows which, by February 1984, had increased to 3,000 sows. He had also 120 boars and 11,000 weaners or thereabouts. In 1985, the turnover of the business was over £2 million. These figures demonstrate the scale of the business.

In order to finance this business, Mr Medforth had borrowing arrangements with his bankers, Midland Bank plc. His borrowings were secured by two Agricultural Charges both dated 13 July 1982 and made under the provisions of the Agricultural Credits Act 1928. One was to secure his current account overdraft; the other was to secure his indebtedness on a loan account. They were in identical terms.

Each Charge entitled the Bank to appoint receivers of the property subject to the Charge and provided that the receivers should have power (inter alia):-

“(a) To take possession of collect and get in any property hereby charged ...;

(b) to carry on manage or concur in carrying on and managing the business of the Farmer and ... to raise or borrow any money that may be required upon the security of the whole or any part of the property hereby charged;

(c) to sell or concur in selling all or any of the property hereby charged ...;

...

(g) to do any such other acts and things as may be considered to be incidental or conducive to any of the matters or powers aforesaid and which he or they lawfully may or can do as Agent for the Farmer”.

Each Charge provided also that:-

“any Receiver or Receivers so appointed shall be deemed to be the Agent of the Farmer and the Farmer shall be solely responsible for his or their acts or defaults and for his or their remuneration”.

By February 1984 Mr Medforth's indebtedness to the Bank exceeded £800,000. The Bank, on 21 February 1984, appointed Mr Blake and Mr Jones, partners in Robson Rhodes, Chartered Accountants, "to be the Receivers of all the property comprised in the said Charge(s) with all the powers conferred on a Receiver thereby". The appointments expressly said that "the Receivers shall be the Agents of the Farmer who alone shall be responsible for their acts and defaults".

On 1 May 1987, following Mr Blake's retirement, another Robson Rhodes partner, Mr Hore, was appointed Receiver in his place. Mr Blake has since died. The defendants named in the title to these proceedings are Mr Blake, Mr Jones and Mr Hore. The action against Mr Blake has presumably abated, but nothing turns on that. They, or, more accurately, Mr Jones and Mr Hore are the respondents to this appeal.

After their appointment the Receivers exercised their power to carry on the farming business. Their accounts for the period 22 February 1984 to 30 April 1985 showed a net profit of £251,836. That profit was applied in reduction of Mr Medforth's secured overdraft. The next trading year appears to have been less successful. A net loss was incurred. The secured overdraft was reduced to £23,896 but the Receivers' own overdraft rose to £106,498.

A very substantial element in the trading costs consisted of the cost of feed for the pigs. In the first accounting period sales of pigs produced £2, 473,171 and out of the total cost of sales of £1,359,513, the cost of feed stuff comprised £1,193,919.

In September 1988, by which time Mr Medforth's secured indebtedness to the Bank was £537,944 odd, the Bank entered into new financial arrangements with him under which the secured indebtedness was repaid. The Receivers were then discharged.

Mr Medforth was dissatisfied with the manner in which the Receivers had carried on the farming business. He had a number of complaints, of which only one remains relevant. His complaints led to the commencement of proceedings in February 1990. The one remaining issue relates to the arrangements made by the Receivers for the purchase of feed for the pigs.

The Receivers, as Mr Medforth had done when he had been running the pig farm, purchased their supplies mainly from two sources. One was the B.O.C.M. Group of Companies, in particular, United Agricultural Merchants Ltd; the other was Dalgety Agriculture Ltd. As to this, Mr Medforth's pleaded case included the following allegations:-

(i) that B.O.C.M. and Dalgety offered, or were willing to allow, discounts to large-scale purchasers such as the Receivers;

(ii) that Mr Medforth had, prior to the appointment of the Receivers, bought pig feed from B.O.C.M. and Dalgety to a value of between £10,000 and £15,000 a week upon which weekly discounts of about £1,000 a week had been allowed.

(iii) that the Receivers purchased pig feed exclusively from B.O.C.M. and Dalgety;

(iv) that the obtaining of discounts from feed suppliers was normal commercial practice and, in any event, that Mr Medforth had frequently reminded the Receivers of the availability and importance of discounts; and

(v) that the Receivers had made no attempt to obtain any discount from either B.O.C.M. or Dalgety until

early 1988.

The Amended Statement of Claim alleged (in paragraph 5) that in conducting the farm business the Receivers had owed Mr Medforth a duty of care and that their failure to request or obtain the discounts was a breach of that duty. In the alternative, if the Receivers' only duty to Mr Medforth was a duty of good faith, it was accepted that the Receivers' failure to do anything about the discounts was not a result of any deceit or of any conscious or deliberate impropriety, but nonetheless it was alleged that the failure was a breach of that duty.

The Receivers, in their Amended Defence, contended that they owed Mr Medforth only a duty to exercise their powers in good faith and denied that their failure to do anything about the discounts constituted a breach of that duty.

The pleadings dealt also with Mr Medforth's other complaints against the Receivers but, as I have said, each of those has, for one reason or the other, fallen by the wayside and I need not complicate this judgment by referring to them.

The trial of the action was due to start in September 1998 but the parties asked for the issue whether the Receivers owed Mr Medforth a duty of care or simply a duty of good faith in their conduct of the pig farming business to be dealt with as a preliminary issue. They asked that the trial date be vacated and that the trial be re-listed after the court had dealt with the appeal from the judge's decision on the preliminary issue. An appeal on the issue was apparently regarded as inevitable. The judge agreed to the request and expedited the hearing of the preliminary issue.

The formulation of the preliminary issue was as follows:-

"Assuming that the plaintiff can prove the facts pleaded in the Amended Statement of Claim and Reply:-

(1) Did the Defendants in the course of the receivership of the plaintiff's farm owe to the plaintiff only a duty of good faith when -

(a) exercising their powers of sale; and/or

(b) exercising their powers of managing the business; and/or

(c) otherwise acting (if there is such a case) in the factual circumstances alleged in the Amended Statement of Claim and Reply?

(2) If the Defendants owed only a duty of good faith in cases (a) and/or (b) above (and (c) if appropriate), what is the nature and meaning of good faith in those cases?

(3) If the Defendants' duties in cases (a) and/or (b) (and (c) if appropriate) are not limited to good faith, did the Defendants owe to the Plaintiff in those cases where it is not so limited a duty of care (whether in equity or at common law) and what is the standard) and scope of such duty in the factual circumstances alleged in the Amended Statement of Claim and Reply?"

In a judgment running to some 60 pages and containing a careful analysis of the relevant cases, the judge expressed the following conclusions on the preliminary issue:-

(1) that the Receivers, when exercising their power of sale, owed Mr Medforth, over and above a duty of good faith, an equitable duty of care, (paragraphs 4.3.1.2 and 4.3.3.4).

(2) that the standard of that duty of care was the standard of a reasonably competent receiver (paragraph 4.3.4.6).

(3) that no sensible distinction could be drawn between the exercise of a power of sale and the exercise of a power to manage a business, that the power to manage was ancillary to the power of sale and that the equitable duty of care was applicable to both (paragraphs 6.11 and 6.13).

These conclusions answered paragraphs (1) and (3) of the preliminary issue and made paragraph (2) irrelevant. But the judge dealt with paragraph (2) nonetheless. He held that if the evidence showed that the Receivers acted in a wholly unreasonable way in failing to seek discounts, the failure would be a breach of their duty of good faith (paragraph 8.16).

In their Notice of Appeal the Receivers contend that the answers that ought to be given to the questions posed by the preliminary issues are as follows:-

"(1) The Defendants .... owed to the Plaintiff the following duties:-

(a) a duty when exercising their power of sale to take reasonable steps to obtain a reasonable price for the property to be sold;

(b) a duty when exercising their powers of managing the business to act only in good faith;

(c) a duty when otherwise acting (if there is such a case) only to act in good faith.

in the factual circumstances alleged in the Amended Statement of Claim and Reply.

(2) The nature or meaning of good faith in the context of the Defendants' duties to the Plaintiff means that fraud or deliberate or wilful misconduct is required to constitute a breach of the duty.

(3) The standard and scope of the duty at (a) above ... is irrelevant because the Defendants were not exercising their power of sale".

Mr Peter Smith Q.C., Counsel for the Receivers, has, in some very interesting submissions both in written form and orally, made a sustained attack on the proposition that a receiver of mortgaged property owes to the mortgagor any duty other than a duty of good faith. He accepts, of course, that this court, in Cuckmere Brick Co Ltd -v- Mutual Finance Ltd 1971 Ch. 949 held that a mortgagee, when exercising his power of sale, owes a duty to the mortgagor to take reasonable care to obtain a proper price. He reserves the right, however, to contend in a higher court that Cuckmere was wrongly decided. In any event, he agreed, the rule ought to be applied only to mortgagees and ought not to be applied to receivers. Provided there was no lack of good faith, a receiver who sold mortgaged property at a price lower than that which reasonable steps to obtain a proper price would have achieved had, it was submitted, no liability to the mortgagor.

Mr Smith accepted, too, that a mortgagee in possession would be accountable to the mortgagor on a footing of wilful default - that is, to say, the mortgagee must be treated as having received sums that he would have received if he had managed the property with due diligence. The facts pleaded regarding the Receivers' failure to obtain discounts on the price of the pig feed disclose, I would think, a failure to manage the business with due diligence. So, if the failure had been that of a mortgagee in possession, the mortgagee would be accountable for the lost discounts. But Mr Smith insists that if the failure is that of a receiver managing the mortgaged business, the receiver has no liability to the mortgagor in the absence of a lack of good faith.

Mr Smith did accept that a receiver managing the mortgaged business might well owe a duty of care to the mortgagee who had appointed him. If a receiver's failure to manage the business with due diligence has led to an insufficiency of assets to meet the secured debt, the failure might represent a breach of that duty and expose the receiver to an action in damages by the mortgagee. But, if there is a sufficiency of assets, the failure will have caused the mortgagee no loss. The loss will have been suffered by the mortgagor. Unlike the mortgagee, however, and provided the receiver has acted in good faith, the mortgagor will have no remedy against the receiver.

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. The receiver is not obliged to carry on the business. He can decide not to do so. He can decide to close it down. In taking these decisions he is entitled, and perhaps bound, to have regard to the interests of the mortgagee in obtaining repayment of the secured debt. Provided he acts in good faith, he is entitled to sacrifice the interests of the mortgagor in pursuit of that end. But if he does decide to carry on the business why should he not be expected to do so with reasonable competence? The present case, if the pleaded facts are established, involves the failure of the Receivers to obtain discounts that were freely available. Other glaring examples of managerial incompetence can be imagined. Suppose, the Receivers had decided to carry on the business but had decided, through incompetence and not for any dishonest reason, that the pigs need not be fed or watered more than once a week, and, as a result a number of pigs had died. The Receivers would, I suppose, be in trouble with the RSPCA but, if Mr Smith is right, although they might be liable to the mortgagee they would have no liability to the mortgagor. Or suppose, that, as may well be the case, it is common practice to inoculate weaners against diseases to which pigs are prone but the Receivers decided to save money by dispensing with inoculations, with the result that a number of the weaners contracted disease and died and that the rest had to be slaughtered. If Mr Smith is right, the Receivers would have no liability to the mortgagor whose business they had, by incompetence, ruined. It is accepted that, if the mortgagee had gone into possession and carried on the business similarly incompetently, the mortgagee would have been accountable to the mortgagor for the loss caused to the mortgagor by the incompetence. But, it is submitted, not so the Receivers.

Mr Smith has sought to justify this proposition both by reference to the historical origin of receiverships and by reference to authority.

As to historical origin, the position prior to Lord Cranworth's Act (23 & 24 Vict.c.145), enacted in 1860, was that a mortgagee had no power to appoint a receiver unless he had expressly stipulated for it in the mortgage. If he did appoint a receiver, not having stipulated for any power to do so, the receiver was the mortgagee's agent and, in taking possession of the mortgaged property, rendered the mortgagee, his principal, liable to account to the mortgagor on the footing of wilful default. Mortgagees, in order to avoid the disadvantages of becoming mortgagees in possession, began to insist on a contractual provision requiring the mortgagor to appoint a receiver at the request of the mortgagee, with the receiver being directed to apply the income of the mortgaged property in paying the interest on the secured debt and any surplus to the mortgagor. All directions given to and powers conferred on the receiver were, in form if not in substance, given and conferred by the mortgagor whose agent the receiver became. This practice was given statutory recognition, first in Lord Cranworth's Act (sections 11 and 17 to 23) and, later, in the Conveyancing Act 1881 (section 24). The relevant statutory provisions are now contained in section 109 of the Law of Property Act 1925 (see generally the explanation given by Rigby L.J. in Gaskell -v- Gosling [1896] 1 Q.B. 669 in his dissenting judgment later upheld in the House of Lords [1897] A.C. 575).

Mr Smith pointed out that the main reason for the development of the system under which the receiver is appointed by the mortgagee but is treated nonetheless as the agent of the mortgagor, is to enable the

mortgagee to avoid becoming a mortgagee in possession while enjoying the advantages of his nominee, the receiver, displacing the mortgagor from control of the mortgaged property and from the receipt of the income derived from it. He argued that if the receiver is held to owe obligations to the mortgagor that go beyond duties of good faith, the advantages intended to be derived by mortgages from the receivership system will be undermined. They will be undermined, he said, because if the receiver is held to owe the mortgagor the same sort of obligations as a mortgagee in possession would owe, there will be no advantage to the mortgagee in avoiding being a mortgagee in possession. I am unable to accept these arguments.

If receivers who decide to carry on a mortgaged business do owe a duty to the mortgagor to do so with reasonable competence, I do not follow how that could adversely affect the mortgagee. If the receivers are in breach of that duty they will be answerable to the mortgagor. Mr Smith suggested that the mortgagee would then have to indemnify the receivers. Why should they do so? If a mortgagee, on appointing a receiver, has undertaken to indemnify the receiver against any claims for default made against the receiver by the mortgagor, that undertaking might have to be honoured. But, if mortgagees choose to give indemnities to guard receivers against the consequences of the receivers' defaults, that is their affair. It is no reason at all for contending that the system of receivership is being undermined. In any event, Mr Smith accepted that a failure on the part of a receiver to show reasonable competence in his management of the mortgaged property would probably constitute a breach of a duty owed by the receiver to the mortgagee who had appointed him. A mortgagee would hardly be likely to give a contractual undertaking to indemnify a receiver against the consequences of conduct which constituted a breach of the receiver's duty to the mortgagee.

Mr Smith argued that the mortgagee might have given instructions to the receiver as to the manner in which the receiver should manage the business that was to be carried on. He argued that an action by the mortgagor based upon a complaint that the receiver had been managing the business in that manner would entitle the receiver to look to the mortgagee for an indemnity. It is difficult to deal with a submission of this sort otherwise than by reference to particular facts. A mortgagee who has appointed a receiver has no general right to instruct the receiver as to how or when to exercise the powers that have been conferred on the receiver. The mortgagee retains his own powers as mortgagee. He does not, for example, lose his power to sell by appointing a receiver with a power of sale. The receiver, on appointment, exercises his powers as agent for the mortgagor. Paragraphs 3(g) and (h) of the Agricultural charges in the present case so provide. So does section 109(2) of the 1925 Act. If a mortgagee establishes a relationship with the receiver he has appointed under which the receiver exercises his powers in accordance with instructions given by the mortgagee, I can see the force of an argument that if the receiver is liable to the mortgagor then so will the mortgagee be liable. But this begs the question whether or not it is right that the receiver should be liable to the mortgagor. Take the present case as an example. Suppose that the reason why the Receivers had done nothing to obtain the freely available discounts was that the Midland Bank, the mortgagee, had instructed them not to do so. The proposition that the law should refrain from holding the Receivers liable to the mortgagor because to do so would lead to liability being imposed also on the mortgagee and that that would, in effect, be treating the mortgagee as a mortgagee in possession does not seem to me to make any sense. I agree that, on the supposed facts, if the Receivers were liable to the mortgagor, the mortgagee would be liable too. And why not? If the mortgagee chooses to instruct the Receivers to carry on the business in a manner that is a breach of the Receivers' duty to the mortgagor, it seems to me quite right that the mortgagee, as well as the Receivers, should incur liability. This conclusion does not in the least undermine the receivership system. What it might do is to promote caution on the part of mortgagees in seeking to direct receivers as to the manner in which they (the receivers) should exercise their powers. I would regard that as salutary.

For these reasons, Mr Smith's reliance on the history of receiverships as a justifying the exoneration of receivers from any duty to mortgagors other than that of good faith, falls, so far as I am concerned, on

stony ground.

Let me now turn to the three authorities on which Mr Smith particularly relied. They were in re B. Johnson & Co (Builders) Ltd [1955] Ch. 635, and Downsview Nominees Ltd -v- First City Corporation [1993] A.C. 295 and Yorkshire Bank plc -v- Hall [1999] 1 A.E.R. 879).

In re: B. Johnson & Co (Builders) Ltd was a decision of the Court of Appeal. The issue was whether a receiver and manager, who had been appointed under a debenture, was an "officer" of the company for the purposes of section 333(1) of the Companies Act 1948. A second issue, assuming that the receiver/manager was an "officer", was whether a case of misfeasance had been disclosed. On the first issue the court held that the receiver/manager was not an "officer" for section 333 purposes. The court dealt, also, with the second issue although its finding on the first issue had made that unnecessary.

In dealing with the first issue, Sir Raymond Evershed, Master of the Rolls, emphasised that the receiver/manager "is not managing on the company's behalf but is managing in order to facilitate the exercise by him, for the mortgagees, of the mortgagees' power to enforce the security". It is, I think, important, whenever considering the exercise by receivers of their powers, to bear in mind the point made by the Master of the Rolls. The receivers' main function is to assist the mortgagee in obtaining payment of the secured debt. The Master of the Rolls commented, also, that:-

"it is elementary that a mortgagee seeking to realise his security has no duty of care to see that there is as much as possible left over for those who are interested in what is called the equity".

This statement of principle has been qualified, but not invalidated, by Cuckmere Brick Co. Ltd -v- Mutual Finance Ltd [1971] Ch. 949, a case to which I will return. On the second point, the Master of the Rolls analysed the pleaded complaints against the receiver/manager as constituting no more than "charges of mere negligence" (p. 852). A case of mere negligence could not, he held, be prosecuted under section 333.

Both Jenkins L.J. and Parker L.J. agreed with the Master of the Rolls that the receiver/manager was not an "officer" for section 333 purposes. Jenkins L.J., in doing so, made remarks about the nature of a receiver/manager's duty on which Mr Smith relies. After stating that "The primary duty of the receiver is to the debenture holders and not to the company" Jenkins L.J. continued, at p. 662, as follows:-

"But the whole purpose of the receiver and manager's appointment would obviously be stultified if the company could claim that a receiver and manager owes it any duty comparable to the duty owed to a company by its own directors or managers ...

He is under no obligation to carry on the company's business at the expense of the debenture holders. Therefore he commits no breach of duty to the company by refusing to do so, even though his discontinuance of the business may be detrimental from the company's point of view. Again, his power of sale is, in effect, that of a mortgagee, and he therefore commits no breach of duty to the company by a bona fide sale, even though he might have obtained a higher price and even though, from the point of view of the company, as distinct from the debenture holders, the terms might be regarded as disadvantageous.

In a word, in the absence of fraud or mala fides (of which there is not the faintest suggestion here), 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. If the company conceives that it has any claim against the receiver and manager for breach of some duty owed by him to the company, the issue is not whether the receiver and manager has done or omitted to do anything which it would be wrongful in a manager of a company to do or omit, but whether

he has exceeded or abused or wrongfully omitted to use the special powers and discretions vested in him pursuant to the contract of loan constituted by the debenture for the special purpose of enabling the assets comprised in the debenture holders' security to be preserved and realized. That seems to me to be an issue wholly outside the scope of section 333".

This was not a reserved judgment and it is important to be clear about the object of Jenkins L.J's remarks. He was distinguishing the duties of a receiver/manager from those of a director/manager in order to explain why section 333 applied only to the latter. Mr Smith is, however, entitled to point to the sentence commencing "In a word, in the absence of fraud or mala fides ..." as supporting his submissions.

Downsview Nominees Ltd -v- First City Corporation was a Privy Council decision on an appeal from the Court of Appeal of New Zealand. The judgment of the Board was given by Lord Templeman. Lord Templeman made clear his view that such duty as a receiver/manager owed to the mortgagor was, like the duty owed by the mortgagee, a duty imposed by equity. It was not a duty in tort. It was not attributable to the application of the Donaghue -v- Stevenson "neighbour" principle. This was important because the first instance judge, Gault J., had held that "the proposition that a receiver will not be liable in negligence so long as he acts honestly and in good faith no longer represents the law of New Zealand: ..." and that "a receiver owes a duty to the debenture holders to take reasonable care in dealing with the assets of the company ...", and the Court of Appeal had held that "... if there were any duties on the part of the ... receiver to a subsequent debenture holder, they would have to be based in negligence". Lord Templeman did not disagree that the receiver owed duties to the subsequent debenture holder but insisted that they were duties arising in equity and were not common law duties of care. In the result, Gault J's monetary award against the receiver and in favour of the subsequent debenture holder was upheld, but placed on a different jurisprudential basis.

Lord Templeman cited with approval the passage from Jenkins L.J's judgment in In re B. Johnson (Builders) Ltd that I have cited and, at p.315, said this:-

"The general duty of care said to be owed by a mortgagee to subsequent encumbrancers and the mortgagor in negligence is inconsistent with the right of the mortgagee and the duties which the courts applying equitable principles have imposed on the mortgagee. If a mortgagee enters into possession he is liable to account for rent on the basis of wilful default; he must keep mortgage premises in repair; he is liable for waste. Those duties were imposed to ensure that a mortgagee is diligent in discharging his mortgage and returning the property to the mortgagor. If a mortgagee exercises his power of sale in good faith for the purpose of protecting his security, he is not liable to the mortgagor even though he might have obtained a higher price and even though the terms might be regarded as disadvantageous to the mortgagor. Cuckmere Brick Co. Ltd -v- Mutual Finance Ltd . [1971] Ch. 949 is Court of Appeal authority for the proposition that, if the mortgagee decides to sell, he must take reasonable care to obtain a proper price but is no authority for any wider proposition. A receiver exercising his power of sale also owes the same specific duties as the mortgagee. But that apart, the general duty of a receiver and manager appointed by a debenture holder, as defined by Jenkins L.J. in In re B. Johnson & Co (Builders) Ltd [1955] Ch. 634, 661, 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 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".

As a Privy Council case, Downsview Nominees is not binding but, as Mr Smith submitted, is a persuasive authority of great weight. But what did it decide as to the duties owed by a receiver/manager to a mortgagor? It decided that the duty lies in equity, not in tort. It decided that there is no general duty of care in negligence. It held that the receiver/manager owes the same specific duties when exercising the

power of sale as are owed by a mortgagee when exercising the power of sale. Lord Templeman cited with approval the Cuckmere Brick Co. Ltd test, namely, that the mortgagee must take reasonable care to obtain a proper price. So, a receiver/manager when selling must take reasonable care to obtain a proper price. In so deciding, Lord Templeman departed from the proposition to be found in Jenkins L.J's judgment in Johnson.

In Yorkshire Bank plc -v- Hall Robert Walker L.J., at p. 893 reviewed a mortgagee's duty to his mortgagor. He referred to China and South Sea Bank Ltd -v- Tan [1990] 1 AC 536, National Bank of Greece -v- Pinios Shipping Co [1990 1 AC 637 and the Downsview Nominees case and then said this:-

"These cases together establish or reaffirm that a mortgagee's duty to the mortgagor or to a surety depend partly on the express terms on which the transaction was agreed and partly on duties (some general and some particular) which equity imposes for the protection of the mortgagor and the surety. The mortgagee's duty is not a duty imposed under the tort of negligence, nor are contractual duties to be implied. The general duty (owed both to subsequent incumbrancers and to the mortgagor) is for the mortgagee to use his powers only for proper purposes and to act in good faith ... . The specific duties arise if the mortgagee exercises his express or statutory powers ... If he exercises his power to take possession, he becomes liable to account on a strict basis (which is why mortgagees and debenture holders operate by appointing receivers whenever they can). If he exercises his power of sale, he must take reasonable care to obtain a proper price".

These remarks apply, in my view, equally to the exercise by a receiver of a receiver's powers.

The Cuckmere Brick Co. Ltd test can impose liability on a mortgagee notwithstanding the absence of fraud or mala fides. It follows from Downsview Nominees and Yorkshire Bank -v- Hall that a receiver/manager who sells but fails to take reasonable care to obtain a proper price may incur liability notwithstanding the absence of fraud of mala fides. Why should the approach be any different if what is under review is not the conduct of a sale but conduct in carrying on a business? If a receiver exercises this power, why does not a specific duty, corresponding to the duty to take reasonable steps to obtain a proper price, arise? If the business is being carried on by a mortgagee, the mortgagee will be liable, as a mortgagee in possession, for loss caused by his failure to do so with due diligence. Why should not the receiver/manager, who, as Lord Templeman held, owes the same specific duties as the mortgagee when selling, owe comparable specific duties when conducting the mortgaged business? It may be that the particularly onerous duties constructed by courts of equity for mortgagees in possession would not be appropriate to apply to a receiver. But, no duties at all save a duty of good faith? That does not seem to me to make commercial sense nor, more important, to correspond with the principles expressed in the bulk of the authorities.

In the Cuckmere Brick Co. Ltd case, the Court of Appeal held that a mortgagee when exercising his power of sale owed a duty to the mortgagor "to take reasonable precautions to obtain the true market value of the mortgaged property at the date on which he decides to sell it" (p. 968). This is firmly established now as a duty in equity.

In Tse Kwong Lam -v- Wong Chit Sen [1983] 1 WLR 1349, a Privy Council decision on an appeal from the Court of Appeal of Hong Kong, the Board held that a sale by a mortgagee to a company in which the mortgagee was interested "can only be supported if the mortgagee proves that he took reasonable precautions to obtain the best price reasonably obtainable at the time of sale" (p. 1356). The same, applying what Lord Templeman said in Downsview Nominees about specific duties, would apply to a receiver. This is not consistent with the notion that a receiver owes only a duty of good faith.

In Tomlin -v- Luce 43 Ch. 191, the Court of Appeal held a mortgagee liable to second mortgagees for any

loss occasioned by the insertion in auction particulars of a misstatement. Cotton L.J. said that “the first mortgagees are answerable for any loss which was occasioned by the blunder made by the auctioneer at the sale” (p. 194). A receiver in similar circumstances would similarly have been liable.

Knight -v- Lawrence [1991] BCC 411 was a case in which a receiver of mortgaged properties which were tenanted failed to serve on the tenants the notices which were necessary to put in motion rent review procedures. As a result the opportunity to obtain increases in the rent was lost. The mortgagor successfully sued the receiver in negligence. It is, I think, now established that the mortgagor ought to have sued on a duty of care owed in equity rather than on a tortious duty of care. But the distinction is an immaterial one. The extent of the duty of care, whether in equity or at common law, depends on all the circumstances of the case. What standard of conduct in all the circumstances does the law require of the receiver in managing the mortgaged properties? Sir Nicholas Browne-Wilkinson, the then Vice-Chancellor held that the circumstances imposed on the receiver a duty of care in regard to the service of the rent review notices. There can be no doubt but that if a mortgagee in possession had failed to serve the notices he would have been accountable to the mortgagor for the loss caused by the default. Sir Nicholas Browne-Wilkinson said this about the receiver:-

“In my judgment [the receiver] had a total misapprehension about the functions of a receiver. He regarded himself as being there to do what he was told by his appointor ...; provided he discharged what they told him to do he had discharged his functions. He was, in his own eyes nothing but a rent collector. That to my mind, is an unhappy misapprehension of the functions of a receiver. ... it is one of the first functions of a receiver in a case like this to get solicitors or others to review the position of the rent review clause, and to take such steps as are necessary to ensure that the reviews take place ...” (p. 418).

There is, in my judgment, no difficulty whatever in regarding the passage I have cited as expressing correctly the duty imposed by equity on the receiver in the circumstances in which the receiver found himself. The duty was, in my opinion, owed both to the mortgagee and to the mortgagor. Each had an interest in the value of the mortgaged property being safeguarded by the service of the rent review notices.

McHugh -v- Union Bank of Canada 1913 AC 299 concerned a chattel mortgage of a herd of horses on a ranch about 55 miles from Calgary. The mortgagee bank took possession of the horses and drove them to Calgary for sale. But they were driven so hurriedly, without being allowed sufficient time to feed, that they lost condition and some of them died. On the taking of the mortgage account the mortgagor sought to charge the mortgagee with damages for his negligent want of care of the horses. The trial judge found negligence proved and assessed the damages to be allowed to the mortgagor in the mortgage account. The Privy Council upheld his decision. There was no suggestion of fraud or mala fides. Suppose a receiver had been appointed and the receiver had managed the drive to Calgary in the same way as the mortgagee had done and with the same result. Mr Smith’s submissions would excuse the receiver from any liability for his negligence.

Mr Smith has submitted that to hold a receiver liable to the mortgagor for anything more than a breach of a duty of good faith would require a number of established authorities on the law of mortgages to be torn up and thrown away. He instanced Kennedy -v- de Trafford [1897] A.C. 181. This was a case where the mortgagors were two tenants in common. The mortgagees, in exercise of their power of sale, sold to one of the two. The trustee in bankruptcy of the other tenant in common applied to the court to have the sale set aside. He claimed, alternatively, damages against the mortgages for negligence in the exercise of the power of sale. The report of the case in the House of Lords shows that the trustee’s main complaint was that the purchaser from the mortgagees had been one of the two mortgagor tenants in common. It was argued that this individual stood in a fiduciary relationship to his co-tenant and was disqualified from purchasing. It was argued, also, that the sale had been at an undervalue. The House of Lords dealt with the

case peremptorily. Counsel for the respondents was not called on. Judgment was delivered at once. Lord Herschell, in rejecting the argument based on sale at an undervalue said that:-

"... if a mortgagee in exercising his power of sale exercises it in good faith without any intention of dealing unfairly by his mortgagor, it would be very difficult indeed, if not impossible, to establish that he had been guilty of any breach of duty towards the mortgagor. Lindley L.J., in the court below, says that "it is not right or proper or legal for him either fraudulently or wilfully or recklessly to sacrifice the property of the mortgagor". Well I think that is all covered really by his exercising the power committed to him in good faith. It is very difficult to define exhaustively all that would be included in the words "good faith", but I think it would be unreasonable to require the mortgagee to do more than exercise his power of sale in that fashion. Of course, if he 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.

My Lords it is not necessary in this case to give an exhaustive definition of the duties of a mortgagee to a mortgagor, because it appears to me that, if you were to accept the definition of them for which the appellant contends, namely, that the mortgagee is bound to take reasonable precautions in the exercise of his power of sale, as well as to act in good faith, still in this case he did take reasonable precautions". (p. 185).

The other members of the House agreed.

Mr Smith submits that the Cuckmere Brick Co. case is inconsistent with Lord Herschell's statements of principle in Kennedy -v- de Trafford . He reserves the right to contend in a higher court that the Cuckmere Brick Co case was wrongly decided. In my judgment, Kennedy -v- de Trafford did not lay down as an inflexible principle that the only duty owed by a mortgagee when selling was a duty of good faith. Lord Herschell's remarks about the difficulty of proving any breach of duty in a case where no want of good faith could be alleged show that he was leaving open the possibility of a case where, on the facts, that difficulty could be overcome.

Moreover, in my view, it is inappropriate to treat expressions of principle delivered ex tempore by no matter how august a judge as if they were of statutory effect. One of the great virtues of the common law duty of care is its inherent flexibility and its scope for development and adjustment in order to meet the changing requirements of society. Principles of equity, we were all taught, were introduced by Lord Chancellors and their deputies, the Vice-Chancellors sitting in the Chancery Courts, in order to provide relief from the inflexibility of common law rules. The equity of redemption was a Chancery invention, introduced in order to ensure that a conveyance by way of mortgage remained a security for the repayment of money whether or not the date fixed for repayment and re-conveyance had passed. The duties imposed on a mortgagee in possession, and on a mortgagee exercising his powers whether or not in possession, were introduced in order to ensure that a mortgagee dealt fairly and equitably with the mortgagor. The duties of a receiver towards the mortgagor have the same origin. They are duties in equity imposed in order to ensure that a receiver, while discharging his duties to manage the property with a view to repayment of the secured debt, nonetheless in doing so takes account of the interests of the mortgagor and others interested in the mortgaged property. These duties are not inflexible. What a mortgagee or a receiver must do to discharge them depends upon the particular facts of the particular case. A want of good faith or the exercise of powers for an improper motive will always suffice to establish a breach of duty. What else may suffice will depend upon the facts. Tse Kwong Lam -v- Wong Chit Sen is a very good example. The fact that the mortgagee had an interest in the purchasing company placed the mortgagee under an obligation to show that a proper price had been obtained. This was an obligation more onerous than would otherwise have been required. It is true that Lord Herschell in Kennedy -v- de Trafford expressed the duty on the mortgagee in terms much less onerous than the terms in which Salmon

L.J. expressed the duty in the Cuckmere Brick Co. case. That does not make the two cases inconsistent with one another. The facts that constituted the mortgagors' complaints were different. And the duty in equity appropriate to have been owed by a mortgagee selling in 1888 is not necessarily of the same weight as the duty appropriate to have been owed by a mortgagee selling in 1967. Equity is at least as flexible as the common law in adjusting the duties owed so as to make them fit the requirements of the time.

I do not accept that there is any difference between the answer that would be given by the common law to the question what duties are owed by a receiver managing a mortgaged property to those interested in the equity of redemption and the answer that would be given by equity to that question. I do not, for my part, think it matters one jot whether the 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.

In my judgment, in principle and on the authorities, the following propositions can be stated:-

(1) A receiver managing mortgaged property owes duties to the mortgagor and anyone else 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 on 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 re-paid.

(5) Subject to that primary duty, the receiver owes a duty to manage the property with due diligence.

(6) Due diligence does not oblige the receiver to continue to carry on a 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 to do so profitably.

In my judgment, Judge McGonigal's answers to the preliminary issue were, with one or two minor qualifications, in accordance with principle and correct. The minor qualifications are these:-

(i) The judge held that a receiver's power to manage a business was ancillary to the power of sale. I do not think it is. I would agree that in many cases, a receiver will manage a business in order to bring the mortgaged property to a state in which the business can then be sold as a going concern. But the power to manage is, in my view, independent of the power to sell. A receiver can manage a business for the purpose of generating profits from which the secured debt can be discharged. The management of the business does not have to be ancillary to an intended eventual sale. But I agree that in the management of the business an equitable duty of care is owed.

(ii) 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. It is sometimes said that recklessness is equivalent to intent. Shutting one's eyes deliberately to the consequences of what one is doing may make it impossible to deny an intention to bring about those consequences. Thereapart, however, the concepts of negligence on the one hand and fraud or bad faith on the other ought, in my

view, to be kept strictly apart. Equity has not always done so. The equitable doctrine of “fraud on a power” has little, if anything, to do with fraud. Lord Herschell in Kennedy -v- de Trafford gave an explanation of a lack of good faith that would have allowed conduct that was grossly negligent to have qualified notwithstanding that the consequences of the conduct were not intended. 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.

Finally, although I am not sure that it is strictly an answer to a question posed by the preliminary issue, in my judgment the facts pleaded in the Amended Statement of Claim and Reply would, if proved, and in the absence of any answer pleaded in the Amended Defence other than denial, constitute a breach by the Receivers of the duty they owed in equity to Mr Medforth.

I would dismiss this appeal.

LORD JUSTICE SWINTON THOMAS: I agree with judgment of the Vice-Chancellor.

LORD JUSTICE TUCKEY: I also agree.

ORDER: Appeal dismissed with costs. Legal Aid assessment of the Respondent's costs. Leave to Appeal to the House of Lords refused.
(Order not part of approved judgment)
