Privy Council Appeal and Cross-appeal No. 13 of 1991

(1) Downsview Nominees Limited and
(2) J.G. Russell *Appellants*

v.

(1) First City Corporation Limited and
(2) First City Finance Limited *Respondents*

FROM

THE COURT OF APPEAL OF NEW ZEALAND

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 19TH NOVEMBER 1992

Present at the hearing:-

LORD TEMPLEMAN
LORD LANE
LORD GOFF OF CHIEVELEY
LORD MUSTILL
LORD SLYNN OF HADLEY

*[Delivered by **Lord Templeman**]*

This appeal requires consideration of the duties, if any, which a first debenture holder and a receiver and manager appointed by a first debenture holder owe to a second debenture holder.

The mortgagor company, Glen Eden Motors Ltd., (formerly Glen Eden Fiat Centre (1975) Limited and hereafter called "GEM") carried on business as new and used motor vehicle dealers and held Fiat and Mazda franchises for the sale of their vehicles and spare parts. The principal shareholder and manager of the company was Mr. Pedersen.

On 11th August 1975 GEM issued a first debenture ("the Westpac debenture") which eventually secured the principal sum of $230,000 in priority to a second debenture. That second debenture dated 18th September 1986 was made in favour of the first respondent, the First City Corporation Limited, ("FCC").

Each debenture created a fixed charge over certain assets of the company and a floating charge over the remainder. Each debenture contained power for the

debenture holder to appoint a receiver and manager, who was to be deemed to be the agent of the company and was authorised to perform any acts which the company could perform.

For the six months' period to 30th September 1986 GEM traded at a loss. On 10th March 1987, the monies secured by the second debenture having become due and payable, FCC appointed two chartered accountants, Messrs. Chilcott and Chatfield, experienced in receiverships to be receivers and managers of GEM. The FCC receivers formed the provisional view that a sale of the assets of GEM would be necessary. They removed Mr. Pedersen from his position as manager of GEM.

Mr. Pedersen consulted the appellant, Mr. Russell, who controlled the appellant company, Downsview Nominees Limited ("Downsview"). On 23rd March 1987 the Westpac debenture was assigned to Downsview and Mr. Russell was appointed receiver and manager under that debenture. Mr. Russell took over the assets and management of GEM from the receivers and managers appointed by FCC and restored Mr. Pedersen to the management of GEM.

On 25th March 1987 Mr. Russell announced that it was his intention to trade the company out of its financial difficulties subject to a review in three months' time. On 27th March 1987 the solicitors for FCC wrote to the directors of Downsview. The letter contained the following:-

> "Our client informs us that you as first debenture holder have now appointed a receiver of Glen Eden Motors Limited. As a consequence our client's receivers Messrs. Chilcott & Chatfield have temporarily withdrawn to permit your receiver Mr. Russell to take control of the company until such time as your debenture can be repaid in full.
>
> Our client informs us that it is your receiver's intention to attempt to trade the company out of its present difficulties. Our client considers that any such attempt is extremely unlikely to improve the situation and indeed is highly likely to result in damage to the shareholders of the company and to itself as subsequent debenture holder.
>
> To prevent any dispute developing our clients have instructed us to write to you and make the following offer on their behalf:
>
> Our client will purchase your debenture at a price equivalent to all amounts outstanding and secured under your debenture at the date of settlement; or alternatively
>
> Our client will sell to you its debenture for a price equivalent to all amounts secured and outstanding under its debenture at the date of settlement."

The letter added that $721,621.69 were then outstanding under the FCC debenture.

On 4th April 1987 GEM issued a third debenture in favour of Downsview and on 6th May 1987 Downsview advanced $100,000 to the company. Mr. Russell claimed that the monies raised by the third debenture were "receiver's borrowings" having preference to all other claims in the receivership, including the claims of FCC.

GEM continued to trade but paid no interest, let alone principal, due under the Westpac debenture or the FCC debenture.

At the end of three months Mr. Russell had prepared no past accounts or future budgets but was aware that the company was trading at a loss.

On 13th July 1987 Mazda (New Zealand) Limited gave notice to determine the company's Mazda franchise dealership. About the same time Mr. Russell caused to be incorporated Gemco. Motors Limited ("Gemco") as a subsidiary of GEM.

By a letter dated 13th August 1987 the solicitors for FCC called upon Downsview to assign the Westpac debenture to FCC as a subsequent chargeholder. Mr. Russell on behalf of Downsview refused, notwithstanding that Downsview would have been paid all the monies secured by the Westpac debenture. These proceedings were instituted on 8th September 1987 and by an interlocutory application FCC sought an order directing Downsview to assign the Westpac debenture to FCC.

From 1st October 1987 proceeds of vehicles sold by the company were received by Gemco, which acknowledged a borrowing from GEM to the extent of the value of the vehicles sold.

On 24th November 1987 Thorp J. heard the application by FCC for an order directing Downsview to transfer the Westpac debenture to FCC. On 5th December 1987 Gemco issued a debenture in favour of Downsview. On 23rd December 1987 Mr. Russell swore in an affidavit that the amount required to discharge the debt owing to Downsview, and the amount required to discharge the liabilities and charges of the receiver, amounted to $825,727.00. He subsequently increased this figure. On 11th January 1988 Thorp J. ordered the Westpac debenture to be assigned by Downsview to FCC on terms. Downsview and Mr. Russell appealed and sought a stay of execution of the order for assignment. On 2nd March 1988 Thorp J. refused a stay on terms.

On 9th March 1988 Mr. Russell borrowed from one of his other companies the sum of $272,000.00 and paid to Downsview the sum of $271,665.39 by way of repayment of the monies secured by the Westpac debenture, so as to

leave a balance outstanding of $1,000. FCC, in ignorance of these manoeuvres complied with the conditions imposed by Thorp J. which obliged FCC to pay $130,000 to Downsview and to pay a further $170,000 into court before receiving an assignment of the Westpac debenture. Downsview assigned the Westpac debenture to FCC but Mr. Russell refused to relinquish control of GEM without a further payment to himself of $329,000 in cash. On 21st April 1988 Smellie J. ordered Mr. Russell to cease forthwith to act as receiver of GEM and to transfer GEM's assets to receivers appointed by FCC. He directed that the order was not to be sealed until FCC had deposited an additional $20,000 in court and had appointed receivers under its debentures. On the same day Mr. Russell effected an assignment of a debenture issued by Gemco in favour of Downsview to another of his companies, Terocon Press Limited. The following day Terocon Press Limited made an advance under the debenture to Gemco of $190,000. This sum was immediately transferred from Gemco to GEM by way of reduction of the intercompany indebtedness. On the same morning Mr. Russell as receiver of GEM paid to his company Corporate Enterprises Limited the sum of $224,000 by way of reduction of his receiver's borrowings. Also on the same day Mr. Russell caused certain new and used vehicles valued at $303,543 to be removed from the premises of GEM and Gemco and stored in a warehouse. On the same day Mr. Russell caused Terocon Press Limited, the holder of the debenture from Gemco, to make demand upon Gemco for repayment upon one hour and twenty-five minutes notice of the amount owing under that debenture said to be $245,129. Mr. Russell also wrote cheques on behalf of Gemco for sums in excess of $100,000 in favour of creditors of Gemco. He then gave notice to the Registrar that he had ceased to act as the receiver of GEM at noon on 22nd April 1988. FCC on 26th April appointed Messrs. Chilcott & Chatfield, their original receivers, to be again the receivers and managers of GEM.

On 30th September 1988 FCC assigned to the second respondent First City Finance Limited ("FCF") the FCC debenture together with all its rights, titles and interests in the monies payable thereunder and all rights, powers and remedies thereunder.

These proceedings were continued by FCC and by FCF. The action came before Gault J. who on 4th August 1989 delivered judgment. He summarised the relevant parts of the statement of claim as follows:-

> "The plaintiffs, in the statement of claim, alleged that Downsview and Mr. Russell, as prior debenture holder and receiver respectively, owed duties to FCC and/or FCF to -
>
> '(1) Exercise their powers for proper purposes
>
> (2) Act honestly and in good faith
>
> (3) Exercise reasonable care, skill and diligence

(4) Discharge the Westpac debenture immediately they were in a position to do so

(5) Pay over or surrender to FCC the surplus assets of GEM after satisfaction of the Westpac debenture.'

They allege that Downsview and Mr. Russell acted, or omitted to act, in a fraudulent, reckless or negligent manner in breach of these duties. The alleged breaches are particularised at length in the fourth amended statement of claim and may be summarised under three headings -

(a) Acquiring the Westpac debenture and carrying out the receivership thereunder for the improper purpose of preventing the plaintiffs enforcing their security.

(b) Conducting the receivership in a reckless or negligent manner.

(c) Failing to accept the plaintiffs' offer to discharge the obligations under the Westpac debenture and to assign the Westpac debenture to the plaintiffs."

The learned judge recorded the following allegations by FCC and FCF:-

"... that Downsview in the course of events I have described, acted in bad faith and other than as a prudent debenture holder would act in the exercise of its power by knowingly, and without any real intention of enforcing the security under the Westpac debenture, preventing enforcement of the plaintiff's security. This was effected by purchasing the Westpac debenture and appointing Mr. Russell knowingly to act as he did as receiver and manager of GEM."

Gault J. made the following findings:-

"Mr. Russell said he took the view his responsibility was to the company to do the best possible job he could and that this would have been ultimately to the benefit of everyone, including FCC. I do not accept that that was his approach at the time. He resolved to acquire the debenture, appoint himself receiver and permit the company to trade on under the same management, without taking the time to fully investigate the financial affairs of the company, the competence of its management or the basis upon which FCC was seeking to enforce its security. In my judgment his true motive was to involve himself in the affairs of GEM for the benefit of himself and his company while undertaking to assist Mr. Pedersen and to 'save' GEM. His own brief of evidence reads -

'170. IT is perfectly lawful for anyone to purchase a debenture. Downsview is in the business of acting as a nominee in the lending of money. The Westpac debenture was a good investment because it was a first charge over a long established company. There was no doubt that it would get its money back plus interest. Therefore, from Downsview's point of view, there was no downside risk in acquiring the debenture.

171. FROM my point of view, I saw it as a good and interesting job as receiver, for which I expected to be well paid.

172. IT was an interesting job, because I saw the opportunity of preserving the company for the benefit of its unsecured creditors and shareholders, as well as for the secured creditors. Saving the company, in circumstances where it had been struck a severe blow by the appointment of the first receivers, was a challenge which I was happy to take up.'

In pursuit of his own objectives Mr. Russell embarked upon a course, having as its first objective disruption of the receivership under the FCC debenture. His intention in urgently acquiring the Westpac debenture and accepting appointment as receiver was not for the purpose of enforcing the security under the Westpac debenture but for the purpose of preventing the enforcement by the plaintiffs of the FCC debenture. Further, ... in conducting the correspondence with the solicitors for FCC in the months immediately following his appointment as receiver, he had no genuine intention of either agreeing to assign the Westpac debenture to FCC, or of acquiring the FCC debenture. During that period, had he so wished, he could have facilitated the speedy acquisition of the Westpac debenture by FCC in a manner similar to its acquisition by Downsview. Subsequently his resistance to prompt assignment of the Westpac debenture, even in the face of a direction from the Court, was prompted in part by his anxiety to secure any outstanding fees and liabilities and in part to secure the interests of his companies. I consider he was also motivated to a considerable degree by a determination simply to retain control of the business affairs of GEM to frustrate the enforcement by the plaintiffs of the security under the FCC debenture ...

The decision to acquire the Westpac debenture and assume the office of receiver of GEM is inter-related with the determination by Mr. Russell that the company should continue to trade. ...

In the circumstances I consider that Mr. Russell and Downsview employed the powers under the Westpac debenture for their own purposes and not for their

proper purposes. To use these powers as they did constituted a clear breach of each of their respective duties to the subsequent debenture holder. ...

I have no difficulty in reaching the conclusion that, taking office for the purposes he did and conducting his receivership in the manner I have outlined, constituted breach by Mr. Russell of his duty to the holder of the FCC debenture. While I consider his conduct fell below the required standard, even in the initial period, I find that after July 1987 his conduct can be described only as reckless. ...

The plaintiff's claim for failure by Downsview to assign the Westpac debenture had two separate bases. The first was on the refusal by Downsview to accept FCC's offer to purchase the Westpac debenture when first made four days after Downsview acquired the debenture. It follows from the finding I have made already, that had Downsview acquired the debenture and exercised the powers under it for their proper purposes, the offer made on behalf of FCC would have been responded to ...

The response by Mr. Russell (for Downsview and I believe for himself) simply underscores the finding I have already made, that both defendants employed the powers under the Westpac debenture in breach of the duty they had to the subsequent debenture holder."

The learned judge held that FCC and FCF were entitled to damages on the basis of the "difference between the loss that would have been incurred had the first receivership of Messrs. Chilcott & Chatfield been allowed to proceed unimpeded, and the loss actually incurred as it has emerged following the second receivership by those two accountants". In the result judgment was entered in favour of FCC and FCF against Downsview and Mr. Russell for $554,566.33. In addition Mr. Russell was prohibited under section 189 of the Companies Act without the leave of the Court from being a director or promoter of or being concerned in or taking part in the management of any company for a period of five years from the date of judgment. Downsview and Mr. Russell appealed asserting over thirty grounds.

The Court of Appeal (Cooke P., Richardson and Casey JJ.) in the judgment of the court delivered by Richardson J. on 12th March 1990 accepted "that on the application of negligence principles a receiver and manager who elects to carry on the business of the company and to trade it out of receivership owes a duty of care to subsequent debenture holders to take reasonable care in dealing with the assets of the company". The Court of Appeal held that Mr. Russell was in breach of the duty of care to FCC, that Downsview were not in breach and that the court had no jurisdiction under section 189 of the

Companies Act to prohibit Mr. Russell from being a director or promoter or from being concerned with the management of a company.

Mr. Russell appealed against the decision of the Court of Appeal against him; FCC and FCF cross-appealed against Mr. Russell and Downsview for the re-instatement of the orders made by Gault J.

When the appeal and cross-appeal came before the Board, it was apparent that the judgments of the courts below raised fundamental questions concerning the nature and extent of any liability by a mortgagee and by a receiver and manager to the mortgagor company or to a subsequent debenture holder for his actions. The statement of claim pleaded that Downsview and Mr. Russell were in breach of a duty to exercise their powers for proper purposes, in breach of a duty to act honestly and in good faith and in breach of a duty to exercise reasonable care, skill and diligence. Gault J. 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 ... The authorities clearly indicate that on an application of negligence principles, a receiver owes a duty to the debenture holders to take reasonable care in dealing with the assets of the company". In the Court of Appeal it was accepted by the court without any argument to the contrary by counsel that Gault J. was correct in his conclusion "that, if there were any duties on the part of Downsview and Mr. Russell as receiver to a subsequent debenture holder, they would have to be based in negligence". The appellants' case and the respondents' case as presented to the Board did not challenge these conclusions. The Board however were considerably troubled by the approach of the courts below and on terms gave leave to the respondents to raise the whole question of the foundation and extent of the duties owed by a first debenture holder and his receiver and manager to a subsequent debenture holder. An adjournment was granted so that both sides could reconsider the whole question and submit supplemental cases and arguments.

The first submission made on behalf of Downsview and Mr. Russell is that they owed no duty to FCC because FCC was only a debenture holder and not a mortgagee. This submission is untenable.

A mortgage, whether legal or equitable, is security for repayment of a debt. The security may be constituted by a conveyance, assignment or demise or by a charge on any interest in real or personal property. An equitable mortgage is a contract which creates a charge on property but does not pass a legal estate to the creditor. Its operation is that of an executory assurance, which, as between the parties, and so far as equitable rights and remedies are concerned, is equivalent to an actual assurance, and is enforceable under the equitable jurisdiction of the court. All this is well settled law and is

to be found in more detail in the textbooks on the subject and also in Halsbury's Laws of England, 4th Edition, Volume 32, paragraphs 401 et seq. The security for a debt incurred by a company may take the form of a fixed charge on property or the form of a floating charge which becomes a fixed charge on the assets comprised in the security when the debt becomes due and payable. A security issued by a company is called a debenture but for present purposes there is no material difference between a mortgage, a charge and a debenture. Each creates a security for the repayment of a debt.

The second argument put forward on behalf of Mr. Russell and Downsview is that though a mortgagee owes certain duties to the mortgagor, he owes no duty to any subsequent encumbrancer; so Downsview and Mr. Russell owed no duty to FCC. This argument also is untenable. The owner of property entering into a mortgage does not by entering into that mortgage cease to be the owner of that property any further than is necessary to give effect to the security he has created. The mortgagor can mortgage the property again and again. A second or subsequent mortgage is a complete security on the mortgagor's interests subject only to the rights of prior encumbrancers. If a first mortgagee commits a breach of his duties to the mortgagor, the damage inflicted by that breach of duty will be suffered by the second mortgagee, subsequent encumbrancers and the mortgagor, depending on the extent of the damage and the amount of each security. Thus if a first mortgagee in breach of duty sells property worth £500,000 for £300,000, he is liable at the suit of any subsequent encumbrancer or the mortgagor. Damages of £200,000 will be ordered to be taken into the accounts of the first mortgagee or paid into court or to the second mortgagee who, after satisfying, as far as he can, the amount of any debt outstanding under his mortgage, will pay over any balance remaining to the next encumbrancer or to the mortgagor if there is no subsequent encumbrancer. In practice the encumbrancer who first suffers from the breach of duty by the first mortgagee and needs the damages payable by the first mortgagee to obtain repayment of his own debt will sue the first mortgagee. If the encumbrancers do not suffer because they have been able to obtain repayment of their debts without recourse to the damages, then it will be the mortgagor who will sue. In *Tomlin v. Luce* (1889) 43 Ch.D. 191 the Court of Appeal held that the first mortgagees were answerable to the second mortgagees for the loss caused by a misstatement made by the auctioneer appointed by the first mortgagees to sell the property comprised in their security. The court directed that there should be an enquiry as to damages and that the first mortgagees should be allowed in their accounts the amount of their debt less the actual proceeds of sale from the property and the amount of the damages.

The next submission on behalf of Mr. Russell and Downsview is that, even if a mortgagee owes certain duties

to subsequent encumbrancers, a receiver and manager appointed by a mortgagee is not under any such duty where, as in the present case, the receiver and manager is deemed to act as agent for the mortgagor. The fallacy in the argument is the failure to appreciate that, when a receiver and manager exercises the powers of sale and management conferred on him by the mortgage, he is dealing with the security; he is not merely selling or dealing with the interests of the mortgagor. He is exercising the power of selling and dealing with the mortgaged property for the purpose of securing repayment of the debt owing to his mortgagee and must exercise his powers in good faith and for the purpose of obtaining repayment of the debt owing to his mortgagee. The receiver and manager owes these duties to the mortgagor and to all subsequent encumbrancers in whose favour the mortgaged property has been charged.

The next question is the nature and extent of the duties owed by a mortgagee and a receiver and manager respectively to subsequent encumbrancers and the mortgagor.

Several centuries ago equity evolved principles for the enforcement of mortgages and the protection of borrowers. The most basic principles were, first, that a mortgage is security for the repayment of a debt and, secondly, that a security for repayment of a debt is only a mortgage. From these principles flowed two rules, first, that powers conferred on a mortgagee must be exercised in good faith for the purpose of obtaining repayment and secondly that, subject to the first rule, powers conferred on a mortgagee may be exercised although the consequences may be disadvantageous to the borrower. These principles and rules apply also to a receiver and manager appointed by the mortgagee.

It does not follow that a receiver and manager must immediately upon appointment seize all the cash in the coffers of the company and sell all the company's assets or so much of the assets as he chooses and considers sufficient to complete the redemption of the mortgage. He is entitled, but not bound, to allow the company's business to be continued by himself or by the existing or other executives. 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 monies due under the debenture, even though the decisions of the receiver and manager may be disadvantageous for the company.

The nature of the duties owed by a receiver and manager appointed by a debenture holder were authoritatively defined by Jenkins L.J. in a characteristically learned and comprehensive judgment in *re. B. Johnson & Co. (Builders) Ltd.* [1955] Ch. 634 at 661. The Lord Justice said that:-

"... the phrase 'manager of the company', prima facie, according to the ordinary meaning of the words, connotes a person holding, whether de jure or de facto, a post in or with the company of a nature charging him with the duty of managing the affairs of the company for the company's benefit; whereas a receiver and manager for debenture holders is a person appointed by the 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 realize 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. He is receiver and manager of the property of the company for the debenture holders, not manager of the company. The company is entitled to any surplus of assets remaining after the debenture debt has been discharged, and is entitled to proper accounts. 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.

In determining whether a receiver and manager for the debenture holders of a company has broken any duty owed by him to the company, regard must be had to the fact that he is a receiver and manager - that is to say, a receiver, with ancillary powers of management - for the debenture holders, and not simply a person appointed to manage the company's affairs for the benefit of the company. ...

The duties of a receiver and manager for debenture holders are widely different from those of a manager of the company. 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 ..., 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."

The duties owed by a receiver and manager do not compel him to adopt any particular course of action, by selling the whole or part of the mortgaged property or by carrying on the business of the company or by exercising any other powers and discretions vested in him. But since a mortgage is only security for a debt, a receiver and manager commits a breach of his duty if he abuses his powers by exercising them otherwise than "for the special purpose of enabling the assets comprised in the debenture holders' security to be preserved and realized" for the benefit of the debenture holder. In the present case the evidence of Mr. Russell himself and the clear emphatic findings of Gault J., which have already been cited, show that Mr. Russell accepted appointment and acted as receiver and manager "not for the purpose of enforcing the security under the Westpac debenture but for the purpose of preventing the enforcement by the plaintiffs of the FCC debenture". This and other findings to similar effect establish that, *ab initio* and throughout his receivership, Mr. Russell did not exercise his powers for proper purposes. He was at all times in breach of the duty, which was pleaded against him, to exercise his powers in good faith for proper purposes.

Gault J. rested his judgment not on breach of a duty to act in good faith for proper purposes but on negligence. He said:-

> "... on an application of negligence principles, a receiver owes a duty to the debenture holders to take reasonable care in dealing with the assets of the company ... Downsview's position is merely a specific example of the duty a mortgagee has to subsequent chargeholders to exercise its powers with reasonable care."

Richardson J., delivering the judgment of the Court of Appeal, agreed that duties of care in negligence as defined by Gault J. were owed by Mr. Russell as receiver and manager and by Downsview as first debenture holder to FCC and FCF as second debenture holders. Richardson J.

agreed that Mr. Russell was in breach of his duty but, differing from Gault J., held that Downsview had committed no breach.

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 *re. B. Johnson & Co. (Builders) Ltd.* [1955] Ch. 634 at 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.

Richardson J. appreciated the contradictions and inconsistencies between the duties of a receiver and manager as set forth by Jenkins L.J. based on historical equitable principles and the suggested additional or alternative duty of care based on negligence. Richardson J. said:-

> "The existence, nature and extent of the receiver's duty of care must be measured in relation to the primary objective of the receivership which is to enforce the security by recouping the moneys which it secures from the income or assets of the company subject to the security, and for that purpose by exercising incidental powers of management, and when recoupment is complete to hand the remaining property back to the control of the company."

Their Lordships consider that it is not possible to measure a duty of care in relation to a primary objective which is quite inconsistent with that duty of care.

There is a great difference between managing a company for the benefit of a debenture holder and managing a company for the benefit of shareholders. If the debenture holder is dissatisfied with the policy or performance of his appointed receiver and manager, the appointment can be revoked. A dissatisfied second debenture holder may require the prior debenture to be assigned to him or may put the company into liquidation. A dissatisfied company may raise the money to pay off a debenture holder or put the company into liquidation. But if a receiver and manager decides at his discretion to manage and is allowed to manage and does manage in good faith with the object of preserving and realising the assets for the benefit of the debenture holder, he is subject to no further or greater liability.

In the United Kingdom the possible harsh consequences to a company of a receivership may be averted by an administration order under the Insolvency Act 1986. Such an order may be made if the company is or is likely to become insolvent and if the order will be likely to achieve, *inter alia*, the survival of the company or any part of its undertaking as a going concern. A petition for an administration order may be presented by the company or the directors or by a creditor. The order appoints an administrator to manage the affairs of the company with powers of sale and automatically prevents a receiver from acting and prevents a creditor from enforcing any security without the consent of the administrator or the leave of the court. The administrator may be removed if the company's affairs are managed by him "in a way which is unfairly prejudicial to the interests" of the company's creditors or members. Similar legislation is in force in the United States. In the absence of any such legislation, the only limitations on the exercise of power by a receiver and manager are the requirements to act in good faith for the purpose of preserving and realising the assets for the benefit of the debenture holder.

The House of Lords has warned against the danger of extending the ambit of negligence so as to supplant or supplement other torts, contractual obligations, statutory duties or equitable rules in relation to every kind of damage including economic loss; see *C.B.S. Songs Limited v. Amstrad Consumer Electronics Plc* [1988] A.C. 1013 at 1059, *Caparo Industries Plc v. Dickman* [1990] 2 A.C. 605 and *Murphy v. Brentwood D.C.* [1991] 1 A.C. 398. If the defined equitable duties attaching to mortgagees and to receivers and managers appointed by debenture holders are replaced or supplemented by a liability in negligence the result will be confusion and injustice. 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, a decision which, whether negligent or not, does not expose him to a suit for damages but may be disadvantageous to the company. A receiver who is brave enough to manage will run the risk of being sued if the financial position of the company deteriorates, whether that deterioration be due to imperfect knowledge or bad advice or insufficient time or

other circumstances. There will always be expert witnesses ready to testify with the benefit of hindsight that they would have acted differently and fared better.

A receiver and manager is appointed when the mortgagor company is in financial difficulties. He may know nothing of the trade carried on by the mortgagor company and nothing about the individual affairs of the company. He is dependent on information furnished by the directors and managers who must bear some responsibility for the financial difficulties of the company. Richardson J. in the present case, in discussing the ambit of section 189 of the Companies Act, said:-

> "There is a further justification for maintaining that clear distinction between the acts of the manager of the company and the acts of the receiver and manager of its property. The company has vicarious responsibility for the acts of the manager and in the exercise of those functions as manager the manager is not personally liable to other parties except for misfeasance. In contrast the receiver is personally liable on any contract entered into by him in the performance of his functions, except insofar as the contract otherwise provides (s.345(2)). In policy terms it may be considered entirely appropriate to confine the external sanction under s.189(1)(c) to officers of the company, leaving errant receivers and managers to their personal liability in respect of contracts, and recognising too that in the ordinary course poorly performing receivers are not likely to be given further assignments by debenture holders of other companies."

Similar considerations apply to Downsview. A mortgagee owes a general duty to subsequent encumbrancers and to the mortgagor to use his powers for the sole purpose of securing repayment of the monies owing under his mortgage and a duty to act in good faith. He also owes the specific duties which equity has imposed on him in the exercise of his powers to go into possession and his powers of sale. It may well be that a mortgagee who appoints a receiver and manager, knowing that the receiver and manager intends to exercise his powers for the purpose of frustrating the activities of the second mortgagee or for some other improper purpose or who fails to revoke the appointment of a receiver and manager when the mortgagee knows that the receiver and manager is abusing his powers, may himself be guilty of bad faith but in the present case this possibility need not be explored.

The liability of Mr. Russell in the present case is firmly based not on negligence but on the breach of duty. There was overwhelming evidence that the receivership of Mr. Russell was inspired by him for improper purposes and carried on in bad faith, ultimately verging on fraud.

The liability of Downsview does not arise under negligence but as a result of Downsview's breach of duty in failing to transfer the Westpac debenture to FCC at the end of March 1987. It is well settled that the mortgagor and all persons having any interest in the property subject to the mortgage or liable to pay the mortgage debt can redeem. It is now conceded that FCC were entitled to require Downsview to assign the Westpac debenture to FCC on payment of all monies due to Downsview under the Westpac debenture. On 27th March 1987 FCC offered to purchase the Westpac debenture and to pay Downsview all that was owing to them. It was faintly argued that Downsview were entitled to refuse the offer because at a later stage they reasonably believed, so it was said, albeit wrongly, that the FCC debenture was void for non-registration. There is nothing in this point. The reason given by Mr. Russell on behalf of Downsview for the refusal of Downsview to assign the Westpac debenture to FCC as a subsequent charge holder was that "we do not know of any right of assignment which subsequent charge holders have in respect of an earlier charge". Mr. Russell is now older and Downsview are now wiser.

Downsview were from the end of March 1987 in breach of their duty to assign the Westpac debenture to FCC. If that debenture had been assigned, Mr. Russell would have ceased to be the receiver and manager and none of the avoidable losses caused by Mr. Russell would have been sustained.

Gault J. decided that the damages payable by Mr. Russell and Downsview were "the difference between the loss that would have been incurred had the first receivership of Messrs. Chilcott & Chatfield been allowed to proceed unimpeded, and the loss actually incurred as it has emerged following the second receivership by those two accountants". Gault J. found that Mr. Russell accepted appointment as a receiver and manager for an improper purpose, namely the purpose of disrupting the receivership under the FCC debenture and for the purpose of preventing the enforcement of the FCC debenture. He was therefore in breach of his duty from 23rd March 1987 onwards. The measure of damages decided by Gault J. applies to this breach of duty just as it would have applied if Mr. Russell had been liable in negligence. The breach of duty of Downsview in refusing to assign the Westpac debenture following the letter dated 27th March 1987 can be dated from the end of March. There was no difference in the position of the company between 23rd March 1987 when Mr. Russell was appointed receiver and manager and the date when Downsview received the letter dated 27th March and should have agreed to assign the Westpac debenture and withdraw Mr. Russell. Accordingly Downsview, by committing a breach of duty in not accepting the offer of FCC to take an assignment of the Westpac debenture, are liable with Mr. Russell for the difference between the loss that would have been incurred, had the first receivership of Messrs. Chilcott & Chatfield been allowed to proceed unimpeded, and the loss actually incurred as it emerged following the second

receivership by those two accountants. FCC accepted that if the first receivership had continued it would not have been possible to get in all the assets of the company until 31st August 1987. Gault J., after hearing expert evidence, concluded that 31st August 1987 was "the date by which substantially all funds available from the disposal of assets would have been paid over to FCC, the debenture holder". Gault J. also found that $898,461.00 was the amount that would have been recovered by the FCC debenture holder at 31st August 1987. After making adjustments for interest, the amounts received by FCC and other matters not in dispute, judgment was entered for $554,566.33.

The Court of Appeal held that Gault J. lacked jurisdiction under section 189 to prohibit Mr. Russell from acting as a director or promoter or being concerned in the management of the company. Their Lordships agree for the reasons given by Richardson J.

In the result their Lordships are of the opinion that the appeal ought to be dismissed and the cross-appeal allowed and that the orders made by Gault J. against Mr. Russell and Downsview should be restored, save that the order against Mr. Russell under section 189 of the Companies Act should be quashed. The costs of FCC and FCF in the courts below and the costs of the appeal and cross-appeal before the Board should be paid by Mr. Russell and Downsview subject to the conditions imposed by the Board and accepted by FCC and FCF when, on 17th June 1992, the Board granted leave for arguments to be advanced which had not been raised before the Court of Appeal. Those conditions were set forth in a letter dated 18th June 1992 addressed to the parties by the Registrar of the Judicial Committee. Their Lordships will humbly advise Her Majesty to order accordingly.