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Lenders' liability for their receivers in buy-to-let cases

Gaining and losing protection



The
Royal
Courts
of
Justice



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Gaining and losing protection

Presented by Clive Whitfield-Jones, Partner, Jeffrey Green Russell Solicitors and Associate member of NARA to the CML LPA Receiver Conference, London.

7th June 2011

Important note

These seminar materials are prepared for illustration purposes only. They do not constitute legal advice and must not be relied on as such. Receivership is a complex and highly technical subject not fully explained in these materials. Readers and seminar attendees should not take any step or make any omission with respect to the subject matter of these seminar materials without taking separate legal advice.

The fundamental nature of BTL LPA receivership

An LPA receiver is a type of custodian appointed by a mortgage lender under a fixed legal charge with the primary purpose of protecting the mortgage lender from various potentially onerous liabilities and repaying the secured debt.

Capacities in which LPA receiver acts

Broadly, an LPA receiver may act in four main capacities:

1. Agent for the mortgagor.
2. Agent for the mortgagee.
3. As a principal (ie. agent for no-one).
4. As the attorney of the mortgagor.

It's crucial that for any particular purpose, the receiver understands in which capacity he or she is acting.

How do LPA receivers protect mortgage lenders?

The receiver as agent for the mortgagor (borrower)

Section 109 (2) of the LPA 1925 provides that the LPA receiver .. “shall be deemed to be the agent of the mortgagor; and the mortgagor shall be solely liable for the receiver’s acts or defaults unless the mortgage deed otherwise provides.”

This statutory deemed agency has subtle limitations and the mortgage conditions should (and normally do) expressly constitute the receiver the agent of the borrower.

At first sight, this is an odd concept. The mortgage lender appoints the receiver to protect the mortgage lender’s interests and the borrower has no control over the receiver. So why should the receiver be deemed to be the borrower’s agent and empowered to impose personal liability on the borrower?

The reasons are historic. Mortgage lenders do not normally take possession of mortgaged property unless left with no choice because of the potentially onerous duties to account as mortgagee in possession. If the receiver were the agent of the mortgage lender, the mortgage lender might:

1. Become exposed to liability as mortgagee in possession.
2. Assume liability to tenants as landlord.
3. Assume other potentially onerous liabilities associated with possession of land eg. occupier's liability.
4. Be liable as principal for the wrongdoing, acts and omissions of the receiver eg. property mismanagement, sale at undervalue, breach of contract with an asset manager or managing agent.
5. Be liable as principal for the receiver exceeding powers.
6. Be liable for the receiver's remuneration.

As far back as the 18th century, borrowers and mortgage lenders agreed, as a matter of contract, that if a receiver were appointed, the receiver would act as the agent of the borrower, shielding the mortgage lender from liability for the receiver's acts and defaults.

Agency in this context is somewhat of a legal fiction. The usual duties of an agent are absent. The supposed principal, the borrower, has no say in the appointment or disappointment of the receiver and cannot give him or her instructions.

The agency of the borrower is in reality a device to protect the mortgage lender, to give the mortgage lender the advantages of possession without its drawbacks. It draws a partial liability screen between the mortgage lender on the one side and the borrower, the property and the tenant on the other. "Agency" in the receivership context is about who assumes personal liability – the borrower, the mortgage lender or the receiver.

Acting as an agent does not absolve a receiver from personal liability for torts eg. trespass or nuisance. *"Speaking generally, a person who causes or commits a nuisance does not avoid liability by pleading that he did so as an agent for, or upon the authority of some other person"* see [Briggs J in John Smith & Co \(Edinburgh\) Ltd v Hill and others \[2010\] 2 BCLC 556 at para 34.](#)

Termination of the receiver's agency

Broadly, a receiver ceases to be the agent of the borrower if that receiver (or one of two joint receivers) receives notice:

- In the case of a borrower who is an individual, when that individual becomes bankrupt, dies or becomes of unsound mind.
- In the case of a borrower who is a company, when that company passes into liquidation.

On termination of the agency, the receiver does not automatically become agent of the mortgage lender and usually becomes a principal ie. not an agent at all. [American Express International Banking Corp v Hurley \[1985\] 3 All ER 564.](#)

Generally, the mortgage lender remains protected while the receiver acts a principal.

When a mortgage lender takes possession of a BTL property after the appointment of a receiver, the receiver becomes the agent of the mortgagee.

How can the protection conferred by an LPA receiver be lost?

Mortgage lenders do not normally wish the receiver to become their agent because the mortgage lender then generally becomes liable as principal for the acts and defaults of its agent. The precious list of protections conferred on the mortgage lender by the receiver acting as agent of the borrower will be lost with potentially serious consequences. In addition, the receiver may be entitled to an agent's right of indemnity against his principal ie. the mortgage lender.

- I. Dancing too closely to the mortgage lender's tune.

Where the mortgage lender directs the receiver in the conduct of the receivership, for example by issuing instructions as to how the receiver should act, a court will readily find that the receiver has become the agent of the mortgage lender.

[Standard Chartered Bank Ltd v Walker and another \[1982\] 3 All ER 938.](#)

There was evidence that the bank instructed the receiver to realise the company's assets as soon as possible and that in accordance with those instructions the receiver instructed an auctioneer to hold a sale of the company's stock very quickly. The guarantors claimed that in consequence of the bank's instructions the sale was held at the wrong time of the year, that it was poorly advertised and

therefore poorly attended, and that the stock was sold for £42,800 which was considerably less than its real value. The amount realised was barely sufficient to cover the costs of realisation.

Held: There was a triable issue as to whether the bank had interfered, by giving instructions to the receiver, in the conduct of the receivership in respect of the sale of the company's assets, so as to make the receiver its agent.

American Express International Banking Corp v Hurley [1985] 3 All ER 564.

There was constant communication between the bank and the receiver and the latter sought the former's approval to such actions as he proposed to take.

Held: Receiver became the agent of the bank and thus liable for the receiver's undervalue sale of sound and lighting equipment used at pop concerts.

2. Receiver acting under appointor's instructions.

The mortgage lender may be liable to indemnify the receiver against any liability to the borrower or a third party incurred by the receiver whilst acting under the instructions of the mortgage lender.

3. Landlord liability, authorised and unauthorised tenancies, tenancy by estoppel.

Consider the package of liabilities and obligations that goes with being a BTL landlord under short term ASTs:

- a. the burden of the landlord's express covenants contained in the AST.
- b. the burden of landlord's covenants implied in the AST by statute and in particular under section 11 of the Landlord and Tenant Act 1985 which imposes obligations on the landlord to repair the structure and exterior (including drains, gutters and external pipes) of the premises; to keep in repair and proper working order the installations in the premises for supply of water, gas and electricity and for sanitation (including basins, sinks, baths and sanitary conveniences, but not other fixtures, fittings and appliances for making use of water, gas or electricity); to keep in repair and proper working order the installations in the premises for space heating and heating water.
- c. the burden of other obligations imposed by statute for example under the Gas Safety (Installation and Use) Regulations 1998, the Electrical Equipment (Safety) Regulations 1994 and the Plugs and Sockets etc., (Safety) Regulations 1994 and the tenancy deposit scheme.

The law recognises two basic types of possession of land, physical possession and possession of rents and income. A mortgagee is entitled to possession. Thus, a mortgage lender need not appoint a receiver in order to intercept rents. A mortgage lender could simply write to the tenants directing them to pay rents to the mortgage lender. Mortgage lenders do not do this as they fear assuming landlord liability.

A receiver acting as agent for the borrower may safely accept rents without either that receiver or the appointing mortgage lender becoming landlord.

If a receiver acting as agent for the mortgage lender accept rents that is the same thing as the mortgage lender itself accepting them, with the potential for assuming landlord liability.

It is particularly dangerous for the mortgage lender where the tenancy is unauthorised and on onerous terms eg. a 5 year tenancy at a fixed low rent. A receiver acting as agent for the borrower may well be able to accept rent under an unauthorised tenancy without prejudice to the mortgage lender's right to obtain possession against the tenant as a trespasser. If the receiver is acting as agent for the mortgage lender, the mortgage lender may find itself bound by that tenancy and unable to remove the tenant. The security may be difficult to realise and its value greatly impaired.

Great care is needed in wording notices to tenants that a receiver has been appointed.

[Chatsworth Properties Ltd v Effiom \[1971\] 1 All ER 604, \[1971\] 1 WLR 144 CA.](#)

The mortgage lender's solicitors wrote to unauthorised tenant informing him that the mortgage lender had appointed R as receiver of the rents and profits of the property, and continued: 'Please take notice that henceforth you should not pay any sums to your former landlords the mortgagors] but to [R] ...' The mortgage lender appealed from an order refusing their claim for possession: Held: Held the claim for possession failed; the receipt of rent by a receiver appointed by a mortgagee did not, without more, create a tenancy by estoppel as against mortgagee; but plaintiffs had so conducted themselves that they were precluded from denying that they had accepted defendant as their tenant, for their letter of December 23, 1968 would have been understood by any reasonable man (and was understood by the tenant) to mean that the mortgagors had ceased to be his landlords and that, in their place, plaintiffs accepted him as their tenant with the result that a new tenancy was created.

Who carries the can?

1. Mortgage lenders do not normally grant indemnities in favour of receivers in BTL cases, so when a receiver acts as agent for the borrower or as a principal, liability normally remains with the receiver and/or the borrower. Where the receiver acts as agent for the mortgage lender, responsibility for the receiver's acts and defaults will normally fall on the mortgage lender and the receiver may be entitled to an agent's right of indemnity against his principal ie. the mortgage lender.
2. If a receiver is invalidly appointed, the person responsible for that appointment, ie. the mortgage lender may be vicariously liable eg. for the trespass of the purported receiver.
3. s 34 Insolvency Act 1986 Liability for invalid appointment.

“Where the appointment of a person as the receiver or manager of a company's property under powers contained in an instrument is discovered to be invalid (whether by virtue of the invalidity of the instrument or otherwise), the court may order the person by whom or on whose behalf the appointment was made to indemnify the person appointed against any liability which arises solely by reason of the invalidity of the appointment.”

4. A receiver invalidly appointed (ie. no powers) or validly appointed but exceeding his powers may be held liable in a number of ways including:
 - Trespass;
 - Conversion;
 - Constructive trusteeship (hand-back of proceeds);
 - Restitutionary claims for unjust enrichment.

Very serious financial consequences may follow.

In Re Goldberg (No. 2). Ex parte Page, a business was transferred fraudulently to a company then charged to mortgagees. The mortgagees later appointed a receiver. The transfer was set aside as fraudulent. The charge under which the receiver was appointed fell away.

Held:

- The purported receiver is the agent of his appointor;
- The appointor and the receiver were jointly and severally liable as trespassers.

In *Rolled Steel Products (Holdings) Ltd v British Steel Corporation plc* [1986] Ch 246. The directors of a company acted in breach of the company's articles of association and their fiduciary duties to the company in purporting to authorise and in executing a guarantee and the debenture.

The defendant corporation and the receiver appointed under the debenture had notice of that breach when they received assets of the Company. They were accountable for those assets to the company as constructive trustees.

5. Sometimes, a lender persuades a receiver to take actions when the receiver has no power to do so, with or without an indemnity. In *Law of Property Act Receiverships* (1994) at page 35 the author Stephen A. Lawson comments:

"It will always be singularly unwise for a receiver to purport to exercise powers that are not, in fact, conferred upon him. Such a situation most commonly arises where a receiver is requested by the mortgagee to trade or carry on the business, there being no express power so to do, to apply the proceeds of sale of non-charged assets to the mortgagee (there being no express power so to do) or to deduct from the sale of freehold or leasehold assets, losses which have been incurred through continued trading. Receivers (and mortgagees) who go down this path do so very much at their own risk and could never be advised to act in such a manner."

6. In the past, accidental or deliberate wrongful acts like exceeding powers were normally limited to individual receiverships. With one receiver dealing with a large number of BTL receiverships and standardised procedures, the stage is set for the replication of the same wrongful act on an industrial scale. A single successful challenge by one borrower may lead to many copycat claims, perhaps backed by claims management companies, with grave financial consequences.

Thanks for listening

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