

KEY POINTS

- Mortgagees should consider the full range of options available to them where a borrower is in default.
- When deciding how to exercise these powers, the mortgagee must do so in good faith. This is defined in accordance with well-established equitable principles and is not the same as a *Braganza*-style implied term.
- A receiver owes similar duties to the mortgagor as the mortgagee does. The advantage of appointing a receiver is that they are deemed to be an agent of the mortgagor.
- However, a receiver is entitled (and is usually bound) to prefer the interests of the mortgagee provided they are exercising their powers for a proper purpose.

Author David Sawtell

The remedies of the mortgagee and appointing receivers

A lender which has a mortgage as security has a number of possible enforcement remedies. It has a broad, but not unlimited, discretion as to how to choose to use them, as shown in recent cases. The appointment of a receiver has enjoyed renewed interest.

When a debtor fails to repay a loan secured against land by way of a mortgage, the mortgagee has an array of possible remedies in order to secure repayment under English law. Not least as a result of the restrictions placed on the enforcement of debts through insolvency procedures and possession claims in England and Wales under the Coronavirus Act 2020 and the Corporate Insolvency and Governance Act 2020 and amendments to the Civil Procedure Rules, mortgagees are re-examining their options. There has been a recent renaissance in the use of receivers to divert profits and rents towards servicing the secured debt. This article considers the mortgagee's remedies especially insofar as they relate to commercial lending, as well as considering recent challenges to the exercise of these remedies by mortgagees and receivers.

THE MORTGAGEE'S REMEDIES

Where the mortgagor is in default of their obligation to repay the secured sum, the mortgagee is generally considered to have five potential remedies:

- debt action for the money owed;
- sale of the mortgaged property;
- going into possession of the mortgaged property;
- foreclosure;
- appointment of a receiver.

In practice, foreclosure is an obsolete remedy for the destruction of the equity of

redemption that a modern court would be very reluctant to order. Remedies other than foreclosure are not exclusive: it is open to the mortgagee to exercise a number of them in turn in respect of a single mortgage. The mortgagee of an equitable mortgage might well find that its options are more limited than the mortgagee of a legal mortgage, however, especially where the mortgage is not made by deed.

DECISION MAKING BY THE MORTGAGOR

When deciding how to exercise its powers and remedies, the mortgagee does not have an unlimited discretion. In equity, a mortgagee has a limited title which is available only to secure satisfaction of the debt. In *Downsview Nominees Ltd v First City Corporation Ltd*,¹ the Privy Council clarified that the powers conferred on a mortgagee or a receiver must be exercised in good faith for the purpose of obtaining repayment. The equitable nature of these duties was reinforced in the subsequent Privy Council decision in *Çukurova Finance International Ltd and another v Alfa Telecom Turkey Ltd*.² An act by way of enforcement of the security purely for a collateral purpose will be ineffective, at least as between mortgagor and mortgagee.

In *Property Alliance Group Ltd v Royal Bank of Scotland plc*,³ the bank had a power to require a valuer to prepare a valuation of each property at the claimant's expense.

The English Court of Appeal held that the exercise of this power was not unfettered: it could only be exercised for a purpose related to the bank's legitimate commercial interests. At [169], it was made clear that the bank "must have been free to act in its own interests and that it was under no duty to attempt to balance its interests against those of [the debtor]": it could not, however, commission a valuation to vex the debtor or for a purpose unrelated to its legitimate commercial interests.

This good faith obligation has a different content to that arising under an implied term in commercial contracts. In *UBS AG v Rose Capital Ventures Ltd and others*,⁴ the defendant cited *Braganza v BP Shipping Ltd*⁵ in support of the proposition that a discretion to call in the loan early was subject to a duty of good faith and was not to be exercised in a manner that was irrational, arbitrary, capricious or unreasonable. The Supreme Court held that in appropriate cases a term to that effect would be implied, qualifying the exercise of a contractual discretion in a way analogous to the review of the decisions of public authorities. Chief Master Marsh rejected the argument that a *Braganza* implied term was applicable in respect of a loan repayable on demand. Instead, mortgage lending had its own protections in its formulation of an obligation of good faith, pointing against the possibility of a *Braganza*-style clause being implied in relation to a core contractual provision. As long as the mortgagee exercised the power for proper purposes, and not for the sole purpose of vexing the mortgagor, it would not be in breach of its duty of good faith.

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DEBT ACTION

The mortgagee has the option of simply suing in contract on the mortgagor's personal covenant to repay the loan. There might well be a number of advantages in doing so. There might be a potential defect with the security instrument which the mortgagee does not want to test. Alternatively, the mortgagee might wish to enforce against the mortgagor's other assets without limiting itself at first to the land over which it has security. Finally, having exhausted its remedies under the security instrument, there might still be a shortfall which the mortgagee would wish to pursue as a straightforward debt claim.

SALE

Most charges contain an express power of sale, setting out more extensive powers than are available under statute. In England and Wales, the statutory power of sale is in s 101(1)(i) of the Law of Property Act 1925 (LPA 1925), which becomes exercisable when the conditions set out in s 103 are satisfied. The security instrument itself may modify or dispense with the notice requirements under s 103. The most significant advantage of a power of sale is that a legal mortgagee can sell without the need for a court order or, indeed, taking possession of the property. This may be of particular advantage where the property has been leased and benefits as a result from a good rental income.

All legal mortgagees, as they are by deed and are registered, therefore have the power of sale. Where a mortgage is by deed but has not been registered, so that the mortgage is not legal but equitable, then the mortgagee can still rely on the statutory power of sale: *Swift 1st Limited v Colin*.⁶ Issues can arise if a mortgage is being transferred to a new mortgagee and the incoming mortgagee attempts to take enforcement action before the assignment is validly registered. This problem arose in *Skelwith (Leisure) Ltd & ors v Armstrong & Polar Holdings Ltd & Flaxby Park Ltd*⁷ where an unregistered charge holder attempted to make a valid sale. The issue was different to that in *Swift*, as the charge itself was registered: the difficulty was that the mortgagee was not its registered

proprietor. The incoming mortgagee was able to succeed by arguing that it was, as an equitable assignee, "entitled to receive and give a discharge for the mortgage money" under s 106(1) LPA 1925 and hence had a power of sale under s 101 LPA 1925, allowing it to give good title pursuant to a sale. There will be circumstances, however, where an equitable mortgagee will not be able to rely on a statutory power of sale. An equitable mortgagee should therefore take advice before purporting to exercise a power of sale.

If the mortgagee exercises its power of sale, it owes a duty to the mortgagor to take reasonable care to obtain the best price reasonably obtainable at the time of sale. The most recent English decisions confirm that this duty arises in equity, and not in tort: *Silven Properties Ltd v Royal Bank of Scotland plc*.⁸ This was a withdrawal from references to negligence made in earlier cases such as *Cuckmere Brick Co Ltd v Mutual Finance Ltd*,⁹ but did not alter the actual content of the duty owed by the mortgagee to take reasonable precautions to obtain "the fair" or "the true market" value. The Australian High Court never adopted tort as a juridical basis for this duty, but it has not provided an authoritative ruling as to the actual content of a mortgagee's duty, namely whether it is simply to avoid breaching a "good faith" test, or if there is a duty to take reasonable care: there were competing comments as to the same in *Australia and New Zealand Banking Group Ltd v Bangadilly Pastoral Co Pty Ltd*.¹⁰ Lower courts have tended to apply the lower good faith test, as discussed by Natalie Skead, 'A mortgagor's remedies against a mortgagee for the improper exercise of the power of sale: You can't always get what you want' (2008) 15 APLJ 130.

A mortgagee cannot sell to itself on account of the self-dealing rule: the interest of the mortgagee in purchasing for a low price inevitably conflicts with its duty to take reasonable care to obtain a proper price. If the mortgagee wishes to sell to an associate in which it is interested, it is necessary to prove that the sale was in good

faith and the mortgagee took reasonable care to obtain a proper price at the time.¹¹

POSSESSION

A legal mortgagee can take possession without a court order, subject to any agreement otherwise: *Ropaigealach v Barclays Bank*.¹² Often a mortgagee will take possession of a property in order to secure vacant possession before exercising a power of sale. A mortgagee entering into possession of a property comes under a liability to account strictly, not only for all that is actually received, but also for all that ought to have been received if the property had been managed with due diligence. A mortgagee in possession must take reasonable care to preserve the property. This can make it unattractive for a mortgagee to take possession of a property. Further, in England and Wales, the mortgagee of a residential property must comply with the Pre-action Protocol for Possession Claims based on Mortgage or Home Purchase Plan Arrears in Respect of Residential Property amongst other procedural requirements.

APPOINTING A RECEIVER

A receiver appointed by the mortgagee has the power to manage the mortgaged property to collect rents and profits from it, so as to preserve the asset over which the lender has security. A receiver is deemed to be the agent of the mortgagor, not the appointing mortgagee, although it is primarily a device to protect the mortgagee. Without, therefore, requiring the mortgagee to go into possession, a mortgagee can ensure that the property is efficiently managed, and its security protected. Normally, the mortgage instrument itself will allow the lender to appoint a receiver, in which case they will be styled a fixed charge receiver; if not, s 101(1)(iii) LPA 1925 grants the power for a mortgagee to appoint a receiver, which arises and becomes exercisable at the same time that the statutory power of sale arises and becomes exercisable.

The appointment of a receiver can put the debtor under considerable pressure.

Biog box

David Sawtell is a barrister at 39 Essex Chambers specialising in property, construction and related commercial dispute resolution. He is regularly instructed in legally and factually complicated disputes arising from the development and use of land, both domestically and internationally, in litigation, arbitration and adjudication. He was called to the Bar by Lincolns' Inn in 2005. Email: david.sawtell@39essex.com

A receiver will divert rents and profits away from the debtor, creating cash flow difficulties. As the receiver is at arms-length from the mortgagee, they are able to deal with the property comprising the security without putting the mortgagee at risk of any allegations of bad faith or self-dealing. Furthermore, the receiver's appointment is not terminated by the liquidation of the mortgagor, so that they can sell the secured asset during the insolvency process. It was confirmed in *Menon v Pask*¹³ that the receiver can bring a possession claim against the mortgagor itself occupying the property.

On the other hand, if the asset itself is creating little profit, any money that does come in may instead go towards discharging the receiver's fees. The receiver may be as hamstrung as the mortgagor in pursuing any remedies against defaulting tenants, such as temporary COVID-19 related restrictions on possession and forfeiture of leases. If there are any issues as to the validity of the appointment of the receiver, the mortgagor might well have potential claims in trespass and a potentially substantial claim for damages.

DUTIES OWED BY RECEIVERS

A receiver of the mortgaged property appointed by the mortgagee owes the same duty to the mortgagor as the mortgagee in relation to sale of the property. The Court of Appeal confirmed in *Medforth v Blake*¹⁴ that these duties arise in equity, not out of negligence. They must be active in the protection and preservation of the charged property. That does not oblige the receiver to await or effect any increase in value in the property before selling it. The receiver is not managing the mortgagor's property for the mortgagor's benefit, but instead is managing the mortgagee's security for the benefit of the mortgagee.

As the receiver finds themselves in a tripartite relationship with the appointing mortgagee and as agent of the mortgagor, they will inevitably find themselves in a position where there is a conflict of interest from the outset of their appointment. The receiver is entitled (and is usually bound) to prefer the interests of the mortgagee

provided they are exercising their powers for a proper purpose.

In *Devon Commercial Property Ltd v Barnett*,¹⁵ HHJ Paul Matthews (sitting as a Judge of the High Court) held that where the mortgagee appoints a receiver, and the receiver exercises the power of sale to sell to the mortgagee's associate, there is no self-dealing. In that case, the claimant acquired a bottling factory which it leased to its connected company, while it mortgaged the factory. Its connected company went into administration and the company's business and assets were sold to a brewery. The brewery then acquired the mortgage. When the claimant went into default under the mortgage, the brewery appointed the defendants as receivers. When the factory could not be sold immediately, they granted a new three-year lease to the brewery. The receivers then sold the factory to a newly formed subsidiary of the brewery, leaving no surplus for the claimant. The claimant argued that the receivers had a duty not to put themselves in a conflict of interest, which would include a duty not to sell to an associate of the mortgagee.

The judge held that the receiver does not have the same interest as the mortgagee in minimising the sale price: instead, it was held that the receiver's interest is in performing the role properly in order to earn their fee. While there may be improper reasons to sell to a mortgagee's associate (such as to curry favour with the mortgagee for future appointments), this is different from there being an inappropriate conflict of duty. The claimant's assertion that the self-dealing rule applied to the sale of the factory failed.

CONCLUSION

The mortgagee's remedies in English law spring from the security instrument, the principles of equity and from the Law of Property Act 1925: they are regulated under the court's equitable jurisdiction. Without unduly diminishing that protection, the content of a duty of good faith has not so far been influenced by the standard expected in such a term under other commercial contracts. There has also been no resurgence

of interest in any tortious duty of care, although in England and Wales this has not watered down the standard expected when selling a property. ■

- 1 [1993] AC 295.
- 2 [2013] UKPC 3, [2016] AC 923.
- 3 [2018] EWCA Civ 355, [2018] 1 WLR 3529.
- 4 [2018] EWHC 3137 (Ch), [2019] 2 BCLC 47.
- 5 [2015] UKSC 17, [2015] 1 WLR 1661.
- 6 [2011] EWHC 2410 (Ch).
- 7 [2015] EWHC 2830 (Ch), [2016] Ch 345.
- 8 [2004] 1 WLR 997 at [19], per Lightman J.
- 9 [1971] Ch 949.
- 10 (1978) 139 CLR 195.
- 11 *Tse Kwong Lam v Wong Chit Sen* [1983] 1 WLR 1349, PC.
- 12 [2000] QB 263.
- 13 [2019] EWHC 2611 (Ch), [2020] Ch 66.
- 14 [2000] Ch 86.
- 15 [2019] EWHC 700 (Ch).

Further Reading:

- The scope of a mortgagee's implied rights (2020) 2 JIBFL 124.
- Lender's liability for the enforcement of security (2019) 8 JIBFL 512.
- LexisPSL: Practice Note: Mortgagee's "self-help" power of sale.