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NZLR

IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

1517

CP.410/93

[redacted] 1000 9/9/93

BETWEEN DOWNSVIEW NOMINEES LIMITED

Plaintiff

AND OFFICIAL ASSIGNEE

Defendant

Hearing: 8 June 1994

Counsel: *Robert Warburton* for Plaintiff
Gina Cole and Bronwyn Barnard for Defendant

Judgment: 5th July 1994

RESERVED JUDGMENT OF TOMPKINS J

Solicitors for Plaintiff: Warburton Solicitors, Auckland

Solicitors for Defendant: Gina Cole, Commercial Affairs, Auckland

The plaintiff holds a debenture over DNJ Hoban Limited (In Liquidation). The defendant is the liquidator of the company. The defendant has made a decision in the course of the winding up, declining a claim by the plaintiff. The plaintiff has applied, pursuant to s 241(5) of the Companies Act 1955, for an order that the defendant's decisions be reversed.

The Sequence of Events

The company traded in Putaruru as a layer and retailer of carpets. It was having some financial problems. It approached the plaintiff for assistance. On 26 August 1986 it executed a deed of debenture in favour of the plaintiff securing an advance of $1000 that was made that day. That debenture was registered on 15 September 1986.

The company was placed into liquidation on 15 July 1987. The Official Assignee was appointed, and remains, the liquidator. On the next day, 16 July 1987, the plaintiff appointed John George Russell as receiver and manager of Hoban. The written appointment, signed by the plaintiff under seal, stated that the receiver is entitled to an indemnity out of the assets of the company for any liabilities incurred by him and in addition, the plaintiff indemnified the receiver from all costs and expenses incurred by him. I note in passing that such an appointment will be prohibited under the Receiverships Act 1993, that comes into force on 1 July 1994. Section 5 (1) (c) prohibits the appointment as a receiver of a person who has within two years been a director of the grantor. Mr Russell was a director of the plaintiff.

In September 1987 the principal shareholder of the company, Mr Hoban, agreed with the liquidator to pay $10,624.77 being the debit balance in his current account. This amount was paid to the liquidator by instalments.

On 3 November 1988 the receiver received $1,496 described as being from sales, presumably from the sale of company stock. No further amounts were received during the receivership.

The receiver continued to incur costs in administering the receivership. As these costs were incurred, the receiver was reimbursed by the plaintiff. On each occasion Mr Russell, as the principal of the plaintiff,

wrote to himself as the receiver of the company, a letter of which the following is a sample:

> "This is to advise that the plaintiff made a further advance to the receiver of $190 on 6 March 1991.
>
> This advance bears interest at the rate of 28% per annum and is repayable on demand.
>
> As this is a receiver's borrowing it is repayable in preference to all other claims in the receivership."

The interest rate of 28% is specified in the debenture as the rate payable on the principal sum. The total amount paid by the plaintiff to the receiver for fees and costs was $21,037.34. Interest brought this amount to $31,459.87 by 31 May 1993. Although not stated in the letter, the clear intention was that the amount of the advance was to be added to the principal sum owing under the debenture. The last sentence is a reference to the provision in the debenture giving the costs and remuneration of the receiver priority over all other debts.

By August 1992 the liquidator was holding $13,234.46. The plaintiff claimed to be entitled to this amount to reimburse it for the receiver's fees, costs and interests. The defendant declined. He wrote to the plaintiff stating his intention to pay out $1260.23 being the amount owing to the plaintiff at the date of liquidation and to pay the remaining funds to the unsecured creditors. It is this decision that is the subject of the application.

On 6 September 1991 Mr Russell filed a notice in the Companies Office that he had ceased to act as receiver and manager of the company. He therefore was the company's receiver from 16 July 1987 to 4 September 1991, a period of some four years and two months.

The Claim and Defence

It was the plaintiff's claim that the plaintiff was entitled to appoint a receiver following liquidation, although Mr Warburton accepted that in those circumstances the receiver does not become the agent of the company. The plaintiff contended that the receiver, on appointment by the plaintiff, was entitled to act on its behalf to realise the security and while doing so to undertake appropriate activity on behalf of the company. The plaintiff was bound to meet the receiver's costs under the terms of the indemnity contained

in the appointment and the amount so paid became due under the debenture. The plaintiff therefore had a first charge on the assets of the company to meet that amount. The plaintiff sought orders that the decision of the defendant be reversed, and that the amount held by the defendant, being less than the amount due to the plaintiff, be paid to the plaintiff.

The defendant required the plaintiff to prove the debenture and the original loan. The defendant even pleaded that the execution of the debenture was a sham in that no monies were ever advanced prior to the date of liquidation by the plaintiff to the company. No evidence was called nor submissions made in support of that allegation. At the hearing the defendant accepted that the debenture was genuine and the stated advance had been made. The defendant also pleaded that the plaintiff had failed to apply to the court for leave to allow the receiver to act, but at the hearing accepted that leave was not required.

The defendant contended that the company was only liable to the plaintiff for the principal sum owing at liquidation less the $1496 received, plus the reasonable costs of the receiver in affecting sales. On that basis, no liability existed. Alternatively, he contended that the receiver was in breach of its duty to the company in providing unnecessary services and incurring further debts as a consequence of which the company was not liable for those costs. He also submitted that any remuneration properly payable to the receiver has priority only to the extent of moneys received in the course of the receivership, and that that remuneration does not carry interest.

Breach of Duty

In *Downsview Nominees Ltd v First City Corporation Ltd*[1] Lord Templeman, delivering the judgment of the Judicial Committee of the Privy Counsel, discussed[2] the duties owed by a receiver and manager to the mortgagor. After referring to the basic principles that a mortgage is security for the repayment of debt and a security for repayment of a debt is only a mortgage, he went on to say:

> "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

1 [1993] 1 NZLR 513

2 At 522.

> 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."

In addition to this general duty, the receiver has various statutory duties set out in s 348 of the Companies Act. These include, *inter alia,* the obligations to notify the appointment, to send to the Registrar and the court a statement of assets and liabilities, and every twelve months to send to the persons specified an abstract showing his receipts and payments.

The issue, therefore, is whether the receiver was in breach of his duty to the company in continuing to act as receiver thereby incurring costs in excess of those reasonably required to discharge his statutory obligations on appointment and to obtain repayment or to preserve and realise the security.

Mr Russell was asked why, when the debt owing by the company to the plaintiff at liquidation was only $1,259.42, the plaintiff appointed a receiver, replied that it was the plaintiff's standard practice to do so because of what he described as the vendetta which the Justice Department has conducted against him and his companies for the last sixteen years, as a result of which he said he has no faith in the Official Assignee paying out on the debenture. When asked why he did not prove in the liquidation as a secured creditor, his answer was that the Official Assignee would not pay him.

At the conclusion of the hearing decision, was reserved to enable counsel to file further memoranda. During that time the Deputy Official Assignee at Auckland, Mr Marshall, filed a memorandum in response to Mr Russell's evidence about the Official Assignee's attitude towards him and his company, and setting out factual matters that he considered refuted the claim. I regard this procedure as irregular. If the Official Assignee wished to put before the court more factual material, he should have sought leave and put that material in affidavit form. The plaintiff then would have been able, had it wished, to apply to cross examine the deponent on these factual assertions. I have disregarded the contents of this memorandum.

In his prepared brief, Mr Russell thus described his activities as receiver.

> "As receiver I set about carrying out my duties. I contacted the directors of the company, Mr and Mrs

> Hoban. I sent documentation to then requesting that a statement of affairs be completed. That was not carried out by the directors and accordingly it was necessary for the receiver, to compile the statement of affairs from documentation and information provided. I also arranged to correspond with the creditors of the company and obtained proofs of debt from creditors. I also dealt with the Inland Revenue Department and brought up to date their records including the preparation of Goods and Services Tax Returns and the preparation and filing of P.A.Y.E. and A.C.C returns together with the preparation and filing of income tax returns. It was also necessary to prepare accounts to 31 March 1987 and 15 July 1987. There was obviously correspondence with the Official Assignees office and the need to deal physically with the assets of the company. In addition to that there has been a great deal of correspondence with the Official Assignee over the payment of monies held by the Official Assignee and I was also required to deal with an abortive application by the Official Assignee for details of income and expenditure in the receivership and further, these present proceedings."

In his oral evidence, Mr Russell referred to some of these activities, such as meeting requirements of the Inland Revenue Department and completing PAYE records, as not really the duty of a receiver. He considered that he had a moral if not a legal obligation to undertake work of this kind.

No more detailed break down of these activities was provided although Mr Russell did in his evidence later observe that the cost of producing a statement of affairs is about $1500. What is notable about Mr Russell's description of his activities as receiver, is that there is little reference to activities directly related to obtaining repayment of the debt. Rather the activity is directed towards administering the company, filing returns, preparation of annual accounts and correspondence. He does refer to the need to deal physically with the assets of the company but does not relate what those assets were or in what way he dealt physically with them.

In my view the conclusion is inevitable that the receiver was in breach of his duty to the company. When the figures are considered it is difficult to see how any other conclusion could be reached. The debt at the time of the appointment of the receiver was $1,260.23 being the original debt of $1000 plus interest. The fees charged by the receiver and paid by the plaintiff was $21,037.34. The receiver was of course aware that to those fees was being added interest at 28% which brought the total amount claimed by the plaintiff to $31,459.87. It must have been obvious that the costs being incurred were far

greater than those reasonably required to obtain payment of the amount owing. Nor is there any evidence to show that costs of that magnitude could possibly have been justified to preserve and realise whatever the security may have been. Although the evidence is not specific, it is a fair inference that the only assets of the company were the stock in respect of which the receiver received $1,469.00, and the debt due to the company by Mr Hoban in respect of which the liquidator has received $10,624.77. The receiver did nothing in respect of the latter. His activities in collecting the former could not in any way have justified the costs incurred. When regard is had to the small amount of the debt, I find that Mr Russell as receiver was in breach of his duty to the company in continuing to act and incur the costs that he did.

It is not possible on the information before the court to determine what would have been reasonable costs. The receiver is entitled to fees and disbursements directly related to carrying out his statutory obligations on appointment and in realising the stock. Any further costs, not being related to the preservation or realisation of the security, would, in my view, not be justified in these circumstances and if incurred, were in breach of the duty the receiver had to the company. Once the limited nature of the assets had been ascertained, and certainly after receipt of the proceeds of the sale of the stock, the receiver should have ceased to act, and left the winding up of the company to the liquidator.

The Authority of the Receiver to Increase the Company's Indebtedness to the Debenture Holder

It is Mr Russell's evidence, confirmed by the letters that were written by him as the principal of the plaintiff to him as receiver, that each time the receiver rendered an account for fees, that account was paid by the plaintiff and the plaintiff then treated the amount paid as a further advance incurred by the company under the terms of the debenture in respect of which interest at the rate prescribed in the debenture was charged. It was the defendant's submission that the receiver had no authority to have the company borrow these additional amounts from the plaintiff.

Ms Cole submitted that under the terms of the debenture and having regard to the liquidation, Mr Russell had no power to, on behalf of the company, borrow further monies from the plaintiff.

Clause 25 of the debenture sets out the powers given by the debenture to the receiver. They include:

> "(b) To carry on any business of the company and if necessary to borrow any monies which he or they may require for that purpose and to secure the same with interest by mortgage or charge in priority or subsequent to the monies hereby secured and otherwise as may be thought expedient."

The receiver could not act under this paragraph because the borrowing the paragraph authorises is only "for that purpose" i.e. to carry on any businesses of the company. The money the receiver purported to borrow on behalf of the company was not to carry on any business of the company, it was to pay fees incurred by the receiver in the course of the receivership. The company was not carrying on any business. In the accounts for the year ended 15 July 1987 which Mr Russell prepared, it is recorded "that the company has ceased business".

Nor was Mr Russell as receiver able to bind the company pursuant to a general provision contained in clause 25 of the debenture that the receiver once appointed shall be the agent of the company and the company shall be responsible for his acts. That is because the effect of the liquidation is that the receiver can no longer act as agent of the company. In *Sowman and Ors v David Samuel Trust Limited and Anor*[3], Goulding J, after considering such authorities as *Gaskell v Gosling*[4] and *Gough's Garages Limited v Pugsley*[5], expressed the following conclusion[6]:

> "Winding up deprives the receiver ... of power to bind the company personally by acting as its agent. It does not in the least affect his powers to hold and dispose of the company's property comprised in the debenture including his power to use the company's name for that purpose, for such powers are given by the disposition of the company's property which it made (in equity) by the debenture itself."

It follows from this that the receiver had no power to have the company borrow from the plaintiff under the debenture, the amounts which the plaintiff had paid to the receiver for his costs and remuneration. Although Mr

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3 [1978] 1 All ER 616
4 [1896] 1 QB 669
5 [1931] KB 615
6 At 623.

Russell treated the payment of the receivers costs and remuneration by the plaintiff as an advance under the debenture, Mr Warburton in his submissions accepted that this payment was not an advance under the debenture. Rather, it was a payment made

What, if any, Priority do the Costs Incurred in the Receivership Have?

As between the receiver and the plaintiff, the receiver is entitled to be indemnified for all fees and costs incurred by him in the course of the receivership pursuant to the indemnity given to him by the plaintiff under the terms of the appointment. Under the doctrine of subrogation[7], the plaintiff is entitled in equity to be subrogated to all the rights possessed by the receiver. This entitlement does not depend on contract. It is the result of the equity of indemnification attendant on the suretyship.[8] These rights include the receiver's right to recover from the company his remuneration and costs properly incurred.

The plaintiff is not entitled to treat any payments made to the receiver pursuant to that indemnity as part of the "principal sum" under the debenture. That is because the debenture in clause 4 defines "principal sum" as including "such further or other sums as the lender may from time to time advance to the company". It goes on to provide that any further advances shall be made upon such terms as to payment "as the parties may mutually agree". But I have already held that the receiver had no power to bind the company to borrow further money from the plaintiff under the debenture.

The debenture provides in clause 27 that the net proceeds of realisation shall be applied, first, in payment of the costs, charges and expenses incurred by the receiver, secondly, in payment of preferential payments, thirdly, in payment of the amount owing to the plaintiff, and fourthly, in payment to the company. Thus, the expenses of the receiver are a priority over other creditors but only in respect of monies coming into the hands of the receiver during the receivership.

Otherwise the receiver or, if the plaintiff has paid the receiver pursuant to the indemnity, by subrogation the plaintiff, is an unsecured

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7 *16 Halsbury* 4th Ed §890

8 *Duncan Fox & Co v North & South Wales Bank* (1880) 6 App Cas. 1

creditor of the company in respect of remuneration and costs properly incurred by the receiver and not paid out of the proceeds of realisation by the receiver. The debenture contains no provision for interest to be paid on any amount owing for receiver's remuneration.

Conclusion

For the reasons I have expressed, the plaintiff as indemnifier of the receiver is entitled to be reimbursed for the remuneration and costs of the receiver properly incurred in carrying out his statutory obligations on appointment and in realising the proceeds from the sale on the stock, but no more. That reimbursement is to be by deduction from the proceeds of stock received, and, if those proceeds are insufficient, by proving as an unsecured creditor in the liquidation of the company. If the parties are unable to agree on the amount of that remuneration and costs, it may be fixed by the court on an application under s 347.

The plaintiff is also entitled to prove in the liquidation of the company as a secured creditor for the amount owing at liquidation, $1,260.23, less the difference between the proceeds from the sale of the stock and the receiver's remuneration, if any, plus interest at the rate of 28%, being the rate specified in the debenture, on the principal sum, but not on the interest, to the date of the proof of debt.

The decision of the defendant is modified accordingly.

As the action by the plaintiff has largely failed, the defendant is entitled to costs, which I fix at $1200, plus disbursements, if any, to be fixed by the Registrar.