Receivers' duties, conflicts of interest and the meaning of bad faith (Devon Commercial Property Ltd v Barnett and another)

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Restructuring & Insolvency analysis: Simon Davenport QC, joint head of chambers, and Daniel Lewis, barrister, at 3 Hare Court, advise that the judgment in Devon Commercial Property Ltd v Barnett and another is significant both for its consideration of the substantive law as to the duties owed by receivers, as well as practical questions as to the evidence used to bring and defend these claims.

Devon Commercial Property Ltd v Barnett and another [2019] EWHC 700 (Ch), [2019] All ER (D) 135 (Mar)

What are the practical implications of this case?

The judgment of His Honour Judge Paul Matthews (sitting as a judge of the High Court) in *Devon Commercial Property Ltd v Barnett and another* is significant both for his consideration of the substantive law as to the duties owed by receivers, as well as practical questions regarding the evidence used to bring and defend these claims.

The key findings of practical significance were as follows:

- a breach of the duty of good faith owed by a receiver to the mortgagor must involve intentional conduct amounting to more than mere negligence and encompassing either an improper motive or an element of bad faith, but it need not amount to dishonesty
- the claimant's argument that the burden of proof should be reversed so as to require the receivers to show that they had acted in good faith were rejected—where bad faith was alleged, even where the sale was to the receivers' appointor, the burden of proof remained on the claimant
- the use of expert evidence in a case of this nature was not of assistance—not only did the judge doubt that acting as a receiver was a recognised field of expertise, but also that assessing the 'management function' of a receiver was something the court was quite capable of doing without expert evidence

What was the background?

The defendant receivers had been appointed over a Devon cider factory by an assignee of the mortgagee, which was also one of the cider manufacturer's competitors. Having marketed the factory and received limited interest, the receivers sold the factory to their appointor. The claimant alleged that the receivers acted in breach of their duties:

- by placing themselves in a position of conflict of interest and/or acting under the direction or control of their appointor
- failing to treat their appointor as a special purchaser and failing to market the property properly, with vacant possession or with the ability to obtain vacant possession at short notice
- replacing the original lease with a new lease, to the advantage of their appointor

It was claimed that the factory was sold at an undervalue.

The claimant argued that the receivers were in a position of conflict in selling to their appointor and that the burden of proof was therefore reversed requiring them to demonstrate that the price paid was the best price reasonably obtainable, treating that the position of the receivers as analogous to that of a mortgagee on a sale to a connected company, relying on *Silven Properties Ltd v Royal Bank of Scotland plc* [2003] EWCA Civ 1409, [2003] All ER (D) 335 (Oct).

What did the court decide?

The judge dismissed the claim finding that the receivers had acted entirely properly.

Burden of proof

The judge rejected the claimant's attempt to apply *Silven* to the facts of the case. The burden of proof may be reversed where the sale is to a party connected to the party conducting the sale (as where a mortgagee exercises its rights to sell property). Here the receivers were not selling to a party with which they were connected. There was therefore no 'self-dealing' such that the 'fair dealing' rule should be extended to the defendant receivers. But even if that were not the case, the burden of proof would not be reversed to require the receivers to show that every step they performed was taken in good faith. The burden of proving bad faith remained on the claimant.

Conflict

On the question of conflict more generally, the judge held that a receiver is not precluded from placing him or herself in a position where the mortgagee's and the mortgagor's interests conflict or may conflict. He noted that those interests are present and in conflict from the outset and that the receiver will be entitled, or actually bound, to exercise the powers in the interests of the mortgagee.

Bad faith and dishonesty

The claimant alleged that the receivers had failed to act in good faith or had acted in bad faith. There was argument as to whether this required the court to make a finding of dishonesty (although the claimants subsequently confirmed it was not intended to allege dishonesty). The judge held that a breach of the duty of good faith owed by a receiver to the mortgagor must involve intentional conduct amounting to more than mere negligence and encompassing either an improper motive or an element of bad faith, but it need not amount to dishonesty.

Use of expert evidence

As an aside, the parties had permission to rely on expert evidence as to the duties of receivers. The judge did not find this evidence helpful, observing that they did not have experience of acting in a case where the receivers sold the property to an associate of the appointor. The judge also doubted that expertise in acting as a receiver was a recognised field of expertise governed by standards and rules of conduct. The function of a receiver was a 'management function' of the sort many people are required to perform and which the court is capable of assessing without expert evidence. The judge did not see that the court required (in the ordinary run of cases) expert assistance where somebody is alleged to have managed or sold an interest in land badly.

Evidential value of email communications

In dismissing the claims, the judge found that the claim was '(over-optimistically) bolstered by the judicious hewing of extracts from emails and other correspondence, to create an impression of some kind of conspiracy between the trade rival and the defendants' when 'there was nothing of that kind here'. Where, as in this case, the receivers are working from different offices and communicating by email, the claimant has the advantage of being privy to their thinking in a way that would not be available if their discussions took place in the same office. The judge recognised this in discounting the evidential value of unguarded comments in emails. In fact, as the judge recognised, the evidential value of those comments might be in tending to support the good faith or honesty of the defendants, rather than the contrary.

Simon Davenport QC is a senior commercial and chancery silk who specialises in commercial disputes, civil fraud, insolvency and professional negligence cases both domestically and internationally (and in particular for/against Russian/CIS clients). He has been described as 'a first-rate silk' and a 'fearless advocate'.

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In Devon Commercial Property Ltd v Barnett and another, Davenport and Lewis represented the defendants.

Interviewed by Kate Beaumont.