[2014] JMSC Civ 123

IN THE SUPREME COURT OF JUDICATURE OF JAMAICA

CIVIL DIVISION

CLAIM NO. 2011HCV07917

BETWEEN	**DUKE HOLNESS**	**FIRST CLAIMANT**
AND	**SUZANNA HOLNESS**	**SECOND CLAIMANT**
AND	**PALMYRA RESORT & SPA LTD (In Receivership)**	**FIRST DEFENDANT**
AND	**PALMYRA PROPERTIES LTD (In Receivership)**	**SECOND DEFENDANT**

IN CHAMBERS

M Georgia Gibson Henlin and Teneisha Rowe instructed by Henlin Gibson Henlin for the claimants

Trudy-Ann Dixon Frith and Mark Reynolds instructed by Grant, Stewart, Phillips and Co for the first defendant

Stuart Stimpson and Franklyn Halliburton for the receiver present but not participating

July 24, 2014, July 29 and August 4, 2014

COMPANY LAW – RECEIVERSHIP - WHETHER DIRECTORS NEED LEAVE TO APPLY TO SET ASIDE DEFAULT JUDGMENT – DERIVATIVE ACTION - WHETHER DIRECTORS SHOULD INDEMNIFY COMPANY AND ON WHAT TERMS

SYKES J

[1] Mr and Mrs Holness have obtained a default judgment against Palmyra Resort & Spa Limited (PRSL). This judgment is now under threat because Mr Robert Trotta and the other directors of PRSL want to set aside that judgment. This company, as the title to this judgment, makes clear, is in financial distress. It is unable to meet the demands of its creditors and has been put into receivership. The Holnesses sued the company for failing to deliver the apartment to the couple in accordance with the terms of the contract. PRSL did not defend the claim. The receiver did not file any defence.

[2] The directors say that they should be permitted to defend the claim in the name of the company because there is a good defence to the claim. They also say the fact that a receiver has been appointed does not do away with their duties as company directors. The directors are bold enough to say that the company should pay for this and no indemnity should be asked for.

[3] The resolution of this case demands a return to first principles regarding mortgagors and receivers in order to establish latent themes that are not readily apparent in this area of law.

[4] How did the Holnesses get a default judgment against PRSL? They followed the rules and PRSL did not. What the Holnesses did was to file a claim on December 16, 2011 against PRSL and served it on PRSL on December 23, 2011. PRSL did not file an acknowledgment of service or indeed a defence. The Holnesses applied for default judgment on February 10, 2012. They got the judgment in July

2012 and it was duly entered. Nearly one year later PRSL filed a defence on June 12, 2013.

[5] Before all this took place PRSL defaulted on its debt obligations and the creditor appointed a receiver by instrument dated July 22, 2011 with effect from July 23, 2011, that is to say, the Holnesses filed their claim after the receiver was appointed. Clearly, the receiver did not seek to defend the claim.

[6] The directors are crying foul. They say that the receiver did not notify them of the claim. In support of the application, Mr Robert Trotta, a director of PRSL, states that the company did not file a defence because he only knew of the claim when, serendipitously, on January 31, 2013, counsel for the company happened to be in court when a petition was presented to wind up PRSL. Counsel made enquiries and found out that a winding up petition had been presented. Diligent searches, thereafter, did not reveal any judgment being entered against the company. Eventually, the default judgment that precipitated the winding up petition was found. Mr Trotta, like the other director, Mr Aronow, complains that the receiver did not tell the directors about the claim, the default judgment and petition to wind up the company. As will be shown below, once the role, duty and responsibility of the receiver is understood, it will be clear that he has no such duty and it is really the responsibility of the directors to make arrangements for themselves or any other person to be notified of these matters once a receiver is in place. Briefly, the reason is that a receiver is not there to look after the affairs of the company as a professional manager. He is there to secure the interest of the lender and any management he undertakes is to facilitate that fundamental obligation he had to debenture holder or mortgagee. This may seem hard but it is really nothing more than ultimate conclusion of the process of mortgage lending that began many centuries ago.

[7] Not to be outdone, the Holnesses have filed their application asking that PRSL's application be struck out and peremptorily dismissed. If that application fails, the Holnesses have asked that the directors provide either (a) indemnity for them as

a condition of permitting them to pursue its application or (b) an indemnity for PRSL in the event that costs orders are made against it. The Holnesses are leaving nothing to chance. They say that if they are successful in their application for indemnity then that indemnity should be in place before the hearing of PRSL's application to set aside the judgment.

A mortgage

[8] The concept of the receiver was a creation of equity designed to redress the imbalance which had developed when the Courts of Equity transformed the creditor (mortgagee) into a holder of security interest and not the owner of the land conveyed to him under the mortgage. To understand this development, it is important to trace how this came to be. The account to be given ignores statutory intervention since these interventions do not change the fundamental nature of a mortgage. They only effect procedural modifications to the mortgage registration and enforcement processes.

[9] 'A mortgage is a conveyance of land or an assignment of chattels as a security for the payment of debt or the discharge of some obligation for which it is given. This is the idea of a mortgage, and the security is redeemable on the payment or discharge of such debt or obligation, any provision to the contrary notwithstanding. That in my opinion is the law.' (**Santley v Wilde** [1895-99] All ER Rep Ext 1338, 1341 (Lindley MR)).

[10] Originally, the mortgage was governed purely by the common law. The debtor (mortgagor) borrowed money from the creditor (mortgagee) and transferred his estate in the land or assigned the chattels to the mortgagee. The condition was that he was to repay the money by a specified date. All this was stipulated in the contract. The transfer to the mortgagee was not absolute but interim or nisi, to use the language of the times. However, being the holder of the legal title conferred certain rights on the mortgagee. For example, if the security was land, he could enter into possession immediately and even maintain an action of ejectment against the mortgagor on the basis that he was now the holder of the

legal title. If the mortgagor failed to pay by the stipulated time, the whole interest in the land became that of the mortgagee, or in the language of the day, the transfer became absolute. This was pure contract. There was no equity of redemption. It did not exist in those early centuries.

[11] Equity intervened. The intervention brought about a revolution that has reverberated across the centuries to today. It created rights and obligations where none existed before. Equity followed the law in so far as it followed the form of the legal contract. Equity did not say that the legal contract was not valid. Equity did not create a new form of contract. Equity did not say that the contract was not a contract or that it was invalid in any way. What it did was to transform the nature of relationships between mortgagor and mortgagee.

[12] Equity held that even though the mortgage took the form of a conveyance of the legal title it was at its core a loan transaction and therefore the mortgagee while treated as the holder of the legal estate at law, in equity was a creditor. The mortgagor got something he never had before. He had transferred the legal estate to the mortgagee but equity told him that he now had something called an equity of redemption. He was also told that even if he missed the date stated in the contract for full repayment of loan with interest and cost, he need not worry because he could tender the money after the contracted date. Better yet, the mortgagee could not refuse to take the money. The mortgagee had to take it and permit the mortgagor to get back (redeem) his property even after the date of repayment had passed. In other words, a breach of the contract to repay did not mean that he lost his legal title forever. Hence the expression, once a mortgage always a mortgage.

[13] Equity went further and held that the mortgagor must always be able to redeem his property from the mortgagee and any clause impeding this was frowned upon. The expression, there shall be not clog on the equity of redemption captured the essence of equity’s attitude.

[14] In the event that mortgagee as holder of the legal estate felt that he could now take possession (the law in fact allowed the mortgagee to do this) and in fact exercised this power, he found, much to his chagrin, that equity held him to very high standards of accountability. He was treated as if he committed some heinous sin in relation to the mortgagor. The reason for this approach to the mortgagee in possession was that 'he did not come under any obligation to account to the mortgagor except in a suit for redemption' and therefore he 'was accordingly treated with exceptional severity in a suit for redemption and made to account, not only for what he actually received, but for what he might without wilful default have received' (**Gaskell v Gosling** [1896] 1 QB 669, 691 (Rigby LJ)). Lenders were now on the back foot. A solution was needed. Needless to say, equity's strictures on the mortgagee began to exercise the minds of lawyers and it was not long before they regulated the position by terms in the loan contract.

[15] But even before clauses were inserted into the contract that permitted the appointment of a receiver, the Courts of Equity, in order to provide some redress for the mortgagee developed the concept of a receiver who could be appointed by the court once the mortgagee established that the mortgagor was in arrears and may not be able to repay the loan. The problem with this was that the receiver appointed by the court was now subject to the control of the court. He was a court officer despite the fact that he was appointed at the behest of the mortgagee. This was good for the mortgagor but bad for the mortgagee. The mortgagee wanted a person who was able to do his bidding at anybody else's expense but his. He wanted a solution that did not require him going to court and to expend the money necessary to do this. What was needed was an out of court appointed receiver.

[16] The lawyers set to work and came up with a clause that enabled the mortgagee to do the following: 'to insist upon the appointment by the mortgagor of a receiver to receive the income, keep down the interest on encumbrances, and hold the surplus, if any, for the mortgagor, and to stipulate often that the receiver should

have extensive powers of management' (**Gaskell v Gosling**, 692, (Rigby LJ)). This was inserted into the contract between mortgagor and mortgagee. The contract permitted the mortgagee to instruct the mortgagor to appoint a being known as a receiver. The terms of the contract actually permitted the mortgagee to give these instructions. This was self help at its best. The mortgagee had his man in place without the attendant risks of being in possession. All this at the expense of the mortgagor. The mortgagor became the dummy and the mortgagee became the ventriloquist. Equity did not disturb these contractual provisions and actually gave effect to them. Note however, that in all this, the receiver was really there to look out for the best interest of the mortgagee and not the mortgagor.

[17] Over time, the question was asked, if the courts have consistently upheld this ventriloquist clause, why have the fiction of the ventriloquist's dummy (the mortgagor purportedly appointing a receiver) in between the mortgagee (ventriloquist) and the receiver (the target audience)? Could not this be accomplished by speaking directly to the receiver with slight tweeking of the clause? The answer was yes. The lawyers eventually became more direct and forthright in the drafting of the clauses. The lawyers found that if they could insert a clause which obliged the mortgagor to appoint a receiver on the instructions of the mortgagee then the same result could be achieved by one clause which said that the mortgagee could appoint the receiver who, on appointment, would be regarded as the agent of the mortgagor. The practical result was that the mortgagee achieved the strategic objective of having 'his man' take possession of the mortgagor's property that was the subject of the mortgage, take in the rents and other revenue, without the risk of a mortgagee in possession and it was treated as if it were the mortgagor who had spoken and gave the instruction to the receiver. This was indeed the best of all worlds.

[18] Lord Cranworth in **Jefferys v Dickson** (1866) LR 1 Ch App 183, 190 explained the position:

> *But a receiver who has been appointed by a mortgagee under the ordinary power for that purpose, is in possession as agent, not of the mortgagee, but of the mortgagor, and it cannot be that the mortgagor, if his agent is receiving and misapplying the rents, has no means of calling him to account without paying off the mortgage. It may be that he could not make the mortgagee party to a bill against the receiver without offering to redeem; but if that be so, it must follow that he might file a bill against the receiver alone, treating him as his agent, bound to account for all his receipts after keeping down the interest due to the mortgagee. And this may well be; for though it is the mortgagee who in fact appoints the receiver, yet in making the appointment the mortgagee acts, and it is the object of the parties that he should act, as agent for the mortgagor. He, as agent of the mortgagor, appoints a person to receive the rents, with directions to keep down the interest of the mortgage, and to account for the surplus to the mortgagor as his principal. These directions are supposed to emanate, not from the mortgagee, but from the mortgagor; and the receiver, therefore, in the relation between himself and the mortgagor, stands in the position of a person appointed by a deed to which the mortgagee was no party.*

[19] Thus the actually reality was that the mortgagee appointed the receiver but the terms of the agreement made the receiver the agent of the mortgagor and the mortgagor could not easily bring an action against the mortgagee but had to seek his remedy against ‘his agent’ the receiver. Here again the position is that the receiver is not there to resuscitate the company, but rather to get the money for the mortgagee.

[20] Having achieved this end run around the Courts of Equity, the judges of that court were to have the last laugh so to speak, or so they thought. The judicial response was to hold the receiver to the strict terms of the contract. He could only take possession of the property that was the subject of the mortgage and nothing more. It was from the mortgaged property that he was to take the revenue and pay over to the mortgagee.

[21] With the rise of capitalism, many of the mortgagors were commercial businesses and simply taking possession of the mortgaged property was quite tricky at times. They were ongoing businesses that may have contracts to fulfill. If only possession were taken, the mortgagee might still be in danger of losing his loan because the receiver was just that, a receiver, and had no powers of management. The lawyers came to the rescue yet again. They inserted powers into the contract that gave the receiver powers of management. Clauses also gave the mortgagee the option to appoint a manager or a receiver/manager. Care must be taken here. The manager in this context is not a professional manager operating the business to make a profit. His obligation was to the creditor and not the debtor. He was not there to make the business better. He was there to collect the money, hand it over to the creditor and if all the moneys were collected, then he would leave.

[22] The receiver and the manager had quite different functions even if both roles were combined in one person. That a receiver is quite different from a manager should no longer be in doubt. In **In re Manchester and Milford Railway Company** (1880) 14 Ch D 645. In that case a receiver had been appointed earlier in relation to the distressed company. Some years later the judgment creditor sought the appointment of a manager which was refused. That refusal prompted the appeal. The directors had been permitted to retain management of the company but the judgment creditor wanted to have that changed and hence his application for a manager. Involved in that case was a statute that indicated that *'the person who has recovered any such judgment may obtain the appointment of a receiver and, if necessary, of a manager, of the undertaking of*

the company, on application by petition in a summary way to the Court of Chancery.' The statute did not define receiver or manager. Sir George Jessel MR made his observation at pages 652 – 653:

> *That being so, what is the meaning of "the appointment of a receiver and, if necessary, of a manager"? "A receiver" is a term which was well known in the Court of Chancery, as meaning a person who receives rents or other income paying ascertained outgoings, but who does not, if I may say so, manage the property in the sense of buying or selling or anything of that kind. We were most familiar with the distinction in the case of a partnership. If a receiver was appointed of partnership assets, the trade stopped immediately. He collected all the debts, sold the stock-in-trade and other assets, and then under the order of the Court the debts of the concern were liquidated and the balance divided. If it was desired to continue the trade at all, it was necessary to appoint a manager, or a receiver and manager as it was generally called. He could buy and sell and carry on the trade. The same distinction was well known also in the working of mines. If a receiver only was appointed, the working of the mine was stopped, but if it was desired to continue the working of the mine, a receiver and manager were necessary. So that there was a well-known distinction between the two. The receiver merely took the income, and paid necessary outgoings, and the manager carried on the trade or business in the way I have mentioned.*

[23] It is clear that there is a difference between the two. What has happened is that debentures have tended to give the receiver extensive powers of management

without calling him receiver/manager but leaving him with the title, receiver. Therefore when one speaks to the appointment of a receiver under a debenture one cannot simply go by the title; one has to look at the document to see whether the receiver is given other powers that would make him a de facto manager as well as a receiver thus giving him both hats.

[24] Lawyers took full advantage of the courts' approval of clauses giving the receiver all sorts of powers. By 1896, Rigby LJ was able to say in **Gaskell**, pp 692 – 693:

> *By degrees the forms of appointment of receivers became more complicated, and their powers of management more extensive; but the doctrine explained by Lord Cranworth in the case cited was consistently adhered to, and it remained true throughout that the receiver's appointment, and all directions and powers given and conferred upon him, were supposed to emanate from the mortgagor, and the mortgagee, though he might be the actual appointor, and might have stipulated for all the powers conferred upon the receiver, was in no other position, so far as responsibility was concerned, than if he had been altogether a stranger to the appointment. So common did this practice of appointing receivers by agreement between the parties become that, first by Lord Cranworth's Act (23 & 24 Vict. c. 145) to a limited extent, and afterwards by the Conveyancing and Law of Property Act, 1881, in a more general manner, a power to the mortgagee to appoint a receiver, who was to be agent of the mortgagor, was made a usual incident of mortgages, when not excluded by agreement between the parties.*

[25] The receiver was originally an office created by the Courts of Equity. It is still available as a judicial remedy (Judicature (Supreme Court) Act, section 49 (h)). The Courts of Equity did not alter the terms of the contract and thus it has also become a remedy embodied in a contract between the debtor and the creditor. It means therefore, that the starting point, when dealing with a receiver who was appointed under a debenture, is the terms of his appointment and the terms of the debenture. This is so because the receiver, appointed out of court, can only act in accordance with the terms of the debenture.

[26] A final word on the manager or the receiver/manager. In **Re B. Johnson & Co. (Builders) Ltd.** [1955] Ch. 634, 661 – 662 (Jenkins LJ) it was stated:

> *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.*
>
> *…*
>
> *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.

[27] The receiver is not obliged to defend any claim brought against the company. He is not a director of the company. He is not there to promote the company's best interest. That is the job of the directors and officers of the company. There have been determined judicial attempts, particularly in England and Wales, to hold the receiver more accountable. However, these efforts bump up against the fundamental principle that the receiver appointed out of court is contractually stated to be the agent of the mortgagor. These efforts at judicial reform have achieved mixed results. The clauses are still in place and being acted upon but the judges have sought to impose some sort of liability on receivers. The precise juridical foundation is still in a state uncertainty: is it contract, is it tort or is it equity?

[28] It should be noticed that in the discussion so far, very little has been said about the directors of the company. When a receiver is appointed the company does not come to end. A receivership is not a winding up. The company is still alive in the sense that it is not being wound up. In practical terms, depending on the nature of the company and the terms of the debenture, the appointment of receiver brings all trading to an end. This is so because, the receiver takes possession of the property covered by the debenture and the company cannot use those assets to continue operating without the permission of the receiver.

[29] The directors still have fiduciary duty to the company and must still manage the company as best they can in the context of a receivership. The Companies Act imposes statutory duties on the directors which must still be carried. If there is property not covered by the debenture then the directors must continue to manage that property in the best interest of the company. It is not that the general powers of the directors are set aside in a receivership; it is that their powers in relation to the property covered by the debenture are paralysed for the time being.

[30] In light of all that has been said, it is clear that the receiver has no obligation to notify the directors of any documents served on the company unless it is in the loan contract.

The debenture

[31] Clause 5 (a) creates a floating charge in respect of '*all of the undertaking and assets of the borrower, both present and future, of whatsoever kind and wheresoever situate*.' Clause 5 (b) states that the '*charge hereby created shall be a first fixed charge on the freehold and leasehold land and buildings, plant, machinery, equipment, furniture [and so on] and fist floating charge on its stock in trade, book debts, other accounts receivable and any other property of the borrower, both present and future, of whatsoever kind and wheresover situate*.'

[32] Clause 10 (a) authorises the lender to '*appoint any person or persons to be receiver of the property hereby charged or any part thereof upon such terms as to remuneration*.'

[33] In this particular case, the debenture says:

> Clause 10 (c)
>
> A receiver so appointed shall be the agent of the borrower and the borrower shall be responsible for such receiver's

acts and defaults (other than fraud and wilful misconduct) and for his remuneration, costs, charges and expenses to the exclusion of liability on the part of the lender…. The receiver shall have authority and be entitled to exercise the powers hereinafter set forth in addition to and without limiting any general power conferred upon him by law:

(i) to enter upon and take possession of or collect and get in all or any part of the property hereby charged and for that purpose to take any proceedings in the name of the Borrower or otherwise as may seem expedient;

(ii) to carry on, manage or authorise or concur in carrying on or managing the business of the Borrower or any part thereof and for any of those purposes to raise or borrow any money that may be required upon the security of the whole or any part of the property hereby charged;

(iii) …

(iv) to make any arrangements or compromise which he shall think expedient;

(v) to do all such other acts and things as may be considered to be incidental or conducive to any of the matters or powers aforesaid and which he lawfully may or can do as agent of the borrower;

(vi) to do any act or thing which a receiver appointed under … the Companies Act would have power to do;

(vii) generally on behalf and at the cost of the borrower (notwithstanding liquidation of the borrower) to do or omit to do anything which the borrower could do or omit to do in relation to the charged properties or any part thereof

...

[34] Clause 13 states that neither the lender nor any receiver 'entering into possession of the property hereby charged or any part thereof shall be liable to account as mortgagee in possession or for anything except actual receipts or be liable for any loss upon realization or for any default or omission for which a mortgagee in possession might be liable.'

[35] The receiver in this case has been given extensive management powers and so is in fact a receiver/manager though he is called receiver. The provisions referred to above do not constitute him a manager of the company as in a managing director. Any management he is exercising is to enable the debenture holder to realise his security. He is not a liquidator and his appointment does not have the effect as if a liquidator had been appointed. The directors are still to perform their duties in relation to the company as they see fit. They are under a duty to act in the best interest of the company. The directors are free to do whatever they think is in the best interest of the company provided they do not interfere with the property in the possession of the receiver by virtue of the terms of the debenture.

The applicant's submissions

[36] Mrs Trudy-Ann Dixon Frith has sought to take this court on an excursion beginning in Canada then across the North Atlantic to the United Kingdom and

on to Hong Kong. This court will not undertake a similar voyage of exploration. There is no need for this. The starting point is simply an appreciation of what a mortgage is, what the terms of the debenture are and interpret them in light of Lord Hoffman's famous formulation in **Investors Compensation Scheme Ltd v West Bromwich Building Society** [1998] 1 All ER 98. The next stage is to understand the role of the receiver, manager and liquidator of companies in financial distress as well as the role of the directors of a company.

[37] The essential argument was that the directors' functions in relation to a company are not set aside because a receiver has been appointed. They still have fiduciary duties which they must perform. This proposition is fully accepted by the court.

[38] It has been noted in the earlier discussion that the primary role of the receiver, historically, is to realise the loan and interest due to the mortgagee and once that task has been completed then his role is at an end. It necessarily follows that the power of the company over the property that is subject to the mortgage is set aside when the receiver takes possession of them. This means that the directors can and must exercise their duty in relation to the affairs of the company provided that such exercise does not conflict with the receiver's power over the property subject to the mortgage. This much was recognised by the Court of Appeal of England and Wales in **Newhart Developments Ltd v Cooperative Commercial Bank Ltd** [1978] QB 814, 821. Shaw LJ stated:

> *What, of course, the directors cannot do, and to this extent their powers are inhibited, is to dispose of the assets within the debenture charge without the assent or concurrence of the receiver, for it is his function to deal with the assets in the first place so as to provide the means of paying off the debenture holders' claims.*

[39] Had matters rested there no issue could be taken with the Shaw LJ. However, his Lordship took issue with this passage from the 14th ed of *Kerr on Receivers:*

> *The effect of the appointment out of court is as regards the crystallisation of the floating charge into a fixed charge and the consequences as regards judgment creditors the same as in the case of an appointment by the court. The powers of the company and its directors to deal with the property comprised in the appointment (both property subject to a floating charge and property subject to a fixed charge), except subject to the charge, are paralysed; for though under debentures or a trust deed in the usual form the receiver is agent for the company, the company's powers are delegated to the receiver so far as regards carrying on the business or collecting the assets; and frequently so as to enable the receiver as attorney to convey a legal estate on sale.*

[40] Respectfully, this passage represents a rational deduction from the premises involved in constructing the role and function of a receiver. The passage points out that in relation to the property covered by the charge, the directors' powers are paralysed. This is an accurate description from this court's understanding of the receiver's powers if the debenture powers permit him to take possession of the property to sell the property. It is his agency powers that permit him to pass good title to a purchaser. This explains why the debenture usually has the power enabling the receiver to sell or let any of the property charged in order to realise the loan made by the mortgagee. If the receiver is to do these things then clearly the director cannot have concurrent and effective authority to dispose of or deal with the same property that is subject to the charge and this points to the necessary and inevitable conclusion that in relation to that property, that is the subject of the charge, the powers of the company is indeed not just paralysed but

set aside unless the receiver gives permission to the directors to deal with the property.

[41] In relation to this passage from *Kerr* Shaw LJ stated at page 521:

> *If that means that nobody else can take any step in regard to the assets of the company which does not amount to dealing with, or disposing of, the assets, it would appear to me to be too wide and not supported by any authority which has been cited to us.*

[42] Respectfully, this not what the learned authors were saying. What they were saying was that when there is a properly appointed receiver over property covered by the debenture then the directors cannot have co-existent and equally existing authority. This must be correct for the reasons give above. It is this court's view that Browne-Wilkinson's VC's view in **Tudor Grange Holdings v Citibank** [1991] 4 All ER 1, 9 are right on the mark where he said:

> *I have substantial doubts whether the Newhart case was correctly decided in any event. That may have to be looked at again in the future. The decision seems to ignore the difficulty which arises if two different sets of people, the directors and the receivers, who may have widely differing views and interests, both have power to bring proceedings on the same cause of action. The position is exacerbated where, as here, the persons who have been sued by the directors bring a counterclaim against the company. Who is to have the conduct of that counterclaim which directly attacks the property of the company? Further, the Court of Appeal in the Newhart case does not seem to have had its attention drawn to the fact that the embarrassment of the*

receiver in deciding whether or not to sue can be met by an application to the court for directions as to what course should be taken, an application now envisaged in s 35 of the Insolvency Act 1986.

[43] Modify this passage and where same cause of action appears, the words 'in relation to property that is the subject matter of the mortgage or charge' are added then one clearly sees the nature of the problem.

[44] Mrs Dixon Frith relied on the decision of Morgan J in **Arawak Woodwork Establishment Ltd v Jamaica Development Bank** (1987) 24 JLR 15 which followed the **Newhart** case and accepted, as correct, Shaw LJ's criticism of the passage from *Kerr on Receivers*. This court makes the following observations. There is no indication that her Ladyship had analysed the role of the receiver when appointed by the debenture holder. If he has the powers given to him to sell the property that is the subject of the mortgage how can it be that at the same time the company through the directors can maintain litigation in relation to the same property without permission of the receiver? Once this is understood, this reinforces Browne-Wilkinson's VC's reservations, referred to above, about the correctness of **Newhart**.

[45] The problem with **Newhart** is that it starts in the middle of the story relating to receivers and how their powers developed over time and how they are regulated by debentures. There was one usual feature of the **Newhart** case and it is this: it was being funded from a source other than the company which meant in practical terms that the resources of the company would not be dissipated by the litigation and perhaps in that sense the property covered by the debenture was not put at risk. But the question is whether the decision would have been the same had there not been an outside source of funding? This comes out most clearly in the following passage from Shaw LJ page 121:

> *What, of course, the directors cannot do, and to this extent their powers are inhibited, is to dispose of the assets within the debenture charge without the assent or concurrence of the receiver, for it is his function to deal with the assets in the first place so as to provide the means of paying off the debenture holders' claims.* ***But where there is a right of action which the board (though not the receiver) would wish to pursue, it does not seem to me that the rights or function of the receiver are affected if the company is indemnified against any liability for costs (as here). I see no principle of law or expediency which precludes the directors of a company, as a duly constituted board (and it is not suggested here that they were not a duly constituted board when they took the step of instituting this action) from seeking to enforce the claim, however ill-founded it may be, provided only, of course, that nothing in the course of the proceedings which they institute is going in any way to threaten the interests of the debenture holders.*** (emphasis added)

[46] In **Tudor**, the Vice Chancellor provided a most satisfactory explanation for the actual decision of **Newhart** which may be said to be an application of practical justice rather than strict legal principle. The Vice Chancellor said of **Newhart** at page 9:

> *However, it appears to be established by authority that company directors do in certain circumstances have power to bring proceedings even after the appointment of a receiver having power to conduct legal proceedings on the company's behalf (see Newhart Developments Ltd v Co-Op*

Commercial Bank Ltd [1978] 2 All ER 896, [1978] QB 814). In that case directors were held to have residual powers to bring proceedings against the debenture holder who had appointed the receiver. In that case the Court of Appeal was very impressed by two matters. First, the fact that the company had been indemnified by outside sources against all liability not only for its own costs but also for costs which the company might be ordered to pay to the other party. Therefore the bringing of proceedings by the directors in the company's name could not in any circumstances prejudice the property for which the receiver was responsible. The court was also impressed by the fact that the receiver was in the invidious position in deciding whether or not to take proceedings by reason of the fact that he was being invited to sue those who had appointed him.

[47] This court, like the Vice Chancellor, entertains serious doubts about the soundness of **Newhart**. Its place in this area of law can be justified on the basis that it appreciated that asking company, in receivership, to fund at the behest of the directors may well result in costs against the company which would mean that the receiver would be diverting funds away from the mortgagee to pay costs. Unless the courts are prepared to rewrite the debenture the debenture there must necessarily be an underlying conflict between requiring a receiver to pay for litigation undertaken in the company's name while at the same time fulfilling his primary duty to advance the interest of the mortgagee. **Newhart** can also be accepted as indicating that the court has a discretion power in permitting litigatiion in the name of the company where there is a receivership and there are factors which are to be considered when deciding how to exercise that discretion. There seems to be two primary factors arising from the case. First, one powerful one is whether the cost of that litigation will be met by a source other than the company. Second, whether the litigation interferes with the powers of the receiver in relation to the property in his possession. If there is no interference

and there is no other funding but that of the company's assets then permission is less likely to be granted. If both factors are satisfied then the permission is more likely to be granted.

[48] In the present case nothing of the sort exists. There is no evidence or offer of independent funding of the proposed application to set aside the judgment and consequential litigation if the application to set aside is successful. Mrs Dixon Frith has referred the court to a number of cases from all over the world where **Newhart** has been followed. Those cases have not dealt with the position would be had there not been an outside source of funding for the litigation in that case. Indeed none of the cases cited has shown that the fact of outside funding was not in fact the foundation of the decision. It is fair to say that none of those cases recognised the inherent conflict between asking the receiver to act in the interest of the company when that is not what he is there for. If the company is to pay, in the absence of an indemnity, then clearly the receiver must be involved in some way because the funding must then come from property that is the subject matter of the mortgage. Therefore, it is the view of this court that **Newhart** is not authority for the broad and sweeping proposition proposed by Mrs Dixon Frith, namely, directors or the company should be allowed to defend a claim without any source of funding being produced other than the company's resources, but rather it is authority for the very narrow proposition the court is about to formulate: directors of a company may be allowed to bring litigation in respect of property under the control of the receiver if there is funding from a source other than the company and the litigation will not impact on the receiver's ability to act in accordance with the terms of his appointment. Framing the proposition in this way recognises the discretionary power of the court while establishing some criteria by which the power will be governed. This is how this court will approach PRSL's application.

[49] The very last sentence of the last cited passage from Shaw LJ contains a statement of exceptional breath but which, happily, has to be read as being

qualified by the sentence that immediately preceded it. In the last sentence the learned Lord Justice paved the way for a board to pursue the most unfounded claim provided that it did not threaten the interest of the debenture holders. The immediately preceding sentence in the same passage spoke to the outside funding. Thus it would seem to this court that the directors are free to pursue any unfounded claim they wish provided that the company's resources, which are properly within the possession of the receiver, are not expended on it. Surely, it cannot be in the debenture holder's interest to spend money from a financially distressed company to pursue a claim that may have next to no chance of success. It is the view of this court that this situation should only be permitted if the directors find some source of funds to litigate claims or defend claims if such claims involve property covered by the mortgage.

[50] Learned counsel relied on the Court of Appeal of Jamaica's decision in **Pan Caribbean Financial Services Ltd v Cartade** [2011] JMCA Civ 2, para 54 -57 to suggest that this court is bound to accept **Newhart**. What the Court of Appeal did was to accept the principle that provided there was indemnity then the court would permit a claim by directors to be brought in relation to property that is covered by the debenture that is being managed by the receiver. In that case, the court had before it an affidavit from a director of the company in receivership which stated that he would indemnify the company against all costs of the action. The court seemed to have accepted the proposition that the company's assets were not at risk in light of the indemnity provided.

[51] In the present case, if the directors are permitted to use the company's name to defend the action then there is possibility that the company's assets available to the receiver may be depleted to meet costs orders that may be made against the company should it succeed in setting aside the judgment. There are also the potential costs of litigation and if the company loses the substantive action and costs orders are made against the company then those orders may well have to be met out of the already depleted resources of the company. This explains why

the existence of indemnity in **Newhart** and **Pan Caribbean** proved decisive to the actual outcome of both cases.

[52] Mrs Dixon Firth cited the case of **Li Lai Fun & Others v Centro Sound Ltd**. [1986] HKCFI 30 for the proposition that the wording of the debenture in the present case did not expressly give the receiver power to defend and so he could not in this case lawfully defend the claim even if he wanted to. Assuming without deciding that the debenture had this consequence, it does not gainsay the point that the receiver would now be asked to set aside money for possibly expensive and expansive litigation which would deplete the assets available to pay the debenture holder. This would have the effect of forcing the receiver to act contrary to his mandate to pay for a claim which he had no lawful authority to defend (on counsel's hypothesis) from resources which are to be used to realise the debenture holder's loan. Should the court force the receiver to use resources to pay for litigation which is said to be outside his remit which does not advance the interest of the debenture holder? This court thinks not. If this proposed litigation is to go forward then it must be on the basis that an indemnity is put in place to pay for any costs orders that may be made against the company and to fund the costs of defending the claim.

[53] It may be said that setting aside the judgment and defending the claim does not affect the receiver in his operations and may in fact benefit the company by having the judgment set aside and the company may prevail in any subsequent trial. But that would be viewing the setting aside and any future litigation in an unrealistic way. All this has to be paid for. The directors need to put up the funds for this. If they are unable to do this then the proposed setting aside application cannot move forward.

[54] Mrs Gibson Henlin has asked for indemnity for the claimant's costs. This is not possible. The law does not deal with the problem in this manner. The manner the law chooses is by way of indemnity in favour of the company for any costs orders

that may be made against it. The Holnesses appreciated this by asking, as an alternative order, that an indemnity in favour of PRSL be established.

[55] Finally, PRSL's application was also framed as a derivative action under the Companies Act. This court agrees with Mrs Gibson Henlin that what is being proposed by PRSL is not a derivative action. Such an action usually arises in the context of harm done to the company and the proper persons are not taking appropriate action. In such circumstances, the court may permit appropriate persons to bring a claim in the name of the company. PRSL is now arguing that the receiver had no lawful authority to defend the claim. If that is so, then clearly it cannot be said that receiver has failed to act appropriately. In any event the receiver's interest is not the welfare of the company. He has no fiduciary duty to the company similar to that of a director. The court simply does not appreciate how this could be a derivative action. This aspect of the submission fails.

Resolution

[56] The court has decided that the directors can, without the leave of the court, to apply to set aside the default judgment using the name of the company. The directors' application is not a derivative action within the meaning of the expression.

[57] Although the directors have succeeded on this application they should pay the costs of this application for the following reasons. The Holnesses, in their notice of application for court orders, had sought as an alternative to their primary order, an order that should the directors be granted leave to apply to set aside the default judgment in the name of the company then the directors should put up an indemnity to meet any costs orders that may be made in their favour against the company. This is actually in line with outcome of **Newhart** and **Pan Caribbean**. However, the directors decided to pursue the avenue of seeking to make their application a derivative action. The strategy was obvious. If the directors succeeded in making their application a derivative action then they it is unlikely that they would have been required to put up an indemnity in favour of the

company. That strategy was a high risk one having regard to what a derivative action is.

[58] The directors having failed to secure their strategic objective prolonged the time for hearing the application longer than was necessary and ultimately got an order in terms of what was being proposed by the Holnesses from as far back as December 2013. In these circumstances it is only fair that the directors should pay the costs of the Holnesses on their application. Those costs to be agreed or taxed.

[59] Regarding the other orders, the court is of the view that the parties should agree a form of order to reflect the following considerations. These indemnities are for the protection of the Holnesses should they prevail at the application and the trail, if there is one. They should not be at risk of not recovering their costs in circumstances where they followed the rules, did what was required and secured a judgment.

[60] The court takes the view that there should be two indemnities. The first concerns the application to set aside the default judgment. In that application, the directors should post an indemnity in favour of the company within ninety (90) days of this order. The reason for requiring an indemnity is that as it presently stands no allegation has been made, in this case, against the receiver that he is acting improperly. Prima facie, he has exercised his functions reasonably and properly. In that event, he should not be required to set aside money to pay for litigation that it appears he has decided is unnecessary. In addition, Mrs Dixon Frith has developed the thesis that he has no power, under the terms of the debenture, to defend the claim. On either bases, having regard to the legal position that the receiver is not there to act in the best interest of the company, in the way that a director is obliged, and he is not there to protect the interests of the directors, the court should not compel him to fund litigation which would have the effect of depleting the money available to pay the creditors. The terms of this

debenture are very wide. It gives the receiver power over receivables and all forms of revenue. Therefore the receiver is entitled to use these receivables and other revenue to meet the obligations to the debenture holder. This leaves no room for the directors to finance the litigation from the company's assets unless the receiver agrees. It seems to this court that in these circumstances the directors should indemnify the company against any costs orders that may be made against it in the application to set aside the judgment. For the setting aside application time is ordered to run during the legal vacation. This is to make sure that the directors act promptly within a reasonable time.

[61] Another consideration that should be taken into account is the actual cost of the defending the claim. The indemnity for this part of the action need only be provided if the directors succeed in setting aside the judgment. The indemnity for that part of the litigation should be in place within one hundred and twenty (120) days of setting aside order failing which the setting aside order would lapse. The consequential orders asked for by the directors in their application to set aside judgment assumes that they will be successful. Those orders are not addressed in this judgment and can be pursued at the application to set aside.

[62] The court understands that the directors reside outside of Jamaica. The indemnities being arranged should be done in such a manner that the money is in Jamaica and available should it be called on. If it is in an overseas institution and the Holnesses prevail then they should not have to undertake the additional costs of enforcing the costs judgment in an overseas forum.