Receivers' liability for costs in failed litigation

A RECENT COURT OF APPEAL DECISION CONFIRMS that when a receiver causes an insolvent company to sue and the action is unsuccessful there is no general rule that the receiver should be personally responsible for the winning party's costs.

In *Mills v Birchall & anor* [2008] the Court of Appeal declined to create a substantive rule that receivers should be personally responsible for legal costs when they cause an insolvent company to sue or defend legal proceedings unsuccessfully. The court retains its discretion to make a costs order against a receiver as a non-party to the litigation, but will only do so in exceptional circumstances. The judgment highlights the need to take prompt steps to secure an amount for potential legal costs when your opponent is in financial difficulties. The decision will be of particular interest to financial institutions (who are most likely to appoint a receiver) but also to any organisation involved in litigation with a company in financial difficulties.

BACKGROUND

A receiver (sometimes referred to as a Law of Property Act (LPA) receiver) is appointed by the holder of a fixed charge (normally a bank) to enforce the charge-holder's security. The charge-holder's right to appoint a receiver is a contractual remedy under the relevant security documents. As a result, the receiver's primary duty is to the charge-holder. This can be contrasted with the appointment of an administrative receiver (by a floating-charge holder) or a liquidator (by the company's creditors).

The company (as mortgagor) is solely responsible for the receiver's acts and defaults by virtue of s109(2) of the Law of Property Act 1925. Despite this, a receiver is still personally liable for contracts it makes (except so far as the contract otherwise provides), and is entitled to an indemnity from the assets of the company for such liability. A receiver ceases to be the agent of the company on a liquidation.

As a general rule, legal costs in English litigation 'follow the event', so the successful party is entitled to seek an order that the unsuccessful party pay costs. However, s51 of the Supreme Court Act (SCA) 1981 provides the court with wide discretion to determine by whom and to what extent the costs of any legal proceedings should be paid. In *Aiden Shipping Co Ltd v Interbulk Ltd* [1986] the House of Lords made it clear that s51 SCA also permits a court to award costs against a person who was not directly party to the proceedings.

An order for security for costs requires a party to pay money into court, or provide a bond or guarantee, as security for their opponent's legal costs. An order for security for costs protects a party against the risk that it will win at trial and be awarded costs, but then not be able to enforce a costs order against the other (losing) party, due to that party's financial position.

FACTS IN *MILLS V BIRCHALL*

In 2001 Mr Mills entered into a written agreement to buy a long lease of a property from Orb Estates plc. The parties verbally agreed, outside the strict terms of the written agreement, that the purchase price was to be paid in full by setting off a debt owed by Orb to Mr Mills.

In 2002 Orb sold the freehold of the property, together with the benefit of the agreement, to Dolphin Quays Developments Ltd (the company), which then granted a fixed charge over the property to a bank as security for all liabilities due to it. Mr Mills was the sole director of the company, and had executed the fixed charge, as well as a related debenture, on its behalf.

In June 2003 the bank appointed three partners of PricewaterhouseCoopers as LPA receivers (the receivers), pursuant to the fixed charge. Two of the partners were also appointed as joint administrative receivers under the debenture.

In November 2004 the company, acting through the receivers, started proceedings against Mr Mills, seeking specific performance of the agreement to purchase the long lease. The claim was then amended to one for damages for breach of contract, equal to the balance of the purchase price (£155,000). The receivers were not personally parties to the action by the company against Mr Mills. When the claim came before the court at first instance, the judge rejected the claim for damages, concluding that the set-off agreement had been an integral part of the contract for the sale of the lease and, not having been included in that document, the contract was unenforceable under s2 of the Law of Property (Miscellaneous Provisions) Act 1989.

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When Mr Mills attempted to seek his defence costs from the company (some £60,000), he was advised that his claim was simply an unsecured claim in the receivership of the company. There was no realistic prospect of a sufficient surplus being available for the unsecured creditors to satisfy his claim for costs. It is important to note that Mr Mills did not apply for security for costs before trial (nor did it appear that he was advised to do so by his solicitors or counsel). Mr Mills' evidence was that he believed that if his defence succeeded, his costs would be paid from realisations held by the receivers (substantial sums having been realised in the receivership). He acknowledged that it had been recognised throughout that there would be no assets available to pay unsecured creditors.

Mr Mills then applied for an order that his costs should be paid by the receivers personally, pursuant to s51(3) SCA 1981. He argued that the action, although nominally prosecuted on behalf of the company, was in substance an action by the receivers for the sole benefit of the bank. Had the receivers succeeded at trial, the money realised would have gone to the bank as secured creditor. The company essentially had no economic interest in the action brought in its name.

Mr Mills also noted that if the receivers had succeeded they would have been able to recover the company's legal costs from him. The receivers also knew that if they lost the action there was no surplus available for the unsecured creditors, and that the company itself would not be able to pay Mr Mills' costs. This was in spite of the fact that the receivers had realised funds more than sufficient to pay Mr Mills' costs as an expense of the receivership.

Finally, Mr Mills argued that there was a general principle of law that a non-party costs order would be granted where:

- the party to the litigation that is liable to pay legal costs is insolvent;
- the non-party has played an active part in the litigation;
- the non-party, or a party on whose behalf it was acting (in this case, the bank), had an interest in the outcome of the litigation; and
- it was in the interests of justice to make the order.

Mr Mills was unsuccessful at the initial hearing of his application for costs. He then appealed. The question before the Court of Appeal was, in substance, whether, when a receiver appointed under a fixed charge causes an insolvent company to unsuccessfully sue, the successful party may recover the costs from the receiver as a non-party under s51 SCA 1981.

COURT OF APPEAL DECISION

The Court of Appeal upheld the first-instance decision and declined to make the receivers directly responsible for Mr Mills' costs. Having considered the various authorities put before it, the Court considered that there was nothing to justify the judicial creation of a substantive rule that receivers should be personally responsible for the costs of a successful party on any litigation. Such a rule would apply in almost every case where a receiver caused an insolvent company to bring proceedings.

However, the judge at first instance retains discretion to award costs against a non-party in appropriate circumstances. The Court of Appeal therefore examined the exercise of discretion in the court below and concluded there was no reason for it to interfere with the judgment at first instance. In doing so, the Court of Appeal has given a helpful summary of the relevant principles that apply.

Not an exceptional case

A non-party costs order will only be made in an 'exceptional' case, following the conclusion of the court in *Aiden Shipping* that:

> '... in the vast majority of cases, it would no doubt be unjust to make an award of costs against a person who is not a party to the relevant proceedings'.

The ultimate question in any such 'exceptional' case was whether in all the circumstances it was just to make the order.

The case before the Court of Appeal in *Mills v Birchall* was not exceptional in the sense that actions by receivers on behalf of a company are not unusual. It is also not exceptional for a company in financial difficulties to bring proceedings that are otherwise proper, without necessarily having the means to pay costs if it loses. Mr Mills should have been aware that there were insufficient assets to pay the unsecured creditors of the company.

There was also no impropriety or unreasonableness by the receivers. This was an entirely normal case of receivers seeking to enforce a contractual right forming part of the security.

Not a real party to the proceedings

Neither the receivers nor the bank could be regarded as a real party to the litigation, sufficient to justify an order for costs against any of them. ›

The receivers could not be regarded as having an interest in the outcome of the litigation simply because they might benefit directly or indirectly from its success (in terms of fees charged and/or the prospect of future work from the bank if they were successful). The receivers directed the proceedings on behalf of the company. The company had also funded the proceedings (from the realisations in the receivership).

The bank was not a real party either. It had not controlled or directed the receivers in the litigation against Mr Mills and had not provided any funding for the claim.

Receivers were acting as agent

It was relevant that the receivers were acting, pursuant to statute, as agents of the company. Receivers are in an analogous position to liquidators and directors, who will not, in an ordinary case, be subject to a non-party costs order.

Failure to apply for security for costs

It was highly relevant that Mr Mills had not sought security for his legal costs. Security for costs was the normal remedy for a defendant in Mr Mills' position, and its availability was an important factor in the exercise of the court's discretion to award costs against a non-party. When considering such an application for security for costs, the courts should make a robust assessment and, where appropriate, should order that the security given amounts to the full amount of the estimated standard.

The evidence from the receivers was that an order for the company to provide security would have had an impact on their overall strategy and increased the possibility of the original proceedings being settled before trial.

Aiden Shipping Co Ltd v Interbulk Ltd [1986] AC 965

Mills v Birchall & anor [2008] EWCA Civ 385

COMMENT

This case restates the position that a costs order will not be made against a non-party to proceedings unless the circumstances of the case are truly exceptional. The Court of Appeal has clearly declined to introduce a general rule that a receiver (or other insolvency practitioner, such as a liquidator) should be liable to pay costs where they cause an insolvent company to sue or defend legal proceedings unsuccessfully.

Any party in a similar position to Mr Mills should apply for security for costs at the first possible opportunity. Here, there is perhaps a slight distinction between proceedings brought by receivers and those brought by liquidators. As set out above, a claim for legal costs against a company in receivership ranks as an unsecured claim. However, where the company is in liquidation, legal costs ordered to be paid to a successful defendant are payable out of the net assets in the hands of the liquidator, in priority to other claims (including that of the liquidator for its own costs in the receivership of the company), perhaps making payment more likely. However, in either case, an application for security for costs should be a standard, precautionary step. Any professional adviser who fails to suggest this (in relevant circumstances) may be acting negligently.

Finally, this decision serves as a timely reminder to banks and other organisations that appoint receivers (or liquidators), not to interfere in the conduct of litigation in a receivership (or liquidation) from which they may ultimately receive some benefit. The only possible exception may be where the amounts involved potentially justify the risk of an adverse non-party costs order.

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