LPA Receivers

June 2011
Introduction

Difficult economic conditions and a depressed property market have seen lenders reviewing their enforcement options. LPA receivership is a longstanding remedy for lenders holding security over land, but one which remains as relevant as ever.

This note is a short practical introduction to LPA receivership.

What is an LPA receiver?

An LPA receiver is a receiver appointed under a mortgage or charge, and typically over real property. The receivers – it is common to appoint two – will usually be surveyors, and do not need to be licensed insolvency practitioners. There is a voluntary licensing arrangement, however, in the form of the Fixed Charge Receivership Scheme, backed by the Royal Institution of Chartered Surveyors (RICS), the Association of Property and Fixed Charge Receivers (NARA) and the Association of Chartered Certified Accountants (ACCA). A member is known as a Registered Property Receiver (RPR). NARA also publishes a Code of Practice. The Council of Mortgage Lenders issued guidance on the role of LPA receivers in February 2011.

Where the mortgage is a deed, a power to appoint a receiver is implied by the Law of Property Act 1925 (the “Act”) – hence the name “LPA receiver” – but there may also be a purely contractual power of appointment in the mortgage. It does not matter whether the mortgage has been given by an individual, company, or other entity, but account must be taken of the Consumer Credit Act and Financial Services Act where relevant.

LPA receivers are also known as fixed charge or non-administrative receivers, to distinguish them from administrative receivers within the meaning of the Insolvency Act. Administrative receivers may generally now only be appointed in relation to certain capital market and project finance transactions.

For convenience the relevant security document is generally referred to below as a mortgage, and the mortgagor and mortgagee as the borrower and the lender respectively.

Why appoint LPA receivers?

The main purpose of appointing LPA receivers is to take control of and to sell the mortgaged property. It may need to be put into better order before it can be sold. Vacant parts may need to be let. There is sometimes a “mess” of some sort to deal with. It may simply be important to take the management of the property and the rental income out of the hands of a defaulting borrower, with whom relations have broken down. LPA receivers should have the relevant skills, and LPA receivership is generally simpler and subject to fewer formal reporting requirements than administration (where the latter is also possible).

Appointing receivers will relieve the lender of the burden of managing and marketing the property, and should avoid it becoming a “mortgagee in possession”, although in practice a lender may decide to remain closely involved. The lender’s exposure to a claim by the borrower arising from the management and disposal of the property should be reduced.

If the security document contains a floating charge over all or substantially all of the borrower’s assets, the issue arises whether an appointment might amount to the appointment of administrative receivers, which is now generally unlawful. There is authority, however, that receivers appointed under only a fixed charge will not be administrative receivers, even when the security document contains a floating charge. The difficulty is likely to be with properties such as pubs, nursing homes and hotels. LPA receivers should not be appointed under the floating charge, and the fixed charge will not cover fluctuating assets which may be needed to run the business such as stock in trade. One solution may be for the receivers to grant a licence to a third party to manage the business.

Before the appointment

The lender will generally be considering its enforcement options some time before receivers are appointment. The appointment itself is likely to follow due diligence by the lender and/or the proposed receivers and their advisors. The lender’s solicitors will often also act for the receivers.

The intended receivers should be provided with copies of valuations, any structural or environmental survey, the title documents and occupational leases and associated
documents. An initial receivership strategy will be produced. If the property is under development, issues such as securing materials on site and the use of copyright drawings will be considered.

The lender owes no duty to the borrower, its unsecured creditors, or any guarantor, in deciding whether or not to make an appointment, so long as it acts in good faith.

**Legal review**

A legal review of the security should include the following:

a. Obtaining copies of all relevant documents, including the full security package, any prior or subsequent charges, and any warranties available from a contractor or the professional team.

b. Checking that the mortgage has been validly authorised and executed, and duly registered at the Land Registry and, where applicable, Companies House.

c. Reviewing any vulnerability of the mortgage to challenge; for example on the grounds of preference, undervalue or abuse of powers by the directors or, largely in the case of residential property, misrepresentation or undue influence.

d. Checking that there is power to appoint the receivers, that it has become exercisable, and the powers the receivers are given. A demand for repayment or prior notice to the borrower is only essential where this is a precondition of appointment under the terms of the mortgage, but making a demand is common practice, and recommended.

e. If the mortgaged premises are residential, a court order for possession will usually be required unless the borrower gives up possession voluntarily.

**Appointment**

Any formalities prescribed by the mortgage must be followed. Unless the mortgage says otherwise, the appointment need not be by deed, but there may be advantages in using a deed.

It is usual to appoint two persons as receivers, for administrative convenience, and usually from the same firm. However, they may only act individually, rather than jointly, if both the mortgage and the appointment allow them to do so. A company cannot be appointed as receiver where the borrower is itself a company.

The Act potentially sets a cap on the receivers’ remuneration, but the mortgage will generally disapply this, leaving it to be agreed between the lender and the receivers at the time of the appointment.

Receivers often request an indemnity from the lender against liability arising from any invalidity in the appointment, and sometimes for liability on any contract entered into or liability incurred as receivers to the extent of any shortfall in the secured assets. Many lenders will give some form of indemnity. Others consider that it is for the receivers to satisfy themselves at the outset that the appointment is valid. From the lender’s point of view, any indemnity should exclude liability arising from any negligent conduct of the receivership or wilful default. Trading liabilities may also be excluded.

If the appointment is invalid, the receivers may be liable to the borrower for trespass to land and conversion of goods, but case law suggests that they may escape liability for conversion in respect of purely contractual rights, for inducing breach of contract and for unlawful interference with contractual rights. Steps taken by receivers where there was no power to appoint them will be invalid.

**Immediate action on appointment**

Where the borrower is a company, the receivers must follow the statutory requirements and time limits for acceptance and registration of the appointment with the Registrar of Companies. A statement that a receiver has been appointed must appear on the company’s stationary, orders and invoices. The appointment will not be registered at the Land Registry, but the receivers may ask for the register to be amended to give their address.

The other immediate steps will depend on the circumstances and the nature of the property. Notice should be given to the tenants to ensure that the next instalments of rent are paid to the receivers, although what is needed depends on the existing arrangements set up when the mortgage was taken. It may be appropriate to remove existing managing agents.

**The receivers’ powers**
The powers available to receivers will be set out in the mortgage, and then conferred on them in the appointment. Those conferred by the Act are woefully inadequate, and it is important that the mortgage extends them. Receivers whose statutory powers under the Act are extended are usually referred to as “receivers and managers”.

The mortgage and appointment will usually provide for the receivers to act as agents of the borrower. The position under the Act is the same, unless the mortgage says otherwise.

The receivers’ duties

The receivers’ primary duty is to the lender in securing the repayment of the secured debt. This takes precedence over the interests of the borrower. Whether or not receivers owe a general duty of care to the borrower is yet to be settled, but they clearly owe a duty to act in good faith and must use their powers for proper purposes. Subject to their primary duty to the lender, they must manage the mortgaged property with due diligence, and should have regard to the borrower’s interests. They need not continue the borrower’s business, but if they do, they must take reasonable steps to try to do so profitably, and may be vulnerable if discontinuing a business reduces the value of the property.

The receivers should check that the property is validly insured, and should implement any rent review under occupational leases. Whether or not they should seek to let vacant parts of the property will depend on their judgement as to the best means of disposing of the property. Leaving the property vacant for an extended period may expose them to a claim by the borrower.

Matters arising during the receivership

Leasehold property

Much will depend on whether the lease under which the borrower holds the property has any residual value, or is required for a disposal of the borrower’s business.

The receivers are not personally liable under the covenants in the lease or for an occupational rent, unless they agree to assume liability. They might, however, be liable to the lender or borrower if, having funds available to pay rent, a failure to do so causes loss.

The grant of the mortgage, or the appointment of the receivers (or indeed non-payment of rent or other breach of covenant), may give the landlord a right of forfeiture under the terms of the lease. The lender may generally apply to court for relief from forfeiture, or the receivers may usually do so as agent for the borrower tenant.

Lettings

The mortgage will generally give the receivers power to grant leases, to deal with matters such as granting licences to assign or sublet, and to initiate rent reviews. Leases will be granted by the receivers in the name and on behalf of the borrower, with an exclusion of personal liability. The consent of any lender with a second mortgage will generally also be required.

The mortgage should extend the power of the receivers to ensure that the landlord’s covenants are included in the lease. If the borrower’s business is in liquidation, the receivers may be able to grant a lease to a subsidiary of the borrower, which then grants an underlease containing the necessary landlord’s covenants. In practice the point is often not taken.

A point which is sometimes overlooked is that when a lender has taken possession, or a receiver has been appointed, most matters authorised or required under the Landlord and Tenant Act 1954 must be done by or to the lender, rather than the borrower. For example a notice by a tenant requesting a new lease will be invalid if given to the borrower (as landlord) rather than the lender.

Contracts

Where the borrower is a company, the receivers are personally liable on any contracts entered into in the performance of their functions (unless the contract provides otherwise), but entitled to an indemnity out of the assets. It is important that any contract, including any lease or transfer, expressly excludes such personal liability. In practice, of course, counterparties are often unwilling to continue to supply the company without assurance that they will be paid.

In the absence of specific provision in the contract to the contrary, the appointment of a receiver will not generally cause an existing contract entered into by the borrower to terminate.

The receivers are generally free to cause the borrower to
repudiate or ignore existing contractual obligations, but do not have a general power to disclaim onerous property.

If they allow the borrower to continue to trade, the receivers may be liable for fraudulent trading (if dishonest) but not for wrongful trading (not being directors of the borrower).

Employees

Where the borrower is a company, the receivers will be personally liable under any contract of employment adopted by them in the performance of their functions. They are not deemed to adopt a contract of employment by reason of anything done within 14 days after appointment, however, so a quick decision is required where the mortgaged property includes a business with employees. If the mortgage gives the receivers the power, it may be appropriate to dismiss employees within that period. The receivers may be forced to seek to renegotiate contracts of employment, or to negotiate new contracts, in both cases excluding personal liability. Liquidation of the borrower will terminate existing contracts of employment.

This will obviously be a key issue with some substantial commercial properties such as a shopping centre with a number of staff. In practice, it will often be essential to maintain services provided to tenants in a multi-let building.

Rates

Receivers acting as the borrower’s agents are not personally liable for non-domestic occupied property rates before liquidation of the borrower. Post liquidation the position may be less clear, but if, as a matter of fact, there is no change in the rateable occupation on liquidation, the borrower should remain in rateable occupation. The position with unoccupied property rates will usually be the same.

VAT

The receivers should check whether or not the borrower has opted to tax the property. HM Revenue & Customs ("HMRC") maintains a central record, but the borrower’s VAT office should be asked. HMRC will not usually allow an LPA receiver to register separately for VAT, and taxable supplies must be accounted for on the VAT return for the borrower’s account and registration number. The receivers may account for output tax using Form VAT 833. If the property is sold by the receivers, it will be a supply by the borrower, and any VAT must be accounted for and paid using the same form. In practice, the receivers will usually insist on making the payment directly to HMRC.

HMRC will not usually allow the receivers to make a separate claim for input tax, although in the past they have sometimes been willing to allow receivers to account on a net basis. VAT on costs incurred by the lender on a sale may, however, be recoverable under the bad debt relief regulations, with the sale being treated as a supply by the lender as agent for the borrower.

Whether or not LPA receivers can exercise powers such as electing to waive exemption is unsettled, and should arguably be determined by the powers conferred by the mortgage and the appointment. It is understood, however, that HMRC’s view is that LPA receivers cannot exercise the option to tax. The borrower remains able to do so at any time, so the sale documents should allow VAT to be charged.

Environmental liability

Due diligence prior to appointment should consider any relevant environmental permits (and whether they are transferable), and possible environmental liabilities and exposure, particularly for industrial land, or businesses where effluent discharges from the property.

Any liability to clean up contaminated land under the Environmental Protection Act ("EPA") falls principally on the person who caused or knowingly permitted the contamination, failing whom, on the owner or occupier for the time being. Receivers will not usually be the “owner” or “occupier”, but the position should be carefully reviewed. There is an exclusion in the EPA where any relevant act was reasonable in the context, which may also assist.

However, receivers will be personally liable if they have committed a tort, such as the tort of waste, and may be criminally liable under certain environmental and health and safety legislation: for example for a dangerous workplace.

Legal proceedings

Whether or not the receivers may take proceedings in the borrower’s name will depend on the terms of the mortgage. The other party is well advised to seek security for costs, since the receivers will not usually be personally liable for that party’s costs when proceedings by the receivers are unsuccessful.
Accounts and information

If the borrower is a company the receivers must send accounts of receipts and payments to Companies House. They also have a duty to the borrower to supply information required by its directors to perform their duties, such as filing accounts, or to enable the borrower to redeem the mortgage (if it genuinely intends to do so), but need not supply information they consider would be prejudicial to the lender.

Liquidation of the borrower

The receivers’ agency for the borrower terminates on the liquidation or bankruptcy of the borrower. They then act either as principal, or as agent for the lender, depending on the circumstances, and have no power to impose personal liabilities on the borrower.

Liquidation does not, however, terminate the receivership, or the receivers’ powers (so long as no new debt or fresh liability of the borrower is created), including the power to dispose of the property. The borrower may not dispose of its assets once liquidation has commenced, but so far as the lender and receiver are concerned, the relevant disposal was the earlier grant of the mortgage, and they retain their powers of disposal.

Liquidation does not prevent the appointment of receivers, but leave of court, or the agreement of the liquidator, is needed to take possession of the mortgaged property.

Administration of the borrower

LPA receivers cannot be appointed following the administration of the borrower – and during the preceding moratorium period – unless the administrator or the court agrees, and any existing receiver must cease to act on such appointment if the administrator requires it.

Sale of the property

The lender may sell the mortgaged property either under the power derived from the Act or under an express power of sale in the mortgage. A sale under the statutory power will be free of any subsequent charge, but subject to any prior charge.

The mortgage and appointment will usually give the receivers power to sell the property, but because the receivers are selling as agents for the borrower, the sale will not overreach any second mortgage or charge or, of course, any prior charge. Given that they are selling as agents of the borrower, the Land Registry will usually insist that the mortgage under which they were appointed is released.

Like the lender, receivers are under a duty to the borrower, any guarantor, and any subsequent mortgagee, to take reasonable care to obtain a proper price on any disposal of the property — often described as being the best price reasonably obtainable at the date of sale — but are not obliged to delay a sale in a rising market, nor to take steps to improve the property or to pursue an application for planning permission before a disposal. The property should be fairly and properly exposed to the market, and consideration given to whether the sale should be by private treaty, public auction, or public tender.

A lender cannot sell to itself, nor can receivers sell to the lender, without the leave of court (the “self-dealing rule”) but a sale to a person associated with the lender is permissible, so long as rigorous steps are taken to demonstrate that the sale is at full market value and achieved the best price reasonably obtainable (the “fair dealing rule”).

Termination of appointment

The lender may generally remove LPA receivers at any time, although remuneration, proper expenses and any indemnity the receivers are entitled to out of the charged property are charged on the property in priority to the lender. Old cases suggest that receivers cannot simply resign without risking a claim from the lender for damages. In practice such a claim may not succeed if the receivers give reasonable notice of resignation.

Foreign Borrowers

In general, where the property is in England or Wales, LPA receivers may be appointed under a mortgage whatever the place of incorporation of a corporate borrower.

As mentioned above, an LPA receiver must generally give way if an administrator is appointed. Administration orders are restricted to a company within the meaning of the Companies Act, a company incorporated in an EEA state other than the UK, and a company incorporated outside the EEA but having its centre of main interests (COMI) in the EU (except Denmark).
It appears that, as the statutory rules currently stand, a receiver and manager appointed over property owned by an offshore special purpose borrower cannot be an administrative receiver.

Contact

For further information, please speak to Andrew Evans or your usual contact at Field Fisher Waterhouse.
LPA Receivers