The Status of Receivership as an Alternative to Winding Up of Insolvent Companies in Kenya Pre and Post-2015: A Review of Relevant Law

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Abstract

When a company becomes insolvent, secured creditors stand at a better position to recover their debt than unsecured creditors. Secured creditors can recover their debt in several ways, including selling the secured asset and appointing receiver managers to run the business of the debtor company with a view to recovering the debt through profits and sales. How has the device of receivership evolved since its inception in England and adoption in Kenya through the repealed Companies Act? This paper seeks to trace this evolution of the device from England with a view to determining its purpose in Insolvency Law. The paper will then examine how the device was applied in Kenya through the repealed Companies Act and then how it has metamorphosed to administration in the current Insolvency Act. The paper will then conclude by determining whether creditors of insolvent companies are now better protected under administration than they were protected under receivership. The paper argues that the insolvency regime that was introduced by the Insolvency Act of 2015 significantly altered the way receivership operates in the country and such an alteration has promoted the protection of creditors while at the same time helping in the preservation of viable businesses.

Keywords: Insolvent; Debenture; Qualifying floating charge; Receivership; Administration; Creditor protection

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1.0 Introduction

A detailed analysis of the nature and purpose of receivership in Kenya would not be complete without tracing it from England, where it all started. Kenya adopted the English law of receivership from England. If the strict meaning of corporate insolvency was to be adopted, receivership would not be discussed as an insolvency proceeding, because it takes place to the exclusion of courts. A holder of a qualifying floating charge, or a secured creditor, can appoint receiver managers to run the business of the insolvent company for the benefit of the creditor.[1] This way, the secured creditor recovers the money and property it had advanced to the now insolvent company. This is what happens if the receivership succeeds. If it fails, the insolvent company is likely to be placed on liquidation.

Originally, a mortgagee whose mortgagor had defaulted could apply to the court to appoint a receiver to collect the profits and rents from the defaulter's/mortgagor's business and property, then direct the collections towards the payment of the mortgage interest. Such a process was lengthy and time consuming, and it was therefore later considered more appropriate for the mortgagor himself to appoint the receivers, at the request of the mortgagee. This process had its misgivings, because a mortgagor could easily appoint a receiver who served the mortgagor's interests, other than the mortgagee's interest. Later on, mortgagees started making the appointments, but on condition that the receiver was an agent of the mortgagor.[2] This enabled the mortgagee to avoid liability as a principal of the receiver, or where he possessed the mortgaged property.[3]

The power to appoint a receiver was later made statutory under the Law of Property Act of 1925, although the receiver remained to be a receiver of income of the estate of the debtor.[4] With time, business expanded, and the need for credit to finance further expansion arose. Creditors started getting concerned about the nature of protection they had, in the event borrowers defaulted in payment. For this reason, they demanded the right to appoint not only a receiver of income but also a receiver and manager of the business and

1 See *Re Maskelyne British Typewriter Ltd*., [1898] 1 Ch. 133 (C.A.).

2 See the dissenting judgment of Rigby LJ in *Gaskell v Gosling* [1896] 1 QB 669 at 691ff, although the House of Lords held on appeal that the receiver will no longer act as agent for the debtor over whose assets he is appointed (*Gosling v Gaskell* [1897] AC 575 HL).

3 See the explanation of the development of the agency of the receiver given by Rigby LJ in *Gaskell v Gosling* [1896] 1 QB 669, subsequently approved by the House of Lords: [1897] AC 575., above, note 4.

4 Section 101(1)(iii) and 109 of the Law of Property Act, 1925.

property of the debtor in the event of default. This kind of security would cover the whole or substantially the whole of the debtor's business. Therefore, the modern debenture evolved, which basically created a fixed charge over fixed assets and a floating charge over the rest of the assets of the debtor company, with power to appoint a receiver manager. The manager would have powers to manage the debtor company and dispose of assets either as a piecemeal or as part of preparation to sell the company as a going concern. The debenture holder could still apply to the court to appoint a receiver manager, but there was no advantage of doing, because as noted earlier, the judicial process is a lengthy and resource-consuming exercise. With such kind of powers as being able to appoint a receiver manager while obviating the judicial process, there was no need to go to court.

Following these immense powers of the receiver manager, the Review Committee on Insolvency Law and Practice (Cork Committee)[5] received a wide range of complaints about the nature of receivership in its pursuit of reform of Insolvency Law in England.[6] The Committee, however, considered that there was a probability of the receiver manager to restore the business to profitability if the receivership was successful. The complains were therefore unjustified. There were, however, concerns from unsecured creditors that their rights were not protected since the receiver manager only protected the rights of the appointing authority, the secured creditor. There was also a concern that the holder of the floating charge could appoint persons who were closely connected to him and not necessarily competent. Hence, they would accelerate the collapse of the company. Therefore, the Cork Committee considered the introduction of the receiver, who would be a qualified insolvency practitioner. In addition, the unsecured creditor would be kept abreast of the process of receivership because he, too, has an interest in the debtor company.

Concerns continued to be voiced regarding the future of receivership, with banks, insolvency practitioners, and members of the academia. The central concern was that receivership placed too much power on one secured creditor to the detriment of other creditors, whether secured or unsecured. On grounds of equity and fairness therefore, a collective proceeding like administration and winding up were favourable because they considered the rights of all creditors,

5 The CORK Committee was commissioned by the UK Labour government in 1977 to investigate and recommend the modernisation and reform of UK insolvency law.

6 A more concise historical account on this subject is provided by Roy Goode, (2005), P*rinciples of Corporate Insolvency Law* (3rd ed.) London. Thomson Sweet & Maxwell, 2005. Chapter on Administrative Receivership, page 315. See also Fiona Tolmie, (2003), *Corporate and Personal Insolvency Law*. London: Cavendish Publishing Limited.

whether secured or unsecured.[7] The persons overseeing these processes owe a duty of care to all creditors where all of them have an opportunity to participate.[8]

England has already amended the law on this subject, following the recommendations to the Cork Committee. Section 250 of the Enterprise Act, 2002 introduced a new section 72A to the Insolvency Act of 1986 to the effect that a holder of a qualifying floating charge in respect of a company's property may not appoint a receiver of the company, regardless of any provision purporting to confer such power.[9] Receivership in Kenya has, until recently, been based on the English Insolvency Act of 1986, devoid of the amendment brought about by the Enterprise Act, 2002. There is need to examine this position.

Kenya's law on receivership was until 2015 based on the repealed Companies Act, Chapter 486 Laws of Kenya. The repealing Act, the Companies Act of 2015 ,[10] does not provide for receivership. Insolvency Law in the country has, however, been consolidated by the Insolvency Act of 2015.[11] This being a fairly new legal regime, there is paucity of literature on this subject and the little that exists is brief commentary by legal practitioners on their websites. There is need to examine how receivership worked under the repealed Companies Act, how courts made decisions regarding disputes arising from the implementation of that Act on receivership, the provisions of the current Insolvency Act on receivership, and the current position as stated by Kenyan courts on receivership. This paper will therefore engage in a voyage whilst critically examining the nature of receivership as provided for under the repealed Companies Act and how this nature has changed under the Insolvency Act, 2015.

2.0 Receivership under the repealed Companies Act

The repealed Companies Act did not define a receiver. The English Insolvency Act of 1986, from where the concept of receivership which is applied in Kenya was derived, provides the definition as follows: "(*a*) a receiver or manager of the

7 See Insolvency Service Review of Company Rescue and Business Reconstruction Mechanisms published in 2000. See also Armour, John and Frisby, Sandra, 'Rethinking Receivership. *Oxford Journal of Legal Studies*', Oxford Journal of Legal Studies, Vol. 21, No. 1, pages 73-102, 2001, for an argument that the case for wide-ranging reform to receivership was not made out.

8 *Ibid*.

9 Although sections 72B to 72G of the Insolvency Act provide for the exceptions to section 72A, in which administrative receivers can still be appointed in cases of capital markets and of certain project markets.

10 Act Number 17 of 2015.

11 Act Number 18 of 2015.

whole (or substantially the whole) of a company's property appointed by or on behalf of the holders of any debenture secured by a charge which, as created, was a floating charge, or by such a charge and one or more other securities; or (*b*) a person who would be such a receiver or manager but for the appointment of some other person as the receiver of part of the company's property."[12]

The appointment and functions of receivers and managers was provided for under Part VII of the repealed Companies Act. The Act stated that a body corporate cannot be a receiver manager.[13] In addition, an undischarged bankrupt was not capable of being appointed a receiver manager.[14] Where the receiver manager is appointed pursuant to powers to appoint him/her contained in a qualifying floating charge, the Act stated that the receiver would exercise their powers as if they were appointed by the court.[15] The effect of this provision is that the receiver manager is an officer of the court, even if he was not appointed by the court itself. Once the receiver has been appointed, every document of the company, including invoices, receipts, order for goods or business letter must include a statement to the effect that a receiver has been appointed and is in charge.[16]

The Act required the receiver to send notice of his appointment to the company. The company would then submit a notice of the financial status of the company to the receiver, within 14 days or any other time as prescribed by the court or regulations.[17] The receiver was then required to send a copy of the statement of the company's affairs to the Registrar and the court, along with any comments that the receiver might have made regarding the company's affairs. This was done within two months after the statement was prepared by the company. The company and any trustees for the debenture holders on whose behalf he was appointed would also receive a copy of the comments that the receiver sent to the registrar and the court. The Act also provided that the receiver manager would be expected to send to the registrar, company and any trustees for debentures, a statement of all money he has received and paid out. This would be done every six months during the time he is in charge of the receivership of the company.[18] The contents of the statement of affairs of the

12 Section 29(2) of the Insolvency Act 1986.

13 Section 345 of the Companies Act (Repealed), Chapter 486 Laws of Kenya.

14 *Ibid*, section 346.

15 Section 348.

16 Section 349(1).

17 Section 351(1).

18 Section 351(2).

company include particulars of the company's assets, debts and liabilities, names postal addresses and occupations of the company's creditors, the securities held by those creditors, the dates the securities were deposited, and any other relevant information.[19] The statement was to be supported by an affidavit of one or more directors and the secretary of the company.

Whereas the appointment, powers and duties of receiver managers were well stated by the repealed Companies Act as outlined in the paragraphs above, some Kenyan courts still misconstrued and/or misunderstood the nature of receivership. Justice Philip Tunoi's appellate decision in *Fina Bank Limited v Spares and Industries Limited*[20] must be analysed here. The case started at the High Court as *Spares & Industries Limited v Fina Bank Limited*.[21] In 1997, Spares and Industries Limited (Spares Ltd) had applied for a credit facility of KShs 75,000,000 from Fina Bank Limited (Fina Bank). The conditions were contained in a debenture dated 3 July 1999, where Spares Ltd charged all its business undertaking to Fina Bank. The directors of Spares Ltd also provided personal guarantees for the repayment of the loan amount. For this reason, Spates Ltd maintained the following accounts with Fina Bank: CC1764, CC474 as overdraft accounts and a loan account number LN 4210. When Spares Ltd defaulted in payment of this loan amount, Fina Bank wrote a demand letter to Spares Ltd on 2 November 1999, failure to which Fina Bank would appoint receiver managers under the terms of the debenture.

Spares Ltd did not pay the demanded money, and therefore Fina Bank appointed Vijay Chhotalal Malde and Subhashchandra Girdharlal Devani to be joint receivers and managers of the respondent's assets and business on 2 November 1999. The receivers immediately notified the company and the directors of the company of their appointment on the same day, after taking over the business of the company, as required by law. Spares Ltd therefore proceeded to court seeking a mandatory injunction to compel the appointed receiver managers to vacate its business premises and to be restrained from interfering with the business until the hearing and determination of the suit. Spares Ltd argued that power contained in the debenture to appoint receivers had not become exercisable, appointment of receivers would occasion the plaintiff irreparable damages, and that appointment of the receivers was not made in good faith. In addition, since the value of the secured assets was more

19 Section 352(1).

20 [2000] eKLR civil appeal number 51 of 2000 (Tunoi, Shah and O'Kubasu, JJA) Judgment written by Tunoi, J.

21 [2000] eKLR civil case 2106 of 1999 (Mulwa, J).

than the loan amount, Spares Ltd argued that Fina Bank should have instead sold the securities to recover the loan amount, instead of appointing receiver managers. Spares also questioned the stiff interest that Fina Bank was charging on the outstanding loan, yet clause 2 of the debenture gave the Bank the power to charge interest at such rates as the bank may think fit.

Justice Kasanga Mulwa (correctly) stated as follows:

> The debenture forms a contractual document between the parties and this provision can only be changed or altered like any other contract under certain conditions. In the absence of any proof that this contractual relationship should be rescinded this provision for the interest remains valid. As to whether the right to appoint the receiver had become exercisable one has to turn again to the document which has created the present relationship between the parties and that is the debenture. Clause 16 of the debenture allows the defendant the lender to appoint receiver and or a receiver manager when the security becomes enforceable in case there is a breach of any of its conditions. In this case the default is based on the failure by the plaintiff to repay the loan when called upon to do so under clause 13 of the debenture which lists a number of conditions if defaulted by the plaintiff would entitle the calling up of the entire loan without demand.

The court, however, questioned the haste with which Fina Bank appointed the receiver managers. The Bank sent a statutory demand on 2 November 1999 and on the same day appointed the receivers. The court also questioned the huge penalties the bank levied on the outstanding loan amount as it destabilised Spares Ltd and led to the company to make huge losses. Judge Mulwa therefore stated as follows:

> Looking at the circumstances leading to the appointment of the receivers in this case it becomes clear that the appointment was not for the benefit of the Bank. Whereas the Court would normally not interfere with the appointment of a receiver under the terms of a debenture holder nevertheless the Court will interfere where such appointment is not for the benefit of the debenture holder. In such a case the Court could use its inherent powers to appoint its own receiver or to make any other order necessary.

It can also be referred from the *Halsbury's Laws of England* that "…A debenture or a trust deed often gives power to appoint a receiver and manager in specified events. Such a power given in debenture is fiduciary power and if an appointment is made which is not for the benefit of the debenture holders but with a view to the benefit of the company or third persons the Court will interfere and appoint

its own receiver…"[22] The Court therefore found the statutory demand issued by the Bank to be unreasonable and proceeded to grant the mandatory injunction restraining the receiver managers from interfering with the business of Spares Ltd. It should be noted that the court did not question the power of Fina Bank to appoint receiver managers under the debenture. In fact, the court stated that this power is derived from the debenture which is a contract and the court cannot interfere with it. The court only questioned the reasonableness of the demand notice and the hefty interest (initially 31%, which could be increased from time to time) that Fina Bank was levying on the outstanding loan amount. The court also questioned the speed with which Fina Bank appointed receiver managers, same day 2 November 1999 when the demand notice was sent to Spares Ltd.

Fina Bank then filed an interlocutory application, in *Fina Bank Limited v Spares and Industries Limited*[23] seeking two orders; firstly, an order staying the execution of the order of the High Court (Mulwa, J), pending the hearing and determination of its intended appeal against it; secondly, an order for the reinstatement of receivers and managers appointed by it over the assets and business of Spares Ltd. The Court of Appeal (Kwach, Bosire and O'Kubasu, JJA) allowed the application and ordered the receivers to be reinstated, pending the intended appeal. The mandatory injunction granted by Mulwa, J at the High Court compelling the receivers to vacate the premises of the business of Spares Ltd was also stayed, pending the appeal. Regarding the debenture constituting a contract, Court of Appeal stated as follows:

> As was rightly pointed out by Mr Fraser, for the applicant, the relationship between the parties herein is based on contract. The respondent wanted credit facilities from the applicant. The applicant spelled out, in its letter to the respondent dated 6 February 1997, the terms under which it would grant the credit facility, which terms the respondent accepted in writing. In its suit before the superior court however, it laments that the terms with regard to the contractual interest are unconscionable and that the court should so declare. The respondent's case is not that it was misled into entering the contractual relationship. Nor is it its case that

22 *Halsbury's Laws of England* 3rd Edition Vol 6 Paragraph 699. See also *Re Masklyne British Typewriters Ltd* [1598] 1 Ch, 133 CA, where it was held that the right to appoint a receiver in the debenture does not oust the inherent power of the court to intervene when the circumstances of the case allow. Likewise, in Civil Appeal Number 134 of 1987 *Godfrey Nyaga and Housing Finance Company of Kenya (HFCK) Ltd*, the Court of Appeal observed that: "Where a party has a statutory right of action the Court will not usually prevent that right being exercised except that the Court may interfere if there was no basis on which the right could be exercised or it was being exercised oppressively".

23 [2000] Civil Miscellaneous application number 25 of 2000 (Kwach, Bosire and O'Kubasu, JJA).

> the applicant by taking steps to enforce its rights under the contract is acting in breach of it, but that it is acting oppressively and would like this court to intervene.

It is noted that the Court of Appeal, just like Mulwa, J in the High Court to the extent that he held the debenture to be a contract, is correct in its ruling that the debenture had provisions that were agreed upon by the two parties and, in the absence of mistake, undue influence or any other vitiating factor, courts should not interfere with the appointment of receivers under the debenture.

At the same time, Fina Bank had an appeal at the court of appeal, in *Fina Bank Limited v Spares and Industries Limited*[24] (Tunoi, Shah and O'Kubasu, JJA) arguing that the decision of Mulwa, J was erroneous since the appointment of receivers was based on an agreement in the debenture. In a decision written by Tunoi, J and seconded by O'Kubasu, J, the court upheld the decision of the High Court by stating that the appointment of the receivers by Fina Bank was oppressive and debilitating on Spares Ltd. The court stated as follows:

> The issue of Receivership is an emotive one and I understand why the respondent had to resort to litigation. It destroys the business. It is expensive. The appointment of Receivers and Managers may not necessarily improve the financial position of the business. These, in my view, are matters for consideration as to whether to grant a temporary injunction or not. I am satisfied that all these observations were in the mind of the learned Judge when he acceded to the application for injunction. Indeed, he acted in accordance with the principles laid down in *Giella v Cassman Brown & Co. Ltd* [1973] EA 358 and came to the correct decision. I find no ground to fault him as he had exercised his discretion correctly and judicially.

This position by Tunoi, J is disturbing and interferes with the principle of freedom of contract. At the time of entering and signing a contract, it is assumed that both parties to the contract have read, understood, and accepted the terms of that contract. In the absence of mistake, misrepresentation, undue influence and any other vitiating factor, courts must refrain from interfering with the contract making and performance process. The debenture is a contract. It has terms that govern it. One of the terms in the debenture in this case empowered Fina Bank to appoint receivers in the event of default by Spares Ltd. Whereas the haste with which they made the appointment was questionable, the decision by the court is equally unreasonable. This case is therefore bad law when the subject of receivership is discussed.

There are, however, other decisions where courts have upheld the right of the debenture holder to appoint receiver managers in the event of default. In

24 Above, note 16.

Showind Industries Ltd v Guardian Bank Ltd and another,[25] (Ringera, J, decided 2 years after the *Fina Bank* case), Showind Industries defaulted in payment of the monthly instalments of KShs 700,000 as agreed with Guardian Bank. Guardian Bank then appointed Joy V Bhatt to be the receiver manager of Showind Industries on 10 May 2002, under powers conferred to the Bank by a debenture. The Bank had not made a formal demand. However, Clause 5 of the debenture empowered the Bank to appoint a receiver if Showind Industries defaulted in the repayment of the loan. Showind Industries therefore filed an application in court for an interlocutory injunction on grounds that the appointment was made pursuant to a debenture which was faulty because it had not been registered, the appointment was premature and unreasonable, and that the receiver/manager had so mismanaged the affairs and business of the company that unless stopped the company would collapse.

The court found that the debenture had been registered and therefore enforceable, and, in any case, it is very trite contract law that a contract under seal need not be supported by consideration for its formal validity. The debenture was a contract under seal and therefore within the scope of this trite contract law principle. Secondly, the court found that there was no need for a formal demand to be issued as clause 18 of the debenture empowered the bank to make the appointment if the company defaulted in payment of the instalments. Thirdly, regarding the conduct of the receiver manager, the court noted that the receiver manager had done everything possible to keep the company operational, that he had accounted for all payments received and that he was not guilty of any illegalities or improprieties. In any case, the poor performance of the company was a result of mismanagement by directors of the company whom the receiver manager had retained in the company after his appointment.

Justice Ringera's decision represents the correct position on the law of receivership. If the debenture empowers the creditor to appoint receiver managers, it is trite law of contract that the debtor has acquiesced on the appointment and cannot therefore seek the protection of the court. The appointment arises from default in payment of the loan amount. Even where the debtor company is at risk of collapsing if receiver managers are appointed, that should not be the concern of receivership as the creditor who is appointing the receiver managers is also protecting its rights in the terms of the debenture and the loan amount. On this topic, the Court of Appeal in *Madhupaper International Ltd v Kerr*[26] (Kneller, Nyarangi, and Gachuhi, JJA) stated that "…It is correct law

25 [2002] eKLR.

26 [1995] eKLR.

that a debenture holder which has this right is under no duty to refrain from exercising its rights because doing so might cause loss to the company or its unsecured creditors…" and that the "…receivers and managers were appointed not by the court or under the provisions of a statute under the debenture which are agreements between the parties interested in the property over which their appointment was made. They are not officers of the court…"[27]

3.0 Receivership under the Insolvency Act

The Insolvency Act[28] consolidated the law on insolvencies of both natural persons and corporate bodies. The only insolvency that the Act does not regulate is the insolvency of partnerships and cooperatives which are regulated by the Partnerships Act[29] and Cooperative Societies Act[30] respectively. The Insolvency Act is supplemented by the Insolvency Regulations of 2016.[31] Administration of insolvent companies is regulated under Part VIII of the Insolvency Act and Part XI of the Insolvency Regulations. The Act and the Regulations do not have provision for receivership. In fact, the word receivership is not used anywhere in both laws. The persons who used to be referred to as receivers or receiver managers are now referred to as administrators and are appointed pursuant to Division 4 of Part VIII of the Act. A holder of a qualifying floating charge in respect of a company's property can still appoint an administrator of the company. A floating charge is a security interest or lien over a group of non-constant assets that may change in quantity and value. Companies can use their dynamic or circulating short-term current assets as security to obtain loans from financial institutions. The floating charge is secured by the current assets while allowing the company to use those assets to run its business operations. They constitute those business possessions that the firm can quickly liquidate for cash and include the accounts receivable, inventory, and marketable securities, among other items. For example, if inventory is used as collateral for a loan, the company can still sell, restock, and change the value and quantity of its inventory.[32]

27 This position is well founded in English decisions such as See *Cuckmere Brick Co Ltd v Mutual Finances Ltd* [1971] Ch 949, 965 and in *Re Potters Oils Ltd* 1985 Ch D.

28 Number 18 of 2018.

29 Chapter 29, Laws of Kenya.

30 Chapter 490, Laws of Kenya.

31 Chapter 490, Laws of Kenya.

32 James Chen, (2021). 'Floating Charge", available on Investopedia through <https://www.investopedia.com/terms/f/floating_charge.asp>, accessed on 17 August 2021.

The charge can be a single charge, a number of charges, or other forms of security that relates to the whole or substantially the whole of the company's property.[33] For the administrator to be appointed, the qualifying floating charge must be enforceable.[34] Hence, if the floating charge is faulty, the appointment cannot withstand legal scrutiny. These provisions are a replica of the receivership under the repealed Companies Act and as adopted from English Law. The only thing that has changed is that the appointment of the administrator will now have to be notified to the court. The holder of a qualifying floating charge has to file with the court the following documents after appointing the administrator: a notice of appointment; and such other documents as may be prescribed by the insolvency regulations for the purposes of this section.

Regulation 102 of the Insolvency Regulations lists the contents of the notice as an affidavit of statement of facts comprising: names of other creditors if the appointment is made by one creditor on behalf of the other creditors, the date of the charge; the date on which it was registered; and the maximum amount if any secured by the charge if the appointment is made by the holder of a qualifying floating charge, the nominal capital, the number of shares into which the capital is divided, the nominal value of each share and the amount of capital paid up or treated as paid up, and whether the company is limited by guarantee, and the principle business carried by the company. Other components are: that the applicant believes, for the reasons set out in the statutory declaration in support of the application, that the company is, or is likely to become, unable to pay its debts; the address for service of the applicant or the applicant's advocate, the names and addresses of the holders of prior floating charges and details of the charges, and a statement indicating whether the company is subject to insolvency proceedings at the date of the notice; and if it is, details of the proceedings. The notice of appointment is available in Form 35 in the First Schedule of the Insolvency Regulations and is reproduced below:

33 Section 534(3) of the Act.

34 Section 536.

FORM NO. 35 PART IV INSOLVENCY ACT r.103 (2) and 105 (3) (1)

REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA

THE INSOLVENCY ACT

IN INSOLVENCY CAUSE NO.....OF 20.....

RE:.....

t/a: .....

B.O. /S. I. O. / L. O. made on .....20.....OF.....

NOTICE OF APPOINTMENT OF ADMINISTRATOR

I, *C.D.*, of ..... give notice that has been appointed as Interim Trustee(s) of the property of the said *A.B.*, the Company with effect from the ..... Day of ..... 20..... and/or in accordance with the provisions of the Part VII of Insolvency Act.

Dated this ..... day of ..... ,20.....

(*Signed*) *C.D.*

Official Receiver*/Creditors/holder of qualifying floating charge/administrator

*The Official Receiver (If the application was made in Court)

The appointment of the administrator will take place when this notice of appointment with the details provided above is served. This is a departure from the previous position under the repealed Companies Act where the receiver managers would assume office immediately after their appointment and assume control of the business of the debtor company.[35] The holder of the qualifying floating charge will then be required to notify the administrator about the appointment and such other persons as may be prescribed by the insolvency regulations. Regulation 103 lists these "such other persons" as the court, the Official Receiver, the directors of the company, contributories of the company, and creditors of the company. The effect of this requirement is

35 As was the case in *Fina Bank Limited v Spares and Industries Limited*, footnote 16.

that administrators appointed by the holder of a qualifying floating charge are now officers of the court,[36] because the process is now carried out with the involvement of the court, and not outside the court as was previously the case.[37] The current position is also that the administrator acts as an agent of the company, and not an agent of the appointing authority who is the holder of the qualifying floating charge.[38]

Once appointed, the administrator is an officer of the court and must work towards achieving the objectives of administration provided in section 522 of the Act. These objectives are: to maintain the company as a going concern; to achieve a better outcome for the company's creditors as a whole than would likely to be the case if the company were liquidated (without first being under administration); and to realise the property of the company in order to make a distribution to one or more secured or preferential creditors. Unlike in the previous regime where the receiver managers would manage the company to the benefit of the appointing authority who is the holder of the qualifying floating charge, administrators appointed under the Insolvency Act will be expected to perform the administrator's functions in the interests of the company's creditors as a whole.[39]

These provisions of the Insolvency Act have already been interrogated by Kenyan courts. In *I&M Bank Limited v ABC Bank Limited and another*.[40] In this case, I&M Bank (I&M) granted the Hillport Ltd (Hillport) facilities of up to an aggregate principal amount of KShs 1,200,000,000 which were secured by the following securities issued by the Hillport in favour of I&M: A debenture dated 10 December 2014 securing an aggregate maximum principal amount of KShs 750,000,000 together with a charge of the same date over Hillport's property Title No. Kajiado/Kisaju/2450 securing the same amount, a further debenture dated 9 March 2017 securing an aggregate maximum principal amount of KShs 70,000,000, a second further debenture dated 12 September 2017 securing an aggregate maximum principal amount of KShs. 380,000,000 accompanied by a further charge of the same date created by Hillport over its property known as Title No. Kajiado/Kisaju/2450 securing the same amount.

36 See section 525 of the Act which states that an administrator is an officer of the Court, whether appointed by the Court or not.

37 See *Madhupaper International Ltd v Kerr* (discussed earlier in footnote 22), where Kneller, Nyarangi, and Gachuhi, JJA stated that receivers are not officers of the court because they are appointed pursuant to powers under a debenture and not pursuant to statutory powers.

38 See section 586.

39 Section 522(2).

40 [2021] eKLR.

ABC Bank Ltd (ABC) advanced to Hillport KShs 60,000,000 secured by a fixed and floating debenture dated 1 July 2014 created by Hillport in favour of ABC. First Community Bank Limited ("FCB") advanced the Company USD 1,180,000 secured by an all assets debenture dated 13 April 2015. Following default of all these facilities, I&M Bank notified ABC of its intention to appoint an administrator pursuant to section 535(1) of the Insolvency Act. On 19 November 2018, ABC filed a Notice of Appointment of Administrator together with a Statutory Declaration indicating that it had appointed Julius Mumo Ngonga and Anthony Makenzi Muthusi of Ernst & Young LLP to act as Administrators over the whole of the Company's property. On 27 November 2018, I&M filed a notice of motion seeking orders to restrain the administrators appointed by ABC from carrying on their duties under the appointment and instead be replaced by P.V. R. Rao as Administrator.

The following day, 28 November 2018, the court granted an injunction restraining the ABC-appointed Administrators from carrying out or continuing with the administration of Hillport and on 4 December 2018, the Court appointed P.V. Rao and/or Mark Gakuru, the Official Receiver to act as Interim Administrator pending the hearing and determination of the application. On 6 December 2018, ABC filed a notice of motion to stay these orders and to reinstate its administrators in office to carry out the administration of Hillport and to remove P.V.R. Rao as the interim administrator of the Company. FCB supported ABC's application. The court (Majanja, J) framed these issues for determination: Whether the application filed by I&M was competent, whether the ABC was entitled to appoint administrators under the Insolvency Act, and if so, which creditor has priority.

On the first issue, the court was convinced that the application by I&M was competent and rejected ABC's preliminary objection. On the question of whether ABC was entitled to appoint administrators under the Insolvency Act, the court stated as follows:

> One of the hallmarks of the Insolvency Act is the introduction of the device of Administration to replace the receiver(s)/managers(s) under the Companies Act (Repealed) in order to meet the overall objective of ensuring that distressed companies are given "breathing space" so that they remain going concerns. In order to benefit from these provisions, the person appointing the Administrator, without recourse to the court, must be the holder of a qualifying floating charge under section 534(1) of the Insolvency Act.

In a way, therefore, the court confirmed that the Insolvency Act replaced the concept of receivership with the concept of administration. ABC debenture

predated the Insolvency Act because it was drawn in 2014. ABC opined that although the debenture empowered it to appoint receiver managers, there was no difference in the way receiver managers and administrators operated. On this point, the court stated as follows:

> ABC has argued that whatever name used, the duties of the receiver/manager under its debenture are co-extensive with those of an administrator appointed under the Insolvency Act hence for all intents and purposes, just as it is entitled to appoint a receiver, it is also entitled to appoint an administrator. I disagree with this position because section 520 of the Insolvency Act ascribes a specific meaning to the term "administrator" and it relates to the manner of appointment rather than to the functions. It states, "administrator," in relation to a company, means a person appointed under this Part to manage the company's affairs and property, and, if the context requires, includes a former administrator."

The gravamen of the court's position on this point is that an "administrator" is so-called because of the way he/she is appointed, and not necessarily how he/she operates. This is because he/she operates the same way a receiver manager would operate. The court expressed itself more succinctly in paragraph 35 as follows:

> As I have shown, the Insolvency Act is clear on the meaning of the term administrator, the manner of appointment and the incidents of a company under administration. The terms "receiver/manager" have a long history in English common law and doctrines equity and nothing would have been easier for the legislator to adopt them in the new statute. The purpose of the Insolvency Act was to break away from the old law and give way to the current practice that places a premium on rescuing or restructuring the company as a going concern rather than winding it up. I therefore hold that a receiver/manager appointed under the debenture or security document is different from an administrator appointed under the provisions of the Insolvency Act.

The court therefore announced a departure from receivership to administration, but not without providing redress to ABC's plight as the bank was caught up between a repealed Companies Act and a new Insolvency Act. The drafters of the Insolvency Act foresaw this conundrum, and therefore made this provision: "734(2) Despite the repeal of the Companies Act, or of Parts VI to IX of that Act, those Parts, and any other provisions of that Act necessary for their operation, continue to apply, to the exclusion of this Act, to any past event or proceeding preceding, following, or relating to that past event, even if it is a step or proceeding that is taken after commencement." Therefore, whilst the

Insolvency Act proclaimed a departure from receivership which was carried out to the exclusion of other creditors, to administration which carries on board every creditor, creditors who were given power by their debentures under the repealed Companies Act can still exercise those powers, oblivious of the new administration regime.[41]

In answering the question as to whether ABC was entitled to appoint an administrator under the Insolvency Act, despite its debenture having created before the Insolvency Act, the court held that this was a misnomer, and that ABC should instead have appointed receiver managers under the repealed Companies Act. This position is reproduced below:

> Based on the material and arguments before me and for the reasons I have set out, I find that the debenture issued by the Company in favour of ABC is not a qualifying floating charge within the meaning of section 534(2) of the Insolvency Act. Consequently, ABC could not appoint an administrator without making an application to the court as a creditor under section 532(1). It follows therefore that its action of purporting to appoint administrators under its debenture is null and void and of no effect.[42]

In answering the question as to whether I&M ranked first in priority over ABC's debenture, the court held in the affirmative, considering its finding in the second question. However, it should be noted that the question of priority of holders of a floating charge is answered by the Movable Property Security Rights Act of 2017.[43] Section 38 of this Act provides that priority amongst competing security rights created by the same borrower in respect of the same collateral is determined according to the time of registration. In effect, I&M's debenture ranked first in priority and ABC's decision to appoint administrators was a nullity.

Justice Majanja's decision in this case represents the current position on receivership as juxtaposed with administration. Other courts have also weighed in, albeit without a comparable clarity. For example, in *Midland Energy Limited*

41 See also *KSC International Limited (Under Receivership) and others v Bank of Africa (K) Limited and others* [2018] eKLR.

42 At paragraph 40.

43 See also section 535(2) of the Insolvency Act (Repealed after the coming into force of the Movable Property Security Rights Act, 2017) which provides that "for the purposes of subsection (1), the priority of a floating charge shall be determined in accordance with the Movable Property Security Rights Act" and section 612(4) of the Insolvency Act which provides that the Movable Property Security Rights Act determines whether one floating charge is prior to another for the purposes of this section.

v George Muiruri t/a Leakeys Auctioneers and another,[44] yet another case involving ABC Bank where the debenture was created before the Insolvency Act came into force (12 August 2012 to be precise), the Bank appointed Anthony Matenze Muthusi and Julius Mumo Nganga as Joint Administrators to Midland Energy Limited (Midland). At the same time, Synergy Industrial Credit Limited (Synergy) which had advanced goods to Midland moved to attach motor vehicles belonging to Midland as a way of enforcing its security. Midland therefore moved to court to seek an injunction to stop the administrators from taking over the management of the company and Synergy from attaching or selling the secured motor vehicles.

The court (Tuiyott, J) did not delve on the intricate nature of the case, but instead held that the administrators were regularly appointed, oblivious of the fact that the debenture was created before the Insolvency Act came into force. This is evidence of a lack of understanding of how different receivership is from administration under the Insolvency Act. The court held as follows:

> My reading of the provisions of sections 534 and 537 are that, the appointment of an Administrator takes effect upon the appointer lodging with the Court a Notice of appointment which is compliant with the provisions of section 537. In this case the Notice of appointment was lodged with Court on 19 November 2018 and that is the day when the Administrator's appointment was deemed to take effect.

In *Athi River Steel Plant Ltd v Ponangipali Venkata Ramana Rao and others*,[45] Athi River Steel Plant (Athi River) filed an application seeking an injunction and restraining orders on the basis that the appointment of Ponangipali Venkata Ranana Rao as receiver manager by Commercial Bank of Africa, KCB Bank, I&M Bank and Bank of Africa Ltd was illegal. Athi River contented that the secured creditors did not notify the court of the appointment as required by section 537 of the Insolvency Act, 2015 and the said non-compliance meant the appointment was unlawful. In addition, it was contented that the failure to notify the court, official receiver, contributors of the company and the company's creditors was in breach of section 539 of the Insolvency Act. Finally, Athi River argued that that the appointment was done under the Repealed Companies Act meaning that the laid down procedures of appointment and taking office, so as to set about performing the functions of receivership had to be complied with as per the Insolvency Act 2015 and not the companies

44 [2019] eKLR.

45 [2019] eKLR.

Act Chapter 486 that was repealed and in the instant case it was not done. In response to these issues, the court (Kemei, J) stated as follows:

> My considered view is that by the above provisions the Debentures gave power to the second to fifth respondents to appoint a Receiver in the event of default of payment; the applicant has not denied default of payment of the amounts advanced to it therefore the circumstances allowed the appointment of a receiver and the first respondent was duly appointed. The law applicable at the time the amount became payable was the Insolvency Act, however, the instruments creating the debenture define the powers of the Receiver. Clause 13 above refers to the person appointed as the Receiver and Manager and not just a Receiver, however for purposes of the contract he is referred to as a receiver. The power of a Receiver and Manager (also called Receiver Manager) is wider than that of a Receiver. The Receiver and Manager has the extra and important managerial function. Once appointed under the provisions of Clause 13, the Receiver and Manager takes up many of the roles which ordinarily belong to the Directors of the Company. A key function of the Receiver and Manager is to keep the company as a going concern. [46]

The court therefore held that the appointment of the receivers was within the contract as the debenture gave the creditors that power in the event of a default. Whereas this position was the right one because the debenture was created under the repealed Companies Act, the court did not say anything with regard the effect of the Insolvency Act on this debenture and how the position would have changed if the appointment was to be done under the new law. The court did not also delve into the claims of mismanagement of the company by Athi River.

In *re Arvind Engineering Limited*[47] the court (Tuiyott, J) was invited to discuss two important aspects of the device of Administration under the current

46 At paragraph 26. For an extensive analysis of the role of receiver managers, see the decision of Gikonyo, J in *Surya Holdings Limited and others v CFC Stanbic Bank Limited* [2015] eKLR. The judge stated as follows: "…[24] From the outset, let it be known that, the law especially on the duties of Receiver appointed by the court, and the one appointed out of court by debenture-holder is no longer seen as disparate. The niche development of the law is found in the difference between mere receiver and ''receiver and manager". The difference is not a moot issue but a matter of law. ''Receivers and Managers" entails not only receiving rents and profits, or getting in outstanding property, but also carrying on or superintending a trade, business or undertaking of the company. Receiver and Manager will have power to deal with the property, run the business of the company and appropriate the proceeds thereof in a proper manner for the benefit of the debenture-holder first, and of the company, secured creditors and guarantors of the company. Receiver and Manager is an agent of the Company, but stand in a fiduciary relationship with and owes duties to both parties. Given the very nature of the position of Receiver and Manager who has control over the property of the company and is running the enterprise as a going concern as is the case here, doubtless, has a duty to account to the law, the debenture-holder and the company".

47 [2019] eKLR.

Insolvency Regime. The first was whether the holder of a debenture created prior to the coming into effect of the Insolvency Act (Act number 18 of 2015) can qualify to appoint an Administrator under the provisions of the statute. The second question was whether the holder of a qualifying floating charge can, without Court sanction, leapfrog a Company which has sought to place itself under Court appointed Administration by appointing an Administrator during the pendency of the Company's application for an Administration Order. Arvind Engineering Limited (Arvind) had filed a notice of motion challenging the appointment of K.V.S.K Sastry by NIC Bank (the Bank) as its administrator and therefore wanted the appointment to be revoked.

Arvind had obtained financial facilities which were secured by two Debentures namely a Debenture dated 13 January 2014 for the sum of US Dollars 4,050,000 and KShs 137,000,000 and registered on 12 February 2014, and a further Debenture of 4 August 2015 for KShs 219,108,000 registered on 24 August 2015. The Company fell into hard times and there was default in the repayment of the facilities. At the time of making the application, the debt was substantial being over KShs 840,000,000. Due to the financial distress, Arvind lodged an application for Administration on 6 July 2018 in Nairobi High Court Miscellaneous application number 306 of 2018, which the Bank participated in.

While answering the question as to whether NIC Bank was entitled to appoint an administrator under the two debentures, the court (erroneously) held that it could, oblivious of the provisions of section 734(2) of the Insolvency Act which regulates transition from the repealed regime to the new regime. Debentures created before the coming into force of the Insolvency Act would be implemented as if the Insolvency Act was never enacted. That is the law. The court (Tuiyott, J) also erroneously stated that administrators appointed by the holder of a qualifying floating charge do not need to inform the court. The court appears to suggest that administration under the Insolvency Act is similar to receivership, which is an erroneous suggestion. The authoritative paragraph of the court's decision is reproduced below:

> Unlike a person who has applied to Court for an Administration order, the appointment of an administrator by the holder of a qualifying floating charge is achieved by compliance of the provisions of section 537 in conjunction with those of Regulation 102. Once there is compliance then the Administration takes effect (section 538). No fuss, no need for Court approval! It is indeed an out of Court appointment of an administrator. This is not available to the person who has to

> seek Court sanction. So the Debenture Holder can literally leapfrog the person has already moved the Court and is queuing up for approval. Is this acceptable?[48]

At paragraph 10, the court engages itself in a rhetoric by asking the following questions:

> If the Court was to uphold the argument by the Company then all such Debenture holders could never qualify to appoint Administrators as holders of floating Charges. That would mean that if they wanted to pursue Administration, then they would have to seek appointment like any other creditor. A process that requires Court sanction and is not as summary as the appointment made by a holder of a qualifying floating Charge (see the provisions of section 532 on applications for an Administration order by a creditor which require Court approval). Could this have been the intention of the legislator?

The answer to the last question is in the affirmative. That was the intention of the legislator, and it is the reason the legislator included section 734(2) for transitional purposes so that holders of a qualifying floating charge created before the coming into force of the Insolvency Act cannot appoint an administrator. They can only appoint receiver managers. It is interesting to see another judge, Ndolo, J, agreeing with this thinking in the case of *Shee Hamisi Mashipa v Mare Nostrum Limited*,[49] where he quotes Tuiyott,J with approval by stating that:

> This, I think, is the correct interpretation of Section 534 of the Insolvency Act and I do not need to say more. It follows therefore that in the present case, Ponangipalli Venakata Ramana Rao, is for all intents and purposes, an Administrator of the respondent under the Insolvency Act.[50]

This analysis demonstrates the confusion that courts have regarding the device of receivership under the repealed Companies Act and administration under the Insolvency Act. Whereas receivership was carried out to the exclusion of the court and in pursuit of individual creditor interests, administration is an inclusive process and is intended to run the company as a going concern for the benefit of all creditors. Administrators, unlike receiver managers, are officers of the court.

4.0 Conclusion

The inevitable conclusion on this review is that the device of receivership has greatly evolved from the time it was introduced in England as a tool for secured

48 *Ibid*, at paragraph 21.

49 [2021] eKLR.

50 *Ibid*, at paragraph 11.

creditors to recover their debt, to the current position in the Insolvency Act where it has metamorphosed to administration. At its inception, receivership was an exclusive device, in which a holder of a qualifying floating charge could appoint receiver managers to run the business of the debtor company with a view to receiving income towards the settlement of the debt. This device was adopted in Kenya through the repealed Companies Act but has now been replaced by administration. Under the Insolvency Act, administrators are now officers of the court and must carry out the administration of the company to achieve the objectives of administration set out in section 522 as: to maintain the company as a going concern; to achieve a better outcome for the company's creditors as a whole than would likely to be the case if the company were liquidated (without first being under administration); and to realise the property of the company in order to make a distribution to one or more secured or preferential creditors. The administrators are therefore required to run the business of the debtor company as a going concern for the benefit of all creditors, whether secured or unsecured.

Whereas Kenyan courts have weighed in on the nature of administration as juxtaposed with receivership, most decisions demonstrate a considerable lack of clarity. The correct position on this subject is the one provided by Justice David Majanja in *I&M Bank Limited v ABC Bank Limited and another*[51] where the judge noted that the Insolvency Act has changed receivership to administration, although holders of a floating charge which was created before the Act came into force will still be able to appoint receiver managers as though the Act was not in force. This is the intention of section 734(2) of the Insolvency Act.

This paper therefore concludes that creditors of insolvent companies now enjoy more collective protection that they were not able to enjoy under receivership in the repealed Companies Act.

51 Discussed in footnote 36.