

THE DUTIES OF RECEIVERS
by
D.F. Dugdale, B.A. L.L.B. Barrister & Solicitor.

I.

Modern forms of debenture almost invariably confer on the debenture-holder the power in the event of default by the mortgagor company to appoint a receiver and manager of the mortgagor. So that the debenture-holder will not be liable for any debts incurred by or the remuneration of the receiver modern documents equally invariably provide that the receiver shall be the agent not of the debenture-holder but of the mortgagor.

This practice is one of respectable antiquity. It had its origin in the fact that the courts imposed stringent requirements on mortgagees in possession. The device of appointing a receiver was evolved by wily conveyances as a means of enabling mortgagees to enjoy the advantages of possession without the drawbacks. First it became usual for mortgagees to insist on the right in certain circumstances to require the mortgagor to appoint a receiver. Then it became customary for mortgagees to stipulate for the right themselves to appoint the receiver.¹

Any person (and a company is for these purposes a person) has the right to appoint an agent or attorney to manage all or some part of his affairs and in certain circumstances such appointment is irrevocable. Precisely analysed the right given by the terms of a debenture to the debenture-holder to appoint a receiver of the mortgagor is a conferring upon the debenture-holder by the mortgagor as a term of his contract with the debenture-holder of the mortgagor's own power to appoint a person to act as the mortgagor's agent or attorney in the administration of the affairs of the mortgagor.

Is the sole duty that the law imposes on such a receiver one to the debenture-holder appointing him? Is it his sole legal duty to raise enough cash to pay out the appointing debenture-holder? Or is the receiver under some legal obligation in carrying out this primary duty to have regard to the effect of his actions on the financial position of the mortgagor (usually secured creditors of the mortgagor ranking after the appointing debenture-holder, unsecured creditors of the mortgagor and shareholders in the mortgagor)? And if the law does not impose on a receiver any duty towards the mortgagor adequate to protect the mortgagor ought the law to be changed so as to bring such a duty into existence? Is it these questions that this paper sets out to discuss?

II

A well drawn debenture will confer on a receiver wide-ranging powers but I propose first to consider separately the receiver's power of sale. Now where a mortgagee exercises his power of sale directly, without the intervention of a receiver, it is clear that such mortgagee while entitled to choose the moment to sell that suits him is under a duty to exercise reasonable care to obtain the proper or true market value of the property sold.²!

What then is the position if the sale is effected not by the secured creditor but by a receiver appointed by the secured creditor? In the New Zealand case of *Nelson Bros Ltd. v Nagle*³ Sir Michael Myers C.J. held that the receiver in that case owed like any other agent a duty to his principal (the debtor company) to

exercise due care skill and judgment in exercising his power of sale and get the best results reasonably possible in the circumstances, those circumstances including the fact that the sale was a forced one for the purpose of discharging the indebtedness of the debtor company. If this decision were accepted as an accurate and comprehensive statement of the law then the duty cast on a receiver exercising his power of sale would for all practical purposes be identical with that cast on a mortgagee exercising his power of sale. If this were the law one could have little or no quarrel with it.

But unfortunately there are two difficulties in the way of accepting the decision in the *Nelson Bros* case as a universally correct statement of a receiver's obligations. The first is the effect of the mortgagor's going into liquidation. A receiver being merely an agent appointed in a particular kind of way one would have thought that logically a receiver's powers like those of other agents of the company would come to an end on liquidation. But the courts influenced no doubt by the principle the liquidation or bankruptcy does not prevent a mortgagee's realising his security, have shrunk from so inconvenient a conclusion, and it seems clear that if a company goes into liquidation either before the receivership commences or during its course the receiver retains his powers.⁴ (The Macarthur committee (para. 385) rejected a submission by the Law Society that on liquidation the liquidator should supercede the receiver.) But while retaining his powers the receiver ceases on liquidation to be the agent of the mortgagor.⁵ Where then the company is in liquidation the basis for imposing a duty to the debtor company on the receiver adopted in the *Nelson Bros* case ceases to exist. Secondly there are subsequent English and Australian authorities which conflict with the decision in the *Nelson Bros* case. The issue in the case of *In re B. Johnson & Co (Builders) Ltd.*⁶ was whether a receiver was a "manager" or "officer" of the company within the meaning of the English section corresponding to our S.321 (the misfeasance section). It was held that he was not; in the course of their reasons for judgment there fell from the various members of the English Court of Appeal that decided the case observations that may be construed as negating the existence of a duty by a receiver to the debtor company. Thus Jenkins L.J. stated roundly "In a word, in the absence of fraud or mala fides . . . the company cannot complain of any act or omission of the receiver and manager provided that he does nothing that he is not empowered to do, and omits nothing that he is enjoined to do by the terms of his appointment".⁷ In the Victorian case of *Re Neon Signs (Australian) Ltd.*⁸ decided in 1964 the debtor companies sought an injunction restraining the receiver from disclosing to Claude Neon Limited a competitor and a potential purchaser certain particulars of the debtor company's business. An injunction was refused, the Judge holding that the proposed disclosure was a reasonable incident to the receiver's power of sale and that in the absence of any evidence of dishonest or reckless exercise of the powers of a receiver the Court will not interfere with the exercise of such powers notwithstanding any prejudice thereby suffered by unsecured creditors or shareholders of the debtor company.

There are grounds on which both these judgments can be criticized, but perhaps I have said enough to show first that the legal position is uncertain, and secondly that it is possible that the law could be held to be that the duty to the debtor company of a receiver in exercising his power of sale is no higher than a duty not to act dishonestly or recklessly. If it is the law that in exercising his

power of sale a receiver is under no more exacting a duty of care to the mortgagor than not to act recklessly, then we have the strange legal position that a mortgagee if he exercises his power of sale directly may be liable if he fails to use reasonable care; if he chooses to appoint a receiver that receiver is liable to the mortgagor only if the exercise of his power of sale his lack of care is so rash and heedless of the consequences as to amount to recklessness. Such a distinction is unjustifiable and absurd.

III.

Whether a receiver has any and if so what duty to the mortgagor in the exercise of his other powers is because of a lack of decided cases even less clear. Should the matter fall to be decided it would no doubt turn on which was preferred of the two approaches already referred to in relation to powers of sale. Has the receiver the same sort of duty to the mortgagor as any other agent? Or is the law correctly stated in those cases that indicate that the receiver's duty is no more than one not to act dishonestly or recklessly? The situation in relation to such matters as the preservation of goodwill and the completion of contract is of course complicated by the fact that the receiver will under S.345(2) be personally liable (but with a right of indemnity out of assets) for new contracts which he may enter into.

Let us take the purely hypothetical case of a receiver who chooses to abandon a building contract that if completed would yield \$200,000 to the mortgagor rather than incur liability for the \$20,000 necessary to effect completion. Considerations both of what the law is and of what it should be seem to me to give rise to a genuine dilemma of policy. On the one hand a receiver may argue that even if he is subject to the ordinary duties of an agent to his principal neither law nor common sense requires an agent to incur personal liabilities of this magnitude. The retort of the mortgagor would no doubt be that no-one is bound to accept appointment as a receiver, and that if the receiver is not prepared to stick his neck out he should not have taken the job on. If such a case as I have posed were ever to be litigated I would expect the Court to favour the approach that imposed on a receiver the duties of an agent and to regard the likelihood of the receiver's being effectively indemnified in the particular circumstances as a factor in deciding whether or not he had been in breach of his duty of care.

IV.

I mention two further matters for the sake of completeness. One is that it is arguable that the exercise by a receiver of his powers recklessly or for an ulterior motive may be attacked dishonestly. Thus in *McKendrick Glass Manufacturing Company Limited and anor. v Wilkinson and Ors*⁹ it was contended that a debtor company had a remedy on this ground where (so it was alleged) a receiver carried on the business of a glass company at a loss because the government requested this on grounds of public policy.

Secondly it is always open to a company by special resolution to require the Court under S.169 to appoint inspectors to investigate the affairs of a company. It has been held that the term "the affairs of a company" used in this section includes the conduct of a receivership¹⁰ so that this underemployed section offers marvellous scope to a company disgruntled with its receiver. But while the section provides a machinery to determine whether a receiver is in breach of his duties it is no help in deciding what those duties are.

V.

Assuming the law to be as I have indicated does it call for reform? It seems to me that for three reasons it plainly does. First the mere fact that the law is uncertain is an argument for clarifying legislation. Secondly if as may be the case the law imposes a higher duty on a mortgagee exercising a power of sale than on a receiver this difference cannot be justified. Thirdly and most importantly it seems to me that change is needed to protect the mortgagor company and those claiming under it. Surely the law should cast on a receiver a positive duty to preserve the assets of the debtor company to the extent that this is possible consistently with his duty to procure sufficient cash to pay out the debenture holder appointing him? It may well be that most chartered accountants appointed as receivers are sufficiently jealous of their reputations in the commercial community to perform their duties as receivers in a way that is fair as between the debenture-holder appointing them on the one hand and the debtor company and its unsecured creditors and shareholders on the other hand. But not all chartered accountants behave properly all the time; and not all receivers are chartered accountants. Speaking of the J.B.L. group on 5 October 1972 the then Minister of Justice Sir Roy Jack said "Substantial losses there will be, but there is reason to believe they will be much less than would have been the case if the fate of the group had been left to the receivers for the high priority creditors without the Government's appointing a receiver to deal with the overall position"¹¹ I am not protected by parliamentary privilege and I have no knowledge greater than that of the general public in relation to the J.B.L. affair so I must choose my words with care. My reason for referring to J.B.L. is this, that common sense suggests that if it be true of J.B.L. that unnecessary losses to unsecured creditors have been avoided by the appointment of a receiver charged with a duty to *all* creditors and investors in place of a receiver with a duty only to high-priority creditors then this is likely to be equally true of other more humble cases. There are I suspect many other receiverships where similar considerations apply and where unnecessary losses are incurred because receivers have been concerned only to pay out the debenture-holder appointing them without having regard to the effect of their actions on the company and its other creditors.

VI.

If it be correct that reform is needed precisely what change to the law should be made? It must be kept in mind that an important factor in the readiness of lenders to advance money on the security of debentures is the existence of the swift and simple remedy of appointing a receiver in the event of default. There would be no wisdom in so trammelling the powers of receivers as to make this form of security an unattractive one to lenders.

VII.

There are many different possible sorts of reform. One might be to enact that only chartered accountants might be appointed as receivers. I do not favour this. One might be to give the debtor company certain rights to be consulted in relation to the sale of any asset with a right to the debtor company to require a sale by auction. This would I think be excessively clumsy in practice. I think that probably all that is needed is the enactment of a provision spelling out in general (and because general perhaps to some extent question-begging) terms the duties of a receiver. Perhaps something along the lines of the following draft

section to be inserted by the Companies Act (which I proffer very humbly and tentatively) would do the trick:—

(i) A receiver or manager of the property of a company appointed under the powers contained in any instrument:—

(a) in exercising any power conferred on him by such instrument to sell all or any of the assets of such company may exercise such power of sale at such time as he may in his absolute and unfettered discretion choose but save as aforesaid shall in the exercise of such power of sale be under a duty to such company to take such steps as are reasonable in the circumstances to procure the true market value of such assets so sold.

and

(b) in exercising all or any of the other powers conferred on him by such instrument shall be under a duty to such company to preserve the assets including the goodwill of such company to the extent that this may be possible consistently with any duty such receiver or manager may have to pay to the person or persons entitled thereto the monies secured by the instrument pursuant to the powers contained wherein such receiver or manager was appointed.

(ii) Nothing in this section shall be so construed as to impose on a receiver or manager a duty to incur a personal liability in circumstances in which the exercise of his right to the indemnity referred to in section 345 subsection 2 is unlikely to result in the full amount of such personal liability being paid or satisfied.

(iii) A receiver or manager shall be subject to the duties imposed by this section notwithstanding the provisions of any agreement to the contrary.

1. See the judgment of Rigby L.J. in *Caskell v Gosling* [1896] 1 Q.B. 669 at p.691 ff.
2. *McHugh v Union Bank of Canada* [1913] A.C. 299; *Cuckmere Brick Co. Ltd. v Mutual Finance Limited*. [1971] Ch.949.
3. 1940 G.L.R. 507.
4. There is a useful discussion of the effect of liquidation on the position of a receiver in the unpublished University of Auckland thesis by B.J. McWilliams *The Law Relating to Receivers and Managers appointed by Debenture Holders*.
5. See *Gaskell v Gosling supra*.
6. [1955] Ch. 634.
7. p.662; and of *R. v Board of Trade* [1965] 1 Q.B.603.
8. [1965] V.R. 125.
9. [1965] N.Z.L.R. 717.
10. *R. v Board of Trade, supra*.
11. 381 N.Z.P.D. 3069.

COMMENTARY ON MR DUGDALE'S PAPER

by
K.S. Crawshaw

Mr Dugdale's paper has highlighted the points which have exercised the minds of all competent Receivers from time to time. In particular, as a Receiver, I have often asked myself 'What is my obligation to other creditors and to the Company? What do I do under a certain set of circumstances when there is nothing in the Act to guide me?'

Let me say at this stage that I consider a Receiver has a definite responsibility to third parties, my main reasons being -

(1) It is not a good practice to sell goods or assets for less than they are worth and the Receiver should make every effort to sell at a fair price.

(2) Although he has no direct responsibility to other creditors and to the company, the misfortunes that can befall these classes of individuals in a Receivership, should be heeded and although in many cases credit has been granted unwisely to the debtor company the Receiver should do his best to produce the best results for all parties.

(3) The cumulative effect of the business failure should not be overlooked. The failure of the debtor company to pay its creditors may in turn cause those creditors to fail, with an ever-increasing area of loss.

Every receivership must be treated according to the particular circumstances. Every one presents different problems and debenture holders should not overlook this fact when appointing Receivers.

The work is specialised and a competent Receiver is essential. I shall mention this later.

In many cases a Receiver, on his appointment, finds himself in a difficult position from the very start. He is not greeted like an old friend when he walks onto the premises, introduces himself to the proprietor, whom probably he has never met before and advises him that he has been appointed Receiver and that he will make the decisions from then on. The degree of co-operation received from management varies; sometimes it is complete, sometimes it is given grudgingly and sometimes it is completely absent. This is, I suppose, understandable, as the appointment of a Receiver has, on occasions, had a considerable emotional effect on a proprietor. As far as the Receiver is concerned, decisions have to be made - on some occasions major decisions - and made quickly, as all the time the business is continuing perhaps losses are increasing, wages are accruing, staff is getting restive, and more than likely the Receiver, while required to make these decisions urgently, is not in the possession of full information.

He must remember that his first duty is to the debenture holder who appointed him. He has been appointed to safeguard the interests of the debenture holder by protecting the property of the company which forms part of the security. How he does it - and we note from Mr Dugdale's paper that providing the Receiver does not act dishonestly or recklessly, he can virtually please himself - is up to the Receiver. He has to consider a number of factors

before making the decision whether to take the 'hatchet man' approach, close down the business, sell the available assets, satisfy the debenture and leave the wreckage; or adopt - and you will pardon the expression - 'the father image' and attempt to satisfy all parties.

The factors to be considered include the following :- (I have not listed these in any particular order) -

(1) The past trading history of the company and its present overall financial situation. Has the company traded profitably in the past? Has it a history of continuing losses?

(2) What are the reasons given by the company for its present predicament? Such as, a change in fashion, a shortage of supply of raw materials, a bad spell of weather, a fire - and so on.

(3) An evaluation of the ability or otherwise of the management of the company. It is interesting to note the comment in the Year Book regarding the causes of bankruptcy which in my opinion applies just as much to causes of any other business failure. It is stated in the Year Book 'Personal extravagance or business incompetence are probably much more important factors in the majority of cases'. Without adequate management, of course, it is not possible for the business to continue satisfactorily.

(4) The position disclosed by the last set of accounts of the company. Is it only a liquidity problem which can be resolved by effective action to reduce debtors or stocks, or realise on capital tied up in fixed assets by sale or re-financing?

(5) What is the comparison between the debenture holder's claims and the claims of other creditors? Very often claims of creditors other than the debenture holder are many times greater than those of the debenture holder who, in addition to his debenture, has personal security from the proprietor of the business.

(6) What is the company's position in the particular trade and what are the prospects of the trade itself? Is the company a leader in the field? Is the competition keen? Is the trade overful of suppliers? Is the trade experiencing depressed or boom conditions? What is the position regarding supply of raw materials? Is there any likelihood of the trade being affected by overseas conditions?

(7) What is the attitude of the company's creditors, are they sympathetic or antagonistic? Has action been commenced to collect accounts? How old are unpaid creditors' accounts? Is the situation likely to be complicated by say claims under the Liens Act, or by liquidation? With regard to liquidation, I would refer you to paragraphs 385 to 387 in the recently published report of the Companies Act Review Committee.

(8) What is the present value of work in progress, which, in some cases is the major asset of the company? Is it worth while continuing? What does the company's order book disclose? If the work in progress is worth completing, are the necessary finances available to do this?

(9) Has the company the expertise to rehabilitate itself? Are key staff available and will they stay? Is large capital expenditure necessary to improve results?

(10) What is the time element? Is it possible to rehabilitate the company within a reasonable time, remembering that although those concerned start with the best will in the world, working for the bank or for creditors for a long time would, I feel, be a soul-destroying situation, and is seldom successful.

(11) What is the attitude of the debenture holder? Is he prepared to leave funds in the business, or, if necessary, advance further funds during the period of rehabilitation?

(12) Will creditors benefit by postponement of the sale of assets until a certain time of the year?

(13) Should the business be carried on until a major contract is completed to obtain the best result for all concerned?

Finally, the Receiver must, as Mr Dugdale says, decide whether or not 'to stick his neck out', remembering his liability under Section 345(2) of the Companies Act.

Quite a formidable list, you will agree, and on occasions, I am completely in sympathy with the Receiver who takes the quick and easy way out. In some cases there is no alternative and in others the attitude of some creditors tends to make the Receiver unsympathetic.

The personal liability of a Receiver no doubt influences his decision in some cases and I feel that the provision of an indemnity over and above that provided by the value of the assets of a company could be of value. The indemnity could be either qualified or unqualified, say to cover costs involved in completing a certain contract and could be provided by the debenture holder or by a certain class of creditors, say those entitled to claim under the Liens Act on a certain contract, or by creditors as a whole, although trying to get creditors to agree to anything is an unenviable task and seems to become more difficult if they refer the matter to their legal advisers.

As Mr Dugdale says the law on the duties of Receivers is uncertain and I am fully in agreement with his proposition that change is needed to protect the mortgagor company and those claiming under it. As he points out in paragraph 7 of his paper, any change made must not react adversely to make security by debenture, which is a popular and effective method of raising finance so unattractive to lenders that it is replaced by some other form of arrangement, perhaps more unsatisfactory to the borrower.

A competent Receiver is essential and who better than a chartered accountant to do the job. At least, if negligence results the aggrieved party has recourse to the Society of Accountants. Perhaps an Official Receiver would be the answer. An individual, possibly a member of a firm of Chartered Accountants, licensed and bonded for the job; or perhaps an extension of the Official Assignee's Office, through the Justice Department. This latter course does not appeal as, in my opinion, a receivership is usually a fairly personal matter and is best left in the hands of private individual.

The suggestions made by Mr Dugdale in the final paragraph of his paper are, I consider, definitely worth considering, although I think that the Receiver would need rather more protection than that provided in his paragraph 1(a) and 1(b). How many times have I heard it said 'I could have got a better price than that'.

Recently published reports of the Companies Act Review Committee has also considered the question of Receivers and makes fourteen suggestions, some of the more important being -

(1) The provisions of a standard set of powers to cover all the ordinary needs of a Receiver and manager, such information to be incorporated in the Act. Similar provisions relating to liquidation are, of course, already in part 6 of the Act and this would no doubt be useful and would clarify many questions at present unanswered by the present Companies Act.

(2) The Receiver to have power to make calls if the security covers the uncalled capital. This appears to be an essential if the Receiver is to be able to carry out his task effectively.

(3) The Committee recommends that the appointment of the Receiver should be advertised in the Gazette and in local newspapers. This is necessary as all parties concerned in the financial affairs of the company should be advised. My suggestion would be that the requirement be extended so that the Receiver must give advice to all unsecured creditors of the company as soon as possible after his appointment.

(4) The Committee recommends that an interim statement be provided to the Receiver within 14 days of his appointment detailing the nature and whereabouts of the company's assets and whether or not they are subject to any charge or hire purchase agreement. It also recommends that the detailed statement of affairs be provided within one month after the provision of the interim statement. I agree that the interim statement would be of considerable value, but on some occasions I have no doubt that the time of one month allowed for the provision of the full statement could still be inadequate.

(5) The Committee disapproves of my previous comment regarding the provision of an indemnity for the Receiver.

(6) The introduction of a system of official management by a manager appointed by creditors is suggested. This would definitely fill a gap as at present the arranging of deeds of compromise, deeds of supervision, etc. is, on many occasions difficult and unsatisfactory. Such legislation would require careful drafting as it would appear to place a considerable responsibility on any manager so appointed. I consider that indemnities in this case would be essential. It would be necessary for the manager to report regularly to creditors or to a committee of creditors; it would be necessary for realistic fees to be paid to a manager, not like those in the Insolvency Act covering summary instalment orders. The manager would require considerable powers to ensure that he was not required to continue the business so that creditors, who have made one mistake in extending credit, did not become over-optimistic in the hope of recovering their accounts, while leaving the manager in an impossible situation.

(7) The Committee also recommends that the Receiver - but not the debenture holder - does not have to comply with Section 92 of the Property Law Act regarding the power of sale of the company's land. This would appear to be directly opposite to the views of Mr Dugdale.

In conclusion, I should like to say once again that the competent Receiver is not necessarily - as I have been called - 'the commercial undertaker' that he has an obligation, not only to the debenture holder, but to all parties concerned in the present situation of the company, but this obligation should be viewed in the light of the terms of his original appointment. If he is expected to fulfil his

obligation to all parties, those parties must co-operate fully with the Receiver and in their turn must do their best to produce the best overall result. I think the law should be rather more precise in defining the duties, powers and obligations of a Receiver and I feel that the points raised by Mr Dugdale, the recommendations made by the Companies Act Revision Committee and the suggestions that will no doubt emanate from this seminar, will go a long way towards achieving that end.

COMMENTARY ON MR DUGDALE'S PAPER

by
T.N. Johnston

We are indebted to Mr Dugdale for his succinct paper which is misleading only, I think, in the sense that it fails to reveal a good deal of research in stating in simple terms the author's conception of the law which is almost all to be found in decided cases. I only wish to touch in a haphazard fashion on one or two aspects of the opinion expressed by Mr Dugdale and to express my own reservations concerning the imposition of statutory duties on a Receiver as proposed by Mr Dugdale. It is important to remember that the development of commercial and industrial expansion is heavily dependent on *capital* from borrowing and that it is of great importance to commerce that well established practice in this area should not be interfered with. In any event, I take the view that the present state of the law is not unsatisfactory. I sympathise with the Receiver who looks to the statute law for definition of his duties. He will be a disappointed man for a Receiver's duties have evolved through the common law, the secrets and mysteries of which are for lawyers to unfold or which has the great capacity as we have all witnessed to unfold and develop with changing times.

May I briefly take a closer look at the law concerning the duties owed to third parties *by a Receiver* but first let me emphasise that there is a difference well understood by lawyers and not by the commercial world, between a Receiver simpliciter and a Receiver and Manager on the other hand. The appointment of a bare Receiver these days is really an extremely rare affair. One only has to look at a typical modern debenture and the extensive powers therein to a Receiver to carry on the company's business to realise that almost every appointment of a Receiver these days is really an appointment as Manager as well.

You regard a Receiver as a pure mortgagee in relation to a specific asset — say land. The duties of such an appointee are much more confined than those of a Receiver and Manager. He takes possession of the asset concerned and it is probably correct to say that so long as he operates in good faith and without fraud but with some proper regard to the benefit of all concerned — mortgagor and mortgagee — his sale of that property may not be reviewed.

However, modern debentures do not generally confine themselves to specific assets such as land and improvements, but embrace the entire undertaking — goodwill, book debts, the lot.

A very strong Court of Appeal, in 1912 — *Newdigate Colliery Limited* 1912 1 Ch. 468 — drew attention to the distinction and the judgments merit careful study.

The judgments all demonstrate that a Receiver and Manager of a company's undertaking have a duty to preserve and to protect the goodwill and business and to guard against taking steps which may destroy the business when it may be that the company its shareholders and other creditors have a real interest in the equity of redemption.

Lord Justice Buckley said of the Receiver and Manager whose debenture holder's security included the undertaking —

"It is his duty to do and our business to see that he does everything reasonable and right for the protection of the property as an undertaking for the benefit of all the persons interested in it."

3. It must also be remembered that a Receiver may be appointed in two ways — either by the debenture holder himself in which case he is usually for good reason I may say, the agent of the company *OR* the debenture holder may ask that he be appointed by the Court — in which case he becomes an officer of the Court and acts under its authority and not as agent of the company.

Newdigates case was dealing with a Court appointed Receiver and so the Court had the jurisdiction to watch the interests of all.

What of a Receiver appointed by debenture holders?

In the Board of Trade case referred to by Mr Dugdale the Court had no hesitation in concluding that such a Receiver and Manager of the undertaking had, *as agent of the Company*, at least the same duty to all concerned as the Court appointed Receiver.

The question was asked — Could the Receiver and Manager play ducks and drakes with the Company's affairs without regard to the interests of shareholders and the clear answer was in the negative.

"I cannot think that a company of *whose undertaking* a Receiver and Manager has been appointed ceases to be commercially and materially concerned with the business he conducts and transactions he enters into which affect, or are capable of affecting, its future trading prospects goodwill or financial position."

Accordingly, in my view the law is not so alarming as is suggested and provides the correct balance of the interests of secured creditors which must of course be paramount, and the interests of others. The source of the confusion is, I think, the failure to distinguish between a pure Receiver and a Receiver and Manager.

4. I wish to make a brief mention (briefer still since hearing Mr Crawshaw earlier) of the recommendations of the MacArthur Committee on the review of the Companies Act in relation to Receivers. In what cannot be called an inspiring radical or reformist report the Committee in two brief paragraphs refer to the question of the Receiver's personal liability. The Accountants Society which undoubtedly holds the view as I do that Receivers have a duty wider than one to their appointer only, recommend strongly that the Companies Act confer the same sort of power on the Court to grant relief for breach of duty as is presently available to auditors or officers under the present Section 468 but this reasonable request has fallen on deaf ears partly on the mistaken grounds it seems to me, that there is no duty owed to the Company. I say mistaken

because it cannot be assumed that the common law does not impose the wider duty that I have attempted to show and I would have expected much more consideration to the request of the Accountants. They asked for no more than that the Court could grant relief and this it seems to me, would be of considerable benefit to all. Receivers would have more flexibility and would have encouragement to trade out. Such a reform would in my view be appropriate and go some distance to encourage a Receiver to trade out rather than to realise with all possible speed.

5. Even if the law is not as I have suggested, can I briefly mention other protections there are for the shareholders and unsecured creditors and what changes there could be without attempting to define the duties of a Receiver by Statute.

FIRST Could I mention the recommendation of the MacArthur Committee as to official management pp. 177 and 178 of the report.

This is novel to New Zealand but briefly provides for the control of an insolvent company by creditors through official Managers. It has the strong support of the Bankers Association and is designed to provide further protection to unsecured creditors.

The official Managers take possession of all property and run the company for the benefit of members and creditors and all actions are stayed.

Time does not permit me to go into further detail but it has the full recommendation of the MacArthur Committee and makes available a third alternative to Receivership and winding up.

SECONDLY There is the Section 169 referred to by Mr Dugdale providing for the company to require the Court to appoint inspectors and in my view in the light of the Board of Trade case there is every scope under this for scrutiny of the conduct of the Receiver.

THIRDLY I referred earlier to Court appointed Receivers. The Courts have for a very long time had jurisdiction at the instance of debenture holders to appoint a Receiver who is an officer of the Court and there is no doubt on the authorities that a Court appointed Receiver and Manager has duties to all concerned and the Courts have consistently refused to give their Receiver permission to take a step for the benefit of debenture holders but to the detriment of the company and other creditors. Newdigates case is typical and a powerful illustration of this.

It is in this area that I would prefer to see the law amended so that the Court would have jurisdiction *at the instigation of shareholders or unsecured creditors* to appoint a Receiver and Manager at any time after the appointment by debenture holder and to supersede the latter. In other words once a Receiver was appointed by a debenture holder it would be possible to have this appointment replaced by a court appointment. This would ensure that all concerned share in the duties owed by the Receiver and would avoid precipitate action by the out of Court Receiver. No alteration of the right of the secured creditor to be paid first would be involved.

FINALLY We cannot ignore the very powerful executive weapon that has already been exercised in New Zealand in the JBL case where under the Companies Special Investigations Act 1958 the administration may swiftly appoint an official Receiver.

To me such items including provision for a specially appointed Court Receiver as earlier referred to provide the means of ensuring adequate protection to the equity holders against the over-eager Receiver, if the common law does not do so already.

COMMENTARY ON MR DUGDALE'S PAPER

by
R. Dwyer

I would have thought in the circumstances of prepared reports and especially by those of the commentators that it would have been more appropriate to have someone here to read Mr Muldoon's remarks rather than ask me yesterday to come up and act in his place. It was a pleasure in some ways, Mr Dugdale, to be handed a copy of your address when I was met so pleasantly at the airport and to be able to read it on the drive into town, arriving five minutes after we were expected to start the session.

Page 1, last paragraph, 3rd line down:

"Is it his sole legal duty to raise enough cash to pay out the appointing debenture holder?"

When you talk of a Receiver raising cash you talk about a Receiver borrowing. A Receiver's liability ranks ahead of a debenture holder's debt. We have seen recently a Receiver raising \$1,000,000. This comes after a duty to discharge prior mortgages over land and mortgages over chattels.

Mr Dugdale and so many others talk about the correct moment to sell and what is the true market value of the property sold. Over 20 years I cannot give you the answer to that. Many many times we have put up assets for sale at auction and they have not reached the reserve.

Where a property (a factory) ranges from \$113,000 to possibly \$120,000 to a possible maximum of \$125,000, what is the market value? You ask the auctioneer to come along. They say we can only get this if we spend \$2,000 on advertising and commission is 5% on the first \$1,000 and 2½% on the balance. This means on a sale at auction of \$125,000 the Receiver will get \$14,850 after repayment of mortgages whereas if he sells for \$120,000 the Receiver will get \$15,000. Quite obviously the Receiver should give the benefit of the sale to the party who is prepared to pay \$120,000 but the true market value is thought to be \$125,000. But the Receiver would be worse off because of the advertising and the commission. To get the best results I say we should spell out what is the best result. You just cannot define these terms.

Well, of course, if anybody says that a liquidator should supercede a Receiver you are going to have so many Receiverships throughout the country it won't be anybody's business. And what is the definition of being "rash and reckless"? I challenge Mr Dugdale to define those words, particularly in the context of receivership. What do you do when you are losing \$1,000 a week in a

receivership and what do you do when you watch this particular receivership run month after month after month. It is immediately put on the market as a going concern. It is looked at by a creditor (\$19,000) wanting to take it over. Others investigate it — no offers. It is eventually sold — after months of negotiations. The mortgages total \$105,000, the debenture holder \$60,000, the Receiver's overdraft \$40,000, Receiver's creditors \$30,000. Stock and work in progress are around \$100,000 — at auction or tender, possibly \$10,000.

Is the Receiver reckless carrying on that business? Of course. He should have closed the door the moment he went in. It is a small miracle and if the Receiver does not believe in the Almighty he should put the Almighty in this fair city of yours.

You talk of goodwill. A Receiver can create goodwill by administering where there are areas of profit. He could go the way of bold modern American technique. You start off by saying you want a return on your investment of 15% and you work backwards. You work out your costs. You finish up with an end product of plant. You say capitalise that. That is value of the plant. You have blown the value of the plant sky high. You have made a decent profit but what about the idiots who are buying?

The question of being personally liable for new contracts and the possibility of being liable in damages if forced to abandon those contracts, raises the question of being indemnified out of the assets. What are these assets? In some cases they are virtually non-existent.

I have been met in a Rover car, on lease. These assets that demonstrate such great wealth. Behind us there is no wealth at all. Nothing. Only one type of contract to take on; that is a profitable contract. Only one type of practice to adopt is one that contains a foreseeable right of lien and not force the Receiver to adopt responsibility for which in many cases he could have been liable.

I have never yet asked to be indemnified by my bank debenture holder and I am strongly against indemnity.

Recently in the building industry it was urged on me to complete a contract. One was a 2nd class lien, the other a 1st class lien, but they would indemnify me from the costs of completion of the contract. With some reluctance I said that if the contract would be completed at a profit or minimal loss I would accept their indemnity. If I had adopted that contract I would have lost \$40,000. That loss possibly could have been reduced to \$30,000. Would you have liked me, if I had a separate bank account for that contract, would you have liked me to run up an overdraft of \$56,000 at the most, and after the maintenance period when I received \$16,000 I presented you across the board with a loss of at least \$30,000. Ladies and gentlemen even \$5,000 is not justified. It can be demonstrated over and over again that the easiest thing in the world to do is talk about contracts that could have been profitable. There is no contract in the ordinary course of business that can go from loss to loss. We have talked about work in progress. Work in progress expressed as a percentage of sales in the building industry is an extremely important consideration. I will give you a case where in the previous accounting period this was 8.5; twelve months later it had leapt to 15.8. Comparable figures but with much larger contracts starting in 1968 were 9.93, 1969 8.08, 1970 8.33, 1971 12.59.

You might say it, I criticised 1971 figure not really because those are good solid figures from a company which has consistently made profits. But I had

compared 1971 figure with sales of \$14,500,000 in 1970, \$16,900,000 in 1971. I say on that basis I would not expect the figures to be the same.

Earlier figures: In 1968 \$13.2 million, 1969 \$14.1 million, 1970 \$14.48 million.

In another receivership again in the construction industry — the thing is crazy — nominal capital \$2,000, shareholders owe their company \$2,900 accumulated losses \$12,800, sales for work in progress: 1970 17.92%, 1971 23.60%. They showed a profit but that profit was not there. 1972 15.31% losses. They have stock on their books of \$14,800. People who come to look say it is lucky if it is worth \$400. Stock includes shutters at \$12,000 which are usually written off on the contract. In my opinion The Wages Protection and Contractors' Liens Act should be torn up.

If more emphasis on this paper had been given to what is the cause of the receivership than to the legalities of the receivership you would get a more telling message.

Go through the assets of any limited liability company and consider stock. How much is obsolescent or out of fashion? In a dairy — tobacco that is aged is no good. It is rubbish. If you asked the grocer-candy business, when they are being valued merchants know from the actual tins of biscuits how old they are. Now, fashion goods. I was appointed a Receiver in a company that manufactured women's coats and skirts. Solicitors acting for major shareholder pleaded with the bank (no lawyer can direct the debenture holder) pleaded, there should not be a precipitate sale. It only cost the bank and the guarantor a lot of money for not having the precipitate sale because the garments were out of fashion and a crash sale would have got much more.

There has been so much said this afternoon about precedents and even going to Court. The Court is probably the last place in the world you should go to. I have seen the Court hold up proceedings to have the company wound up for 15-18 months and we had to go back and back and in the judgment it was said by the learned judge that the Receiver was most difficult, but of course he could not be challenged because he did not complete the building contract.

The company had half yearly accounts — for the sake of argument \$7,500 for the half year. In the full year it showed a profit of say \$3,000, so of course you do not have to be a magician, you say you have lost \$4,500 in the last six months and you cannot dispute that. You have got to look at these things quickly. You have to work out the position in turnover in regard to saleability. It has to be looked at in the terms of the contract. I refused to adopt the contract. The Court thought I was being obstructive. The managing director and his foreman went into partnership. The owner wanted to consult his solicitors before giving formal approval. The solicitors said we do not advise you to accept completion of this contract by this managing director and his foreman, so the owner came back and said to me, explain the position. I knew quite well that it was his decision and you should not interfere with it, but I also knew that there had been this expectation from what he had said to us that he would consent to it. So I went to the accountant (the secretary) of the company and said — you have always said throughout the course of this receivership (7 to 8 weeks) they were really worthwhile and could make profits. You guarantee completion of this particular contract only. It is no use saying you believe in profitability and expect the Receiver to take the responsibility. The accountant had to guarantee

the bank overdraft. They were to account to the Receiver at the completion of the contract for the value of the work in progress. Needless to say they did not account for work in progress. They made a loss. The bank overdraft was not paid. The managing director left the country. The foreman went bankrupt, and there was nothing for the creditors.

Please be practical.

Receivership of millinery. They name a valuer. Valuer said the stock was worth nothing. He worked it out. didn't even charge a fee. Alright, what do you do? A man who knew nothing about millinery, had a shop in a good position where there was a good traffic count, he sold the millinery. The experienced are not always right. It must mean that you act recklessly where you are not orthodox and get value for assets where experts say there is no value.

Question to Mr Dwyer:

What is the responsibility to answer to creditors?

Reply:

Order of priorities in relation to the debenture holder, sales tax, specifically secured creditors and unfortunately now you have P.A.Y.E. deductions and electricity ahead of the debenture holder, bills of sale, leases, mortgages, liens.

Next priority is creditors of the Receiver, then you have Receiver's overdraft. No matter what the bank might say or the debenture holder might say, the creditors of the Receiver rate equally with the Receiver's overdraft but in my coin they come ahead. After repayment of the debenture debt plus interest, come the unsecured creditors and last but not least, the shareholders.