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RECEIVERS

The Receiver on the Run

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THE RECEIVER ON THE RUN

In the early stages of any receivership the receiver is rather like a house surgeon in the casualty department of a busy city hospital. The patient is placed before him on a moment's notice. His diagnosis must be swift and accurate.

The patient may be bleeding from a multitude of wounds; his bones may be broken; his brain is possibly damaged; and he will unquestionably be in a state of shock.

Both the receiver and the house surgeon must make immediate endeavours to stabilise the patient's condition. To begin the long march towards either remission or death!

In considering the concept of corporate death, it has not been unusual in commercial circles for the receiver to be thought of as a corporate undertaker, although this role fits more closely over the shoulders of liquidators.

In reflecting on the negative role given to receivers, I am reminded of a story told by a former president of the Australian Society of Accountants, Mr Jim Jamison who became known internationally as a result of the Mineral Securities Limited, Mainline Corporation Limited and Patrick Partners disasters.

He was a partner of a leading firm of auditors and like most of us, was fairly flexible in his professional life. He was in fact the review partner on the audit of a major Australian company. As part of this function he had arranged with the partner in charge of that job to visit the client to discuss the completion of the current year's audit. It was a time of economic recession in Australia and the audit client was suffering more than its share of solvency problems.

The financial director of the client when he heard that Jim Jamison was going to visit said: "For God's sake bring him in the back door. If any of our creditors see him coming here, they will think we have failed."

The appointment of a receiver will be the final link in a long chain of disasters, broken promises and ill considered decisions. It will not eliminate the underlying causes that have given rise to the receivership.

### Underlying Causes

Why does a company go into receivership? We all know the legal reason - the enforcement by a debenture holder of his security. But the underlying reason is generally mismanagement of financial and other resources.

The receiver is likely to find all the effects of over-trading and under-capitalisation; of inexperienced or incompetent management; and in rare cases, of simple misappropriation of the company's funds. In present economic conditions, there may have been no more than excessive optimism and a refusal to face economic reality.

In almost every case the receiver can expect to find poor financial records, no system of effective budgetary and financial control and inadequate costing systems.

And it is likely not only that the goodwill of every supplier to the company has been exhausted but also that problems of supply and manufacture have alienated every customer.

### Why Trade?

With this background of inadequate records, insolvency and outright hostility why then will a receiver make the decision to continue to trade?

In the initial days following his appointment, the receiver must establish a clear identity of interest with the objectives of the debenture holder. The debenture holder will expect the receiver to exercise his judgement as to the course of action to be taken in realising the security. It is possible that this may involve carrying on the business in order to maximise the realisation values.

The resources of a trading company include not only plant, equipment, stocks and so on, but also the specialised skills of management and staff. All these resources can be dissipated and lost in a forced sale situation.

The receiver is working with a very delicate balance. On the one hand he is endeavouring to obtain a sale on a going concern basis and is therefore obliged to carry on business, on the other hand he is operating a business which is unlikely to be trading profitably in the initial stages of his receivership.

He must balance the additional cash he obtains from a going concern sale against the money he may dissipate in unprofitable trading. His unit of measurement is the net cash recovered.

It follows that he will be operating within a limited time scale unless he can achieve profitable trading. It should be noted that it is very rare for a company to be "traded out" of receivership.

In this whole context of carrying on business, I would like to quote from an article by Mr Rupert Nicholson, who was the receiver of Rolls-Royce Limited. In this article he said:

"A receiver is not concerned, until the latter stages, with the trading and profit and loss account, as his primary duty is to ensure that he gets value for all his expenditure. This means that propositions have to be judged on a cash-flow basis.

"If by utilising materials and finishing off work in progress in existence at the time of his appointment, he can recover in the selling price a sum which exceeds his wages, out of pockets costs and the scrap value of the raw materials used, he has shown a cash surplus and he is not concerned with the book values.

"In pursuing this concept, a receiver must be quite sure of his facts. He must not drift into a contract which he could have refused to carry out, only to find that his expenditure exceeds his income which may become blocked in some way. A question which a receiver and his staff must continually be asking themselves is : Do we get the money back?"

The concepts discussed by Mr Nicholson are of particular relevance in contracting companies. The effect of the operation of the Wages Protection and Contractors Liens Act is such that the receiver is generally defeated by the Liens before he can even begin.

If he chooses to attempt to carry on a particular contract then the receiver must :

- reach an accommodation with sub-contractors arranging for them to set aside their liens so that the contract can be continued
- obtain an accurate assessment of the current position of the contract, of the likely costs of completion, and the expected final profitability. To do this the receiver requires the services of a skilled, swift and accurate quantity surveyor
- negotiate with the owner or the principal contractor on the completion of the contract
- be certain that the resources available are such that the contract can be completed efficiently and economically.

In practice unless the contract is close to completion the organisational and liens problems are so great that the receiver can be little more than a passive observer. In such cases his interest in the contract is restricted to any balance remaining after the liens and the costs of completion by either the owner or the principal contractor are charged against any balance due.

### Management Steps

Once a decision is made to continue to operate a business in receivership the receiver must take not only the debenture holder into his confidence but also the major unsecured creditors. This can best be achieved by arranging a special meeting with the major unsecured creditors and by asking them to nominate a three or four man advisory committee.

The decision to continue will have been reached after a rapid organisational and financial review.

The appointment of a receiver does not eliminate the underlying causes of the problems of the company, although it does sometimes create a breathing space.

If management was inadequate before receivership it will still be inadequate after receivership, although the receiver who is effectively the chief executive of the company, can sometimes assist in strengthening the skills available. In general terms it is often necessary to replace the upper level of management and this can cause problems because of the receiver's inability to offer any security to any new employee.

As part of the initial organisational review specific short term trading objectives must be set and these objectives will be converted into short term financial targets.

The appointment of a receiver has the effect of freezing the debts due to unsecured creditors and therefore funds arising from the conversion of stock and debtors into cash, are sometimes available to provide initial working capital.

In the very short term it will be necessary for the receiver to arrange for some standby funds either by way of overdraft or specific loan from the debenture holder. And in arranging these funds the receiver must be sure that he is covered by the assets of the company and does not place his personal liability at risk.

### Personal Liability

The whole question of personal liability is one of the most onerous aspects of receiverships. A receiver does have personal liability on all his contracts and on all orders placed with suppliers for goods and services even if they are entered into in the name of the company.

In the case of orders for goods and services, it is impossible for the receiver to contract out of or limit his personal liability. He must therefore, be quite sure when placing orders that his indemnity against the assets of the receivership in terms of Section 345(2) of the Companies Act 1955 is completely effective - ie that those assets will cover the orders being placed.

Where the receiver enters into specific contracts of a longer term nature, he must ensure that he contracts with the other party on the basis that his liability is limited to the assets in his hands. If this is not possible, then either he does not enter into the contract or he ensures that his liability is covered by an indemnity from the debenture holder.

If it is the wish of the debenture holder that the receiver continues to operate the company, or even if the debenture holder accepts the receiver's recommendation to continue the business, then the debenture holder must be prepared to provide a fair and reasonable indemnity for his receiver. If the debenture holder is prepared to rely on the judgement of the receiver, then the debenture holder must also be prepared to back that judgement with an indemnity.

#### Day-to-Day Control

Once the decision is taken to continue trading with a specific objective in view, then it is equally important for adequate control to be exercised. It will be achieved by the receiver through his own staff and through the operating staff of the company in receivership and to exercise this control, it will be necessary to :

- prepare detailed operating and cash budgets. Because of the time factors, these budgets must be prepared, in my opinion, in weekly segments
- obtain timely reports against those budgets to monitor the performance of the company against the targets which have been set
- hold regular meetings with the operating staff of the company to review performance and to plan future decisions.

In the initial stages of the receivership, objectives will be set on a short term basis but once the affairs of the company are brought under control, longer term planning can be implemented. One effect of the monitoring process may be to indicate that the effect of continuing the company will be to produce a negative cash effect and therefore, the objective of the company may rapidly become its early demise.

The receiver in a trading situation must be flexible, must be informed and must be prepared to act quickly to safeguard the assets. The receiver in a trading situation can only operate if he has the complete goodwill, not only of his debenture holder but also of the unsecured creditors.

If he loses the goodwill of creditors then he risks the issue of a notice in terms of Section 218 of the Companies Act 1955 and the eventual presentation of a winding-up petition to the Supreme Court.

Without the support of the unsecured creditors he has little defence to prevent the Court making a winding-up order and effecting the cancellation of his agency.

### Methods of Sale

The receiver has a duty to take reasonable care to obtain a proper price for the assets under his control. He must endeavour to realise those assets to the best advantage and this may imply some selectivity as to the method of sale adopted.

He can endeavour to obtain a sale on a going concern basis but this will not stop him identifying redundant assets and selling them off on a piecemeal basis. To achieve a going concern basis of sale, he must reach the widest possible public and this may involve newspaper and trade journal advertising; placing the business with the widest possible range of land agents and other specialists; and also circularising members of related trade associations.

A going concern basis of sale does not necessarily imply a competitive tendering situation but may in fact, involve the sale by private treaty - the negotiation on a horse trading basis of a satisfactory price with the prospective purchaser. If the going concern basis of sale fails then the receiver has no other option but to auction the assets or to sell them by tender. A good auctioneer can often achieve much more satisfactory realisations than a sale by tender approach, although the nature of the assets will often determine the approach to be adopted.

It of course, does not follow that the receiver will accept the best price tendered, as in many cases the advertisement of a sale by tender seems to be the signal for the bargain hunters to attack.

If the tender offer is unsuccessful, and the auction approach is not available, then the only other alternative available is to place the plant and equipment with specialist dealers for sale on a commission basis.

In presenting this paper I have endeavoured to give some idea of the approach a receiver should take to a continuing receivership and of the problems he is likely to experience.



A receiver in a continuing situation is always at risk. He has chosen to exercise his judgment in terms of the best facts available to him. But he may find that the facts he was given were incorrect and therefore he must be flexible and react quickly to the day to day situation.

If he is successful he will have the satisfaction of achieving the best recovery possible both for his debenture holder and for the unsecured creditors but if he is unsuccessful he places his own professional reputation at risk.