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LIQUIDATORS

The Powers and Duties of Liquidators

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THE POWERS AND DUTIES OF LIQUIDATORS

A Liquidator is a creature of statute whose task it is to put to rest the body of another creature of statute. The statute concerned, namely the Companies Act 1955, does not give any definition of the office but, rather deals in considerable length with the mode of his appointment, his powers and duties.

A company may either be wound up by the Court if any of the circumstances specified in Section 217 of the Companies Act 1955 (the Act) apply or it may be wound up if any of the circumstances specified in Section 268 of the Act apply. The latter type of winding up is known as a voluntary winding up and generally arises through a special resolution that the company be wound up voluntarily or, alternatively, "by extraordinary resolution to the effect that it cannot by reason of its liabilities continue its business, and that it is advisable to wind up". In a Court winding up an application on whatever grounds may be applicable, generally an inability to pay its debts, is made by petition to the Supreme Court and the winding up commences from the date upon which the petition is filed if an order is made on that petition. In a voluntary winding up the winding up commences on the date on which the appropriate resolution is passed.

In the case of a voluntary winding up, the company, from the date on which the Resolution is passed, is to cease to carry on its business "except so far as may be required for the beneficial winding up thereof" Section 271. This section provides that the corporate state and powers of the company continue until it is dissolved i.e. the winding up is completed, unless, the winding up is stayed pursuant to the powers of the Court under Section 250 of the Act. Although Section 271 of the Act applies to a voluntary winding up, in the case of a Court winding up the Liquidator's powers to carry on the business of the company are limited to those which "may be necessary for the beneficial winding up thereof" Section 240 (1)(b).

In a Court winding up the Liquidator is an officer of the Court. As such, his masters are the Court and the Minister of Justice (Section 245). As an officer of the Court the Liquidator must act in a "high minded" manner and must deal fairly.

In Re Tyler 1907 1 KB 865 it was held that the rule established some years earlier in Ex Parte James to the effect that a Court of Chancery will not allow its officer, the trustee in bankruptcy, to retain moneys for distribution amongst the creditors, where it would be contrary to fair dealing to do so was not confined to the case of money paid under a mistake of law, but was of general application.

In this case Vaughan Williams L.J. said, "I know it is said that it opens the door dangerously wide when you allow the Court or its officer to order money to be repaid in a case where there is no legal right of recovery; but it must be remembered that ... the discretion must be acted on on judicial principles." This decision has been applied in New Zealand in In Re Horton 1925 NZLR 739.

This principle, the principle of fair dealing, is one essential difference between the position of a Liquidator in a Court winding up and that of a Liquidator in a voluntary winding up.

A Court Appointed Liquidator is not personally liable on his contracts as is the case with a Receiver appointed by the Court. Stead Hazel & Co. v. Cooper [1933] 1 KB 840. Here it was held that the Liquidator was an agent of the Company to act in the interests of the Company whilst a Court Appointed Receiver was to act in the interests of the Debenture Holder.

The position of a Liquidator in a voluntary winding up is somewhat uncertain. This question is of relevance when considering whether or not a Liquidator is liable to suffer

the penalties imposed upon officers of the company by various sections in the Companies Act and whether he is entitled to the relief afforded by Section 468 of the Act pursuant to which the Court is entitled to grant relief in certain cases to officers or auditors of companies.

The editors of Anderson and Dalgleish suggest in their notes to Section 32] of the Act, that is the section dealing with the power of the Court to assess damages against delinquent directors, managers, liquidators or officers of the company, that a liquidator is not entitled to the benefit of the Court's discretion under Section 468 and in support of that contention reference is made to Windsor Steam Coal Co. (1901) Limited [1928] Ch.609 and [1929] 1 Ch. 151. It should be noted that whereas section 32], the penal section, specifically refers to liquidators as well as officers of the company Section 468 merely refers to officers and auditors.

However, in Re X Company Limited [1902] 2 Ch. 92 Parker J. was prepared to hold that a liquidator was an officer of the company and therefore might be liable to penalties for failing to pay stamp duty. The Editor of Buckley also considered that on the strength of that case and on the strength also of the same case cited by the Editors of Anderson and Dalgleish that a Liquidator would be entitled to the benefit of the English equivalent of our Section 468.

The question of whether the Liquidator is an officer of the company and, accordingly, entitled to relief, must remain unsettled.

A succinct general statement of the powers and duties of liquidators is contained in Palmers Company Law Vol.] 22nd Ed. 8] - 34. "The Liquidator's principal duties - speaking generally - are to take possession of and protect the assets, to make out the requisite lists of contributors and of creditors, to have disputed cases adjudicated upon,

to realise the assets subject to the control of the committee of inspection (if any) in certain matter, and to apply the proceeds in payment of the company's debts and liabilities, in due course of administration, and, having done that, to divide the surplus amongst the contributories and to adjust their rights."

A recent judicial pronouncement as to the general powers and duties of a liquidator is contained in Lord Diplock's judgment in Ayerrot v. C. & K. (Construction) Limited]975 3 WLR]6 House of Lords Lord Diplock P.20.

"Upon the making of a Winding Up Order:

(1) The custody and control of all the property and choses in action of the company are transferred from those persons who were entitled under the Memorandum and Articles of Association to manage its affairs on its behalf, to a Liquidator charged with the statutory duty of dealing with the company's assets in accordance with the company's assets in accordance with the statutory scheme. Any disposition of the property of the company otherwise than by the Liquidator is void.

(2) The statutory duty of the Liquidator is to collect the assets of the company and apply them in discharge of its liabilities ...

(3) All powers of dealing with the company's assets, ... are exercisable by the Liquidator for the benefit of those persons only who are entitled to share in the proceeds of realization of the assets under the statutory scheme the company itself as a legal person, distinct from its members, can never be entitled to any part of the proceeds ..."

Does the Liquidator have the powers of the Directors prior to liquidation?

In Re Farrow's Bank Limited]92] 2 Ch.]64 Lord Sterndale M.R. stated that the Liquidator, "is put there to do the act which the directors of the company did before their powers ceased: with this restriction, of course, that is all that he does he must have regard to the interests

of the creditors of the company."

In Re Country Traders Distributors Limited [1974] 2 NSWLR 135 Mahoney J. considered whether a Liquidator in a Court winding up had the power to sign a statement required in connection with a takeover offer which was being made for the shares of the company in liquidation. It was argued that the Liquidator's powers were limited to those specified in the Companies Act. His Honour without citing authority for the proposition came to the conclusion that "where a liquidator is appointed by the Court to wind up a company and the statute imposes an obligation ... and having the public purpose which is obvious from the nature of that obligation and that obligation is imposed on the company, then, whatever be otherwise the limits of his power in a particular case, the power of the liquidator extends, in my view, to do whatever is necessary to cause a company to carry out its statutory obligations".

The Liquidator does not have, in administering the 'statutory scheme' any powers other than those specifically conferred upon him by the Companies Act with, perhaps, the duty to ensure that after liquidation, the company carries out its statutory obligations.

Except to the extent that the liquidator enjoys the powers of the directors in carrying on the business of the company to the extent that it may be necessary to do so for the beneficial winding up of the company and except also to the extent that Section 240 (2)(h) which empowers the Liquidator "to do all such other things as may be necessary for winding up the affairs of the company" extends the statutory powers it is suggested that Lord Sterndale's statement is not sustainable. Mahoney J. although citing the statement appears to have placed little reliance on it.

In considering the power of the liquidator to carry on business the attitude of the Courts, over the years has been consistent.

In Re Wreck Recovery and Salvage Company]5 Ch. D 353 Jessel M.R. stated that "necessary meant more than beneficial. The business must be continued for the purposes of its winding up and not its continuance. Here the liquidator was seeking to continue the business of the company in an attempt to resuscitate it. However, His Honour expressly did not limit the power of the liquidator to carry on the business of the company with a view to its sale as a going concern. In the same case Thesiger L. J. said, "We are not to take 'necessary' as importing an absolutely compelling force, but what might be called a mercantile necessity, something which would be highly expedient under all the circumstances of the case for the beneficial winding up."

In Re Great Eastern Electric Co. Ltd [1941] Ch. 241 in a Members Voluntary Liquidation the Liquidator traded with such lack of success that he was unable to pay his own creditors. However his problems arose in part from the outbreak of the Second World War which he had not forseen. The Liquidator's decision to carry on the business was only "vaguely challenged". It was held that no objective standard could be set up after the event to test the liquidator's decision. It was sufficient if the liquidator bona fide and reasonably formed the opinion that the carrying on of the business was necessary for the beneficial winding up of the company. This was necessary for the beneficial winding up of the company. This case marks the high water mark of the liquidator's powers. It is probably relevant that this was a Members Voluntary winding up.

In Willis v Association of Universities of the British Commonwealth [1965] 1 QB 140 (CA) there is some qualification placed on the freedom of the liquidator. Salmon L.J. endorsed, the suggestion that "the only legitimate benefit that carrying on a business can confer upon a winding up is a financial benefit; ie. unless the carrying on of the business is requisite in order to collect a debt or realise an asset, it is prohibited."

It should be noted that before the liquidator carries on the business of the company he must obtain the sanction of either the Court or Committee of Inspection in the case of the Court winding up but that he may exercise that power without any sanction in the case of a voluntary winding up. In a winding up by the Court see Rule]52 Companies (Winding Up) Rules]956.

Costs incurred by the liquidator in carrying on the business of the company are costs of the liquidation and should be paid ahead of preliquidation creditors. Accordingly, where a liquidator retains possession of leasehold premises, "for the purpose of carrying on the business so as to gain benefit for the estate"

The rent accruing after the commencement of the liquidation will be a cost in the liquidation. As Lindley L.J. said in Oaks Pit Colliery Case (1882) 21 Ch. D322"
" ... as to rent accruing after the commencement of the winding up. If the liquidator has retained possession for the purposes of the winding up, or if he has used the property for carrying on the company's business, or has kept the property in order to sell it or to do the best he can with it, the Landlord will be allowed to distrain for rent which has become due since the winding up ... but if he has kept possession by arrangement with the Landlord and for his own benefit as well for the benefit of the company, and there is no agreement with the liquidator that he shall pay rent, the Landlord is not allowed to distrain." The situation will often arise where a company in liquidation has leasehold premises, alas they are not often owners, and the liquidator requires possession of the premises in order to dispose of the stock and plant. In such circumstances, the liquidator should immediately contact the landlord with a view to making the best bargain he can bearing in mind, of course, the power of the liquidator to disclaim the lease when he has no further use for the premises. If the liquidator does enter into possession of the premises then it is important that he terminates his liability for rent by some overt act either by disclaimer or by yielding up possession to the lessor.

In Re Levy and Co. Limited (1919) 1 Ch. 416 it was held that when a liquidator retained possession of premises leased to a company which was being wound up, either voluntarily or compulsorily, he could only do so on the terms of the lease. He was bound, out of the assets he got in, to pay the full rent to the lessor and, also the full sum required to comply with any repairing covenants in the lease.

The question of the liability of the liquidator most often falls to be determined when he has either omitted to pay a claim which ought to have been paid or has met a liability of the company which was not in fact due. There has been disagreement over the years as to the basis of and nature of the liquidator's liability. The cases are explicable upon the basis that the Liquidator has statutory duty to distribute the assets of the company to creditors in accordance with their entitlement. This, of course, he does not do by omitting a creditor or by paying a creditor he ought not to have paid. However, the Court's have applied a gentler test when determining the extent of the duty of the liquidator otherwise i.e. in the administration of-the affairs of the company.

In Knowles v. Scott [1891] 1 Ch. 717 Romer J. held that a voluntary liquidator was not strictly speaking a trustee either for the creditors of the contributories of a company in liquidation. He was an agent of the company. Accordingly in the absence of fraud, mala fides, or personal misconduct, an action for damages would not lie against a liquidator at the suit of either a contributory or creditor for delay in paying the creditor's debt or handing over to the contributory his proportion of the surplus assets of the company. Romer J. suggested that a liquidator could not be, as an agent, sued by a third party for negligence apart from misfeasance or personal misconduct.

This case and the standards which it sets have been criticised by Gore-Browne on the Companies Act 43rd edition 32/7 where it is suggested that the case overlooked the fact that the person injured by a failure to perform duties imposed by a statute may recover damages for the default. However, the case was cited with approval by the House of Lords in Ayerrot v. C. & K. Construction Limited (1975) 3 WLR 16.

The lenient cases continue with Competitive Insurance Co. Limited v. Davis Investments Limited and Another 1975 1WLR 1240 where a liquidator was held not liable for failure to recognise the existence of "an alleged constructive trust". The head note to this case states "a liquidator's bona fide failure to enquire or realise there might be trust, coupled with his own admitted honesty and good faith in selling "the trust property) could not involve him in any personal liability."

In Leon v. York - O - Matic Limited 1966 3 A11 ER 277 which supported Knowles v. Scott, the Court held that it would interfere with the sale by a liquidator only if it was shown that a liquidator was acting in a manner no reasonable Liquidator could act. This case was followed by Street C.J. in Re Minerals Securities Australia Limited 1973 2NSW Rep 207 where His Honour categorised the position as "ultimately every challenge must come back to some more broadly stated question, such as whether the liquidator's action has such importance, and can be seen to have such defects, as to justify the Court in exercising its discretion.

If however, these cases can be said to support the reasonable man test then the cases dealing with the question of admission of proofs cannot. These cases, often expressly distinguishing Knowles v. Scott, have imposed a very strict standard on the liquidator and one which indicates that, unlike the directors of the company, (In Re Claridges Patent Asphalte Co. Limited 1921 1 Ch 543) the liquidator cannot "hide"behind the advice of his solicitors. If it is correct that there is an

increasing reluctance on the part of liquidators to have disputes determined by the Courts because of the delays arising and the effect that this has on the value of the money to be distributed, it is suggested that consideration should be given to the standards which have been set by the Courts over the years in the following cases.

In Re Windor Steam Coal Co. 1929 1 Ch. 151, which was the case previously cited as supporting and opposing the view that a liquidator was an officer of the company and entitled to the benefit of the Court's discretion under Section 468, a claim for damages for a breach of contract was settled at £15,000 by the liquidator after consulting the solicitors for a large shareholder of the company. The liquidator wrote asking the Solicitors, "I should like to have your views firstly as to whether the selling agents have a claim at all and secondly, as to how that claim should be assessed." The reply, in part, was "there is no doubt that the selling agents have a claim in the winding up of the company in respect of the cancellation of their agreement." The Court held that this advice, in the event, was incorrect. The Liquidator claimed that he was a trustee and entitled to the benefit of an indemnity under the appropriate section of the United Kingdom Trustee Act.

Lord Hanworth MR commenced promisingly with the statement "now it is quite true that the Court ought to be very tender with persons who are placed in the difficult position of directors or liquidators and should not judge their conduct in the light of subsequent events". He then quoted with approval Romer J's dicta in the City Equitable case dealing with the liabilities of Directors. However His Honour held that "a Liquidator is a person who is charged with a number of statutory duties under the Companies Act. At the same time, those acts afford him the opportunity of going to the Court to obtain protection in any difficult circumstances in which he may be placed." Accordingly, the Liquidator was held to be personally liable for having made the settlement.

In the same case Lawrence L. J. stated "in the present case the payment was one made by a trustee on the assumption that he was a trustee to a person who was not his cestui que trust although in the belief that the payee was a cestui que trust. In these circumstances, even if the appellant had taken the best possible advice and had made the payment acting on such advice, I am of the opinion that that would not have been sufficient to excuse him, regard being had to the fact that he was a trustee employed because of his professional skill and paid for his services in performing his duties". In thise case Knowles v. Scott was cited in argument but not referred to in the judgments.

In Re Home and Colonial Insurance Co. Limited 1931 Ch. 102 without legal advice the liquidator wrongly admitted a proof. It was claimed that the liquidator was personally liable in that (a) it was a breach of statutory duty to pay the creditors equally or, alternatively, (b) the liquidator had been negligent in not getting legal advice and court approval. In this case Maughan J. considered that Windsor Steam Coal case had been a case where negligence was found but in this case it was held that there had been no negligence. Once again His Honour started promisingly by stating "I do not therefore accept the view that the liquidator in the matter of admitting proofs is practically in the same position as an insurer so that, in any event, and under all circumstances he is liable if a debt is subsequently shown to have been wrongly admitted." His Honour referred to the fact that the liquidator was getting paid and was able to seek directions of the Court as being relevant in determining the extent of the liquidator's liability. He concluded by stating "I have come to the conclusion that having regard to the magnitude of the claim ... it was the duty of the liquidator to investigate the validity of the proof ... " The claim related to a policy of marine insurance. His Honour went on to state "(the liquidator) chose to navigate in these narrow seas, to him unaccustomed and unknown without either chart or pilot; and for this temerarious conduct he must bear the responsibility."

In Windsor Steam Coal Co. the liquidator had acted on the advice of a Solicitor. So also had the liquidator in the case of Austin Securities Limited v Northgate and English Stores Limited 1969 1WLR 529 in which Edmund Davies L.J. held that a Liquidator could not shield himself behind the mistake of his Solicitors. In this case, a claim had been commenced against the company in liquidation in February 1966. The Solicitor acting for the Plaintiff fell ill and later died. No action was taken on the claim until May 1968 and during the intervening period the assets of the company had been distributed by a liquidator. The company had on its file an account from its Solicitor which indicated that the claim was not being perused. Denning L.J. as he then was, stated "it is the duty of a liquidator to enquire into all claims, to see whether they are well founded or not, to pay good claims, to reject the bad, to settle the doubtful, or, if need be, to contest them." Turning then to consider the duty of a liquidator to call for proofs of debt His Honour relied on Pulsford v. Devenish.

Pulsford v. Devenish 1903 2CH 625 is the case most commonly cited in those decisions which cast doubt on the correctness of Knowles v. Scott. In this case the Liquidator was held personally liable for failing to pay the creditor who did not file a proof of debt. The Liquidator advertised for proofs of debt in six London newspapers and did nothing else. The decision of Farwell J. was no doubt coloured by the fact that it was a members voluntary liquidation and all the assets had been sold to another company and, in terms of the Agreement for Sale, the purchasing company had covenanted to pay the debts of the Vendor. In the event the purchasing company failed to pay the particular debt. Farwell J. cast doubts upon the correctness of Knowles v. Scott and His Honour when considering the duty of the liquidator to pay debts stated "it is an absolute statutory duty without limit in point of time ... it is not necessary to resort to trusteeship or equitable doctrines." The

difficulty facing the Court in this case was that the company had been dissolved i.e. had ceased to exist as a legal entity. However, because the liquidator had been in breach of a statutory duty the fact that the company had been dissolved did not bar a creditor, disadvantaged by failure of the statutory duty, from claiming. This decision has been applied in New Zealand, see Brown v. Cowan 1912 31 NZLR 1219.

Pulsford v. Devenish was followed in James Smith & Sons (Norwood) Limited v. Goodman 1936 1 Ch. 216 where Lord Hanworth M.R. stated "the cases that we have looked at show that if a creditor has been injured by the failure of the liquidator to take the steps that he ought to have taken, and has suffered damage he can 'succeed in an action on the case', as Farwell J. put it in (Pulsford v. Devenish) in establishing a liability against the liquidator." In this case the company had been dissolved and the Court held that in order to establish a liability on the part of the liquidator it was unnecessary to declare that dissolution was void.

Rule 85 of the Companies (Winding Up) Rules 1956 provides that the Liquidator may fix a time within which debts must be proved. In re Armstrong Witworth's Securities Co. Limited 1947 1 Ch. 673 the Liquidator relied on the English equivalent of this rule to exclude himself from liability for not having paid certain creditors of the company who had failed to prove. In this case the company had been its own insurer in respect of its liability under Workmen's Compensation Acts. Complete records of accidents had been kept by the company and these records were comprised in some 16 - 17,000 individual folders. It was held by the Court that the liquidator "must be deemed to have known of the existence and general nature of the information contained in the 16,000 or 17,000 individual folders comprised in the company's accident records ..." Jenkins L.J. went on "in such circumstances, it seems to me that his duty as liquidator was to take all steps reasonably open to him on the information in his possession to ascertain whether any of the former employees concerned did make any such claim.

The obvious step open to the deceased liquidator on the information in his possession was to send a notice to each such employee at the address shown in the folder relating to his case, informing him of the liquidation and asking him whether he made any claim. I decline to accept the suggestion that the number of cases involved rendered this course impracticable."

The liquidator cannot rest behind a direction of his Committee of Inspection. In Ex P. Brown 1886 17 QBE 188 the Trustee in Bankruptcy had been directed by a Committee of Inspection to reject a proof. The proof was lodged in respect of a judgment which was defective. It was held per Bowen L.J. that the Committee's Act in rejecting the proof was "monstrous". Accordingly, the trustee was ordered to pay the cost of the action having taken an utterly frivolous point". Fry L.J. went on to state the duty of the trustee "was to look into the merits of the claim. Instead of doing that he has thought fit to raise a technical objection in order to shut the claimants entirely. In so doing I think he has been guilty of misconduct which it is competent to the Court to visit by making him pay costs personally." Lord Esher M.R. stated that the liquidator would not be relieved from responsibility because he had been acting "merely because a stupid committee of inspection" had directed a certain course of action.

In many ways the liquidator cannot win. If in carrying out his statutory duties he makes a mistake he may well be personally liable notwithstanding the fact that he may have received advice thereon from his Solicitors. The only insurance policy available to a liquidator, a liquidator in a Court winding up or voluntary winding up is to seek directions from the Court.

The liquidator at his peril pays a debt of the company which is not properly payable. However, should he fail to meet payment of a debt which could be payable but to which he takes some frivolous objection he may be personally liable in respect of costs in the action.

He cannot shield himself behind a protection of the Winding Up Rules in calling for proofs of debts. He must consider, in the light of all the information available from the records of the company, the areas from which claims may come and must seek out creditors. However, in making decisions in connection with the disposition of the company's assets, the carrying on of the company's business the liquidator will be looked on by the Court tolerantly. His de cisions will be upset only if he has not obtained the proper sactions e.g. from the Court if applicable or Committee of Inspection or members of the company and if he has acted in a manner in which no reasonable person could have acted.

The breach of a statutory duty will render the liquidator liable even after the dissolution of the company and there will be no assets against which he may claim an indemnity. It is not open for liquidators in fulfilling their statutory duties to take what they may regard as a reasonable commercial approach. Whatever may be the inconvenience the cost and the time involved they must ensure that they pay no creditor who should not be paid and pay any creditor who should have been paid. In fulfilling these duties the Liquidator must not take 'technical objections' to the claims of creditors and the liquidator in a winding up by the Court must act in a 'high-minded' manner not taking unconscionable legal points.

The magnitude of the liquidator's problem is highlighted by the recent decision of British Eagle International Airlines Limited v. Compagnie Nationale Air France 1975 2 All E.R. 390 where the House of Lords by a majority of three to two reversed both the Court of Appeal and the original judgment. This case related to the Clearing House arrangements entered into by I.A.T.A.. It was held that the Court may refuse to give effect to provisions of a contract which achieved a distribution of an insolvent's property which ran counter to the principles of insolvency legislation. The dominant purpose to evade the operation of such legislation is not required to enforce this new doctrine.

With respect to the majority it is suggested that the judgment of Lord Morris which, of course, upheld the trial judge and the Court of Appeal is more soundly based.

Lord Morris must be correct when he states, "It is a general rule that a trustee or liquidator takes no better title to property than that which was possessed by a bankrupt or a company. In my view the Liquidator in the present case cannot remould contracts which were validly made."

Lord Simon in support said, "Since this was a bona fide commercial transaction, and not a 'deliberate device' to give a preference on liquidation ... the liquidator has no higher claim than the company had before liquidation."

If this new doctrine, that is striking down commercial transactions, bona fide in all respects, but which have the effect of benefitting one creditor at the expense of others other than by taking security which is registered, is adopted in New Zealand the task of liquidators and their advisors will become very much harder.

Palmer's Company Precedents (7th Ed. Part 11 page 184 puts it thus: "The Liquidator should for his own protection, apply to the Court in every case of doubt, and should do so where large sums are involved, even if his advisors express no doubt upon the matter".

In conclusion I would like to suggest that in the light of increasingly complex legal situations facing liquidators, and one has merely to look at the Securitibank liquidation as an example, the standards imposed by the Court have been unreasonably high. The Courts have not recognised the need for the costs of the liquidation to be minimized or the desirability of a prompt distribution to creditors. It would be a rash man who placed reliance on these worthy aims. Rather the liquidator should if there is any doubt seek the guidance of the Court. Failure to do so in a proper case may render the liquidator liable. On the

other hand the liquidator should not take frivolous points of law. Where the boundaries are to be drawn is uncertain. What can be stated is that acting reasonably and bona fide is not enough if the liquidator has failed in his statutory duty.