LIABILITY OF RECEIVERS, LIQUIDATORS, INVESTIGATORS AND INSPECTORS

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In preparing this commentary we bring to the task not a legal background but rather our combined practical experience in receivership, liquidation, investigation and inspection assignments.

INVESTIGATIONS

This aspect was not discussed in Mr Blanchard's paper; perhaps because an investigator is not appointed in terms of a statute nor usually in terms of a document such as a debenture. In the context of the topic we confine our comments to what accountants term "pre-insolvency investigations". Such appointments need to be delicately handled. Typically a debenture holder (the trading bank) has some considerable concern about the debtor company, but may as yet be reluctant to appoint a receiver. The bank requires both information and an independent source to weigh the evidence in a business sense. The company through its officers may be helpful or uncooperative. The bankers have no wish to incur a professional fee. The often unwilling company appoints an investigator of the bank's choosing who reports to the company, with the clear understanding that the bank is to receive a copy of that report. The investigator is looking to the company for his or her fee.

In contrast to a section 9A inspector who has a narrow function, the investigator's brief tends to be open ended, and is often unwritten. The investigator, unlike an auditor, does not have the relative security of a standard form report to fall back on. These matters increase an investigator's possible liability.

We know of no reported cases, but surmise the investigator's liability might include:

- a duty to the debtor company with consequent potential liability to it in contract.

- a potential liability in the tort of defamation

- potential liability to the bank in negligence; it being plainly clear to the investigator from the start of the assignment that the bank may rely on the investigation report.

- a potential liability in negligence to other third parties, who might reasonably be contemplated to read and rely on the report. The company may be endeavouring to attract further equity investment to relieve its liquidity problems with the bank.

The liability in negligence encompasses a failure to detect and report on matters amiss in the affairs of the debtor company. The investigator does not have the same luxury of time afforded even an auditor. Neither does he or she possess the same background knowledge of the company and its industry.

Attempts by an investigator to lessen such liabilities will usually include:

1. The inclusion of some form of disclaimer in the investigation report to limit both the purposes for which the report is used and the parties to whom it is presented. Such disclaimers are at best a partial defence mechanism.

2. Discussion of the report contents in draft with officers of the company in order to clear any misunderstandings which may have arisen from the investigator's brief consideration of the company and its business. In reviewing the draft report with officers of the company, the investigator must remember that one of the purposes of the report is to provide an independent assessment of the company.

3. The investigation report will usually contain a clear identification of the basis of the engagement, mentioning particularly that it is not an audit, and indicating where reliance has been placed on explanations given by the company's staff and officers.

RECEIVERSHIPS

Receivers are remunerated on the basis of the time spent on an assignment, and not on the basis of the risks taken. It is important that they are aware of their exposure to liability. We highlight below some liabilities receivers may face.

1. Liability in trespass

The rights, powers and duties of a receiver are determined by two documents, the debenture itself and the instrument of appointment. A receiver must be satisfied that both documents have been properly drawn, executed and are valid in all respects. The receiver must be acquainted with his or her powers and duties set out in the documentation.

If either the Deed of Appointment or the debenture is unsound, the receiver may be regarded as a trespasser and become personally liable on contracts undertaken in the name of the company or for assets converted into cash.

The Court is empowered to relieve a receiver from liability due to a defect in his or her appointment. Section 345A states, inter alia,

> "(1) Where the court is satisfied that a person who has acted as receiver... has incurred liability solely by reason of some defect in his appointment ... and that in all the circumstances the person ought fairly to be excused, the Court may relieve the person, either wholly or in part, from his liability on such terms and conditions as the Court thinks fit.
>
> (2) Where the Court grants relief from liability pursuant to subsection (1) ... then, subject to such terms and conditions as the Court thinks fit, the liability shall be that of the person who appointed the receiver ..."

This in effect empowers the Court to impose any liability arising from a defect in the debenture or the appointment on the debenture holder. However, a receiver 'elect' would be most unwise to rely on section 345A as an alternative to taking all reasonable precautions to ensure that the appointment is in order before it is accepted.

A somewhat related issue arises with regard to assets located overseas. Receivers appointed to companies with assets and liabilities overseas must take special care. They must ensure that the debenture under which they are appointed has been registered in the jurisdiction in which the assets are situated, and must seek appropriate local legal advice. Failure by a debenture holder to register a debenture in another jurisdiction means that the debenture will be void as against other creditors in that jurisdiction in respect of assets situated there.

2. Liability - selling goods without title

If the debtor company has purchased goods and the goods have been delivered and title has passed, then the receiver is entitled to retain such goods on behalf of the company and the vendor will rank simply as an unsecured creditor. If, on the other hand, title to the goods is not passed to the debtor company, or alternatively will pass only on payment, then the receiver, if he or she does not wish to use the goods, should return them to the supplier without payment.

Some suppliers purport to retain title until such time as the goods are paid for. This condition of sale is commonly known as "reservation of title" or a "Romalpa clause". On appointment, a receiver should enquire as to whether any stock held by the company is held subject to an alleged reservation of title. Where this is so, the receiver should seek legal advice concerning the effectiveness of the purported reservation of title. Often, however, the debtor company's staff will have no clear idea as to whether any stock held by the company is subject to alleged reservation of title.

Aside from the "Romalpa clause" situation, the receiver must ensure that the company otherwise has good title to goods offered for sale. It would be embarrassing and costly to find, after a sale was consummated, and the receivership terminated, that the goods sold were subject to a hire purchase or lease agreement.

When selling assets or the business as a going concern, the receiver should insist on excluding his or her personal liability as permitted by section 345 of the Companies Act 1955 by inserting in all agreements a clause which makes it quite clear that the receiver is entering the agreement as receiver and shall not be personally liable pursuant to the agreement.

3. Liabilities of continuing to trade

Usually the powers conferred on a receiver by a debenture include an authority to carry on the business of the company. Although the receiver is less likely to incur personal liability by closing the business down and selling the assets piecemeal, the assets may not be realised to the best advantage.

Receivers tread a very thin line. They are unlikely to trade profitably in the initial stages of a receivership and must balance the additional funds they expect to realise from a going concern sale against the cash loss from unprofitable trading. Receivers must operate for only a limited time unless they can achieve profitable trading. A simple, efficient and accurate reporting system is vital.

The carrying on of a business necessarily will involve borrowing even if it is only by way of normal credit terms extended by suppliers. When receivers obtain credit by way of countersigning approval on a purchase order they borrow in their personal capacity. This is true of any borrowing unless the receiver specifically states in writing prior to actually incurring the liability that he or she is borrowing only as an agent and is excluding any personal liability. Usually such an exclusion of liability, while highly desirable, will be very difficult to obtain in practice.

However, when borrowing, other than by obtaining usual monthly credit, receivers should discuss with their solicitor the possibility of excluding their personal liability. There must be no doubt about the receiver's authority to borrow or to pledge assets in support of borrowings.

Where a construction company is trading in receivership and the receiver tenders for a new contract, he or she will be faced with having to arrange a performance bond. There will be full recourse back to the receiver for any amount the surety has to pay under the bond, unless and it is most unlikely, the receiver is able to exclude personal liability.

Often a receiver continuing to trade a company will be making sales on hire purchase. All hire purchase sales agreements entered into after receivership should be appropriately endorsed by the receivers to exclude personal liability. Similarly where a hire purchase agreement is discounted, the assignment should exclude the receiver's personal liability. This might be achieved by the following clause:
'This agreement/assignment is made by the receiver as agent for the vendor and the receiver shall be under no personal liability whatsoever to the purchaser/company.'

It is not uncommon for a liquidator to be appointed while the receiver is still in office. In these circumstances the receiver must immediately cease trading as the liquidation automatically cancels the receiver's right of agency, and he or she becomes personally liable in respect of any contract entered. The receiver is not entitled to create debts which would be provable in liquidation. While the receiver can no longer carry on the business, his or her power to realise assets continues, subject of course to the debenture being enforceable against the liquidator.

4. Coping with liabilities after termination

Before the receiver terminates the receivership he or she must be satisfied that all claims and outstanding liabilities have been satisfied. If the receiver has been trading advice should be sent to all parties with whom he or she has had transactions. That advice should indicate that the receivership is being terminated and ask for a final statement of account. As a precaution the receiver should obtain, if this is not already held, a suitable indemnity from the debenture holder against any contingent liabilities.

It is possible that the receiver's appointment may be withdrawn by the debenture holder prior to the completion of the receivership. Under these circumstances the receiver must ensure that the following liabilities are discharged:

a) Costs of realisation of the company's property

b) Outgoings and costs incurred by the receiver in carrying on the business and in collecting and recovering the company's assets

c) Receiver's remuneration

d) Preferential creditors.

The receiver is entitled to retain assets in order to meet those liabilities. If a receiver appointed under a floating charge debenture neglects to discharge the preferential creditors, he or she will become personally liable.

The judgment of Goff J in Commissioners of Inland Revenue v. Goldblatt (1972) 47TC 483, is of interest. The Judge said, inter alia,

> "It would follow that, if a receiver be not merely removed but another appointed, the first cannot safely account to the second, nor can the second demand the assets from the first, without the preferential debts of which the first receiver has notice being paid or provided for ..., but in any judgement, once the receiver has collected assets, he is liable to the extent of those assets for any preferential debts of which he has notice."

5. Attempts to lessen a receiver's liabilities

Indemnities

As already noted above, the receiver is personally liable for all contracts into which he or she enters and for any losses sustained while carrying on the business. Receivers have a right of indemnity out of the assets, but if the assets are insufficient they could be faced with personal loss.

There is often a large element of risk in continuing to trade a company in receivership, particularly in the early days. Often there is no accounting information system or, alternatively, it is inadequate. Often it is well behind, and, together with the general administration, is in a state of poor repair. The receiver often has to make significant decisions on the basis of inadequate facts.

Receivers who continue to trade a company in receivership should first insist upon a full indemnity from the debenture holder.

Competent independent legal advice

It is important for receivers to have a basic understanding of the law which will enable them to recognise legal problems as they arise. It is of even greater importance to have the assistance and guidance of a solicitor who is a specialist in commercial and corporate law and who is prepared to be readily accessible to the receiver. Not only must the legal advice sought be highly competent, but the solicitor or solicitors advising receivers should be independent of both the debenture holder and the company.

File notes

It may become necessary for the receiver to defend his or her position, possibly in Court. It is thus important that receivers maintain proper and adequate working paper files. Notes and/or minutes should be kept of each meeting, telephone call, or other discussion of any significance. Both the minutes and notes are an important documentary record, and should be written clearly and concisely and be initialled and dated.

LIQUIDATIONS

1. Carrying on business - a contrast

A liquidator has the statutory power to carry on the business of the company, so far as necessary to beneficially wind the company up. A liquidator carrying on the business of the company does so as the company's agent and is not personally liable on contracts entered into as liquidator. Creditors for the liquidator's period of trading are entitled to be paid in priority to the creditors at the commencement of the winding up.

The liquidator also has a statutory power to raise money on the security of the assets of the company.

2. Statutory Duties

As indicated in Mr Blanchard's paper the liquidator has certain statutory powers and statutory duties. If the liquidator exceeds those powers or fails to carry out those duties he or she will be liable to anyone who thereby suffers loss.

Creditors or shareholders, who may have lost a considerable amount of money through the debtor company, will often look to what recovery they might make from the liquidator. The liquidator is not liable for debts of the company incurred before the liquidation, neither, as Mr Blanchard points out, is the liquidator an insurer against all the hazards of a liquidation. The major areas of practical concern are:

a) negligence in realising the assets
b) not meeting a valid claim against the company
c) paying out a claim which is not due by the company.

The liquidator cannot use the Companies (Winding Up) Rules 1956 as a shield for protection in calling for proofs of debt. He or she 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 then seek out creditors. Liquidators often interpret their power to make a compromise or arrangement with creditors or persons having a claim against the company, as a licence to take a "commercial approach" in admitting and rejecting proofs of debt. A "commercial approach" is inappropriate for a statutory duty and, however difficult that may be, liquidators must make sure that they pay no creditor who should not have been paid, that they seek proofs of debt from all possible creditors, and that they pay any creditor who has proved and who should have been paid. The power to compromise applies only where the creditor has a claim against the company, but the amount of that claim is unable to be ascertained or is contingent.

3. Attempts to lessen a liquidator's liabilities

Competent independent legal advice

As for receivers, it is equally important for liquidators to have a basic understanding of the law, and to have the assistance and guidance of a solicitor specialising in commercial and corporate law who is independent of both the major creditors and the company. However, as Mr Blanchard points out, "legal advisors, unfortunately, are fallible." The liquidator may well be personally liable notwithstanding the fact that he or she has received legal advice and acted on it.

Directions from the Court

The best available solution to resolve a question arising in a liquidation is the liquidator's power to apply to the Court for directions. Having a dispute determined by the Court is time consuming and expensive. We have yet to see what impact the new Commercial List may have on the time and cost of such actions. Delays lessen the value of any ultimate distribution to creditors. Yet the best advice is for a liquidator to apply to the Court in cases of doubt, especially where considerable amounts of money are involved.

AN ACCOUNTANT'S POSTSCRIPT - ACCOUNTING RECORDS

Can receivers or liquidators be held liable as officers to maintain proper accounting records for the company in terms of section 151(7) of the Companies Act 1955; and if so are they exposed to potential liability in terms of section 319(1)?

The term "officer of a company" is generally regarded in a narrow sense as including only the director(s) and secretary. Section 2(1) of the Companies Act 1955 states that the term officer "includes a director, manager or secretary". The same sub-section states that the term director "includes any person occupying the position of director by whatever name called". The definitions are not exhaustive.

A receiver, per se, does not come within the definition of an officer of a company. The obligation to maintain accounting records still remains with the directors of the company. (Refer Smiths Ltd v. Middleton (1979) 3 All E.R. 842, at 847.) But a receiver may take over the management functions of a company. So long as a receiver merely takes control of particular assets and takes receipt of revenue from those assets for the benefit of the debenture holder, the receiver is not acting in the management of the company. But should the receiver's powers extend to those of a manager, then we believe that the receiver/manger could incur liability under ss.157 and 319.

When a company is in liquidation the directors no longer have authority to act for the company. The liquidator however, has power to trade the company so far as is necessary for a beneficial winding up. In Australia, there has been a reported instance of a liquidator being held personally liable for the debts of the company. (Refer Re Timberlands Ltd (In Liquidation) (1979) 4 A.C.L.R. 259). The court enquired into the liquidator's failure to perform his statutory duties, and his failure to keep proper accounting records. As a consequence of the investigation, the court ordered his removal as liquidator, disallowed his remuneration and ordered the liquidator to make good losses totalling nearly $367,000.