One Way Road to the Death of Ailing Companies – the New Receivership Bill

By Chris Iacovides*

There has been much speculation in relation to the Receivership Bill which proposes to introduce a requirement that floating charge holders must obtain a Court Order in order to appoint a Receiver Manager ("RM") and bring an end to the quick and easy route currently relied upon by floating charge holders to appoint RM's.

We have made a fine mess with the introduction of Examinership as opposed to Administration (a procedure that works in a country with a sophisticated court system, compared to ours, which I am sorry to say, is in the stone age). I very much doubt that an Examiner will ever be appointed (with the exception of those that might be appointed on an interim basis) and now, we are about to introduce another fine mess, by tampering with receiverships! Interestingly, all these discussions are taking place in the absence of representatives from the insolvency profession.

It is being argued by the Association for the Protection of Bank Borrowers (the "Association") that the appointment of RM's is a tool being abused by financial institutions, that banks act without any constraint/accountability and that their decision to appoint a RM starts a company on a route to its dissolution whilst leaving other unsecured creditors at risk and exposed to the actions of RM's, who have a duty to protect only the interests of the secured creditor which appoints them.

However an analysis of the points raised by the Association quickly reveals their arguments are fallacious and fail to take into consideration other existing options open to unsecured creditors as part of the insolvency framework upon the appointment of a RM and the practicalities and implications of our overloaded court system, if the proposed Bill was to be introduced.

It is correct that the procedure to appoint a RM can be initiated at any time provided for in the contract by a floating charge holder. It is an established principle that a RM owes a duty of care to the appointer and their primary task is to realise the assets of the company for the benefit of the secured creditor.

With regard to the validity of the RM's appointment, it is the duty of the RM to ensure, before accepting the appointment, that the security pursuant to which he/she is appointed is valid and that the power to appoint has arisen, alternatively the receiver will be liable to the company for the torts of trespass and conversion. The company itself can challenge the appointment and, if successful, the company will retake control of the company assets and may sue the RM.

It is misleading and incorrect to suggest that the RM is not accountable to anyone, that RM's exercise a low level of professional conduct and they sell assets at levels below their market value; a RM has a duty to take care to obtain the best price reasonably obtainable in any sale of charged assets, receivers are not entitled to act in a way which unfairly prejudices the company by selling hastily at a knock down price sufficient to pay off the debt to the secured creditor[1]. Also, whilst a receiver's primary duty is owed to the debenture holder, a duty is also owed to guarantors of the company debts[2] and subsequent chargees[3].

Whilst the RM does not have a duty to the company to preserve its goodwill and business[4], if a decision is made to carry on the company's business, the receiver owes a duty to manage the business with due diligence, by taking reasonable steps to carry on the business profitably[5]. Furthermore, the claims made by the Association that the RM only pays the secured creditor which appoints him, are incorrect, pursuant to s89 of Cap 113 of the Laws of Cyprus the RM must pay the preferential creditors of the company over which they are appointed, from the proceeds of any realisations of assets subject to the floating charge, before they pay the floating charge holder.

Comments made that floating charge holders appoint RM's arbitrarily and unjustifiably are also unsubstantiated, I have personally been appointed in relation to several receiverships by banks in Cyprus and in all cases the appointment of a RM is a last resort for the floating charge holder and several efforts will already have been made to restructure its debts before an appointment is made. In any event, whilst the debenture holder does not owe a general duty to the company to refrain from appointing a receiver merely because this would cause damage to a company[6], a duty

[1] Silven Properties v Royal Bank of Scotland plc [2004] All ER 484
[2] Barclays Bank Plc v Kingston [2006] 1 All ER (Comm) 519
[3] With regard to the criticism of the professional conduct exercised by RM's, it is worthwhile noting that only licensed Insolvency Practitioners (IP's) can be appointed as RM's therefore if someone in particular is acting with conduct which falls short of their professional obligations then this should be a matter to be considered by the body licensing the specific IP, as opposed to introducing a new bill taking away fundamental powers of charge holders.
[4] Re B Johnson & Co Builders [1955] 2 All ER 775
[5] Medforth v Blake and others [1999] 2 All ER 97
[6] Shamji v Johnson Matthey Bankers Ltd [1991] BCLC 36

is owed not to do so in bad faith, for example by appointing a receiver maliciously with a view to damaging the company or another creditor[7].

UK Administration Regime and the Rescue Culture

Arguments have been put forward by the Association that the fact that receivership has effectively been abolished in the UK (except if the security falls within one of a small number of exceptions) in favour of the Administrator regime, by virtue of the changes brought about by the Enterprise Act 2002[8], is evidence that receivership is not fit for purpose; that it gives too much power to the debenture holders and the receiver and that the law should be reformed to redress the balance.

However, under the UK Administration regime, a floating charge holder has the power to appoint an administrator **out of Court**, they merely file the necessary forms with the Court, hence in the UK the significance of giving charge holders the ability to quickly and easily appoint a RM without interference from the Court is acknowledged and maintained. Furthermore, in the event of a petition being filed by a company and/or a creditor, prior written notice must be given to the secured creditors enabling them to appoint an administrator of their own choosing, unlike the changes that are being proposed in Cyprus.

The Association, further raises the point that receivership promotes a culture of break up and dissolution (unlike Administration) however, from experience in relation to hundreds of appointments as RM, I can confirm that in the main, by the time bank's decide to appoint RM's the companies are insolvent, they are trading at a loss and a sale of their assets is the only viable option, although in the event a receiver decides it would be profitable or worthwhile to do so, he/she has the power to continue the trading activities of the company, provided the company is not in liquidation.

In fact, if the legislation was changed and receivers were given a primary objective of trading the company they may feel constrained by this purpose and feel obliged to follow a strategy to rescue the company. It is possible, perhaps even likely, that a rescue purpose would be more difficult and more expensive to achieve where as, currently, a RM can proceed to realise the assets of a company through whatever means are most beneficial and most cost effective for the appointing lender[9]. If the purpose of receivership was to be changed, it could be more expensive reducing the amount left for unsecured creditors.

In any event, whilst a RM must prioritise the appointers interests, this does not of itself inevitably prejudice all other stakeholders, nor is it necessarily prohibitive of

[7] Principles of Corporate Insolvency Law 4th Edn Roy Goode (London: Sweet & Maxwell 2011)

[8] A floating charge holder remains entitled to appoint an administrative receiver where the floating charge was created prior to 15th September 2003.

[9] Inga West and Ross Miller, *Enterprise Act 2002: issues for Secured Lenders* Journal of International Banking Law and Regulation 2004

corporate rescue. It is only when the appointer is over secured that a receiver could properly pursue a break up sale strategy. Where the appointer is under secured, in order to maximize value and comply with his duty to that appointer the RM will look to other means of realising the security, such as to attempt to sell the business as a going concern[10]; in the event of a successful sale, any realisations in excess of the secured debt will be available to the unsecured creditors.

From experience, in the vast majority of cases when a bank appoints a RM they are under secured; in accordance with statistics from a survey conducted in the UK secured creditors were fully repaid in only 19% of receiverships suggesting that appointment by under secured charges are the norm, and the proposition that receivers are not adequately incentivised to maximize value, is flawed[11].

On 7th May 2015, with the introduction of Examinership as part of our insolvency framework, the rescue culture was purportedly introduced in Cyprus. The legislation now gives stakeholders (creditors/directors/shareholders/guarantors) 30 days from when a RM is appointed to apply for the appointment of an Examiner. The Court may make the Examinership appointment where a company has prospects of survival as a going concern, and from the making of the application there is a four month moratorium period (extendable to 6 months) during which creditors cannot take action against the company.

Therefore, in cases where a RM is appointed by a floating charge holder and the directors/shareholders/creditors/guarantors of that company can persuade the court that the company has reasonable prospects of survival as a going concern they can apply for the appointment of an Examiner, and upon the making of the order appointing an Examiner the Court will decide whether the RM shall cease to act.

Therefore unsecured creditors of companies in relation to which RM's are appointed do have another option, they are not at the mercy of the RMs actions as claimed by the Association, provided the company has prospects of survival as a going concern.

If the legislation does not allow secured creditors to take swift action to enforce their security, banks will be discouraged from further lending to companies, ultimately the draft Bill, if introduced, will harm those that the Association is purportedly aiming to protect, if all powers are taken away from banks they will not be willing to provide new finance.

Finally, it is common knowledge that our judicial system is prone to lengthy delays and an overload of cases and mounting backlog, hence if this bill is passed the delays which will be introduced will be catastrophic for ailing companies, as well as floating charge holders. Any petition for the appointment of a receiver will be challenged, and

[10] Sandra Frisby *In Search of a Rescue Regime: The Enterprise Act 2002* Modern Law Review March 2004

[11] Eighth SPI Survey of Company Insolvency (London: SPI, 1999). The survey comprised a sample of 137 receiverships

the case could be pending before the court for a considerable amount of time, probably at least 3/4 years, if not longer, with disastrous consequences; during this time directors will inevitably dissipate company assets and by the time the court decides whether to appoint a RM its likely there will be no assets left, the only option left will be liquidation.

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