

## Effect of Winding Up upon Secured Creditors

By Chris Iacovides



Ordinarily, the instrument creating the debenture confers on the holder a right to appoint a receiver and or a receiver and manager, notwithstanding the passing of a resolution for Voluntary Liquidation or the Compulsory Winding up of a company by the Court, Sections 263 and 219 of Cap 113 of the Laws of Cyprus.

Formerly it was the case that once a liquidator was in office, in a compulsory winding up; the receiver had to obtain the leave of the Court to take possession of the assets, because he would otherwise have been guilty of contempt should he interfere with the possession of an officer of the Court, **Re Henry Pound & Son & Hutchins Ltd (1889)**.

Nevertheless, in **Re Landmark Corp Ltd**; it was held by the Australian court, that leave was only necessary if there was a dispute as to the right of the receiver to possession of the assets under the de facto control of a liquidator who refuses to give them up.

In other respects the right to appoint a receiver is absolute, the debenture holder as secured creditor stands outside the liquidation, **Strong v Carlyle Press Ltd [1893]**.

Insomuch as the event of liquidation does not prevent the appointment of a receiver, the appointment of a receiver does not prevent liquidation.

A receiver is appointed primarily to enforce the security of the debenture holder who appoints him. As a result, his duties to the company are limited, even though he acts as its agent, the agency comes to an end upon liquidation when the receiver becomes the agent of the appointee.

The receiver owes no duty of law to the company but he does owe the same duties in equity to the company as does the chargee pursuant to the security under which he was appointed, and to anyone else interested in the equity of redemption.

This is an important point when dealing with the sale of property. It means that the receiver and manager will owe a duty in equity to any subsequent encumbrance and also any surety for the company's obligations. The receiver owes no separate duty of care to ordinary creditors whose position is protected by the duty owed to the company.

In the main the receiver's duties can be summarized as follows;

- to act in good faith for the purpose of obtaining repayment for the debenture holder;
- to take proper care to obtain the best price reasonably obtainable for the assets when selling them;
- to manage the property assets in a business with due diligence if the receiver elects to continue with that business;
- such other duties, consistent with the primary duty to the debenture holder to obtain repayment of the debt as the facts and circumstances of the particular case merit.

## **Security and Charged Assets**

In the normal course of lending, secured creditors, in the UK and in most common law jurisdictions, when taking security by way of a debenture against a borrower, this will normally contain a fixed charge over land and buildings and a floating charge over other assets. The debenture will almost certainly confer on them a fixed and floating charge.

Unfortunately the practice adopted by secured creditors, in Cyprus over the years, is to register debentures conferring on the holder only floating charges and legal mortgages over immovable property. Although a floating charge will enable a secured creditor to appoint a receiver over a borrower's assets, in the absence of a specific fixed charge over immovable property, sale of land and buildings has to be orchestrated, through the Land Registry by virtue of the legal mortgage; this process takes several years to complete. In the event of the receiver selling pursuant to the powers conferred on him by the floating charge, he will be unable to provide clear title to the purchaser, as charging orders registered against title will survive.

This causes delay in secured creditors realizing security and perhaps it is time for banks to reconsider current practice with their legal advisers.

In the event of a debenture incorporating a fixed charge, this will enable a receiver to sell the charged property and provide clear title to the purchaser, without the need to involve the Land Registry. In the event of a willing buyer, the sale can complete almost immediately and charging orders, known as "memos" cannot frustrate the sale as the receiver will be able to provide clear title.

On a different note, If a receiver is appointed under a charge which was created to be floating and the company is not at the time in the course of being wound up, preferential debts must be paid out of the floating charge assets in priority to the debenture holder.

This rule does not apply to fixed charge assets; a charge which was created as a fixed charge does not fall within this rule, with the result that the charge holder has priority over the preferential creditors.

Finally, a receiver appointed under the fixed element of a charge has no right to run or interfere with the running of the company. He will normally take control over land and buildings and manage them until their disposal. In contrast, a receiver appointed under the floating element of the charge, he is styled as receiver and manager and he can take over the company, its business and assets.

## **Disposal of Assets**

A secured creditor as mortgagee only, cannot appoint a receiver, unless a fixed charge is also registered with the Registrar of Companies. In such eventuality however, a receiver can most certainly be appointed and he will be deemed to be the agent of the property. Alternatively, the charge holder as mortgagee can go into possession of the mortgage property as mortgagee in possession. The difference will be on disposal, the receiver sells as agent of the company whereas the mortgagee sells as mortgagee in possession.

It should be noted that the appointment of a receiver is without prejudice to the rights of any prior encumbrances. Therefore, where a prior mortgagee is not in possession, the appointment is subject to that mortgagee's right to take possession. The prior mortgagee can take possession without the leave of the Court, although this is of course subject to any rules relating to the need to take possession proceedings in the case of dwellings etc.

The receiver or mortgagee's power to sell is normally an express right contained in the legal charge. The power of sale arises after due notice or the happening of some specified event. Where there are successive mortgages the first mortgagee can exercise his power of sale without the concurrence of the subsequent mortgagees, although he will have to account to them for the surplus (if any) of the purchase money.

A second or subsequent mortgagee may sell subject to the first prior mortgage.

Alternatively, he may sell free of prior encumbrances by arranging for them to be discharged out of the proceeds of sale.

### **Duty to obtain Best Price**

A mortgagee and receiver exercising a power of sale are under a duty to take reasonable care to obtain the best price reasonably obtainable. This is an equitable duty. The development of this equitable duty has derived from the need to protect the equity of redemption and to prevent redemption being evaded at anything other than a bona fide arm's length sale. The duty is one of ordinary competence acting with ordinary care and on competent advice. The mortgagee can choose his own time for sale and is not required to defer sale until an expected change in the market. It follows that professional advice should be taken although negligence is not necessarily avoided simply by following such advice. Recent English authority *Medforth v Blake* 1998 suggests that there is little if any difference between the equitable duties of a mortgagee as opposed to that of a receiver even though the receiver acts as agent of the company.

### **Priorities**

In respect of charges on registered land charges, they rank in order of priority of registration, save as varied by the parties e.g. by deed of postponement. In unregistered land charges, they rank in priority of date. In the case of registered land, equitable charges, e.g. charging orders to protect judgments of the Court, should be registered by caution. Thus a charging order protected by caution, will take priority against a subsequent legal charge. In the case of an insolvent company the charging order must be completed before the insolvency to take effect as a charge, i.e. the charging order must be made absolute. If so, then the charge will take effect as from the date of order nisi. If there is insolvency between the order nisi and the hearing of the order absolute, then the order will not be made absolute as to do so would give an unfair advantage against other unsecured creditors.

Charges granted require registration with the Registrar of Companies, within 21 days of been signed, if not registered are void as security against a liquidator and creditors. In the event of a charge properly created, fails to be filed within the statutory period, on application and only on good cause shown, the court may allow late registration.

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