<u>TOPIC 13: RECEIVERSHIP AND LIQUIDATION OF COMPANIES</u>

RECEIVERSHIP

A receiver is an individual appointed to take control of property. A receiver of property may be appointed by the court to collect and protect the property until its fate can be determined by the court or by a chargee to utilize the property in meeting the obligations secured by the charge.

<u>Administrative receiver</u>

This is one appointed under a floating charge where the company is a going concern.

Upon his appointment he should take position of whole or substantially the whole of the company's property.

<u>Qualification of a receiver</u>

The following persons shall not qualify for appointment as receivers.

i. A body corporate e.g. a company
ii. Undischarged bankrupt

1. Appointment of a receiver by court

The court may appoint a receiver:

i. Where the principal / interest are in arrears
ii. Where the company is being wound up
iii. Where the security is in jeopardy
iv. Where creditors have obtained judgment against the company and are about to execute it by attaching property and assets which is held under debenture.
v. Where a company is disposing off its undertaking in violation of the terms of the debenture deed
vi. Where there is dispute between directors i,e the management of the company is in a crisis.

- **Differences and similarities between a receiver and a liquidator**

Difference

- A receiver is a representative of secured creditors appointed by them or by the court on their behalf to enforce their security. If the debt is paid the receiver vacates the office and the directors take full control of the company , a liquidator on the other hand is appointed by the or members or creditors and his main task is to wind up the affairs of the company consequently leading to the dissolution of the company. There is no possibility of the directors resuming control of the company

LIQUIDATION

A company being an artificial person cannot die a natural death.

In order put any end to life of the company any of the following legal processes may be followed:

a) **Through a scheme of reconstruction and amalgamation** - in which the undertaking of company may be transferred to another company and the court orders for the dissolution of the transferor company without winding up process.

b) **Through the removal of the name from the register of companies by the registrar**

c) **Through winding up**-Winding up is the process where life of the company is ended and property administered for the benefit of the creditors and distribution of the surplus if any among the members of the company.

Winding Up and Dissolution

Winding up precedes dissolution. Prior to dissolution and after winding up, the legal entity of the company remains and it can be sued in a court of law. On dissolution, the company ceases to exist and its name is struck off the register of companies by the registrar and the fact is published in the Kenya gazette.

Modes of Winding Up

The law provides for winding up of a company in any of the following ways
a) Winding up by the courts/Compulsory winding up
b) Voluntary winding up

I. <u>Winding Up by Court/Compulsory winding up</u>

It is the court which makes the order that the company be wound up.

Grounds for compulsory winding up

1. **Passing of a special resolution**

In this case, the company resolves that it be wound up by the court.The reasons underlying the passing of a special resolution may include:

a. Deteriorating financial and trading position of the company which may imply future inability of the company to pay its debts
b. Lack of working capital
c. Change of business conditions which renders the continued operation of the company difficult
d. Where the object for which the company was created has been achieved
e. General paralysis arising from labor/ industrial unrest and strikes

2. **Default in holding a statutory meeting or delivery of a statutory report to the registrar**.

Winding up on this ground can be presented either by the registrar or by a member on or after 14 days after the due date of the meeting.

3. **Where the company fails to commence business within one year of Incorporation or suspending business for one year**
4. **Reduction in membership below the statutory minimum and the company carries on business for more than 6 months**
5. **Where, the company is unable to pay its debts or honor its monetary commitment.**

This is determined when:

- A creditor owed Ksh.1,000 or more has served on the company at its registered office a demand for payment and the company has for 3 weeks or more neglected paying the creditor.
- An execution or other order issued by the court in favor of a creditor is returned unsatisfied in whole or in part
- The court is fully satisfied that the company is completely unable to pay its debts

6. Where it is just and equitable for the court to wind up the company

a) Failure of the object (substratum)
   The substratum of the company is deemed to be gone when the main object for which the company was formed has become impossible or impracticable to achieve
b) Where there is a complete deadlock in the management of the company
c) Oppression of minority
d) Where the business of the company is continuously making losses.
e) Justifiable loss of confidence in the management of the company affairs
f) Where the company was conceived to carry on illegal or fraudulent business
g) Exclusion from management

Who may petition for winding up?

a) Company itself- By passing a special resolution to this effect.
b) Contributory (a member)
c) Creditor
d) Registrar
e) Attorney General
f) Official receiver
g) Commissioner of Insurance

Company itself- By passing a special resolution to this effect.

Contributory

A contributory is any person liable to contribute to the assets of the company in the course of its winding up. A contributory can petition only if:
1. He is an original allottee of the shares
2. He has held the shares in his name for at least 18 months
3. The shares devolved to him due to the death of a former shareholder

Creditors

The following are regarded as creditors:
1. A secured or unsecured creditor
2. A holder of any debentures
3. The trustee of debenture holders
4. The government for any outstanding revenue from the company

Registrar

He may petition for winding up in public interest where the company's books and documents have been investigated and the inspectors have made a report

Attorney General

This follows a report of inspectors upon the company's affairs where it appears that the business of the company is being conducted with intent to defraud creditors

Official receiver
The official receiver may petition for winding up in the following circumstances;

- Winding up a company carrying on business in Kenya if winding up proceedings have commenced against it outside Kenya and a liquidator has been appointed to wind it up.
- For the continuation of a voluntary winding up subject to the supervision of the court as a compulsory winding up.

Commissioner of insurance
The commissioner of insurance may present a petition to wind up an insurance company if:

- ✓ It is unable to pay its debts.
- ✓ It has failed to comply with the requirements of the insurance Act.
- ✓ It is carrying on insurance business while unregistered by the commissioner.
- ✓ It is unable to meet reasonable expectations of the policy holders.
- ✓ It is just and equitable in the interest of policy holders.

FORM OF PETITION

It must be in the form prescribed by the Act and lodged at the High court and verified by affidavits (sworn statements)
The petition is required to state: (contents)

I. The name, description, occupation and address of the petitioner
II. The name of the company and its date of incorporation
III. The location of the registered office of the company
IV. It's nominal and paid up capital
V. The objects for which it was formed
VI. The grounds on which winding up is sought

- ✓ If the petition is presented by the company itself, the particulars of the resolution passed by the company must be given to the registrar.
- ✓ The petition must be advertised in the Kenya, gazette at least 7 days before the hearing
- ✓ Once the court makes a winding up order, it appoints the official receiver to be provisional liquidator so as to preserve the assets of the company.
- ✓ The company must then submit to the official receiver a statement of affairs of the company's assets and liabilities together with causes of failure within 14 days of the making of the winding up order
- ✓ Within one month after le winding up order, the official receiver must send a summary ***creditors of appointing a committee of inspection.

LIQUIDATION COMMITTEE

It Consists of an equal number of creditors and contributories and the number is determined by the court. They meet at least once a month under the chairmanship of the liquidator. Members of (he committee are in a fiduciary position towards the company
<u>Functions of the committee</u>
1. To appoint a liquidator to replace the official receiver
2. To determine the remuneration of the liquidator
3. To consider the progress of liquidation
4. To supervise the conduct of the liquidator

5. To sanction certain powers to be exercised by the liquidator

Cessation of membership of committee of inspection

a) Resignation by written notice to the liquidator.
b) If declared bankrupt by a court of law.
c) Enters into arrangement with his creditors to compound his debts.
d) If he absents himself from 5 consecutive meetings of the committee without permission of the person with whom he represents.
e) If he is removed by ordinary resolution of the group, he represents

Consequences of winding up order

1. The winding up order shall be deemed to be notice of discharge of the officers and employees of the company except when the business of the company is to be continued for the purpose of beneficial realization of assets
2. The powers of the board of directors are terminated and the same will now be exercised by the official liquidator
3. The winding up order shall operate in favor of all the creditors and contributories of the company
4. The official receiver by virtue of his office becomes the liquidator
5. Any debts payable at a future date become immediately payable on the winding up order
6. No legal proceedings can be commenced against the company without the leave (permission) of the court.
7. The court which is conducting winding up shall have full powers to entertain or dispose of any new or pending suit by or against the company. Any suits pending in any other court shall also be transferred to the court in which the winding up of the company is proceeding

THE LIQUIDATOR

This is the person appointed to realize the company's assets, ascertain and pay its liabilities and distribute the remainder, if any, to members. This is a person appointed to wind up the company.

<u>Qualification of a liquidator</u>

The Act is silent about the qualification of a liquidator, but disqualifies undischarged bankrupt and body corporate.

<u>Appointment of a liquidator (depends on the type of winding up)</u>

In winding the court, the official receiver is the liquidator or any other person appointed by the court.
In a members winding up, he is appointed by members in the general meeting.
In a creditors voluntary winding up, he may be appointed by;

- ✓ Members
- ✓ Creditors
- ✓ Both creditors and members
- ✓ The court on application

The legaI position of the liquidator.

1. Liquidator as an officer of the court- he is answerable to the court.
2. Liquidator as trustee- of creditor's in general
3. The Liquidator as an agent of the company.
4. Liquidator as a fiduciary- must act in good faith and avoid conflict of interest

Powers of the liquidator

He can exercise certain powers with the sanction of the court unless expressly exempted others which he can also exercise on his own without court sanction

Powers with court sanction

1. To institute or defend any suit in the name of and on behalf of the company
2. To carry on the business of the company so far as may be necessary for the beneficial winding up of the company
3. To sell the movable and immovable property and actionable claims of the company e.g. debts either by private contract or by auction
4. To raise any money as may be required and charge it on company assets
5. To appoint an advocate to appear before the court or assist him in the performance of his duties
6. To pay any class of creditors in full or to make a compromise or arrangement with creditors
7. To compromise calls, debts and other pecuniary liabilities with contributories or debtors
8. To do all such other things as may be necessary for winding up of the affairs of the company and distributing its assets e.g. settling a list of contributories and creditors

Powers without court sanction

1. To do all acts in the name and on behalf of the company and to execute deeds in the name of the company and to use the common seal of the company.
2. To inspect the records and returns of the company and the files of the registrar without payment of any fees
3. To draw, accept and endorse any negotiable instrument in the name of the company
4. To make out in his official name letters of administration to the estate of deceased contributory and to do necessary things to obtain payment
5. To appoint an agent to do any business which he is unable to do himself?
6. To prove, rank and claim in the insolvency of any contributory for any balance against his estate
7. To set aside fraudulent preferences effected within 6 months before the commencement of winding up,

NB: Any person aggrieved by any decision or action of the liquidator may apply to the court for the court to confirm reverse or modify the act or decision as it may deem fit

Duties of Liquidator

1. He must exercise unfettered discretion,
2. He must act bonafide for the benefit of interested parties.
3. He must exercise powers for the particular purpose for which they are given
4. He is bound to avoid conflict of interest.
5. He must exercise discretion personally unless appointed jointly.
6. He must act honestly and impartially,
7. He must exhibit the degree of care and skills appropriate to the circumstances.
8. He is bound to secure control of the company's assets,
9. He is bound to realize the assets,
10. He must ascertain and pay the company's debts
11. He is bound to ensure that minutes of the respective meetings are kept.
12. He is bound to keep proper books of account,
13. He is bound to pay monies received into a separate account for purposes of the winding up.
14. At least twice a year, he is bound to deliver to the official receiver an account of his receipts and payments.

Power of the court after the winding up order

1. Power to stay (stop) winding up proceedings, The court on application of either a liquidator or any creditor or contributory, may make an order staying the proceeding completely or for a limited time on such terms and conditions as it deems fit.
2. To settle a list of contributories and order for the realization of the company assets in order to discharge its liabilities
3. To order for the delivery of property books or cash of the company to the liquidator
4. Power to make calls if there is a deficiency in the company's asset to meet the company's liabilities and winding up expenses.
5. Power to exclude creditors who do not prove their debts on time
6. Power to order public examination of promoters or directors if on the report of the liquidator he is of the opinion that fraud has been committed by any person during promotion of the company or an officer of the company in the conduct of his business.
7. Power to arrest a contributory intending to abscond from the country and to have his books, papers and properly seized and safely kept until such time as the court will order
8. Power to order for dissolution of the company after the affairs of the company have been completely wound up, and the liquidator has made an application to the court in that regard The liquidator will then within 15 days file a copy of the order with registrar who shall strike off the name of the company from the register of the companies
9. Power to declare dissolution void. The court may at any time within 2 years of dissolution make an order declaring dissolution to be void on application of the liquidator or other interested persons. The company shall then be reinstated in the register

Release of the liquidator (discharge)

When the liquidator has:

a) Distributed a final dividend if any to creditors
b) Adjusted the rights of contributories amongst themselves,
c) Made a final return to contributories, he must apply to the court for his release or discharge.

Dissolution of the company

When the company's affairs are fully wound up the court may on application the liquidator, order that the company be dissolved from the date of the order and it is accordingly dissolved. A copy of the order must be delivered to the register for registration within 14 days.

Voluntary winding up

This means winding up of the company by the members or creditors without interference by the court

Grounds for voluntary winding up

Section 271 sets out the following as the grounds under which a company may be wound up voluntarily

1. Passing of a special resolution

A company may at any time pass a special resolution that it may be wound up voluntarily due to:

a. Loss of business prospects

b. Adverse business circumstances

c. Where members simply wish to distribute surplus assets among themselves and to terminate the company activity

2. By passing an ordinary resolution on the following grounds

a. Where the company was formed to last for only a fixed period and that period has come to an end

b. If the company was created to last until the occurrence of a specified event e.g on the death of the last founding company director

TYPES OF VOLUNTARY WINDING UP

Voluntary winding up may either be

a. Member’s voluntary winding up

b. Creditor’s voluntary winding up

Member's voluntary winding up

This is where members of the company on their own order the liquidation process through their appointed liquidator, This is only possible when the company is solvent and able to pay its debts in full, this require the filing of a statutory declaration of solvency by the directors.

This is a declaration that the company is solvent and that it has no debts or that if will pay its debts in full within 12 months from the commencement of winding up. The declaration must be made by directors at the meeting of the board.

In order to be effective, it must be made within 30 days of the passing of the winding up resolution and the resolution shall be delivered to the registrar for filing accompanied by a copy of the auditor’s report, a profit and loss account since the date of the last account and the balance sheet as at that date showing a statement of the company's assets and liabilities. Directors making a false declaration of solvency are liable to imprisonment for a term not exceeding 5 years or to a default fine not exceeding shs 2,000,000 or both

Procedure of winding up by members

1. Passing of a winding up resolution: by the members in a general meeting

2. Appointment of a liquidator: the company's general meeting shall appoint one or more liquidator and fix his remuneration.

3. Cessation of the powers of directors: on the appointment of a liquidation the powers of the directors shall cease except as may be required by the company in a general meeting or by the liquidator.

4. Power of a liquidator to accept shares: where the company is proposed be wound up, or if in the process of winding up the whole or part of the company are proposed to be transferred to another company's, the liquidator of the transferor company with the sanction of the company's special resolution may receive in compensation shares or other interests in the transferee company or distribution among the members.
5. Calling creditors meeting: If liquidation goes on for more than one year, the liquidator shall summon a meeting of the creditors and lay before it a statement of assets and liabilities of the company.
This is necessary if in the opinion of the liquidator the company is not able to pay its debts in full without the period stated in the declaration of solvency
6. General meeting of members at the end of the year: The liquidation shall Convene such a meeting where winding up goes beyond one year. He shall lay before the meeting an account of his activities and report the progress of winding up during that year
7. Final meeting and dissolution: After the affairs of the company are completely wound up, the liquidator will call the final meeting of the company for the purpose of laying a detailed account of the winding up process and giving necessary explanation. The meeting shall be called by an advertisement in a local daily having sufficient circulation and by notice in the Kenya gazette .1f everything is satisfactory, the company shall be dissolved

<u>Creditor's voluntary winding up</u>

If in a voluntary winding up, a declaration of solvency is not made the creditors take it up. The creditors take over the winding up process in order to protect their own interests in the company. Winding up will then proceed as follows:

1) The ceditor's and members at their respective: meeting may nominate a liquidator for the purpose of winding up the affairs of the company and to distribute its assets if they appoint different persons as liquidator, then the liquidator appointed by the creditors shall be the liquidator
2) Tabling of the statement of affairs: the board must lay before the meeting of creditors a statement of the position of the company's affairs e.g. a list of creditors of the company and the amount of their claims
3) Appointment of a committee of inspection: the creditors appoint this committee comprising of not more than 5 persons and the committee shall fix the remuneration of the liquidator apart from overseeing the winding up proceedings
4) Cessations of director's powers: on appoint on the liquidator, powers of the board shall cease and the same shall vest in the liquidator. If a vacancy occurs by death or resignation of the liquidator the creditors may appoint another person to fill the vacancy
5) The calling of a general meeting: at the end of the year to review the progress of liquidation where winding up proceeds for more than one year
6) Final meeting and dissolution: once the affairs of the company have been wound up, the liquidator shall call a final meeting at which a resolution shall be passed that the company's affairs shall be wound up. The liquidator shall then notify the court concerning the resolution and the court shall order for dissolution of the company.

DISTINCTION BEIWEEN MEMBERS & CREDITORS VOLUNTARY WINDING UP

MEMBERS	*CREDITORS*
It is resorted to by solvent companies and require filing of a statutory declaration of solvency by directors	Resorted to by insolvent companies and there cannot be a declaration of solvency
It requires the calling of a general meeting of members only	Require the holding of both members and creditors meetings
The liquidator is appointed by member in a general meeting	Liquidator is appointed by either members or creditors
Appointment of a committee of inspection does not arise.	Creditors usually appoint a committee of inspection
Control of the proceedings is by members	Creditors control the proceedings

GENERAL PROVIS ONS RELATING TO CORPORATE INSOLVENCY

1. Winding up is (deemed 'co commence from the date of passing of the winding resolution
2. There must be a notice of commencement of winding up in the Kenya gazette and in a local daily having a wide circulation
3. Appointment of liquidator for the purpose of collecting the company's assets and a final distribution to the creditors
4. Once liquidation has commenced certain activities of the company cease e.g. legal action by or against the company
5. Creditors prove their debts and thereafter the liquidator distributes the remaining assets to the members. At the end of the liquidation process the liquidator shall convene a final meeting and give his final report after which he hands over a copy to the registrar so that the registrar can strike the company's name from the register
6. Dissolution of the company can be challenged on appeal and the company can be re-instated in the register

Offences relating to liquidation

1. **Fraudulent preference**

Under Companies Act, any disposition of the company's property, any creation of a charge fixed or effected during the period of six months before commencement of liquidation shall be void as a fraudulent preference if:

a) It was done voluntarily

b) It was done with the intention of preferring one creditor over another

c) It was done at a time when the company was insolvent

NB: " Disposition" includes the payment of a debt

2. **Fraudulent trading**

Under the Act, if the court finds that the business of a company in liquidation has been carried on with intent to defraud creditors contributors or for any fraudulent purpose it may declare that any persons who were knowingly parties carry on the business in this fashion shall be liable for debts of the company as the court may desire

3. **Misfeasance**

This is a wrongful act of omission committed or omitted by a person charged with the responsibility or authority

Misfeasance proceedings may be instituted against a director, promote manager, liquidator or officer including an auditor of a company in liquidation either to recover the company's property from him or to claim compensation for the loss to the company caused by his misfeasance.

Examples of misfeasance include;

- Payment of dividends out of capital,
- Making of improper payment to promoters by directors.
- Making of secret profit by directors or promoters.
- Making fraudulent preferences.
- Selling a company property at undervalue.
- Applying the company's assets in ultra vires or illegal transactions,

Liability of past members

Members of the company both past and present, are liable to contribute to the assets of the company, such amounts as necessary to meet its debts and other liabilities as well as the expenses of winding up.

However, the liability of past members is subject to the following qualifications;

a. A past member cannot be called upon to contribute the assets of the company if he ceased to be a member for one year or more before flue commencement of winding up,
b. A past member is not liable 10 contribute in respect of debts contracted after he ceased to be a member.
c. A past member can only be called upon to contribute if the existing members are unable to satisfy the contributions necessary,
d. In the case of a company limited by shares, a past member can only be called upon to contribute the amount unpaid on his shares.
e. In case of a company limited by guarantee a past member can only be called upon to contribute the amount he undertook to contribute if the company Was wound up during his membership or within one year of cessation of membership

PRIORITY OF CLAIMS

1. All costs charges and expenses properly incurred in the winding up process including the liquidator’s remuneration must be paid out of the asset's of the company in priority to all other claims.

2. Preferential claims or payments:

a) All taxes and local rates due from the company for not more than one year,

b) All government rent in arrears for not more than one year,

c) Wages and salaries payable to servants of company other than the directors for services rendered to the company during the 4 months preceding the commencement of winding up.

d) Any amount payable under the work injury benefits Act.

e) Any amount payable under the NSSF Act and NHIF act.

3. Secured creditors.

4. Unsecured creditors.

5. Other creditors (Deferred Creditors)

The balance if any is distributed between members.