REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA AT NAIROBI

MILIMANI LAW COURTS

COMMERCIAL & ADMIRALTY DIVISION

INSOLVENCY PETITION NO. 03 OF 2019

IN THE MATTER OF ARVIND ENGINEERING LIMITED

AND

IN THE MATTER OF SECTION 537 (1) OF THE INSOLVENCY ACT NO. 18 OF 2015

AND

IN THE MATTER OF REGULATION 102 OF THE INSOLVENCY REGULATIONS 2016

RULING

1. These proceedings are an invitation to this Court to discuss two important aspects of the device of Administration under the current Insolvency Regime. The first is whether the holder of a Debenture created prior to the coming into effect of the Insolvency Act (Act No.18 of 2015) (**the Act**) can qualify to appoint an Administrator under the provisions of the statute. Secondly whether the holder of a qualifying floating charge (hereinafter also Q.F.C.H) can, without Court sanction, leapfrog a Company which has sought to place itself under Court appointed Administration by appointing an Administrator during the pendency of the Company's application for an Administration Order.

2. This invitation is presented in a Notice of Motion dated 4th February 2019 filed by Arvind Engineering Limited (the company) challenging the appointment of K.V.S.K Sastry by NIC Bank (the Bank) as its administrator. The motion seeks the revocation of that appointment.

3. The facts forming this dispute are neither contested nor involved. On diverse dates between the year 2013 and 2015, the Bank advanced financial facilities to the Company. The facilities were secured by two Debentures namely a Debenture dated 13th January 2014 for the sum of US Dollars 4,050,000 and Kshs. 137,000,000 and registered on 12th February 2014, and a further Debenture of 4th August 2015 for Ksh.219,108,000 registered on 24th August 2015. The Company fell into hard times and there was default in the repayment of the facilities. The debt is substantial being over Kshs. 840,000,000.

4. It must be in acknowledgment of these distress that the Company lodged an application for Administration on 6th July 2018 in Nairobi High Court Misc. Application No 306 of 2018 (hereinafter the Administration proceedings).The Bank opposed the application and the application is still pending. That is a common position. One of the Company's grievance is that the Bank has placed it under Administration in the full view of the pendency of the Administration proceedings. The Company accuses the Bank of failure to disclose the existence of those proceedings and an attempt to steal a march on it.

5. A second attack on the appointment is anchored on the argument that the Bank is not a holder of a qualifying floating Charge. This is grounded on the meaning assigned to the word "*Qualifying floating charge''* by section 534 of the Act which reads:-

> "(1) The holder of a qualifying floating charge in respect of a company's property may appoint an administrator of the company.
>
> (2) For the purposes of subsection (1), a floating charge is a qualifying floating charge if it is created by a document that—
>
> (a) states that this section applies to the floating charge; or
>
> (b) purports to empower the holder of the floating charge to appoint an administrator of the company.

(3) For the purposes of subsection (1), a person is the holder of a qualifying floating charge in respect of a company's property if the person holds one or more debentures of the company secured—

(a) by a qualifying floating charge that relates to the whole or substantially the whole of the company's property;

(b) by a number of qualifying floating charges that together relate to the whole or substantially the whole of the company's property; or

(c) by charges and other forms of security that together relate to the whole or substantially the whole of the company's property and at least one of which is a qualifying floating charge".

6. The Company contends that the Debenture held by the Bank neither states that this section applies to it nor does it purport to empower the Bank to appoint an Administrator.

7. For the Bank it is asserted that since the Debenture empowers it to appoint a Receiver under the provisions of the repealed Companies Act, then that power can be deemed to include power to appoint an Administrator. That quite obviously as the instrument predates the Insolvency Act then it could not make reference to the application of section 234 as required by the provisions. Counsel Mburu for the Bank asked this Court to follow the decision in Re Grant Estates Limited (2011) Scots CS CSOH 119,2011GWD 24-546 where a Scottish Court considering not too dissimilar provisions rejected the submission that a floating charge that predated provisions that partly defined a qualifying floating charge to be one that states that the provisions applies to the charge, could not simply be disqualified because of not making that reference.

8. On bad faith and non-disclosure ,the Bank takes the position that in commencing these proceedings it complied with Regulation 102(3)(h) of the Insolvency Regulations 2016(the insolvency regulations).That the Regulations do not require the appointing authority to inform Court of pending proceedings. The Court was asked to give regard to the substantive statute and to find that section 537(1)(b) thereof only requires the appointing to file such other documents and does not provide that the Notice of Appointment must comply with regulation 102(3)(h).

9. Any debenture or charge instrument that predates the Act would certainly not save the application of section 534 as is contemplated by section 534 (2)(a) of the Act as the makers of the instruments could not foretell the provisions of a yet to be enacted statute. That must be conceded by both sides. In addition, it has to be accepted that the concept of Administration as designed in the Act did not exist prior to the Act. For that reason the construction to be given to the provisions of subsection 2(b) is critically important to holders of the pre 2015 instruments.

10. If the Court was to uphold the argument by the Company then all such Debenture holders could never qualify to appoint Administrators as holders of floating Charges. That would mean that if they wanted to pursue Administration, then they would have to seek appointment like any other creditor. A process that requires Court sanction and is not as summary as the appointment made by a holder of a qualifying floating Charge (see the provisions of section 532 on applications for an Administration order by a creditor which require Court approval).Could this have been the intention of the legislator?

11. A search for intention starts by again setting out the provisions of sections 534(1) and(2) of the Act;-

"(1) The holder of a qualifying floating charge in respect of a company's property may appoint an administrator of the company.

(2) For the purposes of subsection (1), a floating charge is a qualifying floating charge if it is created by a document that—

(a) states that this section applies to the floating charge; or

(b) purports to empower the holder of the floating charge to appoint an administrator of the company".

12. By giving the alternative criteria under subsection 2(b), it is clear that eligibility as qualifying floating charge is not just the express saving of the application of the provisions in the Debenture instrument but also the character of the Debenture. If the Debenture empowers the holder to appoint an administrator then it passes the test.

13. Section 522 of the Act which sets out the objectives of Administration is useful in understanding the nature of administration. It reads;

"(1) The objectives of the administration of a company are the following:

(a) to maintain the company as a going concern;

(b) to achieve a better outcome for the company's creditors as a whole than would likely to be the case if the company were liquidated (without first being under administration);

(c) to realise the property of the company in order to make a distribution to one or more secured or preferential creditors.

(2) Subject to subsection (4), the administrator of a company shall perform the administrator's functions in the interests of the company's creditors as a whole.

(3) The administrator shall perform the administrator's functions with the objective specified in subsection (1) (a) unless the

administrator believes either—

(a) that it is not reasonably practicable to achieve that objective; or

(b) that the objective specified in subsection (1)(b) would achieve a better result for the company's creditors as a whole.

(4) The administrator may perform the administrator's functions with the objective specified in subsection (1)(c) only if—

(a) the administrator believes that it is not reasonably practicable to achieve either of the objectives specified in subsection (1)(a) and (b); and

(b) the administrator does not unnecessarily harm the interests of the creditors of the company as a whole".

14. Both the original and further Debentures give power to the Bank to appoint a Receiver in the event of default of payment. In addition, the instruments define the powers of the Receiver. I reproduce the provisions of appointment and the powers donated;-

"17. *At any time after demand for payment of the moneys secured or without demand upon the happening of any of the events set out in clauses 4,5, and 6 or if the Company fails to comply with any covenant, warranty or other obligation herein contained*

(a) the bank or any officer of the Bank may appoint in writing any person or persons (whether an officer or officers of the Bank or not) to be a receiver and manager or receivers and managers jointly and severally of the property and assets hereby charged or any part thereof upon terms as to remuneration or otherwise as the Bank decides and may from time remove any receiver and manager or receivers and managers so appointed and appoint another or others, or

(b) the Bank may take possession of all or any of the property hereby charged, or

(c) the Bank may take both courses of action.

19. Every receiver and manager so appointed (hereafter called "the receiver") is the agent of the Company and the Company alone is liable for his acts defaults and remuneration and he has the powers hereinafter set forth in addition to any general powers conferred on him by law:

(a) to enter (either personally or by his servants or agents and either accompanied by workmen and others or not so accompanied) upon any land or buildings where any property or assets hereby charged may for the time being be or upon any other land or buildings owned or occupied by the Company.

(b) to take possession of collect and get in all or any part of the security and for that purpose to take all proceedings in the name of the Company or otherwise as he thinks fit and whether by Court action or by arbitration.

(c) to sell or let or concur in selling or letting any of the security in such manner and generally on such terms and conditions as he thinks fit and to carry any such sale or letting into effect;

(d) to carry on manage or concur in carrying on and managing the business of the Company or any part thereof;

(e) in the course of carrying on or managing the business of the Company to do all acts which may be done in the ordinary conduct of the business for the protection of the assets used therein and for obtaining a return therefrom and for that purpose the receiver may claim damages for any wrong done to the business;

(f) for the purpose of carrying on the business of the Company and of defraying costs, charges, losses or expenses (including his remuneration) incurred by him in the exercise of the powers, authorities and discretions vested in him and for all other purposes thereof or any of them to raise and borrow money by charging the security or any part thereof either in priority to this debenture or otherwise and at such rate of interest and on such terms and conditions as he thinks fit and no person lending such money need enquire into the propriety or purpose of the exercise of this power nor see the application of the money; Provided that the receiver may not exercise this power without obtaining the prior written consent of the Bank but the Bank incurs no liability to the lender or the Company or otherwise howsoever by reason of the giving or refusing of consent whether absolutely or subject to any limitation or condition;

(g) to make any arrangement or compromise which he thinks expedient in the interest of the Bank;

(h) to make and effect all such repairs, improvements and insurances as he thinks fit and to renew such of the plant, machinery and other effects of the Company whatsoever as are worn out, lost or otherwise unserviceable;

(j) to appoint, dismiss and remove managers, accountants, workmen, servants and agents upon such terms as to remuneration or otherwise as he thinks fit.

(k) to purchase, lease, erect or otherwise acquire and develop or improve properties and other assets, machinery, plant and equipment without being responsible for loss or damage;

(I) to make call conditionally or unconditionally on the members of the Company in respect of its uncalled capital and unpaid premiums on share issues hereby charged and to sue in the name of the Company or otherwise for the recovery of moneys becoming due in respect of calls so made and to give valid receipts for such moneys and the provisions contained in the Company's Articles of Association in regard to calls apply mutatis mutandis to calls made under this authority and this authority subsists during the continuance of this debenture notwithstanding any change in the Company's directors and is exercisable by the receiver to the exclusion of the powers of the directors and the powers given and moneys due thereunder are assignable;

(m) to incorporate a subsidiary company or companies of the Company and to sell assets to that Company or Companies.

(n) to carry out work on the Company's property and to do anything necessary for its realisation;

(o) to do all such other acts and things as may be considered to be incidental or conductive to any of the matters or powers aforesaid and which the receiver may lawfully do as agent for the Company;

(p) from time to time to substitute and appoint one or more attorneys under him for all or any of the purposes of this debenture and at his pleasure to remove them".

15. Clauses 18 and 19 above refer to the person appointed as the Receiver and Manager and not just a Receiver. The power of a Receiver and Manager (also called Receiver Manager) is wider than that of a Receiver. The Receiver and Manager has the extra and important managerial function. Once appointed under the provisions of Clause 19, the Receiver and Manager takes up many of the roles which ordinarily belong to the Directors of the Company. A key function of the Receiver and Manager is to keep the company as a going concern. Weighing in on the differences between the between the Receiver and The Receiver and Manager,Gikonyo J had this to say in Surya Holdings Limited & 2 others vs. CfC Stanic Bank Limited [2015] eKLR;-

"*[24] From the outset, let it be known that, the law especially on the duties of Receiver appointed by the court, and the one appointed out of court by debenture-holder is no longer seen as disparate. The niche development of the law is found in the difference between mere receiver and ''receiver and manager''. The difference is not a moot issue but a matter of law. ''Receivers and Managers''entails not only receiving rents and profits, or getting in outstanding property, but also carrying on or superintending a trade, business or undertaking of the company. Receiver and Manager will have power to deal with the property, run the business of the company and appropriate the proceeds thereof in a proper manner for the benefit of the debenture-holder first, and of the company, secured creditors and guarantors of the company. Receiver and Manager is an agent of the Company, but stand in a fiduciary relationship with and owes duties to both parties. Given the very nature of the position of Receiver and Manager who has control over the property of the company and is running the enterprise as a going concern as is the case here, doubtless, has a duty to account to the law, the debenture-holder and the company".*

16. To be emphasised is the role of a Receiver and Manager in superintending and managing the Company as a going concern not only in the best interest of the debenture holder but also the Company. This is also one of the central objectives of Administration (See section 522 and paragraph 13 of this decision). There lies some commonality between the past concept of Receiver-manager and the contemporary concept of Administration. So as not to disadvantage debenture holders who hold debentures that predate the Act, there is need to give a purposive interpretation to the provisions of section 534(2)(b).This Court does hold that as the debenture instruments held by the Bank empowered the Bank to appoint a Receiver-manager whose many powers and functions are akin to that of an administrator then the Bank is deemed to have power to appoint an administrator. In that way the Bank is a holder of a qualifying floating Charge. That does it for the first issue.

17. The Bank sought to exercise its power to appoint an administrator under the provisions of section 537 of the Act which reads:-

"1) A person who appoints an administrator of a company under section 534 shall lodge with the Court—

(a) a notice of appointment that complies with subsections (2); and

(b) such other documents as may be prescribed by the insolvency regulations for the purposes of this section.

(2) A notice of appointment complies with this subsection if—

(a) it includes a statutory declaration by or on behalf of the person who makes the appointment—

(i) that the person is the holder of a qualifying floating charge in respect of the company's property;

(ii) that each floating charge relied on in making the appointment is (or was) enforceable on the date of the appointment; and

(iii) that the appointment is in accordance with this Part; and

(b) it identifies the administrator and is accompanied by a statement by the administrator—

(i) that the administrator consents to the appointment;

(ii) that in the administrator's opinion the purpose of administration is reasonably likely to be achieved; and

(iii) giving such other information and opinions of a kind prescribed by the insolvency regulations for the purposes of this section.

(3) A statutory declaration under subsection (2) is not effective unless it is made during the period prescribed by the insolvency regulations for the purposes of this section".

18. In addition to observing the requirements of this section ,the appointing authority must pay heed to the provisions of Regulation 102 which elaborate on the requirements as follows:-

"(1) For the purposes of section 537 of the Act, a notice of appointment of an administrator of a company is required to be accompanied by an affidavit of statement of facts that contains the information specified in paragraph (2).

(2) The notice of appointment shall be in Form 36 set out in the First Schedule.

(3) The affidavit referred to under paragraph (1) shall contain the following information—

(a) if the application is made by a creditor on behalf of that creditor and others, the names of the others;

(b) if the application is made by the holder of a qualifying floating charge, details of the charge including—

(i) the date of the charge;

(ii) the date on which it was registered; and

(iii) the maximum amount if any secured by the charge;

(c) if the company is registered under the Companies Act 2015—

(i) its nominal capital, the number of shares into which the capital is divided, the nominal value of each share and the amount of capital paid up or treated as paid up, or

(ii) that it is a company limited by guarantee;

(d) the principal business carried on by the company;

(e) that the applicant believes, for the reasons set out in the statutory declaration in support of the application, that the company is, or is likely to become, unable to pay its debts;

(f) the address for service of the applicant or the applicant's advocate;

(g) the names and addresses of the holders of prior floating charges and details of the charges;

(h) a statement indicating—

(i) whether the company is subject to insolvency proceedings at the date of the notice; and

(ii) if it is, details of the proceedings.

19. The Bank is assailed for flouting Regulation 102(3)(h)by failing to include information of the existence of the Administration Proceedings. It is not in contention that there exist other proceedings (Being High Court Misc. Application No 306 of 2018) in which the Company seeks to bring itself under Administration. Those proceedings are still pending as they were at the time the Bank gave Notice herein. It is also common fact that the Bank was aware of those proceedings having opposed them. Those proceedings are proceedings under the Act and are insolvency proceedings in much the same way as the proceedings now before me.Yet in the face of this reality the Bank made the following statement in the Notice Of Appointment of Administration filed herein;

"9. That the Company is not the subject of any other Liquidation at the date of the Notice"

20. This is somewhat disingenuous of the Bank! It feigns compliance with the law by stating that the Company was not the subject of liquidation proceedings at the date of notice. While it is true that liquidation proceedings are insolvency proceedings, the converse is not necessarily true. Not all Insolvency proceedings are in the nature of liquidation. The law required of the appointing authority to disclose insolvency proceedings of any nature. So while the statement by the Bank was accurate in so far as there are no liquidation proceedings, it was not a full and frank disclosure.

21. What I observe next demonstrates one possible rationale for the requirement of that disclosure. Unlike a person who has applied to Court for an Administration order, the appointment of an administrator by the holder of a qualifying floating charge is achieved by compliance of the provisions of section 537 in conjunction with those of Regulation 102. Once there is compliance then the Administration takes effect

(section 538). No fuss, no need for Court approval! It is indeed an out of Court appointment of an administrator. This is not available to the person who has to seek Court sanction. So the Debenture Holder can literally leapfrog the person has already moved the Court and is queuing up for approval. Is this acceptable?

22. Before answering this question i note that although the Company had the option of appointing an out of Court Administrator under Division 5 of Part V of the Act, it choose to pursue Administration through Court sanction under Division 3 of the same Part. It therefore had to present to Court an application (High Court Misc. Application No 306 of 2018) for an Administration Order.

23. The holder of the qualifying floating charge is in a privileged position as section 532(2) requires that he is notified of the presentation of an application for an administration order. It reads;-

> "(2) As soon as is reasonably practicable after the making of an application for administration, the applicant shall notify—
>
> (a) any person who is or may be entitled to appoint an administrator of the company under section 534; and
>
> (b) such other persons (if any) as may be prescribed by the insolvency regulations for the purposes of this section".

In this way the QFCH is availed an opportunity of making its representations in respect to the intended appointment.

24. In the matter at hand, the Bank was aware and duly joined the proceedings commenced by the Company. Indeed, the Bank opposed the grant of the administration order. This Court takes the view that once an application for an administration order is pending and which the Debenture Holder is aware, and has chosen to participate, then the Debenture Holder ought to remain in those proceedings and make arguments for or against grant of the order. Further it may argue that it should be the one and not the applying party who should appoint the Administrator. The solution is not to scuttle the pending proceedings by making a quick appointment as done by the Bank here. The presence of bad faith is particularly telling in this matter because not only was the Bank aware of the proceedings but had in fact submitted to them.

25. Given my findings, I will not uphold the appointment made by the Bank. However I will not revoke it. Instead i do hereby suspend the said Administration and stay these proceedings pending the hearing and determination of Misc. application no 306 of 2018. That gives the Court an opportunity to consider who between the Company and the Bank should appoint the Administrator. For purposes of an orderly return of the Management to the Company, the Suspension of the appointment of the Administrator herein shall take effect 7 days from now.

26. The Company has pretty much succeeded in its Motion and it shall have costs thereof.

Dated, Signed and Delivered in Court at Nairobi this 26th day of April, 2019.

F. TUIYOTT

JUDGE

PRESENT;

Mburu for Petitioner

Kojo for the Company

Nixon – Court Assistant