THE LEGAL CHALLENGES OF MISMANAGEMENT AND MALADMINISTRATION OF A COMPANY IN RECEIVERSHIP: THE LAW, PRACTICE AND PROCEDURE IN ZAMBIA.

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An obligatory essay submitted to the School of Law of the University of Zambia (UNZA) in partial fulfilment of the requirements for the award of the Bachelor of Laws Degree (LLB).

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DECLARATION

I, MUSUMALI, BWANGA RAYMOND, of computer number 28032187, do hereby declare that the contents of this dissertation are entirely based on my own research and that I have not in any respect used any person’s work without acknowledging the same to be so. I therefore bear the absolute responsibility for the contents, errors, defects and any omissions herein.

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THE LEGAL CHALLENGES OF MISMANAGEMENT AND
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DEDICATION

I dedicate this research to my mother Mrs Alfonsina S. Musumali and father Mr Evans M. Musumali for their unwavering and all inclusive support they give me as their son. I feel privileged to have both of you as my parents and mentors. I also recognise all my brothers and sisters for their patience and understanding.
ABSTRACT

This research paper considers the legal regime surrounding the concept of receivership of a company in Zambia with a specific focus on legal actions against inept receivers. The genesis of this investigation is from the realization that many such legal actions against receivers are dismissed or fail in court for wrongly invoking both the substantive and procedural law. Thus, this dissertation has endeavoured to establish and analysed the most appropriate legal avenue for an action against a receiver acting with ulterior motives.

In this research, it was realized that the main explanation for placing of a corporation in receivership is failure to repay its debt as they become due. The creditor will exercise his right to appoint a receiver over the whole or part of the assets of the company which is usually pursuant to a debenture and the receiver will be considered to be the core representative of the company in all its activities including suits.

Further, the main obstacle faced by individuals wishing to bring a legal challenge against a receiver is the perception that once in receivership, the company and its receiver are considered as one and thus a member or director cannot have locus standi. Nonetheless, it was discovered that the company does not lose its separate existence even when in receivership as only its power to deal with its assets are in abeyance. Thus, the correct legal position is that the directors, shareholders, and the company itself have standing to sue in the name of the company whenever there is impropriety on the part of the receiver.

The reason why the law on receivership appears to be uncertain or ambiguous in this regard is the lack of sufficient statutory intervention especially in the Companies Act which is the main law on this topic. The Act seems to have no contemplation of a receiver being sued for mismanaging the company and consequently has not adequately provided for rules of procedure to govern such actions. Therefore, the Companies Act should be revisited to exhaustively include all legal matters pertaining to the relationship among the receiver, company, directors, shareholders, creditor and third parties rather than depending on unwritten legal principles.
TABLE OF STATUTES

- Companies Act, Chapter 388 of the Laws of Zambia
- English Law (Extent of Application) Act, Chapter 11 of the Laws of Zambia
- British Acts (Extension) Act, Chapter 10 of the Laws of Zambia
- Lands and Deeds Registry Act, Chapter 185 of the Laws of Zambia
- High Court Act, Chapter 27 of the Laws of Zambia
- Banking and Financial Services Act, Chapter 387 of the Laws of Zambia
- Preferential Claims in Bankruptcy Act, Chapter 83 of the Laws of Zambia
- Securities Act, Chapter 354 of the Laws of Zambia
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- Magnum (Zambia) Limited v Basit Quadri (Receivers/Manager) & Grindlays Bank International Zambia limited (1981) Z.R. 141(H.C.)
- Christopher James Throne v Christopher Mulenga, Edgar Hamuwele and ZANACO (2008/HPC/0841)
- Zambia Consolidated Copper Mines (Z.C.C.M.) and Ndola Lime Ltd. v Sikanyika and Others, SCZ Judgment No. 24 of 2000
- Weisser v Mursam Shoe Company (1942) U.S 127 F.2d 344
- Trevor v Whitworth (1887) 12 App. Cas. 409.
- Salomon v Salomon [1897] AC 22 (HL)
- Santley v Wilde [1899] CH at p.474.
- Development Bank of Zambia and Livingstone Saw Mills Ltd v Jet Cheer Development (Z) Ltd SCZ Judgment No. 33 of 2000
- Moss Steamship Company v Winney [1912] AC 254
- R v Paddington Valuation Officer, Ex parte Peachey Property Corporation Ltd [1966] 1 QB 380
- Macaura v Northern Assurance Company [1925] AC 619
• Foss v Harbottle (1843) 2 Hare 461

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Chapter ONE

GENERAL INTRODUCTION

It is acknowledged in both commercial and legal circles that every company, regardless of its nature and type, needs to raise finance in order to properly function and fulfill its obligations. Therefore, there are various forms of raising capital such as securing loans, mortgages and charges on assets as security for the borrowed money. It can equally issue debentures and grant a floating or fixed charge over the property of the company. Also, the company can utilize its shares in an endeavor to raise finances and this will usually involve alteration of the share capital, public floatation on a stock exchange and inviting the investing public to whom shares are sold if it is a public company. Generally, the creditors of company are categorized into secured and unsecured ones for the sake of security on a credit.

Any failure in the repayment of a loan will have repercussions on a defaulting company and, in case of a secured credit, the creditor is entitled to appoint a receiver for the purpose of recovering the debt. At law, the receiver or manager is treated as the sole representative of the company in receivership and has the power to make managerial decisions for the purpose of running it. In other words, despite the company being a separate entity, it is not distinct and independent of its receiver as they are treated as one. It is very common that while undergoing receivership, a company may experience willful and grave mishandling of its business affairs by the receiver whose intention may be to completely ground its operations in spite of it having prospects of recovering from the debt.

When the High Court decided the case of *Magnum (Zambia) Limited v Basit Quadri (Receiver/Manager) & Grindlays Bank International Zambia limited*, it apparently seemed as if the entire law and practice on receivership was exhaustively established. The plaintiff filed an *ex parte* Summons for an interim injunction to restrain the first defendant (receiver and manager) from dealing with the plaintiff’s assets until such a time that he accounts for his receipts and payments.

The court in this case properly stated that a receiver is an agent of the company under receivership who is there to secure the interests of the debenture holder and in those circumstances the company concerned is debarred from instituting legal proceedings against its receiver or manager. Also, a company under receivership has no *locus standi* independent of its receiver and as long as a company continues to be subjected to receivership, it is the receiver alone who can sue or defend in the name of the company.

Numerous subsequent actions were commenced relying on this precedent and the courts accordingly applied the law as settled in the Magnum case. However, in due course, it became obvious that not every legal aspect was resolved by this otherwise sound decision. For instance, it was not clear whether or not a receiver cannot still be curtailed by anyone if he is inflicting serious havoc and devastation on the company and its assets. In other words, it was not expressly stated whether or not a receiver is beyond any form of legal challenge for any actions or inactions to the serious detriment of the company under receivership and he should be allowed to totally act arbitrarily.

In a later judgment of *Avalon Motors Limited (in receivership) v Bernard Leigh Gadsden and Motor City Limited*, the Supreme Court tackled the legal status of a receiver, whether he

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can be sued in his name and for what sort of acts. In this case, there were allegations to the effect that the receivership was being conducted in a delinquent fashion to the serious disadvantage of the company, the shareholders and all concerned by the first respondent (receiver and manager).

It held that a receiver occupies a fiduciary relationship with the company and in such instances could be sued for gross negligence. Also, a company under receivership has no locus standi independent of its receiver as a general rule. However, the court made an indication that a receiver could still be challenged for his actions.

The two authorities do not adequately explain all the contentious issues with regard to court actions concerning receiverships. Most importantly, the civil procedural aspects such as how to commence the action have not been put in black and white. Consequently, a lot of actions are still failing in courts for both wrongful commencement and lack of a proper legal basis of the challenge, an example of such cases being Christopher James Throne v Christopher Mulenga, Edgar Hamuwele and ZANACO.⁶

In this case, the applicant was a director and shareholder in Kayanje Farming Limited which was placed in receivership as a consequence of failing to settle US$2,940,000.00 owed to the third respondent. He applied for an order of interim injunction restraining the first and second respondents from acting as receivers and managers of the company citing incompetency and acting with ulterior motives. The High Court held that a company has separate legal personality from its shareholders and the director cannot claim on its behalf. Also, in the circumstances of the case, an injunctive relief cannot be available to the applicant since it is an equitable relief. Moreover, the action was improperly before the court since it was commenced by originating summons. For these and several other reasons, the action was dismissed in its entirety by the court.

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⁶ 2008/HPC/0841
Thus, there is a timely need to have clear and unambiguous legal rules governing actions against receivers or manager. It borders on the basic principle that a good legal system should have certain and clear laws to guard against injustice in society. Before an action is commenced, an individual should be on firm ground that he is relying on properly established principles of law and the procedure followed is legally prescribed. There should be no speculations and apprehension as to whether or not the action will be dismissed for being improperly before the court and lacking merit. This problem of uncertainty is compounded by lack of specific legislation or law on the topic but, however, it suffices to state that the precedents that have been generated by the courts this far can provide a reliable and harmonious law on the problem when holistically investigated.

The essence of this discourse is to analyse the law and the legal channel for challenging a receiver or manager who is acting *mala fide* towards the company under receivership especially in the Zambian legal context and structure. In relation to this, it undertakes to establish the appropriate individual who can commence such an action in court and this is in an endeavor to sort out the issue of who has *locus standi*. In addition, the procedural part involving the form of commencement of actions in court or the originating of court process will be a component of this research including the reliefs that can be granted.

This research is undertaken at a time when a lot of companies in Zambia, both private and public, are securing loans and mortgages from financial institutions. With the liberalization of the economy, a lot of foreign and local financial institutions have mushroomed in the country to participate in the economy. As at 31st December 2010, there were 18 registered commercial banks in Zambia compared to 13 as at 31st December, 2005 and the number is likely to increase.

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as predicted by the Central Bank (Bank of Zambia)\(^8\). According to the 2005 statistics, 27% of the total assets of all registered banks where in form of loans and advances to borrowers especially companies.\(^9\)

Considering the above statistics, it is inevitable that the judicial system will constantly be flooded with litigation that borders on recovery of debt by banks and other financial institutions. Actions against receivers appointed pursuant to debenture agreements will not be spared since their genesis is the recovery of debt. Hence, it is very appropriate and vital that this research investigates the law on such actions in an effort to assemble the scanty legal principles currently obtaining in the legal environment.

In view of the nature of the legal issues to be investigated, this research is qualitative in nature rather than quantitative. Therefore, the methodology to be employed will primarily be desk research and there will be no form of field investigations. In this respect, the desk research will be through the collection of secondary data from law reports within the Zambian context and international jurisdictions, text books, journals, and unpublished scholarly works. Lastly, it should be understood that in as much as this research will investigate receivership in Zambia, it does not imply that relevant works from other jurisdictions will not be consulted. The Zambian legal system does not exist in a vacuum as courts make references to foreign judgments and reasoning when deciding local cases.

In order to properly discuss the issues of this research, this paper is structured and divided into five chapters inclusive of this general introduction as chapter one. Chapter two will give a foundation on receivership as it will define ‘receivership’ and explain how and when the


company will be placed under receivership. It will outline the general law governing receivership in Zambia both statutory and otherwise, expressly or impliedly. In chapter three, the focus will be on how and under what circumstances receivers are challenged in court for their actions or inactions. In line with this, individuals or bodies that have brought before court such challenges will be identified in order to sort out the issues of what amounts to mismanagement or maladministration and *locus standi*.

Chapter four is dedicated to the practical or civil procedure aspect of the research since, as it has already been indicated, actions are dismissed on such basis. This will be done with special reference to the case of Thorne v Mulenga and others. The chapter will also delve into the remedies that can be awarded. The last chapter is chapter five which will draw inferences from the matters that will be discussed in the aforementioned chapters and establish the law, practice and procedure for the legal challenge of mismanagement and maladministration of a company in receivership in Zambia. This chapter will generally make a conclusion and recommendations on the topic of this research.
Chapter TWO

THE CONCEPT OF RECEIVERSHIP AND THE LAW APPLICABLE IN ZAMBIA

2.0 Introduction

This chapter gives a foundation on receivership of a company. It defines ‘receivership’ and explains how and when a company may be placed under receivership in order to understand what it implies or its rationale. In doing so, receiverships are distinguished from other processes such as liquidation, insolvency, winding up and all other schemes employed to realize debt recovery since it is usually confused with such processes. This background is necessary as it will assist in appreciating the intended purpose of this concept which in turn will show what is expected of the receiver. The chapter also outlines the general law governing receivership in Zambia both statutory and otherwise, expressly or impliedly in order to precisely identify the legal resources that are resorted to in such disputes.

2.1 Understanding receivership in law

In law, the specific area where the concept of receivership will be encountered and dealt with is company law. Basically, company law is the field of law that is concerned with companies as entities or bodies that are used as tools of commerce and trade.\(^\text{10}\) Therefore, it can be very difficult to understand receivership without a prior knowledge in company law especially its basics. As Armour\(^\text{11}\) correctly asserts;

> business corporations have a fundamentally similar set of legal characteristics .... The five main characteristics are legal personality, limited liability, transferable shares, delegated management under a board structure, and investor ownership.

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The above list of the five characteristics of a company is not exhaustive by itself but consists of the main features of a corporation. All these features have legal implications directly or indirectly on the concept of receivership as it will be observed later in this chapter. Nevertheless, of all the features of a company, probably the most important one is that it is a separate legal person or entity. Registering a business as a company transforms it into an entity in its own right, with legal rights and responsibilities that are distinct from those of its members.\textsuperscript{12} This also excludes individuals benefiting or externally influencing its affairs in one way or another. Such members and individuals may consist of, among others, promoters, directors, workers, shareholders and investors.

In \textit{Zambia Consolidated Copper Mines (Z.C.C.M.) and Ndola Lime Ltd. v Sikanyika and Others},\textsuperscript{13} the respondents were employees of the second appellant which was a subsidiary of the first appellant. The respondents launched these proceedings contending that their contracts of employment would be transferred to those that would buy the second appellant under the privatisation program. The court held that the change of ownership of shares in a company cannot result in the corporate entity becoming a new employer. The court emphasized that there is a distinction between a company as a body corporate and the shareholders in that company.

This principle of separate personality is and should be respected at all costs and is breached by the notion of regarding a receiver as one and the same as the company in receivership. Once incorporated, the company should always maintain its separate personality even if it is placed in receivership until it is wound-up and this is the intention of the legislature. Abrogation of this fundamental principle should always be disrespected by the court.

\textsuperscript{12}Armour, The Anatomy.
\textsuperscript{13}SCZ Judgment No. 24 of 2000.
Further, a company is considered to be a legal body capable of owning property, and entering into contracts, and members normally have limited liability as regards debts of the company. In other words, only the company will be held responsible for all the liability incurred in its operation and not natural persons such as directors unless the lifting of the incorporation veil is invoked. Hence, when a corporation secures a loan, it is only itself that is obliged to settle the debt and it will bear the consequences that will follow in case of default, not the directors or shareholders.

An illustration of this principal was made in Weiss v Mursam Shoe Company in which two individuals owned substantially all the capital stock of the defendant, a shoe making company. The plaintiff argued that the individuals should be liable on a lease contract for the premises entered into with the defendant since they basically owned the company. The court held that individual stockholders cannot be liable for breach of contract or debt of a corporation. The corporation itself should be pursued unless if it is necessary to pierce the veil of incorporation.

Likewise, this other important attribute of incorporation is disrespected when a receiver is viewed as the sole individual in whom all assets of the company are vested. In law, the receiver is only considered as acquiring a superior interest in the properties of the company and not necessarily personally owning the assets. This can even be deduced from most definitions of a "receiver" and "receivership" that are given by many scholars.

The Black's Law Dictionary defines a receiver as "...a person appointed by a court for the purpose of preserving property of a debtor pending an action against him, or applying the property in satisfaction of a creditor's claim [debt]". This definition provides two circumstances when an individual will be appointed as a receiver but the latter sense is contemplated in

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15 (1942) U.S 127 F.2d 344
company law. Therefore, receivership can be defined as the retaining of an individual by a financier of a secured bond to be in charge of the debt defaulting company or borrower for the sole purpose of debt recovery. It is simply one of the debt recovering methods.

Treanor\textsuperscript{17} has identified several processes in which companies that are unable to service their debt repayments are subjected to and these may include receivership, administration and liquidation. She described receivership as the appointment of an administrative receiver by a secured creditor especially a bank which has a charge over all or most of the assets of a company. A receiver is a person appointed to collect or recover the debt owed to the creditor.

It should be noted that even at a non-corporate level, a receiver can be appointed like it is the case in the Bankruptcy Act\textsuperscript{18} in Section 9 which provided that the court can appoint an official receiver to receive the property of the debtor on petition by the creditor. The High Court Act\textsuperscript{19} in order XXVII also has a provision for appointment of a receiver to in custody of any property which is in dispute in a suit. Such kinds of receivers are not the ones contemplated by this essay but rather those that are appointed to manage a company and its assets.

### 2.2 Insolvency related processes distinct from receivership

As earlier indicated, the placing of a company under receivership is just one of the several processes that a financially limping corporation can undergo. There are other mechanisms a creditor can consider where the borrower company defaults on its obligation apart from receivership. These may include suit for recovery of debt, taking possession of the company’s assets, sale, foreclosure, winding-up and liquidation among others.


\textsuperscript{18} Chapter 82 of the Laws of Zambia.

\textsuperscript{19} Chapter 27 of the Laws of Zambia.
One of the commonest ways of debt recovery is suing for the sum by the creditor in court. It may involve, for instance, the initiation of an action by a Specially Endorsed Writ of Summons in the High court specifying the amount claimed in it which can be a debt. However, the parties can agree on an out of court settlement and avoid costly litigation.

With regard to 'winding-up,' it generically refers to the ending of the affairs of the company.\textsuperscript{20} It is immaterial about the cause of the winding-up and thus it can also include insolvency. The inability to pay debts as they fall due is one of the grounds for bringing an action to wind-up the affairs of a company and the principles for this were laid down in the \textit{Matter of Taw International Leasing Corporation and the Companies Act}.\textsuperscript{21} The petitioners petitioned for the winding-up of the company for failing to pay a disputed debt between them. Sakala J. held that the petitioner must show that the debt is due and payable for a company to be wound-up. A winding-up order will not be made on a debt which is disputed in good faith by the company.

Similar to winding-up is the concept of liquidation. There is a very thin line between these concepts but the only point of departure is that liquidation mainly intended to release as many assets as possible to pay off the creditors from the sale of the assets. Nonetheless, 'liquidation' usually, if not always, leads to the 'winding-up' of the company. No wonder these words are used interchangeably. A company may, however, be wound-up despite being solvent if, for instance, the business becomes illegal but to the contrary cannot strictly speaking undergo liquidation when solvent.

This position of the law was established in \textit{Bank of Zambia v Chungu and Others}.\textsuperscript{22} The issue in this case was whether a solvent bank or financial institution can be placed under compulsory

\textsuperscript{20}Baker and Cary, cases and materials.
\textsuperscript{21}(1978) Z.R. 152 (H.C.)
\textsuperscript{22}SCZ Judgment No.15 of 2008.
liquidation by the Bank of Zambia (BOZ) in exercising its supervisory role. The Supreme Court held that the respondent (BOZ) erred in placing the two applicant companies under compulsory liquidation as it was not established that they were insolvent.

Depending on how liquidation or winding-up is initiated, it can be compulsory or voluntary. Compulsory liquidation involves obtaining a court order after an application which may be brought by the company, majority of its directors, the Registrar of Companies, or any creditor. Applications by creditors are by far the most common the ground is usually the inability of a company to pay its debts. Voluntary liquidation refers to the process whereby the shareholders appoint a liquidator, who is then answerable to the creditors or shareholders. During voluntary liquidation, the company liquidator will be supervised by the shareholders if it is solvent and if it is insolvent, the creditors will supervise the liquidator.\textsuperscript{23}

In a mortgage, a mortgagor has other means of enforcing his security other than appointing a receiver. They consist of sale, taking possession of the assets of the company, and foreclosure. In a sell, the mortgagee will dispose of the assets of the company and will only recoup what is due to him with the balance, if any, accruing to the mortgagor. Taking possession is a rudimentary remedy in mortgages and as Riddall\textsuperscript{24} states, "...unless there is a special clause excluding it, [taking] possession is a remedy to which a mortgagee is entitled as of right as against the mortgagor...." With regard to foreclosure, it is an equitable remedy by which the right to redemption of the mortgagor terminates and the propriety interests in the property vests in the mortgagee.

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Quiet clearly, all these processes or remedies differ from receivership in many respects and no confusions should arise. This is especially with regard to suing for the debt and the remedies available under mortgages. However, there is usually confusion between liquidation and receivership especially on the effects of appointing a receiver or liquidator which many individuals conclude to be the same. Professor Gower\textsuperscript{25} in his authoritative work cautioned that;

"...the appointment of a receiver must not be confused with that of a liquidator. The company need not go into winding-up under receivership. If it does, a different person will normally be appointed liquidator, but if a receiver and manager is appointed over the whole of the undertaking the Board of Directors will, for all practical purposes, become \textit{functus officio} just as on liquidation ...."

2.3 How corporations suffer debts that lead to receivership

In order for a company to operate and achieve its desired objectives, it will inevitably require capital which is basically the funds, property and assets used in a business. Consequently, the company should devise methods of raising funds in order to be financially sustainable and be in existence. The company should properly manage its capital structure and assets must only be engaged in productive ventures. The learned author Baker\textsuperscript{26} listed some of the assets and methods that are considered for purposes of financing the corporation. They broadly include corporate promotion, subscription for shares, public issue of shares, issuing securities for bonds, advancing loans, and mortgages among others.

Generally, all these schemes used by corporations to raise finance and capital are classified into two, that is, equity and debt financing or capital.\textsuperscript{27} Equity financing is the utilization of shares by a company to raise finance while debt financing involves the acquisition of secured and

\textsuperscript{26} Baker and Cary, Cases and Materials, 612.
unsecured loans for the same purpose. Therefore, the issuance of shares, alteration of the share capital, and public floatation of shares is equity financing while charges on company assets and debentures are debt financing.

In all these forms of financing, there are demerits or constraints that can be faced by a company. With regard to equity financing, the company should comply with all legal rules that regulate capital raising using shares in terms of issuance, alteration and the general trade in shares. For instance, a company cannot issue shares at a discounted rate or purchase its own shares. In *Trevor v Whitworth* 28, a company went into liquidation and the former shareholder claimed a balance for the price of the shares he sold to the company before it went into liquidation. It was held that a company is prohibited from purchasing its own shares for the sake of maintenance of its capital.

Other than equity financing, a company can also resort to debt financing primarily involving borrowing. As Goulding 29 correctly states, “...borrowing is an important means by which a company can finance its activities and... the overwhelming majority of companies have the power, express or implied, to borrow money.” Usually, these loans or bonds are issued with strict terms and conditions in relations to interest payment, date of redemption and other auxiliary rights.

Further, the credit can be secured or unsecured with a fixed or floating charge over the assets of the company. A security interest in a secured credit is a right given to one party (creditor) in the asset of another party (borrower) to secure payment or performance the borrower or third party. 30

As for unsecured creditors, they have no such protection as they are treated like ordinary

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28 (1887) 12 App. Cas. 409.
creditors and are at risk of losing out when the company becomes insolvent and is wound up. In other words, when there is a conflict between creditors, the court will maintain equality between them and the assets will be distributed proportionately according to the size of each claim of the creditor but priority will be given to secured creditors.

In the renowned case of **Salomon v Salomon**\(^3\), Salomon took debentures of £10,000 charged on the assets of the company. The company later became insolvent and its assets were not enough to pay in full either the debenture holder or creditors. As a result Solomon paid himself £10,000 on the debentures he held and nothing remained for the unsecured creditors. This was challenged by other creditors but the court held that as a secured creditor, Solomon had a preferential right to be paid first and not the unsecured creditors.

Primarily, borrowing by companies is the main culprit for landing them in receivership. Many companies that fail to properly service their debts are placed in receivership at the instigation of the creditors who endeavour at all costs to recover their money. The failure to pay the debt could be in turn caused by poor management of the company by its directors who may take up huge loans without proper investment and an efficient debt servicing mechanism. A creditor will most likely than not exercise his power of appointing a receiver pursuant to a debenture that is drawn up with the borrower.

### 2.4 Debentures and Mortgages as basis for appointment

In simple terms, the document by which a borrowing company creates or acknowledges a debt to the creditor is called a debenture. This understanding of the term “debenture” cannot be extended and there is no single technical or prescribed manner that it should appear. It simply acknowledges the debt and how it will be repaid to the creditor plus other obligations. In **Stamp** [1897] AC 22 (HL)
Duty Commissioners v African Farming Equipment Company Limited, \textsuperscript{32} the appellants contended that the instrument in issue was a debenture liable to pay duty as required by the Stamp Duty Ordinance (1965). The respondent disputed that the document in issue was not a debenture but a mere receipt or acknowledgement of money from Southern Province Improvement Fund Board. The court held the instrument to be a debenture because it provides security for repayment of the loan. Moreover, it also went on to provide for the payment of interest on that loan by installments and for the repayment of the capital hence it was a debenture.

The obligations and rights created by a debenture are contractual in nature as the debenture’s clauses or terms will be enforced to the extent as provided and agreed by the parties. On default of the debtor company, the holder of a floating or fixed charge has all the remedies conferred by the terms of the debenture creating such a charge.\textsuperscript{33} A floating charge is an interest not in specific assets but in constantly fluctuating fund of assets while a fixed charge gives a specific asset of the company to the creditor. Since a floating charge is uncertain as to the value of the secured assets, crystallisation of the charge will automatically take place upon the occurrence of certain events such as the appointment of a receiver or winding up. A debenture will usually grant authority to the creditor which may include the power to take possession of the charged assets, to sell them and to appoint a receiver including the equitable remedy of foreclosure.

Debentures are mostly associated with mortgages since securities and charges are established upon the completion or creation of a mortgage. Therefore, it is irresistible to discuss mortgages without debentures in mind as the former usually generates the latter. The learned author Mudenda\textsuperscript{34} adopted the definition by Lord Lindley in Santley v Wilde\textsuperscript{35} when he defined a

\textsuperscript{32} (1968) Z.R. 32 (C.A)
\textsuperscript{33} Goulding, Company Law.
\textsuperscript{34} Frederick S. Mudenda, Land Law in Zambia: Cases and Materials, (Lusaka: UNZA Press, 2006), 101.
mortgage as "...a conveyance of land or an assignment of chattels as security for the payment of a debt or the discharge of some other obligation for which it is given."

The borrower is the mortgagor while the lender is the mortgagee under the mortgage arrangement. In a mortgage, the mortgagor undertakes as against the mortgagee to repay the loan by the date of redemption and in default the mortgagee will enforce it using all available remedies including the appointment of a receiver.

It seems that it is legally acceptable for a mortgage deed to contain a provision or clause for the appointment of a receiver if the mortgage is not redeemed or settled. This was endorsed by the Supreme Court in Development Bank of Zambia and Livingstone Saw Mills Ltd v Jet Cheer Development (Z) Ltd.\(^{36}\) The mortgage deed between the first appellant and Zambezi Sawmills [1968] Ltd for a loan of US $1,064,000.00 provided for the appointment of a receiver in the event that Zambezi Sawmills [1968] Limited failed to repay the loan or the balance outstanding on demand. When the mortgagor failed to honour its obligation, the second appellant mortgagee appointed a receiver and manager in accordance with the mortgage deed to realise the money and this was never opposed in the court.

Perhaps, the legal basis for permitting the retaining of a receiver in mortgages stems from the principles of contract law which allows for freedom of contracting and obligation to perform the contract. The renowned learned author Riddall\(^{37}\) rationalised that "...a mortgage is...a contract...[and] it follows, therefore, that the general principles of contract law apply.... For example, a mortgage can be avoided on the ground of undue influence on the mortgagor...." Therefore, all the terms governing the mortgage will be valid, binding and enforced by the court but provided

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\(^{35}\) [1899] CH at p.474.

\(^{36}\) SCZ Judgment No. 33 of 2000

\(^{37}\) Riddall, Land Law, 387.
that they do not contravene the fundamental tenets of the law on mortgages such as the rule that 'once a mortgage always a mortgage.'

Quite clearly, the legal basis for appointment of receivers in both debentures and mortgages is that they are documents of contractual nature, that is, they are also governed by the law of contract. In contract law, if two parties consensually agree in writing without fraud or duress, the terms will be binding on both of them. Similarly, if it is agreed as between the creditor and borrower in the debenture or mortgage deed that a receiver will be appointed in case of default, the court will enforce this term. At this point, it suffices to state that the court in Zambia may, however, appoint a receiver in certain circumstances under statute or common law even if there is no express term for his appointment between the parties as it shall be discussed in the proceeding text.

2.5 Sources and applicable law on receivership in Zambia

Generally, there are numerous sources of law in Zambia to which reference can be made depending on the type and nature of the legal dispute. In accordance with their importance, these sources include the Constitution, Acts of Parliament and subsidiary legislation, judicial decisions, English Common Law and equity.\textsuperscript{38} Further, the sources could be categorised in statutory and customary law since Zambia has a dual legal system, that is, both customary and statutory laws are enforced by the courts.

From the foregoing, it follows that any law from the above list that has provisions relating to receivership of a company, expressly or by implication, will be applicable. Nevertheless, in practice, certain categories cannot apply considering their nature and content. For instance, it is

\textsuperscript{38}Margaret Munalula, legal process in Zambia: Cases, Legislations and Commentaries (Lusaka: UNZA Press, 2004), 76.
extremely unlikely that the whole body of customary law will have provisions relating the appointment of a receiver.

This sets aside only statutory law, common law and equity as the broad sources of law on company receivership both in terms of practice and procedure. Common law and equity are imported from England by virtue of the English Law (Extent of Application) Act\textsuperscript{39} which provides in section 2 that common law, doctrines of equity and statutes that were in force in England on 17\textsuperscript{th} August, 1911 shall be applicable in Zambia. However, they are subject to the Constitution of Zambia, the supreme law, and any other written law or statute hence they are subordinate in case of any conflict.

There are various Zambian statutes that have provisions touching on or have a bearing on the topic of receivership. The World Bank Group\textsuperscript{40} has identified and collected statutory laws that control credits, securities, companies, bankruptcy and collateral laws in Zambia. From the list, those seeming to concern receivership, directly or otherwise, include the Banking and Financial Services Act, Preferential Claims in Bankruptcy Act, Companies Act, Lands and Deeds Registry Act, and Securities Act.\textsuperscript{41} Another important statute is the Conveyancing and Law of Property Act (Conveyancing Act)\textsuperscript{42} of England which has a numerous provisions on the topic of receivership and is applicable by virtue of the British Acts (Extension) Act\textsuperscript{43}.

The Companies Act is the principal statute administering receivership of a company because, as earlier indicated, the area of law in which the concept of receivership largely falls is company law. This Act basically provides for the formation, management, administration, and winding up of companies in Zambia. In Part V which provides for debentures and charges, there are

\textsuperscript{39} Cap 11 of the Laws of Zambia
\textsuperscript{41} Cap 387, 83, 388, 185 and 354 respectively.
\textsuperscript{42} (1881)
\textsuperscript{43} Cap 10
provisions relating to issue of debentures, registration and enforcement of security especially the appointment of a receiver.

According to the Act, a company may raise loans by the issue of a debenture which may either be secured by a charge over property of the company or be unsecured by any charge.\textsuperscript{44} The holder of such a charge over the property as a mortgagee is mandated to register it and will be entitled to enforce or redeem the mortgage when it is due. Any default in repaying the loan will entitle the chargee to appoint a receiver and manager over the secured assets of the company or mortgagor as contained in section 108 and 113. All these provisions of the Act will be delved into in the next chapter.

Another specific Act worthy of mention is the Land and Deeds Registry Act\textsuperscript{45} which is the main statutory law on mortgages. In this Act, a mortgage is not adequately defined as the preamble only provides that a “mortgage includes a deposit of title deeds or documents with the object of creating an equitable mortgage on the property comprised in such deeds or documents and any charge”. However, the Lands and Deeds Registry Act has recognized that a mortgage provides security of a loan on the part of the mortgagee who possesses the right to enforce it. Section 65 recognises that a mortgage will have effect as security only but the mortgagee will always have the same protection powers and remedies.

In the Conveyancing Act (1881), there are provisions relating to the receiver. For instance, in section 19, the Act provides that when the mortgage money has become due, the mortgagee has the power to appoint a receiver of the income of the mortgaged property. However, the receiver will be deemed to be an agent of the mortgagor.

\textsuperscript{44} Section 86
\textsuperscript{45} Chapter 185
The other aforementioned statutes and many others are just ancillary to receivership as their main substance do not substantively relate to this concept. For instance, the Securities Act\textsuperscript{46} provides for the regulation of the securities industry in Zambia since securities created by debentures, shares, stocks or bonds can be exchanged. Also, the Preferential Claims in Bankruptcy Act\textsuperscript{47} makes provisions with respect to preferential payments in bankruptcy while the Banking and Financial Services Act is relevant because it regulates banks which are the main lenders to corporations leading to receivership in case of default.

Having considered all the law that is applied in Zambia it can be firmly stated that the basic law is the Companies Act. However, the Lands and Deeds Registry Act and Conveyancing Act are equally explicit on the topic. In fact, in many legal disputes in court that involve receivership, the three stated Acts are relied on in resolving the matter. These statutes are supplemented by doctrines of common law and equity since many principles on the topic were developed from them.

2.6 Conclusion

The concept of receivership of a company emanates from the basic principles of Company Law. Once incorporated, a company is artificially considered to be a separate legal entity, capable of suing and being sued in its own name, own property, and entering into contracts. Therefore, if a company defaults in repaying its loan, a receiver will be appointed by the lender in order to secure his finance pursuant to the debenture, mortgage deed or by court order. Receivership is the appointment of an individual by a lender of a secured bond to be in charge of the debt defaulting company for the purpose of debt recovery. The concept of receivership is usually confused with liquidation but the main distinction is that the appointment of a receiver does not

\textsuperscript{46} Cap 354
\textsuperscript{47} Cap 83
the company to an end. For all intents and purpose, the appointment should not be deemed as dispossessing the company its separate personality and, thus, it is very legally erroneous to state that the receiver and company in receivership are one and the company cannot do anything without the receiver.

Borrowing of funds from financial institutions especially banks is responsible for causing companies to undergo receivership when they fail to repay. This failure is mostly as a result of poor management or investment by the directors and other unforeseeable events which may negatively affect the business of the company. The main source of law that regulates receivership of a company in Zambia is the Companies Act and other statutes especially the Lands and Deeds Registry Act and Conveyancing Act which are supplemented by common law and equity.
Chapter THREE

LEGAL ACTIONS AGAINST COMPANY RECEIVERS

3.0 Introduction

This chapter shows that, although company receivers appear to be beyond any form of legal challenge, they can be sued for their actions and inactions. In doing so, the focus will be on how and under what circumstances receivers are challenged in court for their actions or inactions. The cases in which receivers have been challenged will be examined in order to conclusively determine who has *locus standi*, that is, whether or not it is the receiver himself, company, shareholders, directors, creditors and individual outsiders. Most importantly, this chapter will conclusively state whether or not other stakeholders or personage such as director, workers or shareholders cannot bring an action for the benefit or in the interest of the company as against the receiver.

3.1 The appointment of a receiver and its legal effects

Upon the appointment of a receiver and manager, there are consequences or changes that befall the company, its assets and the staff. The assets, if contained in the floating charge, will crystallise and the specific class of assets is deemed to be assigned to the lender or chargee, that is, they cease to form part of the assets of the company and become the property of the lender.48 The company cannot exercise authority or dispose of the assets as they become fixed. It is only the receiver who can trade or deal with the assets of the company.

Further, if the receiver is appointed by the court, he or she will be considered as the agent and officer of the court and not the company. Thus, the receiver will act in accordance with the

instructions or directions of the court regardless of the repercussions on the company. This is contained in the Companies Act which provides that;

A receiver of any property or undertaking of a company appointed by the court shall be an officer of the court and shall be deemed, in relation to the property or undertaking, not to be an officer of the company, and shall act in accordance with the directions and instructions of the court.\textsuperscript{49}

However, if the receiver is appointed pursuant to a debenture or any other document, the position is different as he is deemed to be the agent and officer of the company or mortgagor. Nonetheless, he is expected to act in line with the provisions of debenture or with the directions of the court where applicable.\textsuperscript{50}

Regardless of how the receiver is appointed, the company will still remain a separate body. The appointment does not annihilate the independent existence of the company but its specific assets will be under the manipulation or control of the receiver. Lord Atkinson explained on this position in \textit{Moss Steamship Company v Whinney}\textsuperscript{51} when he held that the appointment of a receiver and manager over the assets and business of a company does not dissolve or annihilate the company, any more than the taking possession by the mortgagee of the fee of land let to his tenants. Both the mortgagor and mortgagee continue to exist but it entirely supersedes the company in the conduct of its business, deprives it of all power to enter into contracts in relation to that business, or to sell, pledge or otherwise dispose of the property put into possession, or under the control of the receiver and manager. Its powers in these respects are entirely in abeyance.

In this case, the respondent was appointed the receiver and manager of a company and in the course of business of the company, he pledged to the appellant shipper to hold a lien on goods of

\textsuperscript{49}Section 112
\textsuperscript{50}Section 113
\textsuperscript{51}(1912) AC 254
the company even for his previous debt before his appointment. It was contended that this was wrongful as the property or goods belonged to the company and not the receiver.

Additionally, the powers of management of the affairs of the company by the directors are also suspended. The receiver may therefore engage new employees and terminate or continue with the contract of existing employees, that is, the directors become *functus officio* unless they are re-appointed by the receiver to act as such. However, the receiver will normally terminate the employment of workers or managers whose roles are inconsistent with the function his duties. He may elect to carry on with existing contracts in the name of the company for the purpose of its business although he is not liable for any debt incurred by the company with an unsecured creditor before his appointment. Section 110 of the Companies Act obliges the receiver and manager to only pay preferential creditors of the company.

### 3.2 Duties and their breach

By and large, the receiver and manager will have duties and exercise power to the extent as contained in the debenture. Commonly, debentures provide for extensive powers in favour of the receiver as regards disposal of and dealing with the charged property as they will simply have a very wide provision declaring that the receiver will have ‘all the powers provided by the law’. In the Act, there are certain functions a receiver is expected to perform. If the receiver is appointed over the whole or substantially the whole undertaking, he should submit the statement of affairs and periodical accounts of the undertaking according to section 116. However, if the appointment is over a single property which is not substantial, the receiver should lodge his

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52 Goode, Legal Problems of Credit and Security.
53 Akinwunmi and Busari, Receiverships and Business Recovery. (Unpublished)
account documents for the year from the date of appointment with the registrar of companies.\textsuperscript{54}

Default in doing so is breach of his duties and is criminalised.

The Companies Act is insufficient on all matters concerning the duties of the receiver towards the company especially on how he is expected to perform his function as it can be seen from the duties identified above. Hence, the principles under common law and equity are usually relied on which provides principles such as fiduciary duties. In contrast, the \textit{Conveyancing and Law of Property Act} (1881) has provided that the receiver shall apply all the money received by him in the execution of his duties towards the discharge of rents, taxes, rates, and outgoings that are affecting the mortgaged property.\textsuperscript{55} This obligation in the latter Act implies that there should be proper management and all basic tasks to sustain operations should be undertaken in order to maintain the company as a going concern.

Nevertheless, the Companies Act has explained on the nature of the relationship between the receiver and company which gives a hint on his duties toward it. Section 113 declares that;

\begin{quote}
a receiver of any property or undertaking of a company appointed, otherwise than by a court, under a power contained in any instrument shall... be deemed in relation to the property or undertaking to be an \textit{agent and officer of the company} and not an agent of the persons by or on behalf of whom he is appointed....
\end{quote}

Similarly, in the Conveyancing Act (1881), the receiver is considered to be the agent of the mortgagor under a mortgage arrangement. Section 24 (2) provides that “the receiver shall be deemed to be the agent of the mortgagor; and the mortgagor shall be solely responsible for the receiver's acts or defaults, unless the mortgage deed otherwise provides.”

These sections create the principal and agent relationship between the company in receivership and receiver respectively where he is appointed pursuant to a debenture. In fact, this relationship

\textsuperscript{54} Section 117
\textsuperscript{55} Section 24 (8) (i)
was acknowledged by the High Court in *Magnum (Zambia) Limited v Basit Quadri (Receiver and Manager) & Grindlays Bank International Zambia Limited* when it stated that "... a receiver is an agent of the company under receivership who is there to secure the interests of the debenture holder....."

Deductively, therefore, the duties that an agent owes to the principal should apply when the receiver and manager is dealing with the business affairs of the company in as much he is required to recover the debt. For instance, he should exercise his duties with due care or skill, account, avoid conflict of interests, and act in good faith since these are some of the duties an agent owes the principal. In addition, the receiver and manager is required to demonstrate proficiency when managing or administering the company. Anything short of this may amount to mismanagement. Obviously, the standard that applies in this respect is that which a reasonable person would expect an agent of this type (receiver) to exercise in the particular circumstances.

Furthermore, there are fiduciary duties to be complied with by the receiver. A fiduciary duty is a legal obligation of one party to act in the best interest of another and the obligated party (receivers) are entrusted with the care of money or property. In *Avalon Motors Limited (in Receivership) v Bernard Leigh Gadsden and Motor City Limited*, the Supreme Court held that receivers as well as liquidators occupy a fiduciary relationship and are liable for their wrongdoing in relation to the mortgaged property. Whenever a current receiver acts in breach of his fiduciary duty or with gross negligence or in any other case where the vital interests of the company are at risk from the receiver himself or from elsewhere but the receiver neglects or declines to act, the directors should be entitled to use the name of the company to litigate.

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56 (1981) Z.R. 141
59 (1998) S.J. 26 (S.C.)
The Supreme Court in the above case rationalised that directors of a company have fiduciary duties because they controlled it and, therefore, a receiver will take over these duties once appointed since he equally takes over management. It has been widely recognised that there is no precise or comprehensive definition of the circumstances in which a person is constituted a fiduciary in his or her relations with another. However, numerous commercial and professional relationships are presumed as such like that of a director and company, trustee and beneficiary, lawyer and client, agent and principal, and partner and partner.\textsuperscript{60}

Professor Black\textsuperscript{61} has identified the core fiduciary duties which include the duty of care and loyalty. There are other equally important duties such as the duty of disclosure and taking extra care when selling company asset among others. These duties emanate from common law and equity through judicial decisions and in most instances are not statutory based but there is a requirement of adherence to them.

The duty of loyalty demands that the decision maker within the company should act in the interest of the company and not in their own interest.\textsuperscript{62} It is immaterial about the nature of the person acting on behalf of the company. Provided that they are acting on its behalf or influencing its operation the duty arises. The easiest way of complying with this duty is not to engage in any transactions that involve a conflict of interest. The logic behind this requirement is that the decision maker is dealing with their own self and may not make decisions that are fair to the company.

With regard to the duty of care, it may arise where there is no conflict of interest. The controlling officer should pay attention and make good decision or actions in relation to the company and

\textsuperscript{60} Frankel, "Fiduciary Law".
\textsuperscript{62} Black, "Principle Fiduciary Duties."
avoid making irrational decisions. In short, he should be prudent when exercising his work. For instance, risky financial decisions should be avoided unless the decision is the last resort.\textsuperscript{63}

Other duties of a receiver recognised at common law are that he shall, subject to the rights of prior encumbrances, take possession of and protect the property, receive the rents and profits and discharge all out goings in respect thereof and realize the security for the benefit of those on whose behalf he is appointed. Breach of any of these duties will entitle the company to bring an action in court to restrain the receiver and manager. The commonest way receivers and managers abrogate their duties towards the company is through collusion with the mortgagee or creditor to sell the main assets in which the creditor is interested despite the business of the company being viable.

3.3 The problem of locus standi

Before an individual or group of persons can institute an action in court, they should possess sufficient interest in the matter regardless of their claim. This is referred to as locus standi or standing which is basically the existence of a right of an individual or group of individuals to have a court enter upon an adjudication of an issue before that court by proceedings instigated by the individual or group.\textsuperscript{64} Similarly, any individual who undertakes to challenge a receiver and manager on behalf of the company should have locus standi or possess sufficient interest in the matter otherwise the action will be thrown out. As Lord Denning obiter in \textbf{R v Paddington Valuation Officer, Ex parte Peachey Property Corporation Ltd}\textsuperscript{65} "... the court will not listen... to a mere busybody who was interfering in things which did not concern him. But it will listen to anyone whose interests are affected by what has been done."

\textsuperscript{63}Black, "Principle Fiduciary Duties."
\textsuperscript{64}Leslie Stein, Locus Standi, (Sydney: Law Book Company, 1979).
\textsuperscript{65}[1966] 1 QB 380
The problem of challenging a receiver arises, firstly, from the fact that a company is a separate legal entity thereby no one should claim on its behalf and, secondly, a receiver and manager once appointed is considered to be sole representative of the company and the directors of the company are divested of legal power to institute or defend actions on behalf of the company. In view of these issues, it is important to explain in view of different entities that claim having standing and they include the company, receiver, shareholders, directors, creditors and individual outsiders.

3.3.1 Company

As it has already been reiterated time and again, a company is a separate legal person and under no circumstance can this be abrogated even after the appointment of a receiver. Section 22 of the Companies Act has clearly stated that the company shall have the capacity, rights, powers and privileges like that of an individual. Therefore, in matters that concerns it or its assets, the company has *locus standi* and no one should claim on its behalf, the company will always have standing in its matters. In the renowned case of *Macaura v Northern Assurance Company*[^66], the plaintiff insured timber belonging to the company he was a sole shareholder. Lord Buckmaster held that “... no shareholder has any right to any item of property owned by the company, for he has no legal or equitable interest therein....” This landmark case illustrates the point that when there is a wrongdoing to a company, it is only itself that should seek for redress not its members or any ordinary creditor. In short, it is the proper plaintiff. Thus, even under receivership, the company should be able sue in its name independent of the receiver or his authority.

3.3.2 Receiver

Upon his appointment, the receiver and manager will acquire superior rights in dealing with the assets of the company than anyone else including the director. An example of this can be seen in

[^66]: [1925] AC 619
Section 216 of the Companies Act limits the powers of the directors to sell, lease or dispose of substantially the whole of the assets but this does not extend to receivers. The fact that the receiver only has superior powers with regard to the assets of the company is usually misunderstood by concluding that he and the company become one and, therefore, it cannot do anything without the receiver. The receiver is only appointed for the purpose of recovering the debt or secures the interests of the creditor.

Thus, the receiver has locus standi in any matter to the extent that the assets or property of the company will be affected or his execution of duty will be hampered, directly or indirectly. The rationale for this protection of the receiver is that the court should not infringe the legal right of the creditor to realize his sum and contract as contained in the debenture. No wonder the High Court in Magnum (Zambia) Ltd v Basit Quadri (Receiver/Manager) and Another\(^{67}\) held that as long as a company continues to be subjected to receivership, it is the receiver alone who can sue or defend in the name of the company. Nonetheless, this case, which was overruled by the Avalon Motors case, can be criticised for over protecting the creditor and limiting the scope of entities with locus standi.

3.3.3 Shareholders and Directors, Outsiders and Creditors

Whatever wrong is committed in the running of the company, it for the company to decide what action to take. The courts will not usually hear an action brought by a member or members of the company. Such members basically are the shareholders and directors but this position also applies to directors who are not shareholders as well. In Foss v Harbottle\(^{68}\) held in a similar way when two shareholders in a company brought an action alleging that the directors and shareholders had defrauded the company in number of instances.

\(^{67}\) (1981) Z.R. 141 (H.C)

\(^{68}\) (1843) 2 Hare 461
However, the Supreme Court in in Avalon Motors Limited (in receivership) v Bernard Leigh Gadsden and Motor City Limited\(^{69}\) took a liberal approach to locus standing to include a broad category of individuals especially when the receiver continually breaches his fiduciary duties. In this case, "...the receivership was being conducted in a delinquent fashion to the serious disadvantage of the company, the shareholders and all concerned." It held that a breach of a fiduciary duty by a receiver or if he puts vital interests of the company at risk will warrant the directors to litigate in the name of the company. By this decision, the court granted locus standi to directors, shareholders and all individuals concerned with the affairs of the company to legally challenge the receiver for mismanagement and maladministration of the company.

### 3.4 Conclusion

As a general proposition, the appointment of the receiver entails that the directors of the company are divested of their powers to manage the corporation as the receiver and company will be considered as one. Nevertheless, the receiver and manager will be considered as the agent of the company especially if appointed pursuant to a debenture according to Section 113 of cap 388. Therefore, he should exercise his mandate diligently and up hold his duties such as to act with due care or skill, account, avoid conflict of interests, and act in good faith just like a prudent agent does to his principle. The receiver also has fiduciary duties towards the company since he is its principle officer and not the director. Breach of these duties is actionable because the company does not lose its separate personality upon being placed in receivership when the vital interests are at risk or threatened due to mismanagement. The impediment to this is that the directors, shareholders and workers cannot claim on behalf of the company and therefore have no locus standi in this regard. However, this has been circumvented by the fact that a receiver

\(^{69}\) (1998) S.J. 26 (S.C.)
has interest only in the assets or possessions and not everything about the company hence the
director and shareholder can sue in the name of the company.
Chapter FOUR

COMMENCING OF ACTIONS AND AVAILABLE RELIEFS

4.0 Introduction

Chapter four deals with the civil procedure aspect of the research since, as it has already stated, actions may be dismissed on account of failure to follow procedure. This will be undertaken with special reference to the case of Thorne v Mulenga and two others\(^{70}\) which was dismissed by the High Court for wrongly being before it. This chapter will discuss the form of commencement of an action in court especially in the High Court of Zambia. It will consider how actions against receivers have been commenced in past cases. Forms of commencement such as a petition, writ of summons, or originating summons will be taken into account in order to ascertain the most appropriate form for actions against receivers. Lastly, the remedies that can be prayed for in court against the company in receivership will be considered in order to establish all the available reliefs.

4.1 Court with jurisdiction and forms of commencement

Generally, the court that exercises jurisdiction in issues that involve companies in terms of formation, management, administration, winding-up and matters connected or incidental to this is the High Court for Zambia. The Companies Act intends the High Court to have jurisdiction in all matters concerning the running of companies when it states that any reference to the "court" in the Act means the High Court for Zambia.\(^{71}\) According to the High Court Act\(^{72}\), the High Court will exercise civil jurisdiction in the manner provided by the Act or any other written law

\(^{70}\) 2008/HPC/0841

\(^{71}\) Section 2

\(^{72}\) Cap 27
and in default in substantial conformity with the law and practice for the time being observed in England in the High Court of Justice.73

Civil proceedings in the High Court are normally begun by writ, originating summons, originating motion or petition which are filed in the High Court Registry. With regard to commercial matters, they can be filed with the Commercial Registry of the High Court of Zambia which was primarily established to expedite adjudication of commercial disputes under Order 53.74 In Thorne's case, the action to restrain the defendants from acting as receivers was commenced in the Commercial Registry. Therefore, other rules in the High Court Act apply to commercial actions such as the general forms of commencement, interlocutory applications and reliefs that can be granted.

Thus, an action which is appropriate for a writ of summons, petition, originating summons, originating motion or petition should be commenced as such otherwise it risks being dismissed by the court. In the renowned case of Chikuta v Chipata Rural Council75, the High Court refused to exercise its jurisdiction to make a declaration since the matter was wrongly before it and the proceedings had been misconceived. The matter was brought to the High Court by means of an originating summons when it should have been commenced by writ.

Order VI of the Rules of the High Court requires that all actions should be commenced by writ of summons accompanied by a statement of claim apart from petitions under the Constitution and Matrimonial Causes Act. Claims that depend on adducing of evidence by both parties apart from affidavit evidence should be initiated by a writ of summons. Such claims could be for damages, arising from negligence or breach of duty whether the duty exists by virtue of a contract or a provision made by or under an Act or independently of any contract or any such provision.

73 Section 10
74 S.I No. 29 of 1999
75 [1974] Z.R 241
In the same vein, a claim for breach of fiduciary duties or mismanagement by a receiver should be commenced by a writ of summons since it would involve the proving of such allegations. This was the reasoning of the court in *Thorne's case* in which the application was by way of originating summons but the applicants alleged that the respondents had acted in a negligent manner and to the detriment of the company. An application that is to be made to the High Court or a judge under any Act and can be disposed of in chambers must be begun by originating summons and could be determined on affidavit evidence. Allegations of breach of duty cannot be solely determined on affidavit evidence in the chambers.

Further, in civil matters, an Act which is provides for a right of action to the complainant will also normally provide for how to commence the action in court. In *Thorne's case*, the applicant director relied on section 113 of the Companies Act to challenge the manner in which the business affairs of the company where being executed. This section provides that a receiver of a company appointed under any instrument shall be deemed to be an agent of the company who should act in accordance with the instrument of appointment and with the directions of the court. The applicant prayed for an order of an interim injunction for breach of conditions of the debenture and the implied duties of the receiver under this section.

Section 113 appears to grant the right of action in relation to the manner in which the receivership is being undertaken to the receiver himself. It states that the court may, on the application of such a receiver, make any order it thinks fit giving directions in relation to any matter arising in connection with the performance of the receiver's functions or declaring the rights of persons before the court or otherwise. The wording of this section literally implies that when the performance of the receiver is in question, it is him to make an application for directions or declaration by the court. Nonetheless, the director relied on this section when

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76 Section 113 (2)
seeking for a declaration that the respondents acted in a negligent manner and to the detriment of the company.

Another question that arises with regard to suing is that in whose name should the action be commenced and maintained? Ideally, any suit should be initiated in the name of the plaintiff or be in the name of the parties to the dispute whether corporate or not. This issue arise from the fact that the receiver is usually in a superior position with regard to the control or management of the company as compared to the directors and it is difficult to sue in the name of the company by an individual without the desire or cooperation of the receiver.

In *Avalon Motors Limited (in receivership) v Bernard Leigh and another*\(^{77}\), the Supreme Court made a ruling on this matter. The action was commenced by the director and shareholders in the name of the company but this was objected to in a preliminary issue raised by the defendants in the High Court. The defendants contended that the director and shareholder were not entitled to sue in the name of the company but only the receiver could do so. The Supreme Court ruled that the directors should be entitled to use the name of the company to litigate and the High Court was on firm ground to have allowed the substitution of the plaintiff for the director’s name to that of the company.

4.2 Reliefs that can be awarded

In most actions against receivers, the applicants pray to restrain or remove him from acting as such. As an immediate measure, the applicants should apply for an injunction that will be interim or interlocutory in order to prevent further mismanagement of company assets. Order XXVII of the rules of the High Court provides that in any suit in which it shall be shown that any property which is in dispute in the suit is in danger of being wasted, damaged or alienated by any party to the suit, it shall be lawful for the Court or a Judge to issue an injunction.

\(^{77}\) (1998) S.I. 26 (S.C.)
Thus, an injunction can be granted against the receiver to mitigate the damage being caused as a result of the mishandling of its business affairs. All that is necessary is that the court should be satisfied that the claim is not frivolous or vexatious, that is, that there is a serious question to be tried in the substantive case.

In *Antonio Ventriglia and Manuela Ventriglia v. Eastern and Southern African Trade and Development Bank and Robert Simeza [in his capacity as Receiver of Zambezi Portland Cement Limited (in receivership)]* [78] the Supreme Court held that there was need for an interlocutory injunction to be granted to the appellants to protect company property. The Court ruled that Robert Simeza (as Receiver) be restrained from performing his duty and that the assets of Zambezi Portland Cement be secured “*pendante lite*” (pending litigation).

The final relief that can be awarded is the removal of the receiver from acting as such and appointment of another. Also, damages could be awarded in favour of the company if the court is satisfied that the receiver breached his fiduciary duties to the serious detriment of the company. The receiver will be personally liable and could be indemnified if the creditor sanctioned his actions. However, this does not discharge the company from its obligations to repay the loan to the creditor since another individual could be appointed as a receiver. In the *Avalon Motors case*, another person was appointed to replace the receiver who breached his duties to ensure that the court does not interfere with the right of the creditor to enforce his debenture.

**4.3 Conclusion**

An action to challenge the receiver in the performance of his duties should be commenced in the High Court of Zambia being the court with jurisdiction to hear matters that involve the management of companies. The suit can be filed in the commercial registry of the High Court for

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[78] SC Judgment No. 13 of 2010
faster adjudication. Considering that allegation of breach of fiduciary duties against the receiver require proof and the adducing of evidence, they should be commenced by way of writ of summons. The writ will disclose all the material facts of the breaches and a full trial will be commenced by the court to ascertain such allegation. Such allegation cannot be disposed of solely of affidavit evidence in chambers to require other ways such as originating summons. This was the main ground the court in Thorne's case refused to exercise its jurisdiction in the matter.

Further, the action should be commenced in the name of the company and not the director since it is the company which is the plaintiff as it was stated in the Avalon Motors case. Only parties to the action should be named unless it is in a representative capacity. As an immediate measure, the plaintiff should apply for an injunction to prevent further mismanagement and damage on the company. Ultimately, if the claim succeeds, the court can order for the removal of the receiver from his position and he will be liable for the damage caused. Nonetheless, the creditor will retain the right to appoint another so that its legal right to enforce the debenture are not abrogated.
Chapter FIVE

CONCLUSION AND RECOMMENDATIONS

5.0 Conclusion

Every company, on at least one occasion, will consider securing a loan in order to satisfy its operations or pursue an investment venture among other purposes. These loans could be huge and could accumulate interest over time thus becoming beyond the capability of the company to repay. This is exacerbated by poor management of the company and unforeseeable low investment returns. Failure to repay the loan may have negative consequences on the company as the creditor may exercise the rights conferred on him in the debenture. This is usually the right to appoint a receiver. Thus, defaults in repaying of borrowed funds from other companies and especially financial institutions such as banks is the main reason why many companies are placed in receivership in Zambia. Receivership is one of the legally recognised means by which creditors recover their funds from borrowers. The purpose of a receiver as an individual is to ensure that the full sum is realised.

This concept of receivership of a company is not precisely defined in all its aspects and raises serious contentious legal questions at least in the Zambian legal context in terms of the substantive law, practice and procedure. For instance, the position of the receiver vis-à-vis the company is not well-delimited and can potentially raise conflicts with the basic characteristic of the company as a separate legal person or entity. It is widely stated that once appointed, the receiver is considered to be the sole representative of the company and it ceases to make any claims independent of him or her. In other words, the receiver and the company become one entity.
This assertion is not the correct legal position or the well-intended essence of placing a company in receivership and should be ignored. As it was held by Lord Atkinson in Moss Steamship Company v Whinney, the appointment of a receiver and manager over the assets and business of a company does not dissolve or annihilate the company. Under no circumstance should the receiver be regarded as fused together with the corporation he is managing as the two will continue to be legally separate. Once a company is incorporated, it can only lose its personality after being wound-up. Being in receivership is not an instance envisaged by the law when a company will lose its attributes.

However, the fact that the company is still legally a separate entity even when in receivership is unfortunately not appreciated and is misunderstood. This could be attributed to the reality that there is indeed a thin line between the functions of the receiver and the personal capacity of the company as most of its powers are overshadowed by the presence of the receiver. Consequently, receivers tend to act in an arbitrary manner and breach the duties they owe to the company with impunity.

Under the Companies Act, the main source of statutory law on companies, a receiver is considered to be an agent of the company in receivership especially if he is appointed pursuant to a debenture according to section 113. All the duties that an agent owes to the principal under the general law of agency will apply. As such, he has the obligation to exercise his duties with due care or skill, account, avoid conflict of interests, and act in good faith.

A receiver also occupies the position of a fiduciary in relation to the company and is expected to act as such in the performance of his mandate. A fiduciary duty is a legal obligation of one party to act in the best interest of another and the obligated party (receivers) are entrusted with the care

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79 (1912) AC 254
of money or property. Many companies in receivership are victims of breach of these duties since receivers and manager in most instances conspire to sell all the vital assets of the company that are of high value to the creditor at a rather undervalued amount. This is despite the company being viable and capable of surviving the receivership ordeal.

Apart from the willful or deliberate acts of mismanagement of the company, some receivers are genuinely incompetent and incapable of bearing the huge burden of managing a company. Such receivers demonstrate high level of poor judgment and cannot identify the essential tools for maintaining a company as a going concern.

By stating that a company in receivership is not separate from the receiver and manager, all these improper acts cannot be subject to any challenge. This has been the main constraint faced by other individuals concerned with welfare of the company such as the director or shareholder. In Magnum (Zambia) Limited v Basit Quadri (Receiver/Manager) & Grindlays Bank International Zambia limited, the High Court went to the extent of holding that a company or its shareholders are debarred from instituting any legal proceedings against its receiver or manager. Also, a company under receivership has no locus standi independent of its receiver and as long as a company continues to be subjected to receivership, it is the receiver alone who can sue or defend in the name of the company.

The above decision had forsaken the fact that the rights of the receiver are superior only where the assets of the company are concerned and not the company itself. Thus, the company will always have locus standi in all its suits since it is distinct form its assets. However, every company is an artificial being which can only perform any action through natural persons that

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80 Frankel, "Fiduciary Law".
are its main decision makers. The receiver is normally its main decision maker thereby rendering the directors or shareholders difficult to sue in the name of the company.

It is out of the realization of this state of affairs that even other entities apart from the receiver have been considered to have standing. Accordingly, the director, shareholder, and any person concerned with the affairs of the company have *locus standi* and can legally challenge a receiver and manager who is mismanaging the company and not acting in its best interest. The Supreme Court established this position in the *Avalon Motors* case in which the legal position on standing was liberalised to include directors and shareholders.

Further, there is another obstacle concerning the name of the plaintiff in such suits. Basically, the action cannot be commenced in the name of the director since the company has capacity in legal suits. In other terms, the proper plaintiff when the company is harmed is the company itself and it should be named. Therefore, the action should be in the name of the company and not the director or any entity undertaking to legally restrain the receiver from impairing the company. Indeed, as it was held in the *Avalon Motors* case, suits wrongly commenced in the name of the director should be substituted with that of the company in accordance the High Court Rules relating to joinder, non-joinder and misjoinder of parties.

On another practical aspect, the most appropriate form of commencement should by way of a writ of summons filed in the High Court for Zambia. Allegations of breach of fiduciary duties against the receiver require proof and the adducing of evidence. The writ will disclose all the material facts of the breaches and a full trial will be commenced by the court to ascertain such allegation, no wonder a writ of summons is favoured. Such allegation cannot be disposed of solely of affidavit evidence in chambers. In view of this, it is inappropriate to commence such proceedings by originating summons, originating motions or petition.
5.1 Recommendations

As it can be observed from the entire research, the main reason why the law on receivership is scanty and uncertain is lack of sufficient statutory intervention. The statutory regime on receivership is inadequate and does not address all the vital areas and common law is mostly depended upon. Statutory law that governs receivership primarily includes the Companies Act which is supplemented by Acts such as the Lands and Deeds Registry Act and Conveyancing Act (1881) among others.

In the Companies Act, division 5.3 consisting of sections 107 to 118 is intended to regulate all matters associated with receivership. It only provides for the ways in which the receiver can be appointed being either by the court or under an instrument and adds that he is an agent of the company and court if appointed pursuant to an instrument and by court order respectively. The Act does not exhaustively state how the receiver is expected to act towards the company or sort of duties he owes it and what will amount to breach of duty.

Further, the Act has not explained on the issue of locus standi of directors and shareholders of the company and whether or not they can legally challenge the receiver. It generally has no contemplation of a receiver being sued for mismanaging the company and consequently has not adequately provided for rules of procedure to govern such actions. These may include a form of commencement of suit in the court with competent jurisdiction.

Therefore, the Companies Act should be amended to include the aforesaid matters and many other uncodified legal principles on receivership. Relying on unwritten principles has a potential of causing injustice and hardship on the part of the company, director and shareholders.
REFERENCES


