IN THE COURT OF APPEAL

AT NAIROBI

(Coram: Madan, Potter & Kneller JJA)

CIVIL APPEAL NO. 20 OF 1981

BETWEEN

QUEENSWAY TRUSTEES LTD .....APPELLANT

AND

OFFICIAL RECEIVER & LIQUIDATOR

TANNERIES OF KENYA LTD.....RESPONDENT

JUDGMENT

This appeal concerns the question of whether or not Simpson J (as he then was) correctly exercised his discretion against Queensway Trustees Limited (the appellant) on October 16, 1980 in Nairobi High Court Bankruptcy and Winding-up Cause 9 of 1978.

He dismissed with costs its application by summons in chambers of September 28, 1979 brought under section 224 of the Companies Act (cap 486) (the Act) and rules 5(2) and 7(2) of the Companies (Winding Up) Rules.

The appellant had asked for these orders:

"1. That the legal charge created in favour of the applicant by Tanneries of Kenya Limited (In Receivership and Liquidation) over LR No 337/613 under the Debenture Trust Deed registered on July 21, 1976 and perfected by registration in the Land Title Registry at Nairobi as LR 30356/4 on July 10, 1978 after the commencement of the winding up of the Company, Tanneries of Kenya Limited, shall not be void but shall be treated by all concerned as valid security for the sum of Kshs 1,600,000 and interest intended to be thereby secured.

2. That the provision be made for the costs of this application;

3. That the taxed costs of the applicant of and occasioned by the application should be added to the amount secured by the Debenture Trust Deed and by the said legal charge."

Section 224 of the Act provides that:

"In winding up by the court, any disposition of the property of the company including things in action, and any transfer of shares or alteration in the status of the members of the company, made after the commencement of the winding up, shall, unless the court otherwise orders, be void."

And according to the learned advocates in this appeal, there are no local authorities on this and my own research has not unearthed any.

The facts before the judge were in the supporting affidavit of Mr Sinclair, one of the appellant's directors, and the replying one of Mr Handa, the deputy official receiver and liquidator of Tanneries Kenya Limited (the respondent) together with the exhibits annexed to each affidavit.

They were distilled by the judge in his ruling and the background to the application and appeal is this.

Tanneries of Kenya Limited (the company) on a petition presented by a creditor on June 20, 1978 was ordered by the High Court on July 18, the same year to be wound up in accordance with section 230 of the Act, the official receiver was appointed its liquidator. The winding up is deemed to have begun on June 20, 1978 (when the petition was presented) in accordance to the provisions of section 226(2) of the Act.

One of the documents the first respondent came across in his investigation of the affairs of the company was a legal charge ('the charge') dated July 6, 1978 registered in the Land Title Registry at Nairobi as IR 30356/4 on July 10, 1978, whereby the company charged 14.86 hectares of land at Athi River, conveniently near the meat factory, which it leased from the Government for ninety nine years from September 1, 1974 at a revisable annual rent of Kshs 7,600.

The Trust Deed dated and registered on July 21, 1976 between the company and its debenture holders appointed the appellant as the trustee for the latter which furnished the company with Kshs 1,600,000 for its finances.

The Trust Deed was issued to secure that sum and interest on it for the stockholders, and in it the company and trustee agreed, among other things, that:

"9(a) The company as beneficial owner hereby charges in favour of the Trustee all its undertaking goodwill assets book debts and property wheresoever and whatsoever both present and future including its uncalled capital for the time being with the payment and discharge of all moneys and liabilities hereby agreed to be paid discharged or intended to be hereby secured (including all expenses and charges arising out of or in connection with any of the acts authorised by the Trust Deed).

(b) ……

(c) ……

10(a) Forthwith upon the execution hereof the company shall for the purpose of perfecting the charge over immovable property herein contained execute in favour of and deliver to the trustee a first legal mortgage or charge over the immovable property described in the fourth schedule hereto as well as first legal mortgages or charges as the case may require over all other immovable property now held by the company upon any freehold or leasehold title or right of occupancy or otherwise howsoever."

The charge was prepared for execution in September 1977, engrossed and executed in December 1977 but not registered, as we know, until July 10, 1978. The delay in registration of about two years (the

Trust Deed was registered on July 21, 1976) was due, according to the appellant, to the company having not paid the rent to the Government for this land for some time. The stockholders held a meeting in February 1978 and agreed to pay the rent to the court and five months later the charge was presented for registration on July 6, 1978 and agreed to pay it and five months later the charge was presented for registration on July 6, 1978 and registered on July 10, 1978.

The company was, alas, insolvent by July 5, 1978 and the debenture stockholders told the appellant to appoint Mr James Tullidelph Birnie as receiver and manager of all the property and assets charged by the Trust Deed. He compiled a profit and loss account for it which revealed the company had incurred losses of Kshs 5,977,011 by that date.

The liquidator, notwithstanding his doubts about the validity of the charge created by the company in favour of the appellant, acting on behalf of the company and Mr Birnie, agreed to the sale of the land to Twentsche Overseas Trading Company (Technical) Limited for Kshs 3,500,000 and the conveyance in favour of Twentsche has been executed.

This money is safe and sound in a joint account in the names of Mr Birnie and the first respondent at the Standard Bank on Kenyatta Avenue, Nairobi.

Against it, however, must be set the liability of the company to its unsecured creditors for Kshs 4,347,370 who will only get Kshs 670,000, which is less than a 15% dividend, if the appellant is treated as a secured creditor for this Kshs 1,600,000 loan and the interest on it.

It was left open in the agreement for sale of the land to Twentsche for either the appellant or the respondent to apply to the High Court for directions under section 224 of the Act, so that is how it all began with the appellant's summons in chambers.

The respondent asserted the directors had no power (in law) to execute it on July 6, 1978 when the day before the debenture holders had appointed Mr Birnie receiver and manager of the company or after June 20, 1978 which is when the winding up by the court began. Furthermore, the charge did not pass any interest, legal or equitable, in the land to the stock holders until it was registered on July 10, 1978 (see section 20 and 32 of the Registration of Titles Act (cap 281) and, again, that is after the winding up began. Finally because any charge created by the company within the six-month period before the presentation of a winding up petition is deemed to be a fraudulent preference of its creditors and void - see section 312 of the Act - so a charge created after the winding up begins must also be void.

The learned judge held the charge was indeed void and turned to the issue of whether he had any discretion under section 224 to order otherwise.

First, he cleared out of the way the submission of the advocate for the respondent that the charge was not a 'disposition' at all. It is not defined, the judge pointed out, in the Act or the Interpretation and General Provisions Act (cap 2) but it includes a mortgage and a charge in the Trusts of Land Act (cap 290) and

"any act by a proprietor whereby his rights in or over his land, lease or charge are affected, but does not include an agreement to transfer, lease or charge."

in the Registered Land Act (cap 300). A debenture issued by the directors between the presentation of

the petition and the order was confirmed by the court in *Re Steane's (Bournemouth) Ltd* [1950] 1 All ER 21 (Ch D) Vaisey J under the parallel section in the English Legislation and the respondent's advocate cited no authority for restricting the meaning of the term so the judge gave it a liberal construction and held it included a legal charge and mortgage. There was no appeal from this finding and, in my view, it is correct.

Secondly, he held that under section 224 he had a discretion to make the orders sought but only if the reason for the charge being void was because it was made after the winding up began and for no other reason. He went on to explain that this disposition was void, however, for another reason, namely, when it was made on July 10, 1978 the directors had no authority to do this because Mr Birnie was appointed receiver and manager of the company on July 5, 1978.

If that were wrong, he continued, he took a passage from Vaisey J's judgment in *Re Steane's (Bournemouth) Ltd* (ibid) as a guideline for what factors should be taken into account for exercising this discretion. It is at page 25 of the report and it is this:

"Each case must be dealt with on its own facts and particular circumstances (special regard being had to the question of good faith and honest intention of the persons concerned), and that the court is free to act according to the judge's opinion of what would be just and fair in such case."

This was accepted by the parties' advocates in the High Court and this court as the true basis for the exercise of the discretion and, in my judgment, it is the right way to look at the issue of whether or not the discretion should be exercised in favour of the party asking for the disposition to be declared valid.

Then he dealt with the facts and circumstances of this disposition, especially the good faith and honest intention of the appellant, the debenture stockholders, the directors of the company (supposing they had the powers to register the charge) and the unsecured creditors, all being 'the persons concerned'.

The upshot was that, in his view, it would not be just and fair to the unsecured creditors to treat the charge as valid.

He found there had been no adequate reasons advanced for the delay of two years between the execution of the debenture trust deed and the registration of the charge in favour of the appellant.

This delay meant that unsecured creditors may well have been misled by the absence of this encumbrance on the title which, in turn, affected the creditworthiness of the company. He suspected "the delay was at least partly deliberate, with a view to protecting its credit.'

So he exercised his discretion against the appellant who now asks this court to reverse the learned judge's decision because in the words of its memorandum of appeal:

"1. The learned judge erred in law by holding that the appointment of a receiver and manager under the provisions of the Debenture Trust Deed rendered void *ab initio* any charge thereafter executed by the company pursuant to an undertaking in that behalf contained in the same Trust Deed.

2. The learned judge erred in law by holding that the appointment of a receiver and manager of the assets of a company ever divests its directors of any further power to execute in the name of the company dispositions of assets other than those of which he is receiver and manager.

3. The learned judge overlooked the facts that the charge was actually executed in December 1977 and

that only its registration was delayed until July 1978.

4. The learned judge erred in his finding that the reason given for delay in registration of the charge (namely prevention of registration pending payment of outstanding arrears of land rent) was not an adequate reason for such delay.

5. The learned judge erred in his view that the creditworthiness of a company in the eyes of unsecured creditors (as opposed to prospective mortgagees or chargees) is affected or that they can be misled by failure to register a charge against the title of the company's land when public notice of the obligation to create such a charge has been duly given by registration in the Companies Registry of a debenture Trust Deed whereby that obligation was expressly undertaken by the company.

6. The learned judge failed to distinguish between:

a) the purpose of the Register of Charges in the Companies Registry, which is to give notice to the creditors of a company of all the latter's commitments, and

b) the purpose of the Registry of Titles, which is merely to give validity to dealings with a particular title and to regulate the priority of such dealings.

7. There was no evidence whatsoever to justify the interference by the learned judge of a suspicion that the delay in registration of the charges was deliberate with a view to protecting the credit of the company.

8. The learned judge erred in his failure to recognize the complete good faith of the trustee for the debenture holders in seeking to perfect a charge to which it was publicly entitled by the terms of the registered Debenture Trust Deed and the justice and fairness to all concerned (including unsecured creditors) of allowing it to do so."

Taking the first two together, it is necessary to set out what happens to the powers of the directors of a company when the winding up is by order of the court and when it is a voluntary one.

A winding up by the court dates from the presentation of the petition: section 226(2) of the Act: which for the company was June 20, 1978. The winding up order of July 28, 1978 meant the directors were dismissed from that date and their powers to act on behalf of the company ceased on that date: See *Fowler v Broad's Patent Night Light Co* [1893] 1 Ch 724, 730 (Ch D) Vaughan Williams J: and so did the employment of the receiver and manager: *Gosling v Gaskell* [1897] AC 575, 591, 595, (HL) (see also *Palmer's Company Law*, 21st Edition, 1968, p 749). The directors could not as a matter of law validly register the charge on July 10, 1978.

Where a receiver is appointed out of court, as Mr Birnie was by the debenture holders on July 5, 1978, the management and control of the company's assets are taken out of the hands of the directors (and the secretary of the company) though the corporate structure remains and these main officers in the company have their usual statutory duties to discharge eg the board could convene a general meeting of the company to put it into voluntary liquidation. See section 274 of the Act. It can deal with its assets that are not covered by the security under which the receiver is appointed, and in any event, property held by the company in trust for third parties, because it would not be caught by the turns of the security: *Aluminium Industrie Vaassen BV v Romalpa Aluminium Ltd* [1976] 2 All ER 552 and the directors who still control the company would have to see to it that the company fulfilled its duties as trustee, (see generally *Kerr on Receivers*, 15th Edition 1978, p 33). The appellant's advocate emphasized all this. Mr

Birnie was appointed receiver and agent by the debenture holders under the Trust Deed which by clause 9(b) created a charge as a first charge on all the property charged including the immovable property of the company which embraced the company's land at Athi River and in the fourth schedule it is specifically charged. This asset of the company is, therefore, well and truly covered by the security under which the receiver was appointed and it was not held by the company in trust for third parties so after the receiver and agent was appointed the company's directors could not deal with it. The first two grounds of appeal fail.

The fifth and sixth grounds are that the learned judge overlooked or did not take into account the fact that the Trust Deed of July 21, 1976 created by the company for securing the loans by the debenture holders was registered the same day as a mortgage in the Companies Registry which was notice to the unsecured creditors of the company of its obligation to perfect a charge, if and when the stockholders asked it to do so, and the creditworthiness of the company was made plain because everyone concerned could see what the company's commitments were. This was all covered in the ruling and the answer is that assuming an unsecured creditor searched the company's registry and saw this mortgage and then read the Trust Deed, a further search of the Registry of Titles would not have revealed until July 10, 1978 that the company's land at Athi River set out in the fourth schedule was affected for until the charge was registered in that registry no interest passed: section 20 and 32 of the Registration of Titles Act: and up to that date he could reassure himself that the company's land at any rate was still free from any encumbrance. The fifth and sixth grounds also fail.

The remaining grounds refer to the delay in the registration which was about two years though it was seven months between its execution and registration but this was not overlooked in the ruling. The appellant sought to perfect a charge provided for by the Trust Deed which was registered in the Companies Registry for all to see but until it was registered in the appropriate Land Registry the company's land was not affected. The delay, or some part of it, was said to be due to the company's failure to pay the Government the rent for the land and the stockholders decided to pay it when they met in February 1978 but still the charge was not presented for about four and a half months and that lapse has never been explained. It is only after these debenture holders appointed a receiver and manager on July 5, 1970 under the Trust Deed of July 21, 1976, as amended by a deed of amendment of June 14, 1977, that the directors of the company purported to register the charge which they were powerless to do. This is, it should be recalled, when the company's losses total about Kshs 6,000,000 and it was after an unsecured creditor presented a petition on June 20, 1978 for the winding up of the company by court order. The learned judge was right to suspect that the delay was in part deliberate so that the credit of the company was protected and certainly entitled to find that it would not be just and fair to the unsecured creditors to pronounce the charge to be a valid one. These grounds do not prevail.

The learned judge exercised his discretion in all this and the appellant has been unable to satisfy me that he misdirected himself on any matter so that this decision was wrong; or that the case as a whole revealed he was clearly wrong when he exercised his discretion as he did because the result is unjust, which is when the Court of Appeal should interfere: per Sir Charles Newbold P in *Mbogo v Shah* [1968] E A 93, 96 G, H (CA-K). This is not the position here.

Accordingly, I am of the view that the appeal should be dismissed with costs.

Madan JA. I have had the advantage of reading the judgment of Kneller JA in draft. I agree with the conclusion reached by him.

The exercise of a judge's discretion ought not to be lightly interfered with by a Court of Appeal, and specifically only when it is clear that owing to a misdirection in some manner an error of judgment has

occurred resulting in a wrong decision. Nothing like that happened here.

A beneficial result incidentally arising from the learned judge's decision, though it was not and could not be an inducement in the making of the decision, will be that the sum of Kshs 1,600,000 will also become available for distribution among the unsecured creditors of the company which is for the greater good.

As Potter JA also agrees the appeal is ordered to be dismissed with costs.

Potter JA. I agree fully with the judgment of Kneller JA, which I have had the advantage of reading in draft.

Dated and delivered at Nairobi this 21st day of April , 1983.

C.B MADAN

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JUDGE OF APPEAL

K.D POTTER

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JUDGE OF APPEAL

A.A KNELLER

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JUDGE OF APPEAL

I certify that this is a true copy of the original

DEPUTY REGISTRAR