Cristal Advocates

Navigating Receivership as a means of Debt Recovery

An Overview of Ugandan Legal Considerations

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1. Introduction

Creditors frequently encounter difficulties in collecting outstanding debts despite the legal remedies available. Secured creditors, in particular, often resort to selling collateral to recoup the owed amount. However, this process is frequently protracted and meets considerable resistance from property owners and occupants. Moreover, the sale of security typically yields proceeds below the market value. In this article, we will explore the potential of receivership as a debt recovery option, aiming to offer a solution that enhances efficiency and effectiveness in navigating the complexities of debt collection.

2. The basis for Receivership

Receivership occurs when a secured creditor appoints a qualified individual to manage the collateral and ensure repayment of the outstanding loan obligation. While primarily rooted in insolvency law, receivership is also available under mortgage law.

According to Section 22(1) of the Mortgage Act 2009, a mortgagee can appoint a receiver of the income from the mortgaged property. Thus, the creditor has the inherent right to appoint a receiver, even without an insolvency situation, if the debtor defaults on loan obligations. This appointment can be made in writing, with notification to the debtor, as set out in both the Mortgage and Insolvency Acts.

3. Duties of Receiver

A receiver's duties include:

a. Agency Duties

A receiver is designated as an agent of the debtor, although not in a formal agency capacity but as a legal means of making the debtor, rather than the creditor, liable for the receiver's actions and omissions ***(Lochab Brothers v. Kenya Furfural Co Ltd (1983) KLR 201).***

Under this arrangement, a receiver possesses a broad range of powers to collect proceeds from the property, manage the property, and, in some cases, sell it. However, all these powers must be stipulated in the appointing document. Since the receiver is considered an agent of the debtor, all powers properly exercised by receivers bind the debtor, even when appointed by the creditor, and the proceeds of the collection are dedicated to the payment of the creditor ***(Stephen Lubega v. Barclays Bank Ltd (1992) KALR 230).***

While the receiver is considered an agent of the debtor, it's crucial to note that the creditor may be held accountable for the receiver's actions if it's demonstrated that the creditor interfered in the receiver's management of affairs (Standard Chartered Bank v. Walker (1982) 3 ALL ER 938). This safeguard is in place to ensure that the objectives of the receivership are met without unfair disadvantage to the debtor and to foster a harmonious relationship between the debtor, receiver, and creditor.

b. Acting with Care

The receiver bears a duty of care to the debtor whose property is under receivership. Courts have stressed that a receiver must consider the mortgagee's interest in obtaining payment of their debt, and if acting in good faith, may prioritize the mortgagee's interests over those of the mortgagor.

Even if a receiver decides to continue the debtor's business, they must do so in good faith and without defying commercial sense. If a receiver sells the mortgagor's property without taking reasonable care to obtain a proper price, they may incur liability even in the absence of fraud or bad faith (Douglas Medforth v. James Blake & others 2000 Ch 86).

4. Why Receivership

Receivership proves to be a more effective debt-collection method compared to outright selling of the debtor's property, particularly when the collateral is challenging to sell but still generates income. Difficulties in selling collateral may stem from its expensive nature or a limited target market, as seen with special-purpose machinery, for instance. When collateral generates income, it's often more advantageous for a receiver to collect the proceeds rather than for the creditor to pursue a sale.

In certain instances, the inability to repay debt can be linked to poor business management practices, leading to reduced cash flow. In such cases, opting for receivership may be more advantageous than immediately selling the business, especially if the sale price wouldn't cover the accumulating loan amount.

Receivers, often qualified managers, possess the expertise to implement more effective cash flow management strategies. This enables them to meet loan obligations and cover other essential expenses. Such an approach not only has the potential to strengthen the business relationship between the debtor and the creditor but may also create additional business opportunities for the creditor with the debtor.

Receivership offers a means to minimize disputes, time, and expenses associated with litigation, as well as costs associated with selling the debtor's property. Courts are currently overwhelmed with lawsuits from debtors seeking to impede debt collection efforts. Since the primary role of a receiver is to collect outstanding amounts or improve the situation before considering selling the collateral, receivership may be more acceptable to debtors than an immediate property sale.

However, in cases where the financial situation of the business or property under receivership is irreparable, the receiver holds the authority to sell it to satisfy the mortgage. A sale by a receiver is typically facilitated smoothly, as the property under receivership is usually registered in the receiver's name in their official capacity, representing the debtor in such transactions, with proceeds remitted to the lender ***(AK Detergent v. East African Development Bank, Court of Appeal No. 51/1997).***

During a sale, the receiver must ensure fairness, publicity, and competitiveness, ensuring the property is sold for the best possible price. The receiver is obligated to avoid conflicts of interest when overseeing the sale of property under receivership, thereby mitigating potential liabilities ***(Emerald Hotel Ltd & Others v. Barclays Bank of Uganda & Others, HCCS 170 of 2008).***

5. Conclusion

From the preceding discussion, it's evident that receivership offers better safeguards for both lenders and borrowers. These safeguards primarily stem from the appointment of a professional intermediary who manages the conflicting interests of both parties regarding the same property. The prospect of preserving the collateral serves as an incentive for debtors to accept the process, while lenders are assured of payment through periodic collections or the eventual sale of the collateral.

Receivership thus presents a more reliable and mutually beneficial debt collection mechanism for both debtors and creditors compared to the outright sale of collateral. From this perspective, receivership offers a less chaotic means of maximizing debt collection, especially in cases where the collateral generates income and maintains a stable clientele. Even in scenarios where the collateral is eventually sold, debtors may find the process more acceptable, as the creditor made efforts to preserve their property.

Contacts for this Publication.

Kalema Paul Lincoln
Author

Denis Yekoyasi Kakembo
dkakembo@cristaladvocates.com

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Contact us

Cristal Advocates
32 Lumumba Avenue
4th Floor, Padre Pio House
Lumumba Avenue

P.O. Box 1769 Kampala, Uganda
+256 (414) 971274
admin@cristaladvocates.com
www.cristal advocates.com