Corporate Rescue and the Nigerian Insolvency System

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DECLARATION

I, Bolanle Adenike Adebola, confirm that the work presented in this thesis is my own. Where information has been derived from other sources, I confirm that this has been indicated in the thesis.

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ABSTRACT

Foremost insolvency practitioners are agitating for the reform of the Nigerian corporate insolvency law, and in particular, its rescue system. They seek to transplant the corporate rescue model of either the United States or of England and Wales into the Nigerian insolvency system. On the premise that the present system, as well as the proposed models should be clearly understood before reforms are executed, this thesis examines the three rescue models in focus.

Very little is written on the existing Nigerian rescue system. Utilising an analytical and empirical method, the thesis educes a robust and, it argues, representative picture of the Nigerian corporate rescue law and practice. It finds that the Nigerian rescue system comprises an informal and a formal phase. A company is more likely to be rescued at the informal phase, which is being developed by stakeholders to mitigate the substantive and institutional challenges that beset the formal phase. The formal rescue law is inadequate because itsregimesare not fit for purpose.The greatest challengeit faces, it is argued, isadministrative. Institutional failings have injected the tardiness and uncertainty that now characterise the Nigerian rescue system.

The thesis proposes an analytical framework by which the rescue systems of Nigeria, the US and England and Wales, as well as other corporate rescue models, can be examined. From the analysis it presents, prospective reformers can identify the core elements of corporate rescue and how these are administered by their preferred models. They can also observe how these elements are administeredbythe Nigerian rescue model. It is expected that the robust findings presented in the thesis will contribute considerable value to the on-going insolvency reform debate in Nigeria.

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Chapter 1

Introduction

Overview

This chapter introduces the thesis. It is divided into three main parts. Part I discusses the main questions with which the thesis is concerned. It sets out the structure of the thesis. It explains the method used and the contributions made. Part II introduces the Nigerian legal system. It is important to understand the complex network of rules undergirding this system. It explains the relationship between the legal systems of Nigeria and of England and Wales. It also explains the (continued) effect of English and Welsh cases on Nigerian courts. Part III introduces the Nigerian company and insolvency law. It outlines the history of the law. In particular, it highlights the relationship between that law and the British Companies Act 1948. The distinction between both laws is important for the analysis to follow in the latter portions of the thesis.

Part I

1.1 The Challenge

There is a dearth of information on the Nigerian insolvency law and practice. One contributory factor may be the lack of an Insolvency Act. Failure is culturally pariah in the Nigerian society, though it is quite evident in the perpetually distressed economy. In 1999, Nigeria turned a new chapter; after a prolonged spell of military rule, a civilian dispensation was ushered in. The new government advocated a market-driven economy.[1] Since then,

[1] The Obasanjo administration commenced its governance by implementing series of economic reforms designed to address the structural and institutional weaknesses of the Nigerian economy. By 2003, the key policies designed by the government were encapsulated in a home-grown economic program referred to as the National Economic Empowerment and Development Strategy (NEEDS). NEEDS can be described as the

successive governments have embarked on deregulation exercises, as well as substantial legal reform to stimulate the growth of private enterprise. Interestingly, neither the insolvency legislations nor the company law to which they are appended have been reformed since enactment in 1990.[2] Most of what is known of the Nigerian insolvency system is anecdotal. Case law is sparse; even the trickle appears to have dried up.

Foremost insolvency practitioners in Nigeria have called for reforms to the extant insolvency procedure.[3] They propose the enactment of an Insolvency Act that is at par with international regimes. The practitioners are unanimous in their call for a corporate rescue regime but divided on the most suitable model. Some prefer a court-driven rescue procedure akin to chapter 11 in the United States of America (US), while others advocate an administrative procedure like the administration procedure in England and Wales.

Since the late 1970s, many insolvency systems have been reformed to provide modern corporate rescue procedures that facilitate the preservation of failing companies and businesses. These systems are based on the notion that liquidation may not maximise the value locked in the assets of distressed businesses.[4] The assertion that rescue is a valid role of insolvency law has been challenged however. Since the 1980s, a debate on the proper purpose of insolvency law has raged amongst insolvency scholars. Any person who purports to discuss insolvency law starts from an assumption on its purpose. There are scholars who

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precursor to the Vision 2020 program. See generally, Nigerian National Planning Commission, 'Meeting Everyone's NEEDS' http://siteresources.worldbank.org/INTPRS1/Resources/Nigeria_PRSP(Dec2005).pdf, accessed on 06/10/2012.

[2] Discounting the fact that Part XVII was repealed and re-enacted as the Investment and Securities Decree (No.45) in 1999.

[3] Seyi Akinwunmi, 'Receiverships and Business Recovery' (copy on file with researcher); Anthony Idigbe, 'Using Existing Insolvency Framework to Drive Business Recovery in Nigeria: The Role of the Judges' http://www.insol.org/_files/Africa%20Round%20Table/Using%20existing%20insolvency%20framework%20to%20drive%20business%20recovery%20in%20Nigeria.pdf, accessed on 06/10/2012.

[4] *Communication from the Executive Director, Commission on the Bankruptcy Laws of the United States transmitting a report of the Commission on the Bankruptcy Laws of the United States* (July 1973). Insolvency Law and Practice: Report of the Review Committee(Cmnd 8558,1982)

perceive it to be a device that merely regulates debt collection.[5]For such persons, rescue is an incidental but not a core purpose of insolvency law. For others, insolvency law seeks to remedy the effects of corporate distress.[6] One of the mechanisms by which it accomplishes that task is corporate rescue. Simultaneously, amongst those who accept the validity of the rescue ambit of insolvency law, there are disagreements on its essence. While some assert that the purport of rescue is to save distressed entities, that is, companies, others insist that it seeks merely to save the businesses owned by such entities.[7] To the latter school of thought, the company may fail while the business is preserved, at rescue.[8]

In the US, rescue has, since the late nineteenth century, been construed to mean the preservation of distressed companies. The history of the chapter 11 procedure, and of the rescue concept, dates back to the nineteenth century.[9] The chapter 11 procedure leaves the debtor in charge of the distressed company after distress. The debtor is transformed to a trustee of its assets which constitute an estate. Its creditors and members establish committees which act as conduits between the debtor and the groups they represent. Judges plays a very central role in the procedure. They make many decisions after hearings at which the parties-in-interest may be heard. The system is unsurprisingly very litigious. Conversely, in England and Wales, the meaning of rescue is considered to be ambiguous, at best. While some rescue enthusiasts describe it as the preservation of failed businesses – as it was described in its first introduction to the system – others insist that it means the rescue of companies, as well as businesses – as the reformers insisted in the late 1990s and early noughties.[10] The

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[5] Thomas Jackson, *The Logic and Limits of Bankruptcy Law* (Harvard UP 1986).
[6]Elizabeth Warren, 'Bankruptcy Policymaking in an Imperfect World' (1993) 92 Mich LR 336.
[7] Rizwaan Mokal, 'The Harm Done by Administrative Receivership' (June 2004) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=568702, accessed 12/07/212.
[8] Sandra Frisby, 'In Search of a Rescue Regime: The Enterprise Act, 2002' (2004) 67 MLR 247.
[9] David Skeel Jr, *Debt's Dominion: A History of Bankruptcy Law in America* (Princeton UP, 2004).
[10] Compare *Insolvency Law and Practice: Report of the Review Committee*(Cmnd 8558,1982) with The Insolvency Service, *Productivity and Enterprise: Insolvency – A Second Chance* (Cmnd 5234, 2001);

administration procedure replaces the pre-distress managers with the administrator who is an insolvency professional. The administrator makes most of the essential decisions, leaving the courts to play a comparably less role. Consequently the model is administrative. Since the transformation of the insolvency system in 1985, the insolvency profession has also undergone a transformation to suit the central role played by the practitioners; prospective practitioners must be certified to act in that capacity.

The Nigerian insolvency law is modelled on the British Companies Act 1948. The law provides for the liquidation of insolvent companies. The main alternatives to liquidation are receivership and the arrangements and compromise procedure. The present law was enacted in 1990 after extensive deliberations in the late 1980s. The law has not been reformed in the 22 years since its enactment. Judging from the dearth of case law, it appears not to have been subjected to much use either. Its disuse is likely attributable to its unsuitability to the needs of the stakeholders because many companies have been failing in the economy. The main goal of the thesis is to determine whether there is a rescue option in the Nigerian insolvency law.

Primarily, the thesis examines the non-liquidation procedures in the law to determine whether they are conducive to corporate rescue. This requires a comprehensive analysis of the system. To that end, the thesis explores and elucidates the law and practice of the receivership and arrangements and compromise procedures. It explores the history of the extant provisions. It outlines the law and discusses the rules of their enforcement. It explores the case law and teases out the opinions of the various stakeholders implicated at distress. The cases suggest a parallel system in practice from that provided in the law. Consequently, the practice is explored in great depth by engaging in detailed interviews with a sample of stakeholders. The

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Department of Trade and Industry, *A Review of Company Rescue and Business Reconstruction Mechanisms* (2000).

information teased out by the interviews provides the opportunity for a more robust analysis of the system.

The main challenge, even after the Nigerian rescue law and practice have been clearly outlined, is how to analyse them; in the absence of a clear understanding of the purpose of insolvency law and its rescue ambit. Consequently, the thesis examines the existing theories and debates, as well as the history of insolvency law and corporate rescue. The aim is to provide a definition of insolvency law and of corporate rescue. As a corollary, it seeks to provide a framework by which rescue systems may be analysed. With the definitions and framework, the thesis analyses the two rescue models that have been recommended; to determine their effectiveness as rescue models, as well as the requirements for their effective administration. It highlights lessons for Nigeria and its prospective reformers. The same framework is applied to the Nigerian insolvency system to determine whether there is a rescue option in the law and the effectiveness of that option. The thesis also seeks to propose practical reforms to the existing rescue procedure. Its proposals take into consideration the strengths and weaknesses of the Nigerian legal and insolvency systems, which have been highlighted at the analysis phase.

1.2 The Structure

The thesis is divided into 7 chapters including the introduction and conclusion. Chapter 1 provides a background to the project and explains the main questions that the thesis seeks to answer. It sets out the methodology and gives an overview of each chapter. Given the complexities of the Nigerian legal system, chapter 1 gives a brief description of Nigeria and her legal system. It explains the relationship between the Nigerian legal system and that of England and Wales. Usually, the Companies and Allied Matters Act (CAMA) 2004, which stipulates the Nigerian company and insolvency law, is studied as a complete (and so stand-alone) document. Departing from that model, the chapter, for the first time, discusses the history of CAMA and explains the reasons for some of its peculiarities that are typically scoffed at as anomalous. The relevance of the history becomes apparent at the discussion phase.

Chapter 2 examines the purpose of insolvency law. For convenience, it splits the main theories into the inclusive and exclusive perspectives. The exclusive perspective consists of theorists who believe that the main purpose of insolvency law is to resolve the common-pool problems that arise when a debtor is unable to repay its debt. The inclusive perspective comprises theorists who argue that insolvency law caters to a wider range of values and interests than the creditor's primary economic needs. The chapter finds that both perspectives fail to justify the many facets of insolvency law largely because of their fascination with the term 'insolvency'. It argues that insolvency law has both insolvent and solvent dimensions. In addition to its debt recovery role, it is the only formal legal mechanism by which creditors' interests may be validly modified. The modifications can be accomplished whether or not the debtor is actually insolvent; hence the modern call for the timely initiation of insolvency procedures. On this basis, it finds that rescue is a valid facet of insolvency law because it facilitates the process by which a distressed company may modify the claims of its investors.

Chapter 3 explores the rescue debate. It examines the 'company' and 'business' rescue perspectives. It finds that the concept is not as ambiguous as it is portrayed. Many definitions focus either on the procedure or on the outcome. Though a company may appear to have been rescued, in truth, it is possible that its failure is just shifted to another date. Likewise, while a sale may indeed give the business a new lease on life, it is not the sale *per se* but the actions of the purchaser that give rise to rescue. The chapter examines different types of business sales. In particular, it contrasts market sales to third parties and rescue oriented sales in the nineteenth and early twentieth century United States,with modern notions of business sales in England and Wales. It finds that three elements set the former apart from the latter. The first is that an objective decision is taken to purchase or rescue the business, short term operating funds are made available while the rescue is negotiated and implemented, the new company is provided a viable capital structure and a plan is put in place to revitalise the company. It therefore identifies the rescue decision, rescue finance and rescue plan as the three main elements of rescue. These elements form the basis of the framework with which rescue procedures will be subsequently analysed.

Chapter 4 introduces the Nigerian insolvency procedure. It focuses on the receivership and arrangements procedures. It discusses the use and decline of both procedures in the economy. It discusses the few opinions that have been expressed by experts. It outlines the procedures as provided in CAMA 2004 and their interpretation by the courts. It becomes quickly apparent that a parallel system from that expressed in the law runs in practice; the courts also create ad hoc rules; all of which introduce uncertainty to the law. At this stage, the relationship between CAMA 2004 and the British Companies Act 1948 becomes important. The receivership procedures in both laws are structurally similar. However, some fundamental changes were made during the reforms that give rise to CAMA 1990 which the judges failed, for the most part, to recognise and implement. One reason for this was because they had been relying on a precedent that was decided under the previous Companies Decree 1968 which was a transplant of the British Companies Act 1948. The arrangements procedure appears to have fared even worse. The judges have given decisions that are difficult to interpret, at best. Moreover, practices not indicated by the law appear to have evolved which require closer observation. Consequently, an empirical research was undertaken to better elucidate the insolvency system.

Chapter 5 explores the insolvency practice in Nigeria. It sets out interviews with some of the main stakeholders at insolvency: bankers, entrepreneurs, judges and practitioners. Banks highlight the problems with enforcement as the main reason why they prefer not to take all-asset debentures.[11] The bankers are also sceptical about the management capacities of receivers. Consequently, they prefer asset-based lending, which they combine with aggressive monitoring practices. They are disenchanted by the judges in general and the legal system in particular. They also indicated that most debtors cannot be trusted. The entrepreneurs likewise distrust every other group of stakeholders. They complained that the insolvency system does not facilitate rescue. The practitioners, in the established pattern, distrust every other group of stakeholders. They highlighted problems in the administration of the present insolvency system. In particular, they flagged the proclivity of judges to introduce extra-legal rules to the process. They advocated for specialisation in the judiciary. The practitioners proposed the introduction of either a chapter 11-based or administration-based model to replace the outdated CAMA 2004 model of rescue. The judges were not impressed with the call for specialisation in the judiciary; though they noted that some reforms were necessary to improve the judiciary. They explained that many of the rules introduced by judges were based on the corrupt practices of the other stakeholders. The chapter shows that the system has fundamental institutional needs without which substantive reforms cannot be successfully implemented.

Given the call for the introduction of the chapter 11 or administration procedures, as well as the fact that the two models present diverse but globally acclaimed rescue models, chapter 6 analyses the two procedures. It provides a brief outline of the chapter 11 procedure. It examines how the rescue decision, rescue finance and the rescue plan are addressed under the

[11] The document by which receiver/managers are appointed.

law and in practice. It finds that the most attractive component of the chapter 11 procedure, the debtor-in-possession, does not function as the Nigerian practitioners envisage. It finds that the creditors are often in charge of the rescue. Consequently, the rescue decision is usually skewed in their interest. It finds that the debtors, even when in charge, are unlikely to take objective decisions; the managers merely stayed in control for as long as they could. As companies have become even more leveraged, the opportunities for creditors to take control have increased, and they have not been slack in exploiting these opportunities. Likewise in England and Wales, the chapter finds that the rescue decision in particular, and the procedure in general, are skewed in the interest of the main lenders. However, in this system, companies that would be rescued do so through the informal, not formal procedure.

Chapter 7 provides a detailed snapshot of the options available to a Nigerian company from its quest for credit to its attempted rescue. With the information obtained from the interviews and the doctrinal review, it finds that there are two systems of rescue running in Nigeria: the informal and the formal. Like in England and Wales, rescue takes place informally. The companies resort to the formal procedures are unlikely to make it beyond the commencement phase. The formal phase is characterised by complex legal battles, complicated judicial rules and convoluted procedures that may take as long as a decade to resolve. The rescue decision is taken, as in every other system, by the party with the money – the main lender. The system does not provide for rescue finance, neither is there a requirement for a rescue plan. Unlike the other models however, Nigeria lacks the institutional wherewithal by which reforms can be successfully implemented; there is no advanced judicial system to implement a chapter 11 model, or professional administrative system to implement an administration model. Nonetheless, the proposed reforms are skewed towards the administration model because even the chapter 11 process shows that leaving debtors in charge of distressed companies is not necessarily prudent in any society. The proposals reduce the number of court hearings and gives pride of place to the Securities and Exchange Commission, as well as the Business and Insolvency Practitioners Association of Nigeria; subject to the proposed reforms to their administration.

1.3 Methodology

The thesis combines an analytical and an empirical method. The doctrinal aspect of the thesis examines extant economic and socio-legal theories, black-letter law, as well as judicial pronouncements on the rescue concept and procedure. On the strong belief that law may work differently in practice from the law on the books, empirical studies on various aspects of the concept and procedure are also examined to provide a more robust understanding of the issues at stake. Having combined the history of the law, the law on the books, as well as the law in practice, the thesis offers an explanation of the insolvency and rescue concepts; highlighting the limitations in some of the previously offered perspectives. The empirical ambit was undertaken to elucidate the Nigerian insolvency practice. It involves semi-structured interviews administered to a random sample of Nigerian stakeholders. The interviews yielded a wealth of information which gave a deeper and broader understanding of the Nigerian system than otherwise available. It also limits the opportunities for analysis based on unsubstantiated assumptions.

1.4 Contribution

The thesis provides a comprehensive analysis of the Nigerian rescue procedure. It highlights the changes in the corporate finance landscape of the country. It is important to take note of these changes because the financial instruments affect the administration of the rescue procedures. Most discussions on the Nigerian insolvency system focus solely on the formal phase. They do not recognise the fact that the system also consists of an informal phase. The financial instruments enable informal rescue under the aegis of the banks and their professionals. Further, most critics fail to distinguish the Nigerian insolvency provisions from those of the British Companies Act 1948. In fact, it appears that neither the judges nor the practitioners have been able to identify and explain the conceptual differences between the two. The thesis not only offers an explanation of these differences, it explains the historical context in which the differences were introduced. In addition, it pin-points the commencement stage as the most crucial stage in the formal phase of the Nigerian rescue system. Many rescue attempts falter because of the ad hoc rules created by the confusion identified above. Generally, the thesis also provides a robust definition of insolvency law and its rescue ambit that takes into account its solvent and insolvent dimensions. Similarly, it explains the reasons why corporate rescue is not ambiguous. It defines the concept and highlights the elements that an effective rescue system must take into consideration.

Part II

1.5 Introduction to the Nigerian Legal System

Nigeria is a Federal Constitutional Republic.[12] She is comprised of 36 states and a Federal Capital Territory, Abuja.[13] The 36 states are further sub-divided into 774 Local Government Areas. The Local Government Areas bring the government to the grassroots comprising more than 250 ethnic groups with diverse languages and customs.14 Given that there more than 500 indigenous languages in Nigeria, the decision was taken to adopt an official language to

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[12]Nigeria, officially, The Federal Republic of Nigeria, has the Constitution of the Federal Republic of Nigeria, 1999 (now CAP C23 LFN 2004) ('1999 Constitution') as its grund-norm.

[13] CIA, 'The World Fact Book: Nigeria' https://www.cia.gov/library/publications/the-world-factbook/geos/ni.html, accessed on 06/10/2012 ('CIA Fact Book').

[14] Ibid.

promote the cultural and linguistic unity of the country.15English Language was chosen largely because a cross-section of the Nigerian populace already spoke the language as a result of the country's colonial heritage. With a population estimated at over 150 million, Nigeria is the most populous country in Africa.[16] Comprising a total area of 923,768 km2 (356,669 sq. mi), Nigeria is located in West Africa and shares land borders with the Republic of Benin to the west, Chad and Cameroon to the east, and Niger to the north; to the south lies the Atlantic Ocean.[17]

In October 2012, Nigeria celebrated her 52nd anniversary as an independent nation. While Nigerians have been free from direct foreign oppression, the years of independence have mostly been turbulent years of domestic oppression. Nigeria has been ruled by the military for about 30 of her 52 years as an independent nation. The decades of military rule were characterised by human rights abuses and the suspension of the rule of law. They were also characterised by corruption, mismanagement and little economic development.[18] Since 1999 however, the restoration of democracy and the implementation of vital economic reforms have put Nigeria back on track towards achieving her economic potential.

Nigeria is classified as an emerging market with a lower middle income status by the World Bank. Petroleum plays a large role in the Nigerian economy; accounting for 40% of GDP and 80% of Government earnings.[19] Since the return to civilian rule, there has been a shift in the economic aspirations of the country.[20] Successive governments have sought to promote economic growth by reducing reliance on petroleum resources and diversifying the economy.

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[15] Of the 521 languages in Nigeria, 510 are existing, 2 without native speakers, and 9 extinct. The English language is widely used in education, business, and other official purposes.Rachel Ogbu, 'Dying Mother Languages' http://www.newswatchngr.com/index.php?option=com_content&task=view&id=647&Itemid=1, accessed on 06/10/2012.

[16] CIA Fact Book (n 13).

[17] Ibid.

[18] Ibid.

[19] Ibid.

[20] See (n 1) above.

This has resulted in the implementation of schemes that aim to liberate the Nigerian market; the underlying goal being to encourage the growth of the private-sector. The government has relinquished its monopoly in many sectors and assumed a supervisory role. To facilitate the achievement of stated goals, the government has also embarked on the reform of key sectors.[21]

1.6 The Relationship between Nigeria and the United Kingdom

Nigeria is a former colony of the British Empire's. The name Nigeria was coined by Flora Shaw, a British journalist and the future wife of Baron Lugard, a British colonial administrator, in the late 19th century.[22] The name, literally 'Niger-Area' derives from the Niger River running through the country. The British Empire's conquest of the Niger-Area commenced in the late 19th century and had many of the existing (West African) Empires at the time fighting wars against subjugation.[23] Following the success of the British Army in subduing the native warriors, the Niger-Area became a British protectorate on January 1, 1901; though it remained divided into the northern, southern and the Lagos Protectorates administratively.[24] In 1906, the Colony of Lagos was merged with the Protectorate of

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[21] In particular, the government has focused on an overhauling of the financial sector to ensure the availability of finance necessary for the growth of the private sector. Dele Balogun, 'A review of Soludo's Perspective of Banking Sector Reforms in Nigeria' http://mpra.ub.uni-muenchen.de/3803/1/MPRA_paper_3803.pdf, accessed on 06/10/2012.

[22] Flora Shaw, the colonial editor of The London Times, first referred thus to what is today known as 'Nigeria' in an article published in The Times of 8 January 1897. 'Flora Shaw gives the name Nigeria'http://www.hh-bb.com/flora-shaw.pdf, accessed on 06/10/2012. See also, Omo Omoruyi,'The Origin of Nigeria: God of Justice Not associated with an unjust Political Order: Appeal to President Obasanjo Not to Rewrite Nigerian History' (2002)http://www.nigerdeltacongress.com/tarticles/the%20origin_of_nigeria.htm, accessed on 06/10/2012.

[23] Lagos became a British colony by the Treaty of Cession in 1861. Other regions that refused to agree to such treaties were not conquered until early 20th century; the Northern Sokoto Caliphate was conquered finally in 1903. Mamman, *The Law and Politics of Constitution Making in Nigeria, 1862-1989: Issues, Interests and Compromises* (Ed-Linform services, 1998) 49; Hon. Justice Ayoola, 'Rationale, Objectives and the Scope of Law Reform',in Osibanjo and Kalu (eds.), *Law Development and Administration in Nigeria* (Intec Printers Limited, 1990) 21.

[24] The Northern and Southern Protectorates became British protectorates by Orders in Council in 1899. The Orders in council came into effect on the 1st of January, 1900. See generally, Appendix to the Laws of Northern Nigeria 1910; Appendix to the Laws of Southern Nigeria 1900-01.

Southern Nigeria to form the Colony and Protectorate of Southern Nigeria.[25] In 1914, under Lord Lugard, the Northern and Southern protectorates were formally amalgamated as the Colony and Protectorate of Nigeria.[26]

By mid-twentieth century, there was a surge in the growth of Nigerian nationalism amongst the educated elites.[27] Political activity was a catalyst to the proliferation of demands for independence. In the period after World War II, successive constitutions legislated by the British Government moved Nigeria toward self-government on a representative and increasingly federal basis. By the middle of the 20th century, a great movement for independence was sweeping across Africa.[28] On October 1 1960, Nigeria gained her independence from the United Kingdom.[29] In 1963, Nigeria abolished the monarchy, declaring herself a Federal Republic.[30] In 1979, Nigeria completed her deviation from the British model of government by adopting a constitution modelled on the Constitution of the United States, which provided for a President, Senate, and House of Representatives.[31]

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[25] Obilade, *The Nigerian Legal System*, (Sweet & Maxwell, 1979) 24, ('Obilade, *NLS*').
[26] Nwabueze, *A constitutional History of Nigeria* (C. Hurst & Co (Publishers) Ltd, 1982); Ehindero, *The Constitutional Development of Nigeria: 1849-1989* (Ehindero (Nigeria) Ltd, 1991).
[27] Mamman, (n23) 90-91.
[28] Many of Nigeria's neighbours in the Sub-Saharan region, including the Republic of Ghana, the Republic of Cameroon, the Republic of Togo and the Republic of Senegal amongst others, attained independence in this period.
[29] The British parliament ceased to legislate for Nigeria in 1960 but Nigeria was still a monarchy. The government's functions were carried out in the queen's name; though the constitution vested the queen's functions in the Governor-General of the Federation. Ehindero, (n26) 24-25.
[30] The Queen ceased to be the queen of Nigeria. Her functions were taken over by the president. Nigerians owe allegiance to the Republic, not the queen. The Constitution of the Federation Act 1963 replaced the Nigeria Independence Act 1960. Ironically, although the 1963 constitution abolished British Rule in Nigeria, it was authorised by the British Government.
[31] Nwabueze, *Nigeria's Presidential Constitution, 1979-83: The Second Experiment in Constitutional Democracy* (Longman Nigeria Ltd, 1985); Oyediran (ed.), *The Nigerian 1979 Elections*(Macmillan Press Ltd, 1981).

1.7 Sources of Nigerian Law[32]

The principal legal source of Nigerian law is Nigerian legislation.[33] Nigerian legislation comprises statutes enacted by the Legislature and subsidiary/delegated legislation enacted in the exercise of power given by a statute. Nigerian statutes consist of Ordinances, Acts, Decrees and Edicts, depending on the type of government in place. Subsidiary legislation consists of Rules, Orders, Regulations, By-Laws and other instruments made under the authority of statutes.

Another important source of Nigerian law is Customary Law.[34] Customary Law consists of customs accepted by the members of a community as binding.[35] In Nigeria, existing Customary Law includes Ethnic or Non-Islamic Customary Law.[36] Ethnic Customary Law is indigenous and unwritten.[37] Customary Law also includes Islamic Law. Islamic Law is a religious law based on the Islamic faith and is applicable to the members of that faith.[38] Islamic Law, unlike the Ethnic Customary Law, is largely written.[39] Customary laws are subject to tests of validity prescribed by statute and cannot be enforced unless they pass these tests.[40] The tests of validity include the repugnancy test,[41] the incompatibility test[42] and the test of public policy.[43]

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[32] The Sources of Nigerian Law include Nigerian Legislation English Law Judicial Precedents Customary Law. See generally, Obilade, *NLS* (n25); Okonkwo, *Introduction to Nigerian Law*, (Sweet & Maxwell, 1980); Ajibola et al., (eds.) *Law Development and Administration in Nigeria* (Federal Ministry of Justice Law Review Series, 1990).
[33] Okonkwo, (n32) Chapter 1.
[34] Ibid 1.
[35] *Owonyin v Omotosho* (1961) 1 All NLR 304.
[36] Obilade, *NLS* (n 25) 83.
[37] *Alfa v Arepo* (1963) WNLR 95.
[38] In Nigeria, the Islamic Law of the Maliki School is the applicable Islamic Law. See Sharia Court of Appeal Law (Northern Nigerian Laws 1963), s14.
[39] Islamic Law is more commonly referred to as Sharia Law in Nigeria. It consists of the words of the Holy Koran; the Sunna, the practice of the prophet; the consensus of scholars and analogical deductions from the Holy Koran and the Sunna. See Obilade, *NLS* (n 25)83.
[40] Proviso to Evidence Act (CAP E, LFN 2004), s 14(3). *Edet v Essien* (1932) 11 NLR 47; *Esugbayi Eleko v Officer Administering the Government of Nigeria* (1931) AC 662.

Judicial Precedent, otherwise referred to as case-law is another very important source of Nigerian law.[44] This consists of laws found in judicial decisions. As in England and Wales, the hierarchy of courts is highly respected in Nigeria. In Nigeria, there is a fairly complex court system based on her quasi-federal structure.[45]There are federal, as well as state courts.[46] The federal court system is the more complex system because it consists of courts established by federal law, as well as those established by state law but which are given jurisdiction in federal matters by federal law.[47]

The Supreme Court is the apex court in Nigeria.[48] Its decisions bind every other court in Nigeria.[49] The Federal Court of Appeal is next in hierarchy. Its decisions are binding on the High courts, both federal and state, the Sharia or Customary Court of Appeal of any state and on various other tribunals.[50] Except for cases tried in the Sharia or Customary Courts, or by Tribunals, the High Court, federal and state, is next in the hierarchy of courts. The decisions of the High Courts are binding on the Magistrate and District Courts; they are also of persuasive authority in courts of equal jurisdiction.[51] Next in the hierarchy are the District and Magistrate Courts whose decisions are merely of persuasive authority. As Customary

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[41] A custom will not be applied if it is repugnant to natural justice, equity and good conscience. However, a custom does not fail the repugnancy test merely because it does not meet up to the standard behaviour observed in certain societies of advanced social development, like England. *Dawodu v Bankole* (1958) 3 FSC 46.

[42] A customary law will not be applied if it is contrary to any law for the time being in force. *Adesubokan v Yinusa* (1971) NNLR 77.

[43] A custom will not be applied if it is repugnant to natural justice, equity and good conscience. *Alake v Pratt* (1955) WACA 20.

[44] Okonkwo, (n 32) 1.

[45] Nigeria is not a truly federal system of government because there is a concentration of power in the federal government which leaves States with very limited autonomy.

[46] 1999 Constitution, Chapter VII.

[47] Obilade, *NLS* (n 25), 115.

[48] 1999 constitution, s 235, The Supreme Court of Nigeria replaced the Judicial Committee of the Privy Council as the highest court in Nigeria when Nigeria became a republic in 1963.

[49] 1999 constitution, s 233, s 235.

[50] 1999 constitution,s 240 –s 246. In election petitions, the Federal Court of Appeal is the Highest Court of Appeal. s 246 (3).

[51] 1999 constitution, s 252, s272.

Courts are not expected to enforce the provisions of the Common Law, it follows that the principles of judicial precedent do not apply in such courts.[52]

Another important source of Nigerian law is English law. English law as a source of Nigerian law derives from Nigeria's colonial relationship with Britain.[53] There are two classes of English law that operate in Nigeria. The first is received English law.[54] Received English law consists of the Common Law, doctrines of Equity, Statutes of General Application in force in England on January 1, 1900, as well as statutes and subsidiary legislation on specified matters.[55] Received English Law was introduced into Nigerian law by Nigerian legislation.[56] The second class of applicable English laws in Nigeria includes English Law and Subsidiary Legislation made before October 1, 1960 and extended to Nigeria.[57] Unlike Received English Law, English Laws extended to Nigeria were the result of direct provisions in the applicable English Legislations.[58]

In sovereign Nigeria, the applicability of English Law has been progressively limited by Nigerian legislation and judicial pronouncements. Some statutes of general application have been repealed, expressly or impliedly.[59] Moreover, some laws instruct that the applicability of received English law is subject to Nigerian legislation.[60] Thus, to the extent that the subject

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[52] *Olalekan v. Commissioner of Police* (1961) WNLR 215; *Ogo v Ogo* (1964) NMLR 117.
[53] Historically, the first English Law was introduced to the Colony of Lagos by Ordinance No 3 of 1863.
[54] When an English Statute is enacted or re-enacted as Nigerian Legislation, it ceased to be Received English Law; the Nigerian legislation becomes the source of that law. Obilade, *NLS* (n 25) 69.
[55] Obilade, *NLS* (n 25) Chapters 2, 5.
[56] For example, Interpretation Act of 1958, s 45 introduced the Common Law of England, the doctrines of Equity and the statutes of general application in force in England on January 1st 1900 into Nigerian law.
[57] These consist of statutes made on or before the 1st of October 1960, that have not been repealed by an appropriate authority in Nigeria.
[58] Examples include Carriage of Air Navigation Order 1955. Bill of Sale Acts 1878-1891. The Independence Act 1960 abolished the Colonial Laws Validity Act of 1865 with respect to Nigeria. It provided that no Act of the United Kingdom Parliament or Subsidiary Legislation that was passed after October 1st 1960 shall extend to Nigeria.
[59] Lagos State Applicable (Laws) Edict, 1968, s 4(1) repealed the provisions of the Obscene Publications Act 1857 which were Statutes of General Application.
[60] See for example, High Court Law (Lagos Laws 1973),s 16; High Court Law (Northern Nigerian Law), s 28, s 29, s33.

matter of a received law is dealt with by a Nigerian legislation, the Nigerian legislation, not the received law, is the applicable law.[61] Also, in the event of a conflict between received law and a Nigerian legislation, the Nigerian legislation prevails.[62] The scope of application of some of the received law is also limited by local circumstances.[63] Thus, wherever a particular factor which is essential to the application of an English statute is not present, the courts will hold that local circumstances do not permit its application. In the same vein, Nigerian courts have decided that decisions made by English courts have no binding force in Nigeria because no English courts form part of the hierarchy of courts in sovereign Nigeria. [64] Notwithstanding, the decisions of English courts are of persuasive authority and are treated with great respect by the Nigerian judges.

Part III

1.8 Nigerian Company and Insolvency Law

In Nigeria, there is no Insolvency Act. The source of the Nigerian corporate insolvency legislation is the Companies and Allied Matters Act (CAMA) 2004 which governs companies. [65] CAMA 2004 finds its roots in British company law, albeit with some indigenous modifications. The reason for this is as explained above: Nigeria is a former colony of Britain's. [66] As a result of its colonial pedigree, most Nigerian legislations, (including, of course, its company law), evolved from and are modelled on the laws of England and Wales. Though Nigeria gained her independence from colonial rule in 1960, the structure of her legal system has remained largely unaltered.

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[61] See *Adesubokan v Yinusa* (n 42).
[62] Ibid.
[63] *Lawal v Younan* (1961) 1 All NLR 245.
[64] *Alli V Okulaja* (1970) 2 All NLR 35.
[65] Chapter C20, Laws of the Federation of Nigeria, 2004. Except as otherwise stated, CAMA refers to CAMA, 2004.
[66] See Page 25.

The first company law in Nigeria was the Companies Ordinance 1912.[67] This was an indigenous enactment of the Companies (Consolidation) Act 1908.[68]With the amalgamation of Southern and Northern Nigeria in 1914, the Companies Amendment and Extension Act 1917 was enacted; to extend company law to the entire country.[69] Five years later, both the Ordinance of 1912 and that of 1917 were repealed and replaced by the Companies Ordinance 1922; which was modelled after the British Companies Act 1929.[70] The 1922 Ordinance was amended by subsequent ordinances in the following decades; based on subsequently enacted British Companies Acts.[71] In 1968, the Companies Decree 1968 was enacted and remained in force for the next two decades.[72]

The Companies Decree 1968 was, largely, a direct transplant of the British Companies Act 1948.[73] The Decree was an amalgam of some sections of the repealed (Nigerian Companies) Amendment Act 1958 and some (new) provisions of the British Companies Act 1948. Ironically, at the time the 1968 Decree was promulgated, the Companies Act 1948 had been amended by the Companies Act 1967.[74] As the failure of the 1968 Decree to support economic development in Nigeria during the (post) oil-boom era became more apparent, there were heightened calls for its amendment or repeal. In 1990, the Companies and Allied Matters Decree replaced the failed Companies Decree 1968. Though CAMA 1990 was

[67] This ordinance was in force only in the Lagos colony. Akinola, 'A Critical Appraisal of the Doctrine of Corporate Personality under the Nigerian Company Law' (NLII Working Paper Series 002).
[68] International Centre for Nigerian Law, 'Guide to Business in Nigeria'http://www.nigeria-law.org/BusinessInNigeria.htm, accessed on 06/10/2012.
[69] Akinola, (n67) 1.
[70] CAP 38, LFN, 1948 and CAP 37, LFN, 1958. See also, Olakunle Orojo, *Company Law and Practice in Nigeria*, (3rd Edn, Mbeyi & Associates (Nig) Ltd, 1992) 17.
[71] For example amendments were made by the Companies Amendment Ordinances 1929, 1949 and 1954. See generally, Nigerian Law Reform Commission, 'Report on the Reform of Nigerian Company Law and Related Matters' (Volume 1, Review and Recommendation, 1988) ('The Commission Report').
[72] Akinola, (n67) 1.
[73] The Commission Report (n71) 6.
[74] At the time the 1968 Decree was promulgated, the Law makers had the Jenkins Report of 1962, the new Companies Act, 1967 of England and Wales, as well as the Final Report of the Commission of Enquiry into the Working and Administration of the Company Law of Ghana, a commission chaired by Professor Gower, to provide information on the inherent problems of the Companies Act 1948. Yet, then government still went ahead to promulgate provisions of the 1948 Act as law in Nigeria.

amended in 2004, the insolvency provisions in both statutes are the same. The key purpose of the amendment was to separate the portion that became the Investment and Securities Decree.[75]

1.9 The Nigerian Law Reform Commission

CAMA 1990 has been described as a landmark company legislation in Nigeria.[76] It is the first indigenous company law in Nigeria. CAMA 1990 was born of the need to create a comprehensive body of legal principles and rules suitable to the Nigerian situation.[77] At the time, the consensus was that the Companies Decree 1968 had ceased to suit to the needs of the country.[78] As stated above, the 1968 Decree was a mere re-enactment of the British Companies Act 1948. It failed to take into consideration the peculiarities of the Nigerian economy.[79] Moreover, by 1968 when the Decree was promulgated in Nigeria, the 1948 Act had been amended by the British Companies Act 1967. In March 1987, the then Attorney-General of the Federation and Minister for Justice directed the Nigerian Law Reform Commission to undertake a review of the Nigerian company law, to provide laws that were better suited to the peculiarities of the rapidly developing Nigerian corporate sector.[80]

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[75] Investments and Securities Decree No. 45 of 1999. Subsequently, the Investment and Securities Act Cap124, LFN 2004. The 2004 Act was modified and repealed by the Investment and Securities Act No. 29 of 2007.

[76] Akanki, 'Company Law Development Through the 1990 Legislation' in Obilade, '*A Blueprint for Nigerian Law: A collection of critical essays written in commemoration of the thirteenth anniversary of the establishment of the Faculty of Law of the University of Lagos*' (Faculty of Law, University of Lagos, 1995), ('Akanki, Company Law Development').

[77] The Law Reform Committee was directed by the then Minister of Justice and Attorney-General of the federation, Honourable Price Bola Ajibola, SAN, on the authority of the Nigerian Law Reform Commission Act 1979 to propose a Nigerian Companies Act.

[78] For example, the Decree did not facilitate the achievement of the stated goals in the Nigerian Enterprises Promotion Acts 1972-1977. These Acts mandated greater Nigerian participation in incorporated companies in Nigeria. They also promoted widespread ownership of companies among Nigerians. There was therefore a need for clearer and more stringent rules on company capital, insider trading, take-overs and mergers amongst other matters, which the 1968 Decree failed to regulate acceptably in Nigeria.

[79] The Commission Report (n71) 6.

[80] See (n77).

1.10 Structure and Goals

The Nigerian Law Reform Commission, ('the Commission'), was established in 1979.[81] It is charged with the duty of reforming, simplifying, modernising and indigenising federal laws in Nigeria (and state laws, if required).[82] The Commission is to ensure that Nigerian laws reflect the norms of the Nigerian society. Also, that the laws are competent to deal with the complexities of the modern Nigerian society.[83] Since its establishment, the Commission has adopted a *Participatory Approach to law reform*.[84] Members of the commission, in the early 1980s, distinguished the *Participatory Approach* from the prior system of legal reform in Nigeria which had been largely reactionary. It was observed that the *Reactionary Approach to legal reform* created ad hoc laws which failed to engage with Nigerian norms.[85] The *Participatory Approach* consults with the experts, practitioners and members of the public whose activities the laws are expected to regulate.

To achieve the stated goals, there was a clear need for expertise in (received) English law, Nigerian legislation, Nigerian case law, Islamic law and Customary law. In essence, there

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[81] By Act No.2 of 1979 under the government of General Olusegun Obasanjo (who subsequently became the first civilian president in 1999 after about 15years of uninterrupted military rule).

[82]Nigerian Law Reform Commission Act, 1979, No. 7 (Cap. N118, LFN 2004), s 5 (1). Before the Commission was created, law reform in Nigeria had been made sporadically by government officials and ad hoc bodies. Examples of such bodies are the Area Courts Reform Committee, the Customary Courts Reform Committee and the Land Use Panel 1975-1979. Many of these bodies were dissolved after the project was completed.

[83] See 'Welcome Address by the Chairman of the Nigerian Law Reform Commission, The Hon. Sir Darnley Alexander, GCON, CFR KT, CBE, at the Opening Session of the Workshop on the Reform of Nigerian Company Law, on Wednesday, February 10, 1988' Appendix 3, The Commission Report, (n 71) 360.

[84] The Participatory Approach engages with the vital agents of social change when reform is proposed in any community. Yusuf (Commissioner, Nigerian Law Reform Commission), 'Social Perspectives of Law Reform in Nigeria' in Nigerian Law Reform Commission, 'Law Reform' (Issue No.4, December 1984) 50-54; Nigerian Law Reform Commission, Annual Report and Accounts for the Year Ended 31st December, 1987, 3.

[85] The Reactionary approach is also referred to as the traditional approach to legal reform. It focuses only on the legal issues in question. Before 1979, the laws in Nigeria had undergone a spasmodic process of amendment and reform by government functionaries or ad hoc bodies. The result had been the evolution of laws that did not cater to the needs of the country and were more suitable, usually, to the jurisdiction of England and Wales. See, Yusuf, Social Perspectives of Law Reform (n84) 50; Lecture on "Aspects of Law Reform in Nigeria" delivered in Sokoto on Wednesday, 16th February, 1983 by the Chairman of the Nigerian Law Reform Commission, The Hon. Sir Darnley Alexander, C.F.R., C.B.E. in Nigerian Law Reform, Law Reform, (Issue No.4, December 1984) 13.

was a need for expertise in the core legal sources of Nigerian law.[86] There was also a need to balance legal expertise with expertise in other relevant fields, particularly the social sciences and humanities. The government's desire to satisfy these needs was evident in its choice of commissioners. The commission was constituted by 4 full-time and 3 part-time commissioners, as well as research and administrative staff.[87] At its inauguration, a former Chief Justice of the Federation was appointed as chairman.[88] Other full time commissioners included an eminent social scientist who was versed in the sociology of law;[89] an expert in legal research and reform;[90] as well as a very experienced educationist.[91] The part-time commissioners included a learned Islamic lawyer who was distinguished in Islamic and

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[86] The sources of Nigerian Law are discussed above. See page 27 above.

[87] Today, the Commission is constituted by 4 full-time commissioners and a secretary, all of whom are selected by the President. Nigerian Law Reform Commission Act 1979, No. 7 (Cap. N118, LFN 2004), s 2.

[88] The Hon. Sir Darnley Alexander, GCON, CFR KT, CBE. Sir Darnley, born in 1920, was of Caribbean descent. His elementary and college education were undertaken at St Lucia. He studied at the University of London and was called to Bar in England in 1942. He served in different capacities in the legal service of the Caribbean before moving to Nigeria in 1957. He worked successively as a legal draftsman, acting director of Public Prosecutions and as Solicitor-General and Permanent Secretary of the Ministry of Justice of Nigeria. He was appointed as Queen's Counsel in 1961.He was appointed as a Judge of the High Court of Lagos, Nigeria in 1964. Concurrently, he headed various tribunals. He was appointed as Chief Justice of the former South-Eastern State of Nigeria (now Cross River State) in 1969. In 1975, he was appointed Chief Justice of Nigeria; a post that he held until 1979. He was also a Life Member of the Body of Benchers of the Nigerian Bar. Nigerian Law Reform Commission, 'Law Reform' (Issue No.1, December, 1980) 5 (Law Reform (No.1)).

[89] Dr Ahmed Yusuf. Dr Yusuf obtained a B.A in French language, both from Toulouse, France and the renowned Ahmadu Bello University, Zaria, Nigeria. He obtained an M.A (Anthropology) in 1973 from State University of New York. His PhD in legal anthropology was obtained from the State University of New York in 1976. He worked as a French Lecturer at Bayero University (BUK) Kano, and then as a lecturer of sociology at the Ahmadu Bello University (ABU), Zaria. He went on to become a Dean of the Faculty of Social Sciences at University of Sokoto. He was an African Fellow of the International (Customary) Folk Law Commission (Netherlands). Law Reform (No.1), (n88) 6.

[90] Dr Samuel Obi. In 1953, Dr Obi obtained a B. Sc (Hons) from the University of London. He also obtained an LL.B from the University of London in 1959. He attended, amongst others, the London School of Economics (LSE) and the School of Oriental and African studies, University of London, (SOAS, where he was also a Research Officer). He was called to Bar (Lincoln's Inn) in 1960. After his education, Dr Obi engaged in legal practice in Nigeria. He also served as Commissioner for Law Revision, researching and reporting in the former East Central State of Nigeria. Dr Obi served as Chairman, Commission of Enquiry into Plot Allocation in the East Central State between 1970 and 1973. He was a member of the Customary Courts Reform Committee between 1976 and 1977. Law Reform (No.1), (n 88) 6.

[91] Mrs Titi Osindero. Mrs Osindero was also the only female member of the commission. She was educated at Queen's College, Yaba, Lagos, Norwick Training College, England and Trinity College, Dublin. She had a BA and a UK Professional Certificate. She worked successively as an Education Officer at Queen's College, Lagos; Inspector of Primary Education, Secondary Schools and Teacher Training College, Surulere, Lagos and of Awori Ajeromi Grammar School, Apapa, Lagos; Staff Inspector of Education (Primary and Teacher Training). In 1972, she became the Principal Inspector, Teacher Training. Law Reform (No.1), (n88) 7.

Customary Law;[92] an eminent Professor of economic history, who was also an expert on Nigerian Customary Law;[93] and a reputed legal practitioner who was actively involved in legal practice.[94] In 1980, the position of secretary and director of research was introduced to the Commission.[95]

1.11 The Commission and CAMA

Pursuant to its mandate, the commission very quickly commenced the process of reforming, simplifying, modernising and indigenising many Nigerian laws in the 1980s. In 1987, it was instructed to examine the entire body of laws applicable to corporate affairs in Nigeria; with an aim to proposing recommendations that would best-suit the evolving economic climate of

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[92] Dr Aliyu Abubakar. Dr Abubakar had his early education in Northern Nigeria. He travelled to London for higher studies. He obtained a B.A (Hons) Arabic and Diploma from the University of London. He also had an M.A and a PhD which he obtained from the University of Cairo, Egypt in 1967. He spoke Arabic, English, Persian, Fulfulde, Hausa and French. He taught in various institutions in Nigeria, including the Law School, Kano, the Judicial School, Kano, Bauchi Teachers' College, Barewa College, Zaria, School for Arabic Studies (at which he became principal). He was head of Arabic Department and Associate Professor, Abdullahi Bayero College, Kano, Ahmadu Bello University (ABU), Zaria. He held many public posts, including, Chairman Civil Service Commission, Bauchi State, Chairman, Jama'atu Nasril Islam, Bauchi State, Commissioner, Federal Judicial Service Commission and Public Complaints Commissioner, Bauchi State. Law Reform (No.1), (n 88) 7.

[93] Professor Richard Ekundare. Professor Ekundare held a B.A (Econs) and an M.A (Econs) from Durham England. He also obtained a B.C.L from the same University. He was called to Bar (Lincoln's Inn) in 1964. He lectured in various institutions in Nigeria including, Nigerian College of Arts, Science and Technology, Ibadan, The Polytechnic, Ibadan, University of Ibadan, and Kings College, University of Durham, England. He was a Professor of Economic History and the Head of Department of Economics of the University of Ife. He was a fellow of the Royal Economic Society (Britain), a member of the Honourable Society of the Lincoln's Inn (Britain), amongst other professional bodies. Law Reform (No.1), (n88) 8.

[94] Dr Emmanuel Okereke. Dr Okereke was educated at the Woolwich Polytechnic, London and University College, University of London from which he obtained an LLM and a PhD. He was called to Bar, Middle Temple in 1960. He worked in various capacities in the Nigerian legal sector. He served as solicitor to Urban City Council, Obia, Port-Harcourt. He was external solicitor to African Continental Bank ltd, solicitor to Niger Motors, a division of UAC ltd, Enugu, and solicitor to Dizengoff West African Nigeria ltd Enugu, amongst others. He held a number of public posts including member, Expert Committee on the Revision of Public Health in 1972; member East Central State Law Reporting Committee in 1973, 1976; Director of the Imo Broadcasting Corporation. Law Reform (No.1), (n88) 9.

[95] Mr Ndubuisi Nnadi. Mr Nnadi was educated at the University of Hull, England and the Council of Legal Education, England. He was called to Bar, Middle Temple Bar in 1960. He worked successively as State Counsel in the Federal Ministry of Justice, Senior Legal Assistant and Federal Law Officer. He was Deputy legal adviser at the Department of Customs and Excise, Registrar of Ships at the Federal Ministry of Transport, Registrar of Companies at the Federal Ministry of Trade and Legal Adviser/Company Secretary at the Nigerian National Shipping Line. Law Reform (No.1), (n 88) 9.

modern Nigeria.[96] The commission was expected to discover and eliminate loopholes in the law, streamline all procedures and design a modern Nigerian company law for the benefit and protection of all stakeholders.[97]

Though the indigenisation of the existing law was the primal goal, the commission recognised the corresponding need to be alert to the international implications of proposed laws. [98] Nigeria has important business relationships with fellow members of the Commonwealth of Nations, the European Economic Community and other countries across the globe. Moreover, Nigeria is a prominent member of the Economic Community of West African States (ECOWAS). ECOWAS protocols require that the company law of member states should be simple in form and easily accessible; to facilitate business relations across borders.[99] Thus, there was a need to propose reforms that would be understood easily by the country's trading partners.[100] In sum, there was a duty to ensure that the indigenisation of the Nigerian company law did not hinder economic relations between Nigeria and its trading partners.

With these clear goals, the committee in charge of the reform project embarked on the reform of the Nigerian company law. The designated project commissioner was the foremost company law specialist in the country at the time.[101]Following the characteristic participatory

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[96] By the directive of the then Minister of Justice and Attorney-General of the federation, Honourable Price Bola Ajibola, SAN. Nigerian Law Reform Commission Act 1979, No. 7.

[97] 'Welcome Address by the chairman of the Nigerian law reform commission, the Hon sir Darnley Alexander, GCON, CFR, KT, CBE, at the opening session of the workshop on the reform of Nigerian company law on Wednesday, February 10 1988.

[98] The Commission Report (n 71) 6.

[99]In particular, the provisions of ECOWAS Protocol A/P.1/11/84 dated 23 November 1984 on Community Enterprises were carefully considered; with a view to simplifying rules on the growth of commerce and facilitating the accessibility of national company legislations amongst member states.

[100] The Commission Report (n 71) 6.

[101] Dr Olakunle Orojo OFR, CON. Dr Orojo was appointed to the Commission in 1985. He was educated both in Nigeria and in the United Kingdom. He obtained an LLM from the University of London and another LLM and a Phd from the University of Lagos. He was called to Bar (Middle Temple). He worked in various capacities in Nigeria. He was a former Chief Judge of the High Court of Justice of Ondo State and a past Director of the Nigerian Law School. He subsequently became the Chairman of the Nigerian Law Reform Commission.

law reform approach, the committee engaged in wide consultations with stakeholders and members of the public.[102] The primary aim was to identify the (perceived) inadequacies of the 1968 Decree. Through this medium, the commission also sought to identify Nigerian economic norms and the particular needs of stakeholders.[103]

Having acquired a wealth of valuable information from its public consultations, the committee considered three approaches to the reform project. The first was a suggestion to adopt a modern company statute from a (developing or developed) country with a similar legal system or economic situation to Nigeria's.[104] This suggestion was rejected because such laws, not having been designed for the Nigerian society, though there may have been fundamental similarities, may not be suited to the peculiarities of the Nigerian system and/or economy. The second was an ingenious proposition to return to indigenous concepts of business associations.[105] The committee rejected the proposal for a number of reasons. The fact that the Nigerian company law was already fairly well-developed and that stakeholders had been trained in that system, were key reasons. The committee decided that the consequences of a sudden rejection of the existing model made it an unreasonable approach to reform. Moreover, there was also a very fundamental problem: the 'indigenous principles of Nigerian business law' were undocumented. The result was that no one was quite sure of their contents. Further, the practicality or feasibility of the principles was untested.[106] The third option was to 'ply a middle course between the above approaches'.[107] The commission chose the third option. It decided that the established principles of company law applicable in

[102]The Commission Report (n 71) 'Programme of Reform' 3-4.
[103] Ibid 5-7.
[104] Ibid 5.
[105] Ibid 5.
[106] There being no homogenous 'culture' in Nigeria, it would be difficult to see how the indigenous principles would be selected.
[107] The Commission Report (n 71) 5.

Nigeria would remain the base, while Nigerian needs and circumstances would serve as the measure of the suitability of any law that was proposed or retained.

Consequently, the Committee reformed the Nigerian company law by keeping the English structure in place but examining each rule and procedure in light of Nigerian circumstances and needs.[108] To that end, the committee retained and codified relevant rules of Common Law and doctrines of Equity but rejected such as were not suited the Nigerian economy/society.[109] New concepts and procedures were introduced, while existing procedures were streamlined.[110] The committee also arranged the subject matter of the law in a more logical sequence for easier comprehension. It suggested the establishment of a Corporate Affairs Commission to administer the new decree when promulgated.

The Committee was influenced by the company laws of other countries across the globe, including, principally, the company laws of the United Kingdom, the United States, Australia and Ghana. The committee was also influenced by the reports of peer committees in other countries including the Ghana Company Law Report,[111] the Report of the Working Party on the Harmonisation of Company Law in the Caribbean Community,[112] and the Jenkins Report of the United Kingdom,[113] amongst others.[114] Given that the proposed legislation would not go through the proper process of law making because Nigeria had a military government at the time, the Attorney-General of the Federation convened separate colloquia at which the proposals were subjected to thorough debate by stakeholders. The result was a

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[108] Ibid 6-7.
[109] For example, non-voting and weighted shares were rejected. The Common Law rule of constructive notice was abolished.
[110] For example new provisions on Unit Trusts, Mergers, Take-Overs and Insider Trading were introduced to the Nigerian Company Law.
[111] *Final Report of the Commission of Enquiry into the Working and Administration of the Company Law of Ghana* (1961).
[112] 1979.
[113] Board of Trade, *Report of the Company Law Committee* (Cmnd. 1749, 1962).
[114] The Commission Report (n 71) 6.

comprehensive indigenous Nigerian company law that was evolved to facilitate businessactivities in the country and to protect the interests of the investors, the public and the country as awhole.[115]

1.12 The Commission and the Insolvency Provisions

Part XV of CAMA 2004 governs liquidation. The thesis is however concerned with Parts XIV and XVI which govern receivership and arrangements, respectively. The reform committee made only a few changes to the arrangement and compromise regime.[116] Primarily, it modified the structure.[117] Under the British Companies Act 1948, only one procedure applied to diverse arrangements.[118] Conversely, CAMA 1990 provided that arrangements could be administered under two broad chapters. Part XVI, with which this thesis is concerned, deals with arrangements between a company and its members and/or creditors. Arrangements could also be administered under Part XVII which regulated arrangements between two entities and was administered largely by the Securities and Exchange Commission (SEC).[119] SEC could review arrangements administered under Part XVI only when invited by the courts.[120] The other reform introduced by the Committee was the proposal that the court should have the power to refer complex arrangements to SEC; to

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[115] Akanki, a renowned Nigerian Legal expert commended CAMA and the process which resulted in its promulgation in a lecture. He said

> *'Historically, those responsible for the formulation of the 1990 Companies and Allied Matters Act would be cited and remembered as the makers of our tradition in progressive Company Law reform and development. We have not seen it before in this country – law reform based on assiduous and painstaking research combined with enquiries spanning English-speaking jurisdictions.'*

Akanki, Company Law Development (n 76) chapter 5.
[116] The Commission Report (n71) Part XVII.
[117] It split the reform of the arrangements procedure with the Securities and Exchange Commission which has jurisdiction over some aspects of the reforms; aspects that affected competition in Nigeria according to the SEC Decree 1988, s 6. The Commission Report (n71) 8.
[118] Companies Act 1948, s 206.
[119] This part was hived off in 1999 for enactment as the Investment and Securities Decree 1999.
[120] In contrast, all Part XVII arrangements must be vetted by SEC.

determine the fairness of the scheme.[121] These were the only changes made to the arrangements and compromise procedure. The Committee noted that the procedure was rarely used by stakeholders. Ironically, it decided not to reform the main body of the procedure because it had not been tested; having not been used.[122] The commission did not consider whether the disuse stemmed from the unsuitability of the procedure to the needs of stakeholders. Till date, the procedure is still rarely used. Unlike the reform committee, the thesis will explore the reasons behind the disuse of the arrangements and compromise procedure.

The committee made comparably more changes to the receivership procedure. Although it retained the same structure as the British Companies Act 1948, it sought to make the Nigerian receivership procedure more inclusive and rescue-friendly because Nigeria was at the time in the grip of an enduring recession.[123] Using the Ghanaian model, and departing from the British model, it placed the receiver/manager in a similar position to directors.[124] Consequently, it proposed that the Nigerian receiver/manager should take all stakeholders' interests into consideration when making decisions. To that end, it proposed that the receiver/manager should choose options that maximise the objectives of the company and preserve its existence. The proposal was based on the notion that the preservation of

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[121]The Nigerian Law Reform Commission, Report on the Reform of Nigerian Company Law, Volume II; Draft Companies Decree, s548:

> *'...if a majority in number...agree to any compromise...the compromise may be referred to the Securities and Exchange Commission ....'*

Compare with s 601:

> *'...if a majority in number...agree to the scheme, the scheme shall be referred by the court to the commission....'*

[122] The Commission Report (n71) 325.
[123]Part XV: Receivers and Managers; Ibid, 300.
[124] These were contained in clause 238(1) and (2) of the Ghana Draft Companies Code Bill. The Commission Report (n71) 304.

companies would protect employment. Though the committee rejected the call for the certification of receivers in general, it sought to improve the quality of prospective appointees by making the appointor personally liable for their receivers' actions.[125] To that end, it departed from the British model by making the receiver/manager the appointor's agent.[126] It also listed the implied powers of a receiver/manager in Schedule 11 to the Act.

The judges, as well as the practitioners have, for the most part, been unable to grasp these changes or to deal with them effectively. As will be seen, until 2011, the judges decided cases as though the pre-CAMA rules still applied. Moreover, in spite of these changes, the receivership procedure is still widely regarded as, and administered exclusively in the interests of banks which are the main appointing parties. Ironically, the banks also decry the procedure. Ultimately, the receivership procedure is not considered to be rescue-friendly by the stakeholders as a whole. The thesis will also explore the law and practice of the receivership procedure to determine the reasons for these criticisms.

Conclusion

Nigeria clearly has a complex legal system. The government's effort to modernise the law relating to companies in 1990, laudable as it was, did not improve its insolvency system by much. The arrangements and compromise procedure is still unused. At receivership, its efforts have convoluted, rather than simplified rescue. Clearly, the participatory approach requires more targeted investigations. Given the call for new reforms to the insolvency system, this thesis will provide a well-focused investigation into the law and practice of the extant rescue regimes. It will explore the history of each procedure, outline the law and analyse the interpretations given by the court to the legislations.The thesis will also

[125] Ibid 302.
[126] Ibid 303.

contextualise and elucidate each procedure by explaining its practice. Given the call for their introduction, the thesis will explore the chapter 11 and administration models. It is important that the concepts with which the thesis and the calls are concerned – rescue and insolvency law in general – are clearly understood. On the belief that the insolvency and rescue systems can only be well understood when the underlying concepts are clarified, the thesis will commence by exploring these concepts and providing definitions that will inform the analysis to follow. The thesis will conclude by proposing reforms to the extant Nigerian procedure.

Chapter 2

Dimensions of Corporate Insolvency Law

Overview

The debate on the primary purpose ofInsolvency Law has been broad ranging. From political to legal, social to economic, there has beenno shortage of theories seeking to elucidate the main purpose of insolvency law. Surprisingly, there is as yet, no ubiquitous theory of insolvency law within and across jurisdictions.[1]Notwithstanding, any person who seeks to analyse an insolvency system inevitably makes an assessment based on expressed or implicit notions of insolvency law. After all is said and done, all musings point back to the question: what is the purpose of insolvency law?[2] What makes insolvency law distinct in the legal system? It follows that a thesis, such as this one, which seeks to examine a key component of insolvency law, must express its opinion on its essence.

The chapter assesses the success of existing theories of insolvency law in identifying its primary purpose. For clarity and convenience, insolvency theories are often categorised broadly, based on fundamental similarities, and then analysed.[3] Similarly, this chapter examinestwo broad perspectives of insolvency law which it terms the Exclusive (Interest) Perspective and the Inclusive (Interest) Perspective. The exclusive perspective comprises theorists who describe insolvency law simply as a collectivized debt-collection device that

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[1] There seems to be as many theories on the main purpose of Insolvency Law as there are writers.
[2] Elizabeth Warren, 'Bankruptcy Policy' (1987) 54 UCLR 775, 777 ('Warren, Policy').
[3] Finch describes them as '*visions of corporate insolvency law*'. Vanessa Finch, *Corporate Insolvency Law: Perspectives and Principles* (2nd edn, CUP 2009) chapter 2 ('Finch, *Perspectives and Principles*'). Baird groups them into: proceduralists and traditionalists. Douglas Baird, 'Bankruptcy's Uncontested Axioms' (1998) 108 Yale LJ 573, 576-577 ('Baird, Axioms'). Some authors prefer to evaluate each theory independently. For example, Mokal assesses the Jackson and Korbokin models individually, though he still considers his opinions to be applicable to similar theories. Riz Mokal, *Corporate Insolvency Law – Theory and Application* (OUP 2005), Chapters 2 and 3 ('Mokal, *Insolvency Law'*).

seeks to facilitate the orderly collection of debts from a debtor who has defaulted to multiple creditors but cannot repay them in full; the underlying aim being to maximise the welfare of creditors.[4] In contrast, the inclusive perspective comprises those who describeinsolvency lawas a device through which the effects of a debtor's failure on various interests may be recognised and mitigated.[5]

The chapter finds that the exclusive perspective ignores the substantive rights that would be granted to the debtor at insolvency which results in its narrow perspective of the purpose of insolvency. Conversely, the chapter finds that insolvency law will grant the debtor substantive rights, and would necessarily be inclusive (of other interests apart from the creditors'). If insolvency law is inclusive, then it ceases to be a mere debt-collection device; it is also a device that caters to the interests of the debtor - a conclusion which has important ramifications. In addition, the chapter finds that the inclusive perspective does not sufficiently explain the dimensions of insolvency law because, like its exclusive counterpart, it also ties the operation of insolvency law to the debtor's insolvency. It argues that the debtor, if it has substantive rights, may initiate insolvency proceedings whenever it is in its interest, not necessarily when it is insolvent. If insolvency law is not inextricably tied to insolvency, then the inclusive theorists also ignore a legitimate dimension of the law.

Further, the chapter examines the dimensions of insolvency law. It finds that a company may propose to modify the rights/entitlements of its members as its fortunes begin to wane. If the conditions persist, the company may (also) propose to alter the rights/entitlements of its creditors. This is a drastic step because unlike members' rights to dividends, creditors' rights

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[4] Thomas Jackson,*The Logic and Limits of Bankruptcy Law* (Harvard UP1986) ('Jackson, *Logic*').
[5] Warren, 'Policy' (n 2), 777; Karen Gross, 'Taking Community Interests into Account in Bankruptcy: An Essay' (1994) 72 Wash ULQ 1031, 9 ('Gross Community Interests').

to repayment enjoy the protection of the law. Usually, the procedures set out in company law for the modification of members' rights may not apply to, or may be ineffective in relation to creditors. The company's main option would be to seek an informal agreement, which may be costly and unwieldy to negotiate. Insolvency law provides an efficient device by which the company may modify the rights/entitlements of its creditors. The modification may occur automatically when the company becomes insolvent. It may also be administered discretionally, where the company, in its interest, makes a proposal to its creditors even if it is yet solvent.

The chapter finds that the device referred to as insolvency law regulates both the solvent and the insolvent dimensions of creditor rights/entitlements modification. It examines the suggestion that modification may be achieved outside of insolvency law. It finds that the applicable law would either have to replicate, or refer to insolvency regulations to create a sufficiently collective and equitable device for modifying creditors' rights/entitlements. On that premise, it surmises that many issues which are attributed to the debtor's insolvency are actually insolvency law issues – in its multiple dimensions. This means that they arise whenever the company must modify the rights/entitlements of its creditors, regardless of its solvency. The chapter concludes by stating its perspective of insolvency law. It finds that the concept is, normatively and positively, a device that empowers creditors to collect otherwise uncollectable debts and regulates the procedure by which a debtor may modify its creditors' rights/entitlements as a group.

The chapter is divided into two broad parts. Part I discusses the perspectives of insolvency law, while Part II discusses the dimensions of insolvency law.

Part I: Perspectives of Insolvency Law

2.1 The Exclusive Interest Perspective

Identifying the main purpose of insolvency law, it has been suggested, requires the isolation of insolvency issues from other related issues that come to fore when a debtor becomes insolvent.[6] In other words, to delineate the distinctive purpose of insolvency law, one must identify issues that can be addressed *only* by that law within the legal system. On that premise, Professors Jackson and Baird,key proponents of the exclusive perspective, sought, in a series of studies, to justify the existence of insolvency law by distinguishing it from other procedures within the legal system; particularly, the individualised debt-collection regime.[7] Identifying the core purpose also limits, in their opinion, purported goals of insolvency law.[8]To achieve their purpose, Jackson and Baird considered a hypothetical world in which there is noinsolvency law. From their studies a series of conclusions emerged, which have continued to be a focal point in insolvency scholarship.

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[6]Douglas Baird, 'A World without Bankruptcy' (1987) 50 SPG Law & Contemp Probs 173; ('Baird, World Without').

[7] See generally: Thomas Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain' (1982) 91 Yale LJ 857; ('Jackson, Creditors' Bargain'); Jackson,*Logic (*n 4); Douglas Baird and Thomas Jackson, 'Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy' (1984) 51 UCLR 97; ('Baird/Jackson, Corporate Reorganizations'); Baird, 'World Without' (n 6); Douglas Baird, 'Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren' (1987) 54 UCLR 815; ('Baird, Reply to Warren'); Baird, 'Axioms' (n 3).See also: Barry Adler, 'A World without Debt'(1994) 72 Wash ULQ 811; Mark Roe, 'Commentary on "On the Nature of Bankruptcy": Bankruptcy, Priority, and Economics' (1989) 75 Va LR 219; Robert Scott, 'Through Bankruptcy with the Creditors' Bargain Heuristic' (1986) 53 UCLR 690; Michael Bradley and Michael Rosenzweig, 'The Untenable Case for Chapter 11' (1992)101 Yale LJ 1043;Robert Rasmussen, 'The Ex Ante Effects of Bankruptcy Reform on Investment Incentives' (1994) 72 Wash ULQ 1212;Douglas Baird and Robert Rasmussen, 'The end of Bankruptcy' (2002) 55 Stan LR 751.

[8] Baird, 'World Without' (n 6) 3.

2.1.1 Insolvency Law: A Collectivized Debt-collection Device

In the hypothetical world, Jackson posited, some creditors would take decisions in self-interest as the company slid into distress, which would adversely affect the collective interests of all claimants to the debtor's assets and in many instances, precipitate the debtor's failure.[9] From the model, Jackson surmised that a 'race for the debtor's assets' would ensue,via the individualised debt-collection regime, whenever a debtor defaulted to multiple creditors.[10]Each creditor would try to recover in full, or as much as was possible before the assets were depleted. The individualistic race would result in strategic and administrative costs for the debtor and its groups of creditors.[11]

To avoid theunbeneficial consequences of the individualistic system of debt collection should their debtor become insolvent, Jackson asserted, creditors - as a group - would, if they had the opportunity, agree to a collective system of debt collection*ex ante*; as this would result in net benefits for all interests concerned, *ex post*.[12]Such a regime would be compulsory, as well as collective, because creditors would only agree to be bound if all others would also be so compelled. The regime would not be required in all debt collection cases because problems arise only where the debtor owes multiple persons with conflicting interests at the time that it

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[9] The prisoners' dilemma: in the absence of prior agreement or assurance of cooperation, each creditor would have an incentive to take advantage of individualistic rights, and to do so before the other creditors enforce similar rights. See (n 14).

[10]Jackson, 'Creditors' Bargain' (n 7) 861; Jackson, *Logic* (n 4) ch 1.

[11] Strategic costs are those incurred as creditors expend resources, simultaneously, to place themselves at vantage positions in the race for debtor's assets. The creditors' position is aggravated by the fact that the individualistic procedure would also result in variations in the amounts recoverable by each creditor. Further, the individualistic enforcement of rights against the debtor's assets may lead to the untimely removal of vital operating assets which may result in reduced aggregate value for the assets. Administrative costs would be incurred as individual actions are instituted against the company. Jackson, 'Creditors' Bargain' (n 7) 861-865; Jackson, *Logic* (n 4) chapter 1.

[12] Jackson, *Logic* (n 4) 14-15; Jackson, 'Creditors' Bargain' (n 7) 865.

is unable to repay in full.[13] Insolvency law, to Jackson and Baird, mimics the bargainthat creditors (and the debtor) would conclude in the absence of the 'mandatory agreement' currently imposed by insolvency law.[14]The provision of a collective debt-collection system, Jackson and Baird posit, is the historical function of insolvency law from which modern theorists and policy makers have deviated.[15]

The essence of the bargain, according to Jackson, is that the creditors would need to work as a group to take collective decisions on the use to which the assets would be put in order to generate the maximum possible returns: this he referred to as the *deployment question*.[16] The relevant 'group' would be the owners of the debtor's assets. At insolvency, 'owners' refers to creditors because they become the residual claimants.[17] The assumption stemmed from the finance theory that owners are those with the right to take deployment decisions, which at insolvency refers to creditors.[18] Baird and Jackson insisted that creditors are not obliged to consider broader constituents that may be affected by the debtor's insolvency; neither are they to consider the non-legal interests of the owners at decision-making because such interests have no justifiable place at the negotiation table and consequently, at insolvency law.[19] Dealing with the unfortunate effects of insolvency, Jackson and Baird noted, is *good*but should be the domain of general law; as only a fraction of failed companies engage the use of insolvency law. Caring for these interests only in insolvency law would result in

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[13] So Jackson says that the need for insolvency law arises only where there is a common pool problem. Jackson, *Logic* (n 4) 17-18.
[14]This theory of Insolvency Law, which was designed by Jackson, is more commonly referred to as the Creditors' Bargain Model.Jackson, 'Creditors' Bargain' (n 7) 858.
[15] Jackson, *Logic* (n 4) 2; Baird, 'World Without' (n 6) 4.
[16] Jackson, *Logic*, (n 4) 24-25.
[17] Sanford Grossman and Oliver Hart, 'The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration'(1986) 94 Journal of Political Economy 691,692; Baird, 'World Without' (n 6) 5.
[18] Jackson, *Logic* (n 4) 5.
[19]Baird, 'World Without'(n6) 4; Jackson, *Logic* (n 4) 24-26; Barry Schermer, 'Response to Professor Gross: Taking the Interests of the Community into Account in Bankruptcy--A Modern-Day Tale of Belling the Cat' (1994) 72 Wash ULQ 1049.

the creation of rights which do not exist elsewhere and would lead to strategic and perverse use of insolvency law.[20]Jackson and Baird noted that substantive rights are created when the treatment of creditor rights/claims is modified and the pre-insolvency distribution regime altered at insolvency. In sum, they argued that insolvency law is mainly procedural and ought not to create substantive rights that are not replicated in the general law.[21] They asserted also, that the device is concerned exclusively with the protection of legally cognizable rights of creditors, not the protection of their non-legal interests – which is a non-insolvency matter to be addressed by the general law.[22]

2.1.2 Merely a Collectivised Debt-collection Device?

The exclusive perspective of insolvency has been subjected to extensive criticism.[23] Rather than restate popular criticisms however, this section aims to further elucidate its limits. If insolvency law is merely a debt collection device, then it is a device to be used only by creditors – who are the parties that wish to collect unpaid debts.[24] Jackson confirms this premise expressly by stating that the device is used historically by creditors '*against insolvent debtors*'.[25]Clearly, debtors would have no interest in triggering the insolvency law when they become insolvent because it is a weapon that is used against them. Corroborating this notion is finance scholarship which states that the debtor, as it slides into distress, would prefer to engage in risky activities in the hope of reversing its fortunes; not trigger debt

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[20]Baird, 'World Without'(n 6) 4.
[21] Jackson, *Logic* (n 4) 24-25.
[22] Baird, 'Reply to Warren'(n 7) 833 -834.
[23] See (n46) below.
[24]That the debtor is not interested in terminating its existence to repay its debts is a notion that has been explored in detail by finance theorists.
[25] Jackson, *Logic* (n 4) 26.

collection.[26] Staying in business protects the interests of both the shareholders and management; particularly where the relationship between the two is perfect.[27]

To combat the perverse incentives of the debtor and to increase the chances of timely initiation, it is necessary to align the interests of both the creditors and the debtor. Even Jackson acknowledges this notion by suggesting that insolvency law should offer shareholders a *bounty* to incentivize timely initiation of the insolvency regime because timing is key.[28] Given the problems involved in valuing the bounty, as acknowledged by Jackson himself, a more cost-effective alternative may be to give the debtor the right to participate in the (hypothetical) bargain - aligning the interests of the debtor with those of its creditors.[29] Underlying the concept of alignment is the (unstated) notion that the efficiency of insolvency law is improved when it caters to other interests apart from those of the creditors. In addition, giving the debtor the right to participate in the bargain, or its proceeds means recognizing non-legal interests at insolvency.

One may ask: what is the import of the debtor's right to participate? The right to participate is really a *substantive* right granted to the debtor.[30] That right gives the debtor a further right to initiate the procedure, independently of the express wishes/interests of the creditors.[31] When the debtor observes that it is distressed, it may initiate the procedure in order to guarantee perhaps an even bigger *bounty* or participation in the proceeds. One inference which can be

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[26] Michael Jensen and William Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976) 3 Journal of Financial Economics 305; (Jensen & Meckling, Theory of the Firm'); Robert Scott, 'A Relational Theory of Secured Financing' (1986) 86 Colum LR 901; Clifford Smith and Jerold Warner, 'On Financial Contracting: An Analysis of Bond Covenants' (1979) 7 Journal of Financial Economics 117.
[27] Mokal, Insolvency Law (n 3) 274-279; Elizabeth Warren, 'Bankruptcy Policymaking in an Imperfect World' (1993) 92 Mich LR 336, 342; ('Warren, Policymaking').
[28] Jackson, *Logic*(n 4) 207.
[29] See also Mokal, *Insolvency Law* (n 3) 210-212.
[30] In spite of the exclusive claim to the contrary.
[31] The main reason for giving it that right is to be able to utilise it independently at a time that the creditors may not even realise that it is required.

made is that the device is not (or has perhaps mutated from) a mere exclusive device to one which is more inclusive: it at least takes into consideration the interests of the debtor; 'debtor' being a pseudonym for the shareholders and, usually also, the managers who represent them. Cognising the interest of the debtor therefore amounts to recognising the interest of the shareholders and (some) employees. Another inference is that insolvency law ceases to be a mere debt-collection device: it is also, legitimately, a device that protects the interests of the debtor; one which it can trigger in its own interest to achieve that very purpose. A third inference is that insolvency law therefore permits the consideration of contemporaneous social goals, not exclusively economic goals; the bargain, hypothetical or real, will involve the trade of multiple interests belonging to various parties.

Proponents of the exclusive perspective may argue however, that giving the debtor the right to initiate or participate does not require that it be given some of the far reaching powers it is given against creditors at insolvency. The extent of the debtor's role and powers will be considered in a subsequent section.[32] Suffice it to say in this section however, that broader interests are, and ought to be considered at insolvency.

Baird and Jackson have asserted that insolvency law exists historically to solve the common-pool problem.[33] In essence, when there is a single creditor there would be no need for insolvency law because there is no common-pool problem. This assumption, it is submitted, fails to consider a very important facet of the history of insolvency law. The common law history of insolvency law dates back to the 16th century.[34] In the pre-1543 mercantile world, *in which there was no insolvency law*, creditors could seek to recover unpaid debts via self-

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[32] See (n 94).
[33] See page 47 above.
[34] Markham Lester, *Victorian Insolvency: Bankruptcy, Imprisonment for Debt, and Company Winding-up in Nineteenth-century England*, (OUP1995) 13 ('Lester, *Victorian Insolvency*').

help or by obtaining judgment to recover the debt.[35] The problem with the system was that the creditor who had obtained judgment may still be unable to recover the debt because the debtor could not be served with the writ. In addition, his assets may be out of the reach of the parties looking to seize them.[36] Creditors needed a legal means by which they could enforce their judgments and/or recover their unpaid debts from a debtor that was out of reach.[37] The debtor placed himself and his assets out of reach by keeping house or running away.[38]

In the modern age, that basic need of creditors still exists. Keeping house or running away would amount to placing the assets out of the reach of creditors by any means possible: granting security in the twilight days, disposing of the assets to preferred creditors, risking the assets in an attempt to reverse fortunes, sale, amongst others.[39] Even when there is only one creditor and there is no common-pool problem, a law that prevents the debtor from placing his assets out of reach of that single creditor would still be necessary.[40] Jackson writes this aspect of insolvency law off by stating that it is part of the '*initial establishment of entitlements, not…something that bankruptcy policy should itself have anything to say about'*.[41]His assertion is challenged below.

First, as he states himself, questions as to preferences and fraudulent conveyances arise only when the debtor is unable to repay his debts in full.[42] The secured creditor because he has proprietary interests in disposed assets, can still reach the asset or its replacement with the help of the court via other legal means. In contrast, the unsecured creditor cannot stop the

[35]Bruce Mann, *Republic of Debtors: Bankruptcy in the Age of American Independence*, (Harvard UP 2002).
[36] Lester, *Victorian Insolvency*, (n 34) 14.
[37] See preamble to the Statute of Bankrupts (34 & 35 Henry VIII, c. 4) of 1542.
[38] Lester, *Victorian Insolvency* (n 34) 14.
[39] This was the basis of the introduction of voidable preferences.
[40] The enforcement of judgement debts is only effective against available assets.
[41] Jackson, *Logic* (n 4) 148.
[42] Ibid 147.

debtor from disposing of his assets; he can only challenge the debtor's transactions when the consequence of the debtor's actions is that he will not be repaid in full. Extrapolating from his comments, one could argue that Jackson's criticism of the avoidance provisions in insolvency law stems from the fact that this facet of the law does not fit his collectivist model, and so must be illegitimate - even though it is an event that arises only when the debtor is insolvent.

His argument is even more perplexing because one of the main reasons for the collectivist thesis he proposes is the reduction of administrative costs. Insolvency law mitigates costs by preventing the duplication of actions.[43] If fraudulent conveyances were to be pursued outside of insolvency law, then two separate actions would be instituted by the same creditor. Even worse, the actions would be instituted at a time when the original debt cannot be repaid in full; costing the creditor, and reducing the estate. Insolvency law, it can be argued, has therefore responded, and still responds to much more than the common-pool problem. It is not merely a procedural law that regulates the forum at which the question of deployment may be answered. It also creates and gives creditors substantive rights – for example, to avoid otherwise valid transactions concluded by the debtor – which do not exist elsewhere in the legal system, whether in a single or multiple creditor case.

Second, though insolvency law may be relevant in a single creditor case, most times, the debtor becomes insolvent at a time when it owes many creditors. In the said mercantile period, the law could merely have modified the debt recovery process to give each creditor the right to enforce his debt following an act of insolvency. However, the law-makers recognised that the unencumbered right to enforce would be detrimental to the group of

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[43] See page 47 above.

creditors and the credit system as a whole because some creditors would recover in full while others would receive nothing. The law traditionally promoted the full recovery of debts but when the debtor had insufficient funds, it was recognised that the law needed to compel the modification of the entitlements of each creditor, so that all creditors could partake of the available assets.[44] The modifications could not be administered however, unless all claimants were assembled and verified, and the assets assembled and sold, hypothetically or in fact.

The classic (individualistic) debt-collection law did not, and still does not, permit the modification of entitlements. Insolvency law is the only legal device by which creditors, via a process of collective representation, not only reach otherwise unreachable assets of the debtor; it is also the device by which creditors' entitlements may be equitably modified. An important question that may be asked is: does the fact that modifications were historically made after the debtor had defaulted mean that modifications *may only be made* after a debtor has defaulted?[45] This question will be answered as the chapter develops.

2.2 Inclusive Interest Perspective

The exclusive perspective has been roundly criticised by theorists who insist that insolvency lawhas broader goals and roles than depicted.[46] Proponents of the Inclusive Perspective propose, they assert, more realistic and expansive theories which adequately reflect the

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[44] Lester describes the rateable distribution of proceeds as a '*most significant*' aspect of the Act of 1542. Lester, *Victorian Insolvency* (n 34) 14.

[45] See page 59 below; also (n 65).

[46]Warren, 'Policy' (n 2);Donald Korobkin, 'Rehabilitating Values: A Jurisprudence of Bankruptcy' (1991) 91 Colum LR 717; Elizabeth Warren and Jay Westbrook, *The Law of Debtors and Creditors: Texts, Cases and Problems* (6th edn, Wolters Kluwer Law & Business 2008); Elizabeth Warren, 'The Untenable Case For Repeal of Chapter 11' (1992) 102 Yale LJ 437; Elizabeth Warren and Jay Westbrook, 'Searching for Reorganization Realities' (1994) 72 Wash ULQ 1257;Gross, 'Community Interests' (n 5); Karen Gross, *Failure and Forgiveness: Rebalancing the Bankruptcy System*, (Yale UP 1997); ('Gross, *Failure and Forgiveness*'); Donald Korobkin, 'Contractarianism and the Normative Foundations of Bankruptcy Law' 71 Tex LR 541; Donald Korobkin, 'Rehabilitating Values: A Jurisprudence of Bankruptcy' (1990) 91 Colum LR 717; ('Korobkin, Rehabilitating Values'); Warren, 'Bankruptcy Policymaking' (n 27); Samuel Bufford, 'What is Right about Bankruptcy Law and Wrong about its Critics' (1994) 72 Wash ULQ 829.

realities of the world in which insolvency law operates.[47] To place insolvency law in its proper context, some of the main inclusive theorists have studied its practice *in real life*. The empirical approach, they believe, results in theories that stem from actual (insolvency) facts - preferable to methods that propose theories on *what reality is hypothesized to be*.[48] Nonetheless, another inclusive enthusiast, Korobkin, eschews the empirical method for a more normative approach.[49]

Cumulatively, inclusive theorists highlight a broad range of problems that, they believe, are resolved by insolvency law; which problems, they assert, should legitimately be - and are - at the centre of insolvency policy debates. Their observations highlight important values that must be considered at insolvency, and enrich the insolvency debate.

2.2.1 Insolvency Law: Failure Remedying Device

Warren and Gross posit that the chief concern of insolvency law is how the losses occasioned by the debtor's insolvency should be equitably distributed amongst all the interests concerned.[50] According to them, a realistic study reveals that at insolvency, a wide range of losses would be suffered by a diverse range of stakeholders.[51] In addition to the losses suffered by the debtor and its creditors therefore, other interests such as the employees'

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[47] Gross refers to the empirical method of studying Insolvency law and practice as the 'inside-out approach'. She claims that it provides a more complete method of analysing Insolvency Law and practice; giving rise to a broader theoretical framework for Insolvency Law than the outside-in approach. By the 'outside-in approach', she means a method of analysing Insolvency Law which utilises meta-theories; theories constituted by overarching objectives that can be used to analyse the structure of any other theory or field of studyGross, *Failure and Forgiveness*, (n 46) 60-61; Gross, 'Community Interests' (n 5) 1036-1037.
[48] Elizabeth Warren and Jay Westbrook, 'The Dialogue between Theoretical and Empirical Scholarship' (2006) Harvard Public Law Working Paper No 137, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=945155, accessed on 28/04/2012; ('Warren/Westbrook, Empirical Scholarship'). Also, Gross, 'Community Interests' (n 5) 1036-1037.
[49] Donald Korobkin, 'The Role of Normative Theory in Bankruptcy Debates' (1996) 82 Iowa LR 75.
[50] Elizabeth Warren, *Chapter 11: Reorganizing American Businesses,* (Aspen Publishers 2008) 4; Gross, *Failure and Forgiveness,* (n 46) chapter 1.
[51] Gross, *Failure and Forgiveness* (n 46) 21-24; Warren, 'Policymaking' (n 46) 343-344.

interests in their continued employment, suppliers' interests in a continued relationship with the company, the government's interest in revenues, customers' interests in the company's products and the community's interests in the existence of the company would also suffer significantly. Though the latter sets of losses may not easilybe recognised or measured, they insist that such losses are 'real' and must be the central concern of any effective insolvency law.[52] For that reason, Warren states that 'insolvency policy becomes a composite of factors that bear on a better answer to the question, "How shall the loss be distributed" in insolvency?'[53]

The inclusive perspective rejects the notion that insolvency law seeks to resolve deployment but not distributional problems.[54] The economic welfare theory, Korobkin asserts, fails because it is incapable of recognising non-economic values that are essential to an explanation of the dimensions of insolvency law.[55] Insolvency law, Gross insists, achieves social goals even if the consequence would be that the economic welfare of the group of creditors would not be maximised.[56] Cumulatively, their theories suggest that loss distribution inheres in situations in which a debtor is unable to repay its debts, regardless of insolvency law. What insolvency law does is to provide an equitable regime for loss recognition and distribution.[57] To that end, Warren insists, creditors - particularly secured creditors - should be (and are) compelled to give up some of their contractual rights when their debtor becomes insolvent, (which rights would ordinarily be protected in laws other than

[52] Gross, 'Community Interests' (n 5) 9; Bufford, 'What is Right' (n 46) 836-838; Warren, 'Policy' (n 2) 786.
[53] Warren insists that distribution (of losses) is an independent goal of insolvency Law, not merely an incidental objective. Warren, 'Policymaking' (n 27) 352.
[54] Distributional questions lie at the heart of the Inclusive Perspective debate. See Warren, 'Policy' (n 2) 785-786; Warren, 'Bankruptcy Policymaking' (n 27) 374.
[55] Korobkin, 'Rehabilitation Values' (n 46) 10.
[56] See Gross, *Failure and Forgiveness* (n 46) chapter 12.
[57] Warren insists, that even in the case that Insolvency Law does not provide a distribution scheme, some scheme must exist to distribute the consequences of insolvency; whether or not that scheme would be equitable is a different question. Warren, 'Policymaking' (n 27) 343.

insolvency law), for the collective benefit of all concerned interests.[58] Korobkin encapsulates these ideas in his theory that insolvency law provides a forum and rules by which the affected parties may trade diverse values; these parties include but are not limited to creditors, while the values include but are not limited to the economic.[59]

2.2.2 Failure Remedying Device?

Again, the aim of the thesis is not to restate popular criticisms of the inclusive perspective but to provide a novel perspective on the import of their claims. Like the exclusive account, the inclusive perspective has been criticised by various theorists over the past decades. Though key proponents of the exclusive perspective are some of its most vociferous critics, the perspective has also been criticised by theorists who themselves prefer a more expansive and inclusive theory.[60] Admittedly, there is a limit to the role of insolvency law when companies fail because they may fail for reasons other than insolvency.[61] Nonetheless, the theory rightly encourages the recognition of secondary interests held by persons who are affected by insolvency – to the extent that that they are proximate enough to be bargained at the forum.[62] As a theory that seeks to explain the dimensions of insolvency law however, the theory limits itself by starting from the same point as the exclusive perspective.

Like its exclusive counterpart, the inclusive perspective starts from the premise that insolvency law is a device that is triggered by insolvency - which means that the company

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[58]Warren, 'Policymaking' (n 27) 383-385.
[59] Korobkin, 'Rehabilitating Values'(n 46) 21-22.
[60] Mokal, Insolvency Law (n 3) ch 3.
[61] For example, in Nigeria, many companies are closing and relocating to other jurisdictions with better security and power supply. As long as they are able to repay their creditors, there is no need to resort to insolvency provisions. Amaka Agwuegbo, 'As Companies move to Ghana' *Vanguard* (Nigeria, 14/08/2009) http://www.vanguardngr.com/2009/08/as-nigerian-coys-move-to-ghana/ accessed 10/06/2012.
[62] For example, Mokal, Insolvency Law (n 3) 68.

has become (or will quite soon become) unable to repay its debts as they fall due.[63] This view like its exclusive counterpart also starts to explain the *post insolvency* role of the law: recognising and protecting multiple values, inter alia. The import (of the perspective), it is argued, is that insolvency law plays no substantive role in the absence of insolvency – perhaps because it is after all called *insolvency* law.[64]

For a perspective that seeks to explain the dimensions of insolvency law, it has yet to explain the pre-insolvency dimensions of insolvency law. In the preceding section, it was argued that the debtor, if it is given substantive rights at insolvency, can exercise them self-interestedly. Conversely, the implication of the inclusive perspective is that the debtor, though it has substantive insolvency rights and can exercise them independently, can only do so after it becomes insolvent. In fact, the debtor, though it may be compelled to initiate the insolvency

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[63] See, for example, Warren, 'Policymaking' (n27) 343:

> *'This description of the functions of the business bankruptcy system begins with a factual observation: when a business fails, there is a substantial risk that it will not have sufficient resources to meet all its outstanding obligations.'*

Also, Mokal, *Insolvency Law*, (n 3) 68:

> *'The ACM developed here focuses, then, on what makes insolvency law* ***special****. It provides and validates principles to govern* ***insolvency*** *issues, those "unique difficulties that arise only in the context of an insolvent debtor's inability to satisfy [its] obligations as they come due".'*

[64] Interestingly, Mokal suggests, subsequently in Mokal, *Insolvency Law* (n 3) 211, that:

> *…a rescue process that could be initiated without the need to demonstrate formal insolvency, actual or impending, would be initiated earlier during the distress cycle, when rescue efforts were more likely to be successful. This also opens up the possibility, however, that the company made subject to the formal rescue proceedings, while distressed, is still solvent….'*

Given that he insists that insolvency law is only to govern *insolvency issues*, he does not sufficiently explain why the system that shouldonly govern, by his words, *special insolvency issues* would also govern the activities of a solvent company. This corroborates the notion that there is another unexpressed dimension of the system we have historically referred to as *insolvency law*.

procedure when it becomes insolvent, has the right to initiate proceedings whenever it is in its interests; its interests may require the proceedings *even when it is not 'insolvent'.*[65]

Part II: Dimensions of Insolvency Law

2.3 The Multi-Dimensional Perspective

In his hypothesis, Korobkin challenges any theory to explain why insolvency law has various facets and dimensions.[66] He chose to explain the reorganization dimension of insolvency law which he believed that the exclusive perspective had failed to grasp sufficiently.[67] One may criticise Korobkin's account as overstating the role of insolvency law.[68] Regardless of one's proclivities however, it is clear that insolvency law has facets and dimensions which have not been sufficiently explained in previous iterations of its purpose. Taking the example alluded to earlier as an instance: if insolvency law seeks to regulate *onlyinsolvency issues*, why encourage and permit solvent companies to initiate the procedure?[69] Like the exclusive theorists argue, subjective notions of *good* cannot justify giving the debtor rights in insolvency law that it does not have elsewhere in the legal system - *that is if insolvency law is really just a debt-collection device.* This section seeks to explain the main essence of insolvency law and to justify its - seemingly conflicting or controversial – dimensions.

[65] In fact, many insolvency systems are removing the insolvency barrier to initiation of the regime. See, Vanessa Finch, 'The Recasting of Insolvency Law' (2005) 68 MLR 713.
[66] Korobkin, 'Rehabilitating Values' (n 46) 739.
[67] Ibid 744-755.
[68] Mokal, Insolvency Law(n 3) 62-67.
[69] Finch, for example, describes the change in the philosophy of insolvency law from a reactionary to a precautionary approach. Finch, *Perspectives and Principles* (n 3) 253-272.

2.3.1 Capital, Management and Creditors

As Belcher notes, management runs the daily affairs of the company.[70] Given its position, management is therefore best placed to recognise the onset of distress or decline in the company's fortunes.[71] Managers may take any action deemed necessary to reverse the trend: solicit (more) loans to boost output, alter the capital structure of the company, issue new securities, propose arrangements to members, negotiate mergers with other companies to improve economies of scale, inter alia. Though any of these measures may successfully remedy the company's problem, they may also fail to accomplish the desired goal. It may be that the company is suffering from deep financial problems; such a company is said to be financially distressed.[72] For example, the company may be overladen with fixed or non-contingent costs resulting from its debts.[73] Financial distress may also be symptomatic of a deeper structural or operational problem; the company would be economically distressed.[74] It may be that the company is producing goods that nobody wants; the cost of production far exceeds profit; its competitors are winning over its market share.[75] Where the internal measures or proposals to members fail to remedy the distress, management may also need to modify the creditors' entitlements to improve the company's chances of rejuvenation or even survival.

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[70] Alice Belcher, *Corporate Rescue: A Conceptual Approach to Insolvency Law* (Sweet & Maxwell 1997) ('Belcher, *Corporate Rescue*') 22-24.
[71] Om Kharbanda and Earnest Stallworthy, *Corporate Failure: Prediction, Panacea and Prevention* (McGraw-Hill Book Company (UK) Ltd 1985) 28.
[72] Barry Adler, Douglas Baird and Thomas Jackson, *Bankruptcy: Cases, Problems and Materials*, (4TH edn, Foundation Press 2007) 27-28.
[73] Ka-keung Chan & Nai-Fu Chen, 'Structural and Return Characteristics of Small and Large Firms'(1991) 46 Journal of Finance 1467, 1468.
[74] See (n72) above.
[75] Baird, 'World Without' (n 6) 183.

Credit is a non-contingent liability.[76] The corollary is that creditors get paid regardless of their debtors' financial situations; unlike members whose rights to dividends are contingent on the companies' profit.[77] Members have the right to oust directors who do not pay sufficient dividends but they cannot engage the powers of the state to coerce the same. In contrast, an unpaid creditor cannot vote to remove directors but may resort to the court or enforce any other contractual powers it has negotiated, to extract payment from his debtor. Why give creditors this power? Finance theorists provide a plethora of arguments, most relevant of which is the fact that creditors will not lend if they are not guaranteed repayment.[78] Financial institutions in the absence of that basic protection may seek other profit-making avenues, which would ultimately cost companies because they would have no access to a very essential source of capital.[79] Nevertheless, Hart and Moore, like other financial theorists, observe that creditors, though they insist on it, do not exercise their rights to enforce as soon as their debtors default.[80] Creditors often choose to renegotiate loans, subject to their assessment of a company's future viability; liquidating the assets is usually the last resort.

The economic models used by these theorists are however built on the notion of symmetry of information at the point of negotiation, with negotiations limited to the single creditor and the debtor. This means that at default, the creditor knows as much as the debtor about the

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[76] Oliver Hart and John Moore, 'Default and Renegotiation: A Dynamic Model of Debt, (1998) 113 Quarterly Journal of Economics 1; ('Hart/Moore, Default and Renegotiation')

[77] Franco Modiglianand Merton Miller, 'The Cost of Capital, Corporation Finance and the Theory of Investment' (1958) 58American Economic Review 261.

[78] Raphael La Porta et.al, 'Legal Determinants of External Finance' (1997) NBER Working Paper No. w5879, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=8179, accessed 12/06/2012; Oliver Hart, *Firms, Contracts and Financial Structure* (OUP 1995); ('Hart, *Firms*).

[79] For example, the Nigerian situation, see GiuseppeLarossi et al, 'An Assessment of the Investment Climate in Nigeria' (The World Bank 2009) ch 4; particularly 62-63.

[80] Hart/Moore, 'Default and Renegotiation' (n 76) 8; Patrick Bolton and David Scharfstein, 'Optimal Debt Structure and the Number of Creditors' (1996) 104 Journal of Political Economy 1.

debtor's cash flows and he is the only creditor.[81] For that reason, one may argue that the willingness of creditors to renegotiate is negatively related to the number of creditors involved and positively related to the level of information symmetry: the higher the number of creditors, the less likely that each one may be willing to re-negotiate but the higher the level of information symmetry, the more willing the creditor may be to renegotiate.[82]

Companies may have just one (major) creditor, though in reality they would usually engage in credit relationships with many creditors. As stated above, management may seek to modify the creditors' entitlements as the company's fortunes begin to dwindle. In practice, management would need to negotiate with the creditors as a group because they would be numerous. The law does not prohibit the renegotiation of debts. Renegotiation may therefore take place informally. Hart notes however, that the problems attending informal renegotiations are legion.[83]

The arrangement would require unanimous approval, as dissenters are not bound by an arrangement to which they have not agreed. The implication is that the potential gains of the arrangement may be scuppered by a few creditors, even where an overwhelming majority consent. Unanimous consent may be easily negotiated where there are only a few creditors. The problem is that even such agreements would not bind those who were absent or without knowledge of the proceedings. Consequently, debt modification would benefit from a mechanism which identifies and binds everyone with claims against the company. In addition, when a company becomes distressed, some claims may be contingent or unliquidated. There are no clear rules on the treatment of such claims in informal

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[81] In some models, there is a maximum of 2 creditors, for example, the Bolton/Scharfstein model above.
[82] For corroboration, see Hart, *Firms,* (n 78) 116-117.
[83] Ibid; also, Jackson, *Logic* (n 4) 17.

renegotiations. An attempt to create binding rules, in the absence of legal imprimatur, is likely to prove unsuccessful.

Further, although the arrangement may be beneficial, any creditor may initiate legal action during the negotiations or attempt to hold out in order to obtain higher pay-outs than others. Moreover, the costs of the proceedings may prohibit certain companies from proposing arrangements, even when potentially beneficial to all concerned.[84] Regardless of its benefits, the proposal may trigger a creditor-run which would accelerate the debtor's decline and ultimately precipitate its insolvency. For these reasons, the informal procedure may be financially and strategically costly for companies, in spite of an obvious need or benefit.

Recall that creditors may choose to liquidate their claims – rather than renegotiate the debt - if the estimated value of renegotiation is considered to be insufficient.[85] To give impetus to the creditors' rights, Hart/Moore state, debt contracts grant creditors the right to seize and to sell debtors' assets, to generate funds for repayment upon default. The creditor may exercise this right with or without the involvement of the court, depending on the agreement.[86] Again, finance theories assume that each creditor would have perfect information and act individually. This means that the creditor would know just when to liquidate and would take over all the cash proceeds, to the maximum allowed, to off-set the outstanding sums. Many issues arise from these assumptions. Recall that the symmetrical information is between the

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[84] For example, in the UK, the cost of the London Approach is considered prohibitive for their smaller counterparts. John Flood, Robert Abbey, Eleni Skordaki and Paul Aber, *The professional Restructuring of Corporate Rescue: Company Voluntary Arrangements and the London Approach* (ACCA Research Report 45, 1995) ii.
[85] See (n80) above.
[86] Hart/Moore, 'Default and Renegotiation' (n 76) 1-2.

debtor and each creditor about their mutual financial dealings.[87]Consequently, where there are multiple creditors, there would be information asymmetries because each creditor is only aware of its dealings with the debtor; yet the actions of other creditors may impinge on each creditor's interests. For example, a creditor may wish to permit the debtor to renegotiate the debt but the actions of other creditors may precipitate a decision to liquidate. Each creditor would therefore devise a mechanism for monitoring the debtor closely, to know just when to call in its debt. Besides, each creditor may be compelled to liquidate his claims even when it is not the preferred choice; to protect his interests.

The theories posit that each creditor would have the right to seize all the cash proceeds and/or assets to repay his loan.[88] Again, the theories do not consider what happens when the debtor owes many creditors simultaneously. Given that there may be insufficient funds to repay all the debts owed, some creditors would recover in full, while others would get nothing. To avert this result, creditors would expend considerable resources on monitoring the debtor just to get ahead of the queue if it defaults. In any case, all the jostling or monitoring will not prevent the debtor from protecting the interests of preferred creditors on the eve of insolvency, by giving them its assets, and leaving a hollow estate. Costs would be duplicated because each creditor would initiate an individual recovery action. The debtor would have to expend funds to defend these cases and to contest bogus or disputed claims. Consequently, the estate will be further depleted.

Ultimately, there would be value destructive strategic and financial costs where the debtor is permitted to administer liquidation in its discretion, or its creditors permitted to act

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[87] The Grossman and Hart model describes the cash flow as observable by the parties but not verifiable by outsiders. Sanford Grossman and Oliver Hart, 'The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration' (1986) 94 Journal of Political Economy 691; Bolton/Scharfstein model, (n 80) above.
[88] Ibid.

individually, first come, first served.[89] In such cases, it would be necessary to deal with all claims against the estate, consensual, non-consensual, contingent and future because the debtor may be insolvent and some claims may not have matured. In addition, it may be necessary to modify the entitlements and rights of some creditors before disbursements can be made because the debtor's default may stem from its insolvency.

2.3.2 The Purpose of Insolvency Law

Insolvency law is not merely a debt-collection tool. The preceding section identifies two main situations in which the rights and entitlements of creditors, as a group, may be modified. They must be modified *automatically* when the company is insolvent but modified *discretionally* when it becomes distressed. The section highlights the problems that may attend an individualised or informal attempt to modify these entitlements. A device that permits the modification of creditors' rights/entitlements and eliminates many of the costs identified would therefore be ideal. Insolvency law, it is argued, is a legal device by which the rights/entitlements of creditors may be efficiently modified, either in their collective interest as a group or in the interests of the creditors, as well as their debtors.[90] It limits costs by compelling the creditors to act as a group, broadening the group to include contingent and future claimants, binding all those with claims against the company, whether or not they consented or were aware of the proceedings; subject, of course, to necessary safeguards of creditors' interests. It maximises the pool by preventing the debtor from placing assets beyond the reach of creditors and recovering those which have been illegitimately removed.

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[89] See Jackson, *Logic* (n 4) 14-18.
[90] Though technical notions of efficiency may also be applied, efficiency here refers to the ordinary sense of the word: minimal cost to achieve the desired output.

Historically, the law only permitted insolvent companies to modify their creditors' entitlements, as a group. Initially, all creditors' claims were modified by the same rateable standard and then proceeds distributed.[91] Belatedly, it was recognised that the unpaid balance had to be discharged if the modifications were to be effective. Subsequent insolvency laws therefore comprised provisions to that effect.[92] However, as corporate finance evolved, so did the device by which creditors' entitlements were modified. Given that protection follows the creation of creditor rights, the creation (and protection) of certain rights meant that certain creditors' entitlements could not be modified by the generic modification rule.[93] As a corollary, it became the law that modification of creditors' entitlements would be stratifiedwhen the debtor became insolvent. For that reason, entitlements supported by proprietary rights could not be modified unless the value of assets was insufficient to repay even those debts. For the secured claimants to be paid in full however, the rights and entitlements of the unsecured claimants had to be modified: their rights to institute actions were waived, while they received less than they were owed. This debt-modification role, it is argued, has always been as significant as the debt-collection role.

2.3.3 Insolvency Law and General Law

The question was asked earlier why debtors are given the power to modify creditors' entitlement at insolvency law that they do not have elsewhere.[94] Baird argues that insolvency law ought not to give the debtor rights that it does not have in the general law.[95] Like him,

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[91] For the history of insolvency law in the UK: Lester, *Victorian Insolvency* (n 34). In the US: Mann, *Republic* (n 35); Charles Warren, *Bankruptcy in United States History* (Beard Books (Reprint) 1999).
[92]Interestingly, insolvent companies are not discharged from unpaid balances. This may have been overlooked because the companies would usually be liquidated and dissolved thereafter. Modern insolvency laws recognise the need to discharge unpaid sums when the creditors and debtors agree modifications however.
[93] See (n 77)and (n 78) above.
[94] See (n 32) above.
[95] Baird, 'World without' (n 6) 185.

Jackson insists that the decision on the modification of entitlements should be left only to the creditors after the debtor defaults.[96] To answer this question, it is again necessary to disengage insolvency from insolvency law. It has been argued above, that the modification of entitlements is a normal aspect of debt finance; whether or not a legal regime is created, the need would still arise.[97] First, it is not true that the debtor cannot modify claims outside of insolvency law. It may renegotiate terms with individual creditors or the creditors as a group. The general law does permit the debtor, if it can be managed, to modify its creditors' entitlements. So, these theorists' gripe is that no other legal regime gives the debtor express right and facilitates the process of modification like insolvency law. That is simply because insolvency law exists to achieve precisely those goals.

As stated earlier, it was historically thought that creditors' interests ought only to be modified when the debtor was insolvent but as debt finance evolved, it became clear that a timely modification of creditors' entitlements would protect the value invested in a company by all investors.[98] It followed that the law which permitted debt modification was *de-rigidified.* Given that the debtor is best placed to predict decline but would initiate negotiations only if incentivised, and the claimants, creditors/shareholders, would be less likely to hold out or to scupper negotiation if given stakes in the renegotiations, the system became more flexible to permit broader negotiations amongst classes of creditors, as well as amongst various stakeholders, with the debtor at the helm. Consequently, the debtor was granted broader

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[96] Jackson, *Logic* (n 4) 210.
[97] Page 61 above.
[98] See the history of corporate reorganizations in the US: Stuart Daggett, *Railroad Reorganization* (General Books, Reprint, 2010); David Skeel Jr, *Debt's Dominion: A History of Bankruptcy Law in America* (Princeton UP 2001). The underlying principle has also been followed in the UK: (n 69); Bruce Carruthers and Terrence Halliday, *Rescuing Business: The Making of Corporate Bankruptcy Law in England and the United States*(OUP1998). For changes across the globe, see: Charles Booth, Christoph Paulus, Harry Rajak and Jay Westbrook, *A Global View of Business Insolvency Systems* (IBRD/World Bank 2010), Terrence Halliday and Bruce Carruthers, *Bankrupt: Global Lawmaking and Systemic Financial Crisis* (Stanford UP2009).

modification powers. Recognising that modifications are best negotiated when the company still has a lot of value and a hope of recovery, the need to wait for, or to prove insolvency has receded over the years; management is encouraged to initiate the process at the onset of distress; before the company becomes insolvent. That the modification procedure should be activated sooner, rather than later, has been argued by practitioner and theorist alike – even when they argue along traditional lines.[99]

2.3.4 Insolvency Law and Insolvency Issues

One may argue that the assertion that insolvency law is a debt modification device is an overstatement or a misunderstanding of its primal purpose. Let's imagine that the application of insolvency law is limited to insolvent companies and that another device would be necessary to resolve the problems that attend the renegotiation of creditors' claims when the company is solvent. Given that members' rights are modified by company law for example, would it not suffice to introduce a similar regime for creditors in company law? A procedure, it is argued, that seeks to modify the entitlements of creditors such that they receive less than they contracted ought to be collective and it ought to be equitable. For these reasons, many of the rules which would regulate the *insolventdimension* of modifications ought also to regulate *solvent dimension* of modifications.

What does this mean? For example, when a company is insolvent and modifications must take place automatically, insolvency law seeks to ensure that the procedure is collective and equitable. Insolvency law prescribes rules for the recognition and quantification of all claims, existing and future, contingent and non-contingent. It compels all claimants to act as a group, prohibits individual actions, creates a forum to facilitate participation, and provides

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[99] See (n 69) above; Mokal, *Insolvency Law*(n 3) 211; Jackson, (n 4) 206.

information on the debtor's state of affairs, inter alia. Insolvency law rescinds certain pre-insolvency agreements which would otherwise have been valid, so that all parties are treated equitably within their strata. Similar rules, it is argued, would be necessary when the desire is to modify the entitlements of creditors whose debtor is solvent, should the need arise. The creditors would have to be compelled to act collectively but must be treated equitably.[100]The debtor ought not to be permitted to treat some claimants more favourably than others in the period leading to the modification. One difference is that the solvent modification procedure would also require rules to facilitate decision-making. Company law does not include relevant rules but insolvency law does. One may choose to replicate the insolvency rules in company law – an unnecessary cost - or to leave the rules separate but to cross reference – a cumbersome practice. In either case, one can predict that the courts would refer to the insolvency precedents when deciding the issues that arise under the company law procedure.[101] Given that the procedure would be unduly cumbersome and costly, it is expected that the solvent modification procedure would be included in insolvency law where it (normatively and positively) belongs.

If similar issues arise whenever a company seeks to modify its creditors' entitlements whether or not it is insolvent, perhaps the issues are not *insolvency issues* as traditionally posited but *insolvency law* issues. Insolvency issues have been defined as those special issues that arise when the company has *becomeunable to repay its group of creditors*.[102] While some, like Brunstad and Jackson, delineate the issues they consider to be insolvency issues,

[100] Jackson, *Logic* (n 4) 17. For what it means to treat creditors equitably, see Mokal, *Insolvency Law* (n 3) ch 4, particularly 116-128.
[101] For example, in determining the import of certain sections of the Company Voluntary Arrangements (CVA) in England and Wales, judges often refer to decided cases on Individual Voluntary Arrangements (IVA): *Re Cancol Ltd*, [1995] BCC 1133 applied *Doorbar v Alltime Securities Ltd*, (N0.2) [1995] BCC 728.
[102]Mokal, Insolvency Law (n 3) 68-70.

others, like Mokal prefer an open-ended list.[103] The common factor however is that these theorists believe that such issues arise solely because the company has become *unable* to repay its debts and that insolvency law deals with them because it is designed to deal with the situations that arise when a company is unable to repay its debts. This claim, it is submitted, has not been justified by its proponents. As depicted in the preceding paragraph, similar issues must be resolved whenever the company *will not* repay the creditors' entitlements in full, regardless of the state of its solvency. Given that insolvency law is a multi-dimensional device which deals with the debtor's right to modify its creditors' claims – whether it is solvent or insolvent – the highlighted issues are not insolvency issues, they are insolvency law issues that are dealt with using the same principles – though the manifestations of the rules may differ as appropriate.

Conclusion: Dimensions of Insolvency Law

One clear characteristic of insolvency law is that it is not a simple device. It is multi-faceted, as well as multi-dimensional. Traditionally, insolvency law has been construed as a device which is triggered by the insolvency of a company which owes several creditors that it cannot repay in full. Given the lexical and historical links between insolvency and insolvency law, the connotation is understandable. Theorists have focused more on the disbursement aspect of insolvency law, ignoring the debt modification that precedes it. As this chapter asserts, the orthodox conception of insolvency law does not capture the other valid dimensions of the system we refer to as *insolvency law*. Normatively, insolvency law gives both creditors and debtors substantive rights. While the creditors require an efficient procedure to modify rights and entitlements before outstanding sums may be repaid when their debtor is insolvent, the

[103] Eric Brunstad Jr, 'Bankruptcy and the Problems of Economic Futility: A Theory on the Unique Role of Bankruptcy Law' (2000) 55 Business Lawyer 499. Compare with Mokal, *Insolvency Law* (n 3) 68.

debtor also requires an efficient procedure that resolves similar issues that arise where, though it is solvent, it seeks to modify its creditors' entitlements. Neither the debtor nor its creditors are compelled to trigger the device as soon as the need to modify interests arises; the device is activated when other procedures, formal or informal, would inefficiently resolve the issues at stake. This is not only a normative statement of insolvency law; it is also a positive statement of its purpose. The multi-dimensional perspective therefore proposes a theory of insolvency law that captures its multi-facets, and its solvent and insolvent dimensions, as well as the relationship between the two.

Chapter 3

Understanding Corporate Rescue

Overview

The core purpose of this thesis is to examine the Nigerian corporate rescue system. A cogent examination requires a concise understanding of the subject of the examination; in this case,an understanding of the significance of corporate rescue. Given the problems with agreeing a universal theory of insolvency law, it is unsurprising that corporate rescue, a sub-theme of insolvency law, also lacks ubiquity. Over the decades since it has been part of the insolvency rubric, the only universal theme has been the failure of policy experts, theorists and stakeholders to agree on its definition and purpose. This has not deterred the construction of elaborate mechanisms predicated on vague notions of rescue however. The state of things poses a problem for a country which is unsure of the measure by which to evaluate its system; particularly where the proponents of rescue within its borders nurse conflicting ideals and aspirations. To alleviate the problem, the chapter explores the main assumptions of rescue, examines inherent premises and seeks to proffer a semantic definition of the concept.

The chapter commences by examining the two prevalent notions of rescue: business rescue and company rescue. It finds that many debates focus either on outcomes or on procedure; neither of which reveals the semantic definition of the concept. Rescue procedures may evolve, while its outcomes may vary but the meaning of corporate rescue ought to be invariable. The chapter describes rescue as a process by which a business, with or without its company, may be rejuvenated whenever a market sale is undesirable or impossible. It distinguishes corporate rescue from the rescue procedure. It finds the former to be a process and the latter, the procedure by which the process may be implemented. It asserts that the rescue procedure is important when resolving the problems of distressed companies; though they may not always be rescued. The chapter identifies the main elements of rescue. These include the rescue decision, rescue finance and the rescue plan. It describes how the rescue procedure can be designed to facilitate these elements. The definition, in particular, the elements, provide a framework by which the insolvency procedures of the jurisdictions considered in this thesis will be examined.

The chapter is divided into 2 parts. Part I examines the business rescue and company rescue propositions. It culminates by defining corporate rescue and distinguishing it from the rescue procedure. Part II examines the essential elements of corporate rescue and analyses the issues which must be considered by the procedure.

Part I

3.1 Defining Corporate Rescue

A survey of popular reorganization theories in the US reveals a debate between scholars who support the existing reorganization procedure and its detractors, who criticise its existence and role.[1] Interestingly, many propositions do not actually deal with the semantic meaning of

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[1] Douglas Baird and Thomas Jackson, *Cases, Problems and Materials on Bankruptcy*; Thomas Jackson, *The Logic and Limits of Bankruptcy Law* (Harvard UP 1986); Lucian Bebchuk, 'A New Approach to Corporate Reorganizations' (1988) 101 HLR 775; Douglas Baird, 'The Uneasy Case for Corporate Reorganizations' (1986)15 JLS127; Mark Roe, 'Bankruptcy and Debt: A New Model for Corporate Reorganization'(1983) 83 Colum LR, 527; Lynn LoPucki, 'The Debtor in Full Control - Systems Failure Under Chapter 11 of the Bankruptcy Code' (1983) 57 Am Bankr LJ, 247; Charles Adams, 'An Economic Justification For Corporate Reorganizations' (1991) 20 Hofstra LR 117; Stephen Lubben, 'Some Realism About Reorganization: Explaining The Failure Of Chapter 11Theory' (2001) 106 DickLR 267; Karen Gross, 'Taking Community Interests into Account in Bankruptcy: An Essay' (1994) 72 Wash ULQ 1031; Elizabeth Warren, 'Bankruptcy Policy' (1994) 92 Mich LR 336; Thomas Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain' (1982) 91 Yale LJ 857; Douglas Baird and Thomas Jackson, 'Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy' (1984) 51 UCLR 97; Douglas Baird, 'Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren' (1987) 54 UCLR 815; Michael Bradley and Michael Rosenzweig, 'The Untenable Case for Chapter 11' (1992) 101 Yale LJ 1043;Barry Schermer, 'Response to Professor Gross: Taking the Interests of the

corporate rescue; the meaning of rescue having been implicitly agreed for centuries.[2] Rescue in the US basically refers to the hypothetical sale of a distressed company to its pre-distress stakeholders.[3] Traditionally, the US rescue procedure aims to preserve the distressed entity, though the company may, in practice, not always be saved.[4] Nonetheless, corporate rescue in the US can be described as the procedure by which distressed companies may be saved from liquidation by their pre-distress stakeholders.

Community into Account in Bankruptcy - A Modern-Day Tale of Belling the Cat' (1994) 72 Wash ULQ 1049;Elizabeth Warren, 'Bankruptcy Policymaking in an Imperfect World' (1993) 92 Mich LR 336; Elizabeth Warren, 'The Untenable Case For Repeal of Chapter 11' (1992) 102 Yale LJ 437; Elizabeth Warren and Jay Westbrook, 'Searching for Reorganization Realities' (1994) 72 Wash ULQ 1257;Samuel Bufford, 'What is Right about Bankruptcy Law and Wrong about its Critics' (1994) 72 Wash ULQ 829; Douglas Baird, Arturo Bris and Ning Zhu, 'The Dynamics of Large and Small Chapter 11 Cases: An Empirical Study' (December 2005) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=866865&http://papers.ssrn.com/sol3/papers.cfm?abstract_id=866865 accessed 15/07/2012; Lynn LoPucki and William Whitford, 'Patterns in the Bankruptcy Reorganization of Large, Publicly Held Companies' (1993) 78 Cornell LR597; Lynn LoPucki, 'The Trouble With Chapter 11' (1993) Wis LR 729; Douglas Baird and Robert Rasmussen, 'Chapter 11 at Twilight' (23/10/2003) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=455960&http://papers.ssrn.com/sol3/papers.cfm?abstract_id=455960&rec=1&srcabs=866865, accessed 14/07/2012; Lynn LoPucki and William Whitford, 'Bargaining Over Equity's Share In The Bankruptcy Reorganization Of Large, Publicly Held Companies'(1990) 139 U Pa LR 125; Robert Rasmussen, 'Debtor's Choice: A Menu Approach to Corporate Bankruptcy' (1992), 71 Texas LR 51;Frank EasterBrook, 'Is Corporate Bankruptcy Efficient?' (1990) 27 Journal of Financial Economics 411.

[2] Douglas Baird and Robert Rasmussen, 'Control Rights, Priority Rights, And The Conceptual Foundations Of Corporate Reorganizations' http://www.law.uchicago.edu/files/files/121.DGB-RKR.Control.pdf, accessed 15/07/2012, 2 ('Baird/Rasmussen, Conceptual Foundations').

[3] Thomas Jackson, *The Logic and Limits of Bankruptcy Law* (Harvard UP 1986), 211 ('Jackson, Logic and Limits').

[4] Lynn LoPucki and William Whitford, 'Patterns in the Bankruptcy Reorganization of Large, Publicly Held Companies' (1993) 78 Cornell LR597 ('LoPucki/Whitford, Patterns').

In England and Wales, there is, unlike the US, no broad consensus on the meaning of rescue.[5] The rescue law, in its first iteration, was anchored on the preservation of distressed businesses, as opposed to piece-meal sales.[6] Pursuant to the reforms of 2002, the main focus of the law, at least theoretically, shifted to the preservation of not only the distressed businesses, but also the companies in which they exist as well.[7] This shift in focus sparked debates amongst industry experts, stakeholders and scholars on whether the goal of the law ought to be the preservation of companies or the preservation of distressed businesses.[8] The consensus appears to be that corporate rescue is a vague concept.

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[5] Sandra Frisby, 'In Search of a Rescue Regime: The Enterprise Act, 2002' (2004) 67 MLR 247; Rizwaan Mokal, 'The Harm Done by Administrative Receivership' (June 2004) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=568702, accessed 12/07/212; BBA, 'Response of the British Bankers' Association to the Report by the Review Group on Company Rescue and Business Reconstruction Mechanisms' http://www.insolvencydirect.bis.gov.uk/insolvencyprofessionandlegislation/con_doc_register/con_doc_archive/responsecomprescue/pdfs/bbares.pdf accessed 26/12/2012; Vanessa Finch, 'Corporate Rescue Processes: The Search For Quality and the Capacity to Resolve' (2010) 6 JBL 502; John Armour and Sandra Frisby, 'Rethinking Receivership' (2001) 21 OJLS 73;*Cork on Cork: Sir Kenneth Cork takes Stock with Hugh Barty-King* (Macmillan London, 1988);Rizwaan Mokal, 'Administrative Receivership and Administration – An Analysis' (2004) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=466701 accessed 19/04/2012; Rizwaan Mokal, *Corporate Insolvency Law: Theory and Application* (OUP 2005); Vanessa Finch, *Corporate Insolvency Law: Perspectives and Principles* (2nd Edn CUP, 2009); Muir Hunter, 'The Nature and Functions of a Rescue Culture' [1999] JBL 491; Pont and Griggs, 'A Principled Justification for Business Rescue Laws: A Comparative Perspective Part II' (1996) 5 International Insolvency Review 47; *Re Paramount Airways (No.3): Powdrill v Watson* (1995) 2 AC 394; British Bankers' Association, 'A Statement of Principles: Banks and Businesses – Working Together When You Borrow' (BBA, London 2005); Charles Booth, Christoph Paulus, Harry Rajak and Jay Westbrook, *A Global View of Business Insolvency Systems* (IBRD/World Bank, Washington, 2010); Bruce Carruthers and Terrence Halliday, *Rescuing Business: The Making of Corporate Bankruptcy Law in England and the United States* (OUP 1998);Jeremy Goldring and Mark Phillips, 'Rescue and Reconstruction'(2002)15 Insolv Int 75; David Milman, 'Rescuing Corporate Rescue' (1993) 14 Co Law 82; Ian Fletcher, 'UK Corporate Rescue: Recent Developments – Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements – The Insolvency Act 2000, The White Paper 2001, and the Enterprise Act 2002' (2004) EBOR 5: 119-151; S Frisby, 'Report on Insolvency Outcomes' (2006) http://www.insolvencydirect.bis.gov.uk/insolvencyprofessionandlegislation/research/corpdocs/InsolvencyOutcomes.pdf accessed 25/06/2012.

[6] *Insolvency Law and Practice: Report of the Review Committee*(Cmnd 8558,1982)Chapter 4, particularly, 53, Para 193 ('Cork Report').

[7] The Insolvency Service, *Productivity and Enterprise: Insolvency – A Second Chance* (Cmnd 5234, 2001); Department of Trade and Industry, *A Review of Company Rescue and Business Reconstruction Mechanisms* (2000), foreword.

[8] See (n 5).

A word – or concept – is vague if ‘there are borderline cases for its application’.[9] Put differently, it is unclear whether certain meanings ought to be attributed to the word or excluded from it.[10] Corporate rescue is vague if it may be defined simultaneously by competing notions, yet it is unclear whether either of these meanings ought to be excluded however it may have formed; in fact, both the rescue law of the US and of England and Wales recognise and validate both outcomes.[11] Consequently, determining the semantic meaning of rescue appears challenging because it appears that neither meaning can be validly excluded.

The mainstream notions of corporate rescue in both the US and in England and Wales may be challenged as missing the essence of rescue. The prevalent notion of rescue in the US may be termed a partial description of the concept, which misses its core essence. It focuses on financial negotiations, ignoring the primal question that ought to be answered before valuation and negotiations ought to be conducted. On the other hand, the prevalent arguments in England and Wales focus on outcomes. Like in the US, the debaters have failed to identify the primal questions that ought to be answered before outcomes can emerge. In fact, outcomes may be the least important aspect of corporate rescue. The following sub-sections examine the business sale and company rescue theories. They explain each practice, highlighting questions that ought to be raised, if they were to achieve rescue. The section culminates by proposing a semantic definition of corporate rescue.

[9] Timothy Endicott, *Vagueness in Law*, (OUP 2000) 31.
[10] Randy Barnett, ‘Interpretation and Construction’ (2011) 34 Harv JL& Pub Pol'y 65, 67; Allan Farnsworth, "Meaning" in the Law of Contracts’ (1967) 76 Yale LJ 939, 953.
[11] 11 USC s1129 (a) (11) (1978); Para 3, Schedule B1, Insolvency Act 1986.

3.1.1 Business Sale

Basically, a company is separate from its business. Put quite simply, the company is an artificial person who carries on an economic activity called a business. Though the company starts out with lofty dreams of success, it may find that it cannot continue to run its business profitably.[12] As a result, it may become unable, not only to pay dividends to its shareholders but also to repay its creditors. As stated in chapter 2, debt gives the creditor the right to repayment or to the debtor's assets; though creditors do not liquidate assets immediately a company defaults.[13] The debtor may find itself unable to repay all its creditors simultaneously, in which case decisions must be made in concert. The creditors may choose to terminate the loan agreementsand recover the outstanding sums. The debtor's assets may be sold because it lacks the necessary funds with which to repay the said sums. The creditors may choose to sell the assets piece-meal. They may find however, that the assets generate greater value if sold as a unit or if the most viable parts are hived-off to be sold as one or more units, while the balance is sold piece-meal.[14] The choice depends on various factors including the: ingenuity of the negotiator, state of the assets, nature of demand, liquidity of the market and the state of the industry.

Usually, the assets are sold to the highest bidder(s), via the most value maximising option.[15] If the seller, (practitioner/company), is satisfied with the price, then he has a duty to accept.[16] Frisby notes, '*it is almost certainly no concern of presiding practitioners whether or not the*

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[12] Arthur Dewing, *The Financial Policy of Corporations*: *Expansion (vol.4)* (The Ronald Press Company 1921) 33.

[13]See p61 above.

[14]Alice Belcher, *Corporate Rescue*(Sweet & Maxwell 1997)26-27; 201 ('Belcher, Corporate Rescue').

[15] Jackson, *Logic and Limits* (n 3) 215.

[16]Sandra Frisby, 'Report to the Association of Business Recovery Professionals: A Preliminary Analysis of Pre-Packaged Administrations' (2007) http://www.r3.org.uk/media/documents/publications/press/preliminary_analysis_of_pre-packed_administrations.pdf, accessed 16/07/2012, 74('Frisby, Prepacks').

new business is or is not likely to fail'.[17] To enhance the value of the sale, the rights of stakeholders against the assets would, usually, be terminated; their only recourse would be to the proceeds.[18] To protect their interests however, stakeholders may be given the right to seek redress in court against the actions of the seller.[19] The court may grant them any remedy it deems satisfactory, including the suspension of the sale, if appropriate. After the sale, the business starts afresh - negotiates new contracts with suppliers and financiers, sources new customers, inter alia.

The business sale proponents assert that the sale of an on-going business is corporate rescue.[20] The Cork report which heralded business rescues in England and Wales stated that businesses which are capable of contributing value to the economy are the real subject of rescue, not companies.[21] It is quite reasonable to assert that a sale may grant a business a new lease on life. The transfer to a financially healthy entity may grant it a new opportunity to succeed.[22] The sale may also retrieve the business from the care of ineffective managers, giving the business potential hope of future survival.[23] Moreover, the sale may enable a quick resolution of the failed company's distress, ultimately preserving value and giving owners a

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[17] Ibid74.
[18] Belcher, *Corporate Rescue* (n14), 201.
[19] For example, in England and Wales, aggrieved stakeholders, usually creditors, can seek redress against the actions of the administrator in court. See *DKLL Solicitorsv HMRC* [2008]1BCLC 112; *Re Hellas Telecommunications(Luxembourg)II SCA* [2009] EWHC 3199 (Ch).
[20] Sandra Frisby, 'In Search of A Rescue Regime: The Enterprise Act, 2002' (2004) 67 MLR 247 ('Frisby, In Search');'Receivership under fire'(2001) 22 Co Law 161; BBA, 'Response of the British Bankers' Association to the Report by the Review Group on Company Rescue and Business Reconstruction Mechanisms'(2001) http://www.insolvencydirect.bis.gov.uk/insolvencyprofessionandlegislation/con_doc_register/con_doc_archive/responsecomprescue/pdfs/bbares.pdf, accessed 16/07/2012 ('BBA, Response').
[21] Cork Report, (n6) 53, Para 193.
[22] In DKLL Solicitors cited above for example, the business sale was to protect employment of about 50 staff and to prevent major disruption of the service they provided to clients - their business model. [2008]1BCLC 112.
[23] Practitioners cited poor management as one of the main causes of distress in Naresh Pandit, Garry Cook, David Milman and Francis Chittenden, 'Corporate Rescue: Empirical Evidence On Company Voluntary Arrangements And Small Firms' (2000) 7 Journal of Small Business and Enterprise Development 241, 245. ('Cook et al, Corporate Rescue').

second chance to succeed at the business through a new corporate entity.[24] Is this what corporate rescue means however?

It is quite important to note a few points with respect to the sale. Baird and Jackson, who are also strong proponents of the business sale, argue that it is one way of determining the desirability of that particular business in the economy; if the business has some potential,someone would buy it.[25] Their argument is however premised on a sale to third parties.[26]These parties diagnose, at their own cost, the cause of the failure and the potential viability of the business. One can reasonably infer that such persons would also have a strategy for turning the business around over time; monitoring it as it is implemented. The parties will also provide the required finances with which the business can be nurtured to profitability. In England and Wales for example, empirical research reveals that at least 70% of business sales to third parties result in successful revivals.[27]

A sale to third parties is merely a market sale. The argument of the sale proponents therefore ought to be that a market sale does not require the piece-meal sale of assets. That argument would go to the preferred type of market sales but not to the meaning of rescue. This assertion is based on the argument that what actually saves or rescues the business is not the sale itself but the actions taken by the buyers in relation to the business. A seller may validly sell a business that has no hope of future survival to anyone who is willing to pay the highest value for it. It is up to the purchasers to help the business to survive, if they can. The seller may equally validly sell the business to the people in whose care it had failed because he only

[24] BBA, Response (n 20). See also (n 22).
[25]Douglas Baird, 'Bankruptcy's Uncontested Axioms' (1998) 108 Yale LJ 573; Robert Rasmussen, 'Debtor's Choice: A Menu Approach to Corporate Bankruptcy' (1992) 71 Texas LR 51; Douglas Baird, 'The Uneasy Case for Corporate Reorganizations' (1986) 15 JLS 127.
[26] Jackson, *Logic and Limits* (n 3) 211.
[27] Frisby, 'Prepacks' (n 16) 79.

seeks to obtain the highest available price for the assets.[28] If these are the people who offer the highest value for the business at the time of the sale - or if they are the only persons interested in its purchase - then the sale must be concluded.[29] One cannot compel the seller to dissuade them, flag potential pitfalls, or to demand to see their plans for the future of the business. The same data set cited above estimates that about 1 in every 2 sales to connected persons, particularly the pre-packed variant, fails again.[30] This may be attributable to the fact that there is no one to take and implement objective decisions that would be taken at a market sale.[31]

One can contrast the business sale approach with two rescue-oriented approaches: one which results in the preservation of the company; the other, in the preservation of the business. Turn-around doctors assert that an assessment of the causes of distress is fundamental to rescue.[32] It is necessary to assess the viability of the business, its operational structure and the financial condition of the company within which it is run, amongst other things. The information obtained facilitates the creation of a sustained recovery strategy.[33] This strategy is implemented and monitored over a period of time. The exercise is deemed successful when the company recovers from its steady plunge into failure, and its fortunes are reversed.[34] In contrast, the business sale, as depicted by the practitioners hinges,[35] not on a diagnosis of the business' extant problems, an objective assessment of its viability or future needs, and a

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[28] Ellis, 'The Thin Line in the Sand– Pre-Packs and Phoenixes' (Spring 2006) Recovery 3; Moulton, 'The Uncomfortable Edge of Propriety - Pre-packs or Just Stitch-ups?' (Spring 2005) Recovery 2.
[29] Then they can make the statement at (n 17).
[30] Frisby, 'Pre-packs' (n 16) 79.
[31] See also, Davies Q.C, 'Pre-pack - He Who Pays the Piper Calls the Tune' (Summer 2006) Recovery 16, 17.
[32] Om Kharbanda and Ernest Stallworthy, *Company Rescue: How to Manage a Business Turnaround* (WilliamHeninemann Ltd 1987) 27-29 ('Kharbanda/Stallworthy, *Company Rescue*').
[33] A mere turnaround is not recovery. '*The turnaround may well be only the beginning of a long, long road to full recovery*', Om Kharbanda and Ernest Stallworthy, Corporate Failure: Prediction, Panacea and Prevention (McGraw-Hill Book Company (UK) Ltd, 1985) Chapter 15 (Corporate Failure).
[34] Belcher, *Corporate Rescue*(n14) 12.
[35] See p 78 above.

strategic implementation of a recovery plan but on the hope that the new owners would do a better job than the previous owners, or that the new company would somehow survive where the former did not. Moreover, the seller is not obliged to determine whether the purchasing company is financially and structurally capable of running the business. As long as an acceptable price is agreed, the business will be sold.

Perhaps the outlined steps are too lofty to achieve when it comes to selling the business to existing stakeholders. One can compare the modern practitioner approach to business sales captured by the Frisby report with a vintage approach to business sales conducted in the 19th century US through equity receiverships. At the time, there was no rescue precedent.[36] Market sales, which would have been the first choice option, were impossible for many reasons: no one had enough funds to purchase the assets as a unit; no one could sort out the tangle of securities attached to the assets, the peculiar nature of the securities, inter alia.[37] Stakeholders recognised that piece-meal sales would have yielded substantially less than the assets were worth as units.[38] The first decision was whether to keep the business going.[39]

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[36] Arthur Dewing, 'The Theory of Railroad Reorganization' (1918) 8 American Economic Review774, 775 ('Dewing, Theory').

[37] Fredrick Cleveland and Fred Powell, *Railroad Finance* (D Appleton and Company, 1923) Chapter 13; Alfred D. Chandler Jr, 'Patterns of American Railroad Finance, 1830-50' (1954) 28 Business History Review 248; Albro Martin, 'Railroads and the Equity Receivership: An Essay on Institutional Change' (1974) 34 Journal of Economic History 685 ('Martin, Railroads').

[38] Thomas Greene, 'The Commercial Basis for Railway Receiverships, The American Law Register and Review' (1894) 42 American Law Register and Review 417 ('Greene, Commercial Basis'). For the equity receivership procedure, Stuart Daggett, *Railroad Reorganization* (Reprint Bear Books, 2010); Francis, Stetson (ed), '*Some Legal Phases of Corporate Financing, Reorganization and Regulation*' (Reprint General Books LLC, 2009).

[39] This decision was taken by the investment bankers who had underwritten the bonds sold to investors. See Greene, 'Commercial Basis' (n38) 419.

The second decision was how to create an environment in which the business could recover its profitability.[40] The owners and their investors discovered that the businesses required viable financial structures, operational finance and structural rehabilitation.[41] While the financial matters were negotiated – amongst the sellers who incidentally were also the buyers- professionals with adequate knowledge of the failing company assessed the physical state of the assets and determined what restructuring was required if the business was to succeed in future.[42] In essence, the 19th century sales required the creation of a business environment in which distressed businesses could potentially succeed in future.

In contrast, the modern business sale imposes no such requirement. Perhaps the 19thcentury sale required such great detail because it was not really a 'sale'. The judicial sale was considered to be legal fiction because the sellers were also the buyers. All that the sale did was to legally sanction the arrangement that had been negotiated amongst the investors inter se.[43] Perhaps, if the business had been sold to third parties the need for such elaborate measures may not have arisen. It is not unreasonable to argue that if the business could have been sold to third parties all that would have mattered would have been obtaining the best possible price – like most modern sales. The ingenuity of the sellers would have been in devising the most attractive means of packaging the assets to enhance value. In that case, the 19th century sellers would not have been discussing rescue but mere sales, *albeit in (perhaps) hope*. As long as the best possible price was obtained, all duties would have been successfully

[40] This was effected by an arrangement crafted by the investment bankers and their legal counsels. See, Paul Cravath, 'The Reorganization of Corporations; Bondholders' and Stockholders' Protective Committees; Reorganization Committees; and the Voluntary Recapitalization of Corporations' (1916) in Stetson (n38), 95.
[41] Arthur Dewing, 'The Procedure of Contemporary Railroad Reorganization' (1919) 9 American Economic Review 1 (Dewing Contemporary Reorganizations).
[42] Martin, 'Railroads' (n 37) 696.
[43] Robert Swaine, 'Federal Legislation for Corporate Reorganization; an Affirmative View' (1933)19 ABAJ 698, 699 – 700.

discharged – as modern practitioners insist. In contrast, the prerequisites for rescue had to be in place because the intuition was to rescue the distressed business, not merely to sell.

3.1.2 Company Rescue

Creditors' options when they choose to enforce their rights are subject to few limits. They may choose piece-meal liquidation or a market sale where either option will maximise returns according to their estimations. There may be circumstances in which the returns from a piece-meal sale would be significantly insufficient. Also, a market sale may be impossible, undesirable, or costly.[44] Perhaps the company's problems were precipitated by external circumstances including a general economic downturn, an industrial downturn, or a one-off event.[45] It is possible that the company requires financial or structural reorganisation but its underlying business idea is sound.[46] In some cases, the business' success depends on the specific skills of those presently in charge or its assets can only be used by a similar firm.[47] The list of circumstances is inexhaustible and may present in various combinations. In such circumstances, the stakeholders may choose to preserve the company, as well as its business.

Company rescue literally refers to the preservation of the corporate entity, or some part of it, after distress has been remedied. Belcher highlights the impossibility of saving the entity intact – it is after all, usually insolvent.[48] Company rescue will involve the preservation of the

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[44] For example, Olympia and York's Canary Wharf project in London.
[45] For example, the $10.3billion awarded to Pennzoil against Texaco in the US precipitated Texaco's bankruptcy was a one-off event that was unlikely to recur.
[46]In England and Wales, for example, the banks have intensive care units at which financial restructuring takes place. Julian Franks and Oren Sussman, 'Financial Distress and Bank Restructuring of Small to Medium Size UK Companies' November 26, 2002http://www.rieti.go.jp/en/events/03010801/pdf/Sussman.pdf, accessed 14/07/2012 ('Franks/Sussman, Bank Restructuring'); British Bankers' Association, A Statement of Principles: Banks and Micro-Enterprises Working Together' www.bba.org.uk/download/2080, accessed on 19/04/2012.
[47] For example, the American railroads; see (n 42). See also, Baird/Rasmussen, 'Conceptual Foundations' (n2) 33-34.
[48]Belcher, *Corporate Rescue* (n14) 22-24.

interests and entitlements of some pre-distress stakeholders, though they would have undergone some modifications.[49] The preservation of the company, not just its business is fundamental to this notion of rescue. It is the prevalent idea of rescue in the US. In England and Wales, the underlying aim of the 2002 reforms was to promote the preservation of distressed companies, not just businesses.[50]

It is important to mention that many of the so-called advantages of company rescue may also be achieved by selling the business. It is not necessary to preserve the distressed corporate shell in order to preserve the interests of some pre-distress stakeholders – including the interests of (some of the) owners. It is possible to sell the business to the existing owners, while the shell is liquidated.[51] Many of the so-called advantages of rescue would still accrue: the alignment of incentives, the preservation of existing interests, beating general or industrial illiquidity, ensuring that those with firm-specific skills keep running the business, inter alia. The interests of some pre-distress employees, suppliers and customers would similarly be preserved even when the business is sold.

More importantly, preserving the company, on its own, does not result in 'rescue'. It may only mean that the date of its ultimate failure has been moved further along. For example, the US notion of rescue focuses largely on the financial rehabilitation of the distressed company. This is an important issue but it is neither the primal nor the only issue to be resolved at rescue.[52] An inquiry into the aftermath of rescued large companies in the US reveals that about 1 in every 5 of such companies re-files for reorganization within 5 years of emerging

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[49]Rizwaan Mokal, *Corporate Insolvency Law: Theory and Application* (OUP 2005) 211 ('Mokal, Theory').
[50] The Insolvency Service, *Productivity and Enterprise: Insolvency – A Second Chance* (Cmnd 5234, 2001), Foreword; Department of Trade and Industry,*A Review of Company Rescue and Business Reconstruction Mechanisms* (2000), foreword; 9; Para 2.1.
[51] Equity receiverships for example, involved resale to the pre-distress owners. In England and Wales, businesses are resold to the pre-distress owners via pre-packs.
[52] See also, Baird/Rasmussen, 'Conceptual Foundations' (n2) 38-39.

from the original procedure.[53] In some years, as many as 1 in 3 or 1 in 2 re-file.[54] Company rescue, it may be argued, is therefore not the panacea for the distress plaguing the business. The preservation of the company, it is submitted, is merely a possible outcome of the rescue process. In addition, financial rehabilitation is one of but not the primal problem that must be resolved when stakeholders decide to rescue the business.

This assertion is neither novel nor modern. Early in the 20th century, Arthur Dewing observed that many scholars at the time merely provided cursory definitions of rescue.[55] According to Dewing's analysis, the predominant precipitate cause of railroad reorganization was the inability of a business to meet its operating costs.[56] In a significant number of cases, he believed that could be traced to the railroad's weakened credit. Weakened credit, he found, was a symptom of diminished earning power, which was itself a symptom of a bigger problem - expansion. Reorganizing railroads, he argued, needed to penetrate beneath the tangle of proximate causes to determine the main cause of their malady; which they often did not.[57] Martin, of the same mind, asserted that such inquiries ought to be conducted by people with requisite knowledge and skill.[58] In essence, the reorganizing railroad business needed a diagnosis of its problems and a monitored recovery plan, amongst other things. Dewing's analysis, prescient though it was, missed an even more important issue: the desirability of

[53] UCLA-LoPucki Bankruptcy Database Research Database, 'Percent of Companies Emerging in Year Indicated that Filed a Second Bankruptcy within Five Years, 1985 –2004' http://lopucki.law.ucla.edu/tables_and_graphs/Refilings_total_emerging_1_5_2011.pdf, accessed 12/07/2012.
[54] See also, LoPucki/Whitford, 'Patterns' (n 4) 604.
[55] Dewing, 'Theory' (n 36) 777-778.
[56] For other causes, see Daggett, *Railroad Reorganization* (n38) 232-233.
[57] (n 55).
[58] (n 42).

saving the business at all.[59] This can be attributed to the fact that all were agreed on the desirability of saving the distressed railroads.

Railroad reorganizations are describedas the precursor to modern corporate reorganization law in the US.[60] Although they played a fundamental role, one may still benefit from contrasting the procedure of railroad reorganization with that of industrial corporations – as companies were known at the time. Robert Swaine, a leading reorganization lawyer at the time, highlighted some essential differences between both practices.[61] He noted that the first step at corporate reorganization was determining the potential viability of the distressed business.[62] Unlike with railroads, this matter was not a foregone conclusion; it had to be decided before other factors, including financial reorganization, could be considered in every case. His assertion coincides with that of modern turnaround professionals who state that the purport of rescue is to diagnose the cause of the distress, assess the desirability of carrying on the business and create a financially healthy environment in which the business may operate. Where the company is preserved but all these matters have not been resolved, one may question whether there has been rescue. In time, as the statistics show, the company may fail and have to re-attempt rescue.[63] Even in the case that the underlying business idea is sound,

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[59] See Baird/Rasmussen, 'Conceptual Foundations' (n 2) 38-39.
[60] David Skeel Jr, *Debt's Dominion: A History of Bankruptcy Law in America* (Princeton UP 2001) Introduction.
[61] Robert Swaine, 'Reorganization of Corporations: Certain Developments of the Last Decade' (1928) 28 Colum LR 29.
[62] Ibid 29:

> *'Usually the necessity is not so much to reduce fixed charges or provide for future capital expenditures but rather, if the industrial venture is inherently meritorious, to obtain new working capital and fund current debts into long-time obligations. If the venture is not meritorious, it is likely to collapse so thoroughly that reorganization is impossible.'*

[63] See (n 53) and (n 54).

as the railroads were, it is important, as Dewing asserted, to get to the real cause of the distress, if the company is to subsist profitably for a sustained period thereafter.[64]

3.2 Corporate Rescue

A semantic definition of corporate rescue ought not to focus on outcomes or procedure. As Dewing stated, while procedures may evolve, these changes ought not to affect the real meaning of corporate rescue.[65] His prescient statement has been proven right in the US; the reorganization procedure has evolved since the time of equity receiverships, the challenge is whether experts can distinguish these changes from the meaning of rescue. Lopucki's study of large insolvency cases in the US, reveals that reorganization cases generally yield a variety of outcomes.[66] Rescue can result in the preservation of the company, or a part of it; it may also salvage only the business or a part of it. Another challenge is therefore for outcomes to be distinguished from the meaning of rescue.

Essentially, corporate rescue is a process. It may be defined as the process by which a distressed business, including or excluding its corporate shell, may be salvaged and rejuvenated by a cross section of its existing owners when a piece-meal or market sale is either undesirable or impossible. The process mimics that which would be encountered in a market sale – assuming that the buyers are rational creatures.[67]

[64] See (n 55). A survey of railroad history reveals that many of the roads refiled for reorganizations several times during the course of their history, see Daggett, *Railroad Reorganization* (n 38).
[65] Dewing, 'Theory' (n36) 778.
[66] LoPucki/Whitford, Patterns, (n 4) 612. See also, Elizabeth Warren and Jay Westbrook, 'Chapter 11: Conventional Wisdom and Reality' http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1009242, accessed 17/07/2012.
[67] Recall that the actual sale itself does not bring about the rescue; the buyers must take some important steps if the business is to be saved. P 79 above.

At a market sale, the buyer must make some fundamental decisions when contemplating a purchase. He must decide on the potential viability of the business. Baird and Jackson have argued over the past few decades that the business would be purchased only if it is deemed viable.[68] Likewise, the business must be rescued by its stakeholders only if found to be viable.[69] The challenge is how to take the decision objectively at rescue.[70] The market buyer recognises that it must provide short term operating funds, as well as a long term financial plan, if the business is to succeed. Likewise, the rescuers must provide funds to tide the business or company over during the rescue, and negotiate a healthy financial structure for the company in which the business would reside going forward.[71] The buyer would have to identify the main source of the distress and design a recovery plan. He would engage professionals, with requisite experience, to oversee the process. Likewise, rescue should involve a careful diagnosis of the distress and a plan to reverse it.[72] It requires the engagement of professionals who can oversee the process; many times, this may include some of the previous management. The plan must be well monitored until the business is fully recovered.

Where a buyer in the market takes these decisions, it is reasonable to expect objectivity and little conflict. The problem with rescue is that there would be a raging conflict between the groups of stakeholders at the negotiation table. Fuelling the conflict would be the self-interests of parties, which would skew decisions in their own interests. For example, the owners and management would be over-optimistic in their evaluations; secured creditors may be unduly pessimistic; unsecured creditors may also be unduly generous in hope that they can

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[68] (n 25).
[69] (n 62).
[70] See (n 31). This notion is further discussed below at P91.
[71] See (n 40); further discussed below at P 98.
[72] See (n 42); further discussed below at p102.

recoup prospective losses if the company keeps going. While rescue procedures and outcomes may vary or change, it is submitted that its semantic meaning and core elements hold true.

3.3 Corporate Rescue and the Rescue Procedure

It is also important to distinguish between corporate rescue and the rescue procedure.[73] Many debates centre on the desirability of various aspects of the rescue procedure, not on the process that is corporate rescue. It is valid to argue that rescue is not always ideal for distressed companies but the designation of the ambit of insolvency law that facilitates decision-making at corporate distress as unnecessary, should be a separate argument.[74] Recall that liquidation is not the automatic or primal choice of creditors.[75] They may prefer to renegotiate their claims at default. Recall also that efficient renegotiations require enabling environments. Both insolvency and finance theories establish that informal negotiations with the creditors as a group while ideal may be impracticable or costly.[76] A formal procedure which facilitates decision making may therefore be required.[77] Unlike liquidation which requires the termination of the business and a quick sale of assets, it may be necessary to keep the company running while the desirability of renegotiation is considered.[78] Even where a market sale is the outcome, the procedure is necessary at least to ensure that the business is kept going and to prevent precipitate actions by impatient or uncooperative stakeholders; first

[73] Quite simply, one may define the rescue law as the procedure by which the rescue process may be facilitated.
[74] Many articles by Jackson, Baird and Roe, for example, form the bedrock of these arguments. See (n 1). See also the equivalent in England and Wales in (n 5) and (n 6).
[75] P 61 above.
[76] P 62 above.
[77] Warren asserts that informal arrangements succeed in many instances because they are conducted in the shadows of the formal rescue procedure. Elizabeth Warren, 'Bankruptcy Policy' (1994) 92 Mich LR 336, 371 ('Warren Policy').
[78] To preserve the going-concern.

while the creditors come to an agreement, and then while the sale is negotiated with potential buyers. This procedure is what is colloquially referred to as the rescue procedure.

The availability of a rescue procedure does not guarantee or compel corporate rescue in every case of corporate distress. Whether a market sale or rescue is optimal is an issue to be decided, not by theorists but by the stakeholders themselves, on a case by case basis.[79] They may decide to liquidate the business piece-meal, sell the business as a going-concern at a market sale, or rescue the business, with or without the company. The rescue procedure is however an essential (legal) device which protects and aligns the interests of stakeholders when the company becomes distressed or when renegotiations become desirable. Essentially, it seeks to promote value preservation by facilitating decision making at a time that conflicts between stakeholders are exacerbated.[80] The procedure resolves stakeholders' claims, provides negotiators with the imprimatur to make important arrangements and administers other ancillary but essential matters. Baird acknowledges, if grudgingly, that a procedure must exist to resolve these claims even if the market resolves the asset deployment question, given the cost of multilateral, informal negotiations amongst stakeholders.[81] For these reasons amongst others, Easterbrook concludes that the rescue procedure continues to exist because it provides a more efficient and essential service than available options.[82] A rescue procedure may require reform to improve its efficiency as many claim, but its utility, it is submitted, is unquestionable.[83]

Part II

[79] The decision is not one the law can prescribe.
[80] Daggett, *Railroad Reorganization* (n 38) 231.
[81] Douglas Baird, 'The Uneasy Case for Corporate Reorganizations' (1986) 15 JLS 127, 146-147.
[82] Frank Easterbrook, 'Is Corporate Bankruptcy Efficient?' (1990) 27 Journal of Financial Economics 411.
[83] Charles Adams, 'An Economic Justification for Corporate Reorganizations' (1991) 20 Hofstra LR 117.

3.4 Essential Elements of Corporate Rescue

The preceding section identifies three essential elements of corporate rescue: the rescue decision, rescue finance and the rescue plan. There are, of course, many other ancillary issues to be decided during the course of the rescue but these basic 3 must be addressed before the others can be considered. The law cannot prescribe the answers to these questions. Nonetheless, insolvency history and theory show that it can facilitate the decision-making process by providing an effective rescue procedure. The procedure will be effective if it achieves the desired goal – facilitating decision-making – in less time and at less pecuniary cost than other options. This challenge is made difficult by the fact that the procedure must endeavour to treat all parties equitably. Any group of stakeholders which thinks it is inequitably treated by the procedure may try to protect itself in the period leading to or following the acknowledgement of distress. The consequences of such actions may hasten distress or lengthen the time and pecuniary costs of rescue, ultimately destroying value. The ensuing subsections examine each element of rescue and consider some questions that may arise when designing the rescue procedure. They set the scene for issues that will be considered as rescue procedures from different jurisdictions are examined subsequently.

3.4.1 The Rescue Decision

19th century reorganization practice and modern management rhetoric corroborate the assertion that the primal element of rescue is the decision on the desirability of preserving the company and/or its business. Finance theory also supports the notion that creditors must take a decision on the business at default.[84] These assertions do not indicate the party responsible for the decision however. Intuitively, one would suggest that the decision should be taken

[84] P 61 above.

objectively and without bias by the designated party. The challenge however, is in identifying this person.

Whenever a company is funded by debt, there is a temptation for the shareholders (and their managers) to engage in risky ventures or activities which may have low probabilities of success.[85] This follows from the recognition that there is a cap on their losses but no limit on the benefits of success. Consequently, creditors,before granting credit to a company, ascertain the amount of equity in it; they tend not to give credit to a company without a sufficient equity-base because of the temptations already outlined.[86] As a company slides into distress, its equity-base shrinks. Eventually, the company takes on the features of a company with little or no equity-base. The shareholders and managers become increasingly incentivized to engage in risky ventures, in a bid to gain the benefits of success, though their share in failure is substantially diminished. If they are allowed to take the rescue decision singly, they are likely to decide to continue to run a business that should be terminated - equivalent to engaging in a high risk-low probability of success venture. While that decision may benefit them, it negatively impacts the creditors who bear the full financial cost of failure.[87]For that reason, the debtor, shareholders and/or managers, ought not to be allowed to take the rescue decision singly. Recognise that this argument does not stipulate that the debtor ought not to be consulted on the rescue decision; it merely states reasons why it ought not to act singly.

Perhaps the creditors – as owners – should be permitted to take the rescue decision. It should be noted however, that creditors do not have homogenous interests. In addition, they have

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[85]Michael Jensen and William Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976) 3 Journal of Financial Economics, 334 ('Jensen/Meckling, 'Agency Costs').See also, Frank Easterbrook and Daniel Fischel, *The Economic Structure of Corporate Law* (HUP, 1991).
[86] Ibid 334.
[87] This notion undergirded, it may be argued, the motivation of the creditors to decide the fate of failed industrial corporations in the early 20th century. See (n62).

quite different bargaining strengths which become most important after their debtor becomes distressed. In the US, some theorists proffer the 'efficient allocation of control' theory.[88] A similar notion in England and Wales is the 'concentrated-creditor control' theory.[89] The theory asserts that the rescue decision is to be taken by the most competent stakeholder, who has been identified as the *senior lender*.[90] Usually, the senior lender is the main secured creditor, whose loan contract entitles him to regular, detailed updates on the company's affairs.[91] The theorists assert that the senior lender ought to decide, if the debtor fails to, when to trigger the rescue procedure.[92] Further, given the extent of information he must have acquired, they insist that the senior lender must also decide whether to rescue the company/business or to conduct a market or piece-meal sale.[93] Allocating control to the senior lender, according its proponents, obviates the need for a procedure at which all stakeholders would participate in decision-making. This approach, they argue, lowers transaction costs and facilitates optimal decision-making.[94] Both strands of the theory recognise that the senior lender will take the most competent decision only when he will not be repaid in full but they assert that the lender is unlikely to recover in full in most cases.[95]

The proposition that the senior lender should act as a whistle-blower with the power to initiate the collective procedure when the company becomes distressed but its owners or managers fail or refuse to act is quite valid. The second ambit of the argument that the lender

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[88] Douglas Baird and RobertRasmussen, 'The End of Bankruptcy' (2002) http://www.law.uchicago.edu/files/files/173.dgb_.bankruptcy.end_..pdf, accessed 13/07/2012, 27-34; Baird Rasmussen, 'Conceptual Foundations' (n 2) 38-39.
[89] John Armour and Sandra Frisby, 'Rethinking Receivership' (2001) 21 OJLS 73.
[90] Referred to as the 'financing creditor' in Robert Rasmussen, 'Debtor's Choice: A Menu Approach to Corporate Bankruptcy' (1992) 71 Texas LR 51; the 'senior lender' in Baird/Rasmussen, 'End of Bankruptcy' (n 88) 33; the 'main creditor' in Frisby/Armour, 'Rethinking Receivership' (n89) 85.
[91] Baird/Rasmussen, 'Conceptual Foundations' (n 2) 38-39.
[92] Ibid. See also, Frisby/Armour, 'Rethinking Receivership' (n89) 85-86.
[93] Ibid.
[94] Frisby/Armour, 'Rethinking Receivership' (n89) 85.
[95] Baird/Rasmussen, 'End of Bankruptcy' (n 88) 33; Frisby/Armour, 'Rethinking Receivership' (n 89) 90-91.

should take the rescue decision singly is untenable however. The rescue decision hinges on objectivity and neutrality; the ability to make a value-maximising decision in relation the assets without bias for one or another set of interests. To prove that the senior lender can take decisions objectively, it is depicted as the residual claimant. The residual claimant is the stakeholder who receives the net-value after necessary disbursements have been made.[96] The residual claimant would ensure that the value in the assets is maximised so that it can benefit from the realisations. In essence, the senior lender, as residual claimant, would take objective, value maximising decisions because it would otherwise receive far less than the value of its debt in most cases.

LoPucki discovered that there is usually more than one (type of) residual claimant in a distressed company.[97] Determining who the residual claimant is in any rescue requires a valuation; as the outcome varies from case to case. Valuations are however expensive and time-consuming. The number of stakeholders who fall into the group of residual claimants depends on the difference between the actual value of the assets and the actual value of unpaid claims. The senior lender will not be the only residual claimant where the value of the business or its assets supersedes the value of its claims; recall that the debtor may initiate a rescue procedure in the absence of insolvency or default.[98] Consequently, the senior lender will make an objective or optimal decision only when it is the only residual claimant because it is in these cases that, like the sole proprietor, it bears the full costs of the rescue decision

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[96] Douglas Baird and Thomas Jackson, 'Bargaining After the Fall and the Contours of the Absolute Priority Rule' (1998) 55 U Chi L Rev 738, 761.
[97] Lynn LoPucki, 'The Nature of the Bankrupt Firm: A Response to Baird and Rasmussen's "The End ofBankruptcy" (2003) 56 Stan LR 645.
[98] In this case, the senior lender is likely to be over-secured: that is, it will receive 100% of its claims.

and is incentivized to maximise value.[99] It therefore becomes pertinent to explore the possibility that the senior lender will be the only residual claimant in most cases.

It is worthy to note that the senior lender's rights are not limited only to its immediate rights against the company. When it takes its decisions, it considers the entire network of rights and entitlements that it holds against the company, its alter egos, and other entities to which it may have recourse.[100] Consequently, the value it obtains from the assets will be complemented by value obtained from ancillary securities; ultimately undermining the possibility that it will be the residual claimant with the incentive to maximise value in the assets. It is also worthy to note that the party who makes the rescue decision invariably determines its implementation strategy. Such a party must balance the cost of enforcement against the possible benefits. In this case, the senior lender must balance the cost of implementation against the possible benefits.[101]Extracting the highest value from the assets may increase the cost of the extraction even though the senior lender cannot receive more than the full value of its claims.[102] The senior lender is therefore likely to take a decision that guarantees the repayment of its loan, all things considered, but which may not maximise value in the assets.

To recap, the senior creditor is unlikely to maximise value in the assets unless it is the only residual claimant in the company. When taking decisions, it will consider its primary and ancillary rights against the company and its alter egos. Morrison/Ayotte, who examined a

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[99] Mokal, *Theory* (n 49) 227.
[100] In addition to personal guarantees extracted from the directors, senior lenders may also have purchased credit-default-swaps or other derivatives.
[101] There is a limit to the benefits he can extract, though he can be paid less than he is owed, George Trantis, 'Debt Financing and Motivation' (1997) 31 U Rich LR 1323, 1325.
[102] John Armour, Adrian Walters and Audrey Hsu, 'The Impact of the Enterprise Act 2002 on Realisations and Costs in Corporate Rescue Proceedings' (2006) 38-40. The benefits of the returns were negated by the higher costs however. The system would benefit from cost cutting reforms which will be discussed in a subsequent chapter.

sample of large companies that filed for rescue in the US in 2001, discovered that secured creditors will indeed press for quick sales when over-secured.[103]They opt for business or company rescues – in other words, value-maximising decisions - only when under-secured.[104]Frisby observes, in a survey of insolvency returns conducted in England and Wales, that the senior lender will receive at least 90% of its claims in about a third of insolvency cases.[105] Add to that the sums realisable from other securities, and one can predict that in 1 of 2 cases, the senior lender is unlikely to be the only residual claimant.[106]For these reasons, senior lenders ought not to take the rescue decision singly because they are unlikely to make value maximising decisions.

When a company becomes distressed, the parties with substantial amounts of information about the debtor and the state of its business are usually too self-interested to take the rescue decision singly. Given the power that the senior lender can wield over the company, it is unlikely that such stakeholders - that is, the senior lender and the debtor/shareholders/managers – would take a decision objectively even if they were to decide in tandem.[107]Consequently, the challenge is in identifying the mechanism by which to engender this elusive objectivity in the absence of full valuation battles. The court, which should act as neutral arbiter, often lacks detailed knowledge. The information presented to it is likely skewed in the interest of the party that presents it. The court is also incapable of designing and forcing a neutral plan on the parties. Likewise, unsecured creditors often lack

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[103] Kenneth Ayotte and Edward Morrison, 'Creditor Control and Conflict in Chapter 11 Bankruptcy' (2009) 1 Journal of Legal Analysis 511.
[104] Ibid Table 9.
[105] Sandra Frisby, 'Interim Report to the Insolvency Service on Returns to Creditors from Pre- and Post-Enterprise Act Insolvency Procedures (2007) http://webarchive.nationalarchives.gov.uk/+/http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/research/returntocreditors.pdf, accessed on 29/09/2012, 14.
[106] In most of the cases mentioned above, the senior lender received 100p on the £1.
[107] For example, in the US, seeHarvey Miller and Shai Waisman, 'Does Chapter 11 Remain a Viable Option for Distressed Businesses for the Twenty-First Century?' (2004) 78 AMBKRLJ 153.

adequate information with which to contest the decisions of the other, more sophisticated investors or to provide cogent alternatives.[108]Even if the unsecured creditors were permitted to take the decision singly, it is unlikely that they would be objective and neutral. Ayotte/Morrison found that unsecured creditors are also likely to prefer to attempt rescue or to delay decision-making in the hope of recovery.[109]

The law cannot force parties to rescue distressed companies; neither can it be structured to predict the viability of businesses. It merely provides a framework that facilitates the decision-making process. The parties decide the outcomes. Nevertheless, the law should be structured to ensure that the representatives of all tiers of investors are consulted at the negotiations because it is unclear just who the actual residual claimant is. Lopucki/whitford found, in their survey of reorganization cases, that parties which are absent at the negotiation table usually receive nothing.[110] It is also important to recognise that various parties have various levels of sophistication and bargaining strengths. Usually, the senior lenders are sophisticated while the junior claimants are less likely to be.[111] In some instances, the managers are also less sophisticated than the senior lenders. Consequently, the law ought to ensure that the less sophisticated parties are adequately represented by candidates whotake their interests into consideration but who owe the duty to act objectively and in good faith. This may require the appointment of professionals, who would be imbued with certain investigatory powers; who have the experience necessary to provide cogent opinions during

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[108] Lynn LoPucki, 'The Debtor in Full Control – Systems Failure under Chapter 11 of the Bankruptcy Code?' (1983) 57 AMBKRLJ 99;Lynn LoPucki, 'The Debtor in Full Control – Systems Failure Under Chapter 11 of the Bankruptcy Code?' (1983) 57 AMBKRLJ 247; Jerome Kerkman, 'The Debtor in Full Control: A Case for Adoption of the Trustee System' (1987) 70 Marq LR 159.
[109] Ayotte/Morrison, (n103) 16; also, Table 9.
[110]LoPucki L, and William Whitford, 'Bargaining Over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies' (1991)139 UniPenn LR 125.
[111] Unless their claims are purchased by sophisticated investors in the period leading up to or after the commencement of the rescue procedure.

the course of the case. With improved representations, it is possible that the parties can negotiate more balanced results; with the court acting as final arbiter if no consensus is reached.

It is possible that the parties, in spite of the improved negotiation process would focus more on expected distributions than the viability of the company or its business, however.[112] They may be compelled to consider the rescue question by making the business plan compulsory.[113] The business plan, to be discussed below, must indicate the manner in which the rescue decision was made. It must also stipulate the changes to the operations that would be required, going forward.

3.4.2 Rescue Finance

The second core element of rescue is finance. Having studied many reorganization cases, Dewing observed that there were 2 main financial needs of a distressed railroad.[114] The more immediate need was for ample new money to repay crippling floating debts, facilitate the receivership, pay for the reorganization and keep the business going till it was rescued. The more fundamental but ancillary requirement was the creation of a profitable capital structure for the company within which the rescued business was to operate.[115] He noted that many 19th century reorganizers and finance experts focused on the latter but failed to recognise that it was valuable only if the former was achieved.[116] Similarly, in the modern age, turnaround specialists have identified the first financial problem to be resolved by distressed companies

[112] Ayotte/Morrison, (n103) 18.
[113] Discussed at 102 below.
[114] Dewing, 'Theory' (n 36) 777.
[115] Ibid 778; Daggett, *Railroad Reorganization* (n 36) 240-245.
[116] Dewing, 'Theory' (n36) 778.

as that of initial cash flow, if the business is to be stabilised or survive.[117] Thereafter, the reorganising business can focus on refinancing to promote future growth. Consequently, if rescue is to be achieved, both short and long-term finance problems faced by the distressed company must be resolved.

An assessment of the financial aspects of the 19th century reorganizations may be beneficial at this stage. Railroads sometimes raised short-term funds by selling new securities orby diverting current income from the payment of bondholders to the use of the company.[118] The main sources of short-term finance however, were assessments and the proceeds from the sale of receivers' certificates.[119] Assessments were levied on shareholders and junior bondholders who were interested in participating in the reorganized roads.[120]The shareholders were more likely to pay the assessments to retain their interests, than were new investors to buy new stocks at competitive prices. In return, the pre-distress shareholders received stock in the reorganised railroads. Receivers' certificates were also a popular source of distress finance because their purchasers were guaranteed repayment. The certificates were backed by the promise of the court to sell the underlying assets to repay the holders, where required.[121] The certificate-holders were also guaranteed repayment if the negotiations disintegrated before

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[117] Mark Blayney, 'Funding a Business Turnaround – 5 Steps to Success' http://www.tma-uk.org/uploads/Funding%20a%20Business%20Turnaround%201%20to%205.pdf accessed 15/07/2012.

[118] The reorganizers preferred assessments to the sale of new securities because it permitted the company, not the buyers, to fix the value of the reorganized company's security. The amount they could levy had to be decided carefully however, not to discourage further participation by the pre-distress investors.

[119] An assessment was a levy paid mainly by pre-distress shareholders and sometimes by junior bondholders for continued participation in the reorganized railroad. Receivers' certificates were short term collateralised instruments sold to fund the activities of the reorganizing road; returns could only be used for the stated purpose approved by the court.

[120] These stakeholders were amenable to the payment because investors generally believed that the railroad would recover from the distress and become profitable in the future. Swaine, 'Reorganization of Corporations' (n 61) 29.

[121] Charles Dickson, 'The Rights of Material and Supply Men in Railroad Foreclosures' (1896) 30 Am LR 523 ('Dickson, Material and Supply Men').

consensus could be reached. In some instances, they were paid ahead of the first bondholders; sometimes against the latter's protests.[122]

By the proceeds of the certificates, as well as the assessments, trade creditors and employees were incentivised to continue to support the struggling railroads.[123] The courts prioritised the repayment of some pre-distress trade debts, ranging from a few weeks to as long as 6 months; this became 'the six-months rule'.[124] The court based its decision on the equitable notion of restoration: creditors usually delayed filing after default for long periods of time during which money that was to have been used to repay trade creditors was diverted to funding improvements on railroad operations or the payment of dividends or interests; the payment was therefore merely restoring trade creditors to their rightful status.[125] New supplies during the reorganization were also paid; sometimes ahead of the first bondholders.[126] The payment was based on the notion that secured creditors had to give up some value in advance for the benefit of achieving greater future value.[127]

Many questions which had to be answered at 19th century reorganization are still being grappled with at modern rescue. Decisions must be made on how to facilitate the provision of short-term finance. Empiricists find that companies with access to short-term funds are likely to be reorganized successfully; or at least, the fates of such companies are determined in less time than it takes companies without short-term finance.[128] The problem is that potential financiers will not provide a failing company with funds unless they are guaranteed to

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[122] Dewing, 'Contemporary Reorganizations' (n 41) 21-22.
[123] See (n122).
[124]*Gregg v. Metro. Trust Co.*, 197 US 183 (1905); Dewing, 'Contemporary Reorganizations' (n41) 20
[125] Dickson, 'Material and Supply Men' (n121) 523-528.
[126] Based on the equitable doctrine of necessity. See (n 122).
[127] (n 125).
[128]Maria Carapeto, 'Does Debtor-in-possession Financing Add Value?' (Oct 6, 2003 Cass Business School) 1.

recover their investments, with interest.[129] Recall that finance theorists posit that creditors do not lend unless they have assurances of recovery; hence they are given the power to sell, or have sold, the debtor's assets at default.[130] The challenge that the typical distressed company faces is that it would have granted security over all its assets pre-distress.[131] It would therefore lack resources by which to raise new funds during the rescue procedure. Consequently, it is necessary to provide measures, like was done in the 19th century reorganizations, by which new credit may be raised by a distressed company that is to be rescued.

Suppliers in modern times will still refuse to supply goods to a distressed company unless paid upfront or given priority as administrative expenses. The rescue system must therefore provide for that. Lenders, who provide the funds by which some of these expenses may be paid, may however require even greater protection if they would be wooed into investing.[132] In the 19th century, they were paid ahead of all administrative expenses. In some cases, they were paid ahead of the senior bondholders. The courts permitted this system because their funds were needed to save even the interests of the senior bondholders. In the modern age, in which the senior lender may be able to recover substantial value, their interests must be balanced against the benefits to the estate of the new funds. A rescue system may leave the decisions to the equities of each case. Nevertheless, if the repayment structure is not guaranteed, lenders and suppliers cannot be certain that normal bankruptcy rules will not apply, in which case, they would be unlikely to recover their advances.

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[129] Sandeep Dahiya et al., 'Debtor-in-possession Financing and Bankruptcy Resolution: Empirical Evidence'(2003) 69 Journal of Financial Economics, 259.

[130] Oliver Hart, *Firms, Contracts and Financial Structure* (OUP 1995); Raphael La Porta et.al, 'Legal Determinants of External Finance' (1997) NBER Working Paper No. w5879, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=8179, accessed 12/06/2012.

[131] Kenneth Ayotte and Edward Morrison, 'Creditor Control and Conflict in Chapter 11 Bankruptcy' (2009) 1 Journal of Legal Analysis 511.

[132] Tony Groom, 'In Excess' *Insolvency Today Magazine* (August 2012) 23.

When the business or company has been stabilised, it is important to relieve the company of some of its debt load going forward. Again, this requires negotiations amongst the pre-distress claimants. The proposed financial restructuring will be presented as a plan on which the parties are invited to vote. It is possible that a financial restructuring plan may be rejected by the claimants, though it is the best possible in the circumstances. It is also possible that some parties may decide to hold-out or enforce the nuisance values of their claims; in a bid to receive pay-outs during the negotiations. In the case of a rejected plan, liquidation would be the only other option; unless the system provides for the presentation of a subsequent proposal which would not be guaranteed approval either. Alternatively, the party who proposes the plan should be permitted solicit court sanction for the rejected plan. The court may examine the plan to determine if it is fair and if the stakeholders will receive at least the liquidation values of their claims. The court will take its decision based on the information that has been presented to it. As in the preceding sub-section, this is another instance in which the less sophisticated parties will depend on the results of their investigations and experts, to present a strong case before the court.

3.4.3 The RescuePlan

The results of the financial negotiations are set out in what is called the reorganization plan.[133] This is actually the financial plan. There is also what may be termed the business reorganization plan.[134] In the 19th century reorganization, the business plan was drafted while

[133] Cravath, 'Reorganization of Corporations' (n40) 108.
[134] Martin, 'Railroads' (n37) 696:

> '*As the Erie reorganization had shown, much expert knowledge of a railroad's situation, its problems, and its prospects was required. Sooner or later, the superior qualifications of the men who had been running the railroad would have to be reckoned with. If this meant putting in charge of reorganization the*

the financial negotiations were on-going. The plan was required to transform the distressed business into a profitable venture. The plan was designed by people with relevant experience about railroads or more specifically, about the conditions of the railroad in question. Usually, someone involved in the running of the distressed company was retained to design a plan; often the person was appointed receiver. This was not a *carte blanche* for all managers to participate in the reorganization however. Managers who were considered to be culpable in the failure of the company were ousted at this stage to smooth the negotiation process. The person in charge of the plan determined the operational and structural changes that were required going forward. The plans were monitored after implementation. Likewise, modern turnaround professionals also indicate the need forwell-monitored recovery plans for distressed businesses which seek to be rescued.[135]

It is important that the plan indicates just how the rescue decision was made. In the 19th century plans, the requirement was unnecessary because it was apparent to all stakeholders, as well as to the public that the railroads were viable and important. In many modern rescues however, it is unclear whether the distressed company has a viable business; hence the need to indicate how the decision was made.[136] The plan should also indicate the changes that would be made to the company's or business' operations to ensure that it is actually rescued. It may be necessary to retain some pre-distress managers, particularly managers of small companies, because their firm-specific knowledge may be vital to the rescue.[137] Outside

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men who had got the road in a mess in the first place, perhaps it also meant, paradoxically, keeping in charge the men who knew best how to get it out.'

[135] See (n 33).
[136] Recall that at industrial reorganizations, the rescue decision had to be made in all cases. See Robert Swaine's statement at (n 62) above.
[137] Baird/Rasmussen, 'Conceptual Foundations' (n2) 24; Mokal, *Theory* (n49) 211. See also, Barry Adler, Vedran Capkun and Lawrence Weiss, 'Destruction of Value in the New Era of Chapter 11' (2006), http://archive.nyu.edu/bitstream/2451/26005/2/06-032.pdf, accessed 16/07/2012.

appointments may delay the process of reorganization by taking time to familiarise themselves with the business of the company before they can propose a plan. Nonetheless, lazy, fraudulent or otherwise unacceptable managers must be displaced if the business is to be rescued.[138]

Conclusion

Corporate rescue seeks to mimic the process by which a business may be rejuvenated by disinterested rational purchasers at a market sale. It comprises 3 basic elements. The rescue decision must be made at the initiation phase. Rescue finance, which comprises short-term funds and a healthy capital structure, must be negotiated. There must be a (monitored) business plan, by which the business may be revived. The plan should indicate how the rescue decision was made. Ideally, the rescue procedure would address all 3 elements. Given the self-interests of the parties, it is important to create access to detailed but neutral information on the company and its business. These observations do not arm prospective procedural architects with blueprints for the ideal rescue procedure. Nevertheless, they highlight the fundamental elements that must be considered by an effective rescue procedure. The following chapters will examine how these elements have been addressed by the Nigerian rescue system and those of the United States, as well as England and Wales.

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[138] See (n 23). See also, Laurence Kallen, *Corporate Welfare:Corporate Welfare: The Megabankruptcies of the 80s and 90s*(Carol Publishing Group 1991) 468; Lynn LoPucki and William Whitford, 'Corporate Governance in the Bankruptcy Reorganization of Large, Publicly Held Companies' (1993)141 U PA LR 669, 723 -726; LoPucki/Whitford, 'Patters' (n4) 610-611. See also, David Skeel Jr, 'Creditors' Ball: The "New" New Corporate Governance In Chapter 11' (2003) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=416420 accessed 15/07/2012.

Chapter 4

The Nigerian Insolvency Law

Overview

When a company becomes distressed, the company and its stakeholders may not desire liquidation. To facilitate the rejuvenation of the company, they may require or prefer to utilise formal insolvency procedures which benefit from judicial impetus that may be required to push compromises through. The Companies and Allied Matters Act 2004 (CAMA) offers Nigerian stakeholders two formal rescue options: Receivership and Arrangements and Compromise. There is a dearth of information on the administration of these procedures however; what little there is merely provide general overviews of the system or restate the procedures as outlined in the statute. Conversely, this chapter explores the opinions of experts, provides relevant historical information, outlines each procedure and examines the rules of enforcement. The chapter seeks to provide a clear overview of each procedure, ahead of the analysis to follow.

The chapter finds that the receivership procedure has disappointed the stakeholders such that it is scarcely used. Experts characterise it as archaic, citing the common law as the main source of its authority. The procedure attracts so much input from the court as a result of seemingly unending litigation by both debtors and creditors that it is fair to describe it as court-driven. It follows that there are many unwritten rules. The arrangements and compromise procedure is even less used. Like receivership, it is also characterised by non-statutory, ad hoc rules; which are even less clear. Though the chapter culminates in more questions than answers, it is an important step to evaluating the place of rescue in the Nigerian insolvency system.

The chapter is divided into 2 main parts. Part I examines the receivership procedure. It discusses the surge and decline of receiverships in Nigeria, outlines the regulatory framework and examines the rules of its enforcement. Part II provides a detailed history of the arrangements and compromise procedure. It outlines its regulatory framework and examines the rules of its enforcement. The chapter finds gaps between the statutory provisions and apparent practice. It appears that both procedures have been altered by the court as it sought to project fairness onto the system.

Part I

4.1 The Nigerian Receivership Procedure

Next to liquidation, receivership is the most prevalent insolvency regime in Nigeria. Although there are no actual statistics reflecting the trend, insolvency case law is representative of possible percentages. Most of the case law was initiated between the late-eighties and mid-nineties; fuelled by a persistent downturn in the economy.[1] Prior to that period, in the seventies and early eighties, Nigeria was one of Africa's largest manufacturing economies.[2] Successive national development plans and economic policies, both in the pre-

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[1] Seyi Akinwunmi, 'Receiverships and Business Recovery' (copy on file with researcher). Seyi Akinwunmi is a founding member of the Business Recovery and Insolvency Practitioners Association of Nigeria (BRIPAN). He has also served as general-secretary and president of the association.
[2] Louis Chete and Adeola Adenikinju, 'Productivity Growth in Nigerian manufacturing and its correlation to trade policy Regimes/indexes' (1962–1985)', (AERC Research Paper 127,2002). See also, World Bank, 'World Development Report 1988'http://www.aercafrica.org/documents/rp126.pdf, accessed 26/07/2012.

oil-boom and oil-boom eras, accelerated the growth of the manufacturing sector, which made substantial contributions to the nation's Gross Domestic Product (GDP).[3]

The Manufacturing Industry was especially capital intensive because it was heavily dependent on imports.[4] Internal revenues and investor contributions initially funded its activities but it depended largely on debt for its rapid and sustained growth.[5] A large proportion of its loans were secured by mortgages. Where the loans were secured by fixed and floating charges over the companies' assets, they were documented in debentures that gave the creditors the right to appoint receivers, (including receivers and managers), upon default.[6]The persistent economic downturn that followed the crash of the oil-market, as well as acts of mismanagement and fraudulent practices by many directors precipitated a wave of defaults in the sector.[7]To avoid protracted debt recovery litigation, many creditors exercised their contractual rights to appoint receivers; hence the surge in the number of receivers appointed from the mid-eighties.[8]Receivership attained notoriety however, when receivers were appointed to manage the affairs of notable companies in the late-nineties and early-

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[3] Ibid 11-13. See also, 'Economic Commission for Africa, 'Capital Flows and Development Financing in Africa' (Economic Report on Africa, 2006) http://www.uneca.org/eca_resources/publications/books/era2006/index.htm, accessed 26/07/2012.

[4]Chete and Adenikinju, (n2) 7-8.

[5] Generally, individual financial institutions granted loans to individual companies. However, there were also many syndicated loans granted by consortia of financial institutions, (both Nigerian and foreign), to companies that required them. For example, Tropic Foods Ltd was granted a loan of 4,800,000 Naira in 1980, by Union Bank Plc and Icon Ltd Merchant Banks jointly. Likewise, in 1977, Nigergrob Ceramics Ltd obtained a loan provided jointly by four financial Institutions, including the Nigeria owned Universal Bank of Africa and the foreign Societe Internationale Financiere pour les Investissements et le Developpement en Afrique, amongst others. *UBN v Tropic Foods Ltd*(1992) 3 NWLR (pt228) 231; *UBA v.Nigergrob Ceramic Ltd* (1987) 3 NWLR (pt62) 601.

[6] CAMA 2004, s 208; s 209. Note that a debenture may also be unsecured. CAMA 2004, s 173.

[7] Nigergrob Ceramics Ltd had defaulted on its loan by 1984; while Tropic Foods Ltd defaulted by 1987. See (n 5).

[8] For example, both Nigergrob Ceramics Ltd and Tropic Foods Ltd mentioned above had had receivers appointed over them by the mid to late eighties.

noughties; most prominent of which was the first independent television station in Nigeria, African Independent Television (AIT).[9]

There has been a reduction in the number of receiverships following the first surge; again this is based on rudimentary inferences from case law. It is possible to explain the reduction in case law by other phenomena including: undisputed receiverships, reduction in the indices of corporate failure, and the evolution of loan debentures, amongst other things. It may also be that the procedure does not suit the needs of the stakeholders and is therefore underutilised. A survey of expert opinions in Nigeria suggests that the latter may be the more plausible explanation.

Layonu, in an address, described the debt collection trend of the mid to late nineties.[10] Perhaps because of the inadequacies of the receivership procedure, creditors switched tactics. They explored other debt recovery avenues, particularly the engagement of uniformed personnel to hasten debt recovery.[11] He noted that the latter trend has resurrected in the noughties, though with a new spin. Creditors '*resort to the use of the Economic and Financial Crimes Commission (EFCC)*' to enforce debts.[12] The EFCC is not a private debt enforcement agency; it was established to fight financial and economic crimes in

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[9] Dipo Okubanjo, 'Dokpesi Finds Succour', (*All Africa,* 7 November 2000)http://allafrica.com/stories/200011070354.html, accessed 24/07/2012.
[10] Abiodun Layonu, 'Improving the Quality of Bank Credit and Recovery in Nigeria: the Role of the Law and the Judiciary in the Development of Insolvency and Business Recovery' 9 (Unpublished. Copy on file with researcher). Layonu is a founding member and 1st Vice President of the Business Recovery & Insolvency Practitioners of Nigeria (BRIPAN); was president of BRIPAN from 2004 to 2006.
[11] Ibid 14. Nigeria was ruled by the military in that era, until 1999, when she returned to democracy.
[12] Ibid 14-15.

Nigeria.[13]So, banks "invent" and impute criminal conduct to their defaulting customers' to justify its involvement.[14]

Ubiquitous in the litany of criticisms are the age and inefficiency of the extant procedure. Critics cite the fact that the Nigerian insolvency legislation has not been reformed since 1990 when CAMA was enactedas a fundamental aspect of its problems.[15] Government has thus far resisted calls to reform the law; though disputes on core features of the receivership procedure have blighted its effectiveness. Nwauche cites the contents of receivers' duties as one of the most problematic aspects of the receivership procedure in Nigeria.[16] As will be observed subsequently, much of the case law derives from conflicts on receivers' powers and duties.

Akinwunmi attacks the paucity of knowledge and understanding of the receivership concept which he believes is exacerbated by the corrupt practices of many receivers.[17] In his opinion, many receivers neither understand the nature of receivership, nor their roles or duties as receivers. Corroborating his opinion, though from another perspective, is Aribisala, who observes that many cases which should result in receivership or other insolvency procedures

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[13]Economic and Financial Crimes Commission (Establishment) Act 2004, s6.
[14] Layonu, (n 10) 15.
[15] Iyiola Oyedepo, 'The Imperatives of a Vibrant Insolvency Practice in Nigeria' (February, 2008)http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1089345 accessed 23/07/2012. Cooper traces the law to the Companies Act, 1948, of the United Kingdom. Neil Cooper, 'Insolvency Law and Reform and Some Preliminary Thoughts on Nigeria'http://siteresources.worldbank.org/INTAFRSUMAFTPS/Resources/Insolvency_Law_Reform_&_some_preliminary_thoughts_on_Nigeria_(NC).pdf, accessed on 23/07/2012.
[16]Nwauche, 'The Duties of A Receiver/Manager in Nigeria and Ghana' (2005) 14 International Insolvency Review 71, 90-91.
[17] Ibid 8-9.

are treated as debt recovery cases, both by debenture-holders and the courts.[18] Layonu calls for the enactment of a separate Insolvency Act and a reappraisal of the Nigerian insolvency culture.[19] Like him, Oyedepo believes that the extant sparselegislationsappended to the company law should be developed in more detail, to provide better guidance on various aspects of the receivership process.[20]

It is imperative to mention that many comments on the Nigerian procedure are merely anecdotal; often characterised by unarticulated premises. This observation is important when analysing opinions expressed in articles or case law on the Nigerian insolvency system. For example, comments on the meaning of corporate rescue are merely anecdotal. For that reason, the perceptions of experts on corporate rescue will not be rigorously analysed in the ensuing discussions.

The prevalent notion of rescue appears to be the preservation of the company as a going concern. Practitioners'statements imply that receivership merely empowers a different (creditor-appointed) manager to run the company as best possible in an effort to obtain repayment of the debt.[21] The striking feature of this perspective is that the receiver is expected to keep the company running as a going concern and to return it to its owners after the debt has been repaid. If that objective cannot be achieved, then the business ought to be sold as a going concern.[22]Akinwunmi asserts that receivership enables secured creditors to

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[18] Theodora Kio-Lawson, 'Nigeria's Insolvency and Debt Recovery Laws Need Urgent Reforms- Aribisala' *Business Day* (30th November 1999), http://www.businessdayonline.com/NG/index.php/law/case-review/3809-nigerias-insolvency-and-debt-recovery-laws-need-urgent-reforms-aribisala, accessed 24/07/2012.
[19] Layonu, (n 10) 9.
[20] Oyedepo, (n15) 14.
[21] See Akinwunmi, (n 1) 18-19; Nwauche, (n 16) 90-91.
[22] Nwauche, (n16) 91.

act promptly and decisively at the onset of insolvency; resulting in the preservation of the company or its business as a going concern, with desirable consequences for other stakeholders.[23] However, Oyedepo calls for a more inclusive insolvency system which balances the interests of the stakeholders at insolvency.[24]While Nwauche suggests that a clear set of principles ought to be enacted to help the receiver/manager balance different interests that vie for recognition at insolvency.[25]

The dearth of robust analysis also helps to perpetuate a somewhat peculiar feature of the Nigerian receivership procedure. It appears that the source from which the Nigerian receivership procedure draws its authority is vague. Recall that a concept is vague if the borders of its application are unclear.[26] Recall also that the Nigerian legal system is made up of a complex network of legal systems, including the tenets of Common Law and enacted legislation.[27] Some insolvency experts believe that the authority of the Nigerian receivership procedure stems from the principles of the Common Law (in force in Britain in 1948). To Akinwunmi, receivership in Nigeria '*derives it force from Common Law and the rules of equity,supplemented by the Companies and Allied Matters Act 1990*'.[28] Further, he claims that in Nigeria, '*the general principles of receivership under the Common Law apply'*.[29] Likewise, Cooper asserts that the Nigerian Insolvency Law is based on the British Companies

[23] Akinwunmi, (n 1) 19-20.
[24]Ibid 18-20
[25] Nwauche, (n16) 91.
[26] See p76 above.
[27]See p 27 above.
[28] Akinwunmi, (n 1) 15. Emphasis mine.
[29]Ibid 16.

Act 1948.[30] Their opinions contrast, for example, the assertions of the committee that was commissioned to review the Nigerian Company Law in 1987 ('the committee').[31]

The committee claimed to have designed CAMA 1990 to provide '*a comprehensive body of legal principles and rules'* suited to Nigeria's economy.[32] Though it acknowledged the structural similarities between CAMA 1990 and the Common Law, as well as some other substantive similarities reflective of CAMA's origins, it insisted that the provisions of CAMA 1990, and therefore the receivership provisions were largely conduced to Nigeria's economy - at least at the time of enactment.[33] To that end, the committee claimed to have introduced '*new concepts and procedures'* to company law in Nigeria,streamlined and codified relevant Common Law principles '*with a view to producing a Company Law that will be responsive to the economic activities both in Nigeria and in ECOWAS*'.[34] The views expressed above appear to be describing two different sets of legislation; yet they refer to the same law. Some of the effects of this disparity will be observed in the analysis that ensues.

4.2 Outline of the Nigerian Receivership Procedure as presented in CAMA2004

4.2.1 Types and Effects of Appointment

CAMA 2004authorises companies to borrow money for business needs.[35] Debt may be secured or unsecured.[36]The debt agreement may beset-out in a debenture. Where required, the

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[30] Cooper, (n15).
[31]Nigerian Law Reform Commission, 'Report on the Reform of Nigerian Company Law and Related Matters', (Volume 1, Review and Recommendation, 1988) Part A ('Committee Report').
[32] Ibid 4.
[33] Ibid 5-6. This is based on the fact that fundamental principles of common law that did not suit the Nigerian climate were either amended or rejected. For example, the English rule in *Royal British Bank v Turquand* was codified and amended and the Common Law doctrine of constructive notice of filed documents was abolished.
[34] Ibid 6.
[35] CAMA2004, s 166,

company may secure the debenture with a charge or mortgage over its assets or uncalled capital.[37] The charge may be fixed, floating or (a hybrid of) both.[38] A fixed charge is taken over a specific property, while a floating charge is taken over a specified part or the whole of the company's assets and undertakings. CAMA 2004 permits the debenture holder(s) or their trustee(s) to enforce the security on the occurrence of agreed contingencies.[39]The standard debenture includes a clause which sanctions the appointment of a receiver or a receiver and manager ('receiver/manager') to enforce the security on the occurrence of specified contingencies.[40] If the debenture is secured by a fixed charge, a receiver may be appointed, while a receiver/manager is typically appointed, when the charge(s) on which the debenture is secured include(s) a floating charge over a part or the whole of the company's assets.[41] Although a receiver or manager may be appointed in relation to a debtor company's assets, whenever a manager is appointed, there must also be appointed, a receiver. The two offices may be performed by one person however.[42]

CAMA 2004 does not define receiver or manager: it merely states that a receiver includes a manager.[43] Likewise, the Act does not specify the persons who may be appointed as receivers, (including managers), butit prohibits a list of persons from acting in that capacity.[44] Prohibited persons include: infants and persons of unsound mind,[45] bodies corporate,[46]

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[36] CAMA 2004, s 173(1).
[37] CAMA 2004, s 166.
[38] CAMA 2004, s 173 (2).
[39] CAMA 2004, s 208.
[40] See CAMA 2004, s 173; s 178.
[41] CAMA 2004, s178.
[42] CAMA 2004, s 209 (5).
[43] See CAMA 2004,s.400; s 650.
[44] See CAMA 2004,Part XIV.
[45] CAMA 2004,s 387 (1) (a) & (b).

director(s) or auditor(s) of the debtor company,[47] persons who have been convicted of offences involving fraud, corruption or moral turpitude, as well as undischarged bankrupts.[48] Appointments which contradict these stipulations are void; appointees, except infants and those of unsound mind, will be guilty of an offence and liable to a fine.[49]As the Act sets out no (minimum) qualifications for a prospective receiver, any person, apart from the outlined, may be appointed as receiver.

CAMA 2004 provides dual routes to the office of a receiver or receiver/manager. The first is the court-initiated appointment.[50] The court may appoint a receiver on the application of the trustee of a covering debenture trust deed, the debenture holder(s), or an interested person.[51] CAMA 2004 does not define 'interested persons'. Regardless, interested persons may pray the court to appoint a receiver if the company defaults in making necessary disbursements on the principal or interest, or where they perceive the security or property of the company to be in jeopardy.[52] On receipt of the prayer, the court may appoint a receiver even if the charge has not, in fact, become enforceable; so long as the court is satisfied that certain events have occurred, or are about to occur, that make it unreasonable, in the interests of the debenture holder(s), for the company to continue to hold the right to dispose of the secured assets.[53]Nonetheless,the court may prefer to appoint an Official Receiver instead, if the

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[46] CAMA 2004, s 387 (1) (C).
[47] CAMA 2004, s 387 (1) (e).
[48] CAMA 2004, s 387 (I) (d) & (f).
[49]CAMA2004,s 387 (2). A body corporate will be liable to a fine of NGN 2000 (£8.73); while an individual will be liable to a fine of NGN 500 (£2.18), or a term of imprisonment not exceeding 6 months.
[50] See CAMA 2004, s 180; s 209; s 388; s 389, s 390. For a receiver to be appointed as a means of enforcing a debenture, however, such a debenture must be secured by a charge. CAMA 2004, s 180 (3).
[51]CAMA 2004,s 180; s 209 (1) (d); s 388; s 389. Federal High Court (Civil Procedure Rules) 2009, Order 40.
[52] CAMA 2004,s 389 (1) (a) & (b).
[53] CAMA 2004,s 180 (1).

company was in liquidation at the time of the application.[54] The second route into receivership is out of court. The debenture holder(s) or trustee(s) may appoint a receiver when the security becomes enforceable.[55]

The receiver, (including a manager), takes possession of the assets subject to the rights of previous encumbrancers.[56]During its pendency, the powers of directors in relation to the assets subject to the receivership will be in abeyance until the receiver is discharged.[57]If the company was in a members' voluntary liquidation at the time the receiver was appointed, the liquidator's power over the assets shall also be deferred until the receivership culminates.[58]If the company was in a creditors' voluntary liquidation or the assets were in the possession of an officer of the court at the time of appointment, the liquidator or officer of the court is not bound to relinquish the assets to the receiver, except the court so orders.[59]

4.2.2 Notifications

Within 14 days of the appointment, the receiver must notify the Corporate Affairs Commission ('CAC').[60] The notice must indicate the terms of the appointment and the agreed remuneration.[61]If the receiver defaults, the company, culpable officers and the receiver will be guilty of an offence and liable to a fine.[62] On the application of the company or the liquidator, the court may determine the receiver's remuneration,even when appointed under a

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[54] CAMA 2004,s 388.
[55] CAMA 2004, s 209. Also CAMA 2004, s 390.
[56]Generally, CAMA 2004,s 393 (1).
[57] CAMA 2004,s 393 (4).
[58] Ibid.
[59] CAMA 2004,s 393 (5).
[60]CAMA 2004,s 392 (1).
[61] CAMA 2004,s 392 (1).
[62] Of NGN 25/day (£0.10/day), CAMA 2004,s 392(2).

debenture.[63]Where the receiver appointed by the debenture-holder is alsoto be manager, he is required by CAMA 2004 to notify the company of the appointment and its terms.[64]Within 14 days, the company should provide the receiver with a statement of affairs of the company in the prescribed form.[65]The receiver must send a copy of the statement, accompanied byhis comments ora notice of decline, to the Corporate Affairs Commission (CAC) or the court, if appointed by the debenture-holder or court respectively.[66] The receiver is also to send copies of the statement and comments or notice to the debenture-holder(s) and/or trustee(s).[67]The receiver is to provide an account of receipts and payments made during the period of the receivership to the CAC, the debenture holder(s) or their trustee(s) and the company within stipulated time frames.[68]If the receiver fails in this duty, the court may order compliance on the application of the liquidator or the CAC.[69] The receiver would also be liable to penalties.[70] During the receivership, all official documents issued by the company must

[63] CAMA 2004,s 395.
[64] CAMA 2004,s 396 (1) (a).
[65]CAMA2004,s 396 (1) (b). CAMA sets out the information required to be provided. See generally, CAMA 2004, s 397.The Statement of Affairs must be verified by the persons making them, by affidavit. The court may direct that the person(s) making the statement and affidavit should be paid by the receiver, for the expenses incurred. Where the receiver is appointed out of court, a statutory declaration, as opposed to an affidavit will be made and presented to the CAC, not the court. Default is an offence; rendering the receiver liable to the liability of a fine of NGN 50/day (£0.20/day) for everyday during which the default continues.
[66] CAMA 2004,s 396 (1) (c) (i) & (ii).
[67] CAMA 2004,s 396 (1) (c) (iii).
[68]CAMA2004,s 396 (2) & S. 398. If the receiver is appointed by the court, the accounts ought to be rendered within 2 months of every 12month period; or as the court directs. If the receiver is appointed under the debenture, the accounts should be rendered within 2 months of every 6 month period.
[69] CAMA 2004,s 399 (1) (a) & (b), (2). If a notice is served on the receiver, he is required to comply within 14 days of its receipt.
[70] CAMA 2004,s 399 (3).

indicate the receivership.[71] A contravention of these requirements is a punishable offence which also results in liability for a fine.[72]

4.2.3 Agency, Powers and Duties

The receiver appointed by the court is deemed to be an officer of the court.[73] As an agent of the court, the receiver is required to act according to the directions of the court.[74]Likewise, the receiver appointed under a debenture, is the agent of the debenture-holder(s).[75] Such a receiver is entitled to act according to the powers and remedies conferred by the debenture.[76]The out-of-court appointeemay also apply to the court for directions in relation to any matter arising out of the performance of his functions.[77] In addition to the powers

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[71] CAMA 2004,s 392 (1).
[72] CAMA 2004,s 392 (2). The company, its officers, the liquidator, if one has been appointed and the receiver, who willingly or knowingly permit(s) or authorise(s) the default will be guilty of an offence and liable for a fine of about 25 Naira (£0.11), for everyday that the default continues.
[73]CAMA2004, s 389 (2) :

> *'A receiver or managerof any property or undertaking of a company appointed by the court shall be deemed to be an officer of the court and not of the company and shall act in accordance with the directions and instructions of the court'.*

s 390 (1) :

> *'A receiver or manger of any property or undertaking of a company appointed out of court under a power contained in any instrument shall, subject to section 393 of this Decree, be deemed to be the agent of the person or persons on whose behalf he is appointed....'*

[74] CAMA 2004,s 389 (2). See (n73).
[75] CAMA 2004, s 390 (1). See (n73).
[76] CAMA 2004,s 393 (3).
[77] CAMA 2004,s 391.

specified in the debenture, certain powers outlined in Schedule 11to CAMA2004 are implied in all receiverships, subject to the terms of the debenture.[78]

The receiver, who is not also manager, is to realise the security for the benefit of the persons on whose behalf he is appointed.[79] To that end, the receiver is entitled to take possession of, and protect the assets subject to the security. He may receive rents and profits from the assets; he may sell the assets or enter into arrangements in respect of them.[80]If hechooses to sell or enter into arrangements, he must choose the most favourable terms available.[81] When executing his duties, the receiver who is not also a manager is however prohibited from carrying on the business of the company unless also appointed manager.[82] In contrast, a receiver/manager is to manage the company's business with a view to the beneficial realisation of the security on behalf of the debenture-holder(s).[83]Though the receiver/manager may give special consideration to the interests of the debenture holder(s), CAMA 2004 stipulates that such consideration must not be to the exclusion of other interests.[84] CAMA 2004 requires the receiver/manager to, in considering the best course of action to take, have regard to other interests in the company's existence, including those of the employees and members.[85]

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[78] CAMA 2004,s 393 (3).
[79] CAMA 2004,s 209 (3); s 393 (1).
[80] CAMA 2004,s 393 (1).
[81] CAMA 2004,s 209 (3).
[82] CAMA 2004,s 393 (1).
[83] CAMA 2004,s 393 (2).
[84] CAMA 2004,s 390 (2).
[85] Ibid.

When carrying out these functions, the receiver/manager is deemed to stand in a fiduciary relationship to the company.[86] To that end, he is required to observe utmost good faith in any transactions with the company or on its behalf.[87] He is to carry out his functions with the same level of care as would be expected of a faithful, diligent, careful and ordinarily skilled manager.[88] CAMA 2004 expressly prohibits the exclusion of these statutory duties by contract and construes default as an offence.[89] The receiver (including the manager) is personally liable on contracts entered into by him; unless otherwise stated in the contract of appointment.[90] Nevertheless, where the contract relates to the receivership duties, he is entitled to indemnity in respect of liabilities incurred from carrying out such duties.[91] The receiver is also entitled to indemnity from the debenture-holder(s) if the funds recovered under the security are insufficient to meet such liabilities.[92]

4.3 Interpretation and Unwritten Rules of Enforcement

4.3.1 Agency

At Common Law, the receiver is usually expressed to be the agent of the company.[93] The court may be invited to determine the receiver's agency when it is not expressed in the

[86] CAMA 2004,s 390 (1):

> *'...and, if appointed a manger of the whole or any part of the undertaking of a company he shall be deemed to stand in fiduciary relationship to the company and observe the utmost good faith towards it in any transaction with it or on its behalf'.*

[87] Ibid.
[88] Ibid.
[89] CAMA 2004,s 390 (3).
[90] CAMA2004,394 (1).
[91] Subject to prior encumbrances on the asset. CAMA 2004,s 394 (2).
[92] CAMA 2004,s394 (3).
[93] *George Barker (Transport) Ltd v Eynon* (1974) 1WLR 462, 471.

agreement. The court may examine the intentions of the parties or the receiver's powers, to identify the receiver's principal.[94] As the agent of the company, the Common Law receiver who is appointed under a debenture can do anything necessary to take possession of the company's assets and carry on its business, amongst other things; including bringing actions in the name and on behalf of the company.[95] Recall that the Nigerian Companies Decree, 1968 merely codified the British Companies Act 1948.[96] Recall also that the reform committee claimed to have introduced new concepts to CAMA in 1990.[97] One of the fundamental changes made by the committee was the reversal of the receiver's agency.

CAMA 2004 states that the receiver is the agent of the appointor: debenture-holder or the court.[98] In explanation, the committee stated that its aim was to impose a duty on the appointor to monitor the activities of its appointee (the receiver); for debenture-holders, to the point of personal liability.[99] Given that it had rejected the case for formal qualifications for appointment to the post, it believed that the threat of personal liability would compel debenture-holders to appoint suitable candidates as receivers. Such receivers would execute their duties responsibly, in the interests of their appointors and other stakeholders. The debenture-holder ceases to be liable only where the liability does not arise from the receiver's normal course of duty, or the parties agree otherwise. For example in *Tanarewa (Nig) Ltd v. Arzai*[100] the receiver sold assets not covered by the security. The court held that the liability

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[94] *In Re Vimbos Limited* [1900] ChD 470;*Robinson Printing Company Limited v Chic Limited*(1905) 2 Ch 123; *Gough Garages Ltd v* Pugsley (1930) 1KB 615.
[95] *M Wheeler and Company Limited v Warren* [1928] Ch 840.
[96] Committee Report (n 31) 6.
[97] Ibid.
[98] CAMA2004,s 389; s 390.
[99] Committee Report (n 31) 301-302.
[100] (2005) 5 NWLR (pt919) 593.

arose as a result of the receiver's improper action. The receiver was, for that reason, not entitled to indemnity from the debenture-holder.[101]

Notwithstanding, anyone surveying Nigerian case law on the agency of the receiver is likely to find that receivers are usually referred to as the agent of the company, not of the debenture-holders.[102] In *NBCI v Alfijir (Mining) (Nig) Ltd*,[103]NBCI, the bank, intercepted a cheque made to Alfijir Ltd – the company in relation to which it had appointed a receiver- and issued a receipt in its own name to the payer. The court sought to determine the propriety of the bank's actions by examining the relationship between the debenture-holder and the receiver.[104]The Court of Appeal held that the receiver was the company's agent by examining the terms of the debenture; Clause 32 of which stipulated that the receiver was to be the agent of the

[101] Ibid 640-641.
[102]See also, Bolanle Adebola, 'The Agency of the Nigerian Receiver' (Forthcoming Insol).
[103] (1993) 4 NWLR (pt287) 346.
[104] See also, (1999) 14 NWLR (pt638) 176.

company.[105]The Supreme Court held that the receiver was the company's agent by examining

the provisions of the law.[106] Observe however, that the case was decided with reference to the 1968 Decree. In*Unibiz (Nig.) Ltd. V CBCL Nig. Ltd*,[107] again, both the Court of Appeal and the Supreme Court stated that the receiver was the agent of the company, though the applicable law was CAMA 1990.[108] One reason for this anomaly is that many debentures are based on old precedents adapted without recourse to CAMA 1990; given that the agency provision in CAMA is of an implied nature, the court must give effect to the agreement of the parties. Another reason is that many judges blindly follow the Nigerian locus classicus -

[105] (pt287) 357.
[106] (pt638) 176,196-197.
[107] (2001) 7 NWLR (pt713) 534; (2003) 6 NWLR (pt816) 402.
[108] Aderemi JCA, who read the leading judgment, cited 2 English Cases and Intercontractors as authority; (pt713) 542. Incredibly, Ejiwunmi JSC, who led the Supreme Court's decision gave 2 conflicting opinions on the agency of the receiver; (pt816) 425:

> *'In view of that agency relationship created by law, it seems to me clear that by the agency relationship so created with its principal, the Commercial Bank (Credit Lyonnais Nigeria) Limited, the principal can if it wishes take action for and on behalf of the agent.'*

Thereafter, he read a lengthy passage from Intercontractors. Then stated at 427 (pt816):

> *'The first observation that must be made is that in the instant case, we are concerned with the provisions of S 390 and S391 of CAMA. However, a careful reading of the above passage would reveal that the Receiver/Manager* ***though recognized as an agent of its company****, it was held that it was necessary that agent to be granted leave by the court to prosecute the action.'*

Intercontractors; disregarding the fact that they were decided with reference the Companies Decree 1968 and with strong reliance on Common Law precedents.[109]

4.3.2 Powers

The court's unrestrained reliance on *Intercontractors* in interpreting the receiver's powers produced an anomaly which the Supreme Court has only just reversed.[110] Implied powers of the receiver/manager are listed in Schedule 11 to CAMA 2004. Again, the powers are subject to the agreement of the parties.[111] Fifth on the list is the '*power to bring or defend any action or other legal proceeding in the name and on behalf of the company*'. The schedule does not direct the receiver to seek leave, of the company or the court, to execute these functions.

In *Intercontractors (Nig) Ltd v NPFMB,*[112]the Supreme Court held that a receiver does not have to be joined as a party to an action against the company. It stated further that the receiver, if he intends to represent the company in suits, must seek the leave of court; leave would be granted if the court thinks that an action is the best way of disposing of the issue.[113] The Supreme Court reiterated its opinion in *Intercontractors Nig. Ltd v UAC (Nig.) Ltd*[114] where Karibi-Whyte JSC censured as '*too simplistic'* the notion that a receiver could institute an action without the leave of court.[115]Elucidating his opinion in the NPFMB case, he posited

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[109] For example, Justice Ejiwunmi at (n108).
[110] (n 124)
[111] CAMA 2004, s 393 (3).
[112] (1988) 2 NWLR (pt76) 280.
[113] Ibid 294.
[114](1988) 2 NWLR (pt76) 303.
[115] Ibid 323.

> '*It is well settled that where a Receiver/Manager has been appointed in a Mortgagee's action, it is for the court to determine whether proceedings shall*

that a receiver is appointed to protect not only the interests of the debenture-holder '*but also the estate involved in the debenture and for the benefit of all concerned*'.[116] For that reason, the receiver cannot initiate or defend an action in his own initiative without the leave of court; leave being a discretionary matter to be exercised in the interest of all parties according to the particular circumstances of each case.[117] It therefore became the unwritten rule that the receiver is to seek the leave of the court to bring or defend actions in the name of the company.[118]

In *Casa-fina Nigeria Ltd v. Zenith International Bank*[119]the Federal High court sought to distinguish the *Intercontractors* cases by stating that leave was required only pre-CAMA 1990.[120]The Court of Appeal however refused to uphold this argument in the subsequent case of *Standard Printing and Publishing Co Ltd v. N.A.B Ltd.*[121]The court did not appear to take into consideration the costs of insisting on the need for leave. Likewise, the Supreme Court

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> *be taken at the expense of the mortgaged property. The Receiver cannot begin or defend actions on his own initiative without the direction of the court.'*

[116] Ibid 323. See also, NPFMB, 295.
[117] Ibid 323:

> *'It is clearly not one for the private initiative of the receiver/manager as counsel for the appellant seems to assume.'*

[118] See *alsoTabansi Press Ltd v.Tabansi*(1995) FHCLR 96; *Adegboyega v.Awu* [1992] 7 NWLR (pt255) 576.
[119] (1995) FHCLR 196,
[120] Ibid 203. Ukeje J held:

> *'Admittedly, earlier decisions of superior Courts hold that Leave of Court is necessary before a Receiver/Manager can institute or defend an action in the name of the Company...However, it is necessary to observe that that case was decided under the Companies Act 1968 (CAP 59 Law of Nigeria 1958). That law had no provisions corresponding to paras 5 and 21 of Schedule II to the Companies and Allied Matters Act.'*

[121] (2003) FWLR (pt137) 1097.

reiterated its position on the need for leave in the *Unibiz* case.[122] It did not re-examine the applicability of its earlier decisions in view of the change in the law; neither did it seek to determine if the decisions in those cases had applied the law correctly.[123]

Matters came to a head when the receiver appointed by Wema Bank Plc in relation to Ladgroup Plc instituted an action in the name of the company without seeking the leave of court.[124]The company's directors objected to the action, claiming, amongst other things, that leave was not sought before the action was commenced in the name of the company, according to *Intercontractors*. The trial judge upheld the directors' objection.[125]As prayed by the receiver, the Court of Appeal re-examined both *Intercontractors* cases and the *Unibiz* decision.[126]Rightly, Ogebe JCA noted that the three cases had been decided without (proper) reference to Section 393 and Schedule 11 of CAMA 2004: *Intercontractors*had been decided

[122] (pt816) 427.
[123] Bolanle Adebola,'Common Law, Judicial Precedents and the Nigerian Receivership Procedure' (Forthcoming JAL), states that the Intercontractors decisions merely conflated the law. The courts failed to distinguish between the principles which apply to the court-appointed receiver from those applicable to a receiver appointed in relation to a debenture. The court wrongly applied the Common Law precedents.
[124]*Wema Bank Plc v Onafowokan* (2005) 6 NWLR (pt921), 410; (2011) 12 NWLR (pt1260) 24.
[125] FHC/L/CS/346/2001
[126] (pt921) 410.

under the Companies Decree 1968 that had no analogous provisions, while *Unibiz*had followed *Intercontractors* blindly - though decided with reference to CAMA 1990, reliance was not placed on its relevant provisions.[127]He therefore distinguished the Wema case, and held that the earlier 3 decisions of the Supreme Court did not apply, and that the clear provisions of the law obviated the need for leave to sue.[128]The Supreme Court subsequently upheld his opinion.[129]

The unwritten rule has therefore been scrapped finally by the Supreme Court at the third time of asking. Its most recent decision, it is argued, reflects the correct position of the law on the power of the receiver to sue or be sued in the name of the company.Courts and practitioners ought to rely on Section 393 (3) and Schedule 11 of CAMA 2004, subject to contrary provisions in the debenture. The *Intercontractors* principles and its*Unibiz* interpretation ought not to be applied by the courts for the outlined reasons.

Nonetheless, *Unibiz* still leaves the Nigerian receivership procedure with another unfortunate precedent. In *Unibiz*, the debenture-holder sought orders to facilitate the execution of the receiver's duties. The company objected. It stated that the receiver alone had the standing to

[127] Ibid 419-420.
[128] At 420: 'In my view this power is not limited and does not require confirmation of the receiver's appointment by the court nor leave of court to sue.'
[129] (pt1260) 24. To Fabiyi JSC:

> *'the appellants attempted to place reliance on provisions of the repealed Companies Act, 1968. That has the semblance of living in the past. The cases...cited on behalf of the appellants are clearly not apposite.'*

Ibid 58.

initiate the suit, in which case he would require the leave of court. Ejiwunmi JSC upheld the debenture-holder's action however. For authority, he cited the principle of agency relationships: the bank, as principal, could do whatever its agent, the receiver, was empowered to do – including instituting actions in the name of the company.[130] Then, he distinguished the power of the debenture-holder from that of its receiver. He asserted that the debenture-holder, unlike the receiver, did not require leave to initiate an action on behalf of the company. For this, he relied on *Intercontractors*. In that case, Kalgo JSC stated that the court's aim in granting or withholding leave was to guard against unnecessary depletion of the debtor's estate.[131]The court would determine if the suit was the best way to resolve the issues at stake; the court would also approve the expenses incurred by the receiver. The steps were deemed necessary because the company, not the receiver, possessed title to the assets, and so the estate, (in other words the company), not the receiver, (who is a mere agent), would bear the true costs of any action – and it was the duty of the court to guard against its depletion. Ejiwunmi JSC observed that the debenture-holder did not have title in the goods

[130] (pt816) 427.
[131] (pt76) 294- 295; 323 -324.

but because he is deemed in law to be 'principal', he would bearthe consequences of his actions.[132] For that reason, he did not require leave to institute the action.

Justice Ejiwunmi's decision, with respect, does not even flow from the Intercontractors decision it purports to follow. If the debenture-holder's action is initiated to facilitate the execution of the receiver's duties – in Unibiz, an action for injunctions without which the receiver may not have been able to take control of the company – the cost of the action may count as receivership expenses. In that case, it is the estate (the company), not the bank, as principal, that truly bears the cost of the action. The bank will only bear the cost when it does not fully recover its debts. Consequently, on the authority of Intercontractors, the bank - though principal - ought also to obtain leave because its actions may deplete the debtor's

[132] (pt816) 427.

estate which the court believes that it has a duty to protect. That is not the fundamental problem with the decision however.

The Supreme Court failed to distinguish between two principal property law remedies. If a debenture-holder can execute the duties of the receiver, how shall the law distinguish receivership from the remedy of the mortgagee-in-possession? This is important because a mortgagee has onerous duties with which he must comply, hence the preference for receivership.[133] This decision, it is submitted, merely obscures the fundamental differences between both remedies. Further, it demonstrates that the Nigerian bench, whose duty it is to adjudicate such matters, misunderstands fundamental property law remedies.

4.3.3 <u>Duties</u>

The duties of the Common Law receiver are not codified; they are generally contained in case law. Primarily, the Common Law receiver, though an agent of the company, is obliged to exercise his powers, not in the interest of the company but in the interests of the person on whose behalf the appointment was made.[134] Moreover, the receiver is at liberty to choose whether to manage the company or merely realise the assets to repay the outstanding sums.[135] In contrast, the duties of the Nigerian receiver (and receiver/manager) have been codified.[136] The receiver simpliciter is to take possession of and protect the property when appointed; receive rents and profits; discharge all out-goings in respect of the property; and realise the

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[133] *Gaskell v Gosling* [1896] 1QB, 669, 685.(Rigby LJ dissenting but upheld by the House of Lords).
[134] *Kennedy v De Trafford* [1897] AC 180; *B Johnson & Co (Builders) Ltd* [1955] Ch 634.
[135] See generally, *Medforth v Blake* [2000] Ch 86.
[136] CAMA 2004, s390; s 393.

security for the benefit of those on whose behalf he is appointed.[137] The receiver/manager is to manage the company ‘with a view to the beneficial realisation of the security of those on whose behalf he is appointed’.[138] CAMA 2004 places the receiver/manager in a fiduciary relationship to the company; he must observe the utmost good faith in any transaction with the company or on its behalf.

The clearest distinction between the duties of the Common Law receiver and the receiver/manager according to CAMA 2004 is set out in S390:

(2) States:

> *‘Such a manger shall:*
>
> *(a) Act at all times in what he believes to be the best interests of the company as a whole so as to preserve its assets, further its business, and promote the purposes for which it was formed, and in such manner as a faithful, diligent, careful and ordinarily skilful manger would act in the circumstances;*
>
> *(b) In considering whether a particular transaction or course of action is in the best interest of the company as a whole may have regard to the interests of the employees, as well as the members of the company, and when appointed by, or as a representative of, a special class of members or creditors may give special but not exclusive, consideration to the interests of that class.’*

Unlike the agency or powers of the receiver, the debenture may not modify the receiver/manager’s duties as expressed in the Act.

(3) States:

> *‘Nothing contained in the articles of a company, or in any contract, or in any resolution of a company shall relieve any manager from the duty to act in accordance with subsection (2) of this section or relieve him from any liability incurred as a result of any breach of such duty.’*

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[137] CAMA 2004, s 393 (1).
[138] CAMA 2004, s393 (2).

In its report, the reform committee expressed its desire to put the receiver/manager in the same legal position as an officer of the company, (in particular, a director of the company).[139] To that end, CAMA 2004 ascribes a role to the receiver/manager which is, in effect, parallel to that of a director's.[140]There is a hierarchy of interests which the receiver/manager should consider as he contemplates any transaction. He may give special but not exclusive consideration to the interests of the debenture-holder. Simultaneously he must give a general but real consideration to the interests of other stakeholders: unsecured creditors, employees and members, as he makes decisions. As he enters into transactions, he is to act at all times in the best interests of the company *as a whole;* seeking to preserve its assets, further its business and promote the purposes for which it was formed. His actions must pass both a subjective and an objective test. The subjective test seeks to determine if *he believed*his actions to have been in the bestinterests of the companyas a whole. The objective test determines if *a faithful, diligent, careful and ordinarily skilful manger* would have actedlikewise. CAMA 2004 prohibits the company or the debenture-holder from relieving any manager from these duties. There appears to be a tension between S 393(2) and S 390 (2) however.[141] The crux of the conflict is the extent to which beneficial realisation of debts may

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[139]Committee Report (n31) 301.
[140] Though the committee drew from the Ghanaian Companies Code at the time, it stopped short of expressly equating the Nigerian receiver's position to that of a director, as is done under the Ghanaian Legislation. See Ghanaian Companies Code, Act 179, 1963,s 203 and s 240.
[141] CAMA 2004, s 393 (2):

> *A person appointed manager of the whole or any part of the undertaking of a company shall manage the same with a view to the beneficial realisation of the security of those on whose behalf he is appointed.'*

exclude the fair consideration of other interests; a question which does not arise at Common Law. How have the Nigerian courts interpreted these provisions?[142]

Tropic Food Ltd (TF) obtained a loan from Union Bank of Nigeria Ltd(UBN), which was secured by a debenture that empowered the bank to appoint a receiver on default.[143] TF defaulted, and then it started to sell off its assets to raise funds to aid its business. UBN sought an injunction to prohibit TF from selling its assets but the court refused. So it appointed a receiver. The receiver prohibited the sale of assets and froze the company's accounts. TFinstituted an action seeking nullification of the receiver's appointment, as well as damages; stating that it opted to sell its assets only because it required operating funds after the bank refused to advance any more funds. It argued that the steps taken by the receiver were not in the best interest of the company, which, it claimed, had an estimated value far beyond its debt to the bank. The Federal High Court decided in favour of the company. On appeal, Ejiwumi JCA, as he then was, stated that a receiver '*cannot ignore the interest to the company*'.[144]He based his opinion both on CAMA 1990 and the Intercontractors decisions.[145] In his opinion, a company in TF's position retained the right to '*halt or prevent an unjustifiable exercise of the power of the Receiver/Manager*'.[146] He stated that the company could challenge the manner in which the receiver was managing its assets because a receiver, by virtue of S 390 has a fiduciary relationship to the company; particularly when the receiver's actions could ruin its business. On that reasoning he held that TF could challenge

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[142] See also Bolanle Adebola, 'The Duty of the Nigerian Receiver to "Manage" the Company' [2011] 8 International Corporate Rescue, 248.
[143] *Union Bank of Nigeria Ltd v Tropic Foods Ltd* (1992) 3 NWLR (pt228) 231, 245-246.
[144] Ibid 246.
[145] Ibid 247.
[146] Ibid 247.

the orders of the receiver forbidding the sale of its assets, and freezing its accounts, amongst other things. The court did not apply either test; it merely stated that the receiver had breached the duty of good faith.

West African Breweries (WAB) sued Savannah Ventures over the sale of certain assets belonging to North Brewery Ltd (NB).[147]At the time, WAB held 50% of NB's shares, while the Federal Government of Nigeria (FG) held the other 50%. WAB subsequently acquired the FG's 50%. NB had defaulted on its loans from six banks. The banks, in concert, appointed a receiver/manager over NB. WAB had informed the receiver of its intention to buy out the government and to repay the sums owed. Nevertheless, the receiver sold NB's assets to Savannah ventures at gross under-value. WAB commenced an action, seeking an order to set aside the purported sale. Although the case was hinged on the valuation of the company's assets, and the fraudulent actions of the receiver/manager, the Supreme Court also considered the duty of the receiver to the company. Katsina-Alu JSC heldthat the receiver had a duty to manage NB which he ignored. He '*abandoned his commission to manage the company*'as instructed by CAMA 1990.[148] Instead, he busied himself with the realisation and sale of the company's assets. Again, the courts gave no real content to S 390 and its application. The receiver/manager did not incur additional liabilities for failing in his S 390 (2) duties, as stipulated by CAMA 1990. In sum, the courts have not properly considered the content and tension between both duties of the receiver/manager outlined by CAMA.

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[147]*West African Breweries v Savannah Ventures Ltd*(2002) 10 NWLR (pt775) 401, 432, 436-440.
[148]Ibid 440.

4.3.4 Commencement

Although CAMA 2004 permits ‘interested persons’ to apply for the appointment of a receiver or manager, it does not specify the persons to whom it refers. In *Intermarket (Nig) Ltd v Aderounmu*,[149] the court held that ‘interested persons’ is not limited to creditors. Members and directors may also apply for the appointment if they can show danger to the property. The court will appoint the receiver or manager to protect the property from damage or dissipation till it can be restored to the person who should have control of it.[150] Nonetheless, the court will not appoint a manager unless the applicant makes that specific prayer. In *Ponson Enterprises Nig. Ltd v Njigha*'[151] the Court of Appeal stated that a court which is petitioned to appoint a receiver simpliciter ought not to include management powers which were not requested by the applicant in its order. In that case, the petitioner had requested the appointment of a receiver, not manager; though a close examination of his request suggests that it required a manager, not a mere receiver.[152] The Federal High Court Rules stipulate conditions for the appointment of a ‘receiver’ but is mute on the appointment of managers.[153] CAMA 2004 however defines receiver as including manager.[154] It appears that the statement of claim which supports the motion must include an express prayer for management powers so titled.[155]

[149] (1998) 12 NWLR (pt576) 141.
[150] Ibid 147.
[151] (2000) 15 NWLR (pt689) 46.
[152] Ibid 47-48.
[153]Federal High Court (Civil Procedure) Rules 2009, Order 40.
[154] CAMA 2004, s 650.
[155] Ibid 53, 58-59. But see FHCR 2009, Order 40.

It is argued that the court ought to examine the substance, not the form of the prayers. It should grant management powers if sought in relation to a company, as in Ponson, though the motion purports to seek the appointment of a receiver. Appointing a receiver over a business may be detrimental to the interests of all parties; particularly where it creates a diarchy over the company's affairs. The use of the court's discretion may avert the costs that would attend a case in which a receiver takes charge of a company that it cannot manage, while management remains in charge of the company but lacks access to the funds in the receiver's control.

Another interesting but unwritten rule of the out of court appointment route is that the receiver/manager applies for an order from the court, confirming his appointment before he can take control of the company.[156] The order is known as a 'confirmation order'. The confirmation order is supported by injunctions restraining the owners and staff of the company from interfering with the receiver's duties. In *Unibiz*, the bank applied to the court for a 'confirmation order' and enabling injunctions against the directors, to enable its receiver take control of the company.[157] Similarly, in *Wema Bank Plc v Onafowokan*, the receiver/manager sought a confirmation order and injunctions.[158] In each case, the debtor challenged the standing of the receiver when the application was made without the leave of court. A fundamentally out of court procedure appears to have mutated to a very litigious process which, on most occasions, takes years to resolve.[159] Though in *Onafowokan*, the

[156] For example, *Afric Mining Co Ltd v NIDB Ltd* (2000) 2NWLR (pt646) 618.
[157] (pt816) 231-232.
[158] (pt921).
[159] The *Unibiz* case lasted for 5 years, while the *Wema Bank* case lasted 10 years.

Court of Appeal held that the order was not required per S393, the Supreme Court did not decide on the specific issue because it was not listed for appeal.

Part II

4.4 The Nigerian Arrangementand Compromise Procedure

The arrangement and compromise procedure is not very popular in Nigeria. Again, this is inferred from the quantum of case law.[160] When used, it appears to be favoured by distressed financial institutions. In the late 1980s and early 1990s, the Nigerian economy was deregulated. The new economic system precipitated the proliferation of (bank and non-bank) financial institutions in Nigeria.[161] Many of the new-age institutions became distressed shortly. When some of them realised that they had become unable to repay their liabilities, they decided to propose arrangements to their investors and depositors.[162] Again, in the new millennium, owing to pressures from the Central Bank of Nigeria to recapitalise, there has

[160] See also: Akingbolahan Adeniran, 'A Mediation-Based Approach to Corporate Reorganisations in Nigeria' [2003] 29 NCJ Int'l L & Com Reg 291, 292-293; The Committee Report (n 31) 321.
[161] Peter Lewis and Howard Stein, 'Shifting Fortunes: The Political Economy of Financial Liberalization in Nigeria' (1997) 25 World Development5.
[162] See p 147 below.

been a resurgence of restructuring arrangements.[163] The most prevalent arrangements are take-overs and merger which are outside the ambit of this essay.[164]

Ogowewo criticises the Nigerian arrangement procedure as laden with absurdities.[165] For what he terms its structural absurdity, he blames the ineptitude of the legislative draftsman.[166] He identifies the separation of the main arrangement procedure into special procedures as its principal problem.[167] Under the 1968 Decree, there was a single procedure by which any type of arrangement could be implemented.[168] When CAMA was enacted, the erstwhile single arrangements procedure was split into two separate procedures: arrangements and compromise and amalgamations and take-overs. The error, in his opinion, crystallised when the procedure for dealing with amalgamations and takeovers was repealed for re-enactment under a separate Act.[169]Ogowewo asserts that the split has given rise to incomplete and patently absurd provisions on arrangements and compromise in Nigeria. He insists that the split was not the intention of the reform committee which had stated in its report that the

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[163]On the 6th of July 2004, then Governor of the Central Bank of Nigeria (CBN), Professor Charles Soludo pronounced reforms to the Nigerian banking sector. The first phase of the reforms was aimed at ensuring a diversified, strong and reliable banking sector in Nigeria. To that end, the minimum capitalization for banks was raised to a minimum of N25billion (approx $250million) from N2billion (approx $15million). The banks were given until the end of December 2005 to comply. This led to a flurry of arrangements in the banking sector. See Okagbue and Aliko, 'Banking Sector Reforms in Nigeria' http://www.imakenews.com/iln/e_article000336415.cfm?x=b11,0,w, accessed 20/07/2012.

[164] The essay is focused on options available to insolvent companies. Sale of the company's undertakings under CAMA 2004, s 538 will not be considered because it requires the company to go into a members' voluntary liquidation (which requires a declaration of solvency).

[165] See Tunde Ogowewo, 'The Dual Staturory Procedure for Effecting a Scheme of Arrangement in Nigeria: Law Reform or Retrogression' (1994) RADIC 594 ('Ogowewo, Dual Procedure'); Tunde Ogowewo, *The Market for Corporate Control and the Investments and Securities Act, 1999* (The British Institute of International and Comparative Law, London, 2002) ('Ogowewo, *Corporate Control*'); Ogowewo and Uche, '(Mis) Using Bank Share Capital as a Regulatory Tool to Force Bank Consolidation in Nigeria' (2006) 50 JAL 161 ('Ogowewo and Uche, Bank Share Capital').

[166] Ogowewo and Uche, 'Bank Share Capital' (n165) 180-182. Ogowewo, *Corporate Control* (n165) Introduction.

[167] Ogowewo, 'Dual Procedure' (n165) 602.

[168] s 197.

[169] Ogowewo, *Corporate Control* (n165) Introduction.

arrangement procedure did not require reform.[170] He further asserts that the policy makers also lacked adequate knowledge of the concepts in question and the jurisprudence of the principles that they imported into the Nigerian company law.[171]

Adeniran criticises the adequacy of the procedure as a rescue mechanism.[172] He claims that the paucity of cases suggests disuse.[173] He rejects the notion that its disuse may be attributed to the dearth of corporate distress in Nigeria; citing the high number of insolvencies recorded in the late-eighties and early-nineties. He concludes that the limited uptake of the procedure may be attributed to its inefficiency and ineffectiveness at the point of distress.[174] Adeniran believes that companies can only initiate the procedure when they have become liable to be wound up; a rule that excludes distressed but solvent companies from its purview.[175] He also criticises the potentially prohibitive pecuniary and non-pecuniary costs of the procedure.

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[170] Ogowewo, 'Dual Procedure' (n 165) 602-603:

> *'...it is surprising that the law commission's report nowhere suggested or indicated that there were to be two categories of arrangements. On the contrary, the law commission considered the relevant provisions on Schemes of Arrangements in the Companies Decree satisfactory and adequate for the purpose for which they are designed'. The only change to the procedure it recommended was that which gave the sec a role to examine the fairness of schemes....save for this innovation, the law reform commission did not intend that the statutory procedure for Schemes of Arrangement should undergo any change. So where did the draftsman get his inspiration from?'*

[171] Ibid.
[172] Adeniran, (n160) 293.
[173] Ibid 292.
[174] Ibid 292-293.
[175] Ibid 301. The law merely states that the provisions apply to companies that can be liquidated under the Act. Adeniran apparently misunderstood the clear text of the law.

[176] Like Ogowewo, Adeniran calls for the reform of the arrangements and compromise procedure.

4.4.1 On the Separation of Procedures

Ogowewo asserts that the arrangements procedure is absurd in its extant state. On that premise, he insists that the intention of the reform committee is vital to the analysis of the Nigerian law of arrangements.[177] Like he states, the Companies Decree 1968 provided a single procedure for all types of arrangements.[178] The procedure could be used to effect both internal reorganisations and reorganisations involving other companies. The committee, not the draftsman, however, chose to treat the two types of restructurings (internal restructuring and business combinations) separately; under two different sections. It stated:

> *'...for the reasons which have been set out in extenso in the Introduction to this Report. (sic)* ***Amalgamation and Take-overs are now dealt with in Part XVIII****. We* ***therefore*** *intend* ***in this Part*** *to deal only with Arrangements and Reconstructions not involving Amalgamation.'*[179]

The statements contained in the introduction to which the committee was referring were those describing the nature of its relationship with the Securities and Exchange Commission (SEC).[180] In the introductory chapter, the committee referred to its desire to give special

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[176] He criticises the problems of cost, speed, moratorium and control during the approval stages. Adeniran, (n160) 326-330.
[177] Ibid 13-15.
[178] The main procedure was by a scheme of arrangement or compromise under s 197 and s 286.
[179] Emphasis mine, Committee Report (n 31) 321. It can be surmised that the commission intended that the statements set out in the introduction to the report should be read in conjunction with the statements made in PartXVII of the report.
[180] Committee Report (n 31) 7.

consideration to the position of the SEC.[181]The SEC Decree 1988 imbued the commission (SEC) with additional powers required to pursue its functions more effectively.[182] Pursuant to these powers, SEC prepared draft legislations to regulate dealings with the securities of public companies.[183] It was also to regulate all forms of business combinations.[184] During the company reform workshop, the reform committee recognised that some of its functions overlapped those of SEC. In particular, both were seeking to reform some aspects of the arrangement procedure.[185] The committee reminded itself to be guided by the underlying aim of the reforms: the design of a single, comprehensive corporate legislation to regulate all company matters in Nigeria.[186] The committee was also mindful to resolve the relationship between its proposed Corporate Affairs Commission (CAC) and the newly vitalised SEC.[187] It therefore sought a compromise which would erode neither the powers of the SEC nor the proposed CAC but which would also prevent conflicts (of jurisdiction) between both bodies.[188]

Prior to the company law reform project, SEC had designed a law for the matters with which it was concerned, some aspects of which had been approved by the government.[189] The

[181] Ibid 7-9.
[182] SEC was established by the SEC Decree No 71 of 1979 which came into effect retrospectively on April 1st, 1978. It repealed the Capital Issues Commission Act 1973. SEC, which replaced the Capital Issues Committee (CIC), was vested with power to regulate and develop the Nigerian capital market. The commission began to function, effectively, on January 1, 1980. It commenced its regulatory functions in 1982. Its enabling law, Decree No 71 of 1979, was re-enacted as SEC Decree of 1988. The Decree of 1988 gave the commission additional powers to enable it pursue its functions more effectively. See now, Investment and Securities Act (ISA) 1999; now ISA 2004, CAP I24 LFN 2004.
[183] Also unit trusts, amalgamation, take-over bids and insider trading. Committee Report (n 31) 7.
[184] Pursuant to the powers contained in SEC Decree 1988, s 6.
[185] On take-overs, amalgamations, unit trusts and insider bids.
[186] Committee Report (n 31) 8.
[187] Ibid 8-10.
[188] Ibid 8; 322-323.
[189] The Government had approved some regulations dealing with Insider Trading. Committee Report (n31) 7-8.

committee once again found itself dealing with three options.[190] The first was to propose a single legislation incorporating both the draft Companies Decree and the draft SEC Decree. The second was to propose a Companies Decree which would empower the SEC to administer some parts of the Companies Decree. The third was to propose two Decrees, each containing the laws to be administered by each commission. It elected to propose a Companies Decree which empowered SEC to administer some of its parts; those relating to matters within SEC's statutory jurisdiction.[191] Thus, rules on dealings with the securities of public companies, as well as all forms of business combinations in CAMA 1990, were mostly designed and subsequently administered by the SEC.[192]

It is imperative to briefly describe the role of SEC. In Nigeria, SEC is given the power to regulate the securities market and maintain the competitiveness of the market in general.[193] Pursuant to the latter power or duty, the SEC is to 'review, approve and regulate mergers, acquisitions and 41 forms of business combinations'.[194] SEC may reject any arrangement that will restrain competition in the Nigerian market.[195] There is no other separate or independent body charged with overseeing competition in Nigeria. Thus, whenever a business combination is proposed, the court must refer the scheme to SEC for approval. Notwithstanding that the ISA states that its duty in this case is to check the fairness of the

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[190] Ibid 8.
[191] The second option, Ibid 8-9.
[192] The committee stated in P 9:

> *'Provisions will be made giving the SEC power to administer that Part and to make rules and regulations in respect of those matters.*

[193] First by the SEC Decree and now by the ISA 2004, s 8.
[194] ISA 2004, s 8.
[195] ISA 2004, s 99.

arrangement, its real duty is to ensure that the scheme does not restrain competition. It was the provisions relating to SEC's powers to oversee business combinations and competition that were subsequently separated from CAMA for reform and re-enactment as the Investment and Securities Decree in 1999.

Recall that the economic situation of the country at the time of the company reforms necessitated the creation of effective restructuring mechanisms for the preservation of companies or their businesses.[196] In view of its decision to restrict its proposals to issues relating to the internal restructuring of companies, the committee explored potential reforms that would improve the arrangements procedure. It eliminated S 286, which effectively duplicated S197of the Companies Decree 1968, except that the former was used by companies about to be or in the course of winding up.[197] The Committee also proposed a definition of the term 'arrangement' to distinguish it from amalgamation.[198] Notwithstanding, it proposed only one main reform to the main arrangements procedure which will be considered shortly.[199]

The committee gave 2 reasons for keeping the bulk of the arrangement procedure. First, the arrangements procedure, unlike its receivership counterpart, had been more comprehensively regulated under the 1968 Decree. Second, the committee was not certain that the procedure required reforms because it had not been tested; (it appeared that) its inadequacies were yet

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[196] Committee Report (n 31) 322.
[197] Ibid 324.
[198] The proposed definition was heavily influenced by clause 229 of the Ghana Draft Companies Code Bill. Committee Report (n31) 324.
[199] This was what Ogowewo was referring to when he said that the committee deigned to reform the procedure; n170.

undiscovered.[200] The committee was however concerned with the ability of the courts to sanction schemes. It believed that the courts lacked the necessary skills to determine fairness.[201] Consequently, it proposed that courts should refer arrangements to the Corporate Affairs Commission for an expert report on which they could base their decisions.Signifying its intention to retain internal reconstructions within the scope of the CAC's duties, the committee stated:

> *'We propose that the Court should refer such matters to the proposed Corporate Affairs Commission, so that they may obtain expert and impartial report upon which to base their opinions.'*[202]

The draft Companies Decree also contained Part XVIII which dealt with amalgamations and other forms of business combinations. SEC was given sole jurisdiction over the administration of this Part.[203] Unlike in Part XVII, in XVIII the court had a mandatory duty to refer schemes to SEC, not the CAC, for investigation of fairness.[204] It is difficult to envision how the court would have administered these provisions if the procedures were not separated. Moreover, a procedure which gave both SEC and the CAC power in relation to the same subject matter would have created and stoked the conflict which the reformers sought to

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[200] Committee Report (n31) 321-322.
[201] Ibid 325.
[202] Ibid 325.
[203] Draft Decree, s 550:

> *'The Provision of this Part of this Decree shall be administered by the Securities and Exchange Commission established under the Securities and Exchange Commission Act 1988, and any reference in this Part to 'Commission' shall be a reference to the Securities and Exchange Commission.'*

[204] Draft Decree, s 601.

douse. Unfortunately, at some point between the submission of the draft Decree, its revision and the enactment of the Act, the jurisdiction of the CAC in relation to internal restructurings was eliminated, while SEC was placed in sole charge of all arrangements. This of course gives rise to some confusion and perhaps reinforces the single procedure theory; especially as SEC is to determine the fairness of the arrangement in both cases.

The Act however introduced a distinction between the court's duties at internal restructurings and its duties at amalgamations. In the former, the court is given a discretionary duty to refer the matter to SEC for investigation. In other words, the court may, if it finds the scheme to be fair, give its imprimatur without referring the arrangement to SEC. However, in the case of amalgamations, the court has a mandatory duty to refer the matter for investigation. Further, it is argued that SEC does not have precisely the same duty in both cases. In the case of internal restructurings, if consulted, it examines the equitable treatment of the stakeholders qua stakeholders. In relation to amalgamations however, SEC must (also) decide the effect of the stakeholders' actions on the market in general, even if it perceives the arrangement to be fair to all primary stakeholders.

The duty of the court in either procedure is tied to the nature of the SEC's duty in each instance. The court may decide on fairness to the parties, hence its duty is discretionary but it cannot decide on the effect on the market, hence its duty is compulsory.[205] Put differently, it

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[205] Draft Decree, s548:

> *'...if a majority in number...agree to any compromise...the compromise may be referred to the Securities and Exchange Commission ....'*

Compare with Draft Decree, s 601:

may exclude the involvement of SEC in the former but not the latter. On that premise, it is argued that the intention of the reformers was to provide a dual system of arrangements. Some of Ogowewo's argument about the unprofessional execution of the separation may be tenable but the subject is outside the purview of this thesis.[206]

4.5 Outline of the Compromise and Arrangement Procedure as presented in CAMA 2004

A company in Nigeria may propose an arrangement or compromise between itself and its members or creditors.[207] An application may be made to the court in a summary way by the company, any member, creditors or, if the company is in liquidation, by its liquidator.[208] Upon receipt of the application, the court may summon a meeting of the affected parties.[209] The law requires that every notice summoning the meeting which is sent to a creditor or member must be accompanied by a statement explaining the effects of the scheme.[210] The notice must also be accompanied by statements declaring the interests of directors and the effects on those interests of the scheme where it differs from the effects on like interests of other persons.[211] If the notice is given by advertisement, there must be notification of the

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'...if a majority in number...agree to the scheme, the scheme shall be referred by the court to the commission....'

[206] For example, the draftsman neglected to include the need to send a statement explaining the arrangement to the stakeholders.
[207] Or to any class of members or creditors. CAMA 2004, s 539 (1).
[208] CAMA 2004, s 539 (1).
[209] Ibid.
[210] CAMA 2004, s 540 (1) (a).
[211] This also applies to trustees of debenture-holders. See CAMA 2004, s540 (1) (a) and s 540 (2).

place at which the meeting is to be held and the manner in which the persons entitled to attend may obtain the statements described above.[212]

For the proposal to be approved at the meeting, the assent of a majority representing not less than three-quarters in value of the shares or claims of members or creditors respectively, as the case may be, present and voting either in person or proxy must be obtained.[213] If the scheme is approved, the company must apply to the court for its sanction.[214] If the court is not convinced of the fairness of the scheme, it may be referred to the Securities and Exchange Commission.[215] The Commission is to appoint inspectors to investigate the fairness of the scheme and furnish the court with a written report within a specified period of time. The court will sanction the scheme when it is satisfied as to its fairness; thereupon it becomes binding on all parties concerned.[216] The court's sanction will have no effect, however, until registered by the Corporate Affairs Commission.[217] A copy of the order must be annexed to every copy of the memorandum of the company issued after it is made.[218]

CAMA 2004 also prescribes liability for default in compliance. Thus, if the company fails to annex copies of the order to the memoranda as directed by the statute, the company and every officer who is in default shall be liable to a fine.[219] Also, if a director fails to provide the necessary information concerning his interests as directed by the statute, such a director will

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[212] Every member or creditor upon making an application as directed in the notice must be furnished with a copy of the statements free of charge. CAMA s 540 (3).
[213] CAMA 2004, s539 (2).
[214] Ibid.
[215] Ibid.
[216] CAMA 2004, s 539 (3).
[217] CAMA 2004, s 539 (4).
[218] Ibid.
[219] '...shall be liable to a fine of 5 for every copy in respect of which default is made.' CAMA 2004, s 539 (5). The denomination of the fine is unclear; perhaps NGN 5 (£0.02).

be liable to a fine.[220] Where the company fails to provide the information prescribed under s. 540, the company and every officer in default will be liable to a fine; unless it can be proved that the failure to comply was due to the refusal of any other person to supply the necessary particulars.[221]

4.6 Interpretation and Unwritten Rules of Enforcement

The arrangement procedure is still underused in Nigeria today. The exceedingly few reported cases that exist focus on procedural matters. In *Yinka Folawiyo & Sons v. Hammond Projects Ltd*,[222] the court laid down the conditions under which it would order a meeting of creditors. Justice Karibi-Whyte held that a 'careful reading' of the relevant provisions 'clearly discloses' that the court ought only to make the order if the company could show the likelihood of obtaining the approval of the required majority.[223] Given that the power is discretionary, the applicant must also show that its scheme is fair and equitable.[224] Although the applicable law was s 197 of the Companies Decree 1968, the provisions are similar to those of S 539 of CAMA 2004. A judge may choose to exercise its discretion only when convinced of the fairness of a scheme - in this case the debtor was clearly seeking to avoid liquidation – but nothing in the law requires the debtor to prove that it has the support of the required majority before the court can order the meeting.

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[220] This also applies to trustees of debenture-holders. They will be liable to a fine of '100'; again, the fine is not denominated; at best NGN100 (£0.40). CAMA 2004, s 540 (5).
[221] Fine of '1,500'; again with no denomination; perhaps NGN 1,500 (£6.05). CAMA 2004, s 540 (4).
[222] (1977) 3 FRCR 143.
[223] Ibid 150
[224] Ibid 150; 152.

In *Re-Interfirst Finance and Securities Ltd*,[225] the court refused to order a meeting in relation to a scheme that it considered to be unfair and fraudulent. In the case, a non-bank financial institution which owed at least NGN 90 million to its investors sought an arrangement when it became unable to repay. Justice Eigbedion held that its proposal was 'unilateral' and untenable.[226] Likewise, in *Andruchue Investment Plc v Financial Mediators*,[227] a finance house which owed its investors about NGN 61 Million petitioned the court for an order to convene a meeting at which it was to propose a scheme. The company notified only 9 of its 119 investors. The 9 investors, who were owed NGN 4 million, were the main beneficiaries of the scheme. When questioned, the company could not explain why other creditors were not notified. Again, Justice Eigbedion held that the scheme was a sham under which the company sought to perpetrate fraud.[228] He reiterated his position that a unilateral proposal could not be characterised as a compromise.[229]

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[225] (1993) FHCLR 421, 424-425.
[226] Ibid 424-425:

> *'A unilateral proposal made to Court by a Company stipulating how the Company intends or plans to settle its indebtedness cannot constitute a "Compromise" under S. 539...so as to propel the court to order a meeting to be summoned.'*
>
> *'To fall within the meaning of "Compromise" in Section 539... the proposed Compromise must be between the Company and its Creditors or any class of them or between the Company and its members or any class of them.'*

[227] (1994) FHCLR 51.
[228] In *Andruchue* (n227), the company proposed the scheme less than 2 years after its incorporation. In *Re-Interfirst Finance* (n 225) 425:

> *'That means that a Finance House can collect deposits and other investments from members of the public or from Corporate bodies, and in order to avoid*

It is unclear how the learned justice distinguishes a unilateral proposition from a compromise.[230] Surely, it only becomes a compromise after all parties have negotiated and voted. The scheme may validly commence as a proposal by the debtor to its creditors or members, which the law permits. The debtor was not requesting that the scheme be sanctioned; it was requesting a convening order. Though it should place all its creditors on notice, the distinction between a unilateral scheme and a proposal as a pre-requisite for a convening order is untenable. Moreover, an arrangement is not limited only to a compromise. The unspoken rule appears to be that the court will only endorse a meeting if the arrangement on the face of it appears to be inclusive and fair; it must also evince capacity for acceptance by the statutory majority ab initio. The court can be said to have revised the formal stages of the arrangements procedure. Instead of determining the matter of fairness after the creditors have voted, it conducts a preliminary examination by which it filters the arrangements that go to vote.

Conclusion

There is an obvious tension between what the Nigerian insolvency law states and how it is often interpreted. At receivership, the courts have relied on British cases and the Intercontractors decisions. The former sometimes contradicts the stipulations of the extant law, while the latter was decided without a genuine grasp of the core concepts in question. The arrangement and compromise procedure has untenable court-made rules, which are at

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to meet its obligations under the contractual arrangements, it can approach the court to intervene.'

[229] *Andruchue* (n227)56.
[230] *Folawiyo* (n222) 150-152.

best unclear. It is also quite apparent that most stakeholders lack adequate knowledge of either procedure. The traditionally quick, largely contractual receivership procedure has been converted into a court-driven procedure. Creditors solicit the court’s powers to restrain debtors, while debtors importune the courts to keep creditors and their agents at bay. Unfortunately, the system appears to be poised for hijack by any person, typically the debtor, who can pose the most nuisance during the case. They, of course, cannot achieve their goals without the help of the court which appears to have largely misdirected itself on its role in the process. The result is a very unpredictable system which is hitched to the agonizingly slow engine that is the judiciary. It would be interesting and beneficial to understand why the enforcement procedure has developed in the manner that it has. The analysis of the rescue procedures would benefit from an exploration of the Nigerian insolvency practice which may reveal why the law appears to have been so misconstrued and misapplied.

Chapter 5

The Nigerian Insolvency Practice

Overview

The previous chapter highlighted tensions between the insolvency law on the books and the insolvency law as enforced in Nigeria. This chapter addresses the procedure, practice and culture underpinning the Nigerian insolvency law, via an empirical study.The study involves semi-structured interviews of a sample of major stakeholders implicated at rescue. The interviews engage the banks, entrepreneurs, practitioners, and judges who interact at rescue. It explains how the experiences of these groups have led to the decisions that have shaped the extant system. Supplemental interviews give the perspectives of government officials who shape policy.

The interviews reveal the mutual distrust and incompetence, uncertainty and tardiness that characterise the system. Each group of stakeholders employs legal and extra-legal means to protect its interests, while the court attempts to adjudicate both expressed and tacit issues. Often, this requires the courts to apply rules inconsistently or to make ad hoc rules. The courtsare not blameless however. The adjudicatory system is criticised as complicated, and its officers incompetent to resolve the matters with which they are confronted; judges are accused of enforcing rules that clearly contradict the clear wording of the law. Consequently, the Nigerian insolvency system is complicated, uncertain, slow and inefficient; hence its disuse. The interviews invite participants to propose reforms that would facilitate the reconnection of the disparate interests of the main stakeholders. Though all interviewees espouse a quicker, more accountable system, there is no clear consensus on the goals to be achieved.

This chapter is divided into 2 parts. Part I outlines the methodology and presents a brief sketch of the findings. Part II presents each set of findings in themes.

Part I

5.1 Methodology

The principal aim of the study was to explore some of the tensions observed between the law on the books and the law as enforced captured by the case law. It also sought to elicit reasons for the decline in receiverships and disuse of arrangements. To achieve these goals, a clear picture of the country's credit provision and enforcement landscape was necessary; a requirement that prompted the bank interviews. Debtors appear to fight the appointment of receivers by any means possible: challenging debentures, disputing claims, contesting procedural missteps, litigating unfair management. Consequently, interviewing some entrepreneurs about credit and its enforcement was deemed to be essential. Judges and practitioners largely administer the insolvency procedure. Nigerian judges play a very prominent oversight role in what theoretically, is a largely contractual and administrative process. They have developed unwritten rules of enforcement that have mutated the procedures into court-driven regimes. Judges were invited to explain the reasons for these rules, while practitioners were to provide deep insight on the administration of the procedures and their perspectives on its effectiveness. Generally, the empirical ambit sought to elicit knowledge that would enrich an analysis of the Nigerian insolvency law and practice, given the dearth of information on the subject.

Semi-structured interviews were chosen to elicit detailed information from the participants. The interviews were conducted in person, in Nigeria; most in Lagos state, the commercial hub, and the balance in Abuja, the seat of government. There were 29 interviews with officers of 21 institutions. The institutions included commercial banks, private companies, the Federal High Court, the State High Court, legal and accounting firms, governmental corporations and a university. The interviewees included insolvency practitioners, judges, entrepreneurs, senior bank officials, civil servants and a lecturer. Selection was based on potential knowledge and length of experience in the field, ease of access and the willingness to participate. The length of interviews ranged from 20 minutes to 2 hours, depending on the enthusiasm of the participant and time constraints. Some interviewees spoke individually, while others, usually the banks, constituted a panel of 2 or 3 participants.

The main challenge was access to potential participants. Nigerian bankers are notoriously circumspect, a characteristic that was accentuated by the on-going bank investigations by the Central Bank at the time; access was therefore premised on prior social connections. Of the 24 banks in the country at the time, 12 banks were contacted by formal letters sent through social contacts but only 7 participated. The entrepreneurs were difficult to engage; insolvency and failure are culturally pariah in Nigeria. Of the 7 companies contacted, only 2 granted interviews but they have never been formally rescued. 2011 was a particularly difficult year for the Nigerian judiciary because it was mired in endless controversy. Access was sought through social contacts, as official applications yielded no results. 3 justices were interviewed, one of whom is retired. Though the Nigerian bench is not specialised, each judge had decided some insolvency cases in the course of their careers. The previous chapter informs that there are few restrictions to insolvency practice in Nigeria. To guarantee robust answers however, renowned practitioners from legal and accounting firms were invited to participate. Some of these have online presence and responded quickly to electronic mails. The practitioners were quite happy to introduce other equally enthusiastic participants – only one practitioner refused an interview of the 8 that were contacted. The government officials were sourced from social contacts. Scheduling interviews with them was very difficult. Most interviews were hastily granted in between meetings, and at short notice. The interviews were concluded in 2 months.

5.2 Data

The interviews were digitally recorded and subsequently transcribed. Some transcriptions were done immediately after the interviews, others a short period after. Each interviewee was sent a list of the questions prior to the interview. Each group of stakeholders, apart from the government officials had a set of core, open-ended questions, designed to educe information on their aspect of the insolvency process. Government officials were engaged in unstructured interviews however. Originally, the study was not designed to include civil servants but while in Abuja, an opportunity arose to speak with an official involved with the Nigerian privatization policy. This official was also involved in the design of the liquidation policy for public parastatals. He introduced other colleagues whose knowledge of the government’s policy on corporate liquidation was both immense and helpful. For stakeholder groups with pre-designed questions, each interview evolved differently; depending on the interviewee’s disposition to the pursuit of ancillary information. Consequently, no two interviewees answered the same set of questions eventually. All interviewees except the supplementary group were invited to identify the main problems of the extant Nigerian insolvency system and to recommend potential reforms. Consequently, there is a clear picture across board of the perceived problems and desired reforms.

The data is presented by stakeholder group: banks, entrepreneurs, judges, practitioners and supplementary. Many interviewees had similar opinions to other members of their groups. To avoid repetition, each set of core questions was distilled into themes and the synthesised opinions on each theme was written; augmented by excerpts from interviews. Issues that did not fit into the main themes but which were emphasised during the interviews are discussed as supplementary issues. The interviewees were assured of confidentiality, so all identifications have been removed, even where permission was granted – to regularise the presentation.

The interviews were not designed to prove a hypothesis. It follows that the results may not justify any theories. For example, recurrent allusions to a certain Nigerian culture by the interviewees do not prove that the culture exists. The sample was quite small, given the pecuniary and non-pecuniary costs, but robust; it included a cross-section of stakeholders, as well as some policy-makers. Though many of the interviewees were solicited via social connections, the selection was unsystematic. While generalizations should be treated cautiously, the principal goal of the research was achieved. The answers explain many of the anomalies observed in the case law. For example, the confirmation order is not a known legal requirement for an out of court appointment of a receiver; yet, it was a recurrent issue for which parties went as far as the Supreme Court on more than one occasion. The information derived from the interviews enriches the understanding of the facts of the case law treated in the previous chapter, and elucidate the Nigerian insolvency practice. Quite importantly, it reveals some of the reasons why unwritten rules of enforcement have evolved. It is submitted that the evaluation of the insolvency law which is to follow will benefit exceedingly from a deeper and more insightful analysis of the law and practice of the Nigerian insolvency law occasioned by the interviews.

5.3 Summary of Findings

Figure 1: Summary of opinions of banks

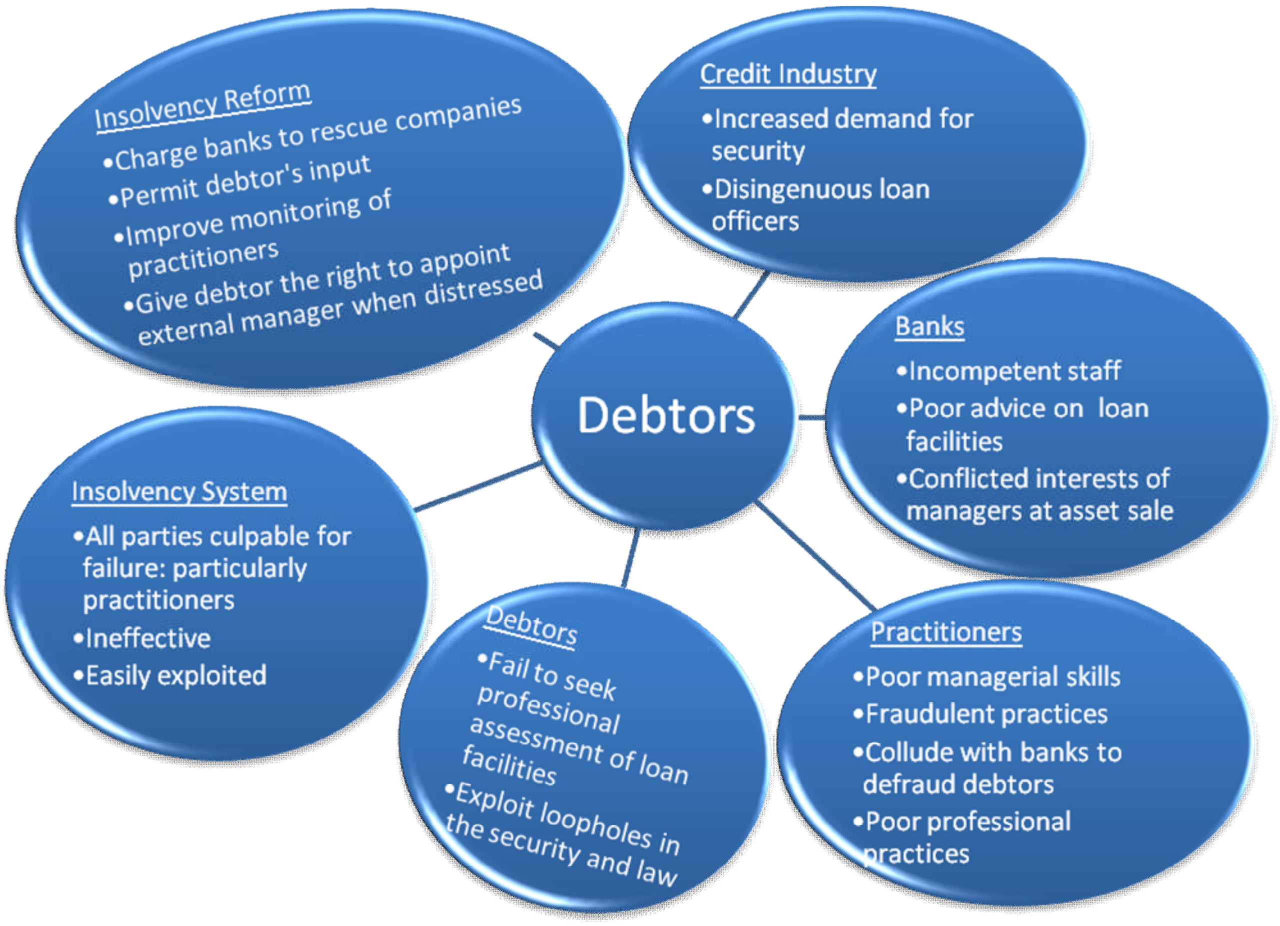

Figure 2: Summary of opinions of debtors

Figure 3: Summary of opinions of practitioners

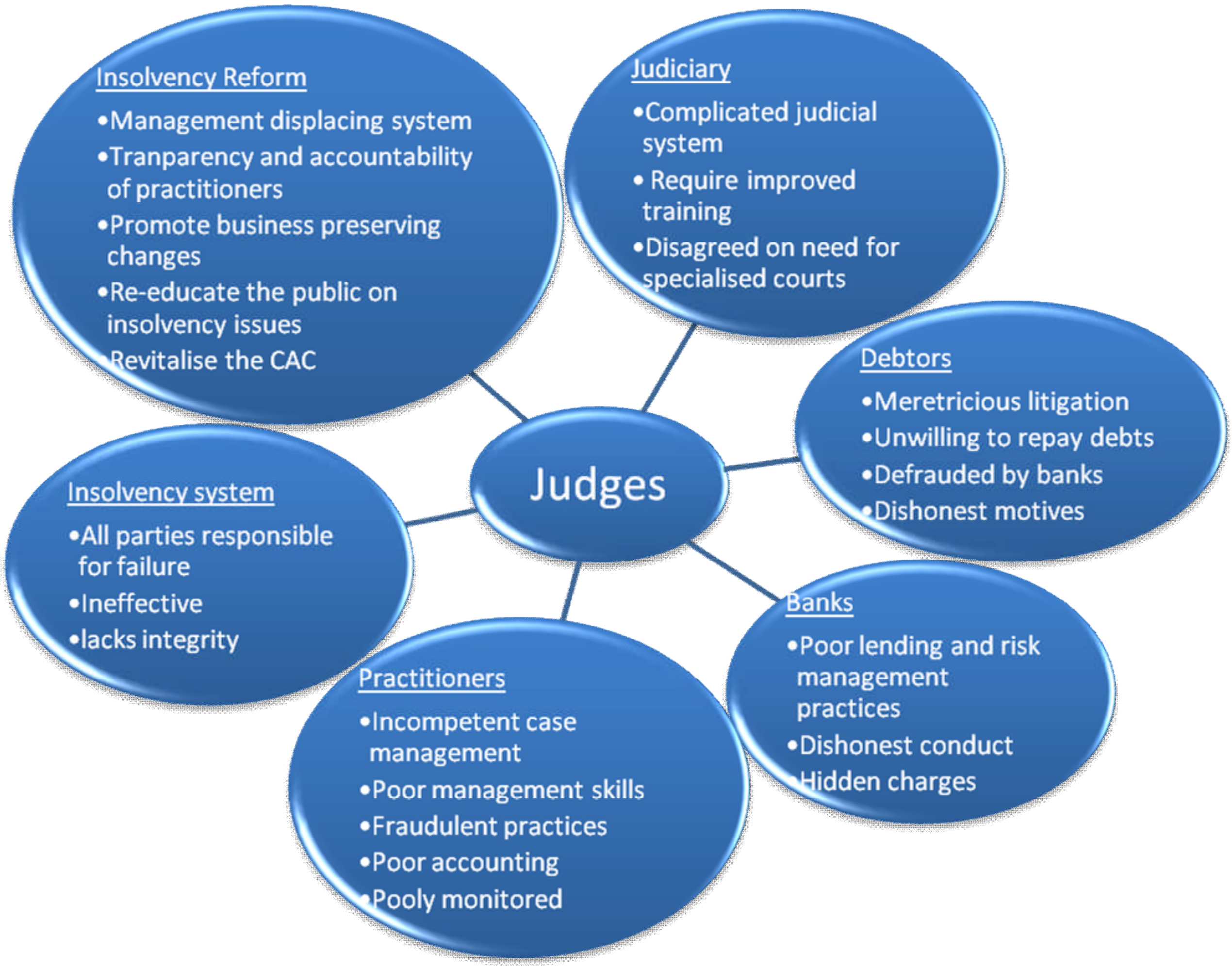

Figure 4: Summary of opinions of judges

Figure 5: Summary of opinions on the non-liquidation insolvency system.

Part II: Findings

5.4 Banks

In May 2011, there were 24 commercial banks in Nigeria; officers from 7 were interviewed.[1] The choice of banks was determined by ease of access, availability of contacts and the willingness to participate. The interviewees included legal officers, loan officers and risk management officers who work at the headquarters of the participating banks. As loan agreements and lending policies are reviewed at the headquarters, the selected officers had the capacity to provide national overviews of the solicited information. Each interview session consisted of 13 core questions; follow on questions were asked as appropriate. The questions educed information on the types of customers that have access to credit, the types of facilities that banks grant and the types of security they demand from customers. The officers were asked about their monitoring practices, measures taken at default and the debt recoveryprocess. They were also asked to posit reasons for corporate failure in Nigeria and focal points for potential insolvency reform. Having spoken to staff of 1 in every 3 Nigerian banks, the information obtained is arguably representative of the prevalent bank practices and perspectives in Nigeria.

[1] In 2004, there were 89 banks in Nigeria with minimum paid capital of about NGN2 billion naira,(£8 million). Following a recapitalisation exercise between 2004 and 2005, by 2006, many of the banks had consolidated; leaving 24 commercial banks with minimum paid capital of about NGN25 billion (£100 million). Following the revocation of the licences of more banks in August, 2011, there are now 20 commercial banks in Nigeria. Duncan Alford, 'Nigerian Banking Reform: Recent Actions and Future Prospects' http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1592599, accessed 27/07/2012; Lamido Sanusi, 'The Nigerian Banking Industry: what went wrong and the way forward' http://www.cenbank.org/out/speeches/2010/the%20nigerian%20banking%20industry%20what%20went%20wrong%20and%20the%20way%20forward_final_260210.pdf, accessed 27/07/2012; Omoh Gabriel, 'Analysis: The Eight Rescued Banks Run Similar Risk' (Vanguard, 9 August 2011) http://www.vanguardngr.com/2011/08/analysis-the-8-rescued-banks-run-similar-risk/, accessed 27/07/2012.

5.4.1 Overview of Findings

There is a broad range of corporate customers in Nigeria ranging from petty traders to big multinationals. Nigerian commercial banks do not provide start-up capital, while term loans typically last between 12-24 months and run in 90 day cycles. Small and medium scale enterprises rarely obtain term loans; typical recipients are the multinationals or big national corporations. Most banks have ostensibly robust mechanisms for vetting potential customers but because of fierce competition and inadequate knowledge, loan and risk management officers often circumvent the rules. As security, most banks request the domiciliation of accounts and extract negative pledges from the multinationals. The treatment of national companies depends on size and renown. The bank may forgo security but where demanded, typical security is a mortgage. The banks may also demand all-assets debentures relating both to present and future assets; the use of this debenture has declined however. Most banks have resorted to creating bespoke securities because of high stamp duties and uncooperative courts.

Many banks have hierarchical structures for dealing with default. Subject to extenuating circumstances, the first step is to restructure the loan, not to recover. The banks employ debt recovery agents when in-house measures fail. The legal system is the last resort because judges are perceived to be excessively sympathetic to debtors. Receivership is not a popular debt recovery mechanism because of its direct and indirect costs. Where utilised, many banks have a list of professionals from which they appoint. The receiver's instruction is usually to liquidate, not to manage. Some banks also use 'dormant receiverships' to pressure customers to repay their debts. They believe that rescue is the duty of the government, not the banks. Banks blame a mélange of extrinsic and intrinsic factors for corporate failure in Nigeria. The extrinsic factors comprise macro-economic issues with which companies grapple in the quest to survive, while intrinsic factors are management related. Most of the banks assert that the insolvency law is adequate but find that inadequate enforcement undermines its efficacy.

5.4.2 Banks' Interviews

5.4.2.1 Corporate Customers

There is a broad range of corporate sectors in Nigeria: oil and gas, food and beverages, construction, automobiles, pharmaceuticals, manufacturing, trade and telecommunications. The banks provide a wide range of services to companies that make up these sectors. Many interviewees said:

> *'Our customers vary from the very small scale businessman to the multinational corporations'.*[2]

The Nigerian economy thrives on oil and gas. By default, companies in the oil and gas sector are the biggest corporate customers. For the manufacturing companies, the banks focus on multinationals like Nestle foods and national conglomerates like the Dangote Group.[3] At the other end of the spectrum, are small traders to whom the banks provide a myriad of services. They are important because the country also thrives on small trade. These small traders are however treated more as individuals, than as companies. The banks are quite cautious in their relations with Small and Medium Scale Enterprises (SMEs).

> *'We are very wary of giving loans to SMEs.'*[4]

> *'The government supports the SMEs.'*[5]

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[2] Banks: 7,3,6,5.
[3] The group engages involved in the food and beverages, energy, building materials, telecommunications, services, packaging, and real estate sectors. It also invests in real estate, oil and gas projects. 'Industrial Conglomerates: Company Overview of Dangote Industries Limited' (BloomsbergBusinessweek) http://investing.businessweek.com/research/stocks/private/snapshot.asp?privcapId=23277111, accessed 27/07/2012.
[4] Bank 6.
[5] Bank 2.

Typically, SMEs only received limited overdraft services but since the return to democracy in 1999, the government's economic policy has been hinged on driving the private sector. Consequently, many banks have expanded the breadth of services provided to SMEs; though most admit to doing just about what is required of them by government policies.[6]

5.4.2.2 Credit Facilities

Many banks do not grant start up loans; '*the customer must have had some history of performance within the industry*'.[7]When considering loan applications, the banks examine companies' cash flow patterns, to evaluate their financial capacities. They also evaluate companies' corporate governance frameworks, as well as the pedigrees of the owners, staff and customers.

> *'We look at the capacity of the organisation to ensure that we are not booking an imminent bad loan.'*[8]

Many banks have introduced specialised, sector-centric desks manned by staff experienced in the relevant industries; loan applications are also vetted by such staff. In some banks, the applications are also forwarded to a loan committee for approval. Finally, they are sent for management approval.

The banks structure the credit facilities to suit their customers' business structures and capacities. Usually, customers need term loans for machinery, salaries and the distribution of goods; bank guarantees for projects; import finance, revolving letters of credit and overdrafts for trade. Most of the loans are short-term: 30days – 12 months, repayable on demand. The

[6] Banks 1, 3.
[7] Bank 2.
[8] Bank 6.

long-term loans are for about 24 months; '*3 year loans are usually the exception*'.[9] Usually, the loan period is split into 90-day cycles.[10] The customer uses the loan facility and repays within each cycle; if it remains a going concern and conducts itself satisfactorily, the bank may turn-over the cycle. The banks explain that the process is premised on the fact that they have only short-term deposits in their coffers: '*short-term funds cannot be used to finance long-term loans*'.[11]

5.4.2.3 Security

Many banks insist that security is not the main incentive when loans are granted; the focus is on the performance of the companies. They point out that many of their customers are multinationals which do not provide security. Such companies furnish the banks with letters of comfort/awareness.[12] The banks also extract negative pledges from these customers and personal guarantees from their directors.[13] The bank may insist on the domiciliation of account.[14] Before the crash of the Nigerian stock market, banks accepted shares as security.

With the smaller national companies, security becomes important. The emphasis is on mortgages. Acceptable property must be situated in a prime area for ease of sale.

> *'Usually, we take landed properties because real properties boom in the country and are easily disposable.'*[15]
>
> *'The bank accepts developed, not undeveloped landed property.'*[16]

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[9] Bank 4.
[10] An astute customer may complete 4 cycles within a year, Bank 2.
[11] Bank 5.
[12] A letter from the parent company which would be domiciled outside of the country indicating awareness of the loan; it is not a guarantee of repayment. Bank 4.
[13] Depending on who is involved; the banks will also not take pledges or security from certain individuals because their status in the society would make it difficult to enforce the pledges or to dispose of such assets upon default.
[14] In essence, the account to which the loan is paid (staggered) must be with the bank; to facilitate monitoring.
[15] Bank 6.

Usually, the first sale price of the property must be between 120% -150% of the value of the loan. In the case of a manufacturing company, the bank may also take an all-assets debenture against its specialised machinery; referred to as the debenture-mortgage. The banks however face many challenges when engaging in mortgages. First, they seek to reduce the,allegedly, high cost of stamp duties. A practice has evolved to stamp a nominal-value on the agreement and to up-stamp upon default.[17] Second, experience has shown the banks that the most difficult part of mortgage lending is enforcement. The banks accuse the courts of being too liberal in granting injunctions to mortgagors which prevent them from realising the security. By the time the asset is sold, the proceeds would be insufficient to repay the debt. Consequently, modern banks now try to be dynamic in creating security.

> *'For example, for the oil traders, a lien is taken on the product that they are financing. If the goods are imported, they would be consigned to the order of the bank; that means that they are bought in the name of the bank and the seller cannot sell without the consent of the bank.'*[18]

The bespoke securities guarantee the banks repayment and help the customer to build a good reputation with the bank and in its sector. The business builds a good turnover which facilitates continued access to credit.

5.4.2.4 Loan Monitoring

Banks consider loan monitoring to be especially important, '*to avoid the diversion of funds'*.[19] Many banks have devised multi-tiered monitoring systems. The first level is routine, consisting of metronomic monitoring by the loan officer; the precise method is tailored to suit

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[16] Bank 2.
[17] Initial stamp value is about 10% of the value of the property. Bank 2. Up-stamping means re-stamping the asset to reflect the full value of the security when it is to be enforced. If the bank fails to up-stamp, its security is limited to the value initially stamped on the asset.
[18] Bank 5.
[19] Bank 7.

the company's business.[20] If the corporate account is not domiciled with the bank, the loan officer visits the company regularly to pick up cheques and to obtain updates on its activities. To enhance efficiency, many modern relationship managers are specialising in specific industries.

> *'To be able to monitor effectively, there is also a need to understand the business. There are always loopholes to be exploited in any business... specialisation facilitates the acquisition of requisite experience in that sector.'*[21]

For some banks, the next level consists of periodic reviews by a credit monitoring unit – a unit within the broader risk management division. The unit examines all loan agreements to verify that customers have complied with covenants.[22] For other banks, the involvement of the credit monitoring unit is triggered by clear signals that '*the credit is not performing*'.[23] A few banks have a third level of monitoring which is conducted by a specialised control unit that produces reports on all loans.

5.4.2.5 <u>Default and Debt Recovery</u>

A customer for whom default is imminent is flagged. The bank, subject to extenuating circumstances, does not recall the facility immediately; *going for the jugular is not the first option'*.[24] Analogous to the monitoring system, most banks have multi-tiered systems for dealing with default. The loan officer, who, by then, would have developed a close relationship with the company, meets with the management to investigate the cause and potency of the problems. If a pragmatic solution cannot be negotiated, the case is transferred to the risk management team. The team may attempt to restructure the loan; the bank may

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[20] He is also known as the account officer or the relationship manager.
[21] Bank 3.
[22] These units or committees and meet at least once a month. Bank 6.
[23] Bank 7.
[24] Bank 7.

take equity in the company which empowers it to vote for a change of management where the problem is poor management. The bank also exerts greater control of the company's cash flow. If in spite of these remedial actions, the company fails to make designated repayments, the bank recalls the facility.

Banks have diverse recovery systems. Some banks have a unit that is dedicated to loan recovery: the Special Assets Department (SPAD). Where SPAD fails to recover the loan, the bank appoints a recovery agent; who is usually a solicitor. Banks without recovery units refer the case directly to recovery agents. During the period of loan restructuring, the bank perfects its security.[25]

> *'In many instances, the bank takes an equitable as opposed to a legal charge over the customer's assets. This is changed into a legal charge when red signals are noticed.'*[26]

As soon as it makes a demand that is not met, the bank realises its security. Some banks engage the help of security forces. Where the bank fails to recover the loan or to perfect the security, it may resort to the court; usually the last resort because banks do not want to be embroiled in protracted court cases.

5.4.2.6 Receivership

Receivers are appointed where an all-asset debenture has been granted and all other recovery mechanisms have failed. It is not a popular choice for Nigerian banks because of the direct costs of the procedure.

> *'Receiverships take a lot of time. If you want to recover your money as soon as possible, receivership is not an option. It is only a text book remedy.'*[27]

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[25] Up-stamping where necessary.
[26] Bank 5.

> *'Most of the banks in the past, smaller banks, would not even grant loans that would require the appointment of receivers.'*[28]

There are also other incidental costs of receivership in Nigeria: loss of life, bodily harm, sabotage of assets.

> *'When the receiver/manager is appointed, there is always a fight. Sometimes the employees or owners may sabotage the assets; sometimes, the receivers also come to bodily harm from the owners.'*[29]

The banks, for reputational reasons, do not appoint their staff as receivers. Most of the banks employ renowned performers; who can accomplish the task by any means necessary. Some appoint only accredited professionals; most of whom are lawyers. Many banks have a list from which names are drawn on a rotational basis.

The receiver must be familiar with the location of the assets. When appointed, the receiver is to repay the bank; he is to '*cannibalise the place and sell it*'.[30] He is not expected to manage the company unless that is the only means by which the debt can be repaid. Many banks highlighted the reluctance of the management of the defaulting companies to relinquish control to the receiver as the key militating factor against management. Distrust of the management abilities of receivers follows closely. The banks also highlight their accountability to their own shareholders, depositors and the central bank as reasons for their impatience with the management of defaulting companies.

> *'In any case, the entrepreneurs do not give up their companies freely. You have to employ the MOPOL that would facilitate the take-over...Receivers are undertakers; on what experience does he want to run the company? If he wants to turn the company around he should negotiate with the company but they must first pay off the bank.'*[31]

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[27] Bank 3.
[28] Bank 5.
[29] Bank 2.
[30] Bank 2.
[31] MOPOL is the feared Mobile Police which has a particularly unsavoury reputation. Bank 4.

> *'...it does not happen in real life. Banks do not want to wait to manage also because they have shareholders and depositors that they are accountable to; besides what is the guarantee that the management would be successful?'*[32]

The banks noted that receivers do not usually request to manage defaulting companies; they also just want to recover the debt and move on to the next appointment. It is not the practice for banks to monitor receivers. The receivers receive their remuneration from the proceeds on a percentage basis; managers may however be paid a regular wage in addition.

Some of the banks also indicated that they use the threat of receivership to induce quick repayments from companies' managers. One bank referred to this as '*dormant receivership*'.[33] In a dormant receivership, the bank appoints a receiver, registers the appointment with the Corporate Affairs Commission (CAC) and notifies the company. If the company requests time within which to repay, the receiver is instructed not to take over. The receivership is revived again if the company fails to make the repayment. The process may be repeated innumerable times before the debt is recovered.

5.4.2.7 Principal Causes of Corporate Failure in Nigeria

All the banks observe that there are multifarious factors that contribute to corporate failure in Nigeria. The difficult socio-economic environment in which companies are expected to flourish is one of the primal factors. Government policies are difficult to predict; changes can wipe out entire industries. Nigeria is an import-centric country and the government bans or lifts the ban on goods capriciously. Creating further hardship are high exchange and interest rates.[34] The society also suffers from poor infrastructure, particularly power and transport.

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[32] Bank 2.
[33] Bank 7.
[34] Interest rate is between 20%-40%.

In addition to the extraneous factors, the banks opine that the actions of companies' managers also precipitate failure. The banks blame management for poor corporate governance practices. They insist that companies do not maintain proper accounting standards; while the auditors also maintain poor audit standards. Many directors are not independent, so there is no robust check on the excesses of the management. Many executive directors are perceived as lacking adequate knowledge of the business and/or the sector in which their companies transact business; resulting in over ambitious business plans and projections. The banks further assert that many directors do not understand the loan agreements that they sign and so the company invariably defaults. Beyond these, the banks stated, many Nigerian companies fail because of the dubious practices of management. Most try to subvert rules; preferring to offer bribes to government officials employed to regulate their activities. Moreover, directors do not separate company accounts from their private accounts. So, when they obtain loans, they divert the sums to their private use.

> *'But the bulk of failures is based on insincerity; the clients divert the funds.'*[35]
>
> *'For example, they borrow loans and divert the funds to build houses, marry wives, etc.'*[36]

Some of the banks also highlight poor banking practices as contributing to corporate failure. Some blame uninhibited competition: '*Competition has gone haywire in Nigeria'*.[37] Banks just want to lend money and obtain interest; many times, they waive policies that were introduced to ensure best practices when selecting potential customers. They obtain very little information about the customers; '*though according to the bank's checklist, the company*

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[35] Bank 3.
[36] Bank 2.
[37] Bank 7.

should provide a lot of information'.[38] Others claim that bank officers do not sufficiently understand the products they offer to the companies and industries within which they operate.

> *'Many of the bankers do not understand the terms and conditions under which specific facilities are provided for different sectors of the economy.'*[39]

> *'Many loan officers are not competent to monitor the loans granted.'*[40]

5.4.2.8 Corporate Insolvency Reform

Most of the banks consider the insolvency law to be adequate; all that is required is better infrastructure and a better working environment. There is a pervasive disenchantment with the attitude of debtors. The bankers do not support granting debtors more legal protection. The banks believe that the extant insolvency system is already very debtor-friendly and does not favour the repayment of debts.

> *'I do not believe that we should put more power into the hands of companies when they become unable to repay because many of them go into areas in which they have no technical know-how.'*[41]

> *'The Nigerian debtor is not the type that needs a debtor-friendly law. The Nigerian human being goes to the bank to take money as part of a national-cake sharing business.'*[42]

The banks perceive the courts as favouring companies over banks. They predict that the introduction of more debtor-friendly laws may incentivize the banks to invest in bonds as opposed to granting loans. The officers unanimously believe that the preservation of companies should be a concern of the government's not the banks'; though one bank noted that the insolvency system may benefit from more practical and balanced laws which cater to the needs of creditors, as well as debtors.

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[38] Bank 7.
[39] Bank 5.
[40] Bank 6.
[41] Bank 1.
[42] Bank 3.

5.5 Entrepreneurs

In May 2011, there were 260 listed companies on the Nigerian Stock Exchange but there were no corresponding figures for SMEs.[43] Obtaining interviews from entrepreneurs was the most difficult phase of the interview sessions. Nigerians are culturally predisposed to secrecy, particularly in cases of failure: the sick are concealed from public glare, likewise debt. One can infer from the interviews that defaulting companies are likely to fail in Nigeria, and that the cultural predisposition of their owners is to be secretive about their failures; difficulty in obtaining interviews naturally follows. However, Nigerians always have or know of a distant relative whose tragedy can be safely retold. As stated in chapter 4, there was a spate of receiverships in the mid-nineties following a recession in the late eighties. The entrepreneurs were likely to know some of the victims and their stories. Indeed, one entrepreneur recalled a distant relative in relation to whose company a receiver was appointed, another knew of some high profile victims.

The interviews comprised 15 core questions, with follow-on questions as appropriate. The entrepreneurs were invited to comment on access to credit and the debt enforcement process. They also spoke about corporate failure and the insolvency law. Like the banks, they were invited to propose reforms to the insolvency law. Though there were only 3 interviews, the entrepreneurs elucidated some of the prevalent practices in Nigerian commercial sector.

5.5.1 Overview of Findings

The entrepreneurs observed an increase in the availability of credit following economic recovery and government policies; though they also observed a corresponding increase in the

[43] The bureau of statistics is presently collating the data.

demand for security. They mentioned that banks sometimes facilitate loan restructurings but that they are usually unwilling to assist struggling companies; even when the company's distress is the result of poor banking practices. They consider all parties at receivership to be culpable for its failure and the failure of the insolvency system in general. The companies do not understand the loan agreements; moreover, they are culturally predisposed to fight receivership. The banks have no concern for the welfare of their clients and are disingenuous. The legal system is ineffective and easily exploited. The receivers exhibit poor knowledge, and lack diligence. They also perform their duties mala fide. The entrepreneurs suggest that the banks ought to be required by legislation to help struggling companies; and that lending practices should be reformed. They posit that entrepreneurs should have an input at receivership; better still, they should be given leave to appoint an external manager when sliding into distress. They also suggest that legal reformers should exercise good faith and due diligence when devising new laws.

5.5.2 Entrepreneurs' Interviews

5.5.2.1 Obtaining Credit

The entrepreneurs have observed a hike in the number of banks that approach them to 'market' products. They believe that the trend follows recovery from the global recession and precipitate measures by the Central Bank of Nigeria (CBN). They noted however, that the banks were increasingly demanding collateral; '*even in cases where they had not asked for securities in the past*'.[44] Usually, the banks ask for 'landed property'.

[44] Entrepreneur 3.

> *'In the past, for example, with Local Purchase Finance, they just requested for the domiciliation of payments but now they want collateral.'*[45]

They noted that most of the funds available mature within 90 days. If the company has performed satisfactorily, it can '*have access to the money again*'.[46]

5.5.2.2 Debt Enforcement

The entrepreneurs affirm that banks are sometimes helpful when a company becomes distressed; they may restructure the loan to facilitate repayment. One entrepreneur noted that on one occasion, when his company could not repay, a committee comprising representatives of the company, the bank and the police, was established to oversee the loan restructuring and its implementation. Nevertheless, they perceive the banks as unwilling to assist on most occasions.

> *'All the bank wants is that at the end of 90 days, you must find ways to pay the bank at all cost.'*[47]

The same entrepreneur noted that on another occasion, the company obtained an advance payment guarantee from a bank for a contract to supply goods to a multinational which was developing a time-sensitive, new product. Representatives of the bank were invited to the negotiations between the company and the multinational, at the company's behest. Customarily, that multinational did not provide advance payments for supplies but on that occasion, given the nature of the product and the time constraints, it did. The money was domiciled with the bank but it refused to grant access to the account; yet insisted that interest was accruing on borrowed (supplementary) sums. The company could not supply the goods because it had no funds; it lost the contract. The bank subsequently pressured the company to

[45] Entrepreneur 1
[46] Entrepreneur 3.
[47] Entrepreneur 3.

pay the interest on the loan; refusing to release the advance in its coffers. The matter was eventually referred to law enforcement agents and the court.

5.5.2.3 Corporate Failure and Receivership

Their companies have never been in receivership but the entrepreneurs knew of companies that had been taken over by receivers. In their opinion, insolvency is not properly practiced in Nigeria. One entrepreneur said that all the stakeholders are culpable in the failure of receivership and the insolvency system in general.

He claimed that many companies do not understand the loan agreements they sign.

> *'They do not seek legal advice before taking the loan. They sign anything. In the case of my brother, he signed an all-assets debenture.'*[48]

When a receiver is appointed, then the company searches for '*loopholes in the security'*.[49]Once identified, it seeks injunctions; leaving the bank to fight to the apex court or to settle out of court. The same entrepreneur noted that there is also a cultural dimension to the struggle to dislodge the receiver. In his opinion, people in more developed countries apply to be made bankrupt in a bid to receive a fresh start but it is alien to the Nigerian culture.

> *'It means: "I am not worthy of being given anything to do". In Nigeria, 'even your family will abandon you if your insolvency becomes public knowledge by receivership; it is culturally abominable.'*[50]

The entrepreneurs noted that many banks are insincere in the advice they provide to their clients; they fail to encourage them to get alternative or proper legal advice. When

[48] Entrepreneur 2.
[49] Entrepreneur 2.
[50] Entrepreneur 2.

negotiating loan agreements, all the loan officer wants is to meet targets. In their ambition, they ignore the welfare of their clients. One entrepreneur noted that the banks also fail in their monitoring duties.In addition, he stated that the banks, when they sell assets, do not exercise good faith. It is normal practice that the banks' management would incorporate companies that buy back the assets from the receivers.

> *'Bankers are supposed to be well learned...well aware of what is going on and to advise their client accordingly.'*
>
> *'Most assets of the company are sold to the bank officials at rock bottom prices. The management would float companies that buy back assets from the receivers.'*

Undergirding the system is an unhelpful and tardy legal system. Receivers also have a poor reputation. To the entrepreneurs, many receivers lack adequate knowledge of the procedure. They also engage in culpable practices. The entrepreneurs believe that the receivers either buy the company's assets personally or sell them off to their cohorts, including the bank officials, for paltry sums. Receivers rarely return a company to the owners because there is usually nothing to return by the end of the receivership.

> *'There are too many loopholes in the legal system; once people identify them, they capitalise on them.'*[51]
>
> *'But the other cases I have heard, the receiver defrauds the company...Usually, when receivers are appointed, they celebrate because it is free money...If the receivers claim that they have managed and returned a company, ask them: which company have they run successfully and returned to the owners'*[52]

The entrepreneurs perceive receivers as lacking diligence and accountability in the execution of their duties. Even on the rare occasion that the company is returned to the owners as a

[51] Entrepreneur 2.
[52] Entrepreneur 1.

going concern, the business and assets would have depreciated substantially. One noted that in a high profile case of the nineties, a renowned company which owned one of the biggest cold room businesses in the region went into receivership following discord amongst the owner's successors. By the end of the receivership, the cold rooms had been looted and were derelict. In another case, the company had been running a market. Its business could only generate revenue if managed as a going concern. The receiver did not maintain the market and its value greatly depreciated.

> *'Most receivers just repay the sums owed and run the company aground...this is because receivers are not accountable.'*[53]

5.5.2.4 Corporate Insolvency Reform

The entrepreneurs suggested that the government should enact legislation obligating banks to help distressed industries. The legislation should also include a mechanism that facilitates the restructuring of loans. The bank may continue to charge interest during the period to protect its position but the customer will also continue to subsist. Further, the banks should reform bad practices when 'marketing' loans; they ought to ensure that their customers understand the loan agreements that they sign. They also suggested that the law should permit entrepreneurs to participate at receivership. One posited that a board should be established, including the owner, to advise and monitor the receiver. Another suggested that the law should permit entrepreneurs to appoint an external manager when in distress. The entrepreneurs also noted that Nigerian legal reformers often identify or introduce loopholes to the law which they exploit post enactment.

> *'If the law can be modified in such a way that the company will have an input, that would be good.'*[54]

[53] Entrepreneur 2.

> *'Entrepreneurs should be able to appoint people of merit to take over the companies when the company is in distress; if that can be introduced into the law that would be a good move.'*[55]

> *'The problem with Nigerians making laws is that the people making the laws will identify loop holes in the law and say nothing so that they can come back to capitalise on the gaps.'*[56]

5.6 Judges

Nigeria has a complex judicial system; particularly on company related issues, at the first instance.[57] The Federal High Court (FHC) has exclusive jurisdiction on matters relating to CAMA – which includes insolvency.[58] However, the State High Court (SHC) has concurrent jurisdiction on issues relating to debt recovery from companies. Thus, a creditor who seeks to attach a company's assets with respect to a debt may commence proceedings in the SHC although the company is undergoing another insolvency related procedure at the FHC.

In May 2011, the judiciary was embroiled in controversy following an alleged corruption dispute between the immediate past president of the Court of Appeal and the erstwhile Chief Justice of Nigeria.[59] Obtaining interviews from judges was therefore very difficult. Interviews with judges of the higher courts had been planned but could not be executed given the dispute. 3 judges acquiesced to interviews: 2 incumbent justices of the FHC and 1 retired justice of the SHC of Lagos State. The interviews consisted of 8 core questions, supplemented as appropriate. The judges were invited to discuss the main problems of the insolvency system. They explained the judiciary's perspective on insolvency practice, the

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[54] Entrepreneur 2.
[55] Entrepreneur 1.
[56] Entrepreneur 2.
[57] See p 28 above.
[58] Constitution of the Federal Republic of Nigeria, 1999, s 251.
[59] 'Salami versus Katsina-Alu: Tyranny of the judiciary' (Vanguard, August 26, 2011) http://www.vanguardngr.com/2011/08/salami-versus-katsina-alu-tyranny-of-the-judiciary-1/, accessed 27/07/2012.

grant of injunctions, specialised courts and the acquisition of specialist knowledge. As with other interviewees, the judges were invited to suggest reforms to the current insolvency law.

5.6.1 Overview of Findings

The judges blame stakeholders and ineffective law and practice for the dire state of the Nigerian insolvency system. They find that debtors often refuse to repay loans, yet they offer strong resistance when the banks seek to realise their securities. Debtors are litigious and uncooperative; they prefer to exploit the system – seeking capricious adjournments and appeals up to the apex court. The judges assert that the banks have furthered the debtors' strategies with poor, and often fraudulent, lending and risk management practices. In addition, they find that many practitioners lack diligence in the execution of their duties. They are ill-equipped to manage companies and are dogged by a fraudulent reputation. They also find that the system lacks integrity, while the law is largely ineffective. The judges conceive their role as giving a purposive interpretation to the law, giving adequate protection to the parties as appropriate, in spite of express provisions of the law, and maintaining an environment that encourages foreign direct investment. They disclaim the allegation that they are excessively generous in granting injunctions to debtors. They claim that they, almost routinely, grant protective injunctions to practitioners; only granting injunctions to debtors as appropriate.

Some of the judges believe that the case for a specialised court is untenable: there are only a handful of insolvency cases, while the Nigerian legal practice is quite generic. Notwithstanding, they admit, that judges would benefit from more intensive training. One judge disagrees. He believes that the system would benefit from the specialised knowledge and time savings that attend a specialised court. Unanimously, the judges denounce an insolvency system that would keep management in office and increase their clout at default. They believe that debtors should rightly be displaced but insist that receivership should be more transparent and receivers given more robust duties. The judges believe that the investigatory ambit of the law should be used more effectively, and that timelines should be introduced. One judge also insisted on the need to educate the public on receivership and insolvency; a job that should not be left to the tabloids as it is presently.

5.6.2 Judges' Interviews

5.6.2.1 The Problems with the Insolvency System

i. Practitioners

The judges criticised the competence of the practitioners; '*the FHC has noted this behaviour over years'*.[60] A judge gave the example of a company which had been in negotiations with an unsecured creditor about outstanding debts when a receiver was appointed. The practitioner subsequently refuted the creditor's claims in spite of written evidence. At the insistence of the court, the practitioner recognised the debt but disputed its quantum. However he could not explain his figures when examined; yet he was an accountant. The judge referred him to the disciplinary committee of the Institute of Chartered Accountants of Nigeria.

The judges also questioned the management capacity of practitioners; particularly in the case of specialised companies. In such instances, they refuse to grant the confirmation order which appears to be a pre-requisite for commencement. In one case, a receiver was appointed to take control of a school. The judge believed that the school would lose its students if the receiver replaced the principal. Consequently, he refused to grant the confirmation order.

[60] Judge 2.

Instead, he instructed the receiver to put the school on notice and the parties to negotiate a loan restructure.

> *'If a parent heard that the principal had been removed and replaced by a receiver/manager, who is not trained in that regard – a legal practitioner - they would remove their children from the school.'*[61]

The judges asserted that many receivers engage in fraudulent practices when executing their duties. Though required by the law, receivers do not provide the court with adequate information. Consequently, it is difficult for judges to administer oversight after they have taken control.

> *'Many times, the receivers end up lining their own pockets while carrying on their duties. That is why it appears that the court is not cooperating with them.'*[62]

ii. Banks

The judges also blamed banks and their poor lending and risk management practices for the state of the Nigerian insolvency system. For corroboration, they referred to recent revelations in the banking sector that many banks' managers facilitated loans to their friends during the boom periods which were not repaid, ultimately harming the sector. The judges further asserted that the banks have evolved shoddy lending practices. Though a loan agreement may state that a debtor has been lent NGN1billion, in reality he would receive only NGN500million but because of the urgent need, he would sign the contract. The debtor may thereafter refuse to repay NGN1billion or to pay the interest calculated at that rate. '*Should he be made to pay interest on what he did not receive'?*[63] The judges also highlighted the

[61] Judge 2.
[62] Judge 2.
[63] Judge 2.

problem of hidden bank charges and high interest rates. A debtor may borrow NGN10million at the beginning of the year and by the end of the year, he is said to owe NGN15million.

> *'If you do an underhand business with the borrower, you cannot expect the borrower to come back to pay interest.'*[64]

iii. Debtors

In spite of the points adumbrated above, the judges do not consider the debtors to be hapless victims. One judge noted that debtors have equally bad practices. They are quick to fight when their properties are attached but unwilling to repay their debts or to negotiate with the banks. Another noted that debtors tend to litigate capriciously even when at fault. In one case, after default, the bank appointed a receiver and initiated liquidation proceedings. The company sued the bank. Though it acknowledged default, it claimed that the bank ought to have permitted a loan restructuring and so the right of the management to run the company had been infringed. For this judge, this practice highlights two broad issues. First, the legal system appears to encourage defaulting debtors to litigate at whim; second, the judiciary appears to conflate the human rights of employees with the rights of the company. To illustrate his point, he gave the example of a company whose premises were to be sealed by the government for failing to pay tax. The company went to the court claiming that its human rights had been infringed and the court granted the requested injunction.

> *'...but the problem is that there is always a very strong resistance from the owners of the companies. In some cases, they litigate to see that the provisions of the CAMA on insolvency do not apply. In any case, they litigate to the highest court.'*[65]

> *'The problem is from the debtors. They know that they owe but they refuse to pay up and when the property is being attached, they begin to fight.'*[66]

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[64] Judge 2.
[65] Judge 3
[66] Judge 1.

> *'When the company has problems, the judiciary often mixes the rights of the company which are similar to human rights with human rights of the individuals involved.'*[67]

The judges assert that the problem with Nigeria is that the system lacks integrity. So judges must understand the peculiar business environment in which they operate, and then apply the law accordingly.

> *'The court must always be careful in insolvency matters not to compound problems'*[68]

They insist that they do not shirk their responsibility to maintain the sanctity of contracts; they are only careful to understand documented and undocumented facts. Parties often fail to disclose or explain all the elements necessary to decide a case. The bank and debtor will not explain the disparity between the agreed amount and the received amount. All that happens is that the debtor questions the final figures. The judge must then walk a fine line between destroying the business and ensuring that the bank gets paid. The judges maintain that their pronouncements are tempered by the need to ensure that they endorse the business-friendly culture which the government espouses – which is necessary to attract foreign direct investment into the country. The judges consequently feel obliged to balance the interests of the parties inter se, on one hand and the interest of the parties with the broader societal goals, on the other.

> *'So the problem is largely ineffective law.'*[69]

> *'These are problems peculiar to Nigeria that is the reason why the Nigerian judge cannot apply the law just as it is. He must understand the environment in which he operates.'*[70]

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[67] Judge 3.
[68] Judge 2.
[69] Judge 3.

5.6.2.2 Injunctions

The judges refute the assertion that they are excessively liberal in granting injunctions; '*we grant injunctions according to the circumstances of the case*'.[71] Sometimes, the bank appoints a receiver to take control of properties that are not included in the deed. In such cases, the court is bound to prevent the receiver from taking over the assets. In other cases, they initiate the action in the wrong name; '*I'm afraid the court will not grant the order*'.[72] Contrary to the claims of the banks and their receivers, the judges assert that they are quite supportive of receivers. They suggest that practitioners '*should also be more helpful to the judiciary*'.[73] They grant them pre-emptive orders, including the support of the police, which facilitate the take-over from management.

5.6.2.3 SpecialisedCourt

The judges agree that there is a need for specialised knowledge on certain matters, including insolvency law. One judge traces the problem to the background of the bench. The bench comprises judges appointed from private practice and public service. Once appointed, the judges handle all types of cases, regardless of their backgrounds. Members of the bench who had been in private practice may be expert in at least one area of law (not necessarily insolvency or commercial law) but those appointed from the civil service are unlikely to be knowledgeable about many matters, particularly commercial or insolvency matters. Yet the Federal High Court (the commercial court) has such judges on the bench.

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[70] Judge 2.
[71] Judge 1.
[72] Judge 3.
[73] Judge 1.

'It is often left for him (the judge) to depend on what the lawyers say or to try to update his knowledge.'[74]

Two of the judges disagree that the situation calls for a need for a specialised court for insolvency proceedings.

'How many insolvency cases are there? Outside of Lagos, there have been no or very few other insolvency cases.'[75]

They suggest that a preferable option would be to introduce a better developed system of continued education for the judges: more workshops, symposia and international exposure.

The third judge disagrees. He believes that the insolvency system will benefit from a specialised insolvency court. In his opinion, the judges presently run a schizophrenic practice. The same judge may deal with constitutional, electoral, criminal and company matters on the same day. The system does not encourage a mastery of any area of the law and adversely affects the competence of the judges.

'About 2 weeks ago, the retired Chief Justice of the High Court recommended special courts to deal with some of these issues...If we had specialised courts, they would concentrate on those issues and deal with them adequately...It would also save time.'[76]

5.6.2.4 Corporate Insolvency Reform

The judges believe that a management displacing regime is preferable to one that retains them. From their experience, they predict that debtors will exploit the former. They may manipulate records and refuse to repay their debts. Ultimately, the regime would precipitate the failure of banks – like in the nineties.

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[74] Judge 2.
[75] Judge 1.
[76] Judge 3.

> *'You cannot put a debtor to manage his business and remit payments to the creditor; he will always manipulate the records and claim that there is no income.'*[77]

> *'Experience shows that directors are the people who strip the companies of their assets.'*[78]

> *'Giving more power to the debtor will create more problems for the lending agencies and such a law will take us back to the failing banks era.'* [79]

In contrast, the judges believe that the transparency and accountability of receivers should be reconsidered. They suggest that the receiver's powers should be matched by his duties. The sale of assets should be regulated by the law, which should prevent the receiver, his friends and family, like the trustee's, from benefitting from the sale of the debtor's assets. Reports filed by the receivers should be more detailed: stating the identity of the buyers and indicating their relationships to the company. The system should help creditors recover debts but encourage the preservation of companies – in recognition of the fact that it is the companies that keep the economy running.

> *'The best way forward is to have a set of rules that exact so much from the receiver/manager who manages an insolvent enterprise; that is the only way out.'*[80]

In one judge's opinion, the insolvency system suffers from the effects of 'mis-education': of the stakeholders - about the nature and functions of the procedure - and of the public as a whole. The members of the public, of whom management are a part, only hear about insolvency law from tabloids which would generally exaggerate their reports. He suggests continuing education, not only for the stakeholders at insolvency, but also for the public as a

[77] Judge 2.
[78] Judge 3.
[79] Judge 1.
[80] Judge 2.

whole. He also suggests the introduction of insolvency law reports. The judges also suggest that the institutions which play oversight roles ought to be put to better use or modified. The investigatory ambit of the insolvency law ought to be used more frequently by the Corporate Affairs Commission to investigate both directors and receivers. Time-limits should be introduced and enforced by the courts to prevent the employment of delay tactics by parties – particularly the debtors.

5.7 Practitioners

It is impossible to estimate the number of insolvency practitioners in Nigeria because accreditation is not statutorily required. Subject to a few exceptions, anybody can be an insolvency practitioner. To remedy the lacuna in the law, and to inject the much needed competence into the system, foremost practitioners in the country established the Business Recovery and Insolvency Practitioners Association of Nigeria (BRIPAN) in 1994.[81]BRIPAN trains (willing) insolvency practitioners but lacks a charter necessary to provide accreditation. Founding members of BRIPAN were recognised as best placed to elucidate the Nigerian insolvency trajectory: from its surge in the nineties to its present state. 7 members of the association were interviewed, including past presidents, an erstwhile director of education, training and technical committee members and the foremost turnaround specialists in Nigeria; of the practitioners, 4 are Senior Advocates of Nigeria.[82]

The interviewees were very enthusiastic and spoke at length about the principal defects of the Nigerian insolvency and rescue system. In particular, they identified the chinks in the law and

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[81] In its first iteration, it was christened Insolvency Practitioners Association of Nigeria (IPAN). Roseline Okere, 'BRIPAN to back AMCON on Business Recovery' (01/04/2011) http://www.proshareng.com/news/13467, accessed 27/07/2012.

[82] The Senior Advocate of Nigeria is the Nigerian equivalent of the Queen's Counsel.

practice of receivership and the arrangements and compromise procedure. They also discussed the role of the judiciary and like other interviewees, posited potential insolvency reforms.

5.7.1 Overview of Findings

Extraneous requirements super-imposed on the law; for instance, the need for a confirmation order and unjustifiable precedents by which courts bind themselves, were considered to be principal defects of the insolvency system. The practitioners also highlighted the unethical practices of the main stakeholders, an inadequate framework – which is geared towards debt recovery as opposed to corporate rescue - and a cultural predisposition to arbitrary debt forgiveness as undermining the efficacy of the system. Practitioners' opinions on the defects of the receivership procedure were polarised. One school of thought was that the law is adequate but its enforcement should be recalibrated. Another group believed that the law ought to be reformed to improve its transparency, accountability and inclusivity. Again, though the practitioners unanimously denounced the procedure by which receivers are appointed, they were divided on the scope of a new regime. They criticised the orientation of many practitioners, the integrity of all groups of stakeholders and the bitter advertorial duels that characterise receivership in Nigeria.

The practitioners find the arrangement and compromise procedure to be cumbersome, lengthy and unwieldy – particularly because of the absence of a moratorium, as well as a tardy and complicated court system. They also consider the arrangements to be fraught with fraud. The practitioners are underwhelmed by the judiciary. They perceive the judges as lacking the requisite knowledge and skills to perform oversight duties effectively. The practitioners highlighted the need for a more viable rescue system but they were again divided on its orientation. One measure on which there was unanimous support was for the introduction of a business plan at rescue.

5.7.2 Practitioners' Interviews

5.7.2.1 Problems with the Insolvency System

i. Procedural Defects

The practitioners criticised extraneous requirements that have been superimposed on the insolvency law as a result of the Nigerian litigious tradition. After a receiver is appointed under a debenture, he goes to the court to obtain a confirmation order – an ex parte order recognising the receivership and providing him with the protection of the police when he takes over the management of the company. Sometimes, the court insists on placing the other party on notice before it grants the order; in addition to the time wasted by the adjournment, the other party may litigate the order up to the Supreme Court before the receivership can commence.

> *'Thus a procedure that is mainly contractual becomes a court process.'*[83]
>
> *'The impression is that without the confirmation order the appointment of the receiver is not valid. In one case, the confirmation order thing set us back from 2003 to 2011 when the Supreme Court decision was given.'*[84]

Some practitioners noted that the courts have ignored the clear provisions of the law. Instead, they have bound themselves by unjustifiable precedents. It is a tradition that the leave of court must be obtained before a receiver can exercise some of his powers, particularly the power to institute actions in the name of and on behalf of the company.

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[83] Practitioner 1
[84] Practitioner 5.

'... in this instance, they like to rely on the Intercontractors case, which is based on the 1968 Act, not CAMA; the courts should know better than to let it apply under CAMA.'[85]

ii. Unethical Practices

The practitioners observed that some of the complications which beleaguer the system originate from the mala fide of the appointing banks' directors: *'this is the Nigerian factor'*.[86] Sometimes, the company may have given a percentage of the purported loan to the directors as an incentive to granting the loan. It may also be that some of the bank's management own, or hold substantial shareholding in, the defaulting company. The appointment of the receiver may on these occasions, be used merely to displace the company's management.

'There was another case where the chairman of the company was also a director of the bank...the bank was trying to plead with the man to allow them appoint a receiver over the company.'[87]

'One finds situations where they use the appointment of the receiver as a means of knocking out the other shareholder, who may be the entrepreneur who pioneered the company, because this is a creditor-friendly system.'[88]

Some practitioners also flagged unethical practices that other insolvency practitioners engage in; precipitating distrust in the members of the public.

'A man owes about 50 million but will pay the practitioner about 2 or 3 million to cripple the whole receivership. The practitioner takes the case, never mind issues of ethics.'[89]

[85] Practitioner 5.
[86] Practitioner 1.
[87] Practitioner 5.
[88] Practitioner 1.
[89] Practitioner 5.

iii. Cultural Predisposition

The practitioners noted that the Nigerian predisposition to contracts, debt and debt recovery adversely affects the efficacy of the insolvency system. One practitioner perceives the general belief to be that a contract is enforceable '*subject to the ability of the other person to complete the contract*'.[90] To him, there is a pervasive casualness about contractual agreements. A practitioner who seeks to enforce such agreements stringently is deemed to be perverse. This attitude creates a hostile working environment for insolvency practitioners. The hostility manifests when the practitioners arrive at a company to take over management. The owners and employees make it difficult for them to gain access, hence the need for police escorts.

> *'If you seek to enforce, you are deemed unreasonable and wicked because you have refused to consider the other man's circumstances.'*[91]

iv. Inadequate Framework

The practitioners noted that the primal defect of the existing rescue regimes is the adverse treatment of debtors: they cannot initiate rescue, while management is dislodged at receivership. The practitioners believe that debtors do not intimate the banks when they slide into difficulties and put up a fierce fight for these reasons. Most practitioners cited the need for a US or UK style rescue system which can be initiated by the debtor and which would not completely displace the company's management.

> *'Our present law does not include a system of self-rescue or administration; nothing like the Chapter 11 procedure or the administration procedure in the UK....'*[92]

[90] Practitioner 1.
[91] Practitioner 1.
[92] Practitioner 3.

> *'I was faced with this scenario where I felt that receivership was not the appropriate strategy to deal with this. But then I examined the law, and quite frankly, there were no any options (sic). There is no provision for one to go to court on behalf of the debtor, submit a plan...'*[93]

The practitioners noted that the debtor may attempt a negotiation with the bank but the banks would not cooperate unless they have problems perfecting or enforcing their security, or they wish to avoid the nuisance of the courts. The only collective procedure – the arrangements and compromise procedure – is criticised as '*creditor-driven*'[94] and '*tedious*'[95]; hence its disuse. The unanimous perception is that the ethos of the system is geared towards debt recovery, as opposed to business or corporate rescue. Some practitioners also stated that the present practice ignores other mechanisms for dealing with debt: debt factoring, management buy-outs, for instance.

> *'The first point of call is liquidation, then receivership. The procedures are only about killing, not rescue.'*[96]

> *'The whole focus of the legislation is not on corporate rescue but on financial recovery; so I think the problem is with the focus of the law.'*[97]

5.7.2.2 <u>Receivership</u>

i. The Law

The debate on the adequacy of the law of receivership appears to be polarised. Some of the practitioners believe that the law is sufficiently broad and robust. Discussing the duties and liabilities of the receiver, one practitioner insisted that broadening the existing provisions would discourage potential receivers from taking up appointments and militate against

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[93] Practitioner 1.
[94] Practitioner 2.
[95] Practitioner 4.
[96] Practitioner 7
[97] Practitioner 6.

business rescue. Another practitioner noted that there usually is nothing left at the end of the receivership – the bank rarely recovers in full – and so there is no need to broaden the receiver's duties, particularly to unsecured creditors. The proponents of this school of thought cite insufficient knowledge of the law as the problem; as opposed to insufficient law.

> *'I think that the duties and liabilities of the receiver in the CAMA are sufficiently broad and sufficiently ensconced in the legislation. The problem is that the people do not know the law.'*[98]
>
> *'If one is not careful, and creates too many legal duties and burdens, one would erode the powers of the receiver and no one would want the office.'*[99]

In contrast, another set of practitioners insisted that the law is lacking in many respects. First, the law does not require the receiver to present a business plan when he takes over the company; they believe that a plan should be a pre-requisite. Second, the receiver's duties are imprecisely enunciated: for example, the content of the duty to report. Third, the power of the bank to remove the practitioner is unfettered: the banks remove the practitioner who chooses to manage as opposed to receive only. Fourth, existing provisions do not encourage inclusivity.

> *'From my experience, my preference should be that the first duty of the receiver, once appointed, is to get the plan. Right now, the law only obligates the receiver to draw a statement of affairs, not draw a plan.'*[100]
>
> *'But I don't think that there is enough pressure on the receiver to be transparent...if the receiver steals money, he can afford not to file his statement for 3 years; he would still make a profit from whatever he stole.'*[101]

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[98] Practitioner 6.
[99] Practitioner 4.
[100] Practitioner 1.
[101] Practitioner 7.

Most of the practitioners criticised the liberal appointment threshold in the law; they believe that the law should specify at least a minimum standard for appointment though they are not agreed on its specificities. Majority of the practitioners called for the appointment of particular professionals – lawyers and accountants in particular; there was no clear preference for one over the other. Going against the grain, one practitioner insisted that any person who shows himself able to run a company successfully should be certified to practise. Another insisted that the problem of unprofessional appointments was no longer as common place as it had been in the past. He insisted that all that was necessary was for the education of the banks about the demerits of appointing a non-professional. Notwithstanding, their differences, the practitioners all highlighted the need for a body with accreditation and oversight powers.

> *'The other way of doing it is to contact the people who appoint the practitioners to inform them not to appoint non-professionals as receivers. I would prefer this approach to make the system more flexible, instead of changing the law.'*[102]

> *'There should be various routes to get into the profession. Business turnaround is essentially about the management of business; this is not limited to graduates only.'*[103]

ii. The Practice

The practitioners posited that receivership does not rescue companies. It is primarily a debt enforcement procedure which focuses on the interests of the bank; though a versatile receiver may save a failing company or its business, where possible. They noted that the Nigerian receiver would not usually take up the appointment with intent to manage; he is typically out to liquidate. One practitioner described receivership as the '*worst thing you can do to a*

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[102] Practitioner 2.
[103] Practitioner 7.

company that has a chance for turn-around'.[104] When receivers take up office, their first action is usually to seal up the premises, regardless of the state of affairs of the business. This tradition has contributed to the adverse strategies adopted by owners and their employees when receivers are appointed. Another practitioner noted that a media battle usually ensues: the owners of the company and the receivers place conflicting advertorials in the newspapers. Many times, the advertisements follow from judicial orders. The content of the advertorials usually portray receivers and receivership in a bad light and confuse the public about the law and practise of receivership. The practitioners also criticised the length of receiverships. They observed that the average length of receivership is about 24-36months. However, the estimate does not include the period of the (often) protracted legal battles, sometimes lasting over a decade, which precedes the actual receivership. One practitioner noted that sometimes, straightforward receiverships are arbitrarily extended by the receiver to maintain a stream of income as manager.

> *'The way it is now, it is essentially to kill. I don't know of any company that has been handed over to the owners. Those that come out of receivership, the owners have gone to find money independently to repay the debts owed.'*[105]

> *'In a case, an engineering company was indebted to the bank to the tune of $70billion...when the receiver/manager took over, he sealed up the company. The owners of the company complained. They had a lot of ongoing contracts, as well as contracts that were being negotiated...the owners of the company appealed to the bank that the receivers should not seal up the company, the receiver may stay in office but he should not scare away the customers...but the bank refused.'*[106]

The practitioners criticised other key stakeholders at receivership: the banks, the debtors and the government officials. The system requires registration of the appointment at the CAC. One practitioner observed that companies often bribe CAC officials to provide them with

[104] Practitioner 6.
[105] Practitioner 7.
[106] Practitioner 2.

information about impending registrations of appointment. They collude with the officials to lengthen the registration process and time. During that period, they also initiate specious legal actions to delay the commencement of the receivership. Another practitioner noted that management would sometimes leverage a company heavily, only to divert the funds to personal use. When the company defaults, they merely incorporate a new company to buy back the assets when sold by the receiver; bidding at nominal prices. In some instances, some bank directors would also hold substantial shareholding in the defaulting company; they shop around for cooperative receivers, who sell the assets back to the directors via a new corporate entity.

> *'The receivership has to be registered at the CAC; often times, because the debtor has anticipated that the creditor will take that step, he connives with the CAC and the file disappears and it becomes practically impossible to register the receivership. The officials of the CAC even when the debtor has no idea, alert the debtor who rushes to court to get injunctions.'*[107]

5.7.2.3 Arrangements and Compromise

i. The Law

The practitioners criticised the arrangements procedure as cumbersome and ineffective. There is no moratorium, which leaves the creditors, particularly the secured creditor, free to attach the assets or enforce a security before the tardy court system sanctions a scheme. The practitioner has a choice between engineering the unanimous cooperation of the creditors and placing the company in liquidation; the latter being the more viable option. Besides, the practitioners noted that self-help measures complicate negotiations amongst the creditors affected by the scheme. In the nineties for example, unsecured creditors employed extra-legal help, particularly from the armed forces, where they could; stripping the company of assets before negotiations were completed. Another clog in the system is the multi-court legal

[107] Practitioner 4.

system in Nigeria. The FHC has exclusive jurisdiction over matters in the CAMA – in this instance, arrangements. The SHC has concurrent jurisdiction over issues relating to debt recovery. While a practitioner seeks to navigate an arrangement through the FHC, creditors may attach the company's assets in the SHC.

> *'But a fundamental flaw of the schemes is that there is no provision that makes the scheme a permanent bar to other recovery activities against that same company while the scheme is in process...to further complicate matters, the tiered court system makes things quite difficult.'*[108]

ii. The Practice

The arrangement procedure is rarely used in Nigeria. In addition to its legal problems, practitioners cited inadequate knowledge and fraud as key to the disuse of schemes. In the nineties, there was a wave of finance house failures in Nigeria. Practitioners sought to restructure the debts by utilising schemes but many directors chose to disappear instead – even when the schemes were viable. In addition, many debtors declare only a fraction of the company's assets. After the scheme is sanctioned, they unearth the hidden assets and carry on a flamboyant life style.

> *'But in Nigeria, will the debtor submit all his assets? Or will he hide-away his assets and show just a fraction of them? Only for him to buy new cars and other things the next day...the owners of the companies would also have transferred most of the assets of the company, leaving a pittance for creditors. These issues fuelled the lack of trust.'*[109]

5.7.2.4 <u>The Role of the Judiciary</u>

When asked about the role of the judiciary, the first reaction was usually a derisive chuckle, followed by a negative shake of the head. All the practitioners perceive the judiciary to be ill-suited to its oversight role at insolvency. Practitioners find that the judges lack adequate

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[108] Practitioner 4.
[109] Practitioner 1.

knowledge and understanding of corporate rescue and of insolvency matters generally. Some practitioners highlighted the necessity of a specialised court, while others emphasised the need to train the judges on the nature and function of insolvency procedures, as well as their role within such a system.

> *'The judiciary is one of the core problems of the rescue system.'*[110]
>
> *'The judiciary has no real knowledge of the important issues at insolvency...if there was a system of specialisation perhaps the judges would be able to get the requisite experience.'*[111]
>
> *'They lack actual knowledge and experience. The judges do not specialise in any matter; so they don't gain enough experience...They need training and perhaps concentrating in about 2 or 3 areas.*[112]

The practitioners also find the judges to be antagonistic towards insolvency practitioners; an attitude which is accentuated by sentiments that, practitioners believe, mar judicial decision making.

> *'The judges do not want to grant orders that kill the company, even when it is clear that a company is heavily indebted and has failed to repay.'*[113]
>
> *'Largely, the judges try to be favourable to the debtor and refuse to give the pre-emptive order and order that the other party be put on notice. But the problem is that if they are put on notice, they would dissipate the company's assets.'*[114]
>
> *'The court can be seen to have formed an opinion of receivers already. There was a case in which directors sought an injunction from the court to prevent the receiver from selling off the assets of the company...the judge said that if he had his way, some receivers should be shot...In another case...the judge said: "you the receiver only want to get in to take the property so that you can share it for your relatives"...without the judge even listening to the case, he has made up his mind.'*[115]

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[110] Practitioner 7.
[111] Practitioner 6.
[112] Practitioner 2.
[113] Practitioner 7.
[114] Practitioner 2.
[115] Practitioner 5.

Some practitioners also censured the court system. The practitioners observe that the structure of the Nigerian judicial system facilitates the abuse of process. One practitioner noted that the failure of the judiciary to award commensurate costs incentivizes debtors to litigate – a trend that explains why the courts are clogged with cases. He further observed that debtors seek and judges grant adjournments capriciously. The debtor may dispute the quantum of the claim. The judges ought to permit the receiver take control while the matter is resolved. The debtor after all did borrow at least a portion of the stated sum. Another practitioner noted that judges may decide arbitrarily not to preside over cases on any given day - with ostensible impunity. Collectively, these practices extend the length of the procedure, to the disadvantage of creditors.

> *'The rules for example have a fast track procedure with no fast track court. The judge who handles the fast track cases also handles slow track matters. If on an average day he has 47 cases - 7 of which are fast track, as far as that judge is concerned, all the cases are slow track.'*[116]
>
> *'Because they don't have to pay real costs, people just institute proceedings at will; adjournments are sought for no cogent reason.'*[117]
>
> *'The time lines are unfriendly. For example, a case was filed at the court on the 1st of February, to take pre-emptive orders (that is the confirmation order in Nigeria). It was a motion ex parte. Counsel filed an affidavit of urgency. It was assigned for hearing on the 14th of March – 6 weeks later...on the 14th, the court did not seat...ruling was adjourned to the 31st of May. On the 31st of May, the court did not seat. The question that arises then is: is that judge conscious of what is at stake? ...why then do we think that a debtor cannot hide under such a system that works at snail's speed? All that the debtor has to do is to take the case to court to hang it there for the next decade or two.'*[118]

5.7.2.5 Corporate InsolvencyReform

The practitioners insisted that the Nigerian corporate sector needs a viable insolvency system but there was a polarised debate on the orientation of the existing system. Some practitioners insisted that it is debtor-oriented because of the ease with which debtors acquire injunctions.

[116] Practitioner 4.
[117] Practitioner 1.
[118] Practitioner 5.

Others perceive it to be creditor-oriented because the banks and their agents dominate decision-making. Members of the former group assert that reform efforts should seek to transform the practice, rather than the insolvency law. They believe that the system will benefit from less litigation and a rescue-orientated culture, practised by all stakeholders. They posit that practitioners should take charge of the company at default. They suggest that the main stakeholders at insolvency – the practitioners, banks, judges and debtors – ought to receive extensive training on corporate rescue, if the system is to succeed. They suggest that the insolvency rules should be modified to include timelines and better instructions to aid the administration of the revised regimes.

> *'...what we have is a very pro-debtor system...in all that we want to do, it must go along with a shift in orientation. There is a need for everyone to understand what the new culture should be.'*[119]

> *'I think we need to first of all have a rescue of the way the judges and the judicial system itself function before we can have an effective rescue system...the debtors hold all the aces...corporate rescue and helping companies out would only arise in situations in which there is a genuine will.'*[120]

The practitioners who believe that the system ought to be more debtor-friendly suggest that the law itself should be modified. Some suggest that the new law should be modified to encourage a debtor to seek for help when it slides into financial distress. The modified system should provide for a court sanctioned moratorium while the rescue is negotiated amongst stakeholders. To encourage its use, the system should permit the directors to remain in place while a practitioner takes over the rescue. Where the rescue attempt fails, then the debtor will cede all its powers to the practitioner who will decide on a sale of the business or outright liquidation. Some of the practitioners however recognised the Nigerian problem of integrity: how will the debtor be prevented from dissipating assets in the period in which it has control?

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[119] Practitioner 5.
[120] Practitioner 4.

'...I think that it is more creditor-driven rather than debtor-driven...The law as it is today needs to be a bit more debtor-friendly but in our society, people abuse anything and everything...How do we prevent abuse? That is the dilemma that I have.'[121]

'The debtor would be in possession but the practitioner would be in charge of effecting the rescue...If the arrangement fails, then the practitioner may take over with more powers.'[122]

Notwithstanding their proclivities, all the practitioners suggested that the law should oblige practitioners to submit a rescue plan as soon as possible after appointment. Some practitioners insisted that other stakeholders should be given the right to review the plan. The practitioners also noted that some other procedural and extraneous matters must be modified to facilitate corporate rescue. They advocated a more circumspect resignation or termination procedure. They suggested the creation of a better credit management system for or by the banks. Undergirding these suggestions was the recognition of the need to inject integrity into the rescue practice.

'Usually, the person who can get to the root of the problem is the person who is advising the debtor...The professional should also be able to contact the creditors with a potential plan that would aid the repayment of the debt. It is possible that the creditors modify the plan. Such a plan ought to be sanctioned by the court.'[123]

'We need a credit ratings agency and a credit registry...We need to regulate the banks better about lending.'[124]

'There is a need to work on the Nigerian culture. There is a need to get the right personnel; to ensure that they have the right competence.'[125]

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[121] Practitioner 2.
[122] Practitioner 1.
[123] Practitioner 7.
[124] Practitioner 4.
[125] Practitioner 5.

5.8 Supplementary Interviews

In addition to the core interviews outlined above, there were also 5 supplementary interviews. The supplementary interviews were spurred by chance meetings, and leads obtained during the planned interviews. The interviewees included 1 senior officer at the Corporate Affairs Commission, 3 senior officers at the Bureau of Public Enterprises and a professor at one of the foremost federal government universities. These individuals had been involved, directly or indirectly, in the formulation of the divestiture policy that undergirds the privatisation of erstwhile government corporations. It was believed that the individuals were best placed to elucidate the government's policy on corporate insolvency, in particular, corporate rescue. Unlike the others, these interviews were unstructured because most were unscheduled and short, given the busy schedules of the subjects. Nonetheless, the underlying themes were analogous to the others. They solicited information that would illuminate the Nigerian rescue perspective and practice.

The officers revealed that the government seeks to promote the rescue of businesses as opposed to the mere liquidation of assets. The government started to divest its investment in corporations in 2000. The Bureau of Public Enterprises which is in charge of the exercise developed what is now known as 'guided liquidation'. At guided liquidations, the companies' assets are sold as comprehensive units to single buyers. The policy ensures that the corporations can continue to provide the services for which they were incorporated; it also enhances the realisable value of the assets.

> *'...when we want to sell it, we sell it en bloc to a single buyer – such that it will continue in the long run in its normal line of business....'*[126]

[126] Civil Servant 1.

5.9 Supplementary Issues

5.9.1 The Assets Management Corporation of Nigeria (AMCON)

In the wake of the bank crises that have rocked the country over the past decade, AMCON was incorporated in 2010 to buy back non-performing loans from banks.[127] The result is that the banks' balance sheets are sanitised while debt recovery is passed to AMCON. AMCON is fully owned by the Federal Government which provided it with an initial capitalisation of NGN10billion, held in trust by the Central Bank of Nigeria.[128] Consequently, many insolvency proceeding will now be instigated at the behest of AMCON. The banks believe that the arrangement potentially solves the problem of default, while the practitioners are interested to see how AMCON will support the rescue of distressed companies, having replaced the bank as chief creditor; though many are sceptical of the success of AMCON.

> *'It is a relief to transfer the bad debts to AMCON. Let AMCON deal with the debtors while the bank deals with banking.'*[129]
>
> *'There is no further need for reform than the AMCON Act...AMCON is not there to kill such companies, it is there to keep them alive.'*[130]
>
> *'It is expected in any case for the powers of AMCON to be contested in court.'*[131]
>
> *'AMCON just strips banks of their bad loans but in countries where this type of thing takes place, there is a market for selling such asset...In Nigeria, there is no system for the sale of such assets. Therefore I predict that in a few years, AMCON will go down because the government cannot continue to absorb such debts.'* [132]

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[127] Nwokoji, 'We have spent N770bn to buy bank's bad loans –Mustafa Chike-Obi' *The Sun News* (28 March 2011,), http://www.google.co.uk/url?sa=t&rct=j&q=&esrc=s&frm=1&source=web&cd=1&ved=0CIcBEBYwAA&url=http%3A%2F%2Fwww.thenigerianvoice.com%2Fnvnews%2F48756%2F1%2Fwe-have-spent-n770bn-to-buy-banks-bad-loans-mustaf.html&ei=CfASUNe0KebX0QXtz4DIBQ&usg=AFQjCNGNuh1Oxjc_hrkvNHVnHF151kbp_g&sig2=_kD-EN2UlmJQ0u2nCy89jQ, accessed 27/07/2012.

[128] Assets Management Corporation of Nigeria (Establishment) Act 2010, s 2.

[129] Bank 1.

[130] Bank 5.

[131] Practitioner 3.

[132] Practitioner 7.

5.9.2 Bankruptcy Law

A judge and some practitioners suggested that the corporate insolvency system would benefit from a complementary Bankruptcy Law; although there is one in the law books, it is not used for, largely, cultural and procedural reasons. They believe that entrepreneurs find it easy to shop around for new funds after defrauding other banks because they have not been declared bankrupt. They suggest that if the Bankruptcy Law was modernised and utilised, company phoenixing and repeated defaults by entrepreneurs would reduce.

5.9.3 Management

Some practitioners have devised an informal procedure dubbed 'joint or turn around management' by practitioners and 'external consultancy' by the entrepreneurs. At management, after the company slides into distress but before it fails a practitioner, referred to as a manager, is appointed under a tripartite agreement between the bank, the company and the manager. The manager evaluates the company's business and draws up a plan comprising his suggestions. If the parties are satisfied, he executes the plan. The advantage of management is that the parties dispense with many of the direct and indirect costs of receivership: stigma, time and resource costs of the legal and extra-legal processes. A cooperative, rather than adversarial relationship is maintained between the company and the bank. The bank remains protected by a clause in the agreement that authorises it to appoint a receiver when triggered by any pre-agreed event. The manager would usually be appointed as the receiver. The procedure may be initiated by the company, the bank or the receiver. However, not all banks or companies understand the concept and they may scupper its success as a result.

> *'For some companies, they appointed external consultants, not receivers and it worked.'*[133]

> *'For example, this company pioneered turn-around management. There has been a good success rate with the regime. But in some cases, there are draw backs; the ego problem amongst entrepreneurs: "who are you to tell me how to run my company".'*[134]

> *'I called the debtors/directors, inviting them to work with me...I said, let's not call it receivership, we will have joint management; the receiver will be released but the practitioner will be on the board on behalf of the bank...the directors agreed. The morning that they were to come to chevron to confirm, the directors refused to turn up. Upon calling the lawyer, I was told that the directors had gone ahead of me to inform Chevron not to deal with me. Chevron terminated the contract...eventually, the directors lost out. There is a lot of lack of knowledge.'*[135]

Conclusion

The interviews paint a very dire portrait of the Nigerian insolvency practice. The credit system is poorly and dishonestly administered. The insolvency practitioners lack the requisite training, the capacity to execute their duties effectively and often defraud both the debtors and the banks. Likewise, the debtors have maleficent practices or are often ignorant of the rules undergirding the credit system. These attributes have sown and nurtured a verdant distrust among stakeholders for decades. To protect their interests, and sometimes their lives, stakeholders employ extra-legal help; involving the courts only as last resort. The rules devised by courts to stem the abuse, or merely because they are unaware that those rules are not premised on the law, have only complicated the system further. The complications have made the regimes uncertain and tardy. It is unsurprising therefore, that they are scarcely used.

Nonetheless, the interviews augment the library-based research as intended. Together, the two chapters provide a more vivid picture of the credit and insolvency systems than would otherwise have been available. The interviews, in particular, highlight the aspirations of each

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[133] Entrepreneur 1
[134] Practitioner 3.
[135] Practitioner 1.

group of stakeholders but identify nuances in perspectives and conflicts of opinions amongst individuals and groups. A heartening discovery is that the government, if it decides to reform the law, will commence from a business preservation perspective; echoing the opinion of the 1988 reform committee discussed in chapters 1 and 4. The information obtained from the interviews will not only enrich the analysis of the law to be conducted in chapter 7, it will also provide an informed guide for the proposals to be presented.

Chapter 6

Lessons from Abroad

Overview

During the interviews, some Nigerian practitioners strongly argued for the introduction of reforms based on the chapter 11 rescue model in the United States of America (US). Another group of practitioners espoused the administration model in England and Wales. As chapter 1 indicates, the Nigerian company law, to which the insolvency law is appended, has thus far been structurally modelled on the old British system. Nonetheless, Nigeria has over the years altered many aspects of her legal system to resemble the US model. Apart from these preliminary issues, chapter 11 and the administration models are some of the foremost rescue models globally. Given that they provide parallel systems of rescue, they afford the opportunity to observe how each system may be designed and enforced. It would therefore be instructive at least, to examine the statutory models, as well as the law in practice; in the quest to propose viable alternatives for the Nigerian system.

The chapter finds that the US system is only theoretically debtor-friendly. It finds that it works differently in practice, however. Creditors exercise greater control over the procedure than the reading of the law on the books suggest. The debtor rarely takes the rescue decision, unless the creditors are not interested in the case. Secured creditors may permit the debtor to take the decision if they are adequately protected; whereas, unsecured creditors may permit the debtor if there is little value to be derived from the case. Usually, the debtor's decision taking role is usurped by an expert hired at the insistence of the creditors. Consequently, the rescue decision is taken in the best interest of the (secured) creditors.

The chapter finds that creditors have identified post-distress lending contracts as the means by which they can exert extra-statutory control over the debtor. The creditors' actions may produce beneficial effects, though they may affect the debtor detrimentally also. For example, while they can press for the speedy resolution of the case, the creditors may also precipitate the debtor's liquidation. For Nigeria to introduce the US model, the court system must be extensively overhauled; to improve its speed and to keep up with the volume of hearings that characterise the model. The judges would require specialisation, at least in commercial law and practice, as well as a comprehensive education on insolvency jurisprudence and philosophy.

The chapter finds that the English and Welsh system is theoretically creditor-friendly. In practice, the system also works somewhat differently than can be discerned by merely reading the statute. The main lenders, typically the banks, first attempt to rescue distressed companies informally. It is the companies that cannot be rescued that would go into the formal procedure. The formal procedure is structured to serve the interests of creditors. The system is based on an administrative model. The insolvency practitioner, a certified professional, takes control of the company and makes the relevant decisions. The court plays an oversight role but makes comparably fewer decisions than its US counterparts.

Like in the US, the secured creditors prefer to take control of the process, with minimal oversight. In most cases, they choose or approve the choice of administrators, which promotes the probability that subsequent decisions will be taken in their interests. Administrators may minimise supervision of their actions by engaging in pre-packs. They insist however that pre-packs are utilised because they may afford the best opportunity for maximising returns for the creditors as a group. If Nigeria is to model her rescue system on that of England and Wales, the present practice would require fundamental reform. Practitioners who are to take charge of the companies must receive requisite training and certification. A robust system must also be established to oversee the practitioners, while the courts will also require reform to improve their contribution to the process.

The chapter is divided into two parts. Part I examines the chapter 11 procedure. It gives a brief overview of the procedure. Then it analyses the practice. In particular it examines the means by which the rescue decision is made and rescue finance provided. It also examines the role of the business plan. Part II applies the same tests to the English and Welsh procedure. At the end of each part, some lessons for Nigeria are briefly discussed.

Part I

6.1 The United States

The rescue procedure in the United States is set out in chapter 11 of the Bankruptcy Code.[1] Though the procedure may also commence involuntarily at the request of creditors,[2] it usually commences voluntarily; when the debtor files a petition with the bankruptcy clerk.[3] Commencement triggers a stay on legal and administrative actions

[1] 11USC.
[2] 11 USC, s303.
[3] 11 USC, s301.

against the company or its assets until the property, the subject of the dispute, ceases to belong to the company or the reorganization terminates.[4] The court may grant relief from the stay at the request of a secured creditor that can show cause, unless the debtor furnishes that creditor with adequate protection and can show that the property is important to its reorganization.[5] The court may also dismiss the case or convert it to a liquidation case if requested, subject to the interests of the stakeholders as a group, or the estate.[6] Soon after commencement, the US trustee appoints a committee of unsecured creditors (the 'UCC');[7] additional committees to represent other interests may be appointed as appropriate.[8] The UCC serves as a conduit between the unsecured creditors and the debtor.[9] It is to consult with the reorganizers on the administration of the case, investigate the debtor's true condition and the desirability of carrying on its business, participate in the formulation of a plan, and advise the interests it represents.[10] The committee may appoint agents to execute some of its duties.[11]

The court may order the appointment of a trustee or an examiner, if requested.[12] The trustee takes control of the debtor, operates its business and administers the reorganization.[13] He is to investigate the desirability of continuing the debtor's business, as well as the conduct of its management. Conversely, the examiner does not take charge of the debtor but investigates allegations relating to the company and

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[4] 11 USC, s362.
[5] 11 USC, s362 (d) .
[6] 11 USC, s 1112.
[7] 11 USC, s1102.
[8] 11 USC, s1102 (a) (2).
[9] 11 USC, s1102 (b) (3).
[10] 11 USC, s1103 (c).
[11] 11 USC, s1103 (a).
[12] 11 USC, s1104.
[13] 11 USC, s1106 (a).

its management.[14] As soon as the case commences, the company's property forms an estate; a company which administers its estate is called a debtor-in-possession ('DIP').[15] The code sets out limits to the DIP's freedom to use its assets and cash collaterals.[16] The DIP enjoys a period of 120 days from the date of the order during which it has the exclusive right to propose a reorganization plan.[17] When permitted, a plan may also be proposed by any party-in-interest.[18] The court may reduce or extend the exclusive period within statutorily allowed limits when requested.[19] The debtor sends the plan, accompanied by a pre-approved disclosure statement outlining information that will facilitate decision-making, to claimants.[20] The debtor may also seek the acceptance of its plan without the statement, if it complies with other applicable statutes.[21]

The proposer of the plan must place all claims in classes based on their similarities.[22] A class of claims accepts a plan if two-thirds in amount and more than half in number of the allowed claims approves it in good faith.[23] An unimpaired class is presumed to approve the plan, while a class which receives nothing is presumed to reject it.[24]The approved plan must be confirmed by the court before it takes effect.[25] To be eligible for confirmation, the plan must be approved by at least one class of claims.[26]At the

[14] 11 USC, s1106 (b).
[15] 11 USC, s 541 (a); 11 USC, s1101 (1).
[16] 11 USC, s363.
[17] 11 USC, s1121 (a) (b).
[18] 11 USC, s1121 (c).
[19] 11 USC,s1121 (d) (1), (d) (2) (A), (B).
[20] 11 USC, s1125 (b).
[21] 11 USC, s1125 (g).
[22] 11 USC, s1122.
[23] 11 USC, s1126 (c).
[24] 11 USC, s1126 (f), (g). A claim is impaired when the legal, equitable, and/or contractual rights that attach to it are altered without the creditor's acquiescence. 11 USC, s1124.
[25] 11 USC, s1141.
[26] 11 USC, s1129 (a) (10).

hearing, the court must ascertain that the plan and its proposer have complied with all statutory requirements.[27] However, if all other conditions have been met except acceptance by all classes, the plan may still be confirmed in spite of the dissent; if at least one class has approved. This is known as the 'cram-down'.[28] The court will cram-down the plan on any dissenting class if it meets the fair and equitable standards and the dissenting class has not been unfairly discriminated.[29]The court can confirm only one plan.[30] The confirmed plan binds all claimants, interest holders and the debtor.[31]

6.1.1 The Rescue Decision

Chapter 11 is structured to engender timely and democratic rescue decisions. More importantly, though unarticulated, the procedure hinges on the assumption that the debtor, in consultation with the UCC, will make the rescue decision objectively.[32] The debtor is expected to know its problems quite well and the UCC, during the consultations, is expected to be guided by the results of its investigations.[33] If the UCC suspects that the debtor is incapable of making objective decisions, it may solicit the appointment of a trustee, who would be guided by his own investigations.[34] Otherwise, the UCC may solicit the appointment of an examiner to investigate its suspicions of the debtor. Thus, theoretically, at the end of the process the business

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[27] 11 USC, s1129 (a).
[28] 11 USC, s1129 (b) (1).
[29] 11 USC, s1129 (b) (1), (2). The cram-down procedure and the fair and equitable standard are fully explained below at p234.
[30] 11 USC, s1129 (c).
[31] 11 USC, s1141.
[32] Jay Westwood, 'The Control of Wealth in Bankruptcy' (2004) 82 TLR 795 describes this as the notion of neutrality.
[33] 11 USC, s1103 (c) (2).
[34] 11 USC, s1103(c) (4).

would have been thoroughly investigated and evaluated. As a corollary, unviable businesses would be terminated while their viable counterparts are sold or rescued, as appropriate.

In practice, chapter 11 does not follow the fine, objective, theoretical lines fantasised by Congress however.[35] The fate of the company is decided, usually, by and in the interest of the party who manages to wrest control of the procedure, while other parties-in-interest jostle, similarly, to serve their esoteric interests.[36] Consequently, the main challenge for chapter 11's critics over the decades has been the identification of the most suitable stakeholder to take charge of the rescue decision.[37] Over the decades, the control-baton has passed from debtors to senior lenders, and then to distress-lenders, to the delight of some and the dismay of others.[38] The ensuing paragraphs examine the evolution of control and seek to extract lessons from the US experience.

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[35] Lynn LoPucki and William Whitford, 'Corporate Governance in the Bankruptcy Reorganization of Large, Publicly Held Companies' (1993) 141 U Penn LR 669 ('LoPucki/Whitford, Governance').

[36] Richard Thomas, 'Tipping the Scales in Chapter 11: How Distressed Debt Investors Decrease Debtor Leverage and the Efficacy of Business Reorganization' (2010) 27 Emory BDJ213; Jonathan Lipson, 'Governance in the Breach: Controlling Creditor Opportunism' (2011) 84 Southern California LR 1035; Harvey Miller and Shai Waisman, 'Is Chapter 11 Bankrupt?' (2005) 47 BCL Rev 129; Harvey Miller, 'Chapter 11 in Transition –From Boom to Bust and into the Future' (2007) 81 AMBKRLJ 375; Douglas Baird and Robert Rasmussen, Chapter 11 at Twilight' (2003) 56 Stan LR 673; Douglas Baird and Robert Rasmussen, 'The End of Bankruptcy' (2002) http://www.law.uchicago.edu/files/files/173.dgb_.bankruptcy.end_..pdf, accessed 13/07/2012.

[37] But see Lynn LoPucki, 'The Myth of the Residual Owner: An Empirical Study' (2004) 82 Wash ULR 1341; Robert Rasmussen, 'The Search for Hercules: Residual Owners, Directors, and Corporate Governance in Chapter 11' (2004) 82Wash ULQ 82.

[38] Douglas Baird and Robert Rasmussen, 'Antibankruptcy' (2010) 119 YLJ 648; David Skeel Jr, 'Creditors' Ball: The "New" New Corporate Governance in Chapter 11'(2003) 152 Uni Penn LR 917 (Skeel, 'Creditors' Ball'); Harvey Miller and Shai Waisman, 'Does Chapter 11 Remain a Viable Option for Distressed Businesses for the Twenty-First Century?' (2004) 78 AMBKRLJ 153 ('Miller/Waisman, Viable Option').

6.1.1.1 Debtor in Control

Though Chapter 11 requires the DIP to make the rescue decision, in practice, it is made by its management. As discussed in chapter 3, when the equity cushion is dissipated, managers are unlikely to take unbiased decisions.[39] They are likely to take decisions aimed at perpetuating their control of the company for as long as possible. Chapter 11 in its first two decades manifested this problem, drawing ire.[40] Contrary to reorganization theory, managers did not file timely reorganizations to consider the desirability of rescue or the viability of their businesses; they filed for reorganizations, usually, to prolong the lives of businesses which would have been terminated by the legal proceedings initiated by their creditors.[41] The debtor, as long as it could meet its operating expenses, taxes and adequate protection payments, continued to operate for as long as was possible; even if its underlying business was unsound.[42] Managers could count on the protection of the courts which rarely compelled liquidation where the debtor did not acquiesce.[43] In that era, it was the norm for large companies to have high levels of unsecured debts and comparably fewer secured debts.[44] For such companies, managers had access to cash, with which unsecured creditors would have been paid but for the automatic stay, which aided their rescue aspirations.

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[39]See p 92 above.
[40] Barry Adler, 'Bankruptcy and Risk Allocation' (1992) 77 Cornell LR 439; Lynn LoPucki, 'The Trouble with Chapter 11' (1993) Wis LR 729; Michael Bradley and Michael Rosenzweig, 'The Untenable Case for Chapter 11'(1992) 101 Yale LJ 1043.
[41] Lynn LoPucki, 'The Debtor in Full Control – Systems Failure under Chapter 11 of the Bankruptcy Code?' (1983) 57 AMBKRLJ 99. 73% of the cases in the sample commenced for this reason. ('LoPucki, First Instalment').
[42] Lynn LoPucki, 'The Debtor in Full Control – Systems Failure Under Chapter 11 of the Bankruptcy Code?' (1983) 57 AMBKRLJ 247, 261('LoPucki, Second Instalment').
[43] Jerome Kerkman, 'The Debtor in Full Control: A Case for Adoption of the Trustee System' (1987) 70 Marq LR 159, 168-170
[44] Lucian Bebchuk and Jesse Fried, 'The Uneasy Case for the Priority of Secured Claims in Bankruptcy' (1996) 105 YLJ 857; Lynn LoPucki, 'The Unsecured Creditors' Bargain' (1994) 80 Virg LR 1887.

The checks entrenched in the procedure to check abuse of control by managers were far less effective than Congress had envisioned. The freedom of the UCC, trustees and examiners to execute the functions outlined in the Code was curtailed by cost or the court. Unsecured creditors participated far less than envisaged; only striving in the bigger cases with greater value.[45] They were also undermined by low levels of information and the cost of the investigations which would have yielded the required information.[46] Moreover, unsecured creditors rarely succeeded in shutting down distressed companies; though at least 3 of every 4 companies that filed for reorganisation failed - indicating unviable businesses.[47] Theoretically, unsecured creditors can have trustees appointed to take control of the company. However, the courts have consistently held that the appointment of the trustee is an 'extraordinary remedy' which makes it the exception, not the rule.[48] On the rare occasion that one is appointed, the trustee rarely investigates 'the desirability of continuing the business'. Trustees merely steer the company, usually to liquidation.[49]

Another option would be to solicit the appointment of an examiner. In practice however, examiners are rarely solicited or appointed.[50] Again, they are appointed mostly in the biggest and most contentious cases; with individual creditors, rather than the UCC, making a higher number of requests.[51] Many judges accede to the request only if they believe that the appointment will contribute direct economic

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[45] Kerkman (n43) 188-192; LoPucki, 'First Instalment' (n41) 112.
[46] LoPucki, 'Second Instalment' (n42) 252-254.
[47] LoPucki, 'First Instalment' (n 41) 4.
[48] *In re Anniston Food-Rite, Inc.*, 20 BR 511 (Bankr.N.D.Ala. 1982); *In re Stein and Day, Inc.*, 87 BR 290 (Bankr. S.D. N.Y. 1988).
[49] Kerkman (n 43) 14.
[50] Jonathan Lipson, 'Understanding Failure: Examiners and the Bankruptcy Reorganization of Large Public Companies' (2010) 84 AMBK RLJ 1, 24 ('Lipson, Examiners'). Appointed in 6.7% of the sample.
[51] Ibid 30-32.

benefit to the case.[52] Even then, the judge may, and would usually, define the scope of the examiner's duties and the extent of his budget; limiting his capacity to execute his duties.[53] Given that an investigation into the cause of the failure or the desirability of rescue contributes no direct economic benefit to the estate, examiners are not utilised as Congress envisaged. Essentially, in the first two decades of the chapter 11 procedure, the rescue decision was hardly likely to be taken objectively by the party in control – the managers. The company would carry on in chapter 11 for as long as it could; until it either could not keep up with the operational costs of the reorganization or actually did reorganize.

6.1.1.2 Creditor in Control

Even in the first two decades of the chapter 11 procedure, empirical studies showed that the UCC participated actively when there was a lot of value at stake.[54] In the reorganizations of larger companies, managers' control of the rescue process was greatly reduced by activist creditors. Rather than find solace in chapter 11, managers of such companies were likely to be ousted.[55] Theoretically, avid creditor participation is preferable because it injects more objectivity into the rescue procedure and may result in less skewed decisions. Creditors of such companies experimented with contractual devices engineered to check the abuse of DIP control during reorganizations, which the courts and unsecured creditors had failed to accomplish.[56] These devices struck the epicentre of the debtor's decision-making structure. The

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[52] Ibid 36. Also, *In re Bel Air Assocs., Ltd.*, 4 BR 168 (Bankr.W.D.Okla. 1980); *In re Lenihan*, 4 BR 209 (Bankr.D.R.I. 1980).
[53] Lipson, 'Examiners'(n50) 51-52.
[54]See (n45) above.
[55] Lopucki, 'First Instalment' (n41) 173; Kerkman (n 43) 6; Stuart Gilson, 'Management Turnover and Financial Distress' (1989) 25 J Fin Econ 241; LoPucki/Whitford, 'Governance'(n35) 723.
[56] Articles listed in (n 36); (n38).

finance contract consequently became the main instrument by which lenders exerted control over managers and the DIP.

By the time a company became distressed, it would have breached some of its loan covenants and would also need an infusion of finance. In return for new funds and/or the waiver of certain default-rights, the main lenders would negotiate for power to influence some of the debtor's future plans or actions.[57] In the eighties and early nineties, the main lender and/or the UCC sometimes pressurised the debtor to appoint 'responsible officers' to senior management positions.[58] These officers effectively took charge of the reorganization while the managers administered the business.[59]At best, they were quasi-trustees. They could only be removed by the court.[60] The practice was controversial however. Experts and courts argued that Chapter 11 does not recognise the office of a quasi-trustee.[61] The concept eventually fizzled out but was reincarnated subsequently. In its next iteration, the Responsible Officer was designated the 'Chief Restructuring Officer' (CRO).[62]

The CRO is a turnaround professional appointed to supplement senior management.[63] The appointment is suggested (or in reality demanded) as a pre-condition for the provision of distress-financing before or after the initiation of formal

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[57] Short term loans, restrictive covenants and revolving credit facilities. Sris Chatterjee et al., 'Debtor-in-possession Financing' (2004) Journal of Banking and Finance 3097.
[58] A responsible officer is a turnaround professional or firm, selected or approved by the creditors but compensated by the debtor, who is given rights, powers and duties similar to the trustee's. The responsible officer is, in effect, a quasi-trustee. Walter Theus Jr, 'Who's Responsible Here? "Responsible Persons" in Chapter 11 Cases' (2008) 27AMBKRLJ 12.
[59]*In Re United Press Int'l , Inc.*, 60 BR 264 (Bankr.D.Col. 1986).
[60]*In Re Gaslight Club Inc.*, 782 F2d 767 (7th Cir. 1986).
[61]*In re Adelphia*359 BR 54 (Bankr.S.D.N.Y. 2006).
[62] Miller/Waisman, 'Viable Option' (n 38)186.
[63] Shai Waisman and John Lucas, 'The Role and Retention of the Chief Restructuring Officer' (The Americas Restructuring and Insolvency Guide 2008/2009) 200; Mark Bossi, 'Are CROs More Powerful than Turnaround Consultants? Creditors Drive Trend Toward New Title' (1Oct 2006)JCR.

reorganization.[64] It is important to mention that the expansion of creditor leverage is predicated on the late nineties evolution of the financial constitution of larger companies.[65] Increasingly, large companies which enter into Chapter 11 have high levels of secured debt, as well as unsecured debts. Consequently, they have less unencumbered cash with which to administer reorganizations and are more reliant on distress-financing – the Trojan horse by which CROs can be introduced to companies.[66]

The lender expects the CRO to provide a fresh perspective on the debtor's problems.[67] A CRO, with appropriate level of experience, is a more credible reorganizer than the managers or, in particular, the trustee who requires time to familiarise himself with the debtor's business. The problem is that the CRO almost assuredly focuses primarily on the main lender's interests. CROs and main lenders are repeat players; the CRO must satisfy the lender to engender future appointments.[68] Moreover, the lender's choice of CROs is based on the latter's reputation for accomplishing certain goals. In addition, lenders enhance their control of debtors through other contractual measures.[69] Through the DIP finance contract, they may negotiate greater representation on the board of directors.[70] They may hinge managers' compensation packages on the achievement of pre-agreed

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[64] See (n62) above.
[65] Skeel, 'Creditors' Ball' (n 38) 925.
[66] Sandeep Dahiya et al., 'Debtor-in-possession Financing and Bankruptcy Resolution: Empirical Evidence'(2003) 69 Journal of Financial Economics 259, 266.
[67] CROs were appointed in the reorganizations of Kodak, K-Mart, Enron, WorldCom, Pinnacle Airlines, to name a few.
[68] Robert Rasmussen, 'On the Scope of Managerial Discretion in Chapter 11' (2007) Uni Penn LR 77, 83.
[69] A discussion of these devices is provided in George Kuney, 'Hijacking Chapter 11' (2004) 21 EMORYBD 19.
[70] The DIP lender bargained for 5 of 12 board seats in the US Airways case; discussed in Skeel, 'Creditors' Ball' (n 38) 925-926.

goals.[71]Consequently, even where the pre-petition managers are left in place, their independence would be severely curtailed.

Simultaneously, there has also been an explosion in claims trading in the US.[72] A creditor, who prefers not to participate in the reorganization for any of a plethora of reasons, may sell its claim at a discount to distress investors.[73]These investors, usually hedge-funds, may buy multiple tranches of a debtor's claims; through which they can obtain seats on the UCC. They make profit by extracting as much value as possible from the rescue negotiations. This may even entail taking-over the distressed company through so-called loan-to-own agreements.[74]

Essentially, the chapter 11 procedure is not a forum at which a neutral, objective decision is made about the company or its business. In practice, results are skewed in the interest of any party who successfully wrests control. Empirical studies show that the DIP lenders speed up the reorganization process and prevent managers from perpetuating unviable companies.[75] Given that they must examine distressed debtors to determine viable investment opportunities, they perform assessment and monitoring roles which the UCC, trustees and examiners have failed to perform in the past.[76]

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[71] Kuney (n 69) 88-89.
[72] Joy Conti et al., 'Claims Trafficking in Chapter 11 – Has the Pendulum Swung Too Far?' (1992) 9 Bankr Dev J 281; Frederick Tung, 'Confirmation and Claims Trading' (1996) 90 NW Uni LR 1684; Michelle Harner, 'The Corporate Governance and Public Policy Implications of Activist Distressed Debt Investing' (2008) 77 Fordham LR 703.
[73] Adam Levitin, 'Bankruptcy Markets: Making Sense of Claims Trading' (2010) 4 Brook J Corp Fin & Com L 64.
[74] Michelle Harner, 'Trends in Distressed Debt Investing: An Empirical Study of Investors' Objectives' (2008) 16 ABI LR 69. A hedge-fund acquired control of Kmart by buying its debts.
[75] Maria Carapeto, 'Does Debtor-in-possession Financing Add Value?' (6 Oct 2003 Cass Business School); Dahiya (n66) 271.
[76] Dahiya, (n66) 274-276.

Notwithstanding the value that they may contribute to the process, the sophisticated devices utilised by some lenders,[77] their perceived disinterest in relational-lending[78] and their focus on margins, may precipitate liquidations where their debts are fully secured.[79] In some instances, the tussle for control amongst the investors, particularly where they seek to take over the company, results in the loss of value.[80] The court is expected to inject neutrality into the system but it lacks the information and sophistication of the lenders and distress-investors. In some large cases, the court has had to appoint examiners to investigate the state of the debtor's business and the actions of the investors.[81]

6.1.2 The Finance Decision

Chapter 11 recognises that a struggling company needs an injection of short term finance to stabilise its business, or to continue trading while long term decisions are made and implemented. Finance experts inform that lenders advance funds because they expect to be repaid.[82] When repayment becomes doubtful, lenders are likely to withhold finances, on which distressed companies rely for survival. Likewise, suppliers will not deliver goods, if they are not guaranteed payment. Alternatively, they may demand upfront cash payments from an already cash strapped entity.

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[77] Particularly, credit default swaps (CDS) and similar derivatives.
[78] Unlike traditional banks.
[79] Kenneth Ayotte and Edward Morrison, 'Creditor Control and Conflict in Chapter 11 Bankruptcy' (2009) 1 Journal of Legal Analysis 511.
[80] For example, *In re Adelphia Commc'ns Corp*., 359 BR 54 (Bankr.S.D.N.Y. 2006); Report of Harvey Miller as Examiner, *In re FiberMark, Inc.,* 349 BR 385 (Bankr.D.Vt.2006); David Peress and Thomas Prinzhorn, 'Nontraditional Lenders and the Impact of Loan-to-Own Strategies on the Restructuring Process, (2006) 25 AMBANKR INST J 48; Michelle Harner, 'Activist Distressed Debtholders: The New Barbarians At The Gate?' (2011) 89Wash U LR 155.
[81] For example, in FiberMark.
[82] See p 61 above.

Chapter 11 bridges the gap between lenders, suppliers and debtors by providing a regime by which short term funds can be filtered to debtors while long term funding decisions are considered. However, the regime has mutated from the benign measure introduced by Congress. As the ensuing sub-sections show, in practice, lenders use the short-term lending device to increase their control over other aspects of the reorganization process – many times to the disadvantage of otherstakeholders, including the debtor. Though certain abusive practices may be easily identified and condemned,[83] it is unclear however whether or not claims-trading is more detrimental than beneficial.[84]As shocking as some of their activities may seem, it is important to recognise the crucial role played by the mechanism, as well as the lenders during the rescue process.

6.1.2.1 Short Term Finance

A debtor can take normal business decisions and use its assets in that capacity without prior approval of the court or its creditors.[85] It requires prior approval of the court, at a hearing at which its creditors may be heard, when it wishes to engage in transactions beyond the ordinary course of its business.[86] The code does not define 'ordinary course of business'.[87] So the court will seek, in each case, to balance the

[83] For example, greenmailing: buying up claims to block confirmation, for example. See *In re Applegate Prop. Ltd.*, 133 BR 827(Bankr.W.D.Tex.1991); *In re Allegheny Int'l, Inc.*, 118 BR282(Bankr.W.D.Pa.1990).
[84] Levitin (n73) 107.
[85] 11 USC, s363 (c)(1); *In re Glosser Bros., Inc*., 124 BR 664(Bkrtcy.W.D.Pa.1991).
[86] 11 USC, s 363 (b)(1); *In re Leslie Fay Companies, Inc.*, 168 BR 294 (Bkrtcy.S.D.N.Y.,1994).
[87]*In re Johns–Manville*, 60 BR 612 (Bkrtcy.S.D.N.Y.,1986).

reorganization needs and prospects of the debtor with the prospects of its creditors who look to those assets for the repayment of their debts.[88]

The debtor may only use its cash, if encumbered by other parties' interests, after securing prior approval of the party[89] or the court.[90] The court has a broad discretion in this regard.[91] Again, it juxtaposes the interests of both parties; it examines the fairness and reasonableness of the purpose to which the collateral would be put.[92] The court may approve the request if it finds that the secured party is adequately protected from the erosion of its claim.[93] The funds that the debtor garners from these sources may be insufficient however. Therefore, chapter 11 provides a dedicated short term finance mechanism referred to as debtor-in-possession financing (DIP Financing). DIP financing is widely regarded as one of the most iconic and innovative features of the American rescue procedure.[94]

The DIP can seek any of four types of DIP financing but it must prove that it has been unable to obtain financing at the lowest level before ascending the hierarchy.[95] The creditor may obtain unsecured credit in the normal course of its business which will be treated as an administrative expense; giving the financier priority but not

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[88] *In re James A. Phillips, Inc., 29 BR 391(D.C.N.Y.,1983).*
[89] *Freightliner Market Dev.Corp v Silverwheels Frieghtliners*, 823 F2d 362 (C.A.9 (Or.),1987).
[90] Described as 'cash collateral': 11USC, s363(a). This usually includes the debtor's account with the bank. *Kenney's Franchise Corp. v. Central Fidelity Bank NA, Lynchburg*, 22 BR 747 (W.D. Va. 1982). See 11USC,s 363(e) also.
[91] *In re Madcat Two Inc.*, 120 BR 990 (Bkrtcy.E.D.Ark.,1990); *In re Lionel Corp.*, 722 F2d 1063 (C.A.N.Y.,1983); *In re Enron Corp.*, 335 BR 22 ((S.D.N.Y., 2005).
[92] *In re Med. Software Solutions*, 286 BR 431 (Bankr.D.Utah.2002); *In re Allied Holdings Inc.*, 337 BR 716 (Bankr.N.D.Ga.2005).
[93] What constitutes adequate protection depends on the vagrancies of each case. *In re Fontainebleau Las Vegas Holdings, LLC*, 434 BR 716 (S.D.Fla.,2010); *In re Lakeshore Apartments of Ft. Oglethorpe, II, Ltd.*,109 BR 278 (Bkrtcy.S.D.Ohio,1989).
[94] DIP finance, introduced into the US rescue law by the 1933 reforms to the Bankruptcy Act 1898, finds its roots in equity receivership.
[95] 11 USC, s364.

security.[96] In practice, the debtor mainly incurs credit from suppliers under this provision.[97] The problem that the supplier may face is that the debt may be challenged as not being 'in the ordinary course of business'. If the creditor is unable to discharge the burden of proof that it is, successfully, it will lose its priority status and may not recover its debt.[98] Recall that the code does not give content to the 'ordinary course of business'.[99]

The courts have engineered a two-pronged test by which they determine the nature of the transaction.[100] The horizontal test requires the creditor to prove that the transaction is typical for businesses similar to the debtor's.[101] The vertical test requires the creditor to prove that a reasonable creditor would not have considered the transaction as a deviation from the debtor's normal operations.[102] To avoid the risk of losing priority, the DIP lender may provide a loan after receiving prior approval from the court.[103] The debtor may use these funds outside the ordinary course of business, while the lender gains priority treatment as an administrative expense. In practice, lenders rarely advance loans based only on priority; most DIP loans are secured.[104]

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[96] 11USC, s 364 (a).
[97] Bruce Henoch, 'Postpetition Financing: Is there life after Debt?'(1991) 8 BKRDEVJ 575.
[98] *In re Hustings Land & Dev. Inc.*, 255 BR772 (Bankr.D.Utah 2000).
[99] *In re Living Hope Southwest Medical SVCS, LLC*, 450 BR 139 (Bkrtcy.W.D.Ark.,2011).
[100] See *In re DartCo Inc*. 197 BR 860 (Bkrtcy.D.Minn.,1996); *In re Waterfront*, 56 BR31 (Bkrtcy.D.Minn.,1985).
[101] *In re RJC Industries, Inc*, 369 BR 845 (Bkrtcy.M.D.Pa.,2006).
[102] *In re Blessing Industries Inc*., 263 BR 268 (Bkrtcy.N.D.Iowa,2001).
[103] 11 USC, s364(b)
[104] Michael Rochelle, 'Post-Filing Loans to the Chapter 11 Debtor: Good Money After Bad' (1990)107 Banking LJ 344:

> '*Unless the lender is '(1)very familiar with the debtor and the proposed transaction, and comfortable with it, or (2) crazy.'*

Also, Dahiya, (n66) 263:

The lender may acquire security on previously unsecured property or a junior lien on previously secured property and priority over administrative expenses; subject to the approval of the court.[105] The code prevents pre-petition liens from attaching to property acquired by the debtor post-petition.[106] Notwithstanding, liens attaching to pre-petition property continue to encumber the proceeds of such property if sold post-petition.[107] The rule affords the debtor an opportunity to access secured finance after proceedings have begun, if it acquires new property. Such property would usually comprise inventory and receivables; on which most DIP finance is secured.[108]

Before accepting a junior lien, the DIP lender will assess the value of the collateral, usually at liquidation value, to determine whether there is a sufficient cushion between the value of the property and the amount of liabilities it secures.[109] Recall that many reorganizing companies in recent times have no unencumbered properties by the time they initiate the proceedings, this reduces the possibility of obtaining first liens. Even where the lender acquiesces, the DIP must receive the imprimatur of the court; for which it must prove it was unable to obtain unsecured credit.[110]

'majority of DIP financing is under subsection 364 (c) or 364 (d)'.

[105] 11 USC, s364 (c). Colloquially 'super-priority'.
[106] 11 USC, s552 (a).
[107] 11USC, s363(a).
[108] For example, *In Re Becker Industries Corp*., 58 BR 725 (Bkrtcy.S.D.N.Y.,1986); hence retail companies appear to have easier access to DIP funding. Dahiya, (n66) 268.
[109] See Rosenberg et. al., *Collier Lending Institutions and the Bankruptcy Code* (1988) cited in Henoch, (n97) footnote 23.
[110] *In re Ames Dept. Stores, Inc*. 115 BR 34(Bkrtcy.S.D.N.Y.,1990).

In practice, potential DIP lenders often demand 'priming liens'; particularly because all the debtor's assets would be encumbered at the time of the reorganization.[111] A priming lien is security at par with, or senior to a pre-petition first lien on collateral.[112] It is the highest form of security obtainable by a potential lender under the Code. Junior lien holders and unsecured creditors may accept the DIP lender's terms because they are likely to recover (portions of) their debts only if the company is rescued and the rescue is predicated on the injection of fresh funds.[113] Pre-petition senior lien-holders may accept the request readily if they are to grant the debtor its post-petition loans.[114] In cases where the DIP financers are different, it is typical for the senior lien-holders to protest the priming lien. In either case however, the court, must approve the arrangement before it takes effect.[115]

Again, the DIP must show that it was unable to obtain credit otherwise.[116] Though it does not have to seek credit from every possible lender, it must have made as much effort as its case required.[117] The debtor must also show that it has furnished the senior lienholder with adequate protection.[118] Again, the code leaves the specificities to the equities of each case. The pertinent question is whether the secured creditor's interest in that property is being unjustifiably jeopardized by parties focused solely on the debtor's rescue prospects.[119] The court may find adequate protection when there is

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[111] 11 USC, s364 (d). Assets drop over 60% while secured debt rises nearly 600% during the 2 years preceding the filing. Ayotte/Morrison, (n79) 8.
[112] *re Fontainebleau* (n93). George Trantis, 'A Theory of the Regulation of Debtor-in-Possession Financing, (1993) 46Vanderbilt LR 901, 907.
[113]*In re Sky Valley Inc*., 100 BR 107 (Bkrtcy.N.D.Ga., 1988).
[114] Dahiya, (n66) 268-270.
[115] See (n113).
[116] It must also provide the pre-distress creditors with adequate notice. *Matter of Stanley Hotel, Inc*. 15 BR 660 (D.C.Colo., 1981).
[117]*In re Snowshoe Co. Inc.*, 789 F2d 1085 (C.A.4 (W.Va.1986).
[118] Ibid.
[119]*In re Aqua Associates*, 123 BR 192 (Bkrtcy.E.D.Pa.,1991).

a sufficient equity cushion, as well as additional safeguards including periodic payments to the prepetition lenders.[120]

DIP financiers contribute much more than cash to the rescue process. They help identify debtors with potentially viable businesses, monitor the DIP during the period of rescue and reduce the length of the process by their efforts.[121] Though all reorganizing companies may seek DIP financing, in practice, only about half succeed – usually the larger companies.[122] Dahiya shows that successful companies have relatively less leverage and more current assets than other distressed companies.[123] This discovery corroborates rescue theory which asserts that companies that initiate the rescue procedure timely are likely to succeed – subject of course to the viability of their businesses. Given their access to crucial information about their debtors, DIP lenders are positioned to press for quicker resolution of the cases – whether rescue or liquidation – as they consider appropriate.[124] Empiricists have observed shorter reorganization cases since the mid-nineties; attributed to the monitoring role played by creditors and DIP financiers.[125]

The Code does not regulate the content of DIP finance contracts. The problem is that laissez-faire DIP financing may also produce grave consequences for debtors as suggested in the preceding sub-section.[126] DIP lenders may precipitate premature liquidations to protect their investments from volatility. Ayotte/Morrison find that the probability of reorganization declines as the ratio of secured debt to value of asset

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[120]*Re Stanley* (n116) 663; *Re Snowshoe* (n117) 1089.
[121] Dahiya (n66) 276; Carapeto (n75) 17.
[122] Dahiya (n66) 266.
[123] Ibid 266; Carapeto (n75) 10.
[124] Carapeto, (n75); Dahiya, (n66) 274.
[125] See (n 121).
[126] See p217.

increases.[127] This fact is often cited as business and asset sales replace reorganizations in chapter 11.[128]

Debtors which fail to comply with their financiers' directives lose access to the funds and, in many cases, their assets because most DIP finance comprises short term, revolving loans; often supplemented with so-called drop-dead clauses.[129]Many (of such) companies are liquidated pursuant to s 363 (f) which does not have the protections built into the traditional bankruptcy proceedings: no disclosure statements, no requirement for majority approval of decisions or price, no court guidance on crucial decisions.[130]In addition, where the DIP lender is a pre-petition lender, it may structure the agreement such that it secures previously unsecured or under-secured pre-petition loans.[131] Through the DIP agreement, DIP lenders may compel the debtor to forego claims it may have had against them. The lenders may also prevent it from confirming a plan they find disadvantageous.[132] Recall that neither the managers nor creditors are neutral parties; each negotiates as best it can, to serve its own interests. Managers therefore accept the terms if there are no other options. It has been left to

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[127] Ayotte/Morrison, (n 79) 14-15.
[128] Sale/liquidation occurred in 66% of the cases; reorganization in which the pre-petition debtors retained stakes, often ownership occurred in 32%. Ayotte/Morrison, (n79) 8; Stephen Selbst, 'General Motors and Chrysler: The Changing Face of Chapter 11' (Commercial Lending Review Nov-Dec, 2009) 3.
[129] Otherwise called 'immediate relief from stay' clauses. They give the creditor the right to lift the stay without a hearing when the debtor defaults. Courts however insist on a hearing in more recent cases. Though what is decided is whether there has been a default, not the fairness of the provision. Kuney (n 70) 68.
[130] Ibid 107-108.
[131] Cross-collateralization. *In re Texlon Corp.*, 596 F2d; *In re Vanguard Diversified, Inc.*, 31 BR; Charles Tabb, 'A Critical Reappraisal of Cross Collateralization in Bankruptcy' (1986) 60 Southern California LR 109.
[132] Kuney (n69) 71 – 73; David Skeel jr, 'The Past, Present and Future of Debtor-in-Possession Financing (2004) 25 Cardozo LR1905.

the courts to be circumspect in approving the agreements.[133] However, in the absence of clear rules on the subject matter, courts may sanction agreements that contradict bankruptcy principles. Notwithstanding, the arrangement enjoys a flexibility which benefits the debtor and its junior claimants.[134]

6.1.2.2 Financial Reorganization

After securing its short term continuity, a debtor which is to be rescued must resolve its balance-sheet problems. If it is to return to health, it must shed some of its pre-petition debt-load. The debtor must emerge with a new capital structure which has fewer expenses than returns; sufficient to yield profits and to facilitate access to future capital investments. The reorganization plan sets out proposals by which these goals may be achieved.[135] If the reorganization commenced voluntarily and no trustee has been appointed, the DIP has the exclusive right to formulate and propose a reorganization plan within a period of 120 days following the date on which the petition was filed.[136] When it has filed a plan, no other party may file a competing plan until the expiration of 180 days from the date on which the petition was filed, if its plan has not been accepted by all classes of impaired claims.[137] When the period of exclusivity terminates, a trustee is appointed, or the case commenced involuntarily, any party in interest may propose a reorganization plan.[138] If the DIP does not file a plan within 120 days or its plan is rejected by the stakeholders, it may request an

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[133] For example, *In re Saybrook Manufacturing Co*., 963 F2d 1490 (11th Cir. 1992); see Guidelines for Financing Requests for the Bankruptcy Court for the Southern District of New York.
[134] See also, Levitin (n 73)71.
[135] The reorganization plan is basically a financial plan.
[136] 11 USC s 1121(b);*In re Barker Estates, Inc.*, 14 BR 683 (Bkrtcy.N.Y., 1981).
[137] *In re National Safe Center Inc*., 54 BR 239 (Bankr.D.Hawai'I.1985); *Matter of Mother Hubbard, Inc.*, 152 BR 189(Bkrtcy.W.D.Mich.,1993).
[138] 11 USC, s1121 (c); *In re Tranel.*, 940 F2d 1379 (5th Cir. 1991); *In re Kun* 15 BR 852 (Bankr.D.Ariz.1981).

extension of its period of exclusivity.[139] The court may grant its request if justified by its circumstances.[140]

In practice, extensions were granted by the courts customarily; without, many argue, due regard for the consequences on other stakeholders.[141] While courts may attribute their liberal extensions ethos to the desire to give the debtor enough time to negotiate a consensual plan, its other effect is to unduly prolong the reorganization, resulting in a hike in direct and indirect costs.[142] The stranglehold debtors had over the reorganization process gave them 'full control' over rescue in the first few years of the 1978 code; resulting in longer rescue cases.[143] In the bigger cases, the creditors, as demonstrated above, have reeled in the debtors but anecdotes suggest that small companies still retain this power with the help of the court.[144] For that reason, Congress introduced a limit, in 2005, to the length of the exclusivity period.[145]

The plan must be approved by stakeholders. Prior to the vote, its proposer must place each claim or interest in a class comprising substantially similar claims or interests.[146] Claims placed in a class will receive equal treatment by the plan.[147] The classes must be properly constituted because a plan that lumps heterogeneous claims into a single

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[139] 11USC, s1121 (d) (1); *In re Nicolet Inc*., 14 BR 506 (Bankr.D.Utah.1981).
[140] *In re Tony Downs Food Co*., 34 BR 405(Bankr.Minn.1983); Andrews, 'The Chapter 11 Creditors' Committee: Statutory Watchdog?' (1985)2 Bank Dev J 247.
[141] Joseph Bodoff, 'Limiting Exclusivity' (1996) 4 AMBKRILR 496; Kerkman, (n43) 181-182.
[142] Neill Fuquay, 'Be Careful What You Wish For, You Just Might Get It: The Effect On Chapter 11 Case Length of the New CAP on a Debtor's Exclusive Period to File a Plan' (2006) Texas LR 431.
[143] Ibid 440; notice change in 1992 – coinciding with rise of creditor control.
[144] Samuel Bufford, 'Chapter 11 Case Management and Delay Reduction : An Empirical Study' (1996) 4 AMBKRILR 85.
[145] 11USC, s1121 (d) (2) (A): maximum of 18months and 20months for the 120 days and 180 days respectively.
[146] 11USC, s1122(a). A group of small unsecured claims may be treated as administrative expenses, as directed by the court – 11USC, s1122 (b).
[147] 11USC, s1123 (a) (4); *In re City of Colorado Springs Creek General Imp. Dist*., 187 BR683(Bkrtcy.D.Colo.,1995)

class will not be confirmed by the court.[148] Each secured claim is typically placed in a separate class, unless a group of secured claims are protected by the same lien. While unsecured claimants may be congregated in a single class, there may be rational business reasons for splitting them into separate classes.[149] In practice, the DIP may strategically stratify the classes to manufacture the consent of at least one class of claims; its ultimate goal being to cram-down the plan with the help of the court, on other classes.[150] The court may refuse to confirm such a plan however.[151]

Prior to the vote, the claimants must be supplied with copies of the plan or its summary, accompanied by written disclosure statements pre-approved by the court as containing adequate information.[152] What constitutes adequate information depends on the circumstances of each case and the cost of obtaining additional information.[153] Nonetheless, the information should suffice a reasonable claimant to make an informed decision, taking into consideration the nature and history of the debtor, and the state of its books.[154] Still, the code permits a solicitation of approvals of the plan even without a pre-approved disclosure statement, if conducted pre-petition and meets the standards of applicable non-bankruptcy law.[155] The plan must be accepted in good faith by each class of impaired claims and interests. A class accepts the plan when approved in good faith by creditors holding at least one-half in number and two-thirds

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[148] *In re Gillette Associates Ltd*., 101 BR 866 (Bankr.N.D.Ohio.1989).
[149] *In re Graphic Communications Inc*., 200BR 43 (Bankr.E.D. Mich.1996).
[150] *In re Boston Post Road Ltd.Partnership*., 21 F3d 477 (C.A.2 (Conn.),1994).
[151] *In re Tucson Properties Corp.*, 193 BR 292 (Bankr.D.Ariz.1995).
[152] 11USC, s1125 (b); *Matter of Northwest Recreational Activities Inc*., 8 BR10 (Bankr.N.D.G.A1980).
[153] 11 USC, s 1125(a).
[154] *In re Bjolmes realty Trust*, 134 BR100 (Bankr.D.Mass.1991); *In re microwave products of America Inc.*, 100BR376(Bankr.W.D.Tenn.1989).
[155] 11 USC, s1125 (g).

in amount of the allowed claims of that class.[156] A class of unimpaired claims is presumed to have accepted the plan, while a class of claims which receives nothing under the plan is presumed to have rejected the plan.[157]

In practice, a hybrid form of reorganization, referred to as pre-packed reorganization, exists alongside the traditional (statutory) reorganization procedure.[158] Pre-packs combine features of informal restructuring with those of the traditional reorganization.[159] At a pre-pack, the debtor and its creditors negotiate the terms of the reorganization before the petition is filed.[160] After a plan has been drafted in consultation with some creditors, the debtor files a reorganization petition accompanied by the plan. Usually, the pre-petition negotiations also include the provision of short term finance; most pre-pack reorganizations do not require DIP financing.[161] Pre-packs drastically reduce the length of time that the debtor spends in the formal procedure.[162] The debtor may file a pre-voted plan, in which case the voting outcome is also filed along with the petition and plan.[163] The court must still confirm the plan however. At the confirmation hearing, dissenters are heard and the court ensures that statutory standards are met. Conversely, if the plan is to be approved post-petition, it must comply with the disclosure requirements.

The court's oversight role is greatly reduced in relation to pre-packs. However, courts are well-known for their reluctance to overturn concluded business decisions,

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[156] 11 USC, s1126(c) (e).
[157] 11USC, s1126 (f), (g).
[158] See 11 USC, s105 (d) (2).
[159] Elizabeth Tashjian et al., 'Prepacks; An Empirical Analysis of Prepackaged Bankruptcies' (1996) 40Journal of Financial Economics, 135.
[160] For example, the General Motors and Chrysler reorganizations were pre-packed. See Selbst, (n128).
[161] Dahiya (n66) 268.
[162] Fuquay, (n142) 444.
[163] Tashjian, (n 159) 138.

particularly when consensual.[164] Empirical scholarship reveals that pre-packed plans are usually approved by courts.[165] Even where modifications are recommended, they are modest at best.[166] Lopucki finds that debtors with pre-packed plans are likely to re-file within five years of approval.[167] It is possible that robust decisions on the debtor's business may not have been made during the negotiations, perhaps because of limited creditor participation.

However, claimants have become increasingly sophisticated. Unsecured claimants who would usually be paid with equity in the rescued companies would be expected to insist on plans that ensure that the company remains a going concern after it is rescued – otherwise, they may not maximise their profits.[168] Some of the lenders may desire to continue a credit relationship with the debtor, thus, it is in their interests for a potentially profitable debtor to emerge from the rescue. Moreover, the same problems with pre-packs are present in non-pre-packed rescues. In the latter case, the influence of DIP lenders and sophisticated claimholders severely curtail opportunities for democratic plans. It is therefore doubtful that such plans, though filed during the proceedings, are consensual.[169]

An approved plan must be confirmed by the court before it becomes effective.[170] The court ensures that the plan and its proponent have complied with statutory

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[164] Trantis, (n112) 909.
[165] Only in 6.25% of pre-voted plans did the court refuse to confirm on account of the voting procedure. The plans still approved after modification. Tashjian, (n 159) 140
[166] Ibid.
[167] Lynn Lopucki and Joseph Doherty, 'Why Are Delaware and New York Bankruptcy Reorganizations Failing?' (2002) 55 Vanderbilt LR 1933. See also, Lynn LoPucki, *Courting Failure: How Competition for Big Cases is Corrupting the Bankruptcy Courts* (University of Michigan Press, 2005).
[168] For example, in loan-to-own cases. See also, Rasmussen, 'Hercules'(n37) 1451.
[169] Miller, (n38) 189.
[170] 11 USC, s 1141 (a).

requirements before it is confirmed.[171] The plan must be feasible; unlikely to be followed by future reorganization or liquidation, unless so proposed.[172] Each member of an unsecured class of impaired claims must have approved the plan or will receive the liquidation value of the claim under the plan.[173] The plan must be approved by every impaired class.[174] Nevertheless, the court may confirm a plan though it is not accepted by all classes of claims; provided that at least one class of claims, excluding insiders, accepts it in good faith.[175] This is another iconic feature of the US rescue procedure referred to as the cram-down. Literally it means forcing a plan on dissenting classes of claimants. The court's discretion is however constrained by rules with which it must comply.

Although unstated in the code, the court must first determine whether the claimants receive more than the full value of their claims.[176] A court which wishes to cram-down a plan must first verify that the plan does not discriminate unfairly against the dissenting class.[177] Courts evaluate the treatment of other impaired classes when making this judgment.[178] The court must also ensure that the plan is fair and equitable with respect to the dissenting class.[179] For a class of unsecured claims, the plan is fair and equitable if it permits them to receive the present value of their entire claims on the date the plan takes effect.[180] If it does not, then the court will inquire whether a

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[171] 11 USC, s 1129 (a); *In re Mansfield Tire & Rubber Co.,* 152 BR 477 (Bkrtcy.N.D.Ohio 1993).
[172] 11 USC, s 1129 (a) (11); *In re Rivers End Apartments, Ltd*., 167 BR 470 (Bkrtcy.S.D.Ohio 1994).
[173] 11 USC, s 1129 (a) (7).
[174] 11 USC, s 1129 (a) (8).
[175] 11 USC, s 1129 (b) (1).
[176] *In re Barrington Oaks Gen Partnership*, 15 BR952 (Bankr.D.Utah.1981); Kenneth Klee, 'All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code' (1979) 53AMBKRLJ 133.
[177] 11 USC, s 1129 (b) (1)*In re Graphic Communications, Inc*., 200 BR 143 (Bkrtcy.E.D.Mich.1996).
[178] *Matter of Rochem, Ltd*., 58 BR 641 (Bkrtcy.D.N.J.1985).
[179] 11 USC, s 1129 (b) (1).
[180] 11 USC, s 1129 (b) (2) (B) (i).

class of interests junior in hierarchy to the impaired claims receives any distribution when the impaired class has not been paid in full.[181]

The court will only cram-down a plan that does not permit the payment of junior claims when senior claims have not been reimbursed in full. This latter test is referred to as the absolute priority rule.[182] This rule, which finds its roots in the equity receivership era, states that claims must be paid in order of hierarchy and that junior claims can only receive distributions if senior claimants have been paid in full.[183] For secured claimants, the plan must comply with at least one of the tests outlined in the code.[184] The claimant may be permitted to retain the lien that secures his claims, to the extent of the allowed amount, and receive deferred cash payments which have a value on the date the plan takes effect, equal to the extent of the claimant's value in the property.[185] If the property is to be sold, then the claimant must have a chance to bid the claim and the lien must attach to the proceeds of the sale to the full extent of the claim.[186] The debtor may also abandon the property to the class and allow the claimant realize the indubitable equivalent of the claim.[187]

In practice, stakeholders prefer consensual plans that cater to all interests, to plans that must be crammed-down.[188] LoPucki finds that the preference for consensual plans stems from the (unexpressed) culture amongst the professionals, which undergirds the

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[181] 11 USC, s 1129 (b) (2) (B) (ii).
[182] The rule is not expressly mentioned in the code however.
[183] *Northern Pacific Railway Co. v Boyd*, 228 US 482 (1913); *Case v Los Angeles Lumber Products Co.*, 308 US 637 (1939).
[184] 11 USC, s 1129 (b) (2) (A)
[185] 11 USC, s 1129 (b) (2) (A) (i) (I) (II).
[186] 11 USC, s 1129 (b) (2) (A) (ii).
[187] 11 USC, s 1129 (b) (2) (A) (iii).
[188] Lynn LoPucki and William Whitford, 'Bargaining Over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies' (1990) 139 Uni Penn LR 125 ('LoPucki/Whitford, Equity's share').

reorganization process.[189] In addition, the professionals consider cram-downs to be expensive.[190] Before the court can cram-down a plan, the business must first be valued. The valuation determines whether the senior claimants have been paid in full and determines the value of stock by which unsecured claimants may have been paid the value of their claims. It is when the court discovers that a senior claimant has not recovered in full that the court can determine the fate of payments made to junior claimants.[191]

Debtors, managers, and junior claimants may seize the valuation process as their opportunity to mount opposition campaigns; particularly when excluded by the plan.[192] A battle of valuation methods would ensue, as parties with conflicting interests seek to administer generous or restrictive methods, as their interests require.[193] While the battle is raging, prospective buyers may lose their interest in the company, while the company daily loses value. Klee believes that the difficulties induced by the cram-down procedure are deliberate; to force parties to negotiate.[194] A consensual plan however eliminates this nuisance, permitting the stakeholders to negotiate any deal they prefer; unlike plans driven through by the court, consensual plans are premised on the relativity of priorities.[195]

The ability of the less sophisticated investors to participate at the negotiations will be based on the level of information that they acquire during the rescue process. It is

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[189] Ibid 154.
[190] Ibid 144.
[191] Ibid.
[192] LoPucki/Whitford, 'Equity's share' (n188) 147.
[193] The type of valuation method chosen by the court will depend on equitable considerations arising from the facts of the case. *ReBecker Industries* (n 108) 736.
[194] Klee (n176) 134.
[195] Ibid 171.

therefore important that they are adequately represented. Particularly where the less sophisticated parties are involved, the professionals that they hire to investigate the company ought to provide unbiased information on the true state of the company and the value of their claims. The information is vital to their negotiation positions, as well as their ability to convince the court to reject a plan that they have rejected. Notwithstanding, the US system recognises that the only available proposition for the debtor may be unpopular amongst some or all of its stakeholders. As long as the outcome is as fair as the circumstances permit, then it may be enforced if confirmed by the court.[196]

6.1.3 The Business Plan

A business plan is a proposal which presents critical information about the companyand its business to potential investors.[197] Designing the business plan compels the debtor to evaluate its ideas and proposals critically. The proposals can also be critically appraised by potential investors. Business plans are flexible documents. Nonetheless, most will present information on the company's history, industry profile, business profile, competitor analysis, the background of the owners and senior officers, finances, loan and investment strategy, risk assessment and operation strategy.

Chapter 11 does not require the DIP or trustee, if appointed, to propose a business plan.[198] Nonetheless, much of the information that would be contained in such a plan

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[196] The cram-down rules.
[197] Thomas Zimmerer, Norman Scarborough and Doug Wilson, *Essentials of Entrepreneurship and Small Business Management*(5th ed, Prentice Hall 2007).
[198] LoPucki/Whitford, 'Governance'(n35) 692.

is presented during the reorganization. The reorganization plan captures the company's pre and post-petition financial positions. The disclosure statements present information on the debtor's history, costs of the reorganization, claims and interests, liquidation analysis, and projections of the company's future.[199]However, the amount of information presented in the document depends on the circumstances of the case, as well as the sophistication of the claimants.[200] Where they can access the requisite information without the debtor's efforts, the court may permit the debtor to provide a less detailed statement. [201] The less sophisticated creditors would require the information, subject to the cost of its acquisition.

The disclosure statement does not require the debtor to provide detailed information on its operation strategy or the reasons for the earlier failure however. Unfortunately the information is crucial when the fate of the company is to be decided or its future planned. Relying on management to provide information on the real causes of the debtor's failure is imprudent. They may have contributed to its distress but would, of course, not reveal that in the disclosure statement. In any event, the DIP does not have to investigate the operation of its business, the conduct of its management or the desirability of continuing its business.[202]

The information presented in the disclosure statements may be abbreviated because the system also relies on the UCC to highlight the debtor's operational needs.[203] The

[199]*In re Dakota Rail Inc*., 104 BR138 (Bankr.D.Minn.1989).
[200]*In re Bjolmes Realty Trust*, 134 BR100 (Bankr.D.Mass.1991); *In re AC Williams Co.*, 25 BR173 (Bankr.N.D.Ohio.1982).
[201]*In re Cardinal Congregate I*., 121 BR 760 (Bankr.S.D.Ohio.1990).
[202] 11 USC, s 1107 (a).
[203] 11 USC, s 1103 (c) (2).

UCC is constituted by the debtor's largest creditors who are willing to serve.[204] Given the level of their sophistication, it is expected that these creditors would be able to decipher the true state of the debtor's business and the possibilities of recovery. Moreover, the debtor is to consult with them when formulating its reorganization plan. The information obtained during the process should improve their abilities to measure the debtor's viability.

One of the UCC's most important powers is the power to investigate the debtor's business, to determine the desirability of rescue.[205] The UCC engages professionals to investigate the debtor or it may seek the appointment of an examiner. Having studied the execution of the chapter 11 procedure, Kerkman found that the UCC rarely executes this function.[206] Likewise, Lipson found that examiners rarely conduct such enquiries because they do not contribute direct economic benefit to the estate.[207] Consequently, it is likely that the debtor, even if it reorganizes its finances, may not reorganize its operations sufficiently to effect a genuine rescue.

Secured creditors also contribute to the determination of the debtor's viability. Typically, they are commercial banks with sophisticated monitoring and assessment capacities. If the debtor's viability is in doubt, the secured creditor would likely apply to lift the stay on its security to prevent the erosion of its value.[208] The problem with relying on the secured creditor is that it has no reason to make the application unless it is not adequately protected. In practice, senior creditors apply to lift the stay routinely.

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[204] 11 USC, s 1102 (a) (1), (b) (1).
[205] (n203).
[206] See p215 above.
[207] See p 216 above.
[208] 11 USC, s 362 (d); *In re Cardinal Congregate I.*, 121 BR 760 (Bankr.S.D.Ohio.1990).

It is thus justifiable to infer that secured creditors focus more on their recoveries than on the viability of the company. The inference is strengthened by recent observations that short term lenders are increasingly taking the place of relational lenders. Distressed debt purchasers are likely to focus more avidly on the possibility of present gains as opposed to the long term viability of the company. Nevertheless, gains are not always independent of the company's viability. Many distressed lenders loan-to-own. Such lenders clearly would have investigated the viability of the companies; as would those who provide the ailing company with short term finance. Essentially, the situation is still quite fluid; abuse must be stamped out as each case requires but the potential value provided by these claimants ought not to be denied. Nonetheless, the system would benefit from an actual duty to provide a statement on the viability of the business and a statement on its operational needs.[209]

6.1.4 Lessons for Nigeria

The rescue system in the US has a democratic model. In theory, it provides mechanisms by which each of the main stakeholder groups may solicit the information required to participate effectively in the negotiations that characterise the system. In practice, the negotiations are skewed in the interests of the parties in control. It becomes very quickly apparent that whoever controls the finances controls the procedure. To constrain such parties, other interests must rely heavily on litigation. Moreover, many issues are resolved by the court, after hearings. Consequently, courts play a very active role in the procedure. It is therefore most vital that the judges have excellent training in insolvency philosophy and jurisprudence. It

[209] Again the neutral professional can help in this regard.

is important that the court system works effectively also. Given the sheer volume of cases, certainty and consistency in the application of the law are essential. Notwithstanding, judges may sometimes alter apparent practices in decisions that shock the system.

There are parallel finance systems for distressed and non-distressed companies. Liberal terms may apply to healthy companies because the secured creditors are more certain of recovery; while distressed companies find that the terms under which they can secure credit are vastly different. Secured creditors will always seek means by which to gain control of distressed companies. Consequently, while the law may be superficially debtor-friendly, it may in practice be controlled by creditors. Creditors prefer to have a neutral or an objective party take control of a distressed company, preferably one whose expertise they can trust. Secured creditors will always test the boundaries of the law to identify means by which to entrench their control while reducing oversight of their actions. Some of their actions may benefit all stakeholders but others may work only to the interests of individual creditors and should therefore be well-monitored.

Directors, though supported by a ‘friendly system’ generally fail to acknowledge failure. Typically, they file under pressure of precipitate actions from unsecured creditors or threats from secured creditors. Directors, where possible, would exploit their position at the helm of affairs when their company is in trouble unless their freedom is curtailed by statute or the creditors. The courts are often quite sympathetic to the plight of debtors; thus, they apply the law favourably in relation to them. If the law or the courts fail in the quest to regulate the actions of the directors, the (secured) creditors will fill the void. Unsecured creditors are unlikely to participate actively in the reorganization process unless they are guaranteed substantial returns. Even when they participate, it is often difficult for them to access information that would improve their bargaining positions. They cannot rely on the court's protection because they lack the information with which to convince the courts. It is difficult to access detailed information about the company. Although the law theoretically provides mechanisms by which the information may be diffused, in practice, the unsecured creditors may be too unsophisticated to effectively utilise them.

Part II

6.2 England and Wales

The principal rescue procedure in England and Wales is the administration procedure.[210] Administration commences when an administrator's appointment takes effect.[211] An administrator may be appointed by court order on the application of the company, its directors, its creditors, the qualifying floating charge holder, or the liquidator.[212] The holder of a qualifying floating charge[213] may also appoint an administrator out of court when his charge becomes enforceable.[214] Alternatively, the administrator may be appointed by the company or its directors, out of court, when

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[210] There were 625 administrations in the 2nd quarter of 2012; compared to 333 receiverships and 352 company voluntary arrangements in the same period. See Insolvency Service, 'Statistics Release: Insolvencies in the Second Quarter 2012' http://www.insolvencydirect.bis.gov.uk/otherinformation/statistics/201208/index.htm, accessed 01/10/2012. The procedure is outlined in Schedule B1 of the Insolvency Act, 1986 (IA 1986, Sch B1).

[211] IA 1986, Sch B1, Para 1 (2).

[212] IA 1986, Sch B1, Para 10, Para 35, Para 37, Para 38. The court may not grant the order if an administrative receiver is in office; unless the appointer consents or the charge under which the appointment was made can be challenged, avoided or released. IA 1986, Sch B1, Para 39.

[213] A qualifying floating charge is defined in IA 1986, Sch B1, Para 14 (2) and (3). It is basically a charge, or a network of charges, including a charge that was created as a floating charge, relating to all or substantially all of the company's property, which empowers its holder to appoint an administrator or an administrative receiver under IA 1986, s 29(2).

[214] IA 1986, Sch B1, Para 14. Unless an administrative receiver or provisional liquidator is in office. Para 17.

the company is or is likely to become insolvent.[215]The administrator and the company must comply with statutory requirements on notice and advertisement.[216] As soon as the appointment takes effect, an automatic stay comes into effect.[217] The stay halts all liquidation proceedings in relation to the company. [218]The stay also prevents the initiation or the continuation of legal processes commenced against the company, without the consent of the administrator or the permission of the court.[219] It also prevents the enforcement of proprietary rights against the company, without consent. [220] An administrative receiver must vacate the office, if one has been appointed, while a receiver of part of the company's assets may remain unless instructed to vacate the office.[221]

Only a qualified insolvency practitioner can validly be appointed as administrator.[222] The administrator is an officer of the court, as well as an agent of the company.[223] During the administration, the company's officers cannot exercise management powers without his acquiescence; management powers are vested in the administrator.[224] He may remove or appoint directors.[225] He may call meetings of

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[215] IA 1986, Sch B1, Para 22. The appointer must give the necessary notices: of intention to appoint and of appointment. Para 26, Para 29. There are restrictions including, when the company had, in the previous 2 months, been in administration, initiated a CVA with moratorium, or prematurely terminated a CVA. If the company is in administrative receivership or has a pending winding up petition or administration application in church, the appointment may also not be made. See Para 23, Para 24 and Para 25.
[216] IA 1986, Sch B1, Para 18, Para 45, Para 46.
[217] IA 1986, Sch B1, Para 42, Para 43. An interim moratorium is triggered by an application for an order or the filing of a notice of intention to appoint. Para 44.
[218] IA 1986, Sch B1, Para 40, Para 42. A winding up petition will be dismissed when an administration order is made or suspended when the appointment was by the qualifying floating charge holder. No resolution may be made or order passed for winding up.
[219] IA 1986, Sch B1, Para 43.
[220] Ibid.
[221] IA 1986, Sch B1, Para 41
[222] IA 1986, Sch B1, Para 6.
[223] IA 1986, Sch B1, Para 5, Para 69.
[224] IA 1986, Sch B1, Para 64, Para 59, Para 68.
[225] IA 1986, Sch B1, Para 61.

creditors or members.[226] He may make distributions to secured and preferential creditors without the prior approval of the court.[227] He may only make distributions to other unsecured creditors if approved by the court.[228] Nonetheless, he may make distributions to any creditor without prior approval, if that would facilitate the achievement of the purpose of the administration.[229]

He may dispose of property secured by a floating charge without prior approval, provided that the secured party is given a corresponding interest in the acquired property.[230] He may dispose of properties subject to other charges with the permission of the court.[231] The secured parties will be protected by orders charging the proceeds to be used to pay off outstanding sums. In addition, the administrator must pay the difference between the market values of the properties and the actual sale prices.[232] When drafting his proposal, the administrator must be mindful that he is not empowered to modify the rights or entitlements of secured and preferential creditors, unless they consent.[233]The administrator can also utilise the powers listed in Schedule 1 to the Insolvency Act. Given the scope of his powers, any person dealing with him does not have to inquire about his authority.[234] The actions of an administrator are valid, even if his appointment is defective.[235]

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[226] IA 1986, Sch B1, Para 62.
[227] IA 1986, Sch B1, Para 65.
[228] IA 1986, Sch B1, Para 65.
[229] IA 1986, Sch B1, Para 66; Sch 1, Para 13.
[230] IA 1986, Sch B1, Para 70
[231] IA 1986, Sch B1, Para 71, Para 72.
[232] Ibid.
[233] IA 1986, Sch B1, Para 73.
[234] IA 1986, Sch B1, Para 59 (3).
[235] IA 1986, Sch B1, Para 104. The court may order the appointer to indemnify the administrator against liabilities that arise as a result of its invalidity where the appointment was made out of court. Para 21, Para 34.

Within 11 days of his appointment, the company's officers must present the administrator with a verified statement of affairs, unless he extends the time limit or revokes the requirement.[236] Within 8 weeks of his appointment, the administrator must formulate his plans for achieving the goal of the administration.[237] He may propose to rescue the company or its business; whichever is achievable or serves the interests of the creditors better.[238] Where he cannot save any part of the business, he may realise the assets for distribution to secured or preferential creditors.[239] He is to send the proposals accompanied by a notice of meeting to the creditors and members; a copy must also be sent to the registrar of companies.[240]

The creditors may approve or reject the proposals at the meeting.[241] They may also establish a committee which may summon the administrator for questioning about his duties.[242] The committee is to decide the basis on which the administrator's remuneration is to be calculated.[243] The administrator may choose not to summon the initial meeting in four instances: where all creditors will be paid in full, where only the prescribed part is available for distribution, where distributions will be made only to secured and/or preferential creditors, or where communication would be through correspondence.[244] If the proposals are rejected, the court may terminate the

[236] IA 1986, Sch B1, Para 47, Para 48.
[237] IA 1986, Sch B1, Para 48.
[238] IA 1986, Sch B1, Para 3, Para 49.
[239] IA 1986, Sch B1, Para 3 (c).
[240] IA 1986, Sch B1, Para 49 (4), Para 51 (1).
[241] IA 1986, Sch B1, Para 53, Para 54.
[242] IA 1986, Sch B1, Para 57.
[243] IR 1986, r2.106 (3) (c) (4). If there is no committee, then the duty falls on the secured creditors. If there will be distributions to the preferential creditors, then the secured creditors and preferential creditors owed more than 50% of the preferential debts who have responded to the invitation to make the decision. Otherwise, the remuneration will be decided by the court on the application of the administrator. r2.106 (5), (6).
[244] IA 1986, Sch B1, Para 52. Unless requested by creditors holding at least 10% of the value of claims.

administration, approve a previously suspended winding-up petition or make any other order it considers appropriate.[245]

The administrator may resign or vacate his position.[246] He may also be removed by court order.[247] The administrator vacates the office automatically when he ceases to be a qualified practitioner.[248] The administration terminates automatically at the end of a year, unless extended by consent or the court.[249] Alternatively, it ends when the purpose of the administration is fulfilled or the court so orders.[250] If there are funds left for distribution to unsecured creditors after the sums due to the secured creditor have been extracted, the company may go into creditors voluntary liquidation; otherwise, the company will be dissolved.[251] Any creditor or member of the company who believes that his interests have been, or will be, unfairly harmed by the administrator may seek redress.[252] The court may also be requested, by an applicant who believes that the administrator is guilty of misfeasance, to examine the administrator’s conduct.[253]

6.2.1 The Rescue Decision

In the administration procedure, the rescue decision is taken by the administrator. The administrator is a certified insolvency professional.[254] Most insolvency practitioners

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[245] IA 1986, Sch B1, Para 55.
[246] IA 1986, Sch B1, Para 87.
[247] IA 1986, Sch B1, Para 88.
[248] IA 1986, Sch B1, Para 89.
[249] IA 1986, Sch B1, Para 76.
[250] IA 1986, Sch B1, Para 80, Para 79, Para 81.
[251] IA 1986, Sch B1, Para 84, Para 84.
[252] IA 1986, Sch B1, Para 74.
[253] IA 1986, Sch B1, Para 75. Applicants include the official receiver, the administrator, a creditor, the liquidator, or a contributory.
[254] IA 1986, Sch B1, Para 6.

are accountants or lawyers. He is appointed to investigate the company, to determine its viability and potential. He is expected to take his decisions neutrally.[255] He is expected to have passed the requisite training and to be fit and proper to undertake the professional and fiduciary duties that attach to the office.[256] Insolvency practitioners can be licensed by any of eight recognised professional bodies.[257] Practitioners may also be licensed by the secretary of state. The bodies are responsible for the continued development and discipline of the practitioners licensed by them. Practitioners must comply with the Insolvency Act, the Insolvency Practitioners' Regulations, as well as the principles and codes drafted by the regulatory bodies acting through the Joint Insolvency Committee (JIC), in concert with the Insolvency Service.[258] The government provides an overarching oversight role through the Insolvency Service.

Theoretically, the law prioritises the preservation of businesses within their corporate shells, over business sales. Regardless, the administrator is to be guided by the option that best serves the interests of the creditors as a group.[259] It is only where the administrator thinks that he cannot achieve either of these preferred objectives that he

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[255] In the interests of all the creditors as a whole. IA 1986, Sch B1, Para 3(2).

[256] Insolvency Practitioner Regulations, 2005, s6, s7. See also, R3, 'Making a Career as an Insolvency Practitioner' http://www.r3.org.uk/media/documents/publications/professional/Making_a_Career_Brochure_V2.pdf, accessed 30/09/2012.

[257] The Association of Chartered Certified Accountants (ACCA), Insolvency Practitioners Association (IPA), The Institute of Chartered Accountants in England and Wales (ICAEW), The Institute of Chartered Accountants of Scotland (ICAS), The Institute of Chartered Accountants in Ireland (ICAI), The Solicitors Regulation Authority (SRA) for The Law Society of England & Wales, The Law Society of Scotland, The Law Society of Northern Ireland.

[258] See for example, Code of Ethics for Insolvency Practitioners, 2008, http://www.accaglobal.com/content/dam/acca/global/PDF-members/2012/2012e/ethical_code.pdf, accessed 29/09/2012; Statements of Insolvency Practice (SIPs) http://www.r3.org.uk/index.cfm?page=1380, accessed 29/09/2012.

[259] *BLV Realty Group II Ltd v Zegna III Holdings Inc*., [2009] EWHC 2994; 2009 WL 3805449, Para 22.

may choose to realise assets for distribution to secured and preferential creditors.[260] The procedure theoretically infuses objectivity into the administrator's decisions by requiring him to consider all interests as a whole.[261] This requires him to contemplate more interests than those of the party who appoints him. For that reason, he is given greater powers and protection than the administrative receiver.

He enjoys the protection of a moratorium during the pendency of the administration.[262] The stay gives him the opportunity to concentrate on the task without interruptions by creditors intent on enforcing their legal or contractual rights. The moratorium will only be lifted where the administrator consents to the creditor's application.[263] If he refuses, the creditor may apply to the court which also has the discretion to lift the stay. Though he is to save the company theoretically; in practice, he may only be able to save the business or a part of it. For that reason, he is empowered to dispose of assets subject to floating security without prior consent and with the approval of the court, dispose of assets subject to fixed security or quasi-security interests, if that would maximise returns for the company's creditors as a whole; as long as the interests of the secured parties continue to be protected by attaching the charge to the proceeds or by ensuring that they gets at least the market value of their properties.[264]

As the Nigerian and US procedures have shown, the law may read differently from how it is implemented. Those two systems demonstrate that the party who wrests

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[260] Ibid, Paras 8-10.
[261] Rizwaan Mokal and John Armour, 'The New UK Corporate Rescue Procedure — The Administrator's Duty to Act Rationally' (2004) 1International Corporate Rescue 136.
[262] *Re Atlantic Computer Systems Plc,* 1990 WL 753435.
[263] *Innovate Logistics Limited (in administration) v Sunberry Properties Limited* [2008] EWCA Civ 1321; 2008 WL 4898806, Paras 18-22.
[264] *Hachette UK Ltd v Borders (UK) Lt*d [2009] EWHC 3487 (Ch) (Unreported).

control of the procedure has many decisions skewed in its interests. In those systems, the main lenders control or constrain the freedom of the parties who take the decisions after the company becomes distressed. It is therefore particularly interesting to observe how the system in England and Wales works in practice.

6.2.1.1 (Un)Fettered Discretion?

The administrator may be appointed by the court, the company or its directors, or by the holder of a qualifying floating charge (the main lender).[265] Statistics reveal that the main lenders make the least number of appointments.[266] The court orders the appointment of administrators at least twice as many times as the main lenders; the order may be granted at the instance of the main lenders however.[267] Companies or their directors make by far the highest number of appointments; accounting for more than half of all appointments made.[268] Bare statistics suggest that the debtor or its agents may be in control of the appointments but further studies on how the appointments are made elucidate the appointment practice. For example, it is suggested that banks prefer to make fewer appointments in order to protect their reputations.[269] By pushing the directors to make the appointment, they avoid being seen as the catalysts of administration.

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[265] IA 1986, Sch B1, Para 2.
[266] Sandra Frisby, 'Report on Insolvency Outcomes' (2006) http://www.insolvencydirect.bis.gov.uk/insolvencyprofessionandlegislation/research/corpdocs/InsolvencyOutcomes.pdf accessed 25/06/2012, 11 ('Frisby, Outcomes'): 12%. Office of Fair Trading, 'The Market for Corporate Insolvency Practitioners: A Market Study' (1245, 2010), 32 (OFT Report): 13%.
[267] 30% of appointments. Frisby, 'Outcomes'(n266) 11.
[268] 58% of appointments. Ibid, 11. 75% of the appointments. OFT Report (n 266) 32. The company made 7% of the appointments, while directors were responsible for 46%. 'Enterprise Act 2002 - Corporate Insolvency Provisions: Evaluation Report (The Insolvency Service, 2008) 26.
[269] Daniel Prentice, 'Bargaining in the Shadow of the Enterprise Act 2002' (2004) 5 EBOR 153.

In the study already mentioned, sampling cases during the first few years after the revised version of the administration procedure came into force in 2003, slightly more than half of the cases in which the company or its directors made the appointment had no qualifying floating charge holder.[270] In such cases, one can infer that the directors and the company were the favourites to make the appointment; other claimants would have inadequate information about the debtor's state of affairs.[271] It is not clear whether the directors made the appointments to avoid precipitate actions by unsecured creditors.[272] It is possible that directors only made the appointments to avoid winding up petitions; not necessarily because they recognised the need for administration.

In the other (slightly under half of the) cases, the company appointed the administrator at the behest of its main lender.[273] In such cases, the appointment was the 'culmination of a process of consultation and negotiation' between the directors and the main lender.[274] Both parties would not only decide that an appointment should be made, they also agree on the identity of the putative administrator.[275] To restate the appointment procedure therefore, where there is a qualified floating charge holder, there will be pressure to appoint an administrator when the banks recognise that the company is distressed; where there is none, the appointment is at the discretion of the directors. It is not clear whether the former set of appointments were made earlier in the distress cycle than the latter. Such information would at least highlight the tilt of

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[270] Frisby, 'Outcomes' (n 266) 12.
[271] Proving the company's insolvency is difficult for outside creditors. See *Colt Telecom Group Plc* [2002] EWHC 2815 (Ch); 2002 WL 31676427. It is comparably easier for holders of qualified floating charges who only have to show that the applicant has the power to appoint under Paragraph 14. IA 1986, Sch B1, Para 35.
[272] The unsecured creditors may present winding up petitions. IA 1986, s122 (1)(f).
[273] OFT Report (n266) Para 4.5.
[274] Frisby, 'Outcomes' (n 266) 13.12.
[275] Most banks maintain a panel of practitioners from which they pick administrators with whom they must have formed close relationships. OFT Report, (n266) Para 4.7 – 4.8.

the directors' discretion when they are not under the direct pressure of secured creditors.

For bigger and more leveraged companies, the bank introduces the prospective administrator or practitioners' firm and persuades the directors to make the appointment.[276] The Frisby report reveals that banks consider the size of the company, the size of the bank's exposure, as well as the size of the equity cushion when condoning or rejecting the directors' choice of administrators.[277] It also indicates that small companies may enjoy more freedom in the choice of administrators than their bigger counterparts. Although administrators are deemed to be professionals and presumed to act neutrally, their actions may be skewed in the interests of their *de facto* appointers. If the main lenders are responsible, in fact, for the appointments, then their interests may take pre-eminence for the following reasons. Given that lenders are repeat players, the administrators must conform to the banks' preferences or risk losing future appointments.[278] Moreover, the particular administrator may be chosen for his particular expertise or proclivity: whether rescue or sale. In that case, the lenders can predict the result of the administration *ex ante*. In addition, the appointee's actions may, consciously or sub-consciously, conform to the presumed expectations of the de facto appointor; particularly, where the administrator hopes for an enduring relationship with the main lender.

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[276] Ibid 14 -15.
[277] Ibid 14.
[278] Most banks have panels from which they pick administrators. See for example, 'Market Intelligence' Insolvency Today Magazine (September 2012) 10: in September, two-thirds of KPMG's cases came from the Bank of Scotland, most of Begbies Traynor's cases came from HSBC, and all Deloitte's work came from Lloyds Tsb.

If the directors are able to take the decision independently, it is possible that they will prefer to save the company, which would benefit the unsecured creditors. Nonetheless, it is also possible that they take actions that are solely in their interests, and would shop around for an administrator who would attempt to salvage companies or businesses that are not viable. Given that these choices are business decisions, they would be difficult to challenge in court. The chances of the directors' choosing patently unsuitable administrators is arguably curtailed by the de facto and de jure veto powers held by the main lender however.[279] The main lender may press for another appointee or utilise its right to appoint an administrator when given the notice of intention to appoint.[280] If the appointment is made by a court application, the main lender may apply for a substitution of the applicant's choice of administrators.[281]

Given that the underlying ethos of administration is the rescue of viable companies, it is preferable that directors make the appointment timely. As the studies show, the lower the leverage or the higher the residual value in the assets, the more likely that an independent practitioner would be appointed. In such cases, it is also more likely that the business would be viable and therefore a prime candidate for rescue. Ironically, the law requires the directors to prove that the company is or is likely to be insolvent before they can make a valid appointment. Recall that chapter 2 discusses the position of the directors and how they may influence the timing of the rescue decision. [282] It states that insolvency law permits the company to propose arrangements to its creditors whenever it recognises that it is important. Directors,

[279] Similarly, unsecured creditors may, where there is no qualified floating charge holder, vote to change the administrator appointed by the company or its directors, at a meeting. IA 1986, Sch B1, Para 97. However, no other party can replace the main lender's choice of administrators.
[280] IA 1986, Sch B1, Para 14.
[281] IA 1986, Sch B1, Para 36.
[282] See p49 above.

given their positions, would know that their company may be unable to sustain its level of debt; if it is to subsist profitably. Chapter 3 argues that more viable companies are the proper subjects of rescue.[283] It is therefore ironic that the company must wait till it can prove that it is insolvent before it can propose rescue. It should be able to take advantage of the rescue procedure timely otherwise it would carry on until forced into the formal procedure by its main lender. At that stage, in practice, the company's viability would be diminished and its opportunity to save its business would be fettered, both by the lenders' control and by its insolvency.

There are theories on how the administrator may be expected to take the rescue decision.[284] Underlying these theories is the hope that the administrator would adhere to his duty to be objective and neutral. For some clarity on the scope of the administrator's discretion, it is important to explore the circumstances in which the rescue decision is typically taken. Before administration became the main rescue procedure in England and Wales, rescues were executed by administrative receivers.[285] Usually, a firm of accountants was appointed by the main lender to carry out an independent business review on the declining company.[286] In the report to the

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[283] See p 88 above.
[284] See(n261) above, for example.
[285]Administrative receivership was commended by *Insolvency Law and Practice: Report of the Review Committee* (Cmnd 8558,1982), introduced and regulated by the Insolvency Act 1986, as well as common law jurisprudence. Administrative receivership was partially abolished by IA 1986, s 72A. Administrative receivers may be appointed in the cases listed in IA 1986, s 72B-G, as well as in relation to qualifying charges created before September 15, 2003. For the reasons for its restrictions, see: The Insolvency Service, *Productivity and Enterprise: Insolvency – A Second Chance* (Cmnd 5234, 2001); Department of Trade and Industry, *A Review of Company Rescue and Business Reconstruction Mechanisms* (2000).
[286] Also called investigating accountant's report. For meaning see, Independent Business Review IBR http://turnaroundanswers.co.uk/what-is-insolvency/independent-business-review-ibr/, accessed on 27/09/2012.

bank, the practitioner or firm may recommend the appointment of a receiver.[287] By the time the receiver was appointed, the fate of the company would have been decided by the banks and their accountants.

In more recent times, banks have become more sophisticated. Distressed companies are transferred from the branches to the business support unit (BSU) of the bank.[288] During their period in that unit, the businesses are assessed. If viable, they are rescued.[289] The companies that go into the formal procedure are those that the banks have decided cannot be rescued. By the time the administrator is appointed therefore, typically, the rescue decision has been made. Hence, both at administration and administrative receivership, the practitioner is not appointed to make a rescue decision; the decision having been made. Consequently, administration does not rescue companies – that is the distressed shell – such rescues are conducted informally.[290] On that premise, it may be argued that the administrator is appointed either to maximise value in the business or to realise assets for distribution to the secured (and preferential) creditors.

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[287] The Insolvency Service, 'A Review of Corporate Rescue and Business Reconstruction Mechanisms' (Department of Trade and Industry and HM Treasury, 2000) 31 http://www.insolvencydirect.bis.gov.uk/insolvencyprofessionandlegislation/con_doc_register/con_doc_archive/consultation/condoc/condocreview.pdf, accessed on 27/09/2012.

[288] Which can generate reports more easily, using computers. Vanessa Finch, 'Corporate rescue: who is interested?' (2012) 3 JBL 190, 194-195 ('Finch, Who is Interested'); British Bankers' Association, A Statement of Principles: Banks and Micro-Enterprises Working Together' www.bba.org.uk/download/2080, accessed on 19/04/2012.

[289] Julian Franks and Oren Sussman, 'Financial Distress and Bank Restructuring of Small to Medium Size UK Companies' (November 26, 2002) http://www.rieti.go.jp/en/events/03010801/pdf/Sussman.pdf, accessed 14/07/2012 ('Franks/Sussman, Bank Restructuring') 13-14.

[290] See Frisby, 'Outcomes' (n 266) 60. Vanessa Finch, 'Corporate Rescue: A Game of Three Halves' (2012) Legal Studies 1.

Although the administrator's discretion may be constrained, it does not mean that businesses may not be rescued however.[291] Recall that chapter 3 highlights three elements of rescue: the decision, finance and a plan.[292] Therefore, an administrator with access to finance and a plan may still rescue parts of the business that are viable. This requires much more than the superficial hiving-off of sections for sale however. The problem at this stage is how the unsecured creditors (and the directors or owners) can ensure that the administrator will commit to the more difficult rescue objective than the more easily achievable sale of the business; particularly where the main lender will recover its claims in full and will want to conserve the costs of enforcement.[293] The factors that inhibit the administrator's choices will be considered as the section progresses. First, it is important to highlight the detriment of the BSU rescues.

It has not been proven that banks' business support units execute their functions less than professionally. As a result, one can validly argue that the decisions taken by the banks informally may indeed, like the bankers argue, be cogent.[294] In that case, the system may also be cheaper and less value destructive. Nonetheless, the system still misses crucial elements of rescue, which is potentially detrimental to even the purportedly successfully rescued companies. Franks and Sussman discovered that banks provided viable companies in the BSU with further loans, to tide them through

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[291] Discussed further in p. 265 below.
[292] See p 91, 98, and 102 above.
[293] Though administration has higher gross returns, the costs of the procedure eliminate the potential advantage. Consequently, net returns are not higher than at receiverships. Adrian Walters, John Armour and Audrey Hsu, 'The Impact of the Enterprise Act 2002 on Realisations and Costs in Corporate Rescue Proceedings' (2006).
[294] BBA, 'Response of the British Bankers' Association to the Report by the Review Group on Company Rescue and Business Reconstruction Mechanisms' http://www.insolvencydirect.bis.gov.uk/insolvencyprofessionandlegislation/con_doc_register/con_doc_archive/responsecomprescue/pdfs/bbares.pdf accessed 26/09/2012.

their difficulties and the informal rescue procedure.[295] Banks rarely forgave any debts during the period of intensive care however.[296] It is not clear whether the unsecured creditors forgave any debts during the period either, though it is quite clear that they also extended further credit to the companies.[297] Reduction of the debt burden by recalibrating the capital structure is an important element of rescue.[298] There are no detailed studies on recidivism but it is possible that previously 'rescued' companies may return to the BSU because their unhealthy debt loads may hinder profitability after they return to branch. Viable companies may therefore be better off going through the formal procedure.[299]

One can only infer that the companies which survive and return to branch would have had modified business plans which would be closely monitored. There is however a limit to the extent that banks can interfere with the company's administration – to avoid a finding of de facto directorship.[300] Historically, banks' reviews reportedly focused more on the financial aspects of the companies' affairs.[301] Banks are unlikely to have sufficiently specific knowledge by which the companies' core problems may be remedied.[302] A formal system will therefore contribute great value to the process. If structured cogently, it will rid the company of debilitating debts when it is rescued,

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[295] Franks/Sussman, (n 289) 21.
[296] There was only one reported case of forgiveness. Ibid 21.
[297] Trade credit grows between 11% - 32.6%. Ibid 21.
[298] See p 102 above.
[299] In the US, companies that are pre-packed – which really is quite similar to what the banks are doing – are put through the formal procedure just to rid them of debts that may impede their future profitability.
[300] David Milman, 'Strategies for Regulating Managerial Performance in the "Twilight Zone" – Familiar Dilemmas: New Considerations' (2004) JBL 493, 495.
[301] See (n286).
[302] Finch, 'Who is Interested' (n288) 194; also, (n286)

and furnish the business with a viable business plan. These requirements are fundamental to the future health of the company and are necessary to stem recidivism.

6.2.2 The Finance Question

The administration procedure leaves issues relating to operational finance to the administrator, the creditors and prospective lenders. It provides no formal mechanism to facilitate access to short term finance when the company is in administration. Although a variant of DIP financing was suggested during the debates preceding the 2002 reforms, government indicated a preference for leaving matters of finance to the market.[303] It believed that the lending market is sophisticated enough to identify and fund viable companies.[304] The government reportedly wanted to avoid creating a situation in which new lenders would be granted returns even when they invested in unviable ventures.[305]

There is a procedure that facilitates the financial reorganization of distressed companies however.[306] The administrator drafts and presents the proposals. He is not obliged to consult with the other stakeholders, though he should take their interests into account when drafting. The administrator chooses whether or not to convene a meeting at which the proposals will be presented, but must convene one if instructed by creditors holding at least 10% in value of the unsecured debts. The administrator also decides the persons to whom the business or assets may be sold – who may include the pre-administration owners and managers – and the price at which the sale

[303] See Gerard McCormack, *Corporate Rescue Law – An Anglo-American Perspective* (Edward Elgar Publishing Limited, 2008), 194-195 (McCormack, *Anglo-American Perspective*).
[304] See Andrew McKnight, 'The Reform of Corporate Insolvency Law in Great Britain' [2002] JIBL 324.
[305] McCormack, *Anglo-American Perspective* (n 303) 195.
[306] The system by which the company's finances may be resolved in the long term.

is concluded. When taking these decisions, the administrator is expected to be objective; being an officer of the court who should be fair and a fiduciary. The ensuing paragraphs discuss administration finance generally. They examine the case for short term finance. They find that there has been a hike in the number of cases in which there are no meetings. The main challenge of the administration system presently, is how to regulate the so-called pre-packed administrations.

6.2.2.1 Short Term Finance

Typically, an administrator who wishes to keep the company running would find that the company has no money with which to finance its operations.[307] This is the first blow to the desire to rescue. The assets would have secured pre-appointment advances, while the bank accounts would also be encumbered.[308] Receivables continue to be encumbered by pre-appointment securities.[309] Consequently, the company would have no new funds by which to trade pending rescue or while the business is marketed. Recall that lenders are unlikely to lend unless they have a healthy assurance of repayment.[310] Also, that short term finance is crucial to rescue.[311] Together, these theories suggest that the administration procedure is not conducive to rescue because it omits a fundamental element of rescue. By omitting a short term finance procedure, the reforms handicap the efficacy of the administration procedure.

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[307] 'Pre-Packaged Sales' (R3) http://www.r3.org.uk/media/documents/publications/press/Pre-packs_briefing.pdf, accessed 29/09/2012.
[308] McCormack, *Anglo-American Perspective* (n303) 195
[309] Vanessa Finch, *Corporate Insolvency Law: Perspectives and Principles* (2nd Edn, CUP 2009) 410-415 (Finch, *Perspectives and Principles*).
[310] See p 61 above.
[311] It ensures that the company continues to trade while the rescue decision is made and executed, the long term finance resolved and the debt burden shed.

One proposal suggests that the statute should modify the law of receivables finance.[312] After the appointment is made, uncollected book debts should be free of encumbrances, permitting the company to use them as security for post-administration finance. The argument does not indicate whether the court's approval would be required before the assets can be used as security for future funds. Such protection may be necessary for unsecured creditors who would otherwise benefit from the proceeds of such assets. Should the rescue attempt fail, then they would have lost an opportunity to improve their returns. Moreover, the proceeds may be insufficient to support the company's operations, if they are the only source of finance.

A mechanism that facilitates access to substantial funds is crucial to the rescue and administration processes. Professor McCormack suggests that the law impliedly permits the administrator to furnish a prospective lender with super-priority status.[313] The law states that the administrator's debts and liabilities are to be paid ahead of his own remuneration and expenses.[314] Typically, one of the core liabilities will be contracts of employments adopted after 14 days of the administrator's appointment.[315] However, the statute does not expressly indicate that the debts or liabilities in question are limited to employee contracts; it merely states that sums payable 'in respect of a debt or liability arising out of a contract' are to be paid in priority to all other expenses.[316]Professor McCormack argues that a literal or broad reading of the section permits the payment of capital and interest charges from a loan contract in priority to

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[312] Finch, *Perspectives and Principles*(n309) 414-415.
[313] Gerard McCormack, 'Super-priority new financing and corporate rescue' (2007) JBL 701('McCormack, Super-priority').
[314] See IA 1986, Sch B1, Para 99 (3), (4).
[315] IA 1986, Sch B1, Para 99 (5); *Powdrill v Watson (Re Paramount Airways)* [1995] 2 AC 394.
[316] IA 1986, Sch B1, Para 99 (4); *Bibby Trade Finance Ltd v McKay* [2006] EWHC 2836 (Ch); 2006 WL 3831159, Para 29-Para 31.

the administrator's remuneration and subsequent payments in the hierarchy.[317] Further, he asserts that the administrator will not require the court's permission to enter into this agreement.[318] Some of the problems highlighted in the US procedure, including cross collateralizations and roll-ups are already void or voidable under the Insolvency Act 1986.[319] Moreover, the lender would not loan-to-control because it would already be in control via the administrator.[320]

Quite clearly, Professor McCormack's new lender is the same as the pre-appointment lender whose future advances may also protect recoveries under the floating charge which would be paid only after the post-appointment debt is fully paid. If the lenders are different, then the floating charge holder requires protection from the diminution of its security; that would require the court's decision.[321] It is expected that pre-administration lenders would initiate actions under Para 74 stating that administrators are taking actions which would prejudice their interests. It may become a routine petition; depending on the level of support they receive from the courts for such actions.[322] Moreover, the post-administration lenders would also want some measure of control over the process to ensure that their positions are indeed protected; considering that they take subject to the fixed charge and possibly the employees.[323] It

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[317] McCormack, 'Super-priority' (n313) 729-730.
[318] McCormack, *Anglo-American Perspective* (n266) 198-199.
[319] McCormack, 'Super-priority' (n313) 729.
[320] Ibid 730.
[321] Whether or not built into the procedure.
[322] Unlike other creditors, main lenders would have the resources to put up quite strong fights.
[323] The provision does not outline the order in which payments would be made. Presumably, all such liabilities rank pari passu amongst themselves.

is possible that their ideas may differ from those of the pre-administration lender; posing problems for the administrator.[324]

More importantly, it is unlikely that administrators appointed at the behest of pre-administration lenders would engage in such contracts with new lenders because that may damage their relationships.[325] Empirical studies reveal that bank-approved administrators are likely to be appointed in the case of bigger companies.[326] Other studies also indicate that the bigger companies are those likely to get short term finance during their rescue.[327] Thus, it is unlikely that this would become the main route to rescue finance in England and Wales.[328] Notwithstanding, the court may approve the payment of such liabilities, if clear business reasons are established.[329] Like Milman states however, courts may be directed to work within the proper confines of the law; in which case they would interpret the provisions of the law within the clear intention of Parliament not to provide for a formal post-administration funding mechanism.[330]

Nonetheless, it is imperative to examine the case for a dedicated administration funding mechanism in England and Wales. First, it is important to have a quick recap on DIP financing in the US. Recall that DIP financing is available to all distressed

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[324] The point is not argued too strongly however because both parties may just want a quick sale. It is possible, nonetheless, that one wants a sale and the other rescue, in order to become a post-rescue lender.
[325] Bibby Ltd was also the pre-administration lender, for example.
[326] Frisby, 'Outcomes' (n266) 15.
[327] Dahiya (n66) 266.
[328] Unless pre-administration lenders are interested in being post-administration lenders.
[329] For example, in Bibby Ltd above
[330] David Milman, 'Judicial Reflections on the Administration Process: a 2010 Perspective' (2010) Co LN 283, 1, 4.

companies in the US but many do not obtain DIP financing when distressed.[331] Empirical studies reveal that only about half of the companies that seek DIP financing receive it.[332] In most cases, larger companies successfully negotiate DIP contracts.[333] Many of these companies have lower leverages and more inventory than others.[334] Fundamentally, they have potentially viable businesses. Recall that DIP lenders perform screening and monitoring roles.[335] Consequently, unviable businesses will not be financed. Recall also that DIP financing may be provided by pre-petition lenders, as well as post-petition lenders.[336] For smaller companies, their pre-petition lenders are typically their DIP lenders because they have informational advantages that new lenders lack.[337] In addition, many distressed companies pre-pack their rescues. Most pre-packs do not require DIP lending because finance would have been negotiated during the pre-petition stages.[338] In addition, the lender ensures that the rescue process is hastened. Companies that cannot be rescued are shepherded quickly into liquidation. The insights gleaned from these observations will now be applied to England and Wales.

As stated earlier, in England and Wales, distressed companies are transferred to the business support units of banks – the typical main lenders.[339] During this phase, the banks perform a screening role: they identify the companies with viable businesses. While the companies are rescued, the banks extend further credit: short term

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[331] See p. 227 above.
[332] Dahiya (n66) 266
[333] Ibid.
[334] Ibid.
[335] See P227 above.
[336] Ibid.
[337] Dahiya (n66) 270
[338] Ibid 269.
[339] Franks/Sussman, 'Bank Restructuring' (n 289) 13.

finance.[340] One may infer that the finance would be used to reinforce the business. During the period, another source of short term credit is the trade creditors, who also extend further credit.[341] Conversely, companies that are not viable are forced into the formal procedure at which, in practice, their businesses and assets are sold, in units or piece-meal. The bank monitors the company's progress: the monitoring role. A rescued company returns to branch.[342] The Franks and Sussman study showed that the company has the option of shopping around for other lenders: new post-distress lenders.[343] One can therefore infer that companies that go into formal insolvency have been refused by other banks also. Consequently, it is those companies with marginally viable or clearly unviable businesses that go into formal insolvency.[344]

One may quite reasonably argue that the two procedures achieve similar goals through different means. Most companies in the US which go into chapter 11 would have negotiated DIP financing with their pre-petition lenders or new lenders before the formal procedure commences. Only viable companies, or companies judged by lenders to be viable, obtain new finance. They go into chapter 11 to eliminate the other debts that may hinder the company's future profitability.[345] The main difference is that the English and Welsh system transpires informally. In both instances, the business must be screened by someone with adequate information and expertise, while the rescue is monitored by the lender. If that comparison is fair, then it can be argued that the companies that enter into formal insolvency in England and Wales are such as would be unlikely to obtain funding even if there was 'administration-

[340] Ibid 21.
[341] Ibid 21.
[342] Ibid 13.
[343] Ibid 29.
[344] This distinction is further explained in the next paragraph.
[345] Recall that this was identified as a detriment of the UK system. See p.255.

finance'. They are likely to fail the screening test a second time, like they did the first time; as the government surmised. The argument is more attenuated than it appears however.

In about a third of the administration cases studied in the Frisby report, the secured creditors receive at least 90% of their claims, the majority of that statistic receiving 100p on £1.[346] At least a third of the time, the preferential creditors receive their full claims.[347] Consequently, it is possible that in at least 1 in every 3 administration cases, there is enough value in the business for a new lender to advance post administration funds – provided that it has adequate assurance of repayment. In such cases, it is possible that a new lender, if enticed with the promise of enhanced priority - referred to as the priming lien in the US - may have funded the rescue.[348] The US experience reveals that many lenders refuse to lend on junior liens; they insist on priming liens.[349] In the absence of such protection, they will not fund. In the absence of funds, fewer businesses will be rescued. A system that facilitates access to credit by creating an enabling environment in which creditors would lend is clearly required. Administration-financing, if introduced, would require prior court approval, for the protection of the pre-administration lenders' interests; if the prior lender does not consent. The hearing is justified because pre-administration lenders, like US pre-petition lenders, would typically protest; resulting in Para 74 hearings.

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[346] Sandra Frisby, 'Interim Report to the Insolvency Service on Returns to Creditors from Pre- and Post-Enterprise Act Insolvency Procedures (2007) http://webarchive.nationalarchives.gov.uk/+/http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/research/returntocreditors.pdf, accessed on 29/09/2012, 14.
[347] Ibid 25.
[348] One that takes priority over senior charges on the property.
[349] See p 226 above.

Usually, the party with access to finance controls the rescue process. If introduced, the procedure would encourage some directors to seek help more timely. If they know that they may rid themselves of the bank's control, they may ensure the appointment of independent administrators while they still have viable businesses. As the preceding sub-section intimated, where the administrators have access to post-administration funding, they may rescue some of the marginal cases that have slipped into the formal procedure. They will keep the businesses trading while a new company is organised to take it over.[350] The US studies show that debtors with rescue finance record higher indices of success than cases without finance.[351] More successful administrations would improve the procedure's profile in the commercial realm and in turn promote more rescue attempts.[352]

The Cork committee highlighted the importance of practitioners' independence at rescue.[353] It improved their independence by preventing the termination of their appointment without a show of cause.[354] It is argued that practitioners' independence would be further improved by the availability of rescue finance; which enables them to act independently of the banks. There is therefore a case for the introduction of a short term rescue finance procedure. One challenge however would be the available protection for the unsecured creditors. Insolvency practitioners have not shown a clear case of independence from their de facto appointers. The US situation shows that

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[350] Refer to P 255 above.
[351] See p. 227above.
[352] In the US, distressed companies seek DIP financing to signal viability.
[353]Insolvency Law and Practice: Report of the Review Committee(Cmnd 8558,1982), Para 444, Para 492.
[354] IA 1986, s 45.

where the secured and preferential creditors are adequately protected, the directors can administer the procedure to the detriment of the unsecured creditors.[355]

6.2.2.2 Financial Reorganization

The administrator has the exclusive right to propose a plan throughout the proceedings.[356] He must send copies of his initial proposals to the creditors as soon as is practicable but within eight weeks of his appointment.[357] The court may grant an extension of time, if necessary.[358] Accompanying the proposals must be an invitation to a meeting to be held at least 14 days after the proposals are sent.[359] The meeting must be convened as soon as practicable but within ten weeks of the administrator's appointment.[360] Only creditors whose claims have been admitted by the administrator may vote at the meeting.[361] Claims represent the amount outstanding at the date the administration came into effect. Notwithstanding, the original amount may be modified by deducting amounts set-off or payments made after the commencement of the administration.[362]

Secured creditors may only vote in respect of the unsecured portions of their claims.[363] Unless the administrator agrees to fix an estimate on their claims and then admit them, holders of unliquidated or unascertained claims may not vote.[364] When

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[355] See p 215 above.
[356] IA 1986, Sch B1, Para 49.
[357] IA 1986, Sch B1, Para 49 (5) (b).
[358] Para 49 (8); Para 107; *Gould v Advent Computer Training Ltd* [2010] EWHC 1042 (Ch); 2010 WL 3017983
[359] IR 1986, r2.35 (4).
[360] IA 1986, Sch B1, Para 51 (2) (b); *Revenue and Customs Commissioners v Maxwell* [2010] EWCA Civ 1379; 2010 WL 4919802.
[361] IR 1986, r2.38(1); r2.39.
[362] IR 1986, r2.38(4).
[363] IR 1986, r2.40.
[364] IR 1986, r2.38(5).

estimating a minimum value on the claims, the chairman should take care to do his best to ascertain the value of the claim.[365] The claimant who is displeased with the rejection of his claim or its estimated value may appeal to the court. First, the court will consider the character of the debt at the date that the administration commenced, to determine its nature.[366] Then the court must examine the factual and legal basis of the claim in estimating its value.[367]

The unsecured creditors vote as a single group. The proposals are passed when claimants holding majority in value of the claims present or voting in proxy approve.[368] The creditors may propose modifications to the proposals, subject to the administrator's acquiescence.[369] It may be necessary to revise the proposals for a second vote when substantial changes are recommended or required.[370] Any creditor who believes that he has been unfairly harmed by the administrator's conduct or will be harmed by actions to be taken by the administrator (under the approved proposals) may apply for redress.[371] The courts examine the petitioner's allegations to determine whether he has been harmed. The fact that he has been harmed does not however mean that the actions were unfair.[372] The petitioner may have been treated differently from others but that differential treatment may have been beneficial to all the other creditors as a group in which case, the claim would not be upheld.[373]

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[365] Ibid Para 63.
[366] *Revenue and Customs Commissioners v Maxwell* (n 360) Para 58-60.
[367] Ibid Para 63.
[368] IR 1986, r2.43.
[369] IA 1986, Sch B1, Para 53 (1) (b).
[370] IA 1986, Sch B1, Para 54 (1).
[371] IA 1986, Sch B1, Para 74.
[372] *BLV Realty Organization Ltd v Batten* [2009] EWHC 2994 (Ch); [2010] BPIR 277 (Ch D), Para 22.
[373] Ibid, Para 22. See also, *Cheshire West and Chester BC,* [2010] CSOH 115; 2010 WL 3166677.

The creditors may reject the initial or revised proposals.[374] The law appears not to give clear directions on the procedure following rejection; apart from instructing the administrator to inform the court of the rejection.[375] There are two main schools of thought on the duty of the administrator in such a situation. One is that the administrator may, but is not compelled to, seek directions.[376] The view suggests that he may prefer to revise the proposals or design new proposals if the rejected proposals were revised proposals. He may summon another meeting at which another vote would be taken. The other perspective is that the administrator is obliged to seek directions when the creditors fail to approve the proposals.[377] In *re BTR (UK) Ltd*,[378] the court had to decide the nature of the administrator's duty to seek directions after his proposals were rejected by the creditors. The court considered both strands of opinions outlined above. It preferred the latter perspective which imposes a mandatory duty on the administrator to seek directions. Behrens J held that the administrator must make an application to the court when original proposals have been rejected; particularly in situations where he intends to act contrary to the wishes of a majority of the creditors.[379] In addition, he stated that the creditors may apply for a hearing where the administrator does not.[380]

The law does not specify the number of proposals that the administrator can place before the creditors. In addition, it permits the administrator to convene further

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[374] IA 1986, Sch B1, Para 55.
[375] IA 1986, Sch B1, Para 53 (2) (b).
[376] Len Sealy and David Milman, *Annotated Guide to the Insolvency Legislation* (14th Ed Sweet & Maxwell, 2011) Vol.1, 571 – 572.
[377] Gavin Lightman et. al, *Lightman and Moss: The Law of Administrators and Receivers of Companies* (4th Ed, Sweet & Maxwell, 2007) 9-024; Muir Hunter, *Kerr & Hunter on Receivers and Administrators* (18th Ed Sweet & Maxwell, 2005) Para 15-45.
[378] [2012] EWHC 2398 (Ch); 012 WL 3492204.
[379] Ibid Para 63 – Para 67.
[380] Ibid Para 64.

meetings of creditors if required.[381] At the meeting, the administrator can propose a revised plan to the creditors. The law instructs the administrator to report the result of the meeting to the court but does not require him to seek directions in all instances. One may ask how the administrator would run the company where he does not seek directions. Can he perform contrary to the wishes of the creditors in meeting without the court's approval? This issue raises another ancillary but interesting issue: can an administrator force the dissenting majority to accept a plan that is, in his professional judgement, preferable to other propositions? That power would be a variant of the US cram-down; in this case, without a need for the court's approval.

i. Cram down?

The administrator is a professional; hence the Insolvency Act gives him few directions relating to the execution of his duties.[382] It empowers him to do anything expedient for the successful administration of the case.[383] He may act according to the directions of the court, or do whatever his business judgment dictates, without directions, where an initial meeting has not been held.[384] In cases where proposals have been approved by the creditors, he is to conduct his affairs according to their provisions; the statute uses 'shall' which connotes an obligation.[385] His discretion to deviate from the proposals is limited to the cases in which his actions do not substantially alter the proposals.[386] An administrator who wishes to make substantial alterations to the approved proposals must present a revised proposal to the

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[381] IA 1986, Sch B1, Para 56 (1).
[382] Sealy and Milman (n376) 576.
[383] IA 1986, Sch B1, Para 59 (1).
[384] IA 1986, Sch B1, Para 68 (2) (3); *Re T&D Industries Ltd* 1999 WL 1019543.
[385] IA 1986, Sch B1, Para 68 (1) (a) (c); (n 382) above.
[386] IA 1986, Sch B1, Para 68 (1) (b).

creditors.[387] Alternatively, he may seek directions from the court if there are objective business reasons why a meeting would not be feasible.[388] The court may, on the equities of the case, approve the alteration. The main question is whether an administrator can 'cram-down' a rejected plan on the creditors with the approval of the court or by exercising his discretion.[389]

In *Stanleybet (UK) Investment Ltd*,[390] Justice Sales held that the administrators were not formally bound by the vote passed at the creditors' meeting, though they were to give considerable weight to the views of the substantial majority creditor on how to proceed.[391] He held that it would be '*unusual, though not legally impossible*' for the administrators in that case to execute proposals that had been rejected by 87% of the creditors.[392] He asserted that the administrators had the discretion to execute the rejected proposals or to apply, as they did, for directions.[393] In *DKLL Solicitors* v HMRC,[394] the court held that a majority creditor does not have a veto on the implementation of the administrator's proposals.[395] It stated that the court may authorise their implementation notwithstanding the opposition of the creditor, on the

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[387] IA 1986, Sch B1, Para 54 (1).
[388] *Re Smallman Construction Ltd* (1988) 4 BCC 784; *Re Dana (UK) Ltd*1998 WL 1119718.
[389] He would be inviting the court's approval where he seeks directions. Where he chooses not to apply for directions and carries on the administration, then he can be said to be acting according to proposal by which the creditors have said he should not act. In that case, he is not according to the instructions in Para 68.
[390] [2011] EWHC 2820 (Ch); 2011 WL 5077772.
[391] Ibid Para 8.
[392] Ibid Para 8.
[393] Ibid Para 8.
[394] [2007] EWHC 2067 (Ch); 2007 WL 2480441.
[395] Ibid Para 18.

authority of its powers under Para 55.2 of Schedule B1.[396] This opinion suggests, like BTR Ltd, that the administrator must apply for directions.[397]

The court has not expressed the principles on which it will base its decision. Nonetheless, one may infer a procedure from its comments.[398] The court will give considerable weight to the considered opinion of responsible administrators; particularly in difficult and complex cases. The court will also take into consideration the opinion of the majority creditor(s). It will examine the situation to determine whether the applicants would be in a worse situation, or the creditor in a better position, if consent was granted. The court will also take into consideration the interests of other stakeholders – creditors and non-creditors – implicated in the rescue. For example, it will consider the interests of employees qua employee and the company's clients. After all its considerations, the court will then decide whether and how to use its discretion. The court may give any directions that would ensure the convenient, economical and sensible management of the company's affairs but it will be circumspect.[399] These steps were applied in Stanleybet (UK) Investment Ltd where the court approved the administrators' application after the proposals had been rejected.[400] Similarly, in *Platinum Developers Ltd v Assignees Ltd*,[401] the court took these factors into consideration and ordered a new meeting at which the original proposals were to be re-presented for another vote. One could surmise that there is no traditional 'cram-down' in the Insolvency Act. Nevertheless, the administrator may secure the approval needed for a rejected plan by applying to the court.

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396 Ibid Para 18.
397 See (n 378) Para 66- Para 69.
398 Particular reference is placed on the DKLL and Stanleybet cases.
399 *Gould v Advent Computer Training Ltd* (n358) Para 13.
400 (n390) Para 19.
401 (Unreported) 05/10/2009.

The procedure by which the court may exercise its discretion outlined above does not determine the content of the administrator's duty in relation to rejected proposals however. Although there is no empirical study on this, reported case law suggests that the creditors would propose modifications where they do not accept the administrator's proposals entirely.[402] In theory, that is an approval subject to modifications. If he accepts their modifications, the administrator may revise the plan where they substantially alter the original proposals. He would present the revised plan at a subsequent meeting. Typically, where suggested modifications are rejected by the administrator, the proposals would be rejected by the creditors.[403] The proposals may also be rejected by majority creditors who have decided that administration would not suffice.[404] In these cases, it is clear that revisions would not resolve the differences in perspectives. Nothing in the law suggests that the administrator can force the proposals on the creditors – which is what he would be doing when he executes the proposals regardless of the rejection, as suggested by Sales J and Sealy and Milman.[405] It is argued that the administrator should apply for directions in such cases.

ii. Pre-Packs

In practice, insolvency practitioners prefer to avoid creditors' meetings entirely; particularly when they can show that there would be no distributions, apart from the prescribed part, to unsecured creditors or that the assets are to be realised for

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[402] For example, in BTR UK Ltd.
[403] Again the BTR UK Ltd provides an example.
[404] The DKLL Solicitors case; *Re Structures & Computers Ltd* [1998] BCC 348.
[405] See Sealy and Milman, (n 376), 571 – 572 and *Re Stanleybet* (n390) above.

distribution to secured and preferential creditors.[406] Consequently, many administrations are pre-packed.[407] Like in the US, a pre-pack is a strategy by which pre-agreed decisions are executed after the formal procedure is initiated. In England and Wales, it is a business sale strategy which involves pre-appointment negotiations for the sale of all or part of the company's business.[408] The sale is executed by the administrator as soon as possible after appointment. In contrast to pre-packs in the US, the sale is executed without presenting the proposal to a meeting of unsecured creditors or confirmation by the court.[409] The decision to pre-pack is a commercial judgment to be made by the insolvency practitioner.[410] The courts have held that such decisions do not need the active involvement of courts.[411]

Although the incidence of pre-packs in England and Wales pre-dated the Enterprise Act, the phenomenon escalated perceptibly after it came into force in 2003.[412] Initial studies pegged them at 35.5% of sales.[413] Subsequent reports by the Insolvency service suggest that slightly over 1 in 4 administrations are pre-packed.[414]However,

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[406] IA 1986, Sch B1, Para 52 (1) (b) (c).
[407] Conducted without meetings.
[408]The Insolvency Service, 'Report on the First Six Months' Operation of Statement of Insolvency Practice 16' http://webarchive.nationalarchives.gov.uk/+/http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/policychange/sip16-final.pdf, accessed on 29/09/2012, 7 ('First six Months').
[408]*Re T&D Industries Ltd* (n384) 6-7.
[409] See the US pre-packs on p. 232 above.
[410] First six Months, (n408) 5.
[411]*Re T&D Industries Ltd* (n384) 6-7.
[412] Sandra Frisby, 'A Preliminary Analysis of Pre-Packaged Administrations: A Summary' http://www.r3.org.uk/media/documents/publications/press/preliminary_analysis_of_pre-packed_administrations_-_summary.pdf, accessed 29/09/2012, 5.
[413]Based on empirical studies of the first year of the then new administration procedure. Anecdotes in that report suggested that as many as 3 in 4 administration cases are pre-packed. Sandra Frisby, 'A Preliminary Analysis of Pre-Packaged Administrations' http://www.r3.org.uk/media/documents/publications/press/preliminary_analysis_of_pre-packed_administrations.pdf, accessed 29/09/2012, 15 ('Frisby, Pre-packaged Administrations').
[414] In 2009, the Insolvency Service estimates pre-packs at between 27% - 29% of all administrations. First Six Months (n408), 15. See also, The Insolvency Service, 'Report on the Operation of Statement of Insolvency Practice 16: July – December 2009'from

R3, the association of insolvency practitioners, estimates that at least 1 in 2 administrations are pre-packed.[415]At traditional administrations – with proposals and meetings - the administrator is (theoretically) expected to study the company's situation, then prepare and present proposals to creditors after appointment. At pre-packs, the administrator takes appointment with a pre-determined goal that is not discussed with unsecured creditors.[416] The sale would have been concluded before commencement, and is implemented shortly after. The company therefore spends a very short time in formal insolvency.[417] Speed is fundamental to pre-packs, as well as circumspection; to prevent the dissipation of value that may follow the public acknowledgment of the company's insolvency.[418] The business may be sold to previously unconnected persons, as well as to the previous owners or staff.[419]

Practitioners assert that pre-packs are misunderstood.[420] They argue that pre-packs save businesses, which saves jobs and benefits the economy.[421] They highlight better

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http://webarchive.nationalarchives.gov.uk/+/http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/sip16/Report%20on%20the%20Operation%20of%20Statement%20of%20Insolvency%20Practice%2016,%20July%20-%20December%202009.pdf, accessed on 08/10/2012; The Insolvency Service, 'Report on the Operation of Statement of Insolvency Practice 16: 1 January to 31 December 2010' from http://www.bis.gov.uk/assets/insolvency/docs/insolvency%20profession/sip%2016%20reports/final%20sip%2016%20report%202010.pdf, accessed on 08/10/2012. Note that even the Insolvency Service indicates that its estimations may under-estimate the incidence of pre-packs by about 10%-20%.

415 R3, 'Pre-Packs and SIP 16' (March 2010) http://www.r3.org.uk/media/documents/policy/policy_papers/corporate_insolvency/Pre_packs_and_SIP_16_March_2010.pdf, accessed on 08/10/2012, which estimates the number of pre-packs for the year at 53%.

416 Vanessa Finch, 'Pre-Packaged Administrations: Bargains in the Shadow of Insolvency or Shadowy Bargains?'(2006) JBL, 568 ('Finch, Shadowy Bargains').

417 Peter Walton, 'Pre-packaged Administration – Trick or Treat?' (2006) Insolvency Intelligence 113, 114.

418 R3, 'Pre-Packaged Sales' (n307) 1.

419 There is a higher indices of sales to connected persons. Sandra Frisby, 'Conclusion on Pre-Packs: Part 1' (2009) Recovery (Winter) 30.

420 R3, 'Pre-packaged Sales' (n307) 1.

421 See also, Frisby, 'Pre-packaged Administrations' (n413) 71.

returns for secured creditors.[422] They surmise that pre-packs promote the retention of value in distressed companies when compared to the sometimes protracted traditional administrations.[423] Conversely, pre-packs have also garnered a poor reputation amongst many, including unsecured creditors who get little or no returns from the sales, other practitioners, and the media.[424] Critics highlight the opaque decision-making process, one of the core reasons why the administrative receivership procedure was restricted, as a main demerit of the process.[425] Pre-packs disenfranchise unsecured creditors; leaving the secured creditors in *de facto* absolute control.[426] They also emphasise the fact that pre-packed sales do not undergo robust marketing.[427] With the rise of sales to connected persons, its detractors state that pre-packs are used to phoenix distressed companies; managers use pre-packs as a mechanism for 'debt-dumping'.[428]

To improve the transparency of pre-packs, the statement of insolvency practice, 16 (SIP 16) was issued in January 2009 by the insolvency regulatory bodies acting through the Joint Insolvency Committee (JIC).[429] SIP 16 provides guidance on best practice in relation to pre-packs. Practitioners are directed to disclose the information listed in the SIP as soon as practicable.[430] In practice, the information is disclosed after the sale has been concluded.[431] The directions have no force of law; failure to

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422 Ibid 60.
423 R3, 'Pre-packaged Sales' (n307) 1.
424 Jon Moulton, 'The Uncomfortable Edge of Propriety--Pre-packs or Just Stitch-ups?' (2005) Recovery (Spring), 2; Ellis, 'The Thin Line In The Sand' (2006) Recovery (Spring) 3.
425 Walton, (n417) 115-116.
426 Finch, 'Shadowy Bargains' (n416) 583-584.
427 R3, 'Pre-Packaged Sales' (n307) 2.
428 Sandra Frisby, 'Pre-packs and the Greater Good: Innovate Logistics Ltd v Sunberry Property Ltd Considered' (2009) CoLN 246, 1.
429 Statement of Insolvency Practice 16 (England and Wales): Pre-Packaged Sales in Administrations.
430 Ibid Para 11.
431 First six Months, (n408) 5.

comply does not indicate misconduct in the sale.[432] Courts are reluctant to overturn commercial decisions taken by administrators. Consequently, they are unlikely to overturn a sale unless the creditors can show misconduct, fraud, undervalue, or establish a prima facie case for investigation.[433] As a result, the disenfranchised stakeholders are left to sue an insolvent company or to sue repeat players acting on behalf of the secured creditors and the managers. In 2010, the government conducted a consultation on proposals to improve the transparency and procedure of pre-packs.[434] Having reviewed the responses however, it decided to leave the extant procedure largely unchanged.[435] In further recognition of the acceptance of pre-packs, practitioners will be reimbursed their pre-appointment expenses.[436]

In England and Wales, there has been a, thus far unsuccessful, quest to substantially reform the pre-pack procedure. The reform agenda hopes to improve its transparency and inclusivity without sacrificing its speed, certainty and circumspection. Again, it is beneficial to review the US practice, to glean possible lessons. In the US, the proposer of the plan must make certain disclosures before soliciting its approval.[437] The disclosures must comply either with the stringent standard under the Securities Act or the more liberal standard under the Bankruptcy Code; the applicable law depends on how solicitations are to be conducted. The court must also confirm the plan before it can take effect. At the confirmation hearing, the court will hear dissenters. It can be

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[432] Ibid 5.
[433] *Clydesdale Financial Services Ltd v Smailes* [2009] EWHC 1745 (Ch); 2009 WL 1657163.
[434] The Insolvency Service, 'Consultation/Call for Evidence Improving the Transparency of, and Confidence in, Pre-Packaged Sales in Administrations' (March 2010) http://webarchive.nationalarchives.gov.uk/+/http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/con_doc_register/Pre-pack%20consultation%2031march%2010.pdf, accessed 29/09/2012.
[435] See Written Ministerial Statement (26/01/2012).
[436] IR 1986, r2.67A.
[437] See p232 above.

inferred that pre-packed plans would be consensual and so, would not require cram-downs. Junior creditors must be included in the bargain; otherwise, the previous owners would not be permitted to participate by the court if the plan is crammed-down; as a result of the application of the absolute priority rule. It may be argued that the US system provides more protection to the unsecured creditors and improves transparency; given the disclosures and hearings.

The protections may be more theoretical than real however. In the typical pre-pack procedure, the pre-agreed plan is confirmed by the court at the hearing.[438] Even in the few instances in which more disclosures or modifications are ordered, it is usually the pre-packed plan, not a competing plan that would still be confirmed. Considering the high rate of recidivism, it is unlikely that the pre-packed plans are robustly assessed.[439] In effect, the feasibility test does not provide the protection that it theoretically suggests.

It is also imperative to mention that a fundamental feature of the US pre-packs is rescue finance. The pre-packed companies typically receive rescue finance.[440] In consequence, it can be argued that they can withstand the more rigorous US procedure because they receive operating finance while passing through the informal and formal phases of the procedure.[441] Moreover, in the US, the judges take certain essential

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[438]Only in 6.25% of pre-voted plans did the court refuse to confirm on account of the voting procedure. The plans still approved after modification. Tashjian, (n159), 140.
[439] See (n167) above.
[440] In England and Wales, practitioners highlight lack of short term funding as a fundamental reason for pre-packs.
[441] Recall that businesses in England and Wales are placed in formal insolvency typically after the main lender has refused further funds, and no other lender is offering support.

decisions routinely.[442] They rely on the information provided by the disputing parties. Consequently, the unsecured creditors are granted significant powers and play an important role through the UCC.[443] These committees can appoint professionals to investigate the DIP. To the extent that they are unsophisticated enough to perform their tasks, an examiner may be employed to perform their statutory duties.[444] In sum, although the US procedure may be improved, the procedure ensures greater disclosures, more oversight and inclusivity than that of England and Wales.

In England and Wales, the government espouses an option that will improve unsecured creditor participation and transparency at pre-pack sales generally and sales to connected parties in particular.[445] Experts highlight informational gaps and coordination costs as some of the main reasons why unsecured creditors are not consulted.[446] They also highlight the fact that the unsecured creditors are usually out of the money.[447] In the US, LoPucki and Whitford discovered that parties who had no representation at the negotiation table often got nothing.[448] Even where junior claimants received returns, some claimants that are hierarchically senior to them may receive nothing; representation at negotiations is therefore fundamental. To address informational deficiencies and coordination problems, committees are used to harness the power of unsecured creditors in the US. The interests of committee members are aligned with those of the body of unsecured creditors. Consequently, as committee

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[442] In England and Wales, courts prefer not to interfere in the daily administration of rescues or with business decisions.
[443]See p 237 above.
[444] Committees, where appointed, play very limited roles in England and Wales. OFT Report (n 266), Para 4.50. Formed only 3% of the time.
[445] See (n434).
[446] See also, OFT Report (n266) Para 4.59.
[447] Ibid Para 4.56 - 4.58.
[448] LoPucki/Whitford, ‘Equity’s share’ (n188) 142-143.

members fight for their individual interests, they fight for those of all unsecured creditors because distributions are made pari passu. A variant of that option in England and Wales would be to enfranchise the major unsecured creditors.

SIP 16 directs the administrator to indicate where the major creditors have been consulted. The study on compliance shows that they are rarely consulted by the administrator.[449] There may, of course, be good reasons for this. The administrator in Clysdale for example, did not want major unsecured creditors to scupper the sale, so he did not consult them until it was too late for them to stop the sale.[450] If the administrator was statutorily required to consult with the major creditors, he would not need to consult the body of creditors. That immediately removes the coordination problem. The administrator can identify the major creditor(s) from the statement of claim or the list of creditors where there is no statement of claim. It is expected that the major creditors would have better knowledge than the other unsecured creditors. In addition, it is expected that they would be sophisticated enough to analyse the information that the administrator would present. Anecdotes suggest that the HMRC, for example, now conducts independent business reviews of the bigger insolvent companies.[451] The same source suggests that recent IBRs focus not only on the financial health of the company, they also investigate the economic well-being of the entity.[452] It is likely that there would also be repeat players, like the HMRC and some landlords who can take advantage of their experience when assessing pre-packs.

[449] First six Months (n408) Para 10.
[450] Robert Smailes, 'SIP 16 – Does It Do What It Says on the Tin or Is It a Can of Worms?' (2009) Recovery, 28, 29 (Winter).
[451] See (n286).
[452] Ibid.

The court's reluctance in taking business decisions, particularly where no other party proposes cogent alternatives is well known. Nonetheless, it would be difficult for the unsecured creditors to propose cogent alternatives where they have no right or resources with which to investigate companies. The need to investigate must be balanced with the urgency of the situation however. Where the major creditors reject the pre-pack proposal, the administrator must apply for directions. The court will base its opinion on that which can be proven at that moment.[453] As discussed above, the court should balance a 'responsible' administrator's opinion with those of the creditors; taking into consideration, the effects of granting or refusing an order for the sale on all parties implicated in the case.[454] These are decisions that courts can make. The major creditors may apply for the case to be moved to liquidation after the sale. They can nominate an interim practitioner to act as liquidator, who would be confirmed at a subsequent meeting or replaced. The new practitioner can satisfy the investigatory needs of the major creditors. If they are unable to prove cause, then the administrator remains in control of the company after the sale; it may be dissolved or liquidated thereafter. This procedure ensures that disclosures are made to the parties that would suffer the most from maleficent pre-packs. They would be given an opportunity to prevent the sale, if they can show cause. The onus would be on them to prove their claims; mere speculations would not suffice. The courts and the creditors can inject the much needed transparency into the procedure, each handling matters to which it is best suited.

[453] In these scenarios, the HMRC can rely on the results of the IBR.
[454] See p271 above.

The problem with pre-packs is that there would be marginal cases in which the proposed pre-pack would comprise an unviable plan. Although the sale may fetch higher returns, the 'rescued' business may not survive. It is important to note that the application is for a direction on the sale, not on the potential for rescue. As stated above, in the absence of a decision and commitment to rescue, a sale of a business is a mere market sale. Consequently, the court may validly permit the sale because it would realise higher returns; otherwise, the court would be making business decisions to which it is not suited or for which it is not equipped. In such circumstances, the court may be more benevolent in granting the right to appoint a liquidator after the sale, to investigate the administration of the case.

6.2.3 The Business Plan

As the statistics suggest, at least a quarter, or if other figures are to be believed, then about half, of all administrations are executed via pre-packs.[455] SIP 16 requires the administrator to provide the details of his pre-appointment involvement with the company and the execution of the sale. It instructs the administrator to provide details of insiders involved in the sale.[456] Given that the business is to be sold, not rescued, there is no need for a business recovery plan. In the traditional administration, the business plan may be included in the proposals; though the proposals may be about the financial details of a sale.[457] Compared to the US, the information to be provided to the creditors is sketchy.[458] In a traditional administration, the details to be provided

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[455] Frisby, 'Pre-packaged Administrations'(n413) 15. See also, the figures stated in (n414) and (n415) above.
[456] SIP 16 Para 9.
[457] As most are, given that administrations culminate in sales.
[458] See p.237 above.

in the statement of affairs or by the administrator in the proposals merely provide a financial snapshot of the company. They provide limited information of its history and the reasons for its troubles.[459] It is expected that the administrator may provide some of those details when explaining why the company or its business may not be saved however; where a meeting is held. Further, the information is not varied according to the sophistication of the creditors and the court has no duty to examine the adequacy of the information provided.[460] The creditors do not have an independent duty to examine the debtor and the desirability of continuing its business. They rely on the information provided by the administrator. They may summon the administrator for more stringent questioning if they establish a committee but one is rarely established.[461] In practice, administrators provide sketchy and haphazard details at traditional administrations.[462]

As discussed above, if the intention is to rescue the marginally viable business and access to post administration finance was secured, there should be a more stringent duty to provide a detailed business plan which should be vetted by the creditors in a meeting. The plan should detail the history of the debtor, identify the core reasons for its failures and how those failures would be remedied in future.

6.2.4 Lessons for Nigeria

The rescue system in England and Wales combines formal and informal phases. The informal phase relies on the professionalism of the bank officials. It depends on the

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[459] See IA 1986, Sch B1, Para 47; IR 1986, r2.33.
[460] See P. 238 above.
[461] If they form a committee. IA 1986, Sch B1, Para 57; IR 1986, r2.52.
[462] Frisby, 'Pre-packaged Administrations' (n413) 32.

speed with which they can spot the on-set of distress and consequently move the company to the BSU. The banks play an active monitoring role, to which they may be suited given the level of information they obtain as monitors. While the company may benefit from the secrecy however, the informal system is potentially inadequate as a rescue device because companies exit the procedure without fundamental and essential debt restructuring that should come with rescue.

The insolvency practitioner is the fulcrum of the formal process. The process is largely administrative. It relies on the professionalism of the practitioners. Consequently, most decisions depend on his experience, training as well as his respect for his status as fiduciary. He makes many vital decisions with minimal input from the court. The court will usually uphold the practitioner’s decisions unless they are patently unfair or improper. Although the law states the duties of the administrator very clearly, this may be unsuccessful in constraining many of his decisions. It is consequently crucial to have robust certification and oversight systems for the practitioners. The court plays a much more subdued role. Nonetheless, judges must have a clear understanding of the philosophy and jurisprudence of the law if they are to execute their duties effectively. The judges play a particularly important role in facilitating the administration of new laws or reforms. They must be able to apply the law consistently however; otherwise, there would be uncertainty in practice.

It is difficult to recover control from secured creditors who have entrenched themselves over the years. Given that they are sophisticated,repeat players, it is quite easy for them to continue to control the process because of their enduring relationships with the foremost practitioners. Their position is bolstered by the fact that they are in charge of rescue finance. It can be argued that banks play a vital role in ensuring that the most experienced professionals handle the bigger, more valuable cases. This role may benefit the system in general. To inject some independence into the procedure, it is necessary to cut the umbilical cord between the practitioners and the main lenders by introducing an alternative source of rescue finance.

In addition, it is important that the system is flexible enough to permit the directors to appoint insolvency experts as soon as they perceive that they are required. The earlier the appointment is made, the more likely that the company will be rescued and the more likely that the directors will be kept on. That the law permits the directors to engage professionals does not necessarily mean that they will abuse the process. To reiterate the point above, the independence of the individuals and professionals will be buoyed by access to post administration finance. Nevertheless, it is possible that the directors will abuse the system, racking up debts to be subsequently discharged. Some protection must be given to the unsecured creditors. It will be difficult to order the subsequent investigation of a rescued business and the administrator may be unwilling to investigate the directors. The unsecured creditors will therefore require stronger committees but this can happen only when returns are improved.

Conclusion

The Nigerian practitioners have chosen parallel systems with contrasting procedures on which they hope to model the reforms of the Nigerian law. The US procedure is theoretically debtor-friendly and democratic. In practice, it can be hijacked either by the debtor itself, to the detriment of its creditors, or by the secured creditors to the detriment of all other claimants. On one hand, debtor control may lead to tardiness and loss in value while the directors seek to perpetuate their stay in power. On the other hand, creditor control may lead to precipitate actions that benefit individual (secured) creditors. Nonetheless, it is important to acknowledge the advantages of the participation of each group of stakeholders. The system can be improved by injecting some objectivity into the decision making process. It is apparent that the self-interest of the stakeholders diminishes the possibility of objective decisions by either the debtor or the creditors. This may be achieved by facilitating the participation of unsecured creditors and improving the clarity of information provided during the procedure through the introduction of a business plan.

In England and Wales, the procedure is theoretically creditor-friendly and administrative. In practice, the system comprises two phases. The first phase can be described as debtor-friendly; given that the lenders seek to rescue the distressed company. A debtor which cannot be rescued is forced into a formal phase that prioritises the interests of creditors. It is important to note that 'creditors' typically refers to the secured (and preferential) creditors, in practice. The extant system also benefits the directors/owners because the companies may be sold to them after it is purged of its former debts; sparking allegations of collusion between the secured creditors, administrators and the directors/owners. The system will also benefit from enhanced objectivity which may be accomplished by improving the independence of the practitioner. His independence can be improved by introducing a mechanism to facilitate access to post-administration finance; the party with the money tends to control the rescue process.

The comparison of both systems reveals the merits and demerits of the court-led system, the administrative system, a system with and without rescue finance, a debtor-controlled system and practitioner-controlled system. It also reveals the potential benefits of secured creditors' actions, as well as the detrimental effects of some of their decisions.

Chapter 7

Analysis and Conclusion

Overview

The chapter synthesizes the information contained in the preceding chapters. It gives a robust and representative snapshot of the credit process in Nigeria by commencing with the establishment of the credit relationship and culminating with the available rescue options for companies that are unable to repay their debts. It highlights the two phases of the Nigerian rescue system. One is the formal rescue process discussed in chapter 4; the other is the informal rescue process discovered during the interviews. Whereas informal rescue attempts by banks are prevalent, informal rescues at the instance of companies or professional debt recovery agents are more ad hoc. It discusses the formal rescue procedure in greater detail than chapter 4 permits; highlighting the practical problems faced by various stakeholders.

In addition, the chapter discusses the ubiquitous requirements for effective rescue. It restates and elaborates on the conclusions reached in the preceding chapters. It also provides an appraisal of the Nigerian rescue system; discussing both its informal and formal phases. The chapter proposes two pragmatic procedures that would best serve the Nigerian corporate sector. It suggests that the procedures should be included in a new, and separate, Insolvency Act. The chapter culminates by setting out the research objectives and demonstrating how these have been met by the thesis.

The chapter is divided into 4 parts. Part I discusses the Nigerian credit and insolvency system as a whole. Part II discusses corporate rescue and the Nigerian rescue system. Part III outlines the proposals. Part IV gives a concise conclusion to the thesis.

Part I

7.1 The Nigerian Insolvency Law and Practice

With the information obtained from the interviews and the preliminary analysis of the Nigerian insolvency law in the preceding chapters, it is possible to paint a robust, and it is suggested, representative, portrait of Nigerian businesses, from debt to death.[1] In the model process, a company with a healthy balance sheet and unencumbered properties may approach a bank for a loan.[2] Similarly, a verdant business may be approached by the bank's staff for a business relationship, including the provision of loans and overdraft facilities.[3] The loan application typically goes through many stages of vetting.[4] For many banks, the loan officer runs a cursory check. Next, the application may be scrutinised by sector-specific professionals in risk management teams.[5] For some banks, the application may also be sent to a loan committee for additional scrutiny.[6] Finally, all loan applications go to the bank's management for final approvals.[7]

Given their desire to grow their customer bases at any cost, many banks by-pass some of these checks. They merely have the prospective security valued, to determine if it would cover the loan; the fire-sale value of the asset should be at least between 120% - 150% of the value of the loan.[8] Sometimes, the loan is passed without the checks

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[1] See chapters 4 and 5 above.
[2] The company must have some pedigree: p164above.
[3] P 174 above.
[4] P 164 above.
[5] Ibid.
[6] Ibid.
[7] Ibid.
[8] P 166 above.

because the company belongs to the bank's managers or their cronies.[9] Anecdotes suggest that in some other instances the checks are by-passed to avoid close scrutiny of the fraud being perpetrated by the banks' officers.[10] For example, the company's directors may sign a loan agreement for NGN x, when, in fact, the company is given NGN x-y.[11] In other cases, the checks may be by-passed as a result of the incompetence of the loan officers or their desire to meet targets at any cost, inter alia.[12]

It is difficult to estimate the prevalence of these practices.[13] However, from the interviews it can be inferred that a lot of value is at stake in these cases.[14] For corroboration, attention is directed to the Assets Management Corporation of Nigeria (AMCON), which has recovered NGN 800 billion[15] of the NGN 3 trillion[16] in non-performing debts it had acquired by 2011.[17] Two lists of the largest debtors have been published to date: one in 2009 and another in 2012.[18] On the lists are top Nigerian personalities; some of whom were top bank personnel, friends of bank Chief

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[9] P 182 above.
[10] P 191 above.
[11] P 182 above. Naira is the denomination of Nigerian currency.
[12] P 172 above. See 'Female Banker Dies of Hypertension Over Inability to Meet 1 Trillion Naira Target in 6 Months' (27 August 2010) http://news2.onlinenigeria.com/latest-addition/191268-female-banker-dies-of-hypertension-over-inability-to-meet-1-trillion-naira-target-in-6-months.html, accessed 15/10/2012.
[13] It is referred to as the 'Nigerian Factor' which connotes actual intention to commit fraud or to by-pass stipulated rules. All interviewees referred to the 'Nigerian factor' several times during the interviews.
[14] Suggesting that the practices are relatively prevalent.
[15] £3,174,310,714.72.
[16] £11,893,305,088.10.
[17] Godfrey Obioma, 'AMCON Recovers N800bn from Bank Debtors' *Business Day*(Nigeria, 01/10/2012) http://www.businessdayonline.com/NG/index.php/news/76-hot-topic/45205-amcon-recovers-n800b-from-bank-debtors-commends-cbn-blacklisting-of-bad-borrowers accessed 11/10/2012.
[18] For the 2009 list, see Bibiana Njogo, 'Risk Management in the Nigerian Banking Industry' (2012) 1 Kuwait Chapter of Arabian Journal of Business and Management Review, 100,102. For the 2012 list, see Austin Ejaife, 'Nigeria: Discordant Tunes Over AMCON-CBN Debtors' List' http://ejaife.wordpress.com/2012/09/30/nigeria-discordant-tunes-over-amcon-cbn-debtors-list/, accessed 11/10/2012.

Executive Officers (CEOs) and CEOs of top companies.[19] The investigations culminated in changes to the executive management of some banks and caused great controversy in the banking sector as a whole.[20]

Should the parties agree on terms, the bank will grant a loan for a period typically lasting between 12-24 months.[21] The loan will run in 90-day cycles.[22]The company uses the loan facility and repays it within each cycle.If the company remains a going concern and conducts itself satisfactorily, the bank may turn-over the cycle until the agreed term is completed.[23] Then, they may renegotiate another term. A diligent company may run as many as four cycles in a year. Usually, the bank will demand that the company's main account be domiciled in one of its branches.[24] The bank will also extract negative pledges from the company.

Banks demand mortgages as security.[25]Where possible, the bank will take an all-assets debenture.[26] The security may cover both present and future assets. Usually, the bank stamps a nominal fee - about 10% of the value of the debt - on the deed, to reduce its stamp duties.[27] Given the problems associated with the enforcement of mortgages, most banks now demand other types of security designed to suit the type

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[19] These debts were mostly unsecured or secured with very little collateral. They were treated just as personal transactions between 'friends'. Gabriel Omoh and Babajide Komolafe, 'CBN Sacks 5 banks' CEOs, Appoints Acting MD/CEOs' *Vanguard* (Nigeria, 14/08/2009) http://www.vanguardngr.com/2009/08/cbn-sacks-5-banks-directors/, accessed 11/10/2012.

[20] Afribank, Intercontinental Bank, Union Bank, Oceanic Bank, Fin bank, Bank PHB, Spring Bank and Equatorial Trust Bank. See also, Biosah Chukwuma, 'Dissecting of Current Situation of Nigerian Banks' (2009)http://www.proshareng.com/reports/2050, accessed 11/10/2012.

[21] The term may be shorter than 12 months, while 3 years are an exception; p164 above.

[22] Official lending rate (Monetary Policy Rate MPR) is 12%. Central Bank of Nigeria, 'Data and Statistics' from http://www.cenbank.org/rates/mnymktind.asp, accessed 04/10/2012. The commercial banks typically lend at higher rates.

[23] P 164 above.

[24] Ibid.

[25] Developed property in a prime area for ease of sale; p 165 above.

[26] A debenture mortgage.

[27] Ibid.

of assets owned by the business.[28]They may negotiate sale and lease-backs. The bank may also demand that the goods be bought in its name but placed in possession of the company which cannot sell the goods without prior approval.[29] Depending on the nature of the business, the loan officer may also visit the company regularly to collect cheques or to ensure that its affairs are as they should be.[30] In addition to the security provided by these quasi-security devices and the visits, the banks ensure that their customers continue to subsist in the long run by monitoring their loans avidly.[31]

For any of a number of reasons, the company may switch from regular repayments to haphazard repayments. The federal government may alter a policy which directly affects its business. The government may refuse to continue to subsidize the sector in which it operates. The price of oil may have risen as a result of a crisis in the middle-east and so the cost of crude oil which fuels the emergency generators on which its plants run may have risen astronomically. It is also possible that the owner/manager failed to invest the money in the business as agreed.[32] With most of the withdrawals, he may have funded the solicitation of a chieftaincy title from his community, married a new wife, bought a new car, built a new house or funded a political campaign.

A customer whose default is imminent will be flagged by the loan officer or the monitors. The standard practice is that the loan officer may visit the company, if he has not been visiting since the loan facility was granted. If he had been visiting, he may increase the frequency of the visits. The aim is to investigate the company's

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[28] The courts are likely to protect the debtor and the case may drag for many years; p 166 above.
[29] Ibid.
[30] P 167 above.
[31] Many have multiple monitoring units. Ibid.
[32] P 171 above.

affairs.[33] On account of his visits, the loan officer may salvage some funds by collecting cheques more frequently and monitoring the inventory. In some cases, the loan officer may be unable to resolve the problem. He will refer the case to the risk management team.[34] The team may recommend loan restructuring.[35] It may also recommend a change of management. Simultaneously, the bank will increase its control over the company's cash flow. If the problem persists, then the company is transferred to the loan recovery unit; for some, the special assets department (SPAD).[36]

SPAD merely seeks to recover the loan. If it fails, the bank appoints a recovery agent; typically a solicitor.[37] Debt recovery agents try orthodox and unorthodox means of extracting the unpaid balance from the debtor. Simultaneously, the bank scrambles to 'perfect' its security. This requires it to 'up-stamp' the charge from nominal to full value – if it can.[38] Typically, this will require underhanded practices by the staff of the registry and/or the staff of the Corporate Affairs Commission (CAC).[39] As soon as possible after it has perfected its security, the bank will make a formal demand.[40] If it is not met, the bank will realise its security. Some banks engage the help of security

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[33] P 167 above.
[34] Ibid.
[35] Ibid.
[36] Some banks have no loan recovery units; the case goes directly to a recovery agent. 168
[37] P168 above.
[38] The debenture must be stamped within 30 days of its execution. A deed that is not duly stamped shall not be admitted as evidence of the agreement by the court. However, the unpaid duty can be paid subsequently, subject to the payment of a penalty. Stamp Duties Act CAP 441 LFN 1990, s 22 (4), s 23 (1), (3) (a) (c). A charge which is unregistered within 90 days of its execution is void against the liquidator or creditors of the company. Companies and Allied Matters Act 2004, s197 (1). Payment of stamp duties is one of the pre-conditions for registration. The period can be extended by court order however. Corporate Affairs Commission, *Notes for Customers Guidance* (sic), Para vi, P.5.
[39] To speed up the process.
[40] P 168 above.

forces to achieve this task.[41] It is the cases that cannot be concluded informally that resort to the court for debt recovery.[42]

7.1.1 What Rescue Options are Available?

7.1.1.1 Informal Rescue

It is imperative to state that some distressed companies survive and return to branch. The empirical undertaking did not include a statistical element; however, anecdotes suggest that not all distressed companies fail. For example, one of the interviewed entrepreneurs recounted a story of a brief time of distress.[43] Though he understated the consequences of his company's failure to repay, the fact that security forces were involved suggests that the events must have affected the company's cash flow substantially.[44] The cycle above shows that the tussle between the bank and the customer would have gone beyond the preliminary stages before the help of the forces is engaged. Yet, the company returned to profitability. Consequently, it is important to examine the rescue options available to companies holistically. Three informal rescue regimes can be identified from the interviews. One is an initiative of the banks, another of the companies, and the third, an initiative of insolvency practitioners.

i. Bank-Led Rescue

The first, and possibly, most prevalent method of informal rescue is that administered by the banks.[45] They may propose loan restructuring for distressed clients.[46] This is

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[41] P 169, 192 above.
[42] Both the Federal High Court and the State High Court have concurrent jurisdiction in such matters.
[43] P 175 above.
[44] If the order outlined above is followed.
[45] There are no statistics on its use but all the banks in the sample mentioned the debt restructuring ambit of debt management. P 167, 175 above.

routinely conducted in-house by risk management units. They may grant a stay on the repayment of outstanding sums; modify the terms of repayment; waive defaults, amongst other things. The bank identifies the companies that have potentially viable businesses during their period under the care of the risk management unit.

It is expected that the bank would continue to support the companies financially. It would therefore provide operating finance while their balance sheets are revitalised. It is unclear, and unlikely, whether the suppliers and other trade partners will forgive the companies their debts during the period however.[47] It is expected that the risk management team will pressure the companies' management teams to produce rescue plans, with the assistance of the risk management officers.[48] The team will monitor the implementation of the plans closely till the company returns to branch. A successfully rescued company will return to branch; otherwise, the risk management team will pass the company to the debt recovery unit or SPAD.

ii. Company-Led Rescue

A company may also be informally rescued at the request of its management.[49] They may propose an arrangement whereby a committee will be established to oversee the repayment renegotiations and plan. The committee will typically consist of representatives of the company, the bank and an independent party – usually the police.[50] When the company proposes the rescue, its freedom to take the rescue decision will be curtailed unless it has enough money secreted elsewhere, can raise

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[46] Ibid.
[47] Recall that debt forgiveness is fundamental to the rescue process. P 102, 256 above.
[48] Some companies complain that these plans sometimes lead to failure however.
[49] There is no data on its use but one entrepreneur described how he used it successfully; p175 above.
[50] The police play the control and neutral role that the court would have played if it was effective.

money from another financier, or can convince the bank to support its proposals. If the bank does not accept its plan and the company has no other funds, then it will not be rescued; instead, the bank will enforce its security.

If the bank accepts the proposals, it may grant further loans to the company. Otherwise, it may be content to receive the designated amounts while the company sources funds from elsewhere. If the bank rejects the proposals, then the company would require funds with which to pay off the bank first, and then to operate its business pending the completion of its rescue. As a result, it may be unable to conclude the rescue successfully. It is unclear the extent to which the debtor can negotiate the forgiveness of some of its pre-default debts from its secured and unsecured creditors. Its debt burden may therefore precipitate its future failure, if unrelieved. The business plan in these cases will be drafted by the management. The bank's input will depend on the level of its involvement.[51]

This method of informal rescue is the most tenuous of the three. It depends on the ingenuity of the managers; their ability to conceive of the idea and to convince the bank of the plan's feasibility. Unless the company has access to other funds or can convince the bank to cooperate, it is unlikely to succeed.

iii. Practitioner-Led Rescue

The third alternative is more complicated than the first two.[52] In this case, the receiver/manager may propose a termination of the receivership. He is thereafter

[51] Generally, banks provide these services for a fee, however.
[52] There are no statistics on its use. However, 2 of the 7 practitioners in the sample indicated that they had used the system; p205 above.

appointed to a senior management position in the company; subject to an arrangement between the bank and the company.This is done to reassure the company of the desire to rescue. It also reassures its employees, suppliers and customers. It prevents the loss of value that attends the appointment of receiver/managers. To the world, the company is operating as before; it has the statutory right to appoint new officers after all. Fundamentally, it prevents the termination of contracts that are structured to terminate automatically when there is a change in the control of the company – such as when a receiver/manager is appointed.[53] If the managers fail to cooperate with the practitioner - either when he proposes the hybrid management procedure or after it has commenced - then the receivership is re-instated and the assets will be realised; which would invariably spell the end of that business.

One advantage of this procedure is that companies, whose loans were not restructured by the risk management unit or who failed to convene a committee or to convince the bank where one was formed, may be handed another life-line after the receiver/manager is appointed. The practitioner may attempt another rescue if he finds that the business is viable. However, the procedure is hinged on the adeptness of the practitioner; one who cannot contemplate it cannot suggest it. Consequently, it may be applied only to a few of the companies that require it.

A receiver/manager who suggests the hybrid-management procedure would have concluded that the company has a viable business. The challenge would be in convincing the bank of the benefit of the arrangement. Banks emphasised the fact that they expect their receiver/managers to go in to ‘cannibalise the place’; in other words,

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[53] For example, see the story in p206 above.

realise assets.[54] Ironically, the receiver/manager also faces a challenge from the directors, who may be unwilling to cooperate with the plan. Without their cooperation, the receiver/manager would have to realise the assets which could, and in most cases would, lead to the termination of the business. A receiver/manager who convinces the bank to support the proposals can rely on the bank for short term finance. Again, it is unclear if there would be debt forgiveness. However, given that the practitioner would be experienced in such matters, he may recognise the need to negotiate some debt forgiveness. The practitioner would also be charged with drafting, implementing and monitoring the rescue plan. The procedure provides the most robust method of rescue; however it is unclear how prevalent it is.

7.1.1.2 Formal Rescue

Companies that cannot successfully conclude an informal rescue would be moved to the debt recovery unit or SPAD.[55] The bank may also refer the case to debt recovery professionals.[56] Recovery ‘professional’ or ‘practitioner’ is used loosely to refer to any person who is in the business of debt recovery. These practitioners are usually accountants or lawyers; lawyers appear to be the preferred choice because they can also handle any litigation that arises in the course of the case.[57] Practitioners are not accredited in Nigeria.[58] However, the Business Recovery and Insolvency Practitioners Association of Nigeria (BRIPAN) was established to improve the insolvency profession and provides certification for its members.[59] Membership is voluntary

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[54] P 169 above.
[55] P 168 above.
[56] Either where it has no debt recovery unit or where the unit has failed to recover the debt.
[57]P 169 above.
[58] CAMA 2004, s387.
[59]P 188 above.

however. Non-members may be appointed as debt recovery or insolvency practitioners.

The appointment of a practitioner does not immediately spell doom for the company; the preceding sub-section shows that the practitioner may suggest an informal rescue. That the practitioner would suggest an informal rescue instead of administering the receivership where appointed as a receiver/manager, is however intriguing. The ensuing sub-sections analyse the challengesthat confront practitioners who seek to rescue distressed companies using the formal procedures.

i. Receivership

Theoretically, there are two main routes into receivership.[60] The directors, members or creditors may apply to the court for the appointment of a receiver/manager to take charge of the company.[61] The court states that the applicants must specifically indicate ‘manager’ if they want the receiver to have management powers.[62] The court will grant the order if the petitioners can show danger to the property.[63] In practice, companies suffering from debilitating debt loads rarely go into receivership through this means. Usually, these applications are made when there is a tussle for power in the boardroom. Typically, the receiver/manager is appointed out of court by banks. The banks can appoint any person, including their staff as receivers. In practice, they tend to appoint renowned debt recovery professionals.[64] Banks rarely appoint

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[60] Contractual and statutory.
[61] CAMA 2004, s389. *Intermarket (Nig) Ltd v Aderounmu*(1998) 12 NWLR (pt576) 141.
[62]*Ponson Enterprises Nig. Ltd v Njigha* (2000) 15 NWLR (pt689) 46.
[63] See (n61) above.
[64] P 169 above.

receivers anymore.[65] Nonetheless, when they hold all-assets debentures, they may make the appointment.[66]

Initially, the bank may activate a 'dormant' receivership, to coerce the management into repayment.[67] At dormant receiverships, the appointment is made and registered at the Corporate Affairs Commission (CAC). The company is also notified of the appointment.[68] The bank will instruct the receiver to hold off from taking over the management of the company if the managers appeal for time within which to repay the debt. However, the threat of take-over remains until the debt is fully repaid. The bank may do this as many times as necessary until the debt is fully repaid.

If the company fails to cooperate with the bank or the bank is not interested in dormant receiverships, it may instruct the receiver/manager to take control of the company immediately. Although the law does not indicate the need for one, until 2011, the receiver/manager usually applied to the court for an ex parte order to confirm his appointment.[69] The order included a directive to the police for the support of (armed) escorts. The order also contained injunctions restraining the owners and their agents from taking control of any assets subject to the receivership. In some instances, the court instructed the receiver to place the company on notice before the necessary injunctions and orders could be granted, and then fierce legal battles commenced between the parties.[70] The battles, on many occasions, went as far as the

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[65] As suggested by the dearth of case law; p169 above.
[66] A debenture relating to all or substantially all of the company's assets; including both fixed and floating charges.
[67] P 170 above.
[68] CAMA 2004, s 396.
[69] Referred to as a confirmation order. *Unibiz (Nig.) Ltd. V CBCL Nig. Ltd*(2003) 6 NWLR (pt816) 402. P 190 above.
[70] P 182, 190 above.

Supreme Court; in Nigeria, that requires no less than 5 years, many times a decade or more.[71] So prevalent was the practice that receivers who did not make the application may be challenged when attempting to take over the company.[72] If the receiver/manager attempted to respond to the allegation of invalid appointment by an action commenced in the name of the company, he faced another challenge. Before the Supreme Court's judgment in *Wema Bank v Onafowokan,*[73] the practice was that the receiver required the leave of court to bring an action in the name of the company; although the law, again, does not make such a stipulation.[74] Thus, the directors could again challenge the receiver for not seeking leave of court to bring the action, and again, the battle could go as far as the Supreme Court as the *Wema Bank* case showed.

The receiver/manager must register his appointment at the CAC, which takes another few months because the CAC officials will verify the appointment documents.[75] During this period, the directors who have arranged with staff at the commission would be notified of the appointment.[76] The directors therefore launch their attack at the Federal High Court (FHC) which has exclusive jurisdiction over such matters. They may contest the quantum of the debt, the validity of the appointment, or the legality of the loan agreement.[77] The judges indicated that debtors often succeed under the last head because many debentures are badly executed: there may be irregular signatures, the properties may not be clearly designated or the bank may

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[71] For example at p 135 above.
[72] *Wema Bank Plc v Onafowokan* (2005) 6 NWLR (pt921) 410.
[73] (2011) 12 NWLR (pt1260) 24.
[74] See Schedule 11, power 5.
[75] CAMA 2004, s 396.
[76] From the comments, one can infer that the directors will make contact with the officials as soon as they know that the case may result in receivership. Unfortunately, discovering willing participants is not a difficult task at all. P 171, 197 above.
[77] P 176, 183, 197 above.

have been unable to up-stamp. At the hearings, particularly those disputing the quantum of the debt, some judges try to read between the lines to determine how much exactly the directors obtained, in spite of the sums indicated on the loan agreement. [78] The directors may, therefore, win injunctions barring the receiver/manager from taking control of the company pending the resolution of the substantive case.[79]

Practitioners argue that the court ought to permit the receivership to continue in these cases, while a hearing is had on the quantum of the debt; given that the dispute is not that the directors did not borrow some money.[80]Practitioners also assert that some judges are quick to grant injunctions to protect companies, or because they distrust receivers generally.[81]Conversely, the courts indicate that they have a duty to promote the business friendly culture which the government espouses, and which is necessary to attract foreign direct investment into the country.[82] In addition,they insist that poor diligence on the part of the banks and their receivers may tip the case in the favour of the company. Again, these cases may go unresolved for years while value drains out of the already distressed company.

Given the problems highlighted above, the astute receiver/manager checks all potential loopholes to prevent as many battles as he can.[83] After he obtains all the preliminary approvals, then his battle with the company's owners and staff

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[78] P 184 above.
[79] Though sometimes, the directors just challenge anything that they can; with the hope that something succeeds.
[80] P 200 above.
[81] Ibid.
[82]184 above.
[83] The astute receiver/manager also has his moles in the appropriate places to facilitate his applications and to give him forewarning of potential problems.

commences in earnest.[84] On the day that the receiver/manager goes to the premises, he is best advised to go with police escort; preferably, MOPOL.[85] An unarmed and unescorted receiver/manager will be confronted by irate owners and staff who will be well armed with dangerous weapons. Such a receiver/manager and his staff would incur actual bodily harm on those occasions; hence the need for the confirmation order which provides also for armed escorts.[86] To the chagrin of owners, employees and other practitioners, some receiver/managers lock up the premises when they take over; preventing the execution of contracts.[87] Those receiver/managers claim, however, that it is for their protection, as well as the protection of the assets. During the period, the receiver/manager and the erstwhile managers sometimes exchange derogatory comments in the national newspapers.[88]

a. The Rescue Option

Theoretically, the receiver/manager is to take decisions in the interest of the company as a whole. S390 of the Companies and Allied Matters Act (CAMA), instructs him to take actions that would preserve the company's assets and promote the purposes for which it was formed. Though he must pay special attention to the interests of the debenture-holder, he is not to act exclusively in its interests.[89] He is also to consider

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[84] P 169 above.
[85] Hence the confirmation order. MOPOL is the most feared Mobile Police. P 169 above.
[86] Receivership has been known to result in death in Nigeria. Dipo Kehinde, Sola Fanawopo and Chris Anucha,'Mobitel MD Dies in Controversial Circumstances'(Online Nigeria, 16 September 2005) http://nm.onlinenigeria.com/templates/default.aspx?a=5271&template=print-article.htm, accessed 12/10/2012.
[87] P 196 above. Valerie Anofochi, 'Bank Shuts Down HiTV Premises' (Daily Times NG, 21/11/2011) http://dailytimes.com.ng/article/bank-shuts-down-hitv-premises, accessed 05/10/2012.
[88] Many cease and desist letters are published on the instruction of the court. Generally, these exchanges give the public a negative opinion of receivership. P 196 above.
[89] CAMA 2004, s 390 (2). P 130 above.

the interests of the members and employees.[90] The Act prohibits relief from liability for the breach of this section.[91] Put differently, the receiver/manager is enjoined to take an objective rescue decision.

In practice, some receivers, as indicated above, may request for the termination of the receivership, in favour of joint-management, if that better serves the interests of the company as a whole. The practitioners noted however, that the banks often refuse to cooperate with their suggestions.[92] The banks explained that they do not believe in the management abilities of the practitioners; a point corroborated by the judges.[93] Further, the banks argued that the companies that go into receivership are those that cannot be saved at all. Consequently, they expect the receiver/managers to take control, simply to realise the assets.[94] One may contest the bankers' statement, given that some companies have been rescued post receivership by resort to joint management.[95] Given that the owners are often evicted from the premises, it is unlikely that they are consulted on the rescue decision. There was no suggestion of any consultations with trade creditors. Hence, it can be surmised that the receiver/manager takes the rescue decision firmly in the interest of the debenture-holder in most cases.

A frequent challenge at this phase is the good faith of the parties in control: the banks, the receiver/managers and sometimes, the owner/directors. First, each party uses his status in society to influence the decisions to be made. For example, properties

[90] Ibid.
[91] CAMA 2004, s 390 (3).
[92] P 193 above.
[93] P 169, 181 above.
[94] P 169 above.
[95] Based on anecdotal evidence, though.

belonging to certain individuals cannot be sold because of their standing in the community.[96] Such persons could bid rock bottom prices for the assets because no one else would purchase them.[97] Second, there is a lot of corruption and mala fide in the administration of the regime.[98] Thus, there are cases in which viable businesses are sold to the receiver/managers and their allies at rock bottom prices.[99] In other instances, the bank's management uses the receivership to edge out the owners, in order to take full control of the company.[100] Third, in many instances, receiver/managers run companies negligently when in charge; their only concern being the repayment of the debt.[101] The entrepreneurs gave instances of receivers taking over vibrant companies and running them aground. The courts have not, thus far, held any receiver/manager liable under S390 (2), though there has been at least one opportunity for such a finding.[102] It is therefore unclear how it will be applied, if at all.

The receiver/manager looks to the banks for short term operating funds. It can only be inferred from the attitude of the banks that they are unlikely to provide short term funds with which to operate, while the receiver/manager attempts to rescue the distressed company. Success depends on the clout of the receiver/manager – or on his own willingness to input personal funds. The receiver/manager also creates the business plan. He is not under an obligation to consult with any other party. In practice, he would consult with the bank. The practitioners noted however, that many

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[96] For that reason, banks usually insist on properties situated in commercial hubs.
[97] P 197 above.
[98] All groups of stakeholders accused one another. P 156,194 above.
[99] P 177 above.
[100] P 191, 197 above.
[101] P 178 above.
[102] *Union Bank of Nigeria Ltd v Tropic Foods Ltd* (1992) 3 NWLR (pt228) 231; *West African Breweries v Savannah Ventures Ltd*(2002) 10 N.W.L.R (pt775) 401.

receiver/managers take control of distressed companies without a plan. They have no clear objective or idea about what to do with the company, for which reason many receiverships fail. Consequently, the practitioners advocate that the law should require the receiver/manager to file a plan as soon as possible after appointment. One problem that the receiver/manager faces at rescue is the fact that he can be removed at will by the banks.[103] Consequently, if he makes proposals that the bank is not interested in, it may prefer to replace him with someone who would work under instructions.

ii. Arrangement and Compromise

At the advice of an insolvency practitioner, the company may attempt an arrangement. It is also possible that the debt recovery professional who is engaged by the bank to recover the debt may attempt to negotiate an arrangement between the company and its creditors. This is the least favoured insolvency mechanism in Nigeria; there is no case on record that went the length. There are many reasons for its disuse. First, there is a dearth of knowledge on the procedure. Practitioners suggest that debtors may prefer to run away, than to see the negotiations through.[104] Second, there is the suspicion that debtors will not be honest in their dealings with the creditors. The practitioners suggest that the debtors are likely to hide their assets away during the negotiations, only to return to flamboyant life-styles after their debts have been modified.[105]

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[103] P 194 above.
[104] P 198 above.
[105] P 198 above.

In addition, the court system is not conducive to the arrangement mechanism.[106] The practitioner may initiate the arrangement at the Federal High Court (FHC) which has exclusive jurisdiction over insolvency matters.[107] However, other creditors may initiate debt recovery actions in the State High Court (SHC) which has concurrent jurisdiction on debt recovery issues.[108] Given that the procedure does not provide for a stay of actions, the SHC may attach the company's assets for the repayment of individual creditors, while a practitioner is attempting to administer an arrangement through the tardy FHC.[109] FHC judges may, with apparent impunity, adjourn the case as often as they desire; even if the case is listed as urgent.[110]Moreover, even if the judge does not adjourn the case, it may still progress slowly; though on a fast track list. This is because the same judge handles both fast and slow track cases on the same day, and across a number of legal subjects. It is likely that the judge merely treats all the cases as slow-track, regardless of their designations.[111]

While the cases are on-going, other creditors may resort to self-help. Using their connections in society, they may employ military or police forces to help to cart away viable assets belonging to the company, in satisfaction of their debts.[112] The practitioners therefore advocate for the introduction of an automatic stay on actions and legal process if the mechanism is to be effective.[113]

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[106] P 197 above.
[107] The Federal High Court has exclusive jurisdiction of matters relating to CAMA. The Constitution of the Federal Republic of Nigeria, 1999, s 251(e), (j).
[108] The Constitution of the Federal Republic of Nigeria, 1999, s 272.
[109] P 198 above.
[110] Of course, the SHC judges may also adjourn often. See p 200 above.
[111] P 200 above.
[112] P 197 above.
[113] Ibid.

Case law suggests that most arrangements stall at the initiation stage.[114]Moreover, judges of the FHC demand proof, at commencement, that the arrangement is fair, or that it is likely to be approved by the requisite majority before an order to convene an initial meeting is granted.[115] It is possible to argue that the facts of the cases in relation to which these decisions were made necessitated the courts' opinions. Nonetheless, it is clear that judges often make ad hoc rules which do not emanate from the ordinary meaning of the words used in the statutory provisions.[116] The party that proposes the arrangement would invariably make the rescue decision. It is unclear how the company would be funded while the process is administered however. Consequently, the company may again find itself at the mercy of its bank; limiting the opportunity for objective decisions.

Part II

7.2 Corporate Rescue and the Nigerian Insolvency System

Corporate insolvency law provides a formal mechanism by which a company's debts may be restructured and repaid.[117] Though it is typically used by insolvent companies, it may also be used by solvent companies. Usually, the debts will be restructured when the company foresees that it will be unable to subsist profitably with its extant debt load. The corporate rescue ambit of corporate insolvency law offers a formal

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[114] All the cases cited in chapter 4 stalled at initiation. P147 above.
[115]*Andruchue Investment Plc v Financial Mediators* (1994) FHCLR 51; *Yinka Folawiyo & Sons v. Hammond Projects Ltd*(1977) 3 FRCR 143.
[116] P 147 above.
[117]The multi-dimensional perspective. P 59above.

mechanism by which viable businesses may be saved.[118] The emphasis is on viable businesses because – like at market sales to third parties – the decision to rescue must be made objectively.[119] The most crucial decision which has dogged most rescue-models is how to identify viable enterprises.[120]The procedure must be designed to ensure that the most suitable person(s) answer(s) this question objectively.

Insolvency models approach the question differently, as the models studied demonstrate. The US model relies primarily on the debtor itself to take the decision; essentially, its managers. However, the model keeps the debtor objective by empowering the creditors tocheck the misapplication of the debtor's powers. The secured creditors can, with the power of the court, remove essential assets from the estate; effectively terminating the rescue. The unsecured creditors can investigate the debtor and make their own deductions. Again, the court acts as final arbiter in these cases. Conversely, the UK model delegates the task to a professional. Similarly, the model keeps the professional objective by empowering the creditors. The secured creditors may also apply to withdraw their assets from the process but the power of the unsecured creditors is restricted to rejecting the proposals proffered by the professional.

Nevertheless, the parties in charge are often too self-interested to make objective decisions.[121] The theoretical checks may be, and in the models discussed have been, less effective than envisaged.[122] Unsecured creditors generally lack the information,

[118] P 87 above.
[119] Ibid.
[120] P 91 above.
[121] P 96 above.
[122] P 215 above.

bargaining power and/or sophistication to perform their roles effectively.[123] Consequently, they are typically unable to convince the courts to reject the debtor's decisions or to influence the professional's choices.[124] The secured creditors would usually wrest control of the decision-making process; by influencing the appointment of the professional or by controlling the remuneration of the managers, inter alia. When the secured creditors are sufficiently protected by the value of their security, they may be impassive. The debtor is only interested in perpetuating its existence; the managers will abandon ship only when they have completely exhausted all expectations of recovery.

A few points must be highlighted. First, regardless of the model, it is clear that secured creditors prefer to have an outside expert with adequate experience appointed to take charge of decision making at rescue.[125] Second, it is not prudent to leave debtors at the helm of the rescue procedure. The US procedure shows that they cannot be checked by the unsecured creditors and are most likely to be influenced by the secured creditors.[126] Third, it is preferable to involve a restructuring expert in the rescue process: either to the undertake investigations on behalf of the unsecured creditors, to review the business with a neutral and professional outlook or to move the procedure along quickly, given his experience with the law and practice of rescue. The problem that ensues is how to ensure the objectivity of such an expert.

Practice shows that the expert's objectivity is directly proportional to his independence. His independence is affected by a number of factors including the *de*

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[123] P 216 above.
[124] Ibid; P 253 above.
[125] P 217 above.
[126] P 216 above.

facto process by which he is appointed, and his appointment terminated.[127] The appointor must be prohibited from terminating his appointment at will. However, even giving the right to appoint to the most vulnerable stakeholder(s) will not promote the achievement of the desired objectivity unless the appointee has an alternative source of operating finance apart from the main lender.[128] Even if he is to execute a pre-pack, he needs short term funding to accomplish the task in the best interest of the investors as a group.[129] Most insolvency critics espouse robust rescue mechanisms. However, a rescue mechanism can only withstand rigour if the reorganizer has access to operating finance, as well as *de facto* breathing space, from all investors, within which to make the decision.[130] Consequently, short term funding is especially important to rescue.

In addition, the rescue expert must have plans by which the company or its business will be revived and its debt burden lightened.[131] The importance of the business plan is often downplayed while the financial plan takes pre-eminence.[132] It is important in every case that the cause of the distress is identified and a proposal to remedy those mistakes presented, if genuine rescue is to be administered. Such investigations would be made at market salesto third parties. It is argued that they are fundamental at rescue also. The business plan should require a minimum amount of information. When the proposals are presented, at least the history of the debtor, the cause of its failure and the proposed reforms should be clearly stated. The thesis demonstrates that these three

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[127]P249 above.
[128]P 217 above.
[129]P 232, 272 above.
[130] Including breathing space from the main lender. P 265 above.
[131] P 237 above.
[132] P 237, 281 above.

elements – the rescue decision, rescue finance and the rescue plan – must be addressed by an effective rescue system.[133]

Rescue systems are designed to suit particular legal systems.[134] Each legal system seeks to build on its institutional strengths.[135] The institutions may be tweaked or substantially modified to facilitate the administration of the chosen rescue procedure where necessary. Typically, rescue systems in fact comprise informal and formal phases.[136] Rescue may take place entirely at the informal or the formal phase.[137] It may also combine the informal and formal processes.[138] Although the informal procedure offers some advantages – speed, certainty and the avoidance of the stigma of failure, as well as its effects – it is less rigorous and more unwieldy than the formal procedure.[139] A system that combines the informal procedure with the formal is therefore preferable.[140] The formal rescue system is suited only to viable companies however.[141] Consequently, the system should encourage timely and easy initiation. These findings will now be applied to the Nigerian insolvency system.

7.3 The Nigerian Corporate Rescue System

A perfunctory review of the Nigerian insolvency law reveals an inadequate, perhaps archaic, system full of anomalous provisions that are not conducive to rescue. This

[133] P 215 above.
[134] As well as socio-economic realities.
[135] The US for example builds on its litigious and individualistic culture, while the UK builds on its administrative culture.
[136] In the US, it may start off as a pre-pack. P 232 above. In England and Wales it may start at the Business support unit. P 253 above.
[137] For example in England and Wales, rescue takes place informally.
[138] In the US, the pre-pack is a hybrid process by which companies may be rescued.
[139] It also benefits the party with greater bargaining power which is the main lender.
[140] Provided that the formal procedure takes into consideration the elements afore-mentioned.
[141] In reality, not all distressed companies can be rescued; though all market economies require a rescue procedure. P 89 above.

verdict is quite common amongst experts within and outside the system.[142] It is argued that the verdict is inaccurate. Many of CAMA's critics believe that they should be reading a replica of the British Companies Act 1948, augmented by the principles of Common Law applicable in that era. Though the foundation of most formal legal rules in the Nigerian legal system is the Common Law, in the decades since independence, many rules and practices have either departed from or modified the received law. CAMA 2004, with which this thesis is concerned, is one of the enactments that have departed from their British roots, at least in part.[143] To avoid the uncertainty that would attend a sudden reversal of what was considered to be the norm, the reformers retained the structure of the British model, as well as the ubiquitous principles that were considered to be good law.[144] Consequently, the Nigerian law still bears a close resemblance, if not conceptually, then at least structurally to the (old) British law. Similarly, in theory, British cases that are on fours with the Nigerian provisions have persuasive power –as long as they do not contravene the direct provisions of the law – in Nigerian courts. One problem is that the courts and the practitioners are more likely to enforce principles of the Common Law, than the express provisions of CAMA 2004.[145]

Many critics believe that the Nigerian rescue system comprises only the formal phase.[146] In England and Wales, empirical studies corroborate the assertions of the bankers that the rescue system comprises informal and formal phases.[147]Anyone who desires to proffer a robust analysis of the system must,therefore, take both phases into

[142]P 109, 137 above.
[143]P 38 above.
[144]Ibid.
[145]P 111, 191 above.
[146] They do not even refer at all to the informal phase.
[147] P 253 above.

consideration. Likewise, in Nigeria, the rescue system comprises both the informal and formal phases. An attempt will always be made to rescue the company informally before it ends up in the formal phase.[148] Even at the formal phase, practitioners have shown their ingenuity in recommending a return to the informal phase when they find that the formal phase would be value destructive.[149] It is unlikely that the practice described by a few of the practitioners is prevalent however; nonetheless, it must be acknowledged.

In addition, banks are often criticised for their high-handedness. Many critics fail to recognise that they have created a system that fills the vacuum left by the inadequate formal system. In the US, banks developed a system for dealing with distressed companies when the debtors, with the support of the courts, injected long delays to the rescue procedure. They created financial arrangements that enable them to take control of the decision-making process after the debtor becomes distressed.[150] Though their actions have some detrimental consequences, they have also improved the administration of chapter 11. Interestingly, many of the quasi-security devices created by the Nigerian banks closely resemble those used by the US banks. They help the banks recognise, quite quickly, companies that are underperforming and to facilitate the resolution of their problems. The banks' actions have improved the administration of many businesses; with benefits for the economy. Simultaneously, the banks' actions have also had some detrimental effects; particularly when undergirded by fraudulent intentions and practices. For the moment however, it suffices to say that a

[148] P 293 above. The practice is that non-performing loans are transferred to the risk management unit at which loan restructurings will be attempted; in the absence of factors that advise to the contrary.
[149] P 295 above.
[150] P 217 above.

distressed company in Nigeria is likely to be rescued at the informal phase. Companies will find it substantially more difficult to negotiate rescue through the formal procedures.

The formal procedures are wholly inadequate. Commencement poses one of the most fundamental challenges. For the receivership procedure, the legal battles that occur at the initiation phase deter the appointment of receiver/managers. The problem has also led to the innovation of quasi-security devices by which banks exert even greater control at distress. Further, the benefits of registering appointments at the CAC cannot outweigh the detriments of that requirement. For the arrangements procedure, the courts' insistence on proving that the arrangement is likely to be accepted by the required majority would discourage attempts to propose arrangements. However, the main challenge for those hoping to propose arrangements is the lack of moratorium. No plans are filed, financial or business, at receiverships. The receiver merely acts in his own discretion; subject only to the bank's direction. Receiverships can go on for years, and the penalties for breach of duties are grossly inadequate.[151] Though anecdotes suggest that some companies have been saved by receivership, there are no clear statistics to corroborate these assertions. There has been no suggestion that arrangements rescued any company. It is no wonder that both procedures are unfavourably regarded and keenly challenged by owners and their agents.

Arguably, the greatest challenge to rescue in Nigeria is institutional inadequacy. Even if the best laws are created, the institutions charged with their administration can render them ineffective. In the US, the courts make many crucial decisions during the

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[151] P 196 above.

course of each chapter 11 procedure. In England and Wales, the insolvency practitioner largely administers the case; while the court gives directions where the office-holder so requests and settles disputes that may arise. In both systems, the judges have a keen awareness of the principles and practice of insolvency law. They have deep knowledge of the jurisprudence and philosophy of the relevant statutes.[152] In contrast, Nigerian courts misunderstand and/or misapply clear statutes.[153] They have failed to show an appreciation of insolvency law and matters. Their decisions inject uncertainty to the law. Likewise, it is clear that many practitioners lack detailed knowledge of insolvency law.[154] If the judges and practitioners lack the requisite knowledge, it bodes badly for the system.

The CAC clearly does not play a relevant role at rescue, while BRIPAN plays only a limited role. Though it currently certifies some practitioners, its process is not robust. The rescue system is therefore quite ad hoc. Underlying the institutional problems is the issue of distrust. No one trusts anyone else: judges do not believe the practitioners, the bankers or the debtors; no other party believes the other.[155] Even written evidence is disbelieved. Clearly, the owner/managers ought not to be left in sole charge of their companies. However, the practitioners are unprofessional and the courts cannot play an effective oversight role. These are fundamental issues that a mere change in the rescue law cannot remedy.

The issue of rescue finance has deliberately been isolated. It is difficult to make sweeping comments about rescue finance when the Nigerian financial landscape is

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[152] P 240, 283 above.
[153] P 198 above.
[154] It is not even a module in law schools.
[155] P 156,177, 191, 194, 197, 199 above.

not well understood. The interviews reveal that corporate finance instruments have developed substantially in the past two decades since CAMA was enacted.[156] The instruments are not limited to mere fixed or floating charges. Most banks do not take all-assets debentures.[157] By the time the bank decides that the company is irreversibly distressed, it may own most of the assets belonging to the company, even if the assets are in the possession of the company.[158] It is unclear how these rights are enforced in other cases apart from those that have resulted in receiverships or arrangements.[159] In addition, the system is opaque, corrupt and quite fragile. Consequently, it is difficult to argue confidently, without targeted studies, for the introduction of priming liens. Given the institutional problems, particularly relating to the judges' appreciation of insolvency matters, it is difficult to contemplate how the mechanism would be administered.

For these reasons, it is suggested that more detailed research on the extant corporate finance mechanisms in the country is required before substantial recommendations to that end can be proposed. This finding poses a big challenge to the proposed reforms to the rescue procedure in general because rescue finance is a fundamental element of rescue, as has been indicated in the preceding chapters. On a tentative note however, given the importance of finance to the rescue process, it is proposed that super-priority and junior liens can be offered to prospective lenders, with the consent of the court.

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[156] P 166 above.
[157] The basis on which receiver/manager appointments are made.
[158] To reiterate, the instruments closely resemble the US distress lending model; only that all companies are subject to this practice in Nigeria.
[159] Which have been the subjects of this thesis.

Part III

7.4 Proposed Reforms to the Nigerian Rescue System

The Nigerian insolvency system is in dire need of reform. It requires both institutional and substantive reforms. It is impossible to change the system even with substantive reforms, if the institutions which administer the procedures are not reformed; herein lies the real challenge for prospective reformers. The easiest aspect of the institutional reforms is creating a body to regulate the insolvency practitioners. The most difficult reform relates to the courts. A tardy legal system cannot support rescue which requires speed. Nonetheless, the writer's recommendations will be outlined below.

Thus far, insolvency law has been treated as a part of company law in Nigeria. Chapter 1 discussed the reform committee's instructions to concentrate company-related legislation in a single, comprehensive statute. However since 1999, that comprehensive statute has fragmented.[160] A separate statute was required to cater to the laws relating to securities. Likewise, insolvency law ought also to be separated from CAMA 2004, and enacted as a separate statute. It is expected that the discussions leading to such reforms will centre on insolvency law and issues, as this thesis has; unlike the reforms that led to creation of CAMA 1990, which focused mainly on the needs of healthy companies. In essence, Nigeria needs an Insolvency Act.[161]

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[160] With the separation of Part XVII of CAMA 1990 which was separately enacted as the Investment and Securities Decree 1999. The Decree was amended in 2004, and again in 2007.
[161] Or an Act, regardless of its title, that is focused solely on insolvency-related issues.

7.4.1 Substantive Reforms

It is quite apparent that the existing procedures are inadequate. As stated in chapter 2, a company should be permitted to initiate rescue when it recognises that it will be unable to subsist profitably given its debt load.[162] In chapter 5, the entrepreneurs indicated the need for rescue mechanisms that would permit them to initiate rescue; hence the informal 'company-led' mechanism described above.[163] However, as the judges indicated in chapter 5, and as noted above, leaving the owner/managers in charge of their companies is not prudent.[164] They are most likely to abuse the process. Having taken due notice of all these comments, two procedures are proposed. The first procedure is referred to as Debtor Restructuring while the other is called Corporate Management.

Debtor Restructuring finds its roots in the informal rescue mechanism proposed by the debtors and the quasi-management regime already practiced by some of the foremost insolvency practitioners.[165] It can be described as a modified chapter 11 procedure. In line with the conclusions above, the procedure leaves the management in control but requires the appointment of a professional to oversee the restructuring and to monitor management. Corporate Management is a variation of the extant receivership procedure. It is quite similar to the administration procedure. It relies on the professionalism and integrity of the practitioner. Whereas the judges and entrepreneurs enumerated points why practitioners should not be trusted, it is argued

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[162] P 59 above.
[163] P 294 above.
[164] P 186 above.
[165] Described at p 295 and P 294 above.

that the easiest institution to reform would be insolvency practitioners. The following proposals are therefore centred on pragmatism.

7.4.1.1 Debtor Restructuring

Management may initiate Debtor Restructuring by filing a notice with the CAC, SEC, and the registrar of the FHC.[166] Management must also notify the bank of its intention.[167] The notice must also indicate the putative restructuring officer (RO) who must be a certified practitioner.[168] The notice must be accompanied by a statement from the RO, indicating his willingness to act, a statement of affairs of the company, the last annual company's report, the history of the company, its reasons for restructuring, and a preliminary statement of the expected outcomes.[169] ROs that support frivolous applications may be fined by the SEC or the supervisory body on the bank's application.[170] Alternatively, the bank may initiate Debtor Restructuring.[171] It must file a notice with the appropriate commissions and notify the directors and the company. Accompanying documents include evidence of security, statement of claim, the RO's statement, reasons for the restructuring, and a preliminary statement of expected outcomes.

[166] Provides management with the opportunity to save their company at their own instance.
[167] The company cannot be allowed to isolate the bank in its rescue efforts, if the banks are to be enticed to cooperate.
[168] As the judges, bankers and some practitioners noted, the debtor cannot be allowed to retain full control of the process.
[169] Companies that do not keep up to date records may not be able to avail themselves of the procedure. The company may be better off going into Corporate Management because its managers have demonstrated inability to comply with their statutory responsibilities.
[170] Hopefully, this will limit the number of frivolous cases at the onset, while the stakeholders become accustomed to the reforms.
[171] Or the secured creditor with a network of securities relating to the whole or substantially the whole of the company's assets. With the establishment of the Asset Management Corporation of Nigeria (AMCON), many appointments may be made by AMCON, not the banks. AMCON is nascent however, and its duties still being worked out.

The procedure commences when the court clerk stamps the documents. The clerk must also stamp certified acknowledgements of receipt of all the other stipulated notifications.[172] It is expected that the removal of the need for hearings or court orders would ease commencement considerably. As discussed above, most attempts at formal rescue faltered at the commencement phase. As soon as the procedure commences, the FHC obtains exclusive jurisdiction over all matters pertaining to the debtor; all such matters must be centred in one court, regardless of the subject matter. This is expected to combat the problem of multiplicity of courts with jurisdiction over a restructuring company.[173]

Commencement also triggers a moratorium on legal and administrative proceedings against the company. The stay also prohibits the enforcement of security and quasi-security rights against the company. However, the bank has the right, within 5 business days, to request, at the court, that the case be converted to Corporate Management; if it shows adequate cause.[174] Secured creditors may also request to have their assets exempted from the stay. The stay ensures that the company has breathing space during which a rescue decision can be validly considered, while the provisos introduce a safety valve. It is possible that companies which ought to utilise another procedure may try to restructure through the fairly simple Debtor Restructuring. The bank is empowered, given the depth of its knowledge, to ask the court to transfer the case to a more suitable procedure. The option may still offer the company a rescue opportunity; at least it offers the opportunity to maximise value in

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[172] The clerk files acknowledgements of receipts because that may be the only way of ensuring that the notices were properly served.
[173] Particularly faced by companies proposing arrangements under the present law.
[174] The second procedure which will be described below.

the business or its assets. If the secured creditors, including the main bank, have no faith in the rescue, they may exit by requesting the court to lift the stay.[175] Where all its assets have been taken out of the procedure, the debtor would be forced to abandon its rescue attempt.

During the procedure, the managers remain in office. They continue to run the daily affairs of the company. However, they cannot pledge the unencumbered assets of the company without the consent of the RO, or of the court if the RO refuses.[176] They cannot dispose of encumbered assets without the consent of the secured creditor and the RO; if one or the other refuses, directions must be sought from the court.[177] Directors who contravene these provisions may be penalised, on the application of the RO, bank or creditors. Third parties from whom they obtain credit must be informed of the restructuring but the company is not obliged to advertise the fact that it has commenced the procedure. Keeping the managers in place and inviting them to apply for the procedure is expected to placate these officers, and the staff as a whole. Many Nigerian companies are owner-managed. As insolvency scholarship reveals, they may be the best persons available to run the company. Moreover, as most of the Nigerian commercial system is informal or skewed, they may have essential insights which may improve the chances of rescue. Fundamentally, they will be less likely to protest or to engage in long, value-destructive legal and extra-legal battles to prevent the hostile take-overs of their companies if they are kept on-side.

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[175] The efficacy of this important valve will however depend on the abilities of the judges to whom the cases are assigned.
[176] One problem would be how to schedule timely hearings.
[177] It is possible that the RO, if shopped by the managers may comply with whatever they request. Hence the need to confer also with the secured creditor.

The RO takes control of the restructuring, while management continues to administer the daily schedule of the company. The RO must give the bank regular updates on his activities. He must also make periodic reports to the SEC, the company and its creditors.[178] He must monitor the company's affairs and attend management/company meetings. He owes his responsibilities to the company as a whole. The RO is to investigate the state of the company and the desirability of continuing its business. As soon as possible after his appointment, he must determine whether Debtor Restructuring is most suited to the needs of the company, or if any other regime is more appropriate. He is not empowered to remove directors but is required to make performance based recommendations to the creditors' meetings and the bank. Based on his recommendations, a senior officer may be replaced, as appropriate. The RO is mainly to bring a professional perspective to the administration of the rescue and the management of the company's affairs.[179] His insight will be essential for the management of the company, post-rescue. For example, if the problem is the way in which the company is managed, some management procedures may be revised.

The RO must present a plan to the creditors in meeting within 12 weeks of his appointment. He must give the creditors at least 14 days' prior notice. The notice must be accompanied by a copy of the proposals, copies of the statements filed at initiation, as well as the RO's post appointment statement on the desirability of preserving the company, the restructuring and liquidation scenarios. If the proposals are rejected, directions must be sought from the court, on the application of the company, the RO, the bank or other creditors. At the hearing, the bank may apply for the case to be

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[178] The managers will file the usual corporate reports with the CAC.
[179] It depends on his ability to act professionally and in good faith.

converted to Corporate Management or the stay lifted.[180] If the plan is approved, its implementation must be monitored by the RO, who must give periodic reports to the SEC, the bank, the company and its creditors. If, at any time, the company fails to comply with the approved plan, the RO, bank, or creditors may apply for the case to be converted to Corporate Management.

Basically, the company is given a period of three months within which to attempt a rescue. If it is unable to achieve the goal, then the right to rescue is transferred to the creditors' representative. Transfer to another procedure may not mark the end of the rescue attempt or precipitate piece-meal sale of assets but it means that management loses control of the company at the end of the initial rescue period. The aim is to afford the directors an opportunity to rescue the company but to protect the creditors, in particular, the banks, whose funds are at stake.

New trade credit will be paid as necessary disbursements, at par with the expenses of the restructuring. New loans may be secured by unencumbered assets. The RO may also grant junior charges on assets secured by fixed interests.[181] The bank must be notified by the RO. The RO must recognise the priority position of employees. He is also to pay their unpaid wages and benefits up to the agreed statutory limits.[182] As soon as the papers are filed at SEC, the RO, under the supervision of a SEC officer, must establish a committee comprising five unsecured creditors with the highest unpaid debts.[183] He must consult with these creditors when designing the plan. They

[180] The court is to give considerable weight to the bank's argument.
[181] For this reason, the bank's ownership interests will be treated merely as encumbrances on the assets.
[182] Employees usually suffer when companies become distressed in Nigeria. It is hoped that their priority position will be recognised and honoured with the reforms.
[183] Subject to their willingness to act.

are to supervise his activities on behalf of the body of unsecured creditors. They have the power to summon the RO and managers for questioning. They should also have the power to request investigations of pertinent issues relating to the company: including the reasons for the failure, the role of a particular officer, inter alia. They may apply to SEC or the supervisory bodies for a directive where the RO fails to comply with their instructions. If no action is taken, then they can apply to the court for directions; with notice to the RO, the company and the bank.[184]

It is hoped that the employees, when afforded protection of their interests, would facilitate the accomplishment of rescue, to the extent that it is possible. Given that they may not have been paid, they are likely to pay allegiance to the RO, instead of joining forces with the managers. The RO, although a professional, also requires some supervision which the major creditors can provide. Instead of clogging up the courts, it is believed that some of the issues raised can be resolved by experts in the SEC or the ombudsman of the supervisory body.

7.4.1.2 Corporate Management[185]

The Corporate Management procedure, as here proposed, is quite similar to the Debtor Restructuring regime. It can be initiated at the first instance or commenced when a Debt Restructuring is converted. If commenced at first instance, then the requirements are similar to the other regime. Both the company and the bank may apply, separately, with similar filing requirements. There will also be a moratorium. However, the bank may apply to the practitioners' supervisory body or the court for

[184] They cannot apply to the court where a directive has been given however.
[185] Entrepreneurs will clearly not take kindly to any person named receiver. Manager suggests a more benign officer.

the substitution of the Management Officer (MO).[186] The application will be granted if the bank can establish cause. As stated above, Debtor Restructuring may be converted to Corporate Management on the application of the bank or the RO to the court. It may also be converted if the proposals are not approved. In these instances, the RO becomes the MO unless the bank succeeds in its application to change the MO.

The essential difference between Debtor Restructuring and Corporate Management is that the company's managers lose their powers in the latter regime. The MO takes over management responsibilities, in addition to his rescue responsibilities. He takes control of the assets and runs the everyday affairs of the business. The managers may only perform functions delegated to them, if they are permitted to remain in office; managers may be removed, as appropriate. The MO takes on greater disclosure responsibilities in relation to the creditors and members; whereas the managers had been responsible for keeping creditors and members informed, it becomes the responsibility of the MO. He must indicate the persons to whom the business or assets are sold in his report. The MO or his family are prohibited from buying the assets. The MO must advertise his appointment and notify all appropriate commissions, the court, the creditors and the members. All documents must indicate that the company is in Management.

The MO has greater responsibilities to investigate management, to determine the culpability of directors and the causes of the company's failure. He may seek an order directing managers to make personal contributions to the estate. He is to design and

[186] But not both.

administer the restructuring plan.[187] The MO carries out his duties on behalf of the company as a whole. A committee similar to that described under Debt Restructuring will be established to perform similar functions. The same rules apply to the disposal of assets and Management-finance.

7.4.1.3 Expedited Restructuring

Where the senior lender is under-secured, taking into account all its rights against the debtor and its directors, the Management procedure may be expedited. In that case, the meetings may be dispensed with. However, the MO must still establish the committee which must be consulted. The committee, if dissatisfied with the proposals, may request for mediation through the aegis of the SEC. If the parties cannot agree, the MO may apply to the court for leave to apply for directions. The court's opinion will be guided by the SEC's recommendations. This provision ensures that quick decisions can be made where necessary. Nonetheless, it still affords the disenfranchised parties some protection.

7.4.2 Institutional Reform

7.4.2.1 Courts

Ideally, the courts should be charged with oversight and dispute settlement responsibilities. However, the courts in Nigeria are characterised by tardiness, inexperience, lack of knowledge and procedural inefficiencies.[188] The system will benefit from a specialised, fast track procedure for resolving distress related issues in order to preserve value at a critical time. Given that distress issues involve the

[187] Though the design is done in consultation.
[188] Summary of findings. Nigerian courts do not compare favourably to those in the US or the UK.

resolution of finance-related and other corporate issues, a specialised commercial or corporate unit ought to be created in the Nigerian court system. It should be administered by staff specialised in these broad areas of law.[189] By focusing on a single broad area of law, the court would handle more cases per day, mitigating the tardiness that characterises the present multiple-focus system. The courts also require important technological reforms. Foremost is the need for an efficient transcription service to replace the handwritten notes by judges.[190] Such a change would facilitate and improve record taking, for example. It would also improve case management; giving the court more time to hear more cases each day. Ultimately, timelines in the court would be improved and better suit the parties' needs.

A specialised court can only succeed if it is complemented by judges with requisite, specialised knowledge and experience. The judges and their supporting staff should receive essential training and continued professional development. They should also interact with similarly situated professionals across the globe; hence the need to organise and attend international conferences and workshops. This will ensure that judges do not merely rely on subjective 'street-smarts' when deciding cases.[191] In addition, well-trained judges would understand the legal principles and provisions relating to insolvency, distress and rescue. These changes will reduce the potential for misapplying the rules as is currently the case.

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[189] The federal government can take a cue from Lagos state which is reforming its judiciary. Lagos has created an arbitration option for minor disputes. It is also creating a commercial court.
[190] Presently, judges write in long-hand, every word spoken in court which makes hearings agonizingly slow. The writing is also detrimental to their concentration on the argument in progress.
[191] P 184 above.

It is hoped that improvements in the court system and the training of the judges would precipitate the creation of specialised rules to enhance transparency, predictability and ultimately facilitate the implementation of the procedure; and lower the initial costs of credit. The judges must also be impartial in the application of the law, circumspect in granting injunctions and refrain from paternalistic attitudes to certain parties once the case is commenced. Judges of the SHC should transfer all matters relating to a distressed company to the FHC once a case is commenced. Judges should also award costs and fines that are substantial enough to deter frivolous and/or corrupt practices amongst stakeholders.

7.4.2.2 Practitioners

The main officers in charge of the distressed company are: managers, the RO, and the MO. The reforms concern the qualifications and actions of the RO and MO. Presently, insolvency practitioners require no qualifications. Their ability to manage companies is questioned by banks, judges and entrepreneurs. Their professionalism has also been questioned. The other stakeholders assert that the practice is marred by corrupt or unprofessional conduct. Insolvency experts are divided on the preferred qualifications; though they recognise that practitioners must be certified to act in that capacity. It is submitted that the persons who act as RO and MO must be certified to act in that capacity. The extent of prior experience required may be decided by the certifying body, as appropriate.[192] Certification at least ensures that they must have undertaken requisite training before they are appointed. The training guarantees that they have at least a minimum level of knowledge of the procedure. It is also important

[192] In both the UK and US, the system is broadening to admit people with business experience; not merely lawyers or accountants.

that such persons are required to continue their professional development. For these reasons, there should be standardised trainings and certification processes organised by the body with oversight.

7.4.2.3 Business Recovery and Insolvency Practitioners' Association of Nigeria

The association, better known as BRIPAN, educates and certifies practitioners within the jurisdiction. The certification is merely voluntary however. Any person who is not statutorily prohibited may be appointed without a BRIPAN certificate. The body will benefit from statutory recognition as the body charged with the responsibility of certifying insolvency practitioners. The law should prohibit the appointment of uncertified candidates to the office of the RO or MO. The Association must outline the qualifications required for training as an insolvency practitioner. It should review these standards periodically; reforming them as appropriate. It should also be charged with the continued professional development of its members. BRIPAN should maintain an updated register of its members and publish same regularly. It should be charged with the supervision of its members: creating an ombudsman for complaints, fines for erring members, practice directions. It should liaise with courts, the CAC, SEC, and other bodies on behalf of its members. It can recommend reforms and participate in consultations. It should organise conferences, publish reports, and create international alliances in order to improve the Nigerian insolvency practice. BRIPAN must also retain a body of expert staff members that would fulfil its roles under the proposed reforms.

7.4.2.4 The Securities and Exchange Commission (SEC)

SEC plays a key role in the Nigerian corporate sphere. It regulates capital and securities-related issues. It reviews and approves mergers and acquisitions. It regulates competition. Consequently, it has vast experience which it can contribute to the corporate rescue system. On that premise, the thesis proposes reforms that would harness the commission's strengths and put them to effective use. It argues that SEC is better placed to oversee matters relating to rescue than the CAC which is mainly responsible for administrative matters like the registration of companies, filing of documents, searches, inter alia.

SEC, it is submitted, should create a division which should take charge of the regulation of corporate distress. The division should play an oversight role at rescue, like it does in other corporate areas. It would be responsible for monitoring the efficacy of the law, consultations, and spearheading reforms. It would liaise with, and coordinate the activities of the courts, the Bureau of Public Enterprises (BPE), Chambers of Commerce, the CAC, and BRIPAN. It would create rules that coincide with other key rules regulating companies that it has or will design; to mitigate inconsistencies. It would have designated officers to monitor distress negotiations. The feedback received from these officers would help to reform and facilitate the distress resolution system. The division should liaise with the courts, the CAC, BRIPAN, Chambers of Commerce and the Bureau of Statistics to ensure regular publication of statistics on business distress in Nigeria.[193]

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[193]There are presently no such publications in Nigeria.

Part IV

Conclusions

In general, this thesis seeks to examine the Nigerian insolvency system in detail. Particularly, it seeks to elucidate and analyse its rescue system. It outlines what rescue options there are in the law. It analyses the efficacy of those procedures. It determines how conducive to rescue the procedures are. The thesis explores and documents the history of the Nigerian insolvency legislations which are outlined in CAMA, 2004. It explains the context in which the changes to the previous legislations were made. This explanation is important for those who analyse the insolvency provisions outlined in CAMA, 2004; particularly, when its provisions are to be compared with those of the British Companies Act 1948. These details are important to the reform of the Nigerian insolvency system.

The thesis finds that there is, in fact, a rescue ambit in the Nigerian insolvency system; albeit dysfunctional, most of the time. The rescue system comprises informal and formal phases. Unless the bank has reasons to decide otherwise, companies generally go through the bank's informal rescue process when they become distressed. Other attempts at rescue may be made by ingenious company managers or debt recovery professionals. Like in England and Wales, it is more likely that a company will be rescued informally than formally. In fact, practitioners prefer to transfer a potentially viable business from the formal to the informal process. The decision stems from the uncertainties that attend the formal rescue process. The formal phase is beleaguered by tedious procedures and a tardy judicial system.

Many judges have failed to make the distinction between the procedures under the 1968 Decree and 1948 Act, on one hand, and CAMA 2004, on the other. Ironically, the ad hoc rules and procedural adjustments made to the rescue regimes stem from the judges' inability to believe the testimony of other stakeholders in the process. The result is a mesh of rules, avidly upheld by the judges, which either have no root in insolvency jurisprudence or are not required by CAMA 2004. It is axiomatic that the problems of the Nigerian procedure are not only substantive, they are institutional as well. Like in the US, the banks have filled the lacuna in the law by creating sophisticated security devices which can be enforced without recourse to the courts, and with little or no reliance on the insolvency legislations. To determine just how banks utilise their innovations, targeted research will be required. However, it is clear that the system is not democratic and the banks' interests take pre-eminence in most cases.

The thesis discusses the desires expressed by some Nigerian practitioners to create either, a debtor-in-possession regime, similar to that of the US, or a practitioner-in-control system like the administration regime of England and Wales. It is important for the former group to recognise that the debtor-in-possession works quite differently from how it is theorized. In practice, the debtor remains in control of the company, while persons concerned with the interests of the main lenders take charge of the reorganization. Moreover, it is impossible to conceive of how the Nigerian court system will process cases as the chapter 11 system requires. The knowledge of the judges is too shallow to support such a regime. The administration regime relies on certified professionals acting in good faith to take charge of distressed companies. However, in the absence of another source of finance, apart from the banks, it is difficult for the administrator to be independent. For Nigeria to introduce a similar system, the debt recovery professionals must, at least, be trained to accomplish their tasks. Administrators and banks prefer to have as little oversight as possible from the courts. It is difficult, given their, reported, proclivity for fraud, to envisage a system in Nigeria that would permit the practitioners to take most decisions without oversight. In any case, the Nigerian courts are still ill-equipped to play even a diminished role, as administration requires.

The thesis suggests pragmatic reforms to the extant insolvency regimes. The proposed reforms cater to the interests of all stakeholders. Having identified the commencement phase as the most difficult phase at rescue in Nigeria, it seeks primarily to ease commencement. The proposals draw on an informal system already practiced by some of the foremost practitioners. It permits companies to institute the proceedings and keeps the pre-distress managers in charge of daily activities. Even where the banks initiate commencement, the managers still have a shot at remaining in charge of their companies while the rescue is administered by a trained professional. The company has at least 3 months to attempt a supervised rescue through the proposed Debtor Restructuring procedure. If the company fails in its attempt, the Restructuring Officer finds that the procedure is not appropriate for its needs, or the banks succeeds in an attempt to transfer the case, the managers may lose their management powers which will be taken over by the professional through the Corporate Management procedure. The proposals minimise the role of the courts and rely on the experience of the Securities and Exchange Commission (SEC), as well as the Business Recovery and Insolvency Practitioners' Association of Nigeria (BRIPAN). To that end, institutional reforms are also proposed, which, in addition to those already mentioned, aim to facilitate the administration of the rescue regimes.

A cynic may suggest that the insolvency provisions will not be reformed in the near future; given that CAMA has not been reformed since its enactment in 1990. However, one needs only to examine the progress that has been made with the Investment and Securities Act, which was also hived-off from CAMA in 1999. It may be argued that the circumstances of both systems are different. The Investment and Securities Act was fundamental to the reform of the banking sector; unlike the insolvency system. It should be noted however, that the banking sector was reformed to facilitate access to credit. The government and its central bank officials are bound to recognise, perhaps sooner than later, with sustained efforts from BRIPAN, that the economy will benefit from reforms to the insolvency system.

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APPENDIX A

Banks

1. Can you briefly describe the range of corporate customers to whom your bank provides credit facilities?
    a. What are your criteria for choosing potential customers?
2. What types of credit facilities do you provide to them?
    a. For what period?
3. What types of assets do you require as security for loans?
    a. Ratio of value to loan.
4. How do you monitor the business performance of your clients?
    a. Do you do this routinely, or on the occurrence of some trigger event?
5. In your experience, what are the principal causes of corporate failure in Nigeria?
6. What steps do you take when danger signs are noticed?
    a. What does your bank do to facilitate the resuscitation of failing businesses?
7. What system of debt collection is most favoured by your bank?
8. In what circumstances do you appoint receivers;
9. Who do you appoint as receiver?
    a. What are your criteria for the choice made?
    b. Are they repeat performers?
10. What role do you expect the receivers to play?
11. Do you have situations in which a receiver has advised the bank that the underlying business was viable and has proposed to run the company; even if this means a delay in the repayment of the loan?
12. What reforms would you propose to the existing rescue system?

Entrepreneurs

1) How does the current credit system in the country affect companies in general, or your own company?
2) In what ways do you think the law could help companies that face financial difficulties?
   a) How do you think that your suggestions, if implemented, would affect the availability of credit?
3) How would you describe the purpose of receivership?
4) Would you facilitate the takeover of the realm of affairs of your company by a receiver?
5) Would you be willing to appoint a receiver over your company before the bank does if your company is approaching financial distress, if the law permits?
6) In the case of a company facing financial distress, would receivership be preferable to the arrangement procedure?
7) What are the problems of the arrangement procedure?
8) How has your company navigated financial distress, if at all?
9) What reforms to the extant system would you propose?

Judges

1. There is a move to reform the Nigerian Insolvency Law, what do you think should be the main goal of the proposed corporate insolvency system?
2. How does this potential goal differ from the current goal of the Nigerian Insolvency system?
3. What would you say are the principal defects of our extant insolvency law?
4. Justice Bage attributed the problems of the courts in dealing with insolvency issues to lack of specialist knowledge; can the courts' liberality with the grant of injunctions at insolvency be attributed to this lack of specialist knowledge?
5. Would the creation of a specialist unit in the court system aid the transition to (a recognised) corporate rescue system of insolvency practice in Nigeria?
    a. Is it a feasible proposal?
6. How can the courts help to reduce the length of time of insolvency cases?
7. How do you balance the receiver's powers and responsibilities with the interests of the company?
8. What would be the most cost and time effective method of educating insolvency judges in Nigeria?
9. What reforms would you propose to the Nigerian Insolvency System?

Practitioners

1. What, in your experience, are the principal defects of the Nigerian Corporate Rescue regimes?
2. Is receivership effective in the rescue of companies or businesses?
3. How does the lack of qualification system affect the Nigerian Receivership system?
4. How long does the average receivership last, in your experience?
5. How would you reconcile the general concept of receivership, per S. 393 CAMA, with the concept of receivership per S. 390 CAMA?
    a. Should a receiver be personally liable if he places the interest of the bank above other interests in the company?
6. How can the duties and liabilities of the receiver be reformed to promote transparency, accountability and collectivity?
    a. Who should enforce his duties, and how?
7. Why is the arrangement procedure rarely used in Nigeria?
8. How do you think that it can be improved?
    a. Do you think that a system of arrangements, if streamlined, ought to be promoted above receiverships as the preferred vehicle for corporate rescue?
9. What has been the general attitude of the judiciary?
10. What reforms would you propose to the Nigerian rescue system?