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## **CORPORATE INSOLVENCY LAW IN NIGERIA - THE NEED FOR REFORM**

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The question that has arisen over the past few years is whether we have a good and modern insolvency law in Nigeria. It is important in answering this question to ponder upon the indices of a good and modern insolvency law and to consider whether our law meets those standards.

Insolvency is a subject concerned with the relationship between a multitude of commercial and social relationships, and it is therefore difficult to invent a complete set of rules for the drafting of an Insolvency law (as we have seen with the wonderful work being done by UNCITRAL). However, there should be general principles to which a good modern insolvency law ought to strive to give effect to. There have been many suggestions regarding the aim of an Insolvency Law (including the draft legislative guide prepared under the auspices of UNCITRAL), but in considering the standards required for an Insolvency Law in Nigeria, I have used the indices specified by the Committee on the Review of Insolvency Law and Practice in the UK headed by Sir Kenneth Cork to the effect that its aims should include the following;

1. To recognise that in the modern world, the creation of wealth depends upon a system founded on credit and that such a system requires, as a correlative, an insolvency procedure to cope with its casualties.
2. To diagnose and treat an imminent insolvency at an early rather than a late stage.
3. To relieve and protect where necessary, the insolvent, from any harassment and undue demands by its creditors, balance its rights against those of its creditors whose own position may be at risk because of the insolvency and prevent conflicts between individual creditors.
4. To realize the assets of the insolvent which should properly be taken to satisfy its debts promptly with the minimum of expense, to distribute the proceeds of the realisation among the creditors in a fair and equitable manner while returning any surplus to the debtor and to ensure that the processes of realisation and distribution are administered in an honest and competent manner.

5. To ascertain the causes of the insolvent's failure and if and insofar as the conduct of its officers or agents merit criticism or punishment, to decide what measures if any are required to be taken against such officers or agents.
6. To recognise that the effects of insolvency are not limited to the private interests of the insolvent and its creditors, but that other interests of society or other groups in society are vitally affected by the insolvency and its outcome, and to ensure that these public interests are recognised and safeguarded.
7. To provide a means for the preservation of viable commercial enterprises capable of making useful contributions to the economic life of the country.
8. To devise a framework of law for the governing of insolvency matters which commands universal respect and observance, and yet is sufficiently flexible to adapt to and deal with the rapidly changing conditions of our modern world. In particular, to achieve a simple and easily understood system that is seen to produce practical solutions to financial and commercial problems, is free from anomalies and inconsistencies and is capable of being administered efficiently and economically.
9. To ensure due recognition and respect abroad for local insolvency proceedings.

If these aims are accepted as a fair description of the principles on which modern insolvency law should be based, then it must follow that our present law, should be weighed against those principles and where they fall short, those laws should be revised to achieve such aims.

While there are various other laws relevant to the law and practice of insolvency in Nigeria, the main legislation that deals with insolvency of companies is the Companies and Allied Matters Act ("CAMA"). CAMA inter alia spells out the events leading to the winding up of the insolvent company and other remedies available to creditors, members and other persons dealing with the company in the event of the company becoming insolvent. It deals with the power of the company to procure credit and create debentures, it also provides for the modes of appointing receivers, powers of receivers, winding up of companies and various other issues relevant to the law of insolvency of companies. It is therefore the provisions of this law that we shall weigh against the principles of a good modern insolvency law earlier enumerated.

### **Recognition of the imperatives of credit and an insolvency procedure to cope with its casualties.**

CAMA recognises the imperatives of credit and therefore empowers a company to borrow money for the purpose of its business or objects and to mortgage or charge its undertaking, property and uncalled capital or any part thereof and issue debentures, debenture stock and other securities whether outright or as security for any debt, liability

or obligation of the company or of any third party. Furthermore, CAMA recognises that in some cases the company may be unwilling or unable to pay its debts and consequently becomes insolvent, and therefore provides various insolvency procedures, which a debenture holder may employ with a view to realizing his security when the company defaults in repayment of the debt. These include inter alia the appointment of a receiver and the presenting of a petition to wind up the company. These insolvency procedures are put into place by CAMA thereby laying the foundation for a good insolvency regime.

### **Diagnosis and treatment of imminent insolvency**

It is generally acknowledged that insolvency arises at the moment when debts cannot be met as they fall due. However, that moment is often impossible to specify and yet it is crucial to any insolvency regime because decisions which will affect the insolvent company such as balancing the interest of the insolvent company and its creditors, have to be taken at that point.

A balance also needs to be drawn between the right of an honest and prudent businessman who is prepared to work hard to continue to trade despite difficulties and the corresponding obligation to accept his state of insolvency when by continuing to trade, he would be doing so at the expense of his creditors. The principal determining factor in striking this balance is the state of the books of account. Section 505(1) CAMA subjects such a company to maintain a proper set of books appropriate to its trade or business and failure to do so amounts to an offence. CAMA also provides in Section 506(1) for a liability for fraudulent trading which includes carrying on the business of the company in a reckless manner, while Section 506(3) provides a penalty of 2 (two) years imprisonment or a fine of N2,500.00 (two thousand five hundred Naira) upon conviction.

It is my view however that there is a lacuna in the law with regard to determining when a company is reasonable unable to pay its debt to enable a plan be devised to rescue the ailing company from insolvency. This approach, which embraces the company rescue culture prevalent in the insolvency regimes of many developed countries, is sorely lacking in ours. Sections 505 and 506 deal with situations which are revealed “**during**” a winding up of a company. Sections 408 and 409 which provide for situations in which companies may be wound up, simply state the situations in which companies may be wound up and go on to define what is meant by “inability to pay debts”. Other sections in CAMA such as Sections 7 and 314 to 330 pay lip service to the regulatory, investigative and managerial powers of the Corporate Affairs Commission but these provisions were obviously not designed for the purpose of diagnosing the causes of Insolvency with a view to devising rescue schemes.

### **Protection of the insolvent and rights of creditors’ interest inter se**

By virtue of Section 412 CAMA, where a winding up petition has been presented and an action or other proceeding against a company is instituted or pending in any court, the court or any creditor or contributory may before the making of the winding up order apply to the court for an order staying proceedings and the court may stay or restrain

proceedings. This is because it is necessary for the assets of a company in liquidation to be preserved in a single pool and not drained by the expenses of litigation.

By virtue of Section 417 CAMA, once a winding up order is made or a provisional liquidator is appointed, no action or proceeding shall be proceeded with or commenced against the company except by leave of the court given on such terms as the court may impose.

Under the present law, while the insolvent company seems to be adequately protected from wanton attachment of its assets by its creditors and the creditors themselves seem to be protected from unfair advantage by other creditors, there is, depending on the form of insolvency proceedings embarked upon, a considerable disparity between the rights and remedies of the different classes of creditors against the property of their debtor.

### **Proper realisation and distribution of assets.**

It is obvious that if each creditor is denied by law, for example by virtue of Section 412 CAMA from proceedings against the debtor on his own, then his interest in insolvency proceedings ought to, so far as is consistent with the claims of his fellow creditors, be as fair and reasonable as circumstances will permit, to compensate him for the loss of his individual rights.

The manner in which these proceedings are conducted for the general benefit of the creditors becomes a crucial matter. Any lack of confidence in the integrity and competence of the person or persons entrusted with the administration of such proceedings such as a receiver or liquidator is bound to create resentment by the creditors affected, as well as bring the collective machinery of the insolvency proceedings into disrepute in the eyes of the public.

The present law in Nigeria does not prescribe any requirement regarding specialised qualification of those entitled to act as receivers or liquidators and the nature and extent of any control or supervision over them is not satisfactory. An insolvency practitioner needs to have a certain degree of knowledge and experience to discharge his function adequately. Section 387 (1) CAMA falls short of this requirement as anyone may act as an insolvency practitioner except with a few exceptions specified therein. The Business Recovery and Insolvency Practitioners Association of Nigeria (BRIPAN) is currently trying to address this problem.

Section 480 CAMA outlines certain steps and prescribes a regimen of priorities which must guide the liquidator in his tasks. However, despite the provision of the section which alludes to *pari passu* distribution, the fact is that the principle of *pari passu* distribution has been so greatly eroded such that today it remains a theoretical doctrine with scarcely any application in reality. In most cases, insolvency results in the distribution of the assets among preferential creditors and the secured creditors with little if anything left for the ordinary unsecured creditors. This accounts for the general

disenchantment with the existing insolvency law which places costs, charges, expenses, incidental remunerations and preferential payments ahead of the payment of debts.

### **Safeguarding public interest during insolvency proceedings**

Concern for the public interest has always been an integral aspect of our insolvency regime and has been made more prominent by the provisions of Section 502 - 508 of CAMA, which deals with directors who have acted fraudulently or delinquently. These sections relate to offences antecedent to or committed in the course of winding up but the provisions contained in them appear to be inadequate and do not seem to enhance the public interest of promoting the highest standard of business probity and competence.

### **Preservation of viable commercial enterprises**

Our insolvency law does not appear to contemplate the failure of companies and therefore does not put requisite structures in place to help preserve companies where they are heading for insolvency. The concept which has been used in most developed insolvency regimes to preserve such companies is known as “Corporate Rescue”. It is however yet to be properly entrenched into our own insolvency practice.

Although some formal procedures such as receiverships and liquidations are provided for in our insolvency law, compromise and arrangements with creditors under Part XVI of CAMA which involves a major intervention due to a financial crisis of some sort are yet to be properly entrenched into our insolvency practice to enable us have a large number of informal rescue schemes as is the case in the more developed insolvency regimes.

Under our present law, a company can enter into a binding arrangement with its creditors only by securing the approval of every creditor or by means of a scheme under CAMA, the relevant sections being Sections 539 and 591. While the former empowers the court to sanction any scheme which has been approved at the meetings of the relevant class or classes of contributions and creditors convened by the court by a majority representing three fourths in value of the shares of those present and voting at the meeting, the latter empowers the court to sanction any scheme proposed for a compromise, arrangement or reconstruction after it has been approved by the Securities and Exchange Commission.

The difficulties of entering into schemes of arrangement under the present law include the following;

1. **Moratorium** - Due to the long and involved procedure for the successful prosecution of these schemes, each individual creditor has ample time to exercise all the rights and remedies available to him against the debtor company even while the process for obtaining a sanction for the scheme is in progress.
2. **Formality and Complexity of Procedure** - Under CAMA, there are three distinct phases, the convening of the necessary meetings, the approval or investigation by the Securities and Exchange Commission and the petition to the

court for the sanctioning of the scheme as approved by the appropriate majorities at the meetings.

3. **Management** - It is obvious that the conduct of a scheme under CAMA requires careful and sustained management over an extended period. Most of the time however, where a company has become insolvent, the management loses interest, so even where the scheme of arrangement would have been beneficial to all concerned, there is no one with the required authority within the company who has the zeal to push it through.
4. **Secured Creditors** - CAMA does not compel or enable a secured creditor to give up part or all of his security, therefore when a scheme requires the secured creditors to agree to some modification of their rights, any one secured creditor can prevent its becoming effective.

### **Devising a framework of law governing insolvency matters and earning respect for Nigerian insolvency proceedings.**

Our laws relating to insolvency of companies are essentially territorial in character. However with the growing phenomenon of complex cross border insolvencies, it is imperative that we devise and develop our insolvency law with a view to avoiding conflicts and confusion in cases of concurrent jurisdiction.

The special needs of the judicial administration of insolvency matters in Nigeria is recognised hence our giving the Federal High Court the jurisdiction to hear insolvency matters, as this court sometimes known as the “**business court**” is best suited to administer insolvency cases because it exercises exclusive jurisdiction in matters of such commercial nature.

### **SUGGESTIONS FOR REFORM**

It is clear from the foregoing analysis of the principles on which a good modern insolvency law should be based, that we have a very good base in CAMA for the development of a modern insolvency law in Nigeria but there is still a need for the reform of our insolvency laws and the requirement for a single comprehensive insolvency legislation.

Probably the most urgent need in the reform of our insolvency law is the introduction of a simple, accessible procedure for dealing with the plethora of cases in our Federal High Courts in respect of the ordinary debtor, whose conduct requires no investigation and whose small company has no realisable assets, but who has a reasonable prospect of being able to discharge all or part of its liabilities out of future earnings surplus to his essential requirement. This would provide for creditors a simplified procedure under which they may expect to receive an orderly repayment of their debts.

Other particular areas of reform are alluded to below;

## **Official Receiver**

The functions and duties of the Official Receiver in winding up proceedings are as stated in Section 419-421 CAMA. He is an official of the court. It is suggested that an insolvency service be set up within the Federal High Court staffed with responsible and trained personnel who would be able to handle the technical work expected to be carried out by an official receiver.

## **Simplifying and modernizing the present law**

The procedure for entering into schemes of arrangement and compromise with creditors under Sections 539 and 591 of CAMA, which at present involves the courts, members, creditors and the Securities and Exchange Commission can be streamlined and improved. There is an inevitable tension between the court's concern to ensure that rights of the parties are not varied until the scheme has been completed on one hand and the need for dispatch and the maintenance of the status quo pending the formulation and implementation of the scheme on the other hand. It is suggested that provisions for the appointment of an administrator of schemes of arrangements be incorporated into our law. The advantage of the provision for such an appointment can be seen under the following heads;

1. **Moratorium** - The appointment of an administrator automatically affects a moratorium and the status quo is maintained while meetings of creditors are convened.
2. **Formality and Complexity of Procedure** - The court will have no part in the formulation of the scheme, the matter will be dealt with wholly by the administrator and his professional advisers, the court will only be involved at the point of receiving the report of the administrator to determine whether to sanction it or not.
3. **Management** - The administrator will have the authority, access to information and the professional responsibility to see a scheme through to finality.

## **Encouraging where possible the continuation of the debtor's business or its disposal as a going concern**

Pursuant to Part XIV of CAMA, a receiver and manager may be appointed by the court or out of court by an instrument given to him by debenture holders of a floating charge. Such receivers and managers are given extensive powers to manage and carry on the business of the company. However the incidents of the preservation of insolvent companies is very rare in Nigeria under our present law where the emphasis is on the disposing of assets of the insolvent company by the receiver in a bid to recover the debt due to the secured creditors, his appointors. The powers of the unsecured creditor to

ensure that the insolvent company is not sold piecemeal where it could be preserved to pay of all the creditors is severely curtailed.

It is my suggestion that the law should be amended to provide for the appointment in justifiable circumstances of an administrator whether or not there is a floating charge in existence with all the powers normally conferred upon a receiver and manager under a floating charge. It is proposed that the power to appoint an administrator should be vested in the court and should be exercisable upon the application by an interested party such as a secured or unsecured creditor, the company itself or the relevant government department.

The creation of a number of charges over different assets of the debtor in favour of several different creditors makes it difficult and sometimes impossible for an insolvent's assets to be realized to their best advantage especially where the asset is essential to the carrying on of the business and is the subject matter of a fixed charge as it cannot be included in a rescue scheme or sold with other assets without the consent of the owner of the charge. Under the present law, there is no power to temporarily stay the enforcement of the right of secured creditors or to include the mortgaged assets in the sale without the consent of such creditors, who may demand to be redeemed or impose unreasonable terms as the price for their cooperation.

To devise an insolvency regime that facilitates rescue, the introduction of the necessary powers to stay and if required, override the rights of secured creditors in appropriate circumstances and for a strictly limited period is essential. A secured creditor who can satisfy the court that delay in realisation of his security will prejudice him, will be able to obtain leave of the court to enforce his security.

### **Improving the standard of administration of insolvent estates, preventing abuse and also encouraging unsecured creditors to take a more active interest in the proceedings**

Section 387(1)(a)-(f) CAMA lists those disqualified from acting as receivers or managers. While this is a good starting point, the law should go further to provide some minimum professional qualification and control in order to ensure a high standard of competence as well as integrity in the persons who are eligible for appointment as insolvency practitioners. The existing system is too open to abuse to command public confidence. We suggest that the law should provide the qualifications required to be an insolvency practitioner such as being a member of a professional body and being in general practice for 5 (five) years prior to acting as an insolvency practitioner. Furthermore, we suggest that the approved professional body admitting persons should stipulate criteria required to be met by interested persons.

### **Ensuring a fairer distribution of the assets realized in the course of insolvency proceedings**

There is no doubt that the system of preferential debts is the cause of a lot of dissatisfaction and the call in some quarters for a reduction or even a complete elimination of the categories of debts which are accorded priority in an insolvency. I suggest therefore that a look should be taken at the present categories of preferential debts with a view to determining which, if any, should be retained.

If the proposals to reduce the number and amount of preferential debts which rank in priority to the debt secured by a floating charge and the imposition of a temporary stay on the enforcement of fixed charges are adopted, it would lead to a significant increase in the sums realisable which would be available to the holder of a floating charge. It would therefore only be fair to insist upon some concession from such debenture holder in return for the benefit of the general body of creditors. I suggest that, upon insolvency, the general body of creditors should to a limited extent participate with the holder of the floating charge in the distribution of the assets comprised in the charge to enhance the possibility that some funds will be made available for distribution among the ordinary unsecured creditors. The increase in the amount available in a winding up for the ordinary unsecured creditors including trade suppliers will enhance a fairer distribution of the insolvent estate, reduce the risk of further insolvencies among those creditors and discourage their increasing tendency to resort to reservation of title clauses and other devices to escape the priority of the floating charge.

### **Increasing the severity of the law towards the director of the failed company who has acted irresponsibly during insolvency proceedings**

Despite the provisions of Section 502-508 CAMA, there have been calls for increasing the severity with which the directors of insolvent companies should be treated. It is unsatisfactory the ease with which a person trading through the medium of a company can allow it to become insolvent, incorporate a new company and then carry on trading as before leaving a trail of unpaid creditors. I suggest that where a person has been a director of a failed company and it appears that the person has been party to fraudulent trading as envisaged by CAMA or it appears that in any other respect his conduct as a director makes him unfit to be concerned in the management of a company, the court should be required to prohibit him from doing so for a period of at least 2 (two) years. This is without prejudice to a jail sentence and/or a fine. Such application ought to be made by a liquidator or with leave of the court by a creditor.

### **Conclusion**

My conclusion is that insolvency law being as crucial as it is to credit transactions which are the bedrock of our economy, should be given the due prominence it deserves and be codified separately from our general company law. The above suggested reforms as a whole should help in creating a fair balance between the competing interests of debtor, creditor and society generally with the ultimate goal of creating more awareness and/or restoring respect for the law of insolvency in Nigeria.

The need for reform of our Corporate Insolvency Law is urgent and imperative.

**Note:** The Attorney General has recently inaugurated a committee to review various laws including those relating to banking and finance. The Author of this article is one of the representatives of the Business Recovery and Insolvency Practitioners Association of Nigeria (BRIPAN) on the Sub-Committee on Review of Laws Relating to Credit Administration.