

INSOLVENCY NEWS

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Legislation

What legislation is applicable to Corporate Insolvency in Nigeria?

In Nigeria the term bankruptcy is limited to personal insolvency while the term Insolvency is associated with corporate insolvency.

The core laws relevant to the insolvency of companies in Nigeria are only part of the general Company Law of the country embodied in the Companies and Allied Matters Act 1990 which is the legislation that deals with corporate matters generally in Nigeria. It contains portions dealing with Receivers and Managers, Arrangements and Compromise, and the winding up of companies. The rules governing the winding up of companies in Nigeria are contained in the Winding-up Rules which were made pursuant to the Companies and Allied Matters Act 1990.

Other relevant statutes include;

1. The Land Use Act Chapter 202 Laws of the Federation 1990 which is the major land legislation in Nigeria and which has made a deliberate incursion into the law of mortgages.
2. Failed Banks (Recovery of Debts) and Financial Malpractices in Banks Decree No. 18 of 1994.
3. Mortgage Institutions Act Chapter 231 Laws of the Federation of Nigeria 1990.
4. Nigerian Deposit Insurance Corporation Act Chapter 301 Laws of the Federation of Nigeria 1990.

Secured lending and credit

The main type of security accepted in Nigeria over immovable property is the Legal Mortgage. The legal mortgage is the transfer of the whole of the debtor's legal ownership in the property covered by the security, subject to a right to redeem the legal title to the property upon repayment of the debt (This is known in legal parlance as the equity of redemption).

An alternative is the equitable mortgage which differs from the legal mortgage in that only the beneficial interest (as distinct from the legal interest) is transferred by the debtor. It is essentially an agreement to enter into a legal mortgage. An equitable mortgage can be created by a written agreement to execute a legal mortgage or by the deposit of title deeds with the creditor with the intention of creating a security.

Another alternative to the legal mortgage is the fixed charge. This involves no transfer of ownership but gives the creditor the right to have the designated property sold and the proceeds applied to discharge the debt. A fixed charge attaches to the property in question immediately on creation (or, if acquired later, after creation but immediately on the debtor acquiring the right over the property to be charged). The debtor may then only dispose of the property once the debt has been repaid or with the consent of the creditor.

Most banks in Nigeria prefer that floating charges are created over the whole business and undertaking of a company and therefore cover all present and future assets of the company. A floating charge does not attach to a specific asset but is created over a class of assets, present or future, and allows the debtor to buy and sell such assets whilst the charge remains floating, it is only on the happening of a certain event, such as default on the repayment of the debt, that the charge attaches to the secured assets which are at that time owned by the debtor company. This is known as 'crystallisation'. On crystallisation, the floating charge becomes a fixed charge and the debtor is no longer free to deal with the assets without repayment of the debt or without the consent of the creditor.

In practice however the security document usually executed to secure credit to companies in Nigeria is the Debenture or what is sometimes known as a Mortgage Debenture. It is a security document that includes the fixed and floating charges as well as a mortgages in one document. Once executed the document has to be registered as a mortgage at the relevant land registry and subsequently the debenture has to be registered at the Companies Registry known in Nigeria as the Corporate Affairs Commission.

Other forms of security such as the Pledge, the Quist Close Trust and Lien are not popular in Nigeria.

Unsecured Credit

What remedies are available to unsecured creditors?

A supplier of goods may protect himself by inserting a clause in the supply contract to more usually, until all monies outstanding from the debtor have been paid. The creditor is therefore contractually entitled to the return of his goods. If that remedy is unavailable, then an unsecured creditor would have to commence proceedings against the debtor for recovery of his debt. If there is no substantive defense to the claim, the creditor can apply for summary judgment under the relevant rules of court, which could take anything from 2 (two) months to 6 (six) months. If the debtor can show that he has a real prospect of successfully defending the claim, it could take much longer. In the meantime, if the creditor has evidence that the debtor is likely to dissipate his assets he can apply to the court for an order that bank accounts be frozen or prevented from being dealt with or dissipated. The creditor may in some cases also apply to court for an injunction restraining the debtor from dealing with relevant assets pending the conclusion of the suit.

Once a judgment has been obtained, then proceedings to enforce the judgment can be commenced. Execution is carried out by the relevant court official who seizes the goods of the judgment debtor, sells them and uses the proceeds to settle the judgment debt. The court may in relevant cases give an order diverting the debtor's source of income to the judgment creditor (this is known as a garnishee order).

There are no special rules for foreign creditors except that in some cases the court might direct that the foreign creditor provides security for the defendant's costs in the event that the foreigners' claims fail. With regard to a foreign judgment against a Nigerian company, such judgment can be registered in the Nigerian court and executed as a judgment of that court would.

An unsecured creditor may also apply to court for the winding up of a debtor company where such creditor has served on the debtor a demand requiring the debtor company to pay the sum due and the debtor has for 3 (three) weeks thereafter neglected to pay the sum due or to secure or compound for it to the reasonable satisfaction of the creditor.

SEE HONG KONG

Courts

What courts are involved in the insolvency process/ Are there any restrictions in the courts jurisdiction?

Corporate Insolvency matters are dealt with in the first instance by the Federal High Court which by virtue of **Section 251 (1) of the Constitution of the Federal Republic of Nigeria 1999** is vested with exclusive jurisdiction to handle insolvency matters. Appeals may be made to the Court of Appeal and then from there to the Supreme Court of Nigeria.

Voluntary Liquidation

What are the requirements for a debtor to commence a voluntary liquidation of its business/What are the effects of the commencement of the liquidation?

A company may be wound up voluntarily;

1. When the period, if any, fixed for the duration of the company by the articles expires, or the event, if any, occurs, on occurrence of which the articles provided that the company is to be dissolved and the company in general meeting has passed a resolution requiring the company to be wound up voluntarily.
2. If the company resolves by special resolution that the company be wound up voluntarily.

The resolution to voluntarily wind up a company must be advertised by publishing notice of it in the official gazette or in 2 (two) daily newspapers within 14 (fourteen) days of the passing of the resolution, and the Corporate Affairs Commission (Companies Registry) must also be notified within that time that the company has resolved to be wound up voluntarily.

CHECK THE INSURANCE ACT

A voluntary winding up shall be deemed to commence at the time of the passing of the resolution for voluntary winding up. Such resolution does not extirpate the corporate essence of a company, it remains a corporate person until it is finally dissolved. It can not exercise its normal powers or carry on its normal business unless such power or business as is conducive to the winding up of its affairs pursuant to the resolution.

Involuntary Liquidations

What are the requirements for creditors to successfully place a debtor in involuntary liquidation/What are the effects of the commencement of the liquidation?

There are various instances pursuant to which a court may wind up a company, such as where default has been made in delivering the statutory meeting, where the number of members is reduced to below 2 (two) or where the court is of the view that it is just and equitable that the company be wound up.

However in order to place a company into involuntary liquidation a creditor has to petition the court to have the company wound up and establish that the company is unable to pay its debts and in order to succeed in its petition to wind up a company for inability to pay its debt, the creditor must prove to the court that there is a debt, that the debt is due, that there has been a statutory demand (requiring 21 days Notice) and the company had been unable to pay.

A company is deemed to be unable to pay its debts if;

1. A creditor by assignment or otherwise, to whom the Company is indebted in a sum exceeding ₦2,000 (about \$20) then due has served on the Company, by leaving it at its registered office or head office, a demand under his hand requiring the Company to pay the sum so due, and the Company has for three weeks thereafter neglected to pay the sum or to secure or compound for it to the reasonable satisfaction of the creditor; or
2. execution or other process issued on a judgment, decree or order of any court in favour of a creditor of the Company is returned unsatisfied in whole or in part; or
3. the court, after taking into account any contingent or prospective liability of the Company is satisfied that the Company is unable to pay its debts.

Where before the presentation of a winding up petition for the winding up of a company by the court, a resolution for the voluntary winding up of the company has already been passed, the winding up shall be deemed to have commenced at the time of the passing of the resolution. In any other case the winding up of a company by the court shall be deemed to commence at the time of the presentation of the petition for the winding up.

Once a winding up order is made no action or proceeding shall be proceeded with or commenced against the company except by leave of court. An order for winding up of a company shall operate in favour of all the creditors and contributories of the company as if made on the joint petition of a creditor and a contributory. Therefore all creditors may prove their debts and all contributories share in the surplus assets of the company.

Voluntary reorganisations

What are the requirements for a debtor to commence a financial reorganisation/what are the effects of the commencement of the reorganisation?

At the present time, there is no formal statutory rescue procedure in Nigeria for the financial reorganisation of companies in financial distress as is the case in many jurisdictions, such as the U.K. where you have the both the informal London Approach and the formal Administration Procedure under the Insolvency Act. Company rescue and corporate restructuring of debtor companies in financial distress are therefore usually carried out pursuant to agreements with the creditors and even then they are few and far between. A company and its creditors may enter into an agreement for the restructuring of a company's debt outside of court, these corporate restructurings usually involve the setting up of a committee of lenders or the appointment of trustees to negotiate the terms of the restructuring of the company with the help of financial and legal advisors paid by the company. Once these terms are agreed upon by the general body of creditors, they are documented in a formal contract.

However, a company, its members, creditors or liquidator may apply to the court, pursuant to the provisions of the Companies and Allied Matters Act, for the sanction of a compromise or scheme of arrangement between the company and its creditors (or any class of them) and/ or its shareholders (or any class of them). The procedure is as follows;

1. Once the scheme of arrangement or compromise is prepared by either the company, its members, creditors or where the company is being wound up, by the liquidator, a summary application is made to the court by such a person or group of persons praying for an order to convene a meeting of the creditors and/or shareholders with whom a compromise is being sought or with whom it is sought to enter into a scheme of arrangement.
2. If the order is granted, then a meeting is called accordingly. The scheme must be approved by at least $\frac{3}{4}$ (three quarters) in value of the shares of members or class of members or of the interest of creditors or class of creditors, as the case may be, present and voting either in person or by proxy.
3. The compromise or scheme of arrangement may thereafter be referred by the court to the Securities and exchange commission to investigate the fairness of the compromise or scheme and make a written report to the court.

4. If the court is satisfied as to the fairness of the compromise or scheme it shall sanction the same and it shall be binding on all the creditors, or class of creditors or members or class of members as the case may be. However such order will be ineffectual until a certified true copy of the order has been filed and registered at the Corporate Affairs Commission.

Involuntary Reorganisations

What are the requirements for creditors to commence an involuntary reorganisation/ What are the effects of the commencement of the reorganisation?

As discussed above a creditor may apply to court for sanction of a scheme of arrangement or compromise. The procedure and the effect of an involuntary compromise are the same as for a voluntary compromise.

Doing Business in Reorganisations.

Under what conditions can the debtor carry on business during a reorganization/What are the roles of the creditors and the court in supervising the debtors business activities?

The relevant law Section 530 of the Companies and Allied Matters Act allows for a scheme of arrangement to be initiated while the company is operating or after it has been placed in liquidation. Where the company is in liquidation, the company's activities usually have ceased and its assets will have passed into the hands of the liquidator but since the law does not provide for a moratorium on creditors taking action against the company in a scheme of arrangement until the scheme is sanctioned by the court, schemes of arrangement are seldom used prior to liquidation because the process could be undermined at any stage by the filing of a petition by an aggrieved or unsatisfied creditor. On the other hand, where the reorganisation is a matter of contract between the parties, the effect of a compromise will depend on the nature and provisions of the scheme. However, it is usual for existing creditors of a company to agree to have their debts subordinated to allow the company to continue trading. The funds advanced by new directors, or fresh funds advanced by existing creditors, is usually given priority ahead of the existing debts.

The scheme of arrangement can be initiated, in theory, either while the company is operating or after it has been placed in liquidation. However, if the company is in liquidation, the company's activities usually have ceased and its assets will have passed into the hands of the liquidator.

A company which has entered into a compromise with its creditors is generally able to continue trading as usual. Sometimes a consultant or a sum committee of the lenders is appointed to oversee the activities of the company and report to the creditors on progress. The courts do not have an ongoing supervisory

role. But an application may be made to court requesting its intervention if the company to comply with the scheme.

Successful Reorganisations

What are the mandatory features of a reorganisation plan/How are creditors classified for the purposes of a plan and how is the plan approved?

There are no mandatory features of an informal reorganisation or informal schemes of arrangement or compromised. The mandatory requirements for a scheme of arrangement under the Act are as follows;

1. A summary application is made to the court by such a person or group of persons praying for an order to convene a meeting of the creditors and/or shareholders with whom a compromise is being sought or with whom it is sought to enter into a scheme of arrangement.

Creditors who can establish valid retention of the title and other proprietary claims will have their property returned (or its monetary equivalent) in priority to those listed above.

Where there have been mutual dealings between a creditor and the company, the liquidator is required to take an account of what is due from each party to the other in respect of dealings and set off the sums due from one party to the other. The effect of this is that unsecured creditors entitled to set-off have an advantage over other unsecured creditors. Note, however that there are special provisions which apply to certain contracts in the financial markets.

The Financial Markets and Insolvency (Settlement Finality) Regulations came into force on December 11 1999. The Regulations implement Directive 98/26/EC of the European Parliament and of the Council on settlement finality in payment and securities settlement systems. The Directive seeks to reduce the risks associated with participation in payment and securities settlement systems by minimizing the disruption caused by insolvency proceedings brought against a participant in such a system.

The same privileged and priority creditors will also be present in a reorganisation but the extent to which they are given priority will be a matter of negotiation between the parties.

Distributions

How and when are distributions made to creditors in liquidations and reorganisations?

In both liquidations and reorganisations, a distribution will be made when sufficient funds are available to justify it. In the case of a reorganisation, the administrator or the responsible office-holder will decide when and how.

Viable transactions

What types of transactions can be annulled or set aside in bankruptcies and what are the grounds? What is the result of a transaction being annulled?

Directors and officers

Do corporate officers and directors have personal liabilities for any pre-bankruptcy actions or for particular types of claims? Can they be subject to other sanctions for other reasons?

Creditor enforcement

Are there processes by which a business can be liquidated outside of the bankruptcy process (e.g) by seizure by a creditor)? Outside of court proceedings? How are these processes carried out and what are the consequences?

There is a very important process available to a secured creditor to enable it to take control without modification, to the United Nations Commission on International Trade Law (UNCITRAL) model Law on Cross-Border Insolvency (and for consequential amendments to Section 426 Insolvency Act 1986 (cooperation between certain courts exercising insolvency jurisdiction) Offering a complementary regime to the EU Regulation on Insolvency Proceedings, the stated purpose of the UNCITRAL Model Law is to:

- i. Promote cooperation between courts and other competent authorities of the local country and foreign states involved in cross-border insolvencies;
- ii. Further the development of international trade links by providing predictability and cooperation between domestic and foreign courts;
- iii. Ensure the fair and efficient administration of cross-border insolvencies in order to protect the interests of all creditors and the debtor;
- iv. Protect the debtor's assets while maximizing their value; and
- v. Facilitate the rescue of financially troubled business in order to protect investment and preserve employment. Intended as and adjunct to, but not as a replacement for, existing legislation, each enacting state has the option to incorporate the text of the Model Law in whole or in part, with or without modification.

Pending legislation

Is there any new or pending legislation affecting domestic bankruptcy procedures, international bankruptcy cooperation or recognition of foreign judgment and orders.

In practice floating charges are generally created over the whole business and undertaking of a company and therefore cover all present and future assets of the company. It is only on the happening of certain event, such as default on the repayment of the debt, that the charge attached to the secured assets which are at that time owned by the debtor. This is called 'crystallisation'. On crystallization, the charge acts like a fixed charge in that the debtor is no longer free to sell the assets without repayment of the debt or without the consent of the creditor.

Unsuccessful Reorganisations

How is a proposed reorganization plan defeated and what is the effect of the plan not being approved/What happens if there is default by the debtor in approving an approved plan?

In order for an informal scheme to succeed all the creditors of the company must be in support of the scheme, a dissenting creditor may defeat the scheme by refusing to take part or where suitable apply that the company be wound up. A reorganisation plan will be aborted if a secured creditor appoints a receiver over the whole or a substantial part of the assets of the company. Where an informal scheme has been adopted and there is a default by the debtor company, the consequences are usually as stated in the agreement codifying the scheme. Usually though a petition is made to the court that such company be wound up.

A proposal for a formal scheme will be defeated if it is not approved by at $\frac{3}{4}$ (three quarters) in value of the shares of members or class or creditors, as the case may be, present and voting either in person or by proxy, or if the court is not satisfied as to the fairness of the compromise or scheme. Where such a scheme is defeated there are a few options open to the creditors, to propose a new scheme, apply that the company be wound up or simply revert to the status quo prior to the proposal.

Insolvency Process

During a bankruptcy case, what notices are given to creditors/what meetings are held/what committees are or can be formed/can creditors initiate proceedings to pursue remedies against third parties or changes in the administration of the case?

In a winding up under the supervision of the court after a petition has been presented and notice of the petition has been served on the company with a verifying affidavit, a hearing of a motion for the advertisement of the petition is conducted and if the petitioner satisfies the court, an order for the advertisement of the petition is granted. The order of the advertisement of the petition shall be as follows;

1. The Petition shall be advertised fifteen clear days before the hearing of the petition.
2. The petition shall be advertised once or as many times as the court may direct in the official gazette and in one national daily newspaper and one other newspaper circulating in the State where the registered office or principal or last known principal place of business, as the case may be, of such company is or was situated, or in such other newspaper as shall be directed by the court.
3. The Advertisement shall state the day on which the petition was presented, and the name and address of the petitioner, and of his solicitor, and shall contain a note at the foot thereof stating that any person who intends to appear at the hearing of the petition, either to oppose or support the petition, must send notice of his intention to the petitioner, or to his solicitor, within the time and manner prescribed by this rule and any advertisement of a petition for the winding-up of a company by the Court which does not contain such a notice shall be deemed irregular.

Claims and Appeals

Priority Claims

What are the major privileged and priority claims in liquidations and reorganisations/Which priority and privileged claims have priority over secured creditors?

A liquidator will apply the proceeds of the realized assets and pay creditors in the following order:

- a. creditors secured by fixed charge or mortgage, out of the proceeds of the asset subject to the fixed charge or mortgage;
- b. the liquidator's costs and remuneration;
- c. preferential creditors, being the Inland Revenue, Customs & Excise, Social Security, occupational pension schemes and employees who are owed remuneration up to a set amount;
- d. creditors secured by a floating charge, out of the proceeds of the assets subject to the floating charge;
- e. unsecured creditors; and
- f. any claims arising from post-liquidation interest.

Each creditor will be paid its full entitlement under one category before any lower category is paid. This may mean that secured creditors are paid in full but unsecured creditors receive nothing. If the value of any security does not cover the whole debt the remaining unpaid debt will rank as an unsecured debt.

THE PRACTICAL OF CORPORATE INSOLVENCY LAW

LEGAL PRACTITIONERS THE WORLD OVER and indeed in Nigeria HAVE MADE COMMENDABLE IN-ROADS INTO VARIOUS AREAS OF PRACTICE IN THEIR VARIOUS JURISDICTION, FOR INSTANCE we accept that there is legal expertise in maritime law, aviation law, intellectual property, environmental law, petroleum law to mention a few. In contrast the mere mention of insolvency law to the average Nigerian including legal practitioners evokes the impression of a company being wound up for inability to pay its debt or of an individual who is tagged bankrupt.

Many people believed that they know as much about insolvency law and practice as they need to, simply because they know the meaning of the word "insolvency" which has the feel of failure about it. The truth is that there is a lot that people do not know about the practice of insolvency law and indeed about insolvency practitioners much of whose work contrary to the popular foreboding belief is very positive for example out of the 230,000 (two hundred thirty thousand) jobs at risk through insolvency in the U.K. In a typical year 70,000 (seventy thousand) are rescued. Also apart from liquidations, Insolvency Practitioners find a rescue solution in at least 59% of formal company insolvencies¹

This write up is inspired by the rather lethargic pace at which the development of our practice of insolvency law is moving and the unimpressive attitude of practitioners to the need for rapid development and prominent activism in this area of practice.

At the end of this paper we are able to provoke some positive thoughts in the minds of readers on the need to give the law and practice of insolvency the meticulous attention that it deserves then we would have accomplished our goal.

INSOLVENCY LAW

INSOLVENCY PRACTICE

The Practice of Insolvency is not new in Nigeria, even before the independence of the country liquidators had been appointed over many indigenous banks and since then particularly since the mid 1980's there have been several liquidations of limited liability companies. More recently there were a large number of liquidations of banks and insurance companies. The practice however become more popular as a result of the economic depression prevalent in Nigeria in the past 15 (fifteen) years. The downturn of the Nigerian

¹ Courtesy Voice of the Insolvency Profession-Society of Practitioners of Insolvency.

economy in recent year as well as the devaluation of the Nigerian currency (the Naira) as compared to the various convertible currencies specially the \$ (US Dollar) since the late 1980's have taken their toll on all business sectors of the economy. Probably most affected is the manufacturing sector comprising of the large manufacturing industries who have had to import raw materials as well as machinery and spare parts at increasingly exorbitant rates. In order to finance this importation, these companies have had to borrow very heavily from the various lending institutions in the country, in some cases the lending institutions have had to form consortiums in order to meet the huge demand for funding.

Most lending institutions and indeed the various consortiums that were created to give out loans have, in a bid to protect their interest, insisted on the execution of a mortgage by the borrower. Where the mortgage included floating assets, the security was documented by way of a debenture which usually provided for the appointment of a receiver in the event of default by the borrower. However, in the event of the harsh economic climate of the time, the inconsistent economic policies of the erstwhile military regimes, mismanagement and fraudulent practices companies, there was a high rate of default in the repayment of those loans. The debenture holders have in a lot of cases took the option of appointing a receiver to sell of the assets of the debtor company to repay the loans. The foregoing scenario has been the major advertisement for the practices of corporate insolvency in Nigeria; therefore the general belief is that the practice of corporate insolvency consists solely of receiverships and that the practice becomes relevant only when a company is insolvent. Nothing could be further from the truth, the fact is that the law and practice of insolvency is relevant not only when the existence of a company is threatened but also when the company is expanding or restructuring. It is relevant not only to companies faced with insolvency but also to creditors, shareholders and employees of such companies. The import of this is that the insolvency practitioners should provide prescriptions to an entity faced with insolvency and also give advice regarding options available to an entity that seeks to avoid the threat of insolvency.