The role of the Court in balancing stakeholder interests in insolvency in Developing Economies – the theoretical conundrum

Abstract

In most jurisdictions the court plays a central role in providing stakeholder protection in insolvency and debt restructuring regimes through legislation that affords such protection. Although there are many advantages to debt restructuring through contractual means, court intervention is usually needed to regulate and deal with difficulties that can arise such as the imposition of restructuring plans on dissenting creditors and wealth transfers between creditors. However, the role of the court in mitigating these concerns in both developed and developing jurisdictions has sometimes been overlooked or misunderstood.

While there exist specialist bankruptcy and insolvency[1] courts in developed economies, such as in the United States of America (US) and in the United Kingdom (UK) that govern bankruptcy proceedings, insolvency proceedings in most developing economies, especially in Sub-Saharan Africa are presided over by general non-insolvency specialist judges who do not tend to be required to decide upon redistributive matters during insolvency proceedings. Although they can still be called upon to interpret the law when there are disputes and contentious issue during insolvency proceedings, there remains a high level of contrasting views on what exactly, the role of the court should or ought to be in insolvency proceedings in these developing economies, owing to differing theoretical perspectives.

In this article, an analysis of the role of the court in bankruptcy proceedings in developing economies through a theoretical lens is undertaken. The article analyses contentious theoretical ideals, such as judicial discretion and rationality and how these have impacted the court's role in the bankruptcy field. The position in developing economies is comparatively analysed in light of the position in the UK and the USA as developed jurisdictions to inform context. This is in addition to setting an agenda for a better approach to designing an efficient insolvency system that takes the role of the court as a central in insolvency proceedings.

[1] The terms "bankruptcy" and "insolvency" are used interchangeably in this article to refer to company insolvency, not personal insolvency/bankruptcy as is the case in the US and other jurisdictions.

Introduction

When a company finds itself in a position that its liabilities outweigh its assets, and therefore, deemed insolvent,[2] the possibility of continuing business operations becomes unsustainable, and directors (internal management) are tasked with the responsibility to intervene swiftly. The mode of intervention depends on the extent/severity of the financial difficulty at hand. Sometimes, directors may intervene through debt restructuring, closing-off underperforming sections of the business or where inevitable, opting for liquidation.[3] At this point, the role of corporate insolvency law comes into play, as corporate insolvency regimes or frameworks are designed by sovereign states to deal with commercial exigencies.[4]

However, the concepts of corporate rescue and the rescue culture can be understood in many different ways by academics, judges, and policy-makers and other stakeholders,[5] due to different approaches and purposes sought in a given jurisdiction.[6] In developing economies, these are a relatively new phenomena.[7] This is unlike the position in developed economies such as the US and the UK where these concepts have been embraced and consolidated into their legal systems.[8]

In the UK for example, the Supreme Court gave a ruling, on 5 October 2022, in *BTI 2014 LLC v Sequana SA and other*,[9] that further highlighted the role of the court in balancing stakeholder interests on corporate insolvency. The key question subject to appeal was on whether, there was a rule (the rule in *West Mercia*) that in certain circumstances the interests of the company, for the purpose of the directors' duty to act in good faith in its interests, are to be understood as including the interests of its creditors as a whole.[10] Although all the sitting judged acknowledged that there were circumstances where the interests of all stakeholders, including

[2] Under the UK Insolvency Act 1986, s.123(1) – (3), a company is deemed insolvent where a creditor owed more that £750 has presented a request for payment and such a request ha snot been met by the company for more than three weeks, or where, to the satisfaction of the court the value of the company's assets is less than the amount of its liabilities taking into account, its contingent and prospective liabilities.

[3] For a broader discussion of different intervention approaches, see, V. Finch and D. Milman, *Corporate Insolvency Law: Perspectives and Principles* (3rd edn, CUP, 2017), particularly, 24–25, Ch 2.

[4] S. Frisby, "Of rights and rescue: a curious confluence?" (2020) 20(1) *JCLS*, 39-72.

[5] See for example, A Belcher, *Corporate Rescue* (London, Sweet and Maxwell, 1997), 12, on the definition of corporate rescue; R. Parry, *Corporate Rescue* (London, Sweet & Maxwell, 2008) Ch.1.

[6] Bo Xie, *Comparative Insolvency Law* (Cheltenham, Edward Elgar, 2016) Chapter 1: Corporate rescue – the new orientation of insolvency law.

[7] On this notion, see; Hamiisi J. Nsubuga, "Reinvigorating corporate rescue in emerging economies – a Ugandan perspective" (2021) 34(4) *Insolvency Intelligence*, 95 – 102, where this aspect is analysed and Uganda as an emerging economy is broadly examined.

[8] L. Qi, "Managerial Models during the Corporate Reorganisation Period and their Governance Effects: The UK and US Perspective" (2008) *Company Lawyer*, 131; G. McCormack, *Corporate Rescue Law: An Anglo-American Perspective* (Cheltenham, Edward Elgar, 2008); R. Parry, *Corporate Rescue* (London, Sweet & Maxwell, 2008).

[9] *BTI 2014 LLC v Sequana SA and others* [2022] UKSC 25.

[10] For a more in-depth analysis on this ruling, see; Hamiisi Junior Nsubuga, "Fifteen Years of the Statutory Derivative Regime under the Companies Act 2006: A Reflection on an unfulfilled Superfluous Statutory Regime" (2023) 25(1) *Contemporary Issues in Law*, 63, 84.

creditors had to be considered on corporate insolvency,[11] they however, rejected the contention that there was a "creditor duty" distinct from other stakeholders, that company directors ought to give special consideration upon corporate insolvency.[12]

In particular, Lord Reed observed that there was a risk of confusion if this was described as a creditor duty, as opposed to a mere rule that modifies the ordinary rule whereby, for the purposes of the director's fiduciary duty to act in good faith, and in the interests of the company, the company's interests are taken to be equivalent to the interests of its members as a whole.[13] Lady Arden, in agreement with Lord Reed's observations further reiterated that the rule in *West Mercia* is concerned with protecting creditors from harm as a whole and it does not create a new duty for the benefit of creditors.[14] Their Lordship, Briggs,[15] and Hodge,[16] also agreed with Lady Arden's and Lord Reed's observations.

The second key issue was whether, as the company enters the vicinity of insolvency, its interests divert to creditors alone and not shareholders,[17] and creditors are therefore, considered the major stakeholders in the company.[18] In addressing this issue, Lady Arden observed that at a certain point in time the interests of creditors will have to have priority over any other interests. However, that point in time is not reached until the company becomes irreversibly insolvent.[19] Lord Reed further observed that although company's creditors have an economic interest in the company, based upon their entitlement to be paid the debts owed to them, this can only occur when the company is insolvent or bordering on insolvency or where an insolvent liquidation or administration is probable.[20]

A successful rescue process involves several players, such as the company itself, and other stakeholders, including creditors, insolvency practitioners, and the courts that would require a custodian oversight to regulate and guide the process.[21] This is because the rescue process involves many risks, such as interfering with the company's existing contractual obligations, changes to creditor interests and creditor enforcement mechanisms through legal mechanisms, such as moratoria, or other statutory stays triggered by the company's insolvency filing.[22] The internal management of the company may also be altered by corporate insolvency as directors may be replaced by insolvency practitioners/court officers depending on a jurisdiction's legal

[11] *BTI 2014 LLC v Sequana SA and others* [2022] UKSC 25, at [11]; [76].
[12] Ibid, at [46] – [51]; [250], [261].
[13] Ibid, at [11]; [12].
[14] Ibid, at [264]; [288].
[15] Ibid, at [205].
[16] Ibid, [206]; [224].
[17] Per the reasoning in *Brady v Brady* (1988) 3 BCC 535 at 552. See also; A. Keay, "Financially Distressed Companies, Preferential Payments and the Director's Duty to Take Account of Creditors' Interests" (2020) 136 *Law Quarterly Review*, 52, 65–66.
[18] Per the reasoning in *Kinsela v Russell Kinsela Pty Ltd* (1986) 4 ACLC 215, at [221].
[19] *BTI 2014 LLC v Sequana SA and others* [2022] UKSC 25, at [325]; [356] - [357].
[20] Ibid, at [12].
[21] J. Payne, "The Role of the Court in Debt Restructuring" (2018) 77(1) *Cambridge Law Journal*, 124 - 150.
[22] Qi (n 7); Frisby (n 3).

setting. This is the position in both developed jurisdictions, such as the UK,[23] and other developing jurisdictions, such as Uganda, Nigeria and Ghana.[24] Therefore, to execute a successful rescue plan in both developed and developing economies, the court is situated to play a key role in ensuring that the process runs as smoothly as possible, and that some actors in this process, such as insolvency practitioners do not constrict the rights and interests of others, due to legal protective tools at their disposal, such as moratoria protection.

However, the role of the court in this context is often, either misunderstood, or underestimated due to divergent theoretical perspectives on the role that it ought to play in an insolvency setting. These theoretical perspectives are dominated by two leading schools of thought – the traditionalists and proceduralists,[25] and then, transcend into theoretical strands, such as the communitarian,[26] and contractarian[27] theoretical strands. Due to the limitations of this paper, the entirety of the theoretical debate is not analysed as this has previously been done by the author.[28] However, the key theoretical contention between the two theoretical schools and central to this article - the role of the court in insolvency proceedings is analysed to set context.

[23] Please note that in the UK, this position is subject to the type of insolvency proceedings initiated as the practice of replacing company directors by insolvency practitioners when a company files for administration proceeding has been impacted by the introduction of the new Part 26A restructuring plan by the corporate insolvency and governance Act 2020 (CIGA 2020). See; s.7 and Sch.9, and Companies Act 2006, Pt 26A, s.901A. See further; Hamiisi J. Nsubuga, "The Debtor-in-Possession Model in the EU Insolvency and Restructuring Framework — A Domino Effect?" 2022(3) *Journal of Business Law*, 239, 250.

[24] C. Nyombi, "The Development of Corporate Rescue Laws in Uganda and UK" (2015) (57) (2) *International Journal of Law and Management* 214; Nsubuga (n 6); Bolanle Adebola, "The Duty of the Nigerian Receiver to 'Manage' the Company" (2011) 8 (4) *International Corporate Rescue*, 248–254; K. Ghartey, "Directors' Duties under the 2019 Companies Act of Ghana" (2020) 46 (2) *Commonwealth Law Bulletin*, 246-269.

[25] T. H. Jackson, "Bankruptcy, non-bankruptcy entitlements and the creditors' bargain" (1982) 91(5) *Yale Law Journal*, 857; E. Warren, "Bankruptcy policy" (1987) 54(3) *The University of Chicago Law Review*, 775-811; E. Warren, "Bankruptcy policymaking in an imperfect world" (1993) 92(2) *Michigan Law Review*, 336-387; D.G. Baird, "Bankruptcy's Uncontested Axioms" (1998) 108 *Yale Law Journal*, 573; Hamiisi Junior Nsubuga, "The interpretative approach to bankruptcy law: Remedying the theoretical limitations in the traditionalist and the proceduralist perspectives on corporate insolvency" (2018) 60(3), *International Journal of Law and Management*, 824-841.

[26] K. Gross, "Taking community interests into account in bankruptcy an essay" (1994) 72 *Washington University Law Review*, 1031; K. Gross, *Failure and Forgiveness: Rebalancing the Bankruptcy System* (Yale University Press, New Haven, 1997).

[27] D. R. Korobkin, "Rehabilitating values: a jurisprudence of bankruptcy" (1991) 91(4) *Columbia Law Review*, 717; D. R. Korobkin, "Contractarianism and the normative foundations of bankruptcy law" (1993) 71 *Texas Law Review*, 554; A. Schwartz, "A contract theory approach to business bankruptcy" (1998) 107(6) *Yale Law Journal*, 1807-1851.

[28] Hamiisi Junior Nsubuga, "The interpretative approach to bankruptcy law: remedying the theoretical limitations in the traditionalist and the proceduralist perspectives on corporate insolvency" (2018) 60 (3) *International journal of law and management*, 824-841.

The role of the court in light of the traditionalists' and proceduralists' ideals

In both developed and developing economies, legal systems have provisions that empower courts, especially, commercial courts to regulate matters related to business and commercial affairs, including insolvency related matters or disputes. The courts make strategic decisions, such as deciding whether a company faced with financial difficulties is worthy of a chance to restructure its debts/capital structures as opposed to being liquidated. In developed jurisdictions, such as the US, this power is afforded to bankruptcy courts[29] by the US Congress through provisions in the Bankruptcy Code,[30] to regulate the bankruptcy process.[31]

The UK moved a step forward to establishing a specialist insolvency and business court in 2018, when the judicial office of registrar in bankruptcy of the High Court was renamed the Insolvency and Companies Court.[32] This in effect, afforded the Insolvency and Companies Courts complete power to preside over proceedings on bankruptcy, company winding-up, and all other matters in relation to insolvency and restructuring proceedings.

However, in developing economies, especially in Sub-Saharan African countries, such as Uganda, Kenya, Nigeria, Ghana, there exist no specialist insolvency judges to deal specifically with insolvency related matters. Rather, insolvency and restructuring proceedings are presided over by non-specialist insolvency judges who are called upon to interpret the law when there are contentious disputes between parties and get these matters resolved. However, the concern and therefore the point of contention between the traditionalists and proceduralists is that sometimes, judges are afforded too much powers and flexibility while presiding over disputes between parties and this raises questions as to the role or degree of involvement, judges should take while presiding over corporate insolvency law cases.

According to proceduralists, the role of a judge in insolvency proceedings should be equated to that of a disinterested arbiter.[33] The judge's task is to control parties' conflicting interests and to ensure transparency and integrity in the bankruptcy process.[34] The judge should allow

[29] Bankruptcy courts include federal district courts and state bankruptcy courts. However, federal district courts have broader jurisdiction over state courts in deciding matters that arise under the Bankruptcy Code or matters related to a bankruptcy case. See, 29 U.S.C. s.1334 (b).
[30] See provisions, such as, 11 U.S.C. s.105 (a), s.305 (a) and s.1129 (a) of the US Bankruptcy Code.
[31] Christopher W. Frost, "Bankruptcy Redistributive Policies and the Limits of the Judicial Process" (1995) 74 *N. C. L. Rev*. 75.
[32] S. Baister and J. Tribe, "The origins and development of the office of registrar in bankruptcy of the High Court" (2019) 28 *International Insolvency Review*, 392, 417.
[33]Douglas G. Baird, "Bankruptcy's Uncontested Axioms" (1998) 108 *Yale L. J*. 573, 580.
[34] Ibid, 579.

creditors to make their own decisions and influence the outcome they seek.[35] Therefore, the role of a judge in this perspective is to direct and control competing stakeholders' collection processes and not to seek a particular outcome for the parties.[36] Traditionalists, however, are of the view that a judge should play a key role in insolvency proceedings, especially on aspects of statutory interpretation and application of the law to facts presented by competing parties. This is because, the judge makes the most important decisions based on factual arguments or matters before the court. These are the decisions that direct the way the debtor-creditor relationship is coordinated during insolvency proceedings.[37]

Because each case is different and is based on different facts and parties, the law should not prescribe "a fit all" legal framework or system to address competing stakeholder legal disputes.[38] This would present judges with difficulty in ascertaining or predicting with certainty, competing and underlying diverse values and policy dimensions to inform a legal decision.[39] Therefore, a judge should exercise broader discretion during the course of the proceedings in order to implement insolvency's equity goals on a case by case basis. This would ensure that insolvency law's policy goals and objectives are fairly and reasonably justified in meeting competing stakeholder interests.[40]

However, proceduralists are against the use of broad judicial discretion. To them, judicial discretion is only useful if a judge is well positioned to use such discretion to make informed decisions. They contend that judges have no magical powers to make business decisions or predict market behaviour that may enhance the going concern value of a company.[41] As such, they prefer using economic models as a basis for analysing corporate insolvency and market solutions, as opposed to seeking judicial intervention for resolving issues arising on corporate insolvency.[42]

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[35] Ibid, 580.
[36] Ibid, 579.
[37] Warren (n 12) at 789-791.
[38] Donald R. Korobkin, "Rehabilitating Values: A Jurisprudence of Bankruptcy" (1991) 91 *Colum. L. Rev*. 717, 722.
[39] Karen Gross, *Failure and Forgiveness: Rebalancing the Bankruptcy System*, (New Haven: Yale University Press, 1997) 238.
[40] Harvey R. Miller, "The Changing Face of Chapter 11: A Re-emergence of the Bankruptcy Judge as a Producer, Director and Sometimes Star of the Reorganization Passion Play" (1995) 69 *Am. Bankr. L. J*. 439.
[41] Christopher W. Frost, "Bankruptcy Redistributive Policies and the Limits of the Judicial Process" (1995) 74 *N. C. L. Rev*. 75.
[42] See for instance, R. Posner, *The Economics of Justice* (Cambridge, MA: HUP, 1983) pgs. 60 – 87 on his account on wealth maximisation as an ethical principle, a typical law and economics perspective.

The role of court analysed: a disinterested arbiter or central player?

Irrespective of the theoretical perspectives advocated by the traditionalists and proceduralists, there are key concerns in a corporate rescue and/or restructuring plan that would necessitate key involvement of the court to ensure probity. While some insolvency processes involve significant court involvement, others only require minimal court involvement. For example, in the US as a developed economy, bankruptcy and restructuring proceedings under Chapter 11 of the US Bankruptcy Code heavily involve the court and its role is pivotal in mitigating divergent stakeholder interests.[43]

In the UK,[44] and other developing economies like Uganda, Kenya and Nigeria, some insolvency processes, such as administration and company voluntary arrangements (CVA) involve less court involvement as these processes are mostly driven by the appointed insolvency practitioner, or existing board of directors, while other processes like schemes of arrangement and liquidation involve more significant court involvement.[45]

Other concerns, such as the potential constriction of creditors' rights and interests by either the company, or the appointed insolvency practitioner, through forced imposition of the proposed rescue or restructuring plan on the minority or dissenting creditors also calls for key involvement of the court in the insolvency arena. Very often, corporate rescue premised on a going-concern basis embody key decision-making stages that ought to be approached with caution otherwise, the exercise and balance of power by those in charge of the rescue process may negatively impact other interest holders, especially creditors.[46]

This is because, key players, such as directors and insolvency practitioners are equipped with statutory *armour* through mechanisms, such as moratoria, creditor cross-class cramdown, absolute priority rules, and the recent shift towards preventive restructuring mechanisms. Therefore, these key concerns call for a key role to be undertaken by the court as a central arbiter in insolvency proceedings, especially, in developing economies as analysed below.

The court as a central arbiter in developing economies

Heavy reliance on the insolvency practitioner

[43] Miller (n 27); Frost (n 28).
[44] For the CVA in the UK, see; Insolvency Act 1986, Part 1, ss.1 – 7 and for administration, see; IA 1986, Part II, Schedule B1. For Uganda, see; Insolvency Act 2011, Part VI, ss.138–174 for the administration procedure and ss.125–137 for the company voluntary arrangement procedure.
[45] Nsubuga (n 6); Adebola (n 11); Payne (n 8); Nsubuga (n 10).
[46] Frisby (n 3).

According to the Cork Report that formed the bedrock of UK's modern insolvency law and processes, and upon which most developing economies' insolvency laws and frameworks are based, the success of an insolvency regime is almost entirely, dependent on insolvency practitioners that administer it.[47] In both developed and developing jurisdictions, insolvency and restructuring proceedings are heavily driven by the insolvency practitioner, in both out of court and via court processes. In rescue proceedings such as administration, an insolvency practitioner plays a central role as sometimes, s/he can be used to replace the existing directors to manage the rescue proceedings. However, in a restructuring, an insolvency practitioner may only take up an oversight role, of working alongside directors in negotiations with creditors and ensuring that the restructuring process runs as smooth as possible and that it does not constrict or abuse overall creditor rights and interest.[48]

In developing economies, use of insolvency practitioners in insolvency and restructuring proceedings may be advantageous in the sense that insolvency practitioners may be specialists in the subject matter as a majority of them are from accounting, finance, business and management backgrounds. This is opposed to relying heavily on courts, where judges have no specialism in the field. However, the problem with over reliance on insolvency practitioners in developing economies is the potential conflict of interest that may arise. Insolvency practitioners are afforded broader discretionary powers in exercising commercial judgments, especially on the nature of proceeding and/or restructuring mechanism to be adopted, and in other cases, how and when to use legal tools, such as moratoria and creditor cross-class cramdown.[49] Yet, the decisions made on commercial grounds may not be challenged by creditors unless there are clear cases of procedural and/or material irregularities that the court may entertain petitions from creditors.

Very often, the current management/directors have much influence on whom to appoint as the insolvency practitioner and on what terms. In addition, secured creditors usually have good working relationships with company directors as these are often, repeat lenders who exert influence over management/director decision-making, especially on matters such as contractual defaults. In other instances, secured creditors may have provisions in their debenture agreements that afford them powers of influence on matters, such as the appointment

[47] Report of the Insolvency Law Review Committee, *Insolvency Law and Practice* (HMSO, 1982), Cmnd.8558), para.732.
[48] Payne (n 8).
[49] Nsubuga (n 6); Adebola (n 11).

of the insolvency practitioner. This is common practice in most developing economies where credit is usually secured on company assets and secured creditors, such as banks have to be kept appraised of any developments that might impact their interest by company directors.[50]

Absolute priority rules and creditor cross class cramdown

Another concern that would necessitate key involvement of the court is the argument that where contractual arrangements are not regulated by a particular system of laws, creditors and debtors would enter into contractual arrangements that might not only be detrimental to each other, but also, bring burdensome effects to the economy as a whole,[51] especially, in developing economies. In most sovereign jurisdictions, creditors are protected by mechanisms such as absolute priority rules that set out to ensure that creditors are paid ahead of shareholders and in any event, this principle can only be set aside where creditors have given their consent, or where, shareholders have provided additional value.[52]

For instance, in 2017, the US Supreme Court reaffirmed this principle in *Czyzewski v Jevic Holding Corp*., by affirming that the absolute priority principle, in the US was codified in the US Bankruptcy Code to ensure a system of priority to determine the order of distribution of the debtor's assets on bankruptcy.[53] Therefore, unless creditors are paid in full, or each class of creditors consents to the deviation from the absolute priority rules, these rules have to be maintained.[54]

The concern however, regardless of whether the jurisdiction is a developed or developing one, is that, since secured creditors have absolute priority of distribution over the proceeds from the sale of the company assets or collateral in non-insolvency settings, this should be maintained in insolvency proceedings. This is also the view point of the proceduralist school of thought, that insolvency law's policy imperatives of fairness, equity of treatment and minimum right of compensation should not be implemented in insolvency proceedings.[55] This is because these rights are pre-insolvency contractual rights that insolvency law should be able to

[50] Nyombi (n 11); Ghartey (n 11).
[51] Paul F. Kirgis, "Arbitration, Bankruptcy, and Public Policy: A Contractarian Analysis" (2009) 17 *Am. Bankr. Inst. L. Rev*. 503, 544.
[52] B Markell, "Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations" (1991) 44 *Stan L Rev* 69, 123; D Baird, "Priority Matters: Absolute Priority, Relative Priority and the Costs of Bankruptcy", (2016) 165 U Penn L Rev 785.
[53] *Czyzewski v Jevic Holding Corp* (2017)137 S. Ct. 973.
[54] D Baird, "Present at the Creation: The SEC and the Origins of the Absolute Priority Rule" (2010) 18 *Am Bankr Inst L Rev* 591; S Lubben, "The Overstated Absolute Priority Rule" (2016) 21 *Fordham J Corp & Fin L* 581.
[55] Kirgis, (n 37) 503, 544.

mirror/replicate.[56] Therefore, where absolute priority rule is maintained and upheld by the judge, creditors are paid in the order of priority agreed pre-insolvency between the debtor and creditors.[57]

However, traditionalists are of the view that this proceduralist arguments is premised on perfect market theories.[58] Moreover, perfect market economies, to which these theories may apply, are most situated in developed jurisdictions such as the US and Europe but may not be compatible to market economies in developing economies. Even in developed jurisdictions, these perspectives may not be fully compatible in practice.[59] That is why traditionalists argue that disregarding absolute priority rules and making changes to non-insolvency stakeholder interests inside insolvency may be desirable to prevent unnecessary liquidations and the judge should be able to exercise discretion on such perspectives.[60] The judge should be able to decide whether or not to pursue different distributional objectives from those the *de facto* scheme of general collection law prescribe.[61]

This traditionalist ideal would therefore, be most applicable in developing economies where the nature of debt and the lending markets are mainly influenced by private contractual agreements which are protected by absolute priority rules on events like corporate insolvency. In developing economies, such as Uganda, the corporate and financial sectors generally prefer to restructure financially struggling but viable businesses through consensual out-of-court workouts. This preference is driven by the belief that debtor-creditors workouts are cost-effective and easier to conclude than formal insolvency procedures, such as administration.[62] Therefore, compromises between debtors and creditors are the most adopted ones as these can be proposed and agreement reached quicker, where three quarters of the value of creditors agree to such compromise or arrangement.[63] The agreements then become binding on all creditors, the company itself, the liquidator and other stakeholders of the company.[64]

However, the concern with informal creditor workouts/compromises is that powerful creditors may have the flexibility to impose restructuring plans/compromises on minor creditors who

[56] Thomas H. Jackson, "Translating Assets and Liabilities to the Bankruptcy Forum" (1985) 14 *J. Legal Stud*. 73, 114.
[57] Schwartz, (n 14) 1819.
[58] S Lubben, "The Overstated Absolute Priority Rule" (2016) 21 *Fordham J Corp & Fin. L.* 581.
[59] Ibid, at 584.
[60] Warren, "Bankruptcy Policy" (n 12).
[61] Warren, "Bankruptcy Policymaking in an Imperfect World" (n 1).
[62] Nyombi (n 11); Nsubuga (n 6).
[63] See generally, CA 2012, ss.234 – 236.
[64] CA 2012, s.234(2).

may be without court oversight/protection. In most developing jurisdictions, the nature of debt and lending markets are significantly different from those in developed jurisdictions. In Uganda, Ghana and Nigeria for example, the most common form of business loan/debt is through charges – both fixed and floating from banks and financial institutions and credit and cooperative societies.[65] Big lenders, such as banks mainly provide business loans secured on company assets or stock in trade and upon financial difficulties or defaults, they exercise powers to recover their interests through receivership and administrative receivership, which are not collective insolvency processes.[66]

Therefore, where there's no court involvement to protect other interest holders, a majority of them may not be able to recover anything as mechanisms, such as absolute priority rules would mean that secured creditors, through less collective procedures like receivership may sell off high-net valuable assets which would otherwise have been used to support the company's rescue/restructuring plan to avoid meaningless liquidations.[67]

Creditor cross-class cramdown concerns

Among the key factors that the court must consider in deciding whether or not to approve a restructuring plan is the best interest of creditor irrespective of whether, a particular class of creditors as a whole, has accepted the restructuring plan from the debtor company.[68] The court's role comes into action at two stages; at the convening stage – where the court has to ensure that creditors are correctly divided into respective classes and at the sanctioning stage where the court approves the plan.[69] In the UK for example, the court's role in this perspective is given legislative force,[70] which is further reinforced by common law.[71] The main aim is to ensure that minority creditors are given appropriate protection where tools such as creditor

[65] Adebola (n 11); Ghartey (n 11).
[66] Ibid.
[67] For a detailed analysis on these perspectives, see; Nsubuga (n 6).
[68] Payne (n 8); G McCormack (n 7).
[69] See broadly, J. Payne, *Schemes of Arrangement: Theory, Structure and Operation* (Cambridge, Cambridge University Press, 2014).
[70] Particularly, the Insolvency Act 1986, s. 6, which empowers creditors to seek court protection by applying to the court to challenge restructuring plans, such as those under a CVA on grounds of unfair prejudice or material irregularity.
[71] See for example; *Re BTR plc*. [2000] 1 B.C.L.C. 740, 748, where Chadwick L.J, emphasised the role of the court in protecting minority creditors during restructuring plans by stating that "[i]t is for the court ... to hold the ring between the different interests." See also, *Re Bluebrook Ltd* [2009] EWHC 2114 (Ch); [2010] 1 B.C.L.C. 338, where the court sanctioned a *de facto* cramdown of creditors where a scheme of arrangement procedure was combined with administration proceedings to enable the rescue of the company and *In Re Van Gansewinkel Groep BV* [2015] EWHC 2151 (Ch); [2016] 2 B.C.L.C. 138, where the court reiterated the requirement for the court to provide timely information to creditors such that they make informed decisions on attending and voting at creditors meetings.

cross-class cramdown are utilised by the debtor to curb potential imposition of the restructuring plan on dissenting minority creditors.

In some developing economies, creditor cross-class cramdown mechanisms have been introduced in company and insolvency laws to boost out of court works between creditors and the debtor. In Ghana for example, new provisions for creditor cross-class cramdown were introduced in the Companies Act 2019 (CA 2019),[72] and the Corporate Insolvency and Restructuring Act 2020 (CIRA 2020),[73] to encourage debtors and creditor to reach less costly agreements and compromises and to effect timely restructuring out of court. Therefore, during compromise or arrangement proceedings, a debtor may opt to pitch creditors in a certain creditor class and provided 75 percent (in value) of creditors agree to the arrangement, dissenting creditors, the company itself and all other members/shareholders would be bound by the arrangement/compromise.[74]

However, concerns of fairness and equity of treatment of diverse creditor classes still exist, which calls for more court involvement as a central arbiter. Among the concerns is the notion that a secured creditor is afforded more power in influencing the approval/outcome of the restructuring plan due to the nature of interest it holds over the company. Although aggrieved creditors may go to court to challenge the plan, in most cases, courts are reluctant to interfere in internal decisions reached, especially those that are initiated out of court unless there are clear cases of material irregularities or unfair prejudice.[75]

A shift towards debtor-in-possession and preventive restructuring frameworks

There has recently been a focal shift in developed jurisdictions, such as the US, the EU and the UK towards less court involvement in corporate insolvency and restructuring proceedings through mechanisms, such as the debtor-in-possession (DIP) and preventive restructuring frameworks, that is attracting attention from developing economies. The DIP model has been utilised by debtors in the US since the 19th and early 20th century bankruptcy reorganisation of

[72] CA 2019, s. 239.
[73] CIRA 2020, s.50.
[74] Kenneth Ghartey, "Directors' Duties under the 2019 Companies Act of Ghana" (2020) 46(2) *Commonwealth Law Bulletin*, 246-269.
[75] Ibid.

the equity railroad receiverships,[76] codified in the US Bankruptcy Code,[77] and recently adopted in the UK.[78] However, it is a relatively new concept and yet to be fully transposed in a majority of developing economies' legal frameworks, especially within Sub-Saharan Africa.

Preventive restructuring mechanisms are premised on the idea that a company's management can adopt interventionist approaches early on upon signs of financial difficulties rather than waiting until the company's financial state is beyond rehabilitation. These preventive mechanisms are debtor led, with less court involvement. Some Sub-Saharan African developing economies have taken initiatives to renew their insolvency and restructuring laws, especially, in the wake of the COVID19 and other economic and systemic shocks, incorporating preventive restructuring mechanisms. In 2021, Kenya undertook reforms to its Insolvency Act 2015, to increase out of court creditor workouts through the Business Laws (Amendment) (No.2) Act, 2021.[79] This Act made amendments to the Insolvency Act 2015 through the introduction of pre-insolvency moratoria provisions,[80] and additional grounds upon which creditors' "prescribed part" could be disregarded in insolvency.[81]

Under the Kenyan Insolvency Act 2015, a moratorium could only be triggered by a company filing for insolvency and/or restructuring proceedings.[82] However, under the changes introduced by the 2021 Act, provided the company is not undergoing any form of insolvency or restructuring proceedings, it can, through its directors, file documents with the court seeking a pre-insolvency moratorium. The key requirement is that it must have the support of a qualified insolvency practitioner (the monitor) who has evaluated the company's financial position, and provided a statement confirming that a pre-insolvency moratorium would be desirable for the company to achieve its restructuring goals. The pre-insolvency moratorium is initially granted for thirty days but can be extended for a further thirty days.[83]

The other new change introduced by the 2021 Act is the amendment to section 474 of the Insolvency Act 2015, to include an additional ground upon which a company can disregard the

[76] Peter Tufano, "Business Failure, Judicial Innovation, and Financial Innovation: Restructuring U.S. Railroads in the Nineteenth Century" (1997) 71 *Bus. Hist. Rev*. 1; David A. Skeel, Jr., "The Past, Present, and Future of Debtor-in-Possession Financing" (2004) 25 *Cardozo L. Rev*. 1905.
[77] 11 U.S.C. ss. 101 – 1330 (2012) Enacted by the Bankruptcy Reform Act 1978 (Pub. L. No.95 – 598, 92 Stat. 2549).
[78] Through Corporate Insolvency and Governance Act (CIGA 2020), s.7 and Sch. 9 and CA 2006, Part 26A, s.901A.
[79] Act (No.2) of 2021.
[80] Ibid, s.12.
[81] Ibid, s.11 – amending s.474 of the Insolvency Act, 2015.
[82] Insolvency Act 2015, s.643.
[83] Act (No.2) of 2021, s.46.

requirement to established a prescribed part from the assets of the floating charge holder for the satisfaction of unsecured creditor interests.[84] Courtesy of the new changes, a qualifying floating charge holder can apply to court to have the company to disregard complying with the prescribed part requirement on the ground that the prescribed part would unfairly harm its interests.[85] It would then be the court's decision to order the company to either regard or disregard the prescribed part depending on the balance of equity.

Although this can be seen as an inclusive move in balancing creditor interests in insolvency and restructuring, both secured and unsecured, it can however, be seen as reinforcing the position of the floating charge holder as a secured creditor. In developing economies, such as Kenya where the nature and form of lending is mainly controlled by secured credit from banks and other financial institutions, this leaves the fate of other minor lenders/interest holders that would otherwise rely on insolvency laws' policy underpinnings of equality of treatment in balance.

In 2020, Nigeria enacted the Companies and Allied Matter Act 2020 (CAMA 2020)[86] which is the main legislation regulating companies in financial difficulties. This was heralded as a timely enactment to improve insolvency law and practice and to promote corporate rescue following reforms to Companies and Allied Matter Act 1990.[87] CAMA 2020 made improvements to already existing insolvency and restructuring processes, such as CVAs,[88] receivership,[89] et cetera, and also, introduced the new administration procedure as one of the key procedures for debtor companies to utilise to rescue/restructure their businesses.[90]

However, like it is the case with insolvency laws/systems in common law jurisdictions, administration, and the arrangement and compromise procedures in Nigeria come with a moratorium (both interim and full), which imposes automatic stays on creditor enforcement actions.[91] The key concern is that the full moratorium may last up to six months, during which no creditor can petition for winding up or enforce other interests against the company.[92]

[84] Ibid, s.11.
[85] Ibid, s.11(5)(b).
[86] Act No3 of 2020. (Hereafter, CAMA 2020).
[87] Companies and Allied Matters Act, 1990, c.59. (Hereafter, CAMA 1990).
[88] CAMA 2020, Ch.17, ss. 434 – 442.
[89] CAMA 2020, Ch.19, ss. 550 – 569.
[90] See generally, CAMA 2020, Ch. 18, ss.443 – 549.
[91] CAMA 2020, ss.480 and 717.
[92] CAMA 2020, s.717 and Ch.18.

In addition, under the arrangement and compromise procedure, the secured creditor is afforded an avenue through which they can challenge the moratorium. A secured creditor can apply to court within thirty days of the notice of the arrangement or compromise to discharge the moratorium where for example, the asset subject to enforcement does not form part of the company's pool of asset, or where the asset is of a perishable nature in that it may depreciate in value during the six months moratorium period, or where the secured creditor has enforced its security prior to receiving of notice of the proposed compromise from the company.[93] Alternatively, the secured creditors may be able to insert terms or clauses in charge instruments that afford them powers to sidestep moratoria restrictions or powers to enforce their security over the company during the six months moratorium period.

Moratoria protection is indeed relevant to the debtor in devising and implementing rescue/restructuring plans and it can help avert disruptive attitudes from uncooperative creditors. However, the law should place time-sensitive restrictions on its adoption, usage and duration such that the debtor does not use this tool to keep operating a non-viable business for longer than necessary. As discussed above under the Nigerian context for example, a moratorium that can last up to six months where the company is administration may provide such a wider scope within which debtor companies may misuse this tool, where as a shorter moratorium period between thirty – ninety days would limit the possibility of abuse/misuse.

Conclusion

In light of the differences in theoretical ideals on the role of the court in balancing stakeholder interests in insolvency proceedings, this article concludes that indeed, the court has a central role to play in balancing stakeholder interests as advocated by the traditionalists. Insolvency proceedings would require a coordination and balancing of various stakeholder interests, of which, a majority of them are born out of private contractual obligations between the debtor company and the interest holder. However, insolvency law has the capacity to alter these privately agreed contractual obligations due to policy underpinnings, such as enhancing corporate rescue or implementing a rescue culture within the legal framework.

When a company initiates insolvency or restructuring proceedings, legal tools such as moratoria protection, creditor cross-class cramdown or alterations to absolute priority rules have the effect of inhibiting creditor enforcement actions. In addition, the power by the debtor

[93] CAMA 2020, s.717(2)(a)-(b).

to obtain rescue financing as a gateway to going-concern continuity of the business may also impact already existing creditor rights by affording new rescue finance priority over old debts. These issues all require court involvement to curb potential abuse of the legal tools and protective measures by debtor companies. In developing economies, where local lending markets and debt structures are not as sophisticated as those in developed jurisdictions like the US or the UK, balancing creditor interests would be key to achieving insolvency law's distributive imperatives of fairness and equality of treatment.

The absence of modern rescue and restructuring mechanisms, such as preventive restructuring frameworks as recently introduced in the UK and the EU, further calls for enhanced court involvement. Therefore, approaching the role of the court in insolvency and restructuring in developing economies as that of a disinterested arbiter as posited by the proceduralists would create a certain degree of imbalance on creditor protection in insolvency. This may also impact the commercial and investment markets as the public would lose trust in the legal system due to poor creditor protective measures on insolvency.