# Economic and Social Perspectives of Corporate Insolvency Law in Uganda: The Recent Collapse of Crane Bank (Uganda) and the Response to the 2007-2008 Global Economic Crisis

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**Abstract**

This treatise analyses Uganda's current insolvency laws, rescue processes and their priorities adopted by the Government, in safeguarding the financial stability of companies and financial institutions during corporate insolvency as a response to the financial /economic crisis of 2007 – 2008. The treatise analyses the historical evolution of Uganda's company law and insolvency law to date and attempts made by both the State and other actors within the financial system to streamline the country's insolvency system. The treatise analyses the policy objectives behind the enactment of the insolvency Act 2011 and its impact on the social and economic imperatives on Uganda's economy. The treatise discusses the recent collapse of banks and financial institutions as a result of corporate insolvency. Particularly, the treatise analyses the recent collapse of Crane Bank Uganda and lessons learned. The treatise concludes by analysing the provisions for devising an efficient insolvency model.

## 1.1 Introduction

The financial / economic crisis of 2007 / 2008 instigated a paradigmatic shift in the approaches that nations adopt in designing or enacting legislation and corresponding policies and processes that deal with corporate insolvencies.[1] While developed economies such as the United Kingdom (UK) and the United States of America (USA) have implemented reforms to their corporate insolvency laws and processes as a response to the economic crisis of 2007 / 2008, other developing or emerging economies have also followed suit.[2]

Uganda is one of the developing economies in Sub-Saharan Africa[3] that responded to the 2007 /2008 economic crisis through changes to its corporate and insolvency laws and processes in a bid to guard against further or subsequent financial crises.[4] This crisis did not only affect main-stream private companies but also affected commercial banks and other financial institutions in the country as will be discussed in this treatise. However, before a critical analysis of Uganda's response to the global financial crisis is undertaken, a historical evolution of Uganda's corporate and insolvency law is discussed to inform context for its recent reforms.

## 1.2 The Development of Corporate Insolvency Law in Uganda

Since Uganda's independence from the British rule in 1962, the main legislation that dealt with corporate insolvency and bankruptcy issues were the Bankruptcy Act 1931 and Companies Act 1961. The Bankruptcy Act 1931 was the first legislation enacted to deal with corporate and personal insolvency and bankruptcy related legal issues in Uganda. However, this statute was a direct transplant of the English Bankruptcy Act

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[1] D. Burdette, R. Parry and A. Walters, "The Global Financial Crisis and the Call for Reform of Insolvency Law Systems" (2012) 4(1) *IRI* 13; B. Moro, "Lessons from the European Economic and Financial Great Crisis: A Survey" (2014) 34 *Eur J Pol Econ* 9.

[2] See for example, M. Prochniak and K. Wasiak, "The Impact of the Financial Systems on Economic Growth in the Context of the Global Crisis: Empirical Evidence for the EU and OECD Countries" (2017) 44 *Empirica* 295 -337.

[3] According to the World Bank, Uganda is one of the fifty-eight countries that make up Sub-Saharan Africa and rated as a developing country. See; <https://data.worldbank.org/region/sub-saharan-africa> (accessed February 2019).

[4] C. Nyombi, A. Kibandama & D. Bakibinga, "The Motivation Behind Uganda's Insolvency Act 2011" (2014) (8) *JBL* 651, 666; C. Nyombi, "The Development of Corporate Rescue Laws in Uganda and UK" (2015) (57) (2) *International Journal of Law and Management* 214.

1914. This statute had provisions that mandated for English insolvency law to be adopted and applied in Uganda where necessary.[5] This was because prior to the enactment of the Bankruptcy Act 1931, as a British protectorate, Uganda was under the direction of Britain as its colonial sovereign. Therefore, Uganda's legal, social, political and economic structures were based on British imperialism.[6]

On the other hand, the Companies Act 1961 was enacted to deal with corporate legal issues in Uganda, as the shift towards the British rule over Uganda grew stronger. However, prior to Uganda becoming a British protectorate in 1894, Uganda had previously witnessed its first legislation relating to business and corporate affairs. This was the Indian Companies Act 1882. This statute was passed to regulate business and trading agreements between Uganda and Indian traders.[7] However, this statute had no provisions on corporate insolvency.

Therefore, after becoming a British protectorate in 1894, reform of the law, or new legislation was needed to guide or regulate corporate insolvency issues in the country. Therefore, the Companies Act 1961 was enacted to address this deficiency. However, this statute was also a direct transplant of the British Companies Act 1948 but this statute had provisions on corporate insolvency and company winding up. This statute further solidified Uganda's accession to English common law and equity, which continues to form a strong base in Uganda's legal structures.[8]

At the time of the financial/economic crisis in 2007 / 2008, Uganda's Bankruptcy Act 1931 was almost eighty years old and the Companies Act 1961 was almost fifty years old. These statutes did not represent the latest developments in the fields of corporate and insolvency law and needed reform to match international trends.

### 1.3 The Insolvency Act 2011 and impact on Uganda's Insolvency Model

In a bid to reform its laws in the field of company law and insolvency law, the Ugandan government commissioned the Uganda Law Reform Commission (ULRC) to review its laws in these areas and to make recommendations on how these laws

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[5] Bankruptcy Act 1931, s.2.
[6] The term British imperialism is used in this context to refer to the British colonial policy of extending the rule or authority of the British Empire over foreign countries or, of acquiring and holding colonies and dependencies.
[7] Uganda Law Reform Commission, *A Study Report on Company Law*, Pub. No.35 (2004), p.7.
[8] J. D. Bakibinga, "Company Law and Business Development in Uganda" (2004) 2 *Uganda Living Law Journal*, 31.

could be reformed to match international trends.[9] These recommendations led to the tabling of the Insolvency Bill 2009 before the parliament in 2009.

Part of the reforms recommended by the ULRC's report was the introduction of a single statute to deal with and regulate the administration of companies undergoing financial difficulties.[10] This was to ensure that abusive practices during the administration of financially struggling companies would be minimised and overall reduction in the cost of proceedings. The ULRC also recommended that Uganda's corporate rescue processes (such as receivership and Deeds of arrangements) be reformed to boost the survival rates of financially struggling companies as these corporate rescue processes were modelled on the Bankruptcy Act 1931 which was almost eighty years old.[11]

The recommendations were adopted by the Ugandan parliament and as a result the Insolvency Act 2011 (IA 2011) was enacted. Among the provisions and corporate rescue processes that the IA 2011 introduced was the administration procedure. The administration procedure was introduced as a measure to improve insolvency proceedings in financially struggling companies to boost survival rates as a response to high liquidation rates premised on processes, such as receivership, which was mainly geared towards liquidation rather than rehabilitation.[12]

A key feature of the administration procedure is that, once formal insolvency proceedings are initiated by the financially struggling company either, through the resolution of the company's board of directors (out of court route)[13] or via court order,[14] a moratorium is triggered. A moratorium is a statutory stay on all creditor enforcement actions or any legal proceedings against the company during the administration process.[15] The moratorium affords the financially struggling company time and protection to pursue its rehabilitation endeavours without interruptions from creditors.

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[9] C. Nyombi, A. Kibandama & D. Bakibinga, "The Motivation Behind Uganda's Insolvency Act 2011" (2014) (8) *JBL* 651, 666; C. Nyombi, "The Development of Corporate Rescue Laws in Uganda and UK" (2015) (57) (2) *International Journal of Law and Management* 214.
[10] Insolvency Bill 2009, Part iv and Sch.4
[11] C. Nyombi, A. Kibandama & D. Bakibinga, "The Motivation Behind Uganda's Insolvency Act 2011" (2014) (8) *JBL* 651, 666
[12] IA 2011, s.140.
[13] IA 2011, s.139 (i).
[14] IA 2011, s.139 (ii).
[15] IA 2011, s.139 (4); s.164.

Under administration, the appointed administrator's main objective is to rescue the company as a going concern.[16] Other objectives include achieving the best outcome for creditors as whole than winding up[17] or realising property to distribute to one or more secured or preferential creditors.[18]

In addition, the IA 2011 requires all insolvency practitioners such as administrators to be licenced practitioners and subject to a regulatory body which may guide and sanction practitioners in cases of professional misconduct.[19] The class or category of people allowed to register and work as professional insolvency practitioners are those that are members of professional bodies or organizations such as certified accountants, Auditors or Advocates. [20] This is to ensure fairness, honesty, transparency and compliance within the insolvency process and the financial system at large.

It was envisaged that having insolvency practitioners professionally regulated and subject to certain Codes of Practice and Conduct would lead to compliance within the insolvency laws and processes which would combat abusive practices and arbitrary use of power in enforcing substantive interests by extant stakeholders on the one hand, and the coordination of these enforcement processes by the insolvency practitioners on the other hand which was hostile to both private and public business sectors.[21]

However, although the enactment of the IA 2011 was to strengthen Uganda's insolvency laws, structures and processes, the adoption and usage of these corporate rescue processes has been relative low.[22] For example, as discussed above, the main policy objective behind the introduction of the administration procedure within the IA 2011 was the need for an inclusive formal insolvency procedure that would consider all creditor rights and interests as a whole upon corporate insolvency as opposed to other rescue processes such as receivership. This is because, receivership as a

[16] IA 2011, s.140 (b) (i). Please also note that the term 'going concern' is used in this context to refer to the value of the company as a going entity for the foreseeable future as opposed to being liquidated. See also, Edith Penrose, *The Theory of the Growth of the Firm* (Basil Blackwell, Oxford 1959).
[17] IA 2011, s. 140 (b) (ii).
[18] IA 2011, s.140 (b) (iii).
[19] IA 2011, Part Viii.
[20] IA 2011, ss. 198 – 211.
[21] C. Nyombi, "The Development of Corporate Rescue Laws in Uganda and UK" (2015) (57) (2) *International Journal of Law and Management* 214.
[22] C. Nyombi, "The Objectives of Corporate Insolvency Law: Lessons for Uganda" (2018) 60 (1) *International Journal of Law and Management* 2, 18.

corporate rescue procedure is more creditor-driven. The receiver who is appointed by the holder of the qualifying floating charge[23] against the assets of the financially struggling company is more concerned with recuperating the interests of his appointer, which is sometimes, to the detriment of other creditors with interests in the financially struggling company and would cause unfairness.[24]

In addition to a slow adoption of the processes in the IA 2011 by mainstream private companies in Uganda, other official statutory bodies with supervisory and regulatory powers over other institutions in Uganda have also taken a slow approach to the adoption of the IA 2011 and its rescue processes. A vivid example is the central bank of Uganda.

The central bank of Uganda has the mandate to supervise and regulate all operations of commercial and financial institutions in the country.[25] This mandate is enshrined in legislations such as the Bank of Uganda Act 1969, Bank of Uganda Act 2000, Financial Institutions Act 2004, Financial Institutions Amendment Act 2016, Micro Deposit Taking Institutions Act 2003 and Tier 4 Microfinance Institutions Money Lenders Act 2016.[26] However, the central bank has recently been the subject of scrutiny in its intervention with the financial difficulties of Crane Bank (Uganda), especially, as to the choice of intervention taken, as discussed in the next section below.

### 1.4 The Collapse of Crane Bank and its Effects on Uganda's Insolvency Model

Crane Bank was a registered commercial bank in Uganda under the supervision of the Central bank of Uganda. Prior to its financial demise in 2016, the bank had over 750,000 customers with several branches nationwide and branches in Rwanda, a member country of the East African Community (EAC). However, towards the end of 2015, reports in the media were circulating about the financial difficulties the bank

[23] IA 2011, s.25 and s.70.
[24] Hamiisi J. Nsubuga, "The Interpretative Approach to Bankruptcy Law: Remedying the Theoretical Limitations in the Traditionalist and Proceduralist Perspectives on Corporate Insolvency" (2018) 60 (3) *International Journal of Law and Management* 824, 841.
[25] These institutions include but not limited to commercial banks, credit institutions, Micro Finance Deposit Taking Institutions (MDIs) and Forex Bureaus.
[26] These Acts of Parliament and other operational regulations are listed on the Bank of Uganda website at, https://www.bou.or.ug/bou/supervision/supervision_acts_regulations.html (accessed January 2019).

was experiencing.[27] On 20 October 2016, Crane bank was officially taken over by the central bank via corrective action courtesy of the FIA 2004 and appointed a statutory manager to oversee to its financial difficulties.[28]

At the Annual Bankers' Conference held in Kampala, Uganda, on 17 July 2018, organised by the Uganda Bankers' Association[29] under the theme: "Financial Sector Stability: Managing Risk in A Growing & Fast Changing Environment", the governor of the central bank in his address to the delegates reiterated why the central bank had to takeover Crane Bank and the rationale for the rapid sale of its assets to another bank – the DFCU Bank.[30]

The governor emphasised that 'the transformation of financial services was changing the risks facing financial institutions and financial markets.[31] The governor admitted that as a regulator, the primary objectives of the central bank are mainly: to protect the interests of depositors and to ensure that overall stability of the financial systems through prudential regulations and supervision of deposit-taking institutions.[32] He further emphasised that "the central bank sought to enhance public confidence in the financial system thereby fostering financial intermediation and limiting the harmful effects of systemic crises.[33]

However, most interestingly, the governor stressed that the central bank of Uganda "has no obligation to bail out a distressed bank by providing it with liquidity support in hope that it will somehow be restored to financial health"[34] The rationale given in support this statement was that if the central bank was to bail out a distressed bank

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[27] See for example, B. Busulwa, "How DFCU Beat Others Bidders in the Race to Acquire Uganda's Crane Bank", *The East African*, 6 February 2017, Available at https://www.theeastafrican.co.ke/business/How-DFCU-won-bid-acquire-Uganda-Crane-Bank-/2560-3801860-format-xhtml-lisgu8z/index.html (accessed January 2019).
[28] B. Busulwa, "Uganda's Central Bank Takes Control over Crane Bank" *The East African*, 20 October 2016, available at https://www.theeastafrican.co.ke/business/Uganda-central-bank-takes-control-of-Crane-Bank/2560-3423876-108c3v0z/index.html (accessed January 2019).
[29] Uganda Bankers' Association is an umbrella body established in 1981 comprising of commercial banks, Uganda Development Bank and other non-bank financial institutions licensed and supervised by the central bank of Uganda. For more details see: www.ugandabankers.org
[30] Why We Had to Take Over Crane Bank – Mutebile, *New Vision*, 17 July 2018 at https://www.newvision.co.ug/new_vision/news/1481579/crane-bank-mutebile (accessed February 2019); See a Press Release by the Bank of Uganda of the Governor's Speech at UBA Conference at https://www.bou.or.ug/bou/bou-downloads/speeches/GovernorsSpeeches/2018/Jul/UBA-Bankers-Conference-2018_17.7.2018.pdf at page 5, (accessed February 2019).
[31] Ibid, Governor's Speech at page 2.
[32] Ibid, page 3, paragraph 3.
[33] Ibid.
[34] Ibid, page 6, Paragraph 2.

through liquidity support, it would allow the distressed bank to continue being mismanaged in the same manner that caused it to become distressed. However, this statement may be interpreted as a misconception (from a regulator's point of view). It may be argued, however, that this statement was made by the governor with no regard to the principles of insolvency law, whose main policy objective is to support the rescue of financially struggling corporations rather than outright piecemeal liquidation of these corporations. Supporting financially struggling companies with liquidity or financial support may be one of the options adopted by the legal system (State) to support financially struggling companies by the State.[35]

### 1.5 Choice of Intervention Model – The FIA 2004 vs IA 2011

The Financial Institutions Act 2004 provides for several resolutions that may be adopted by the central bank in dealing with financially distressed institutions. For example, FIA 2004 provides for corrective action to be taken by the central bank in relation to distressed financial institutions where it deems it necessary to safeguard extant stakeholder interests and the financial system at large.[36] Under corrective action, the central bank may sell the financially distressed institution as a going concern, merge it with another financial institution, subject it to a 'Purchase of Assets and Assumption of Liability' (P&A) transaction, or liquidate the distressed institution.[37]

FIA 2004 also affords the central bank power to take over the management through the appointment of a special manager to oversee the operational duties of the distressed institution.[38] However, FIA 2004 also provides for provisions that are somewhat aligned to the rehabilitation or rescue of the financially struggling institutions. For example, the Act provides for the central bank upon taking over the management of the distressed institution to employ necessary staff[39] to reorganize or

[35] See for example; Hamiisi J. 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, where I analyze the theoretical arguments between the Traditionalist and Proceduralist perspectives on the role that a State (Government) ought to play in rescuing financially struggling companies.
[36] FIA 2004, Part IX, s.82 – s.93.
[37] FIA 2004, s.89(1) + (2).
[38] FIA 2004, s.88.
[39] FIA 2004, s.89 (2) (c).

liquidate the distressed institution[40] or to appoint a person to be known as a 'statutory manager' to manage, control and direct the affairs of the distressed institution.[41]

### 1.6 FIA 2004 Model: Corporate Rescue or Liquidation?

It may be argued that some sections of the FIA 2004, especially s.89 (2), if adopted by the central bank with the main purpose of rescuing financially distressed institutions as going concerns rather than piecemeal sale of assets, perhaps, some of the liquidated banks may have been rescued and rehabilitated into good financial health.[42] This would not only boost confidence in the financial system but also, access to financial credit and financial services to consumers may be continued.[43]

However, it may be argued that the central bank's main policy objectives in invoking corrective actions against distressed banks is mainly to liquidate but not rehabilitate and rescue these failed banks as going concerns. Inadvertently, the central bank opted to utilize a purchase of assets and assumption of liability' (P&A) transaction as the most viable option in dealing with Crane Bank's financial difficulties which is not a rehabilitative option but an option geared towards liquidation.

Although the purchase of asset and assumption of liabilities option carries the advantage of transferring substantial parts of the failed financial institution including all or most of its deposits and all or most parts of its book loans, this option is not geared toward rehabilitation of the distressed institution as a going concern but liquidation.

It is the contention that if the central bank opted for the powers afforded to it by the FIA 2004 in s.89 (2)(g) to appoint a statutory manager to manage, control and direct the affairs of the distressed bank with the main policy objective of rescuing it as a going concern rather than a quick fire sale of the assets and assumption of liabilities option, the rescue of the bank would arguably, have been possible. The statutory manager would in this context be analogous to an administrator whose main priority

[40] FIA 2004, s.89 (2) (f).
[41] FIA 2004, s.89 (2) (g).
[42] "Report Indicts BOU for Illegal Closure of Banks" 22 September 2018, *The East African*, Available at https://www.theeastafrican.co.ke/business/Report-indicts-BoU-for-illegal-closure-of-banks/2560-4772380-c1y0t7z/index.html (accessed January 2019).
[43] M. Prochniak & K. Wasiak, "The Impact of Financial Systems on Economic growth in the Context of the Global Crisis: Empirical Evidence for the EU and OECD Countries" (2017) 44 *Empirica*, 295 – 337.

would be a first attempt at rescuing the distressed bank as a going concern as set out in the Insolvency Act 2011 (IA 2011).[44]

It is the contention that under s.89 (2) (f) of FIA 2004, the central bank or the appointed statutory manager is afforded two options: either to reorganize or liquidate the financial institution in accordance with the Act.[45] However, in this case, liquidation as an option was preferred over reorganization, which is the main policy objective of the IA 2011. Very often, attempts to rescue an insolvent but viable company may involve strategies such as closing off underperforming sections or branches of the business or corporate restructuring or rebranding to minimize losses.[46]

These rehabilitative options were not utilized by the central bank. It is the contention that if Crane bank had been placed under administration, strategies such as closing off some underperforming branches nationwide to limit operational losses would have been an option. However, administration proceedings as established in IA 2011were totally disregarded by the central bank and rather, relied on the FIA 2004.

### 1.7 Conclusion

Designing an efficient insolvency model is not mainly to address corporate failure, that is, supporting companies or businesses experiencing financial difficulties to enable them to overcome these financial difficulties. Designing an efficient insolvency model is also relevant to companies and businesses that are in a good solvent state. This is because, an efficient insolvency model would benefit companies in solvent states by setting out strategies or/ guidance through which enhanced financial risk management and compliance with good financial practices may be maintained to inhibit potential or future financial distress.[47]

For example, following the economic crisis in 2007/2008 some companies in developed economies such as the UK and the US have become more risk-averse[48] to

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[44] IA 2011, s.140 (b) (i).
[45] FIA 2004, s.89 (2) (f).
[46] Hamiisi J. Nsubuga, "Corporate Insolvency and Employment Protection – A Theoretical Perspective" (2016) 4 (1) *NIBLeJ* 221.
[47] L. Qi, "Managerial Model during Corporate Reorganization Period and their Governance Effects: The UK and US Perspective" (2008), *Company Lawyer*, 131.
[48] The term 'risk-averse' is used in this context to relate to a practice that companies or businesses are more reluctant to engage into business activities which may be deemed as being 'risky' post-recession than was the position pre-economic recession in 2008. A 'risk-averse' company is one which chooses to invest in business transactions with known risks that may provide low returns than unknown risks with higher predictable returns. This may include for example, companies entering into business

financial practices or business activities that may potentially affect their businesses or risk the companies' economic and financial stability.[49] This may be attributed to efficient insolvency models in these jurisdictions from which compliance and good financial practices are drawn.

An efficient insolvency model is one that is reliant on the participation and compliance with insolvency laws and processes of the legal system by different actors. These actors may include for example, professionals and non-professional stakeholders who are linked or operate within the circles of the company.

Therefore, upon signs of corporate financial difficulties, these actors may be able to efficiently identify which corrective or rehabilitative approach to adopt and how such an approach may be implemented to support the financially struggling company and its business to overcome such financial difficulties. For example, a rehabilitative approach may aim to support the financially struggling company to continue trading as a going concern or closing off under-performing parts or sections of the company's business.[50]

Very often, the rules that coordinate and regulate insolvency proceedings within a legal system arise out of statutory instruments such as acts of parliament passed to respond to certain situations prevalent in a given jurisdiction. However, although legislation is passed to address certain challenges in a legal system, such legislation requires complimentary policies and procedures to ensure enforceability and compliance with the law to achieve the intended outcomes. Compliance with such legislation requires a two-way strand: that is, compliance from the enforcer of the law and compliance from institutions / consumers.

However, compliance with the insolvency model based on corporate rescue processes such as administration established by the IA 2011 is relatively slow. Other statutory bodies with supervisory and regulatory powers such as the central bank (as discussed

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transactions merely basing on untested and speculative market predictions. See also, Glynn Lowth, Malcolm Prowle and Michael Zhang, 'The Impact of Economic Recession on Business Strategy Planning in UK Companies' (2010) 6 Research Executive Summary Series, online. <http://www.cimaglobal.com/Documents/Thought_leadership_docs/Research%20Funding/R268%20Economic%20recession%20final%20V2.pdf> (accessed February 2019).

[49] See for example, 'The Global Impact of the 2008 – 2009 Recession', A San Jose University, Department of Economics research publication at, <http://www.sjsu.edu/faculty/watkins/globalrec.htm> (accessed February 2019).

[50] P. A. Gibbs, "Determinants of Corporate Restructuring: The Relative Importance of Corporate Governance, Takeover Threat and Free Cash Flow' (1993) 14 *Strategic Management Journal* 51,68.

above in relation to the collapse of Crane Bank) are yet to fully embrace and adopt the use of the IA 2011. Other actors within the private sector are also yet to fully embrace the insolvency model established by the IA 2011.

Therefore, for Uganda to have a coherent and efficient insolvency model, more policies are required across different platforms within the public and private sectors to accelerate compliance amongst professional and non-professionals actors within the legal system. Compliance would give full effect to the provisions established by the IA 2011. That way, the intended policy objectives of having an inclusive rescue model courtesy of administration may be realised, which may lead to improved survival rates of financially struggling companies.