COURSE GUIDE

CLL806
LAW OF SECURED CREDIT TRANSACTIONS II

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INTRODUCTION

The <u>Law of Secured Credit Transactions</u>, a two-semester course, is one of the postgraduate courses at the Master of Laws (LLM) level. The LLM programme and the courses, like the Law of Secured Credit Transactions I, is designed to provide advanced training relevant to and produce the needed higher manpower in the legal profession for educational institutions, courtroom practice, public institutions, the industry and commerce and the society in general. To align the Law of Secured Credit Transactions II (**the Course**) to this general overarching objective, the preparation and presentation of the Course drew heavily from research, experience and strictly on current laws that underlie and impact the area of secured credit transactions. The Course is the second of the two semester programmes that constituted it.

Consequently, the second semester of the Course is concerned with the following:

- Principles of corporate debt finance focussing on corporate borrowing, key terms in corporate debt finance, the instrument of debenture covering contents of debenture trust deed, etc.
- Charge, the fixed charge and its sub-types, floating charge and its sub-types, this history of floating, enforcement of corporate debt including administration (business rescue, receivership and ruination), receivership, winding up and concomitants of enforcement mechanisms of corporate debt.
- Collateral security (guarantees), secured credit transactions in Islamic Law and secured transactions in agribusiness.

COURSE OBJECTIVES

To achieve the aims stated above, some general as well as specific objectives have been pursued in the preparation and presentation of the Course. While each unit within each module prefaced the specific objectives, the general objectives to be successfully attained at the end of the course material should not be lost sight of. Therefore, at the end you should be able to:

1) Understand the extent and limit of powers of a company to borrow.
2) Explain certain key terms in corporate finance.
3) Know the meaning of debentures and its types, debenture trust deed, the qualifications, duties, rights and remedies of debenture trustee.

4) Explain charge as a type of security interest.
5) Differentiate between fixed charge and floating charge.
6) Trace the history of floating charge.
7) Know the nature of interest of floating charge.
8) Know and explain the enforcement mechanisms of corporate debt, including administration, receivership and winding up.
9) Understand and explain the term an insolvency practitioner.
10) Know and understand guarantees as a form of collateral security.
11) Explain the basic principles of Islamic law of finance.

WORKING THROUGH THIS COURSE

To complete this course, you are advised to read the study units, recommended books, relevant cases and other materials provided by NOUN. Each unit contains a Self-Assessment Exercise, and at points in the course you are required to submit assignments for assessment purposes. At the end of the course there is a final examination. The course should take you about 13 weeks to complete. You will find all the components of the course listed below. You need to make out time for each unit in order to complete the course successfully and on time.

COURSE MATERIALS

The major components of the course are.

a) Course guide.
b) Study Units.
c) Textbooks
d) Assignment file/Seminar Paper
e) Presentation schedule.

MODUILES AND STUDY UNITS

We deal with this course in 21 study units divided into 5 modules as follows:

MODULE 1: PRINCIPLES OF CORPORATE DEBT FINANCE

Unit 1: Corporate Borrowing Powers

Unit 2: Collateral Effects of Corporate Debt

Unit 3: Key Terms in Corporate Debt

Unit 4: Capital Maintenance Regime

MODULE 2: THE DEBENTURE

Unit 1: The Nature of Debenture

Unit 2: Debenture Trust Deed

Unit 3: The Debenture Trustee

Unit 4: Rights and Remedies of Debenture Holders/Trustees

MODULE 3: SECURED CREDIT UNDER CAMA

Unit 1: Charge as a security interest

Unit 2: Fixed charge

Unit 3: Floating charge

Unit 4: Distinction between Fixed and Floating Charge

Unit 5: Interests Capable of Creation under CAMA 2020

MODULE 4: CORPORATE INSOLVENCY

- Unit 1: Introduction to Corporate Insolvency
- Unit 2: Company Voluntary Arrangement
- Unit 3: Administration
- Unit 4: Receivership
- Unit: 5: Arrangements and Compromise
- Unit 6: Company Liquidations
- Unit 7: US Chapter 11 Procedure
- Unit 8: The Insolvency Practitioner

All these Units are demanding. They also deal with basic principles and values, which merit your attention and thought. Tackle them in separate study periods. You may require several hours for each. We suggest that the Modules be studied one after the other, since they are linked by a common theme. You will gain more from them if you have first carried out work on the law of contract. You will then have a clearer picture into which to paint these topics. Subsequent units are written on the assumption that you have completed previous Units.

Each study unit consists of one week's work and includes specific objectives, directions for study, reading materials and Self-Assessment Exercises *(SAE)*. Together with Tutor Marked Assignments, these exercises will assist you in achieving the stated learning objectives of the individual units and of the course.

TEXTBOOKS AND REFERENCES

Certain books have been recommended in the course. You should read them where so directed before attempting the exercise.

ASSESSMENT

There are two aspects of the assessment of this course, the Tutor Marked Assignments, and a written examination. In doing these assignments you are expected to apply the knowledge acquired during the course. The assignments must be submitted to your tutor for formal assessment following the deadlines stated in the presentation schedule and the Assignment file. The work that you submit to your tutor for assessment will count for 30% of your total score.

SELF-ASSESSMENT EXERCISES

Self-assessment questions are raised at the end of each module to measure the level of successful engagement with the legal issues covered. The feedback (answers) in the body of the main text is distilled and put up at the end of the course material. This will enable you to understand and apply legal principles to practical situations in resolving legal matters in the field of marine insurance law.

FINAL EXAMINATION AND GRADING

The duration of the final examination for this course is three hours and will carry 70% of the total course grade. The examination will consist of questions, which reflect the kinds of self-assessment exercises and the tutor-marked problems you have previously encountered. All aspects of the course will be assessed. You should use the time between completing the last unit and taking the examination to revise the entire course. You may find it useful to review yourself assessment exercises and tutor-marked assignments before the examination.

COURSE SCORE DISTRIBUTION

The following table lays out how the actual course marking is broken down.

Assessment	Marks
Assignments 1-4 (the best three of all the assignments submitted)	Four assignments. Best three marks of the four counts at 30% of course marks.
Final examination	70% of overall course score.
Total	100% of course score.

HOW TO GET THE MOST FROM THIS COURSE

In distance learning, the study units replace the lecturer. The advantage is that you can read and work through the study materials at your pace, and at a time and place that suits you best. Think of it as reading the lecture instead of listening to a lecturer. Just as a lecturer might give you in-class exercise, you study units provide exercises for you to do at appropriate times.

Each of the study units follows the same format. The first item is an introduction to the subject matter of the unit and how a particular unit is integrated with other units and the course as a whole. Next is a set of learning objectives. These objectives let you know what you should be able to do by the time you have completed the unit. You should use these objectives to guide your study. When you have finished the unit, you should go back and check whether you have achieved the objectives. If you make a habit of doing this, you will significantly improve your chances of passing the course.

Self-Assessment Exercises (SAE) are interspersed throughout the units. Working through these tests will help you to achieve the objectives of the unit and prepare you for the assignments and the examination. You should do each Self-Assessment Exercise as you come to it in the study unit. Apart from the feedback (answers) to the SAE, examples are given in the study units. Work through these when you have come to them.

TUTORS AND TUTORIALS

There are 15 hours of tutorials provided in support of this course. You will be notified of the dates, times and location of the tutorials, together with the name and phone number of your tutor, as soon as you are allocated a tutorial group.

Your tutor will mark and comment on your assignments. Keep a close watch on your progress and on any difficulties you might encounter. Your tutor may help and provide assistance to you during the course. You must send your Tutor Marked Assignments to your tutor well before the due date. They will be marked by your tutor and returned to you as soon as possible.

Please do not hesitate to contact your tutor by telephone or e-mail if:

- You do not understand any part of the study units or the assigned readings.
- You have difficulty with the self-assessment exercises.
- You have a question or a problem with an assignment, with your tutor's comments on an assignment or with the grading of an assignment.

You should try your best to attend the tutorials. This is the only chance to have face to face contact with your tutor and ask questions which are answered instantly. You can raise any problem encountered during your study. To gain the maximum benefit from course tutorials, prepare a question list before attending them. You will gain a lot from participating actively.

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MAIN COURSE

CONTENT

MODULE 1 PRINCIPLES OF CORPORATE DEBT FINANCE[1]

Unit 1: Corporate Borrowing Powers
Unit 2: Collateral Effects of Corporate Debt
Unit 3: Key Terms in Corporate Debt
Unit 4: Capital Maintenance Regime

Unit Structure

1.1 Introduction
1.2 Learning Outcomes
1.3 **Companies and Allied Matters Act 2020**
1.4 Summary
1.5 References/Further Reading/Web Resources
1.6 Possible Answers to Self-Assessment Exercises

1.1 Introduction

The efficiency of the financial system is a core determinant of economic growth. Except financial intermediation is seamless, the financial system cannot be efficient. Undoubtedly, the greatest beneficiary of an efficient financial system is the company. This is because the company succeeds or fails on the strength or weakness of its cash flow situation needed to support its operations. In truth, no company can completely support its operations and maintain a sustained rate of growth from its equity. It must have recourse to credit. In deciding on an efficient capital structure of a company, two theories are usually relied upon. These are the "pecking order theory" and "trade off theory." (Meyers, 1984, Fama & French, 2005). The latter holds that "firms identify optimal leverage by weighing the costs (insolvency or liquidation costs) and benefits (tax treatment) of additional debt." The former assumes that "asymmetric information problems and transaction costs involved in the issuance of equity securities lead firms to finance new investments first with

[1] The various types of debts have been discussed in Semester I of this Course (CLL805 – Law of Secured Credit I). They are generally divided into 'loan capital' and 'debt security'. The latter is represented by bonds, debentures. It is highly recommended that you revisit the relevant sections of the CLL805 with the view to refreshing your memory in this connection. This will facilitate unhindered understanding of this Course, CLL806.

retained earnings, then with debt and only finally with outside equity." Debt finance is not free from problems of asymmetric information (for example, the problems posed by adverse selection and moral hazard). Nevertheless, debt finance is preferred to equity finance by businesses.

Irrespective of the theoretical framework that determines the choice of a company's capital structure as regards debt to equity, there are certain considerations that must be reckoned with. They include corporate borrowing powers and the extent of it; when does a company get into a debt contract that informed the grant of a financial accommodation; and what collateral consequences flow from the debt contract. With respect to the first factor, recourse must be had to the company's constitutional document as well as the statutory provision relevant thereto. In the case of the second factor, so many issues will be thrown up including the question of corporate governance, business rescue, and insolvency. These issues will be considered in this Module. Certain key terms related to corporate debt finance need be brought out, and have been explained, in this Module. In this Unit, the study will focus on corporate borrowing powers.

1.2 Learning Outcomes

By the end of this unit, you will be able to:

- discuss the dynamics of corporate power with respect to borrowing
- explain availability of corporate borrowing powers as a matter of statutory provision that cannot be contracted out from by the company.

1.3 Corporate Borrowing Powers

Corporate power is concerned with the question of the availability, extent, and limit of the powers of a company to borrow money for the purposes of the company's business (Goldface-Irokalibe, 2007 and Fuller, 2009). In Nigeria it is given that the power is available. Subject only to the statutory extent and limit, the absence of such power in the company's constitutional is immaterial.[2] In fact, failure to adhere to the limits set for the exercise of corporate borrowing power may not be fatal

[22] Sections 43 and 89 Companies and Allied Matters Act (CAMA) 2020.

to the case of an innocent third party that acted pursuant to the abuse of power.[3]

1.3.1 Total Absence of Power to Borrow

Previously, where there is a prohibition in the company's constitutional document (specifically, the memorandum of association) the company is bound. Any act, being ultra vires, would be at the risk of the third party. The only exception then related to acts done, though ultra vires, properly incidental to the course and conduct of the business of the company. Trading companies have been held to have implied power to borrow, so that where a trading company borrows against prohibition such act, being ultra vires, will still bind the company for being incidental to the business of the company. Thus, this represents a case where a breach of prohibition to borrow could be excepted for being incidental to 'course and conduct.'[4] Apart from this exception, any borrowing in contravention of the prohibition would be struck down for being ultra vires and void. Do you think this harsh position of the law should apply to Nigeria?

In Nigeria, the position has been altered. In other words, it does not apply to Nigeria. Thus, a company is not only statutorily permitted to borrow, it can also create security interest by way of mortgage or charge to secure the repayment of the debt or performance of an obligation (section 191 CAMA 2020). This implies that even where the memorandum of association or a resolution of the company prohibits the company from borrowing, any act by the company in contravention of this would still bind the company as against innocent third parties (section 49 CAMA 2020; compare sections 39(1) and 40(1) UK Companies Act 2006). In such a case, while the company is bound, the directors that breached the prohibition may be held personally liable to the company for the costs of such ultra vires acts (Orojo, 2008).

Generally, where a transaction is prohibited by a statutory provision, the company is strictly liable if it enters into such a transaction (see, sections 17 and 18 Nigerian Investment Promotion Commission Act Cap N17 LFN 2004). Where the directors of a company act outside the limits of their authority, the company may ratify the act (section 341 CAMA 2020), or it may be presumed against the company. On the other hand,

[3] Sections 44 and 191 CAMA 2020
[4] Blackburn Building Society v Cunliffe Brooks & Co (1882) 22 Ch D 61 and General Auction Estate & Monetary Co v Smith (1891) 3 Ch 432.

where a person not duly appointed and he has not been held out by the company as a director acts on behalf of the company, his act shall not bind the company (section 276 CAMA 2020).

1.3.2 Restriction on Borrowing Power

The restrictions on the borrowing powers of a company can be viewed from two angles. Frist, with respect to statutory restrictions; and second in the context of contractual restriction. You have seen above that, generally, the law permits a company to borrow for its business and use its assets to secure the repayment of the borrowed sum. However, this does not apply to all companies because of the provision of other laws. Can you think of such other statutes where borrowing power is restricted?

a) Restrictions on borrowing powers imposed under a statute. Certain laws restrict the powers of a company to borrow money, even for the purposes of its business.
   i. *Investments and Securities Act (ISA) 2007*. By section 67 of the law only public companies have the power to invite the public to subscribe to its debt securities (like debentures, bonds, etc). Any contravention attracts the severest sanction.
   ii. *Banks and Other. Financial Institutions Act (BOFIA) 2020*. Known as the single obligor rule, banks as companies must first seek and obtain the consent of the Central Bank of Nigeria before making or granting any advance, loan or credit facility or financial guarantee to any person to that is more than 20% of the shareholders fund unimpaired by losses. That is, banks are not permitted to be exposed to any person (natural or juristic) by more than 20% of the shareholders fund by way of loan.
   iii. *Credit Reporting Act 2017*. Under section 57(1) of the law, the regulatory and prudential mechanism of Credit Risk Management System (CRMS), a public bureau, was reinforced and its activities brought within the statutory sphere. Hitherto, it was founded by regulations made in that behalf by the CBN. Principally, the CRMS checks the activities of predatory debtors with high incidence of moral hazard; and generates and maintains accurate and reliable credit data on bank borrowers. However, Onamson (2017) argues that the CRMS suffers from "lumping effect." Following the regime of credit bureaux in Nigeria, no bank is now allowed to advance credit to any

person without first checking the person's credit standing in the CRMS. If the report returns negative, which means that the customer is indebted to a bank (or banks) at the time of its application to another bank, the application for credit will be refused. Reports generated from the CRMS can work hardship on the equity of a borrower that hopes to raise from one bank to repay its indebtedness to another. In Amsel Limited & Anor v UBN plc (2017) LPELR-42980(CA), the Court held that the refusal of the respondent to remove the negative report against the appellant from the CRMS was not only in tandem with CBN guidelines but also the best standard practice in the banking sector. Thus, such an action, even if it negatively impacted the interest of the first Appellant, cannot be held to be a clog in the 1st Appellant's equity of redemption.

b) Restrictions on Borrowing Powers pursuant to a contract. Restrictions on borrowing powers derived from contract are after the fact in nature and thus not restriction in a strict sense. The function of contractual restriction is to restrict or limit the capacity of the borrower to take in more debts which may negatively affect the recovery potential of the first creditor. According to Fuller (2009) contractual restrictions on borrowing power include 'outer borrowing limit,' 'inner borrowing limit,' 'secured borrowing limit,' and 'negative pledge provision.' Unlike statutory restriction, if a company acts in breach of a contractual restriction the remedy of the creditor is that the creditor may opt to treat it as an event of default with a consequent acceleration of the debt. Once the obligation is accelerated it means it falls due for immediate repayment by the debtor in breach. This can precipitate the debtor's insolvency. For example, it can result in cross default on the part of the debtor in relation to other commitments.

1.3.3 Remedies for Absence or Excess of Power

What remedies are available to the company where the directors act in breach of an absence, or excess, of power to borrow? You have already seen that a breach of a contractual restriction can constitute an event of default with potentially costly consequences to the company. The options open to the company intent on remedying absence or excess of power include to restrain the doing of the ultra vires act, or to ratify the ultra vires act or to proceed against the officers responsible for the ultra vires act. Where the company fails to restrain the act before it is completed (sections 44(4) and 45 CAMA 2020, it may ratify the act, if it is a ratifiable act (sections 87(5) and 341 CAMA 2020). If it fails to ratify the act, the company nevertheless is liable on the contract flowing from such ultra vires act. Thus, it will still be bound by the ultra vires act (section 316 CAMA 2020). The company can only seek to extract a pound of flesh by personally proceeding against the officers responsible for borrowing against the limitation in power.

Self-Assessment Exercise 1

a) *The proposition that asymmetric information problems and transaction costs involved in the issuance of equity securities lead firms to finance new investments first with retained earnings, then with debt and only finally with outside equity is also known as…….*
b) *State the three premises on which the capital structure of an entity can be based………*
c) *Before the coming into force of CAMA, what is the position of the law if a company, in contravention of absence of power thereto, enters into a debt contract?*
d) *What do you think is the overarching objective of CRMS?*
e) *Do you think the CRMS has been effective in its objective? Support your answer with a reason(s).*
f) *Contractual restrictions on borrowing powers are tenuous. Discuss.*

1.4 **Summary**

In this Unit, you have been introduced to the idea of corporate borrowing powers. You learned that before a company embarks upon borrowing it weighs its options and takes the most optimal position founded in one of two theories: trade off theory or pecking order theory. The exercise of the powers of the company to borrow is statutory under CAMA. This means whether the company's constitutional document or any resolution of the company empowers it to borrow or not does not count in this case. As a result, where there is prohibition or restriction in the powers of the company, the company will still be bound if the directors act against such prohibition or restriction. Additionally, there are statutory situations where the power of the company to borrow money is prohibited or restricted. These can be found in the NIPC Act, BOFIA and Credit Reporting Act. Another form of restriction on powers of the company to borrow is founded on contract. Examples of contractual restriction include inner borrowing limit, outer borrowing limit, secured borrowing limit and negative pledge provision. The weakness of contractual restriction is that it does not prohibit and when breached the creditor may treat it as event of default, which makes it possible for the creditor to accelerate the repayment of the debt.

1.5 Reference/Further Reading/Web Resources

Books, Journals, Online Resources and Other Publications

Fama, E.E. & French, K.R. (2005). Financing decisions: Who issues stock? *Journal of Financial Economics 76*, 6

Fuller, G. (2009) Corporate Borrowing: Law and Practice, 4th edition, Bristol: Jordans

Goldface-Irokalibe, I.J. (2007). Law of Banking in Nigeria. Lagos: Malthouse Law Books

Myers, S.C. (1984). The capital structure puzzle. *Journal of Finance 39*, 575

Onamson, F.O. (2017). Law and Creditor Protection in Nigeria. Lagos: Malthouse Law Books

Orojo, J.O. (2008). Company Law and Practice in Nigeria, 5th edition, Durban: LexisNexis

Legislations and Statutory Instruments

Banks and Other Financial Institutions Act 2020

Companies and Allied Matters Act 2020

Credit Reporting Act 2017

Investments and Securities Act 2007

Nigerian Investment Promotion Commission Act Cap N17 LFN 2004

1.6 Possible Answers to Self-Assessment Exercises 1

a) *Pecking order theory*

b) *The premises or considerations are corporate borrowing powers and the extent of it; when a company gets into a debt contract that informed the grant of a financial accommodation; and what collateral consequences flow from the debt contract.*

c) *Before the advent of CAMA, such borrowing would be treated as ultra vires the company and therefore void. However, there is an exception that a company has an implied power to borrow in the ordinary course and conduct of its business.*

d) *The overarching objective of the CRMS is to check the activities of predatory debtors that borrow money in one bank, leave it to go bad and run to another bank to seek and obtain a fresh financial accommodation.*

e) *Yes, the CRMS has been effective in its objective. An example pointing to this, is the case of Amsel Ltd & Anor v UBN plc where the court held that the CRMS is the best standard practice in the banking sector.*

It is tenuous because it operates after the fact and the only available option or remedy for the creditor is to treat a breach of a contractual restriction as an event of default. In towing this line, the creditor can accelerate the debt

UNIT 2 IMPLICATIONS AND CONSEQUENCES OF CORPORATE DEBT

Unit Structure

2.1 Introduction

Collateral effects of corporate debt refer to events or situations which become apparent or real in the life of a company as soon as it takes the step to enter into a credit agreement. The Lagos Division of FHC relying on Afribank (Nig) plc v Onyima (2004) 2 NWLR (Pt 858) stated that a credit agreement or contract arises where a customer applied for a loan or finance and where it is granted the relationship that arises between the customer and the Bank is a relationship of a debtor and creditor (Hathiranani v. Sterling Bank Plc FHC/L/BK/05/2014, delivered 5/12/2014)). The company cannot help the coming to pass of any or all of such collateral events. For instance, where a company borrows and secures the repayment by charging a substantial part of its assets or undertaking, the creditor becomes interested in how the company is run and will take steps to secure proper governance. Another collateral event is the potential for insolvent liquidation. Hence, when a company borrows money, it may come out better or it may fare worse off. If the latter occasions and the debt is secured, other events are activated. It may result in the company slipping into administration, or the appointment of a receiver, or even going into liquidation. These events will be appreciated as you explore the Course in greater detail.

2.2 Learning Outcomes

By the end of this Unit, you will be able to:

- explain the collateral effects which are set off when a company takes the step to borrow money

- discuss the consequences of taking out corporate debt, which are corporate governance becomes a critical issue and the creation of security interest to secure the debt obligation becomes nearly inevitable.
- discuss the creation of security interest as a consequence of debt contract
- state the likely but unplanned implications of corporate debt, like insolvency and business rescue.

2.3 Consequence of Corporate Debt

The consequences of embarking on the journey of corporate borrowing are many but two are easily discernible: implementation of good corporate governance and creation of security interest.

2.3.1 The Connection between Corporate Governance and Debt

Marnet (2011) defines corporate governance as the efficiency with which a company is run on its capital reResources, the flow of important financial information between insiders and outsiders and the reliability of financial reporting are important components of the monitoring of the system. In other words, the efficiency of corporate governance as a driver of corporate growth and promoter of firm value is dependent on the quality of monitoring put in place. Traditionally, the levers of corporate governance are the members in general meeting, the board of directors, the external auditors and to a large extent the company secretary. Principally, corporate governance is concerned with detecting, deterring, and correcting managerial slack. Triantis and Daniels (1995) define managerial slack as lapses in managerial competence or effort, managerial entrenchment or empire building and excessive managerial compensation or perquisite consumption. It may safely be added that earnings management reflects the presence of managerial slack.

It is thus not difficult to see why debt plays corporate governance role. Hence debt is an additional lever of corporate governance. It is represented by the creditor with vested interest in the efficient governance of the company. Section 50(a), (b) and (d) *Financial Reporting Council of Nigeria Act 2011* provided a justification for the corporate governance role of debt when it stipulates that the underlying key driver of corporate governance is the need for external funding, which cannot be secured except the prospective creditor, directly or indirectly, will have a measure of control or say in the governance of the entity. Pursuant to section 73 of the Act, the Council issued the Nigerian Code of Corporate Governance 2018. Although there is a statutory justification for the corporate role of debt, more prevalent is the contractually founded corporate governance role of debt. In respect of statute-based corporate governance role of debt, CAMA specifically permits a creditor to bring an action where the affairs of the company/debtor are conducted in a manner that is oppressive or unfairly prejudicial to or discriminatory against the interest of the creditor. Another example of statute-based corporate governance role of debt is seen in section 46(3) CAMA which empowers a company to donate powers to any person notwithstanding that such a person is an outsider qua outsider to appoint or remove a director or an officer.

With respect to contract-based governance role of debt, it is usually to be discovered from the debt contract. This is evidenced through covenants in the loan agreement that permit the creditor to have a say in the way the debtor company carries on its affairs (Ferran, 2008). To be efficient, the role of debt in corporate governance manifests in two ways: “monitoring” and “reaction.” Monitoring means that the creditor must constantly and religiously, throughout the life of the loan, acquire reliable and verifiable data about the debtor. To appreciate the idea of monitoring, in a debt contract there is always a provision that requires the debtor to furnish the creditor with relevant time-sensitive information respecting the activities of the company. This enables the creditor to be able to “react” when red flags are raised. Apart from relying on the ongoing information provided by the debtor, monitoring can be undertaken by representation. This happens where the creditor, under section 46(3) CAMA, is either empowered to remove an officer of the debtor or to appoint its representative on the board of the debtor company. However, there could be consequences for the creditor having a person on the board. (Kuwait Asia Bank v National Mutual Life Nominees Ltd (1991) AC 187)

The end or purpose of monitoring is reaction. Thus, where the outcome of monitoring shows that the going concern situation of the debtor is seriously threatened, the creditor will react. Reaction takes one of two forms. The first form of reaction is ‘Exit’, which, if exercised by the creditor can potentially unleash irreversible damage on the debtor. No wonder Gullifer & Payne (2011) likened ‘Exit’ to a “nuclear weapon”.

Reaction by Exit means the creditor is accelerating the repayment of the debt and this step can potentially set off cross default provisions the debtor might have with other creditors.

On the other hand, the reaction of the creditor following negative report from monitoring may be manifested by "Voice". Reaction by "Voice" expresses the creditors willingness to waive the negative report and pursue other remedial measures to ensure that the position is reversed. Voice-based reaction may be informed by pecuniary consideration, where the creditor reckoned with the loss of profits likely to ensue from Exit. Generally, while Exit can potentially precipitate the debtor's insolvency, Voice massages the debtor in the vicinity of collapse or insolvency.

2.3.2 Creation of Security Interest

The subject of security interest has been exhaustively treated in the first semester. No purpose would be served repeating them here. You should go through the relevant aspects in CLL805. For our purposes, where the company goes into a debt contract, it may support the repayment of the debt by granting security interest to the creditor. This action assures the creditor that, in the event that the debtor falls into financial trouble and becomes unable to pay, the creditor can have recourse to the property used to secure the loan. Generally, it is not every loan that company borrows that is secured by mortgage, charge, or any other form of security. Thus, a secured creditor is one with security interest created in its favour by the debtor for the repayment of the loan obligation. What is the difference between security interest as against proprietary interest? What are the indicia of security interest? See CLL805 for details. Later in the course, you will see effect of creation of security interest on the debtor.

2.4 Implication of Corporate Debt

This most discerning implication of corporate debt is the potential danger of insolvent liquidation arising from failure of the debtor to discharge the debt obligation (repayment of principal and interest). Thus, when a company borrows money, it exposes itself (until the debt is fully repaid) to the potential of insolvent liquidation occasioned by failure to repay the loan. The law prescribes the point at which it can be said that the company has slipped into insolvent liquidation and therefore deserves to die (see section 571(e) CAMA). The ebb and flow of business life cycle make insolvent liquidation a palpably potential danger for every company. Recognising this potential danger particularly in the context of capital maintenance, the court held in Trevor v Whitworth (1887) 12 AC 409 that the probability of the loss of capital is a result which no legislation can prevent. When a company is faced with the stark reality of inability to pay its debts, the question becomes what are the options open to it? It may make a compromise or enter an arrangement with its creditors with the general body of creditors (section 714 CAMA); it may be put into receivership by the appointment of a receiver or manager; or it may go into administration (business rescue). It may try such business options like going into administration or taking out a company voluntary arrangement (CVA). Other jurisdictions including the UK and South Africa have business rescue mechanisms designed to walk a financially necessitous out of the vicinity of collapse and revive its going concern situation. All these mechanisms or approaches are treated in greater detail in the course.

Self-Assessment Exercise 2

a) The proposition that no legislation can stop the ebb and flow of business life cycle is to be found in the case of---------------
b) Where the monitoring activity of the creditor yields up a negative result, what options are open to it?
c) With the aid of authority, what is the best approach by which a financially troubled debtor can work out a mutually beneficial arrangement with its general body of creditors?
d) The financially necessitous debtor faces the double-edged sword of either ----------- or --------------.
e) Differentiate between proprietary right and security interest.
f) What, in your opinion, is the main thrust of section 41(3) CAMA?

2.5 Summary

Like in the first Unit, you saw in this Unit, the collateral effects of borrowing. One, it activates an additional lever of corporate governance, which serves not only the interest of the creditor but facilitates the promotion of the company's interest as a whole. In this context, debt becomes a mechanism of corporate governance utilised by the creditor to watch against managerial slack. However, debt can be a trap and a means of accelerating corporate insolvency. When this happens and if the debt is secured by the creation of security interest, another collateral event following the debt contract, the debtor may not likely survive it. It will be thrown into another phase in its life: the palpability of racing towards receivership or walking the aisle of rescue options.

2.6 References/Further Readings

Books, Journals, Online Resources and Other Publications

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2. Triantis, G.G. & Daniels, R.J. (1995). The role of debt in interactive corporate governance. *California Law Review 83,* 1073. Retrieved from http://repository.upenn.edu/law_series/12
3. Ferran, E. (2008). Principles of Corporate Finance Law, Oxford: Oxford University Press
4. Gullifer, L. & Payne, J. (2011). Corporate. Finance Law: Principles and Policy, London: Hart

Legislations and Statutory Instruments

1. Companies and Allied Matters Act Cap C20 LFN 2004
2. Companies and Allied Matters Act 2020
3. Financial Reporting Council of Nigeria Act 2011

2.7 Possible Answers to Self-Assessment Exercises

a) *Trevor v Whitworth*
b) *Monitoring is the basis of undertaking the corporate governance role of debt. Where it throws up negative report, the options of the creditor are Exit or Voice. For Exit, the facility may be accelerated, and it can have dire effects on the debtor; in the case of Voice it merely sounds out a warning and overlooks the negative report.*
c) *The best approach is for the debtor to make a compromise or arrangement with the creditors, provided under section 538 CAMA.*
d) *Receivership or business rescue (administration)*
e) *Proprietary right is the bundle of rights acquired and exercisable by the owner of property; security interest is the right that a secured creditor in respect of the assets subject to security.*
f) *The main thrust of s 41(3) CAMA is to broaden the governance mechanism of companies.*

UNIT 3 KEY TERMS IN CORPORATE DEBT TRANSACTIONS

Unit Structure

3.1 Introduction

Up to this point, you have seen that a creditor is either secured or unsecured. If secured, the creditor has recovery leverage as its advantage. If unsecured the creditor will look up to the general residue of the debtor's assets for recovery. In other words, the secured creditor is one that knows the source of recovering its investment if anything goes awry with the debtor's business. You will now be introduced to certain key terms which you will meet, or must have come across some of them, in this course or in the first semester or elsewhere. For instance, in the first semester, you learned about the concept of "clog on the equity of redemption."

3.2 Learning Outcomes

By the end of this unit, you will be able to:

- discuss certain key terms you will meet in practice
- explain how the terms are introduced into debt (loan) agreements
- explain the key terms in drafting loan agreements in practice.

3.3 KEY TERMS IN CORPORATE DEBT TRANSACTIONS

Have you ever entered into a debt agreement? Or have you ever advised a client on loan transactions? Can you identify certain key terms you came across in any of those transactional situations? The answer to these questions is the concern of this Unit.

3.3.1 Conditions, Representations and Warranties

(a) Conditions. Usually, the offer letter from the banker to the prospective borrower will contain conditions which the borrower must fulfil or continue to fulfil after the facility has been granted and the funds disbursed. This identifies two sets of conditions: condition precedent and condition subsequent. A condition precedent may be a contingent or promissory condition. According to Peel (as cited in Gullifer & Payne, 2011), a contingent condition may or may not be something within a party's control, but the party must not prevent it from coming about. This supposes that inability to fulfil or failure to meet a contingent condition may not be actionable. However, failure to fulfil a contingent condition entitles the banker to decline the application for facility (Ifemesia v. Ecobank (2018) LPELR-46589(CA). A condition subsequent come in the nature of continuing conditions the borrower must observe and fulfil. An example is where the lender requires the borrower to submit quarterly reports throughout the life of the loan.

(b) Representations. These are statements of fact that induces an innocent party to change its position with respect to a particular contract. If it turns out to be untrue, causing the other party to be injured (that is to suffer loss), it entitles him to a remedy in damages. Representations are critical to any lending or credit relationship. This position can be justified. The truth of a precontractual statement is a precondition of any binding agreement being reached. As echoed in Bannerman v White (1861) 142 ER 685, the lender becomes entitled to refuse to proceed with the lending transaction if the borrower's representations turned out to be a labyrinth of prevarications and falsehood.

(c) Warranties. They are statements which if untrue entitles the other party to avoid the contract and sue for breach of contract. Wood (as cited in Gullifer & Payne, 2011) talks of legal and commercial

warranties. The former are promises or assurances that legal prerequisites and formalities have been met. This fulfilment of legal warranties gives legal validity to the loan agreement. On the other hand, the latter are promises regarding the financial position of the borrower at the time it was made. A representation by the borrower that it has the power to accept the loan is an example of legal warranty; while a statement that there is no pending litigation likely to have material impact on the debtor's going concern situation is an instance of commercial warranty.

3.3.2 Covenants

Generally, they are two – affirmative covenants and negative covenants – to be found in any loan agreement or debt contract.

(a) Affirmative covenants. They are statements which are ministerial in nature and are not directed at constraining or limiting the power of the debtor to run its activities. For example, it is typical to find in a loan agreement covenants or conditions which place duty on the borrower to supply quarterly information to the lender or which require the borrower to furnish certain information to the lender before the making of the loan. Such rights inure to the benefit of the lender. Cranston (2005) gave an example of ongoing periodic information as one that requires the borrower to 'regularly provide specified financial and other information to the bank and maintain certain financial ratios (gearing ratio, minimum tangible net worth ratio, etc). To underline the importance of such informational right, Bjerre (1999) advises that the minimum tangible net worth test is critical because compelling an asset-based lender to share even a small portion of its collateral (security) with an unexpected equitable lienor can upset the rationality of an entire transaction. Affirmative covenants (like the ongoing or continuing obligation to provide periodically certain categories of information) can be an efficient early warning mechanism for the creditor (Onamson, 2017).

b) Negative covenants. Generally negative covenants exist in a debt contract to address the moral hazard (crass opportunism and incendiary misbehaviour) of the debtor by constraining the debtor's power to run and manage his business. According to Ferran (2008) it is aimed at procuring that the borrower remains able to fulfil its obligations under the loan contract and does not engage in conducts that would prejudice that ability. Providing what he calls 'the full set of negative covenants' to be found in loan agreements, Bratton (2006) states that they include restrictions on debt, restrictions on prior claims, restrictions on investments, restrictions on dividends and other payments to shareholders, restrictions on mergers and sales of assets, prepayment alternative and early warning covenants. For instance, the Court in Re Exchange Banking Company, Flitcroft's Case (1882) 21 ChD 518 supports the inclusion of negative covenant restricting distributions to shareholders on the premise that the good faith belief of the creditor entitles it to insist that the corporation shall keep its capital and not return it to the shareholders by way of dividends. Still on the negative covenant restricting distribution to shareholders, Onamson (2017) submits that such contractual restrictions on distributions affecting the debtor's ability to make payment to shareholders reinforce and make watertight the statutory restriction contained in section 428 CAMA.

3.3.3 Repayment

Apart from being related to the concept of clog on the equity of redemption already discussed in the first semester, it involves time of repayment. Generally, the duty to repay the debt (loan) arises either on the date fixed in the contract or on demand. Overdrafts are generally repayable on demand (Ishola v Societe Generale Bank (Nig) Ltd (1997) 2 NWLR (Pt 488) 405. While obligation to pay may not arise where the debt or debenture is perpetual or irredeemable (s 196 CAMA), the law supports the view that creditor must make a notice of demand before it can bring proceedings to recover the debt.

On the other hand, prepayment means repayment of the debt earlier in time than contemplated in the contract. Generally, the rule at common law is that in the absence of any provision in the contract, the debtor may not validly make prepayment. This means that there must be express contractual provision granting right of prepayment to the debtor. Where it is provided, Fuller (2009) states that it may be in the form of a right to repay either all the money lent or only a part thereof.

3.3.4 Interest

a) Nature of Interest. In Bennett v Ogston (1930) 15 TC 374 interest is defined as the payment for the use of money. It is payable where there is express agreement to pay interest or where such an agreement can be implied from the course or circumstances surrounding the dealings between the parties or from the nature of the transaction or custom or usage of the trade or profession concerned. It is important to note that interests are usually charged on flat rate but where the parties agree, it is possible to pay interest on unpaid interest, otherwise called compound interest (Fergusson v Fyffe (1841) 8 CI&Fin 121). In the absence of such an agreement the law frowns at unilaterally subjecting a customer to compound interest: Haliru v. Unity Bank Plc (2016) LPELR-41608(CA)

b) Forms of Interest. Fuller (2009) states that "the borrower's obligation to pay interest can be divided into three separate phases" of pre-default interest, default interest, and judgment interest. These phases have been classified as forms of interest.

(i) Pre-default Interest. This form of interest continues to accrue on the loan "up to the date on which repayment is due". The payment of pre-default interest is always prescribed by law, or it arises by way of agreement, which may "be implied from a course of dealing between the parties or from custom (as in the charging of interest on bank overdrafts)": Alfa Nig. Ltd & Anor v. Keystone Bank Ltd (2013) LPELR-22943(CA) and Asikpo v. Access Bank (2015) LPELR-25845(CA)

(ii) Default Interest. As the name implies, this form of interest arises "from the due date up to the date of judgment or, if earlier, payment". In other words, it arises when the loan has fallen due to be repaid but the debtor fails in doing so. This scenario must be distinguished from one which arises from the occasioning of events of default. When the latter occurs, the bank usually accelerates the facility. Fuller (2009) writes that default interest may be founded on an agreement or by way of damages or on the strength of a statutory provision or the discretion of the court.

(iii) Judgment interest. This form of interest takes effect from the date of judgment. The unique thing about this form of interest is that it affects all monetary judgments of the court and not necessarily judgments given on a creditor-debtor matter. Generally, every judgment debt carries interest at the rate of prescribed by statutory instrument from the time of entering up the judgment until the same shall be satisfied and such interest may be levied under a writ of execution, on such judgment: section 17 Judgments Act 1838; Sabbagh & Anor v. Bank Of West Africa Ltd (1966) 1 ANLR 234. For a difference between pre-judgment

interest as against post-judgment interest, see Etuk v Heritage Bank Plc (2018) LPELR-45777(CA). In Africa Prudential Registrars Plc v Macaulay & Ors (2020) LPELR-49593(CA), where the Court distinguished between "pre-judgment interest otherwise known as 'interest as of right' or moratory interest and post-judgment interest otherwise known as 'discretionary interest' permitted by the rules of Court.

3.3.5 Events of Default

Usually, a debt contract will contain a covenant stipulating circumstances the occurrence of which will be deemed as an event of default on the part of the debtor. Examples of such events may include where the debtor defaults in any loan with a third party, or the debtor falls in default as to payment of interest or principal at due dates, or the debtor without the creditor's consent changes its business, among other events. Where an event of default happens, the bank may elect to accelerate the loan or even waive the default.

Self-Assessment Exercise 3

a) *Using the appropriate authority, explain the various forms of judgment interest.*
b) *Identify at least three examples of events of default usually found in debt contract.*
c) *Disentangle the difference, if any, between prepayment as against repayment.*
d) *What is the overriding philosophy for the presence of negative covenants in debt contracts?*
e) *State without explaining the two types of conditions precedent.*
f) *What is compound interest?*
g) *Identify any authority that drew out the position of the court as regards compound interest.*
h) *With the aid of authority, what is the effect of failure to fulfil a contingent condition?*

3.4 Summary

In this Unit, you were carried through specific terms usually found in any debt contract. They include conditions, representations, and warranties; covenants which may be affirmative or negative; and the concept of interest, the various forms of which were explained.

3.5 References/Further Readings/Web Resources

Books, Journals, Online Resources and Other Publications

Beale, H., Bridge, M., Guillfer, L., & Lomnicka, E. (2012). Law of Security and Title-based Financing. Oxford, London: Oxford University Press

Bjerre, C.S. (1999). Secured transactions inside out: Negative pledge covenants, property and perfection. *Cornell Law Review. 84:305*. Retrieved from http://ssrn.com/abstract=167788.

Bratton, W.W. (2006). Bond covenants and creditor protection: Economics and law, theory and practice, substance and process. *European Business Organisation Law Review. 7, 39.* Available at http://scholarship.law.georgetown.edu/facpub/581

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Legislations and Statutory Instruments

Companies and Allied Matters Act 2020

Financial Reporting Council of Nigeria Act 2011

3.6 Answers to Self – Assessment Exercises

a) In the case of African Prudential Registrars Plc v Macaulay & Ors (2020) the Nigerian Court of Appeal identified two forms of judgment interests. These are pre-judgment interest otherwise known as interest of as of right is a moratory interest, while the second is post-judgment interest also known as discretionary interest usually allowed by the rules of court.

b) Examples of events of default to be found in a debt contract include where the debtor defaults in any loan with a third party, or the debtor falls in default as to payment of interest or principal at due dates, or the debtor without the creditor's consent changes its business.

c) Prepayment means repayment of the debt earlier in time than contemplated in the contract. In the absence of any provision in the contract, the debtor may not validly make prepayment; that is the contract must expressly grant right of prepayment to the debtor. On the other hand, repayment has to do with duty to pay the loan at the set time under the debt contract or on demand, especially in the case of overdraft.

d) Negative covenants exist in a debt contract to address the moral hazard (crass opportunism and incendiary misbehaviour) of the debtor by constraining the debtor's power to run and manage his business. The wisdom for this to procure that the borrower remains able to fulfil its obligations under the loan contract and does not engage in conducts that would prejudice that ability.

e) The two types of conditions precedent are (i) contingent condition, and (b) promissory condition.

f) Compound interest is interest on an unpaid interest.

g) Generally, the courts frown at subjecting the debtor to compound interest. In light of this, there must be an agreement between the parties: see Haliru v. Unity Bank Plc (2016).

h) The effect of failure to fulfil a contingent condition is that such inability entitles the banker to decline the application for facility (Ifemesia v. Ecobank (2018).

UNIT 4 CAPITAL MAINTENANCE

Unit Structure

4.1 Introduction

Due to the possibility of insolvency, the law prescribes rules which are targeted at ensuring that the company does not find itself in a situation where creditors, secured or unsecured, will unduly take a hit for making investment in the company by way of credit. One of such ways is the concept or idea of capital maintenance, the focus of this unit.

4.2 Learning Outcomes

By the end of this unit, you will be able to:

- discuss various capital maintenance rules which the law has put in place to ensure that the capital of the company is not wiped away and thereby leaving creditors helpless
- explain the importance of capital maintenance.

4.3 Capital Maintenance

You cannot discuss capital maintenance rules without understanding the concept of legal capital, which prescribes the minimum capital which can be invested in a trading company. It relates to the idea that the capital must not be diminished or paid out to the members except as expressly provided in the law. That way capital maintenance preserves not just the minimum (legal) capital but firm value through elaborate rules that govern distributions to members of the company.

4.3.1 Significance of capital maintenance

The ultimate beneficiaries of efficient capital maintenance regime are the creditors, especially the non-adjusting creditors and other stakeholders, as both classes cannot possibly protect themselves through security interests. In line with this, companies have a continuing duty not to diminish the minimum share capital, save in the ordinary course of business. On this, **Cotton LJ** noted that any purported return of the legal capital to members would be resisted for that would amount to taking away "from the fund to which the creditors have a right to look as that out of which they are to be paid."[13] Any transaction the end of which would amount to unlawful distribution would be fiercely resisted. Thus the court wasted no time in striking down the transaction where the company assets were grossly undervalued and the directors caused the company to sell to one of their own, who, four years later, caused the company to repurchase the same property at 28 times the amount sold to the director.[5] In another case, it was decried that "to put up with foolish directors is one thing; to put up with directors who are foolish that they make a profit of £115,000 odd at the expense of the company is quite another.[6]

Capital maintenance rules help to restrain corporate officers from manifesting opportunism and getting enmeshed in corporate malfeasance through unlawful distribution or dissipation of corporate assets. Any officer caught in the web of this ignominy commits a breach of duty. **Chadwick LJ** sounded the warning that to enter into an arrangement which seeks to achieve a distribution of assets, as if on a winding up, without making proper provision for creditors is, itself, a breach of the duties which the directors owe the company; and an attempt to circumvent the protection which the law affords those who give credit to a business carried on with the benefit of limited liability.[7] Apart from being a breach of duty, it is ultra vires the company to embark upon unlawful distributions, except such distributions followed the rules set out in the law. Clarifying this point, **Pennycuick J** noted

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[5] Daniels v Daniels (1978) Ch 406; Aveling Barford Ltd v Perion Ltd (1989) BCLC 626
[6] Prudential Assurance Co Ltd v Newman Industries Ltd (No 2) (1981) Ch 257 at 315
[7] MacPherson v European Strategic Bureau Ltd (2000) 2 BCLC 683

that members are free to take assets out of the company by way of dividends, but they cannot take assets out of the company by way of voluntary disposition, however described, and if they attempt to do so, the disposition is ultra vires the company.[8]

4.3.2 Capital maintenance rules.

The capital maintenance rules are the rule on minimum share capital and distribution of capital. Let us examine each of them briefly.

(a) Minimum share capital. This is minimum share capital that members are expected to contribute to the business. It represents the dues that shareholders pay for receiving and putting on the privileged cloak of limited liability. The minimum share capital is usually stated in the memorandum. Without meeting the minimum share capital, the company will be denied registration. What is the minimum share capital for a private company as against a public company in Nigeria? If you want to register a bank or an airline business, what minimum share capital do you require to achieve your goal in relation to each business? For answers to the questions and more helpful resources, **you may do well to visit the Corporate Affairs Commission's portal by clicking here. There, you can easily access and download the CAC Operations Checklist 2022**.

The minimum share capital is thought to protect creditors since the principle of limited liability facilitates judgment proofing for members of a company. On the other hand, the principle operates against creditors, especially the body of unsecured creditors, if the company slips into insolvency. Minimum share capital is "fixed and certain, and every creditor of the company is entitled to look to that capital as his security."[9] Bearing in mind the minimum share capital set for companies in Nigeria, do you think the minimum share capital can offer efficient protection of creditors? For example, it has been hailed as a barrier to frivolous incorporations.[10] Conversely, it has been put forward that the efficiency of the minimum capital regime, in terms of protection for creditors, is dubious: the sum is relatively trivial, and is measured at the time the company commences trading, paying little account to what

8 Ridge Securities Ltd v IRC (1964) 1 WLR 479
9 Ooregum (Gold Mines of India) Ltd v Roper (1892) AC 125
10 Cahn A., and Donald C.D. (2010). *Comparative Company Law: Text and Cases on the Laws Governing Corporations in Germany, the UK and the USA.* Cambridge University Press, Cambridge, UK, p. 168

business risks or mishaps may happen as business continues.[11] This argument against minimum capital may justify why huge capital is required for certain types of businesses before registration can be granted by the Commission.

(b) Distribution of capital.

The court in the case of **Trevor v Whitworth**[12] offered the rationale for the rule against unlawful distribution to shareholders:

> Paid-up capital may be diminished or lost in the course of the company's trading; that is a result which no legislation can prevent; but persons who deal with, and give credit to a limited company, naturally rely upon the fact that the company is trading with a certain amount of capital already paid, as well as upon the responsibility of its members for the capital remaining at call; and they are entitled to assume that no part of the capital which has been paid into the coffers of the company has been subsequently paid out, except in the legitimate course of its business.

Hence, while shareholders are permitted to make distributions out of the assets of the company by way of dividends, they cannot make voluntary dispositions. The domains of the rule in this area include (a) payment of dividend out of profits,[13] (b) redemption of shares,[14] and (c) financial assistance by company for acquisition of its own shares.[15] Financial assistance is defined as a gift, guarantee, any form of security or indemnity, a loan or any form of credit or any other financial assistance given by a company, the net assets of which are thereby reduced by up to 50%, or which has no net assets.

Generally unlawful distributions constitute, and can occur by way of, payments which do not come from distributable profits, dividends paid when there were reasonable grounds not to do so, redemption of shares not qualified to be redeemed, improper redemption of redeemable shares, payments which fall within the meaning of financial assistance and other species of wrong distributions of whatever character or by whatever name called. Albeit unlawful distribution is ultra vires the company, it may still be ratified where it is held to be a mere procedural irregularity. Thus, a distribution challenged on a ground other than that

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[11] Sealy, L. and Worthington, S. (2010). *Sealy's Cases and Materials in Company Law.* (9th edition) Oxford University Press, Oxford, England, p. 463

[12] (1887) 12 App Cas 409. The case that concerns a company buying its own shares is an authority on capital maintenance.

[13] See sections 427, 428 and 430 CAMA 2020

[14] See sections 182, 184 CAMA 2020

[15] See section 183 CAMA 2020

the payment was made from distributable reserves would likely fail if the ground of complaint is "that the company had failed to do all that it was required to do by the companies' legislation to demonstrate that the dividend was permissible."

Self-Assessment Exercise 4

a) *Is there philosophy supporting the rule against distributions to members of a company?*
b) *Briefly discuss the justifications for capital maintenance.*

4.4 Summary

In this unit, you studied about capital maintenance and the rules that underly it. You studied about the significant of capital maintenance and two principal capital maintenance rules, which are legal capital (minimum share capital) rule and the rule against distributions of capital. The latter rule has many variants including (a) payment of dividend out of profits, (b) redemption of shares, and (c) financial assistance by company for acquisition of its own shares.

4.5 References/Further Readings/Web Resources

Books, Journals, Online Resources and Other Publications

Beale, H., Bridge, M., Guillfer, L., & Lomnicka, E. (2012). Law of Security and Title-based Financing. Oxford, London: Oxford University Press

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Legislations and Statutory Instruments

Companies and Allied Matters Act 202

4.6 Answers to Self – Assessment Exercises (SAEs)

Self-Assessment Exercise 4

a) Yes, there is a rationale. It is provided in the English case of Trevor v Whitworth where the court stated that the paid-up capital may be diminished or lost in the course of the company's trading; that is a result which no legislation can prevent; but persons who deal with, and give credit to a limited company, naturally rely upon the fact that the company is trading with a certain amount of capital already paid, as well as upon the responsibility of its members for the capital remaining at call; and they are entitled to assume that no part of the capital which has been paid into the coffers of the company has been subsequently paid out, except in the legitimate course of its business.

b) Two justifications can be adduced for capital maintenance. One it is for creditor protection. Hence, any purported return of the legal capital to members would be resisted for that would amount to taking away from the fund to which the creditors have a right to look as that out of which they are to be paid. Two, it is a disincentive to corporate malfeasance and opportunism on the part of corporate officers. Supporting this point, Chadwick LJ warned that to enter into an arrangement which seeks to achieve a distribution of assets, as if on a winding up, without making proper provision for creditors is, itself, a breach of the duties which the directors owe the company; and an attempt to circumvent the protection which the law affords those who give credit to a business carried on with the benefit of limited liability.

MODULE 2 DEBENTURE

UNIT 1 The Nature of Debenture

Unit Structure

1.1 Introduction

The history of debenture dates to the second half of the 19th century. It was recounted that, then,

> small companies often took loans from private investors in units of, say, £100. For each £100 lent, an investor was given a certificate specifying his entitlement to interest and repayment of principal and giving him an individual right of recourse against the company's property if there was default in paying interest, or repaying the principal represented by that particular certificate. A set of certificates like this issued by a company is called a series of debentures. (Mayson, et al, 1986:252)

Today, debentures have become the fundamental basis for creation of a debt or acknowledgment of debt obligation. Public companies often issue debentures for subscription by the public, while private companies create debt obligation through issuance of debentures to their creditors (banks). Where a company issues debenture to the public, it must constitute a trust. There are benefit and burdens attaching to the office of a trustee. These and much more you will be studying in this Unit.

1.2 Learning Outcomes

By the end of this unit, you will be able to:

- discuss the meaning of debenture
- explain the nature of debenture as a debt instrument.

1.3 The Nature of Debenture

The law specifically empowers the company to borrow money for the purpose of its business or objects. This power is coupled with rights inuring to the company including right to mortgage or charge its undertaking, property and uncalled capital, or any part thereof, and issue debentures, debenture stock and other securities whether outright or as security for any debt, liability, or obligation of the company or of any third party. See section 191 CAMA 2020.

1.3.1 Defining a Debenture

A debenture is a document which either creates a debt or acknowledges it (section 868 CAMA 2020).[16] A company may issue debenture to an individual creditor (like a bank), to private persons or to the public. Where it issues or offers debenture to the public, it must constitute a trust and execute a debenture trust deed.

In Nigeria, only a public company can issue debentures to the public for subscription. Although the statutory regime has limited offer of debentures to public companies, small private companies were involved, and in fact, dominated the issue of debentures and their activities birthed the issue of series of debentures.

Where there are different classes of debentures, there must be a trustee for the debenture holders of each class. Under the law, debentures shall belong to different classes if different rights attach to them as regards among others, the rate of, or dates for payment of interest; any right to subscribe for or convert the debenture into shares in, or other debentures of, the company or any other

[16] Section 868(1) CAMA defines it as a written acknowledgment of indebtedness by the company, setting out the terms and conditions of the indebtedness, and includes debenture stock, bonds and any other securities of a company whether constituting a charge on the assets of the company or not. Also see, City of London Brewery Co Ltd v IRC (1899) 1 QB 121

company; or the powers of the debentures holders to realise any security' see section 208(4) CAMA 2020; and if the debentures do not rank equally for payment: section 208(5) CAMA 2020.

1.3.2 Types of Debentures

The various types of debentures statutorily recognised are:

a) Perpetual debentures, section 196 CAMA 2020
b) Convertible debentures, section 197 CAMA 2020
c) Secured and unsecured debentures, section 198 CAMA
d) Redeemable debentures, section 199 CAMA

You should read up the various types of debentures from the provisions of the law cited above.

1.3.3 Statements Contained in an Instrument of Debenture

The law is clear on the statements that must be contained in every debenture. As you will see, the statement to be contained in a debenture is different from the contents of a debenture trust deed to be considered in this Unit. The law[17] sets out the matters which must be covered by every debenture. They are:

a) the principal amount borrowed,
b) the maximum discount which may be allowed on the issue or reissue of the debentures, and the maximum premium at which the debentures may be made redeemable,
c) the rate of and the dates on which interest on the debentures issued shall be paid and the manner in which payment shall be made,
d) the date on which the principal amount shall be repaid or the manner in which redemption shall be effected, whether by the payment of instalments of principal or otherwise ;
e) in the case of convertible debentures, the date and terms on which the debentures may be converted into shares and the amounts which may be credited as paid up on those shares, and the dates and terms on which the holders may exercise any right to subscribe for shares in respect of the debentures held by them, and
f) the charges securing the debenture and the conditions subject to which the debenture shall take effect.

[17] Section 193 CAMA 2020

The statements embodied in a debenture are mandatory as a matter of statutory stipulation. Moreover, the effect of a statement in a debenture is that it is a "prima facie evidence of the title to the debentures of the person named therein as the registered holder and of the amounts secured thereby." The statements operate as estoppel against the company in favour of any person relying on the statements and by reason thereof changes his position to his detriment. In other words, the company will be estopped from denying the continued accuracy of such statements and may be liable to compensate the person for any loss suffered in reliance on the statements. See section 194 CAMA 2020. **You will have the opportunity to be shown a real life instrument of debenture during the online facilitation classes**. As a debenture holder, do you have any rights apart from the right to be paid the principal and interest?

Self-Assessment Exercise 5

i) *Briefly recount the historical evolution of debenture.*
j) *Provide a statutory definition of debenture from any jurisdiction known to you.*
k) *Itemise no less than five statements that every debenture must embody.*
l) *Identify one critical statutory requirement of public issue of debentures?*

1.4 Summary

In this Unit, you have been exposed to the nature of debenture, including the history and definition of debentures. Debentures issued to the public must be accompanied by the creation of a trust. They are many types of debentures including redeemable debentures, naked debentures, secured debentures, etc. You also saw the statements which every instrument of debenture must contain.

1.5 References/Further Readings

Books, Journals, Online Resources and Other Publications

Ferran E. (2008). Principles of Corporate Finance Law. Oxford: OUP

Fuller, G. (2009) Corporate Borrowing: Law and Practice, 4th edition, Bristol: Jordans

Gullifer L. and Payne, J. (2011). Corporate Finance Law: Principles and Policy. Oxford: Hart Publishing

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Orojo, J.O. (2008). Company Law and Practice in Nigeria, 5th edition, Durban: LexisNexis

Legislations and Statutory Instruments

1. Companies and Allied Matters Act 2020

1.6 Answers to Self – Assessment Exercises

Self-Assessment Exercise 5

a) A brief history of debentures as recounted by Mayson et al holds that mall companies often took loans from private investors in units of, say, £100. For each £100 lent, an investor was given a certificate specifying his entitlement to interest and repayment of principal and giving him an individual right of recourse against the company's property if there was default in paying interest, or repaying the principal represented by that particular certificate. A set of certificates like this issued by a company is called a series of debentures.

b) Section 868(1) CAMA 2020 defines debenture as a written acknowledgment of indebtedness by the company, setting out the terms and conditions of the indebtedness, and includes debenture stock, bonds and any other securities of a company whether constituting a charge on the assets of the company or not.

c) The four statements to be found in a debenture are:

i. the principal amount borrowed,
ii. the maximum discount which may be allowed on the issue or reissue of the debentures, and the maximum premium at which the debentures may be made redeemable,
iii. the rate of and the dates on which interest on the debentures issued shall be paid and the manner in which payment shall be made,
iv. the date on which the principal amount shall be repaid or the manner in which redemption shall be effected, whether by the payment of instalments of principal or otherwise.

d) The critical statutory requirement for debentures issued to the public is that a trust must be created for it.

UNIT 2 DEBENTURE TRUST DEED

Unit Structure

2.1 Introduction

Understandably, when debentures are issued to the public it becomes necessary to constitute a trust to achieve orderly management of the debtor-creditor relationship created by the issue of debentures. Of course, the issue of debentures to the public will entail the presence of large number of diffuse and dispersed number of holders. It is therefore important that you are acquainted with the conditions for constituting a debenture trust, nature of interest created by debenture and the contents of a debenture trust.

2.2 Learning Outcomes

By the end of this unit, you will be able to:

- explain the basis of constituting a trust for debenture holders
- identify the three certainties
- discuss the contents of a debenture trust deed.

2.3 Debenture Trust

The idea of trust arises where the legal owner of a property is under duty to deal with that property in accordance with the terms of the trust for the benefit of the *cestui que trust*. In the context of debenture, a trustee is a person who is appointed and vested with the legal ownership of the debenture for the benefit of the debenture holders. As a trustee equity will operate on his conscience to compel him to carry out the purposes for which the debentures were vested in him and spelt out under CAMA.[18]

The requirement of trust for debenture holders is a condition precedent to the offer of debentures to the public.[19] If there are different classes of debentures, each class must have a trustee. Where the issuer company neglects or fails to make the appointment of a trustee, a debenture holder may approach the court for an order in that respect. One of the orders the court may make include compelling the company to execute a trust deed; directing that a person nominated by the court be appointed to be the trustee; and giving, as to the contents of the trust deed and its execution, such consequential orders as it thinks fit.[20] Beyond these, the company is liable for non-compliance with the requirement as to debenture trust deed. The penalty used to be a fine of N5,000 against the directors of the company jointly and severally.[21]

2.3.1 The Three Certainties of a Trust

As you have seen above it is statutorily mandated to constitute a trust where debentures are issued to the public. Yet, the <u>three certainties</u> which make for the validity of an express trust must always be present.[304] Can you remember the certainties you learned from your undergraduate Law of Equity class? Briefly the three certainties are:

a) there must always be *certainty of intention*[22] as between the trustee appointed under the deed and the borrower (issuer) and expressly stated to be so as clearly to be construed from the words. However, the intention must be construed as a statutory one. This is because the trust is not the product of the debenture holders and the issuer but of the issuer and the trustee.
b) there must be *certainty of subject matter*, which may be interest in land, chattels or money, or a chose in action, such as a covenant or a debt.[23] In our case it is a chose in action which is the money advanced by the debenture holders to the debtor now forming the debt being the subject matter of the trust deed.[24]

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[18] Section 211 CAMA 2020; Westdeutsche Landesbank Gironzentrale v Islington LBC (1996) 1 AC 669
[19] See sections 208 and 211 CAMA 2020
[20] Section 208(3) CAMA 2020
[21] See section 183(7) CAMA 2004 and compare section 208(7) CAMA 2020
[22] Re Kayford (1975) WLR 279; Re Pfrimmer Estate (1936) 2 DLR 460
[23] Martin, J.E. (1997), Hanbury & Martin Modern Equity (15th edn). London: Sweet and Maxell, p. 93
[24] Re Golay's will Trusts (1965) 1 WLR 969

c) there must be *certainty of objects*, which holds that a trust must be for ascertainable beneficiaries. The debenture holders, in whose benefits the trust is created, constitute the objects here.[25]

2.3.2 Nature of Interest Created by Debenture

The constitution of trust for debenture holders leads to two incidents. One, the general property in the debentures resides in the trustee, while the special property is locked in the debenture holders. By this the trustee becomes entitled to the legal ownership of the debentures; while the interest of the debenture holders becomes proprietary in respect of the trust property (i.e., the debentures). The beneficiaries can enforce their interests in equity against any subsequent holder of the property other than a bona fide purchaser for value of the legal interest (Gullifer and Payne, 2011:316). For instance, if the property is inconsistently dealt with, it can be traced to the proceeds thereof.

Two, the trustee has proprietary interest in respect of the security by which the debentures are secured. Thus, if the debentures are secured by a composite charge the proprietary interest created by the charge is locked in the trustee, who could approach the court for the appointment of a receiver if the assets constituted in the security are in jeopardy.

What is the nature of the interest created by naked debenture? Where the debenture constituted in the trust is naked, the nature of the security interest of the debenture holders becomes uncertain. Though the law regards the appointment of a trustee for holders of naked debentures as a form of security (section 211 CAMA 2020), the proprietary interest of the holders of naked debentures under such a trust is not more than a proprietary interest of a bare or naked character. In other words, if the company falls into insolvent liquidation, and its assets are insufficient to settle its liabilities, the position of the naked debenture holders is not different from that of unsecured creditors.

[25] Inland Revenue Commissioners v Broadway Cottages Trust (1955) Ch 20

2.3.3 The Contents of Debenture Trust Deed

The contents of a debenture trust deed is a matter of statutory requirement.[26] Deriving from this, Onamson (2017) classifies the contents of a debenture trust deed into financial provisions, security provisions, governance provisions and events of defaul provisions.[27] These provisions are briefly considered below.

a) Financial provisions. These will be found in every debenture trust deed. Fuller (2009) calls them "entrenched" provisions.[28] Examples of financial provisions to be found in a trust deed include the maximum sum which the debtor may raise by issuing debentures of the same class; if the debenture is issued at a discount or discount is to be allowed re-issue of the debentures, the maximum discount must be stated; the maximum premium at which the debentures may be redeemable; and the right of the issuer (the company) to redeem before the date of their redemption and to re-issue the debentures, etc. Specifically, Onamson (2017) argues that the interests of some debenture holders may be prejudiced by the imprecise and ambiguous provision regarding the way by which the amount borrowed is to be repaid (redeemed) by ballot.[29]

b) Security provisions. Certain debentures are issued on the back of a security created by way of charge over the undertakings or assets of the issuer or mortgage over its property. This does not prevent a company from issuing naked debentures.[30] Where a debenture is supported with charge or mortgage, it must contain provisions evidencing the nature of the assets over which a mortgage, charge or security is created by the trust deed in favour of the trustee. Can you recall the principle of attachment of security interest discussed last semester? The law firmly recognises the common law principles of attachment of security as a condition precedent to the enforcement of security created pursuant to a debenture.

c) Governance provisions. The debenture trust deed must provide for the powers of the company and the trustee to call meetings of the debenture holders and the rights of debenture holders to require the company or the trustee to call such meetings.[31] Onamson (2017) submitted that provisions on the alteration or abrogation of the rights of debenture holders must be viewed in context. Thus, any provisions in a trust deed

[26] See sections 209 and 210 CAMA 2020
[27] For a detailed reading, see Onamson, F.O. (2017). Law and Creditor Protection in Nigeria. Lagos: Malthouse Law Books. pp. 204-207
[28] Fuller, G. (2009). Corporate Borrowing, Law and Practice (4th edn). Bristol: Jordans, p. 218
[29] See section 209(1)(j) CAMA 2020
[30] British India Steam Navigation Co v IRC (1881) QBD 165
[31] Section 209(1)(l) CAMA 2020

purportedly altering or abrogating the rights of debenture holders or indeed any provision in the instrument of debenture must not be repugnant to the law. Otherwise, it will be voided to the extent of its repugnancy thereof.[32]

d) Events of default provisions.The debenture trust deed must provide for cases where the debenture holders shall be entitled to realise any security vested in the trustee and securing the debentures. Such provisions will include detailed affirmative covenants, (e.g., provisions relating to ongoing informational right of the trustee and negative covenants (e.g., the negative pledge clause) Despite this, where a trustee took the view that a material event of default adverse to its interest had occurred and accelerates the debt, but a case of wrongful acceleration is made out, the purported acceleration is ineffective.

Self-Assessment Exercise 6

a) *Explain the three certainties of trust in the context of a debenture trust deed.*
b) *State the contents of a debenture trust deed.*
c) *A trustee of debenture holders is not strictly speaking standing an analogous position to a trustee under a trust. Hence the strict rules of good faith do not apply. Discuss the validity or otherwise of this statement.*

2.4 Summary

In this Unit you learnt a trustee of debenture holders is a person who is appointed and vested with the legal ownership of the debenture for the benefit of the debenture holders. As a trust qua trust, you studied that the three certainties of trust must be present in a debenture trust deed. These certainties are certainty of intention, certainty of subject matter and certainty of objects. On the nature of debenture trust deed, you learnt that the general property in the debentures resides in the trustee, while the special property is locked in the debenture holders; and the trustee has proprietary interest in respect of the security by which the debentures are secured. Finally, you studied about the contents of a debenture trust, categorized into financial provisions, governance provisions, security provisions and events of default provisions.

2.5 References/Further Readings/Web Resources

Books, Journals, Online Resources and Other Publications

[32] Section 723 CAMA 2020

1. Ferran E. (2008). Principles of Corporate Finance Law. Oxford: OUP
2. Fuller, G. (2009) Corporate Borrowing: Law and Practice, 4th edition, Bristol: Jordans
3. Gullifer L. and Payne, J. (2011). Corporate Finance Law: Principles and Policy. Oxford: Hart Publishing
4. Onamson, F.O. (2017). Law and Creditor Protection in Nigeria. Lagos: Malthouse Law Books
5. Orojo, J.O. (2008). Company Law and Practice in Nigeria, 5th edition, Durban: LexisNexis

Legislations and Statutory Instruments

Companies and Allied Matters Act 2020

2.6 Answers to Self – Assessment Exercises

Self-Assessment Exercise 6

a) The three certainties in the context of a trust are:
   i. Certainty of intention as between the trustee appointed under the deed and the borrower (issuer) and expressly stated to be so as clearly to be construed from the words. However, the intention must be construed as a statutory one, since it is not the product of the debenture holders and the issuer but of the issuer and the trustee.
   ii. Certainty of subject matter, which may be interest in land, chattels or money, or a chose in action, such as a covenant or a debt. In our case it is a chose in action which is the money advanced by the debenture holders to the debtor now forming the debt being the subject matter of the trust deed.
   iii. Certainty of objects, which holds that a trust must be for ascertainable beneficiaries. The debenture holders, in whose benefits the trust is created, constitute the objects here.

b) The contents of a debenture trust deed are:
   i. Financial provisions
   ii. Security provisions
   iii. Governance provisions
   iv. Events of default provisions

c) The statement is not valid, because a trustee under a debenture trust deed is for all purposes a trustee qua trustee and all the strict rules of fiduciary obligation applies with equal force to him. As such a trustee he is appointed and vested with the legal ownership of the debenture for the benefit of the debenture holders. As a trustee equity will operate on his conscience to compel him to carry out the purposes for which the debentures were vested in him. Thus, he stands in fiduciary relationship towards the beneficiaries, which in this case are the debenture holders of the relevant class.

UNIT 3 THE DEBENTURE TRUSTEE

Unit Structure

3.1 Introduction

Under the general law, there is no limitation as to who can be appointed a trustee. However, this is not the case with respect to the appointment of a debenture trustee under CAMA 2020. While the law approves that any person can be so appointed, this is subject to disqualifying conditions. On appointment, the trustee assumes and exercises certain powers which can potentially expose him to liability. The good news is that there are cases, to a limited extent, where liability can be excused. These and more you will be studying in this Unit.

3.2 Learning Outcomes

By the end of this unit, you will be able to:

- explain the qualifications of the trustee of a debenture
- explain the duties, powers, and liabilities of the trustee
- discuss the situations the trustee can be excused from liability.

3.3 Debenture Trustee

Although the law does not insist on trustee belonging to any profession, the law is clear that any person, irrespective of his or her calling, falling within the disqualified class, cannot be a trustee of debenture holders in Nigeria. Thus, a debenture trustee is a person duly appointed as a trustee of debenture holders imbued with powers and authority of the office of a trustee of debenture holders. Unlike the position that allows for multiple directorships, a debenture trustee can only be appointed for one class of debenture holders.[33] That is a debenture trust deed covers only one class of debentures.

3.3.1 Qualifications of a Debenture Trustee

To be appointed a trustee of debenture holders, you must not be:[34]

a) an officer or employee of the company which issues debentures covered by the trust deed or of a company in the same group of companies as the company issuing debentures.
b) less than 18 years of age.
c) of unsound mind and has been so found by a court in Nigeria or elsewhere.
d) an undischarged bankrupt.
e) disqualified under section 283 from being appointed as a director of a company, but a corporation shall not be disqualified from being appointed as a trustee.

Under certain circumstances, a person not disqualified and duly appointed can subsequently become disqualified. In such a case, the law provides that such a person immediately ceases to be qualified. The natural thing to do in such a case is for the person concerned to vacate his or her office by resignation. However, if the person becomes recalcitrant and refuses to resign, he or she commits an offence and is liable on conviction as the Court deems fit, or to such fines as the Commission shall specify in the regulation.[35]

3.3.2 Duties of a Debenture Trustee

Gullifer & Payne (2011:331) advise that the trustee as a representative of the debenture holders must take:

> all the steps that one would expect a single lender to take to protect its interests. The trustee has a monitoring role, is expected to consider the seriousness of events of default and, if the default is serious enough, can accelerate and enforce payment of the bonds. The trustee is also able to negotiate restructuring on behalf of the bondholders and is able to agree minor modifications to the terms of the issue during the life of the bonds.

[33] Section 208(2) CAMA 2020
[34] Section 212 CAMA 2020
[35] Section 212(3) CAMA 2020. Companies Regulations 2021 issued by Corporate Affairs Commission in December 2020 has not made provision in this connection.

The above advisory is fortified by the stand of the law that the trustee, for the exclusive benefit of the relevant debenture holders, has the right to hold all contracts, stipulations and undertakings given to him and all mortgages, charges and securities vested in him in connection with the debentures covered by the deed, or some of those debentures. This duty aligns well with the common law duty to exercise his powers in the best interest of the debenture holders.[36]

It is also the duty of the trustee to safeguard the rights of the debenture holders.[37] Similarly, under the common law the trustee is bound by duty to preserve and safeguard the trust property.[38]

In carrying out his duties and exercising the rights and powers and discretions under the trust, he must act honestly and take reasonable care an ordinary prudent businessman would take in managing similar affairs of his own.[39] In other words, the trustee must show the degree of care and diligence required of a person occupying the position of a trustee.[40]

The duties of the trustee or debenture holder cannot be taken away by any means, except subject to the Act. Thus, the law upholds the validity of a provision in a trust deed or debenture that enables a meeting of the debenture holders by a resolution supported by the votes of the holders of at least three quarters in value of the debentures of that class in respect of which votes are cast on the resolution to:[41]

a) Release any trustee from liability for any breach of his duties to the debenture holders which he has already committed, or generally from liability for all such breaches (without necessarily specifying them) upon his ceasing to be a trustee.
b) consent to the alteration or abrogation of any of the rights, powers or remedies of the debenture holders and the trustee of the debenture trust deed covering their debentures. However, such a resolution cannot affect, whittle, or waive the remedy to realise the security or any asset subject to a mortgage, charge, or

[36] Armitage v Nurse (1998) Ch 241
[37] Section 201(2) CAMA 2020
[38] Re Brogden (1888) 38 ChD 546
[39] Speight v Gaunt (1883) 9 App Cas 1
[40] The principle is captured in Latin Maxim, *spondes peritiam***.** See the case of Hart & Hodge v frame, Son & Co (1839) 6 Cl & Fin 193
[41] Section 201(3) CAMA 2020

security, when the debenture holder or a receiver appointed in that respect becomes so entitled to realise the security.[42]

c) consent to the substitution for the debentures of a different class issued by the company or any other company or corporation, or the cancellation of the debentures in consideration of the issue to the debenture holders of shares credited as fully paid in the company or any other company.

The conditions under which the duty or liability of the trustee or a debenture holder can be varied ensures that the decision to tamper with the duties or modify the liability of a trustee is the collective decision of the debenture holders and not the unilateral decision of the issuer. Thus, a minimum of seventy five percent of the holders of the debenture of that class is required for such a meeting to hold to pass such a resolution. The provision firmly establishes in the context of debenture holders the hallowed view that "those who take interest in companies limited by shares have to accept majority rule."[43]

3.3.3 Benefits of Trusteeship Arrangement

The benefits of a trusteeship arrangement for orderly management of debenture holders' interests have been advanced to include the following:

a) The trustee brings specialist knowledge to the management of the trust, especially where the trustee is a juristic person.
b) The appointment of a trustee makes for orderly enforcement of the creditors' (debenture holders) rights, since it is possible to have a trust with a changing group of beneficiaries, so that the trust property is held by the trustee for the benefit of those who are debenture holders for the time being.
c) As pointed out by Fuller (2009:215) the appointment of a trustee avoids the mad bondholder syndrome and institutionalises the "no-action rule". Meaning that no individual debenture holder can institute an action with reference to the debenture, except where the trustee fails to act.

[42] See section 233 CAMA 2020 for a detailed provision on this aspect.
[43] Per Lord Wilberforce in Re Kong Thai Sawmill (Miri) Sdn Bhd (1978) 2 MLJ, Lord Wilberforce

d) The trust structure facilitates the right of realisation of security used to secure the payment of the loan, which can be achieved through the monitoring activities of the trustee.
e) When and if the trustee accelerates the debt and realises the security, he is a trustee of the proceeds of the realised security.

3.3.4 Exemption of Liability

Can these rights be avoided by contract so as to relieve the trustee from liability? The law provides that anything contained in a trust deed for securing an issue of debentures, or in any contract with the holders of debentures secured by a trust deed, is void if it would have the effect of exempting a trustee from or indemnifying him against liability for breach of trust, where, on the principle of *spondes peritiam artis*, he fails to show or display the appropriate degree of expertise, care and diligence required of him as trustee, having regard to the provisions of the trust deed conferring on him any power, authorities or discretion.[44]

Despite this seeming strict stance, the law watered down the provision when it made provision allowing the release of the trustee from liability by those holding not less than seventy five per cent in value of the debenture holders present and voting in person or by proxy at a meeting summoned for the purpose. Will it be correct to say that the provision against exempting trustee from liability is akin to a toothless bulldog?

Self-Assessment Exercise 7

a) What are disqualifying factors that can bar a person from being appointed a trustee under a debenture trust deed?
b) Mention any four benefits of having a trustee arrangement for any class of debenture holders.
c) What is the basic governance construct of a company limited by shares that tend to present it as a climate of survival of the fittest.

3.4 Summary

[44] Section 213(1) CAMA 2020

In this Unit you learnt about the qualifications of debenture trustee, the statutory duties of a debenture trustee, the benefits of trusteeship arrangement and exemption from liability in relation to trustees.

3.5 References/Further Readings

Books, Journals, Online Resources and Other Publications

Ferran E. (2008). Principles of Corporate Finance Law. Oxford: OUP

Fuller, G. (2009) Corporate Borrowing: Law and Practice, 4th edition, Bristol: Jordans

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Orojo, J.O. (2008). Company Law and Practice in Nigeria, 5th edition, Durban: LexisNexis

Legislations and Statutory Instruments

Companies and Allied Matters Act 2020

3.6 Answers to Self – Assessment Exercises

Self-Assessment Exercise 7

a) The disqualifying factors are:
   i. A person less than 18 years of age.
   ii. A person of unsound mind and has been so found by a court in Nigeria or elsewhere.
   iii. an undischarged bankrupt.
   iv. A person disqualified under section 283 from being appointed as a director of a company, but a corporation shall not be disqualified from being appointed as a trustee.

b) The benefits of trustee arrangement include:
   i. The trustee brings specialist knowledge to the management of the trust, especially where the trustee is a juristic person.
   ii. The appointment of a trustee makes for orderly enforcement of the creditors' (debenture holders) rights, since it is possible to have a trust with a changing group of beneficiaries, so that the trust property is held by the trustee for the benefit of those who are debenture holders for the time being.
   iii. As pointed out by Fuller (2009:215) the appointment of a trustee avoids the mad bondholder syndrome and institutionalises the "no-action rule". Meaning that no individual debenture holder can institute an action with reference to the debenture, except where the trustee fails to act.

c) The basic construct is majority rule. This is why it is often said that those that take interest in company limited by shares must accept majority rule.

UNIT 4 RIGHTS AND REMEDIES OF A DEBENTURE TRUSTEE OR DEBENTURE HOLDER

Unit Structure

4.1 Introduction

Onamson (2017) stated that the entitlements (rights) of debenture holders (creditors) whether exercisable by them or through a trustee represent the most visible expression of legislative protection of creditors. Being statutory they are unique and take precedence over any simile provisions under the general law.

4.2 Learning Outcomes

By the end of this unit, you will be able to:

- identify the statutory rights of debenture holders as creditors
- explain the extent of protection afforded creditors by the rights
- state the remedies afforded debenture holders.

4.3 Rights of Debenture Trustee/Debenture Holder

The entitlements of trustees are right to payment; right of action; right of realisation of security; and right of enforcement. Save for the right of enforcement deferred for later treatment in the course all other rights are considered in this Unit.

4.3.1 Right to payment

Every holder of a debenture covered by a trust deed is entitled, *ex debito justitiae*, to share in any money payable under the deed by the company. Also, the holder has a right to the benefit of any mortgage, charge or security created by the deed whether alone or together with others. As to a trustee, he is entitled to remuneration and where none is provided to apply "top slicing" to recover his reasonable expenses is permitted.

4.3.2 Right of action for recovery

All contracts, stipulations, undertaking, and security are vested in the trustee. According to Gullifer and Payne (2011:371) one of the purposes for constituting a trust for the debenture holders is to avoid "mad bondholder" syndrome. This is a situation where one or two cantankerous debenture holders (mad bondholders) purport to enforce their rights which, if allowed, could disadvantage all the other creditors.

In other words, individual debenture holders are discouraged from enforcing the loan in their individual capacity. This justifies the "no-action clause which provides that no bondholder can enforce its rights against the issuer unless the trustee has been directed to do so and has taken no action" usually found in debenture trust deed." Advantageously the trust structure avoids multiplicity of actions. What would be the fate of the debenture holders if the trustee refuses to take action in the face of actionable wrong against the bondholders?

In a case where the trustee refused to sue, a debenture holder may sue the issuer for payment of any amount payable to him in respect of the debentures.[45] Under the common law there is a procedure known as ***Vandepitte Procedure***.[46] The procedure allows a debenture holder to "bring what is effectively the trustee's action. The debenture holder will bring the action in his own name and join the trustee as defendant. Equally, the debenture holder can sue the trustee of the trust deed for compensation for any breach of the duties which the trustee owes him. This provision puts the trustee on notice that he is not at liberty as to the standard of care expected of him in the discharge of his duties under the trust. Is there any benefits why only the trustee is allowed to institute action in the respect of the debenture trust for the debenture holders?

[45] Section 201(1)(a) CAMA 2020

[46] Developed in the case of Vandepitte v Preferred Accident Insurance Corporation of New York (1933) AC 70. Cited in Gullifer and Payne (2011), p. 383

If the mad bondholder is let on loose and not restrained by the trust scheme, his action can give rise to early acceleration. This in turn can trigger cross-default clauses in other agreements which the issuer company has with other creditors. Eventually, this can potentially precipitate premature insolvency or liquidation of the debtor (issuer company). Hence, the wisdom and rule that all actions respecting the debenture of a class held by the trustee can only be commenced by the trustee of that class of debentures.

4.3.3 Right of realisation of security

The right to realise the security can only arise when the secured debt has fallen due, and the debtor defaulted in payment (of principal and interest). Even when the right arises, the creditor may decide to waive the right to enforce the security. A waiver does not amount to abandonment of the right. Thus, the idea of realisation presupposes the occurrence of an event of default pursuant to the debt contract entitling the creditor to exercise its right under the contract.

Where the debtor has fallen into a parlous state, the law encourages the creditor to distance himself from the debtor and pursue his rights under the debenture contract. In support the court reasoned that there is "nothing in the ordinary contract of lending which requires the lender to share in the borrower's misfortune."[47] Specifically, the law lays the crystallisation conditions which, if present, entitles the debenture holder to take steps and realise the security vested in him or any other person for his benefit (i.e., trustee under a debenture trust deed):

a) if the issuer company fails to pay any instalment of interest, or the whole, part of the principal or any premium, owing under the debenture or the debenture trust deed covering the debenture within one month after it becomes due.
b) The company fails to fulfil any of the obligations imposed on it by the debentures or the debenture trust deed.
c) The circumstances occur whereby the terms of the debentures or debenture trust deed entitled the holder of the debenture to realise his security.
d) The company is wound up.

[47] Per Gibson J., in Williams & Glyn's Bank Ltd v Barnes (1981) Comm LR 205

The above crystallising conditions[48] apply to debentures covered by security other than a general floating charge. Where the debenture is secured by a general floating charge, the law provides additional conditions which if they crystallise entitles the debenture holder to realise the security. Thus, the debenture holder secured by a general floating charge is additionally entitled to realise the security[49] if:

a) any creditor of the company issues a process of execution against any of its assets or commences proceedings for winding-up of the company by order of any court of competent jurisdiction.
b) the company ceases to pay its debts as they fall due.
c) the company ceases to carry on business.
d) the company suffers, after the issue of debentures of the class concerned, losses or diminutions in the value of its assets which in the aggregate amount to more than one half of the total amount owing in respect of debentures of the class held by the debenture holder who seeks to enforce his security and debentures whose holder ranks before him for payment of principal or interest.
e) the circumstances occur which entitle a debenture holder who ranks for payment of principal or interest in priority to the debentures secured by the floating charges to realise his security.

4.4 Remedies of Debenture Holders/Debenture Trustees

If the right to realise the security arises, the debenture holder or trustee of debenture trust or any other person may appoint a receiver of any asset in respect of which a mortgage, charge or security has been created in favour of the class of debenture holders or the trustee of the covering trust deed, or any other person.[50]

Those with power to appoint a receiver are the trustee, the holders of debentures of the same class containing the power to appoint, debenture holders having more than one half of the total amount owing in respect of all the debentures of the same class, and the court on the application of the trustee.[51] The powers of the receiver include to take possession of the assets subject to the mortgage, charge or security and sell those assets, among others.[52] The statutory remedies are not to substitute contractual remedies but to complement them as additional and further

[48] Section 232(1)(a)-(d) CAMA 2020
[49] Section 232(2)(a)-(e) CAMA 2020
[50] Section 233(1) CAMA 2020
[51] Ibid
[52] Section 233(3) CAMA 2020

assurance to the creditor (debenture holder or trustee of the debenture trust deed).[53] Expectedly, the parties do not have the power to contract out of the statutory remedies. Receivership will be treated in Module 4.

Self-Assessment Exercise 8

a) When does the right of a trustee to realise security said to arise?
b) What is the difference between statutory remedies of a debenture holder and contractual remedies of a trustee of debenture trust deed?
c) State any three supplemental or additional conditions that can give rise to right to realise the security by a debenture holder with security covered by a floating charge.
d) What is the difference between "rights" of a trustee and "remedies" of a debenture holder?
e) State one remedy that a debenture holder whose right has arisen can pursue before the courts.

4.5 Summary

This Unit treated rights and remedies of debenture holders or trustee of debenture holders under a debenture trust deed. The rights include right to payment, right to realization of security and right to action for recovery. On the other hand, there are remedies which inure to the benefit of debenture holders or trustees of debenture holders. The difference is that the right, when it arises gives the debenture holder the opportunity to pursue one or all the remedies which the law empowers him to obtain in the exercise of his right. In other words, without the right arising, the remedy cannot be activated.

4.6 References/Further Readings/Web Resources

Books, Journals, Online Resources and Other Publications

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[53] Section 233(5) CAMA 2020

Orojo, J.O. (2008). Company Law and Practice in Nigeria, 5th edition, Durban: LexisNexis

Legislations and Statutory Instruments

Companies and Allied Matters Act 2020.

4.7 Possible Answers to Self – Assessment Exercises

Self-Assessment Exercise 8

a) The right to realise the security can only arise when the debt secured by the security has fallen and the debtor defaulted in payment (of principal and interest).

b) The difference between statutory remedies of a debenture holder and contractual remedies of a trustee of debenture trust deed is that in the case of the former remedies are prescribed by law while in the case of the latter the remedies are provided for in the contract between the parties.

c) The supplemental or additional conditions are:
   i. the debenture holder secured by a general floating charge is additionally entitled to realise the security, if:
   ii. any creditor of the company issues a process of execution against any of its assets or commences proceedings for winding-up of the company by order of any court of competent jurisdiction.
   iii. the company ceases to pay its debts as they fall due.
   iv. the company ceases to carry on business.

d) The difference is that the right, when it arises gives the debenture holder the opportunity to pursue one or all the remedies which the law empowers him to obtain in the exercise of his right. In other words, without the right arising, the remedy cannot be activated.

e) Once the right to realise the security has arisen, the debenture holder or trustee of debenture trust or any other person may appoint can appoint a receiver of any asset subject to a mortgage, charge or security in favour of the class of debenture holders or the trustee of the covering trust deed.

MODULE 3 SECURED CREDIT UNDER COMPANIES AND ALLIED MATTERS ACT 2020

Unit 1 Charge as a form of security interest
Unit 2 Fixed charge
Unit 3: Floating charge
Unit 4: Distinction between Fixed charge and Floating charge
Unit 5: Interests capable of creation under CAMA 2020

UNIT 1 CHARGE AS A SECURITY INTEREST

Unit Structure

1.1 Introduction
1.2 Learning Outcomes
1.3 Charge
  1.3.1 Definition of charge
  1.3.2 The nature of charge as a security
1.4 Summary
1.5 References/Further Readings/Web Resources
1.6 Possible Answers to Self-Assessment Exercises

1.1 Introduction

Recall what you studied in the first semester of the course. Generally, you learned about the concept of security interest. Specifically, you learned about form-based security interest regime and functional security interest system. The former constituted what is known as numerus clausus of security interest; while the latter represented unitary security interest and represented by the Secured Transactions in Movable Assets Act 2017. Finally, you learned about pledge, lien, and mortgage, the first three categories of numerus clausus of security interest. In this Module, focus is on the last numerus clausus of security interest, the charge.

1.2 Learning Outcomes

By the end of this unit, you will be able to:

- define charge as a form of security interest
- explain the nature of charge
- state the different types of charge.

1.3 Charge

When a company borrows money, it issues debentures evidencing the indebtedness. As you have seen earlier, the debenture can be secured or unsecured. If secured, the company has created an interest to secure the repayment of the loan. The security created may by way of charge.

1.3.1 Definition of charge

Atkin LJ, answering the question, 'what is meant by a charge?' in the case of National Provincial and Union Bank of England v Charnley (1924) 1 KB 431 said:

> ... where in a transaction for value both parties evince an intention that property, existing or future, shall be made available as security for the payment of a debt, and that the creditor shall have a present right to have it made available, there is a charge, even though the present legal right which is contemplated can only be enforced at some future date, and though the creditor gets no legal right of property, either absolute or special, or any legal right to possession, but only gets a right to have the security made available by an order of the Court. If those conditions exist, I think there is a charge.[54]

From the above statement, is there any difference between a charge and other types of numerus clausus of security interest (like mortgage and pledge)? You will see that there are two types of charge that can be created over an asset or property of the debtor. Do you think it is possible to create fixed and floating charge over the same asset to secure different liabilities? On the first question, a charge is different from a mortgage. A charge does not involve "a conveyance of proprietary interest."[55] Also as you will see, the right of foreclosure usually available to the mortgagee does not inure for the chargee. However, it is possible to create legal mortgage over land by way of charge.[56] As to pledge, the chargee, unlike the pledgee, cannot go into possession.

As regards the second question, it has been stated that by definition the existence of one (type of charge, e.g., fixed charge) excludes the other

[54] At page 449

[55] Gullifer, L. (Ed.) (2012 Rep). Goode on Legal Problems of Credit and Security, 4th edn. London: Sweet and Maxwell, p. 36.

[56] See section 109 Property and Conveyancing Law 1959, and section 18 Registration of Titles Law of Lagos State 1994

(type of charge, e.g., floating charge).[57] It means that a creditor can take fixed and floating charge over the same asset to secure different liabilities, but not the same liability. In practice, an instrument of debenture usually contains "both a fixed and floating charge, the former covering fixed assets and debts, the latter covering the remaining types of assets."[58]

1.3.2 The nature of charge

Security interest is defined as "pledge, mortgage, fixed charge or charge created as a floating charge, …"[59] This definition is ambiguous. Generally, it lumped all the species of interest within the numerus clausus of security interests as constituting one class. Specifically, it failed to disclose anything about the nature of charge (or of the other types of interests).

By its nature, charge is equitable; and in equity a charge is either fixed charge or floating charge. By its nature, a charge, where created, is a mere encumbrance and not a conveyance or assignment at law. It only exists in equity or by statute. Hence, the statutory fixed charge and floating charge created under CAMA.[60]

The main feature of a charge is that a certain property is made available as security for payment of a debt. It is a fixed charge if the property is appropriated immediately to the chargee upon the chargor's acquiring an interest therein.[61] On the other hand, it may be a floating charge, where the interest of the creditor (chargee) hovers and will be hovering over "a shifting fund of assets, while the debtor (chargor) is allowed to use the assets in the ordinary course of his business until a crystallization.

So far, you have been reading about the words fixed charge and floating charge. Intentionally, no attempt has been made to dwell on them. They represent the types of charges. In the subsequent units of this module you will study in greater detail the various types of charges.

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[57] Gough, W.J. (1978). *Company Charges.* Butterworths, London, p. 69
[58] McKendrick, E. (Ed). (2010). Goode on Commercial Law. 4 edn. London: Penguin Books, p. 630.
[59] Section 222(13) CAMA 2020. Pursuant to amendment of the section by Business Facilitation (Miscellaneous Provisions) Act 2022.
[60] Section 203 CAMA 2020
[61] Haque, AKM M. (2006). "The Floating Charge as a Security Device". University of Western Sydney Law Review 10(2):25

Self-Assessment Exercise 9

m) Bring out the characteristics of a charge from the description of the word by Atkin LJ.
n) Explain what you understand by the phrase "the main characteristic of a charge".
o) Charge is of equity jurisdiction. Albeit the equitable character of a charge is not known to be chameleonic, it has transmogrified significantly in Nigerian jurisdiction. Do you support this statement?

1.7 Summary

In this Unit, you learned about charge as a form of security interest founded in equity. Albeit, it has been clothed with statutory flavour when section 203 CAMA 2020 legislated on it. Despite being statutorily recognised in Nigeria, it still retains its equitable character; This is because it does not confer proprietary interest on the creditor but only gives an assurance that the assets subject to the charge will be made available for settlement of the obligation thereby secured. This however arises when an event of default has crystallised.

1.5 References/Further Readings/Web Resources

Books, Journals, Online Resources and Other Publications

Chiu I. H-Y. (2006). "The Legal Fabrication of Security Interests in the United Kingdom". *North Carolina Journal of International Law* 31(3):703

Davies, P.L. (2003). Gower & Davies' Principles of Modern Company Law, 7th edn. London, Sweet & Maxwell.

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Westbrook J.L. (2004). "The Control of Wealth in Bankruptcy" *Texas Law Review* 82:795, p. 808. Available online at http://ssrn.com/abstract=518802

Legislations and Statutory Instruments

2. Business Facilitation (Miscellaneous Provisions) Act 2022.
3. Companies and Allied Matters Act 2020.
4. Property and Conveyancing Law 1959.
5. Registration of Titles Law of Lagos State 1994.

1.9 Answers to Self – Assessment Exercises

Self-Assessment Exercise 9

a) The characteristics to be gleaned from the statement Atkin LJ:

i. The debtor evidence an intention to make its property or assets available for settlement of secured obligation.

ii. The general property in the assets subject to charge remains with the debtor, who can use them in the ordinary course of his business.

iii. The right to have the property made available to settle the obligation thereby secured is usually on the order of the court.

b) The main feature of a charge is that a certain property is made available as security for payment of a debt. It is a fixed charge if the property is appropriated immediately to the chargee upon the chargor's acquiring an interest therein. On the other hand, it may be a floating charge, where the interest of the creditor (creditor) hovers and will be covering over "a shifting fund of assets, while the debtor (chargor) is allowed to use the assets in the ordinary course of his business until a crystallization".

c) Yes, I support the statement for the following reasons:

i. CAMA 2020 at section 203 legislated on charge and fully recognises the concepts of fixed charge and floating charge.

ii. Notwithstanding, the equitable character of charge did not change. Although it has statutory power, it still retains its originality as one of equity jurisdiction.

UNIT 2 TYPES OF CHARGE – FIXED CHARGE

Unit Structure

2.1 Introduction

According to Onamson (2017) the types of charges capable of being created under the Act[62] are as-created floating charge, fixed equitable charge (more specifically identified herein as contingent specific charge) and deemed floating charge. In this Unit you will learn about fixed charge, as created fixed charge and contingent specific charge. The other types of charge will be discussed in subsequent unit.

2.2 Learning Outcomes

By the end of this unit, you will be able to:

- explain fixed charge
- discuss the categorisation of fixed charge.

2.3Fixed Charge

This is made up of "as-created fixed charge" and "contingent specific charge.'' An attempt will be made to explain and differentiate the two species of fixed charge.

2.3.1 As created fixed charge.

This is a charge "that without more fastens on ascertained and definite property or property capable of being ascertained or defined".[63]

[62] See, section 203 CAMA 2020
[63] Illingworth v Houldsworth (1904) AC 355

Fundamentally, it is a fixed charge. By its nature, it attaches immediately on creation. This is because the assets subject to the charge are permanently appropriated to the repayment of the debt thereby secured. This type of charge may be created over land, plant, and machinery, shares in other companies, credit balances in the debtor's own accounts, book debts and future property. Is it possible to create charge over credit balances in the debtor's own account? In other words, can a bank customer that got financial accommodation from his bankers effectively create charge over his own deposit account with the bank as security to payment of the debt obligation?

On the foregoing questions, Mullett J[64] held that it is conceptually impossible for a bank to take a security interest in a deposit by a customer. Can you hazard a guess for this position? One, the bank is a debtor to the customer in respect of the deposit. Two, the customer (debtor) being a creditor with reference to the deposit account, cannot become his own creditor and sue himself. How do you think this problem can be overcome by the bank? The bank, typically, can validly place restrictions on the debtor's right to withdraw sums from the deposit account. McKendrick (2010:652) writes that deposit accounts with a restriction on withdrawal or dealing is called "**flawed assets**." The mechanism of flawed assets does not vest any security interest in the bank. The flawed assets doctrine may no longer apply in Nigeria. Thus, with unitary security interest system powered by the STMA 2017, it is possible to create security interest in a deposit account.[65]

2.3.2 Contingent specific charge.

Formulated by Onamson (2017) contingent specific charge is "a crystallised floating charge under CAMA following the occurrence of any crystallisation events spelt out under the Act." Specifically, it is called "fixed equitable charge" under CAMA 2020.[66]

Although fixed by dint of crystallisation, it has the statutory audacity to decrystallise and thus refloat to become a "deemed floating charge." What would make a crystallised charge to transmute or transmogrify to a floating charge? Two factors or conditions have been advanced:

- **Condition 1:** A contingent specific charge can refloat to, once again, become a floating charge if a receiver or manager is

[64] Re Charge Card Services Ltd (1987) Ch 150
[65] See section 29 STMA 2017. It is also possible to create security interest over a deposit in the United States
[66] Section 203(2) CAMA 2020

withdrawn with the consent of the chargee, the (crystallised) charge shall thereupon be deemed to cease to be a fixed (contingent specific) charge and again to become a floating charge. The refloatation is conditional on the consent of the chargee that the receiver or manager be withdrawn. That is, the receiver or manager is debriefed. A receiver, who may be appointed out of court or by the court, is someone appointed to realise the security for the benefit of those on whose behalf he has been appointed.[67] A receiver is someone appointed to realise the security for the benefit of those on whose behalf he has been appointed.[68]

- **Condition 2:** A contingent specific charge by transmutation can become a floating charge if the chargee withdraws from possession before the charge has been fully discharged. Then the (crystallised) charge shall thereupon be deemed to cease to be a fixed (contingent specific) charge and again to become a floating charge.[69] What do you think will make the chargee (creditor) withdraw from possession? Two considerations account for this. First, if the creditor sees that the debtor has large pool of income-yielding assets subject to the charge, he could precipitate premature crystallisation of the charge. Having taken possession primarily to receive the income from the assets to pay off the debt, he could purport to withdraw from possession if he sees or perceives that the assets could no longer continue to yield sufficient income. Since the creditor will most likely leave the estate of the debtor in a worse state, the withdrawal is meaningless. It may send the debtor to the zone of insolvency. Second, it could be that the creditor entered into possession purposely to preserve the assets and prevent the debtor from dissipating them. In this case, if the chargor/debtor took steps to begin payment of the debt, it might as well turn out to be penny wise, pound foolish for the debtor.

The provision for decrystallisation or refloatation by transmogrification or transmutation of a floating charge is said to be a source of legal problems, leading to these questions being posed:

a) Is the provision for decrystallisation successful at re-enacting its kindred case law?

[67] Uwakwe v Odgowe (1989) 5 NWLR (Pt 123) 562
[68] Ponson Enterprises (Nig) Ltd v Njigha (2000) 15 NWLR (Pt. 689) 46; (2000) LPELR-6805
[69] Section 203(2) CAMA 2020

b) what will be the priority status of the deemed floating charge as against a floating charge created immediately prior to the transmutation; and
c) what will be the relationship between the contingent specific charge and as-created fixed charge that predated the refloatation and one which was-created post refloatation?

As to the first question, the provision for decrystallisation is a failed legislative attempt to re-enact the case law as far as decrystallisation of floating charge is concerned. Failing to capture all cases that could give rise to decrystallisation, the law is silent on what happens if, after crystallisation, the chargee did not enter possession or appoint a receiver but continued to supply the chargor goods (or to advance further credit) and allowed the debtor to trade and deal with the assets in the ordinary course. Does it amount to waiver by the chargee, so that the charge is still floating? Or does the charge become specific albeit enforcement is waived, so that at insolvency the chargee's interest will be that of a fixed chargee? Justifying the foregoing questions, Onamson (2017) believes that it would amount to allowing the debtor and the creditor to have the best of both worlds if the chargor is allowed to continue trading and the charge is taken to be fixed.[70] Such a position if allowed would create animal farm situation with reference to other creditors of the company.

On the second question, the issue will turn on what date should be reckoned with as regards the now transmuted floating charge. Is it the original date of its creation or the date in which it transmuted to floating charge from contingent specific charge? Unfortunately, the law did not provide guidance as to what happens to such a charge which becomes floating by way of transmutation. One can only seek guidance from the provision respecting priority of as-created fixed charges over floating charges.[126] Where the date of its original creation is reckoned with the issue will turn on whether the third party (in this case Creditor B) with intervening floating charge had notice of:

a. the original floating charge, in which case he will lose priority, if he had notice of the original floating charge, since the transmuted floating is a deemed floating charge.[71] or

[70] See Agnew v Inland Revenue Commissioners (Re Brumark Investments Ltd) (2001) 2 AC 710 and National Westminister Bank plc v Spectrum Plus Ltd (Re Sepctrum Plus Ltd) (2005) UKHL 41

[71] With notice, the deemed floating charge will take priority over the third-party intervening (new) floating charge, even if the third party took for value. This is because the transmuted floating charge is always DEEMED to be floating and not otherwise.

b. the yet-to-refloat contingent specific charge but not of the original floating charge and still proceeded to accept encumbrancing floating charge by the debtor, the intervening floating charge will lose priority, since a contingent specific charge stands in the position of as-created fixed charge, or

c. the deemed (refloated) floating charge but not of the contingent specific charge. The relation back effect of the transmuted floating charge will significantly improve the position of the deemed floating chargee. Thus, third party will lose priority.

As regards the third question, if the as-created fixed charge was made before the original floating charge (now contingent specific charge), it will have priority. If it was created on the day the original floating charge attached and became a contingent specific charge, it will lose priority because it is coming later in time to another fixed (specific) charge (albeit it is contingent). Conversely, if the as-created fixed charge is created post-transmutation of the contingent specific charge, the position of CAMA with respect to priority of fixed charge over floating charge would prevail.[72]

It is possible for deemed floating charge to have priority over as-created fixed charge post refloatation. However, two conditions must be met:

- there must be a stipulation in the deemed floating charge, and that stipulation must not be an afterthought which prohibited the company from granting any later charge having priority over the transmuted floating charge.[73] Such a stipulation must have been part of the conditions of the original floating charge, now refloated or deemed floating charge.

- the post transmutation as-created fixed chargee must have had actual notice of that prohibition at the time when the charge was granted to him. Without such notice, his equities will not be affected in any way, and he will sustain a claim to priority.

If the two conditions are satisfied and applying the principle of relation back to the deemed floating charge, any claim to priority of the post transmutation as-created fixed chargee would be defeated.

[72] Section 204 CAMA 2020
[73] Hallas v Robinson (1885) 15 QBD 288

Self-Assessment Exercise 10

a) *What are the conditions necessary for the presence of contingent specific charge?*
b) *What is flawed asset? To what extent does it operate in Nigerian jurisdiction?*

2.3 Summary

In this unit, you learned about the as-created fixed charge and contingent specific charge, which is a floating charge that crystallised but remains likely to transmogrify (change back) to become deemed floating charge.

2.4 References/Further Readings

Books, Journals, Online Resources and Other Publications

Davies, P.L. (2003). Gower & Davies' Principles of Modern Company Law, 7th edn. London, Sweet & Maxwell.

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Legislations and Statutory Instruments

1. Business Facilitation (Miscellaneous Provisions) Act 2022
2. Companies and Allied Matters Act 2020.

2.5 Answers to Self – Assessment Exercises

Self-Assessment Exercise 10

a) The conditions are: (i) a contingent specific charge can refloat to become a floating charge once again if a receiver or manager is withdrawn with the consent of the chargee, the (crystallised) charge shall thereupon be deemed to cease to be a fixed (contingent specific) charge and again to become a floating charge; (ii) a contingent specific charge by transmutation can become a floating charge if the chargee withdraws from possession before the charge has been fully discharged, the (crystallised) charge shall thereupon be deemed to cease to be a fixed (contingent specific) charge and again to become a floating charge.

b) Flawed assets refer to deposit accounts with a restriction on withdrawal or dealing. In the UK, the mechanism of flawed assets does not vest any security interest in the bank. However in Nigeria with unitary security interest system powered by the Secured Transactions in Movable Assets Act 2017, it is possible to create security interest in a deposit account.

UNIT 3 TYPES OF CHARGE – FLOATING CHARGE

Unit Structure

3.1 Introduction

The floating charge is said to be "one of the most suitable creations of equity," which has remained conceptually elusive notwithstanding "the volume of case law and literature devoted to its analysis."[74] For the English jurisdiction, this has been attributed to the nature of floating charge as "an interest not in specific assets but in a constantly changing fund of assets. English law has always found it difficult to grapple with the concept of a fund."[75] For Nigeria and in addition to the reasons attributable to the UK situation, the climate of case law and textual authorities on the subject of floating charge is absurdly near nonexistent and inexplicably disappointing. As you can see, this topic will make an interesting reading and study, so gird loins and let us go as we undertake an in-depth study into this critical equitable tool deployed by creditors to hedge the credit risk of the debtor.

3.2 Learning Outcomes

- By the end of this unit, you will be able to:Gain an in-depth understanding of floating charge.
- Know the conditions leading to crystallisation of floating.
- Distinguish between fixed charge and floating charge.

3.3 Floating charge

[74] Gullifer, L. (Ed.) (2012 Rep). Goode on Legal Problems of Credit and Security. London, Sweet & Maxwell, p. 121.
[75] Ibid

A "floating charge" has been profusely and comprehensively defined[76] as an equitable charge over the whole or a specified part of the company's undertakings and assets, including cash and uncalled capital of the company both present and future, but so that the charge shall not preclude the company from dealing with such assets until:

a) the security becomes enforceable and the holder thereof, pursuant to a power in that behalf in the debenture or the deed securing the same, appoints a receiver or manager or enters into possession of such assets; or
b) the Court appoints a receiver or manager of such assets on the application of the holder; or
c) the company goes into liquidation.

The above statutory definition aligns with the idea of floating charge as an equitable fiction conveniently deployed to enable, "present security to be taken over a shifting mass of present and future assets." It is a "charge over all the assets of a trading business which looked like fixed but had to be interpreted as floating in order to avoid business paralysis."[77]

Although floating charge has been hailed as the great invention of the equity,[78] it is likely that it can be exploited by corporate officers of an entity in the vicinity of insolvency. Mindful of this, the law questions and thus invalidates a floating charge on the undertaking or property of a company created within three months of the commencement of winding up. The transaction may survive if the going concern situation of the company was intact immediately after creating the floating charge.[79]

3.3.1 History of floating charge

Tracing the history of floating Lord Scot[80] recounted:

> By the middle of the 19th century industrial and commercial expansion in this country had led to an increasing need by companies for more capital. Subscription for share capital could not meet this need and loan capital had to be raised. But the lenders required security for their loans. Traditional security, in the form of legal or equitable charges on the borrowers' fixed assets, whether land or goods, could not meet the need. The greater part of the most entrepreneurial companies' assets would consist of raw materials, work in progress, stock-in-trade and trade debts. These were circulating assets, replaced in the normal course of business and constantly changing. Assets of this character were not amenable to being the subject of traditional forms of security. Equity,

[76] Section 203(1) CAMA 2020
[77] Moss, G. (2006). Fictions and Floating Charges: Some Reflections on the House of Lord's Decision in Spectrum. In Getzler J. and Payne, J. (Eds.) (2006). Company Charges: Spectrum and Beyond. Oxford, Oxford University Press, p. 2.
[78] Gullifer (Ed), op cit.
[79] Section 662 CAMA 2020
[80] Re Spectrum Plus Ltd (supra)

> however, intervened. Holroyd v Marshall (1862) 10 HLC 191 was a case in which a debtor had purported to grant a mortgage not only over his existing machinery but also over all the machinery which, during the continuance of the security, should be placed in his mill. The question arose whether the equitable title of the chargee in respect of new machinery that had been placed in the mill prevailed over the rights of a judgment creditor of the chargor/debtor. Could the chargee assert an equitable interest in the new machinery" Lord Campbell LC held that he could not. But the House of Lords reversed the decision, holding that "immediately on the machinery and effects being fixed or placed in the mill, they became subject to the operation of the contract, and passed in equity to the mortgagees and that in equity it is not disputed that the moment the property comes into existence, the agreement operates on it.

While it could be said that Holroyd v Marshall "opened the way to the grant by companies of security over any class of circulating assets that the chargor company might possess, full judicial acceptance was accorded to the floating charge in a transaction in which a company had issued debentures in 1866 charging its 'undertaking' with payment of the debenture debt.[81] In the case, the court construed the word "undertaking" to mean that the company will go on, and that the debenture holder could not interfere until either the interest which was due was unpaid, or until the period had arrived for the payment of his principal and the principal was unpaid. Thus, if the company was subsequently wound up, the charge became a *specific charge* on the assets which it then owned, and so the debenture holders ranked for payment before the general creditors.[82]

The debenture holder would not be entitled to an account or of any dealing with the property of the company in the ordinary course of carrying on their business. On this premise the court held that the debentures by which the company bound itself and all its estate, property and effects entitled the debenture holders to a specific charge on the assets of the company which it owned on winding up, but not while it is a going concern.[83]

The proper character of every charge created by a company charging "all its estate, property and effects", or "its real and personal estate" or "its entire undertakings" has always been floating which would ripen into a specific charge on crystallisation or insolvency. As the charge is

[81] Re Panama, New Zealand and Australian Royal Mail Co (1870) 5 Ch. App. 318
[82] Pennington R.R. (1960). "The Genesis of the Floating Charge". *Modern Law Review 23:630, p. 641.*
[83] Holroyd v Marshall (1888) 12 App Cas 523; Re Florence Land and Public Works Co., ex. p. Moor (1878) 10 ChD 530; a Re Colonial Trust Corporation (1879) 15 ChD 465; and Tailby v Official Receiver (1888) 13 App. Cas. 523

a security on the property and undertakings of the company as a whole,[84] at winding up, or upon crystallisation, realisation of the security can only on a going concern basis. It cannot be piecemeal by way of disentangling the assets and systems of the company in order to discharge the secured debt. This is the foundation of the duty of receiver and manager who has powers to continue and carry on with the business of the debtor.

3.3.2 Types of floating charge

Onamson (2017) categorised floating charge into three, namely as-created floating charge, deemed floating charge and general floating charge.

a) As-created floating charge. Per **Lord McNaghten**, as created floating charge is "too convenient a form of security to be lightly abolished."[85] According to Gough (1987) it is "one of the great legal success stories of Victorian times."[86] These glowing qualities of as created floating charge emanate from its very nature: the chargor is free to meddle with the charged assets and even take them away from the ambit of the security in the ordinary in so far as such dealings is not inconsistent with the interest of the chargee.

While meddling and dealing with the assets in the ordinary course, the floating charge interest watches, and hovers, over the assets subject to the charge to ensure that such meddling or dealing is in the ordinary course of business of the chargor only. In other words, it will be caught by **asset constraint** (the prime feature of fixed charge) if the chargor, by his actions purports to set up inconsistent interest to that of the chargee, the floating charge will berth and fix on the subject matter of the charge because such dealing cannot be dealing in the ordinary course of business of the chargor.

As noted earlier, the floating charge may be invalid if they are created within the twilight period before the commencement of

[84] Gardner v London, Chatham and Dover Railway (1867) 2 Ch App 201
[85] Salomon v Salomon (1897) AC 22
[86] Gough, W.J., "The Floating Charge: Traditional Themes and New Directions" in Find, P.D. (Ed), Equity and Commercial Relationships (Law Book Company, 1987), p. 239. In: Ferran, E. (2008). *Corporate Finance Law*. Oxford, UK: Oxford University Press, n. 145, p. 369

winding up.[87] In Nigeria, a charge created within three months of the commencement of winding up is valid (a) if the chargor was solvent immediately after the creation of the charge; (b) if the company was insolvent at the time of creation, to the amount of any cash paid to the company at the time; or (c) if the chargor was insolvent, to the amount of any cash paid subsequently paid pursuant to the charge.[88] The provision has been criticized:

i. It is capable of cutting deep into what otherwise would have been available for unsecured creditors.
ii. It could be exploited to secure past unsecured indebtedness.
iii. The condition which allows 'subsequent payment' flies in the face of the common law principle of anti-deprivation.[89] The principle deals with provisions in contracts entered before the company became insolvent which has a diminishing effect on the debtor's asset pool. The principle is subject to limitations. It applies only when there is actual reduction in the value of the asset. Hence, if the cash paid is equivalent to the security charged, the transaction will survive. This might have been within the contemplation of the drafters of the specific provision. But the law, loosely drafted, failed to bring out the principle clearly with the result that confusion and abuse can herald the implementation of the provision.

Generally, the floating charge has been criticized as an irrational "strategy for a lender seeking to gain priority over other creditors in a useful way." This is due to the fact that any prior fixed chargee or subsequent fixed chargee without notice will always rank in priority. Alternatively, enforcing the floating charge pre-insolvency of the debtor is the best choice but with the likelihood that preferred payments will seriously erode the chargee's intake.[90]

b) <u>Deemed floating charge</u>. This is the same as a contingent specific charge (called fixed equitable charge under the Act and discussed earlier) that transmogrified by decrystallisation or refloatation to become floating charge. In the eye of the law, it never changed its character; albeit it became floating charge by transmutation the

[87] This was first introduced by section 13 English Companies Act 1907.
[88] Section 662 CAMA 2020.
[89] See Perpetual Trustee Co Ltd v BNY Corporate Trustee Services Ltd (2009) ECWA Civ 1160
[90] Section 207(4) CAMA 2020 preferred payments are subordinated to the fixed charge but does not extend to floating charge (section 207(1) CAMA 2020. For the provision on preferred payments, see section 657 CAMA 2020.

law takes the position that it never crystallised in the first place. Hence, the use of the word 'deemed' to qualify it. Deemed floating charge creates artificiality as the word 'deemed'[91] treats something as if it has qualities that it does not possess.

c) General floating charge. This is the same with as-created floating charge but differs in its scope as it is normally taken over the whole undertaking, business, and property of the company.

3.3.3 The nature of interest created by floating charge.

Several theories have been advanced on the nature of interest created by floating charge. They include:

a) It creates an immediate security interest of some sort that "by a complicated process of addition and subtraction it was possible to arrive at the assets of the company at the date when the charge crystallised and became enforceable.[92]
b) The creditor as chargee holds proprietary interests which are merely a modified, defeasible, form of fixed charge.[93]
c) The floating charge creates a present equitable security, but the holder thereof has no proportionable equitable proprietary interest until the floating charge has crystallised.
d) The floating charge creates a fixed charge with a licence given by the creditor to the debtor.
e) It is a present proprietary interest in a fund of assets.[94]

While you are encouraged to read up all the theories, what will be considered and treated here is the theory that floating charge creates a present proprietary interest in a fund of assets. The theory holds that though floating charge creates immediate proprietary interest it does not thereby change its character to become a mortgage. It nevertheless retains its ambulatory and hovering nature. It applies to every item or asset comprised in the security. However, it does not specifically attach to any item of asset until some event (crystallisation) occurs or some act

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[91] Garner, B.A. (Ed.). (1999). Black's Law Dictionary, 7th edn. Minnesota, West Publishing, p. 425.
[92] Pennington, R.R. (2001). *Company Law.* (8th edition) Butterworths London, pp 539-541
[93] Worthington S. (1996). *Proprietary Interests in Commercial Transactions.* Clarendon Press Oxford, pp. 79-86; Worthington, S., "Floating Charges: the use and abuse of doctrinal analysis". In Getzler & Payne (Eds), op cit, p. 38
[94] Gullifer (Ed), op cit, p. 126

on the part of the chargor is done that ripens and crystallises it into a fixed security (fixed charge).[95]

Pennington (1960) stated that the debenture holders can intervene only when they have obtained a specific charge on the company's assets. Disagreeing, Onamson (2017) argued that the door of justice cannot be shut against a debenture holder who approaches the court for an injunctive relief to preserve the assets subject to the charge if they are in jeopardy. Do you think the argument is correct? The argument is apt because the law provides a case where enforcement can occur before crystallisation. Specifically, the Court can, even if the floating charge has not become enforceable, appoint a receiver or manager if it is satisfied that the security of the debenture holder is in jeopardy. The security of the debenture holder is deemed to be in jeopardy if the Court is satisfied that events have occurred or are about to occur which render it unreasonable in the interests of the creditor that the debtor should retain power to dispose of its assets.[96]

Gullifer (Ed) states that floating charge is a present security in a fund of assets which the debtor company is left free to manage in the ordinary course of its business, though not necessarily completely free. To make the theory clearer, the concept of "fund of assets" was usefully compared to the activity of river Thames:

> In English law, a fund is considered to have an existence distinct from that of its components. The contents of a fund are constantly changing as assets are removed from the fund and new assets come into it, but the identity of the fund itself remains unchanged, in much the same way as the river Thames remains the river Thames despite the fact that the water in it is never the same from one minute to the next.

Using the above analogy, Gullifer (Ed) concludes that floating charge as a present security interest in a fund of assets means that:

a) as to present security, it is different from a mere contract to give security at a future date on the occurrence of a designated uncertain event; and
b) as to an interest in a constantly changing fund of assets, it is distinct from an agreement for a provision of security over a particular asset where attachment is postponed.

It is interesting to note that even the court had settled that the creditor with a floating charge "has a proprietary interest but its interest is in a

[95] Evans v Rival Granite Quarries Ltd (1910) 2 KB 979
[96] Section 205(2) CAMA 2020

fund of circulating capital, and unless and until the chargee intervenes it is for the trader, and not the bank, to decide how to run its business.[97]

3.3.4 Crystallisation of floating charge

As noted earlier, floating charge gives the debtor the latitude to continue, in the ordinary course of its business, to deal with the assets which are subject of the floating charge, remove them from the ambit of the security and even transfer them to third parties unencumbered by the floating security. However, transfer does not mean dealing in a way inconsistent with the rights of the chargee, like charging or assigning the assets to a third party or another creditor.

The flexibility of floating charge as a security is not in doubt. However, its disadvantage is that the debtor being in control of the assets subject to security means that the inherent risk that the debtor may dispose of the subject matter of the security unprofitably, thereby undermining the value of the security and potentially putting its solvency at risk.[98] To address the moral hazard of the debtor which this potentially threw up, the Court is statutorily empowered to appoint a receiver and enforce the security if the assets subject to the security fall into jeopardy before the occurrence of crystallisation event.[99]

Crystallisation is the process by which floating charge is converted into fixed (specific) security. It can arise under statute, by implication of the law or by agreement.

a) <u>Crystallisation by agreement</u>

Generally, crystallisation events forming the basis of agreement between the debtor and creditor include:

- a winding up order is made,
- An administrative receiver (Nigerian equivalent is a receiver and manager) is appointed.
- The company ceases to carry on business.
- A debenture holder takes possession.
- An event expressly provided for in the debenture occured.

[97] Per Lord Walker in Re Spectrum Plus (supra)
[98] Ferran, E. (2008). Principles of Corporate Finance Law. Oxford: OUP, p. 369
[99] Section 205(2) CAMA 2020

Crystallisation by agreement can be automatic where "the charge is made to crystallise on the serving of a notice of crystallisation on the company," or by notice, where crystallisation takes place on serving of a notice of crystallisation on the company.

b) Crystallisation under a statute[100]

The floating charge will crystallise by implication of the law if:

- the security becomes enforceable and pursuant to this a receiver or manager is appointed, whether by the court or out of court or the debenture holder enters into possession of such assets.
- The floating charge will also crystallise if the company goes into insolvent liquidation.
- Where the debenture is secured by general floating charge, crystallisation will occur if the chargor ceases to carry on its business.

Self-Assessment Exercise 11

a) *Explain common law anti-deprivation principle.*
b) *Identify one major criticism of floating charge as a means of securing the payment of debt.*
c) *The difference between fixed charge and floating charge is said to be a touchstone question. What is this touchstone?*
d) *Briefly discuss the relevance of Holroyd v Marshall in the evolution of floating charge.*

3.4 Summary

In this Unit you learned of the history of floating charge types of floating charge, the nature of interest created by floating charge, crystallisation of floating charge and distinction between fixed charge and floating charge. It is hope you will begin to apply the knowledge in your practice.

3.5 References/Further Readings/Web Resources

Books, Journals, Online Resources and Other Publications

Davies, P.L. (2003). Gower & Davies' Principles of Modern Company Law, 7th edn. London, Sweet & Maxwell.

[100] See section 232 CAMA 2020

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Legislations and Statutory Instruments

Business Facilitation (Miscellaneous Provisions) Act 2022

Companies and Allied Matters Act 2020

3.7 Answers to Self-Assessment Exercises

Self-Assessment Exercise 11

a) The principle deals with provisions in contracts entered before the company became insolvent which has a diminishing effect on the debtor's asset pool. The principle is subject to limitations. It applies only when there is actual reduction in the value of the asset. Hence, if the cash paid is equivalent to the security charged, the transaction will survive. This might have been within the contemplation of the drafters of the specific provision. But the law the law, loosely drafted, failed to bring out the principle clearly with the result that confusion and abuse can dovetail the implementation of the provision.

b) The floating charge has been criticized as an irrational "strategy for a lender seeking to gain priority over other creditors in a useful way.

c) The touchstone is whether the chargor is free to use the proceeds of the ostensibly fixed charge for his own purposes without the chargee's consent. Thus, the basic distinction between fixed and floating charge turns upon the ability of the chargor to deal with the charged assets, removing them from the ambit of the security without the consent of the chargee. The charge is fixed if and only if the chargor is required to preserve the charged assets, or their permitted substitutes, for the benefit of the chargee, either absolutely, or as part of the pool of charged assets standing as security for the chargor's obligation.

d) Holroyd v Marshall (1862) 10 HLC 191 was a case in which a debtor had purported to grant a mortgage not only over his existing machinery but also over all the machinery which, during the continuance of the security, should be placed in his mill. The question arose whether the equitable title of the chargee in respect of new machinery that had been placed in the mill prevailed over the rights of a judgment creditor of the chargor/debtor. Could the chargee assert an equitable interest in the new machinery" Lord Campbell LC held that he could not. But the House of Lords reversed the decision, holding that "immediately on the machinery and effects being fixed or placed in the mill, they became subject to the operation of the contract, and passed in equity to the mortgagees and that in equity it is not disputed that the moment the property comes into existence, the agreement operates on it. Holroyd v Marshall "opened the way to the grant by companies of security over any class of circulating assets that the chargor

UNIT 4 DISTINCTION BETWEEN FIXED CHARGE AND FLOATING CHARGE

Unit Structure

4.1 Introduction

So far you have been concerned with understanding and knowing what a fixed charge is as against a floating charge. In this unit, you will study about the difference between the two forms of security interest.

4.2 Learning Outcomes

- By the end of this unit, you will be able to:Know the tests for determining the differences between a fixed charge and a floating charge.
- Explain the explain the tests and apply them in a practical context.

4.3 Distinction between charges

In drawing the differences between fixed charge and floating charge several tests are usually applied. They include control test and nature of asset test. Control test is used here. You are encouraged to read up the nature of assets test.

4.3.3 Nature of Asset test

In the case of Re Yorkshire Woolcombers Association Ltd[101] where **Romer LJ** reeled out the features of floating charge. He said:

> I certainly think that if a charge has the three characteristics that I am about to mention it is a floating charge: (1) if it is a charge on a class of asset of a company present and future; (2) if that class is one

[101] (1903) 2 Ch 284

> which, in the ordinary course of the business, would be changing from time to time; and (3) if you find that by the charge it is contemplated that, until some future step is taken by or on behalf of those interested in the charge, the company may carry on its business in the ordinary way as far as concerns the particular class of assets I am dealing with.

With respect, **Romer LJ** appeared to have bundled up the nature of the subject matter that could be subject to a floating charge with the manner of taking out the security as the fulcrum of finding for the presence of a floating charge. From the description, no conceptual thought has been given to the exact relationship or weight of the two components relative to the other.[102] Due to Romer's seemingly faulty distinctive characterisation it was, for the first time, held that a company could create a fixed charge over its future debts.[103] Subsequent decisions of the courts diverged between the nature of assets[104] and the degree of control.[105]

Discussing the statement of Romer LJ, **Lord Millet**[106] stated among others that the first two features (in Romer LJ's description) are typical of a floating charge but are not distinctive of it. This is because they are not necessarily inconsistent with a fixed charge. It is the third feature which is the hallmark of a floating charge and serves to distinguish it from a fixed charge. Since the existence of a fixed charge constrains the asset and makes it impossible for the company to carry on business in the ordinary way without the consent of the charge holder, it follows that its ability to do so without such consent is inconsistent with the fixed nature of the security. The stage is now set for control test as a definitive basis for determining the difference between fixed charge and floating charge.

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[102] Chiu I. H-Y. (2006). "The Legal Fabrication of Security Interests in the United Kingdom". *North Carolina Journal of International Law* 31(3) 703, p. 719.
[103] Addy, C. (2010). "Fixed and Floating Charges over Book Debts – the Implications of the House of Lords' Decision in Re Spectrum Plus Limited (2005) UKHL 41, Part I". *International Corporate Rescue* (Special Issue), p. 12 Available online at http://www.chasecambria.com/site/journal/article.php%3Fid%3D219. Accessed 29/09/2014.
[104] On decisions based on the nature of the assets, see Re Cimex Tissues (1995) 1 BCLC 409; Re Atlantic Computer Systems Plc (1992) Ch 505 and Holroyd v Marshall (1888) 12 App Cas 523
[105] On the decisions based on this component, see Re Brightlife (1987) Ch 200.
[106] Agnew v Commissioner of Inland Revenue (Re Brumark Investments Ltd) (2001) AC 710

4.3.4 Control Test

Lord Millet[107] developed a two-stage process for deciphering the difference between a fixed charge and floating charge. According to him:

> At the first stage it must construe the instrument of charge and seek to gather the intentions of the parties from the language they have used. But the object at this stage of the process is not to discover whether the parties intended to create a fixed or floating charge. It is to ascertain the nature of the rights and obligations which the parties intended to grant each other in respect of the charged assets. Once these have been ascertained, the courts can then embark on the second stage of the process, which is one of categorisation. This is a matter of law. It does not depend on the intention of the parties...

a) Stage one. The parties' intention should be discovered from the language used. The purpose of this stage is to identify the specific rights and obligations which the parties granted to each other as far as the assets subject to security is concerned. Thus, if the rights and obligations do not give or donate what they purport, the document may be recharacterized for going against the doctrine of sham[108] or the principle of mislabeling.

Lord Diplock in a classic formulation of the doctrine stated that a sham means acts done or documents executed by the parties to the 'sham' which are intended by them to give to third parties or to the court the appearance of creating between the parties' legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create. One thing, however, is clear in legal principle, morality, and the authorities… that for acts or documents to be a 'sham', with whatever legal consequences follow from this, all the parties thereto must have a common intention that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating.[109]

b) Stage two. Subject to the outcome of stage one, the court proceeds to categorise the security arrangement. It is a matter of law and

[107] Ibid.
[108] Snook v London and West Riding Investments Ltd (1967) 2 QB 786
[109] Ibid

has nothing to do with the intention of the parties. That is where recharacterisation comes into the picture.

The control test helps to attribute the correct legal label to the package of rights and obligations of the parties. The court has applied the control test (using the two-stage process) to good effect.[110] Thus **Lord Walker** used the control test to draw out the difference between fixed charge and floating charge. For fixed charge, the assets charged as security are permanently appropriated to the repayment of the sum charged, in such a way as to give the chargee a proprietary interest in the assets. For floating charge, the debtor retains the power of control over the assets subject to the security. The chargee has a proprietary interest in a fund of circulating capital, and unless and until crystallisation the debtor's right to run its business and thereby make use of the assets in the ordinary course of its business, including to remove them from the ambit of the security, remains sacrosanct.

Therefore, the touchstone of the difference between the two is whether the chargor is free to use the proceeds of the ostensibly fixed charge for his own purposes without the chargee's consent. To this Worthington surmised that the basic distinction between fixed and floating charge turns upon the ability of the chargor to deal with the charged assets, removing them from the ambit of the security without the consent of the chargee. The charge is fixed if and only if the chargor is required to preserve the charged assets, or their permitted substitutes, for the benefit of the chargee, either absolutely, or as part of the pool of charged assets standing as security for the chargor's obligation.

Self-Assessment Exercise 12

c) *Identify and discuss the touchstone for determining the distinction between fixed charge and floating charge.*
d) *Why do you think the "nature of asset test" failed as a definitive basis for determining the difference between fixed charge and floating charge?*
e) *Define the doctrine of sham.*

4.4 Summary

[110] Re Spectrum Plus Ltd (supra)

Apart from the types of charges capable of being created under the Act[111] (as-created floating charge, fixed equitable charge (more specifically identified in this work as contingent specific charge) and deemed floating charge) which you studied earlier in this Module, you saw in this unit the defining characteristic between fixed charge and floating charge. The touchstone is in the nature of control exercised over the asset subject to charge and not necessarily the nature of asset.

4.5 References/Further Readings/Web Resources

Books, Journals, Online Resources and Other Publications

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[111] See, section 203 CAMA 2020

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Legislations and Statutory Instruments

Companies and Allied Matters Act 2020

4.6 Answers to Self – Assessment Exercises (SAEs)

Self-Assessment Exercise 12

c) The touchstone for determining the distinction between fixed charge and floating is control test. It rests on the foundation of freedom. Hence, it is floating charge if retains the power or ability to deal with the charged assets, including removing them from the ambit of the security without the consent of the chargee. Inversely, the charge is fixed if and only if the chargor is required to preserve the charged assets, or their permitted substitutes, for the benefit of the chargee, either absolutely, or as part of the pool of charged assets standing as security for the chargor's obligation.

d) To find why the nature of asset test failed, one must first of all take a tour of the statement of Romer LJ in the Woolcombers case. In that case he said: "I certainly think that if a charge has the three characteristics that I am about to mention it is a floating charge: (1) if it is a charge on a class of asset of a company present and future; (2) if that class is one which, in the ordinary course of the business, would be changing from time to time; and (3) if you find that by the charge it is contemplated that, until some future step is taken by or on behalf of those interested in the charge, the company may carry on its business in the ordinary way as far as concerns the particular class of assets I am dealing with." From the above statement, the first two qualifications of a floating charge may not really be correct. While they qualify as features of floating charge, it is not uncommon to find a fixed charge having similar qualities. It is the third quality that truly reflects the distinctive feature of a floating charge. It talks of the the ability of the debtor to deal with the assets and even remove them from the ambit of the charge in the ordinary course of business. In other words, the description bundled up the features of fixed charge and floating charge. To that extent, it is not possible that the nature of assets test can be a basis for deciding the distinction between fixed charge and floating charge. Inevitably, control test, which represent the third quality in Romer LJ's statement is understandably the touchstone for determining the difference or making the distinction.

e) In Snook v London and West Riding Investments Ltd (1967) 2 QB 786, Lord Diplock in a classic formulation of the doctrine stated a sham means acts done or documents executed by the parties to the 'sham' which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create. One thing I think, however, is clear in legal principle, morality and the authorities… that for acts or documents to be a 'sham', with whatever legal consequences follow from this, all the parties thereto must have a common intention that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating.

UNIT 5 INTERESTS CAPABLE OF CREATION UNDER COMPANIES AND ALLIED MATTERS ACT 2020

Unit Structure

5.1 Introduction
5.2 Learning Outcomes
5.3 Interests capable of creation under CAMA 2020
  4.3.1 Examples of Interests
  4.3.2 Registration
5.4 Summary
5.5 References/Further Readings/Web Resources
5.6 Possible Answers to SAE

5.1 Introduction

As you have seen earlier, it is intra vires the powers of a company to borrow money for the purpose of its business or objects and to mortgage or charge its undertaking, property and uncalled capital, or any part thereof, and issue debentures, debenture stock and other securities whether outright or as security for any debt, liability or obligation of the company or of any third party.[112] In other words, the law appreciates the necessity of credit in the life of a company. The law similarly made protections for the creditor by requiring that the assets of the company could be made available as security for repayment of the loan (principal and interest). It is not surprising the law requires that certain interests created by companies must be registered. This is where this unit comes in: to consider the interests capable of being created under CAMA 2020.

5.2 Learning Outcomes

At the end of this unit, you should be able to know the various species of interests which a company can create for purposes of securing the payment of money it borrowed for its business.

5.3 Interests capable of creation under CAMA 2020

The categories of interests which a company can create as security for payment of its debt obligation are specifically spelt out in the law.

[112] Section 191 CAMA 2020

Generally, the interests are within the province of charges, but may take various forms. This is what has been called examples of interests that a company can validly create to secure a financial accommodation.

5.3.1 Examples of interests that can be created.

The interests registrable under the law include a charge for the purpose of securing any issue of debentures; a charge over uncalled share capital of the company; a charge over a ship or aircraft or any share in a ship; a charge created or evidenced by an instrument which if executed by an individual would require registration as a bill of sale; a charge over land, wherever situate, or any interest therein, but not including a charge for rent or other periodical sum issuing out of land; a charge over book debts of the company; a floating charge over the undertaking or property of the company; a charge over calls made but not paid; and a charge over goodwill, on a patent or a licence under a patent, on trademark or on a copyright or a licence under a copyright (i.e., charge over intellectual property). For this course, one example of the interests will be considered, to wit charge over book debts of a company. You will benefit by reading up other examples in the course of your study.

<u>Charge over book debts of a company</u>

Book debt is a debt arising in the course of a business and due or growing due to the company that such a debt would or could in the ordinary course of such a business be entered in well-kept books relating to the business of the company.[113] Another definition sees book debts of a company as debts arising in a business in which it is the proper and usual course to keep books, and which ought to be entered in such books and includes a future book debts of the company.[114] It does not cease to be book debts simply because it is not entered in the books.

(a) What is the nature of charge over book debts?

The nature of charge over book debts of a company can be fixed or floating. On the cases, the test is who is in control or where does control reside? It is a fixed charge if and only if, the rights and obligations between the parties are sufficient to ensure that the charged assets are preserved for the benefit of the chargee.

[113] Independent Automatic Sales Ltd v Knowles & Foster (1962) 1 WLR 974
[114] Per Lord Esher MR in Tailby v Official Receiver (supra)

A charge is fixed which required the company to pay all book debt collections into an account specially designated for the purpose with the chargee bank. If chargee is in control, it implies that the chargor will be expressly prohibited from making drawings without the prior consent of the chargee sought and obtained.[115]

On the other hand, charge over book debts can be by way of a floating charge. This will be the case where the chargor has the liberty to remove the charged assets from the ambit of the security and use them, or their permitted substitutes, for its own benefit, rather than preserving them for the benefit of the chargee. Ultimately, the nature of charge over the book debts of a company turns on the touchstone question of whether the chargor has the freedom to use the proceeds.

(b) Bearing in mind that a creditor can take fixed and floating charge over the same asset to secure different liabilities but not the same liability, is it practicable to create fixed charge over the uncollected proceeds of book debts and contemporaneously create floating charge over its proceeds?

A company granted a charge over its book debts, expressed as a fixed charge over the uncollected book debts and a floating charge over their proceeds.[116] It was held that there were commercial advantages for both parties to these arrangements and that the parties were free to agree to such terms. It accordingly upheld the wording to the effect that the uncollected debt was a fixed charge.[117]

Several writers including Goode (1994) and Worthington (1997) have criticized the decision. Goode argued that it is not possible to create separate security interests over a debt and its proceeds. However, it is possible to create a single, continuous security that moves from debt to proceeds. Rejecting the argument that the book debts and its proceeds constitute an indivisible asset, Worthington postulated that the decision in the case was nevertheless flawed. She felt that the wrong decision was due to the fact that the security arrangement allowed the chargor the freedom to deal with the charged assets and remove them from the ambit of the security without recourse to the chargee. Such a dealing must be in the ordinary course.

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[115] Re Brumark Investments Ltd (supra) and Re Spectrum Plc Ltd (supra)
[116] Re New Bullas Trading Limited (1994) 1 BCLC 485
[117] Sealy, L.S. and Hooley, R.J.A. (2009). Commercial Law: Text, Cases, and Materials. Oxford, Oxford University Press, p. 1050.

As between the positions of Goode and Worthington, the court felt inclined to go with the latter. It ruled that to characterize a charge over book debts as fixed, both the uncollected book debts and their proceeds after collection must be under control of the charge holder.[118]

Specifically, in rejecting the decision in New Bullas case, the Court made the following pronouncements:[119]

> Their Lordships turn finally to the questions which have exercised academic, commentators, whether a debt or other receivable can be separated from its proceeds; whether they represent a single security interest or two; and whether a charge on book debts necessarily takes effect as a single indivisible charge on the debts and their proceeds irrespective of the way in which it may be drafted.
>
> Property and its proceeds are clearly different assets. On a sale of goods, the seller exchanges one asset for another. Both assets continue to exist, the goods in the hands of the buyer and proceeds of sale in the hands of the seller. If a book debt is assigned, the debt is transferred to the assignee in exchange for money paid to the assignor. The seller's former property right in the subject matter of the sale gives him an equivalent property right in its exchange product. The only difference between realizing a debt by assignment and collection is that, on collection, the debt is wholly extinguished. As in the case of alienation, it is replaced in the hands of the creditor by a different asset, namely its proceeds.
>
> The Court of Appeal saw no reason to examine the conceptual problems further. They held that, even if a debt and its proceeds are two different assets, the company was free to realise the uncollected debts, and accordingly the charge on those assets (being the assets whose destination was in dispute) could not be a fixe4d charge. There was simply no need to look at the proceeds at all…
>
> If the company is free to collect the debts, the nature of the charge on the uncollected debts cannot differ according to whether the proceeds are subject to a floating charge or are not subject to any charge. In each case the commercial effect is the same: the charge holder cannot prevent the company from collecting the debts and having the free use of the proceeds. But it does not follow that the nature of the charge on the uncollected book debts may not differ according to whether the proceeds are subject to a fixed charge or a floating charge, for in the one case the charge holder can prevent the company from having the use of the proceeds and in the other it cannot. The question is not whether the company is free to collect the uncollected debts, but whether it is free to do so for its own benefit…

[118] Agnew v IRC (supra) and Re Spectrum Plus Ltd (supra)
[119] Per Lord Millet, ibid

> To constitute a charge on book debts a fixed charge, it is sufficient to prohibit the company from realizing the debts itself, whether by assignment or collection. If the company seeks permission to do so in respect of a particular deb, the charge holder can refuse permission or grant permission on terms and can thus direct the application of the proceeds. But it is not necessary to go this far. As their Lordships have already noted, it is not inconsistent with the fixed nature of a charge on book debts for the holder of the charge to appoint the company its agent to collect the debts for its account and on its behalf. The Siebe Corman case[120] merely introduced an alternative mechanism for appropriating the proceeds to the security. The proceeds of the debts collected by the company were no longer to be trust moneys, but they were required to be paid into a blocked account with the charge holder. The commercial effect was the same: the proceeds were not at the company's disposal. Such an arrangement is inconsistent with the charge being a floating charge, since the debts are not available to the company as a source of its cash flow. But their Lordships would wish to make it clear that it is not enough to provide in the debenture that the account is a blocked account if it is not operated as one in fact…

(c) *What is the nature of a charge securing fluctuating amount?*

Section 227 CAMA 2020 provides that where a charge is expressed to secure all sums due or to become due or some other uncertain or fluctuating amount, it shall state the maximum sum deemed to be secured by such charge (being the maximum sum covered by the stamp duty paid thereon) and such charge shall be void, so far as any security on the company's property is thereby conferred, as respects any excess over the stated maximum. Such a charge remains valid if (a) additional stamp duty is subsequently paid on such charge; and (b) at any time thereafter prior to the commencement of the winding up of the company, amended particulars of the said charge stating the increased maximum sum deemed to be secured thereby (together with the original instrument by which the charge was-created) are delivered to the CAC for registration.

Once the steps are taken, the charge becomes effective to the extent of the increment. However, it only operates against any security interest acquired in respect of the same property after taking the steps. In other words, any proprietary interests acquired on the property before the date of registration of the increase are not affected.[259] In such a case, the interest of the creditor who acquired the security interest prior to registration of the increase will rank in priority to the extent of that increase. At the outset it must be pointed out that the provision is

[120] Siebe Gorman & Co Ltd v Barclays Bank Ltd (1979) 2 LR 142

applicable to all categories of interests which a company can create under CAMA. Its application is not limited to the book debts of a company. However, in this work, it is analysed in the light of the book debts of a company.

The only discernible purpose the provision serves is revenue generation for the government. This explains the emphasis on payment of stamp duty on the excess amount above the registered maximum. The provision can encourage collusive practices between secured creditors and debtors. The fear of collusion is rife because of the open-ended nature of the provision. For instance, under the English jurisdiction certain acts will be construed as anti- deprivation principle if they occurred within the relevant time at the debtor's insolvency. In other words, creditors with fixed charge security could easily collude with debtors to exploit this provision to balloon the value of their security by merely paying the stamp duties and observing the filing requirements. With respect to floating charge holders, it is submitted that this provision will be subject to the provision which spells out the effect of a floating charge created within three months while the company was being wound up Onamson (2017) argue that the provision on failed miserably to mimic the US Article 9 filing system where a single financing statement is required in the life of a credit relationship, whether the amount fluctuates or not. It should be noted thatthe regime of STMA 2017 transplanting the Article 9 UCC unitary system of security interest into Nigeria has made the use and filing of financing statement possible. However, this does not apply to security interests governed by CAMA 2020.

5.3.2 Registration[121]

When a company creates an interest on any of its property or undertakings it must take steps to comply with the requirements of the law as to registration of that interest. The requirement of the law relating to registration of interests created by companies is relevant in two respects. One, failure to register renders the interest void against the creditor and liquidator. The interest thereby created is subordinated to that of subsequent creditor with a registered interest over the same asset. Two, it is relevant to the operation of the priority of a legal interest over an equitable interest. A registrable but unregistered interest will be immediately available to the general body of unsecured creditors while secured creditors will rank in priority. Notwithstanding, the fears has

[121] Source: Onamson (2017). Law of Creditor Protection in Nigeria.

been allayed for an unregistered charge is still valid towards the company, and outside liquidation the chargee can exercise all remedies conferred by the charge. However, the charge is invalid against a secured creditor with perfected interest. Essentially a registrable charge which is not registered is fundamentally fatal to the case of the creditor/chargee. Therefore, the safe route is to register and avoid opportunities which could put the creditor in a tight corner.

In Nigeria, once a registrable interest is created by a company, the prescribed particulars of the charge together with the instrument by which the charge is created or evidenced must be delivered or received by the Commission for registration in the prescribed manner within 90 days after the date of its creation. In other words, any interest created by the company which falls within the categories of registrable interests must be delivered to the Commission for registration. Otherwise, the instrument of charge shall be void and the loan secured by the instrument shall be ordinary debt falling to be immediately payable. If this happens, the creditor can only enforce payment through an ordinary action for liquidated money demand. The word 'prescribed' can only mean the form of registration for such charges. In practice, it refers to the CAC 'Particulars of Charge' Form CAC-8 (Form MG01 in the UK).

Specifically, the particulars of the charge include date of the charge, persons (parties) entitled to the charge, the amount secured by the charge, and short particulars of the property, i.e., the subject matter of the charge. It is the duty of the chargor company to register the charge, albeit any other person can do it and claim for refund of the fees spent in so doing from the company. Failure to deliver the instrument of charge is attracts "such penalty as may be prescribed by the Commission for every day during which the default continues.[122] However, registration can be made out of time. On application to the court, it may be granted if it is shown that the registration will not prejudice the rights of other persons acquired before the registration is actually made. Importantly, it should be noted that an agreement to give a charge at some future date does not amount to a charge and is thus not registrable.

[122] Section 225(2) CAMA 2020. It used to be a specific amount under CAMA 2004, section 199(3)

Self-Assessment Exercise 13

a) *What are the arguments against the feasibility of maintaining a fixed charge over the uncollected book debts and at the same time creating floating charge over the proceeds of the book debts.*
b) *List at least five examples of registrable charge capable of being created under CAMA 2020*

5.4 Summary

In this you learned of the various examples of interests a company can grant as security. Specifically, the use of book debts to create security interest by way of a fixed charge or floating charge was exhaustively discussed. Now you know that to create a fixed charge over book debts the creditor must retain control in fact not in words. The question of registration was also discussed, comparing what obtains here to the UK.

5.5 References/Further Readings/Web Resources

Books, Journals, Online Resources and Other Publications

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Legislations and Statutory Instruments

Business Facilitation (Miscellaneous Provisions) Act 2022

Companies and Allied Matters Act 2020

5.7 Answers to Self – Assessment Exercises

Self-Assessment Exercise 13

(a) Goode argued that it is not possible to create separate security interests over a debt and its proceeds. However, it is possible to create a single, continuous security that moves from debt to proceeds. Rejecting the argument that the book debts and its proceeds constitute an indivisible asset, Worthington postulated that the decision in the case was nevertheless flawed. She felt that the wrong decision was due to the fact that the security arrangement allowed the chargor the freedom to deal with the charged assets and remove them from the ambit of the security without recourse to the chargee. Such a dealing must be in the ordinary course. As between the positions of Goode and Worthington, the court felt inclined to go with the latter. It ruled that to characterize a charge over book debts as fixed, both the uncollected book debts and their proceeds after collection must be under control of the charge holder.

(b) Examples of registrable charges under CAMA 2020 include:
- *(i)* a charge over a ship or aircraft or any share in a ship.
- *(ii)* a charge created or evidenced by an instrument which if executed by an individual would require registration as a bill of sale.
- *(iii)* a charge over land, wherever situate, or any interest therein, but not including a charge for rent or other periodical sum issuing out of land.
- *(iv)* a charge over book debts of the company.
- *(v)* a floating charge over the undertaking or property of the company.
- *(vi)* a charge over calls made but not paid.
- *(vii)* a charge over goodwill, on a patent or a licence under a patent, on trademark or on a copyright or a licence under a copyright (i.e., charge over intellectual property).

MODULE 4 CORPORATE INSOLVENCY[123]

Unit 1	Introduction to Corporate Insolvency
Unit 2	Company Voluntary Arrangements
Unit 3	Administration
Unit 4	US Chapter 11 Bankruptcy Procedure
Unit 5	Receivership
Unit 6	Arrangements and Compromise
Unit 7	Company Liquidation
Unit 8	The Insolvency Practitioner

UNIT 1 Introduction to Corporate Insolvency

Unit Structure

1.1. Introduction
1.2. Learning Outcomes
1.3. Corporate Insolvency
  1.3.1. Theories of Insolvency
  1.3.2. The Philosophy and Principle of Insolvency
  1.3.3. Tests of Insolvency
  1.3.4. Indicia of Insolvency Proceeding
  1.3.5. Corporate Insolvency Approaches or Mechanisms
1.4. Summary
1.5. References/Further Readings/Web Resources
1.6. Possible Answers to Self-Assessment Exercises

1.1 Introduction

When a company borrows money, it is expected to repay according to the terms of the debt contract. However, it is possible that the company may find it hard to cope with repaying the debt. Many reasons can account for this. It might be the company is on the tenterhooks of the ebb and flow business life cycle, against which nobody can prevent; or the governance systems, if any existed, were compromised; or the

[123] The Module is principally concerned with corporate insolvency. For a reading on private insolvency, see Eales, P. G. (1996). Insolvency: A Practical Legal Handbook for Managers. Cambridge, England: Gresham Books.

company's risk and compliance framework was faulty, assuming one has been in place. Companies can take carefully calibrated steps to avoid insolvency completely. Yet, businesses can, and do, fall into hard times due to the inevitable ebb and flow of business cycle.[124] Whatever the reason, if a company finds itself in such a situation, it should, expectedly, activate plans to walk itself out of trouble through friendly non-contentious restructuring mechanisms. Perhaps the Institute of Chartered Accountants of England and Wales (ICAEW) **Seven Stage Business Recovery Paradigm**[125] helpful guide for companies desirous of escaping the trap of insolvency might help. It is also useful to check out **The Ostrich's Guide to Business Survival by R3**.[126] Except the troubled company takes step to avoid insolvency, it should be prepared to face the uncertain future strewn with highly complicated and often litigious insolvency processes.

To process an understanding of the underpinning of insolvency systems, theories of insolvency law, based on normative framework, have been advanced. They include traditionalists and proceduralists schools. You will see the relationship between any or all of the theories and insolvency legislations that adopt and promote various types of corporate insolvency schemes, from rescue mechanisms to liquidation approaches. Corporate insolvency processes include company voluntary arrangements, scheme of arrangements and compromises, administration, receivership, and liquidation. The latter occurs where company's assets are taken to pay off the outstanding monies owed.[127] CAMA 2020 recognises and validate all these insolvency approaches.

1.2 Learning Outcomes

At the end of this unit, you will be able to:

- give a brief history of insolvency.
- state the theories that underpin insolvency regime.
- Explain the different types of insolvency.
- apply the approaches to insolvency in practical situations.

[124] Trevor v Whitworth (1887) 12 App Cas 409
[125] Accessed 23/5/2023.
[126] Accessed 1/7/2023
[127] Legal Practice Areas: Restructuring and Insolvency Law. https://www.law.ac.uk/employability/legal-practice-areas/restructuring-and-insolvency-law/. Accessed 12/2/2023.

1.3 Corporate Insolvency

Insolvency means inability to pay debts. On the rich **history of insolvency law,** you will do well to do a bit of reading on your own.[128] Meanwhile, Anderson (2016) noted that "insolvency law pre-dates company law by several centuries. The first insolvency legislation was passed in 1542, during the reign of Henry VIII. That was an Act dealing with the insolvency of individuals whereas modern company law and its attendant insolvency rules are generally understood to derive from the Companies Act 1862. Recognisable traces of the insolvency provisions of the 1862 Act survive to this day in the Insolvency Act 1986."[129] However, Levinthal (1919) traced the history to a period earlier in time than 1542, and successfully showed the connection of law merchant to bankruptcy.[130]

Generally, during the era when the thinking was *fallitus ergo fraudator,*[131] the bankrupt or insolvent was thoroughly stigmatised, chastised and severely punished. Then the creditor had the privilege of *de debitore in partes secando*[132] "to cut the debtor's body into pieces and share it out proportionately, according to the size of debts."[133] This harsh attitude has today given way to a more accommodating regime that seeks to rehabilitate the debtor if it is reasonably feasible to do so.

The last effigy of the brutality of bankruptcy regime of antiquity was the case of John Perott, who "feloniously concealed from his Creditors a great Part of his Estate and Effects"[134] and thereby feigned bankruptcy. Onamson (2017:72) recounted his story described as "hidden in a labyrinth of prevarication and perjury." He was summarily tried and hanged in November 1761.[135]

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[128] See Levinthal, L.E. (January 1919). The Early History of English Bankruptcy. University of Pennsylvania Law Review, vol 67(1), 1. Available online at https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=7675&context=penn_law_review; Gratzer, K. & Stiefel, D. (Eds). (2008). History of Insolvency and Bankruptcy from an International perspective. Available online at https://www.diva-portal.org/smash/get/diva2:15847/FULLTEXT01.pdf

[129] Anderson, H. (2016) 'An Introduction to Corporate Insolvency Law', *Plymouth Law and Criminal Justice Review*, 8, pp. 16-17. Available at: https://pearl.plymouth.ac.uk/handle/10026.1/9038

[130] Op cit, p. 3.

[131] Meaning, "insolvent thus a swindler."

[132] Said to the name of a law contained in the Twelve Tables. It means "of cutting the debtor in pieces." See The Law.Com Dictionary. Accessible at https://dictionary.thelaw.com/de-debitore-in-partes-secando/

[133] The Gazette (Official Public Record). The historical treatment and perception of bankrupts. https://www.thegazette.co.uk/all-notices/content/100723#:~:text=In%20ancient%20Roman%20law%2C%20the,t%20change%20an%20individual's%20character. Accessed 12/5/2023.

[134] Ibid.

[135] See also, Eales, P.G. (1996). Insolvency: A practical legal handbook for managers. Cambridge, Gresham Books, p. 4.

As to corporate insolvency, Eales (1997) recounts in the following words:

> The law regarding the insolvency of a limited company in England and Wales has developed along with the growth of the company as such. (…) The first Joint Stock Companies Act was passed in 1844. Until that time the shareholders of the 'company' had unlimited liability for the company's debts and there was little difference in practice between the insolvent liquidation of the company and the bankruptcy of the individual. Once the concept of limited liability was introduced in 1844 the whole manner of the winding up of a company had to be restated. The principle of the 'veil of incorporation' which was further developed with the case of Salomon v Salomon & Co Ltd (1897) provided vital new thinking. Thus, there developed two main ways (approaches) of winding up a company which cater for both the situation of the company and that of the shareholders. These are the voluntary liquidation and the compulsory liquidation.[136] (Words in bracket mine)

As you will see in due course, there are, today, more than two approaches to insolvency, whether in Nigeria or the United Kingdom. Various theories propped on normative perspectives have been developed to enable us to understand the efficiency and utility of each approach. These approaches have been examined. Insolvency, as you will see, is an event. When it occurs in the life of an entity, it takes one of two forms or both. At this point, what will be agitating your mind is, why insolvency regime in the first place? What is the function and benefit of insolvency law. These will be explored in the subsequent parts of the Unit.

1.3.1 Theories of Insolvency

What are the theories of insolvency law? Etukakpan (2014) explains that:

> There are numerous theories available for explaining phenomena in different areas of law. However, most theories of insolvency law are normative in nature. 'Normative' is a term of art. Although the term has specialised contextual meanings in different fields of study, it is however used specifically in law to describe the way something ought to be done according to a value position. Normative statements are value statements. They describe the actions and outcomes each theorist values. Thus, in the context of insolvency, normative theories express opinions to be valued or postulate what insolvency law ought to be.[137]

[136] Ibid, pp. 107-108.
[137] Etukapkan, S.E. (2014) The Lost Voice in Insolvency: Theories of Insolvency Law and their Implications for the Employees. *Nottingham Law Journal 23*, p.38

In other words, the theories of insolvency represent a scholastic attempt to set out what an ideal insolvency legal regime should be. Thus, where the theories are divergent and distant from the factual legal position, it should be the basis for further interrogation of the theories. Generally, there are two schools: the Traditionalist and Proceduralist. Laying out the differences between the two schools, Baird (1998) states that:

> The traditionalists' basic approach stems from a conviction that bankruptcy law plays a special role in our legal system and advances substantive goals that are both important and distinctive. This group contains not only scholars firmly ensconced in the academy but also practitioners and judges who write and are active in legal reform. (On the other hand, the proceduralists') distinctive characteristic is its focus on procedure and its belief that a coherent bankruptcy law must recognise how it fits into both the rest of the legal system and a vibrant market economy. (Words in bracket mine)

He summed that each school has its kindred theoretical assumptions or beliefs that arose from the divergent ways they answered three sets of questions, to wit:

- <u>First Set</u>: What role should bankruptcy law play in keeping a firm intact as a going concern? Should that role be anything more than determining whether keeping the firm intact makes economic sense…?
- <u>Second Set</u>: To what extent can one consider bankruptcy a closed or an open system? To what extent should bankruptcy rules be crafted with an eye to the way they affect the incentives of those who are involved with firms that are not in bankruptcy and have no immediate prospect of getting there? To what extent does bankruptcy law affect the way investors and entrepreneurs behave when a firm is in good financial health? Or, to put the matter differently, to what extent can courts shape bankruptcy law by focusing almost entirely on the parties before them and making sure that all the relevant interests are dealt with sensibly? *To what extent should the legal system focus on making the best of a bad situation that no one anticipated and in which the rights of all the players must be balanced along with those of the community as a whole?* (Italics mine).
- <u>Third Set</u>: Once a society settles on a particular substantive policy, how does it implement that policy?

Janger (2001) summarised the above three-set questions, thus:

(i) whether the Bankruptcy Code should seek to rehabilitate firms;
(ii) whether bankruptcy judges should alter non-bankruptcy entitlements in order to rehabilitate firms; and
(iii) whether bankruptcy judges are capable of distinguishing likely candidates for reorganization from firms that are destined to fail.

The paradigmatic proceduralist answers "no" to each question, while the paradigmatic traditionalist answers "yes" to all three.[138]

(a) <u>Proceduralist Theory</u>

As against traditionalists (discussed below), the proponents of this theory "contend that insolvency law should address issues that arise only within bankruptcy and non-insolvency creditors should not be protected by law unless doing so maximises value for creditors."[139] On this basis, insolvency has no business keeping a sick company on life support. The law should strive to prevent creditors' uncoordinated actions from precipitating premature insolvent liquidation of the company. As to secured creditors, their bargain should not be disturbed, whether in an insolvency setting as well as in a non-insolvency setting.

What is secured creditor's bargain? It is the priority the creditor secures against the assets of the debtor subject to the security. To proceduralists, "animal farm situation"[140] cannot be avoided with reference to the estate of the insolvent debtor. Therefore, the secured creditor should not be arm twisted by recognising the calls for fairness or equity of distribution, such as to employees, unsecured creditors, and other stakeholders, except they are to be implemented outside insolvency. Animal farm exposes the hollowness of the much touted "equality of treatment of creditors" in insolvency. It rides on the fact that in the debtors' insolvency all creditors (secured and unsecured) are equal, but some (secured) are more equal than others (unsecured). It lays bare the stark discrimination against the latter.

[138] Janger T. (2001), "Crystals and Mud in Bankruptcy Law: Judicial Competence and Statutory Design", 43 ARIZ. L. REV., pp. 559-566. Cited in: Shekar, M. and Guru, A. Theoretical Framework of Insolvency Law, p. 46. Available online at https://ibbi.gov.in/uploads/reResources/158497d3735f154918648288e56dfebc.pdf Accessed 30/5/2023.

[139] Alan Schwartz (1998), "A Contract Theory Approach to Business Bankruptcy", 107 Yale L. J. 1807, 1851. Cited in Ibid, p. 46.

[140] A phrase coined by Onamson (2017) referring to the secured creditor's leverage which thrives on discrimination by exclusion of the general body of unsecured creditors. It makes hopeless the insolvency paradigm of equality of creditors and creates a system in insolvency where all creditors (secured and unsecured) are perceived equal, but some (secured) are actually more equal than others.

Emphasising the point in relation to creditor's bargain as the fulcrum of proceduralists' postulation, Mooney (2004) stated that procedure theory:

a. insists that bankruptcy law exists to maximize the recoveries for holders of legal entitlements ("rightsholders") of a financially distressed debtor,
b. holds that it is generally wrong to redistribute a debtor's wealth away from its rightsholders to benefit third-party interests, such as at-will employees and the general community or to rearrange priorities in bankruptcy as among a debtor's rightsholders, and
c. explains what bankruptcy law is supposed to achieve, not how bankruptcy law is to achieve its proper ends.[141]

Chen, Azmi and Rahman (2021) added that proceduralists are a group of insolvency law theorists that share a common belief on the use of agreed procedures and bargains for the distribution of the debtor's assets among its creditors only. Various theories arose out of this school, including creditor wealth maximisation theory, creditor bargain theory and risk sharing theory. While you are encouraged to read them, two of them have been briefly considered below.

(i) **Creditor's Bargain (CB) theory.** Jackson (1982) developed the concept of creditors bargains between the creditors and the debtor. It expands on the role of insolvency laws to honour and respect the priority distribution of the debtor's assets first towards the claim of the secured creditors and subsequently among the general body of unsecured creditors.[142]

Precisely, CB assumes that creditors had at the time of extending financial accommodation to the debtor bargained collectively as a group for the distribution of the assets of the debtor in the event it slips into insolvency. The basis of the hypothetical bargain among the creditors was the law outside the insolvency regime. As a result, insolvency law must have respect for the arrangement. The net effect, it is proposed, is that "the priority interests of secured creditors followed by body of unsecured creditors agreed under the non-insolvency law are not to be tampered with under the

[141] Mooney, Jr. C.W. (2004). A Normative Theory of Bankruptcy Law: Bankruptcy As (Is) Civil Procedure. *Washington & Lee Law Rev.* 61 931 (2004). Available at: https://scholarlycommons.law.wlu.edu/wlulr/vol61/iss3/2

[142] Chen, T. W., Azmi, R., & Rahman, R. A. (2021). Theories of corporate insolvency: A philosophical analysis of the corporate rescue mechanisms under the Companies ACT 2016. *UUM Journal of Legal Studies*, *12*(2), 167-202, p. 174. Available online at https://doi.org/10.32890/uumjls2021.12.2.8

insolvency law."[143] In other words, the procedural law of insolvency should not disturb the substantive laws that determine and delineate the interests of creditors – secured and general body of unsecured creditors alike.

The drawback of CB theory is that it failed to recognise that non-adjusting creditors hardly bargain their fate in the event of insolvency. Importantly it did not reckon with the interests of employees as well as other stakeholders. This led to the rise of **Creditor Wealth Maximisation theory** (**CVM)**. You are encouraged to read up this theory,[144] which holds that the protection available to employees (as providers of labour) should be the concern of other areas of law covering all industries (solvent or insolvent) instead of insolvency law which deals with the wealth of creditors and debt collection only.

Albeit CB and CVM theories recognise the presence of the interests of other stakeholders (like the employees as the providers of labour and shareholders as the providers of capital) it asserts that insolvency law should be chiefly concerned and preoccupied with maximising the value of the pool of assets of the debtor in times of insolvency. This may explain why company law displaces and subordinates the interests of shareholders to that of the creditors. In fact, the paramountcy of creditors' interests in insolvency has been upheld in various jurisdictions.[145] Thus, where the company has slipped into insolvency or is doubtfully solvent, the interests of the company transmute to become the interests of existing creditors alone.

(ii) **Risk Sharing (RS).** This is a modification of CB which has been criticised as suffering from an unrealistic presumption that "creditors would agree to alter pre-existing contractual priorities."[146] In other words the redistribution of wealth at the debtor's insolvency is inadequate and inefficient. RS pursues the goal of maximising general value of available assets and reResources of the debtor for

[143] Ibid, p. 175

[144] Baird, D.G. and Jackson, T.H. (1984). Corporate reorganizations and the treatment of diverse ownership interests: A comment on adequate protection of unsecured creditors in bankruptcy. *University of Chicago Law Review, 51*, 97-130; and Etukakpan, S.E. (2014). The lost voice in insolvency: Theories of insolvency law and their implications for the employees. *Nottingham, L.J., 23*, 34-65.

[145] In the UK in Brady v Brady (1987) 3 BCC 535; in Malaysia in Emporium Jaya (Bentong) Sdn Bhd (in liquidation) v Emporium Jaya (Jerantut) Sdn Bhd, (2002) 1 MLJ 182

[146] Jackson, T.H. and Scott, R.E. (1989). "On the nature of bankruptcy: An essay on bankruptcy sharing and the creditors' bargain", *Virginia Law Review, 75(155)*, p. 168.

the benefit all claimholders. How can RS achieve this goal? It seeks to achieve this goal by compelling "all claimholders to partake or share in some part of the collective risk of the entity especially as relating to possible business failure."[147] Do you think there is a relationship between the theoretical assumption and the "prescribed part" obtainable under the UK insolvency regime?[148] What legislative reforms do you suggest for Nigeria in this regard?

Miles (2011) posits that the risks an enterprise faces are twofold:

- common, economic-wide, industry specific or government policy risks which are exogenously determined and beyond the control of the management. That is, they are uncontrollable risks and include "economic-wide global downturn, industry specific challenges and government policies," among others.
- company-specific risks arising from endogenous Resources. They relate "to both existential and lower level risks that may arise chiefly from managerial opportunistic behaviour and the managerial predilection for risk bearing."[149] They are endogenously based and therefore constitute controllable risk elements.

The creditors can bargain and choose to bear one or other type of risks. The legal regime governing insolvency can provide a manner in which this sharing of risk of bankruptcy is handled so that <u>all participants are able to obtain optimum value</u>. Is it practicable to have a system where optimum value is available for claimholders in insolvency? This is highly doubtful.[150]

(b) <u>Traditionalist Theory</u>.

The traditionalists believe that any corporate insolvency regime should as much as possible aspire to address the interests of all stakeholders. In other words, the objective of insolvency law should be to reorganise a necessitous company weighed down by financial distress and avoid liquidation so as to maintain the going concern value of the business and preserve the company itself. In essence, traditionalists build their foundation on the principles of fairness and equity for all stakeholders. They believe this approach enhances the chances of reorganising a

[147] B.O. Adegbemi and E.O. Ayooluwa (2017). Bankruptcy and Insolvency: An Exploration of Relevant Theories. *International Journal of Economic and Financial Issues, 7(3), 706-712,* p. 708.
[148] See section 176A Insolvency Act 1986
[149] Ibid, p. 709.
[150] For example, section 657(6)(a) CAMA subordinated all interests in insolvency to secured creditors leverage. In section 745 CAMA a lip service provision pretended to take care of employees' interests.

financially troubled entity and reduces the opportunities for insolvency.[151]

Out of the traditionalist base, grew the Multiple Values Theory, Communitarian Vision and alternative theoretical approaches aligned with traditionalist theoretical framework like Explicit Value Approach, and Authentic Consent Model. We shall take a brief look at two of them.

(i) **Communitarian Vision (CV).** Adopts enlightened value approach by focusing on public interest. Beyond the interests of creditors, other stakeholders' interests are considered equally paramount. They include employees, suppliers, clients (customers), government and local community. CV holds the view that the interdependent nature of human beings should incentivizes them "to act in the best interest of their communities, even if doing so prejudices their own individual freedom." It is permissible to vary pre-insolvency rights if this would further the interests of the community.

On this footing insolvency procedures that seek to rehabilitate commercial enterprises should be one which would have a better result for the community in protecting jobs even at the expense of some other rights. According to this theory, the survival of the company as well as efficient liquidation of the entity should be the central focus of any insolvency law.

The CV paradigm has been criticised as being riddled with shortcomings. One of them is that it lacks focus, which is evidenced by the "extensiveness of interests to which it refers." This is antithetical to the necessity of focus required in the design of insolvency law. In fact, the number of community interests at stake in each insolvency are infinite; and their boundaries are limitless. It is thus impossible to delineate the community as the CV sought to make us believe. Another drawback of CV is that albeit community interests may be identified, there are so many potential interests in every insolvency and choosing the interest worthy of legal protection is bound to create substantial argument.[152]

At this point, it needs to be pointed out that CV fairly corresponds with another traditionalist theory, Multiple Values (MV) theory, propounded by Warren (1993). Among other propositions, MV posits that "insolvency must, in reality, deal with a distressed company's multiple defaults and distribute the consequences of

[151] Ibid.
[152] Azmi, R. and Razak, A.A. (2013). Theories, Objectives and Principles of Corporate Insolvency Law: A Comparative Study between Malaysia and UK. 3rd International Conference on Management.(3rd ICM 2013) Proceeding. p. 668. Available online at http://repo.uum.edu.my/id/eprint/12310/1/2809141031.pdf

these defaults among the various players who are affected by the company's insolvency, corresponding to their different rights and values." Even financially distressed entity can and do have a great potential. Therefore, insolvency regime should explore other liquidation alternatives that considers such issues as preserving companies, protecting employees and the interests of other stakeholders. Agreeably, rehabilitation of distressed entities should be the preferred choice because the effect of insolvent liquidation of a company can be deleterious as pointed out by Millet J thus:

> The liquidation of an insolvent company can affect many thousands, even tens of thousands, of innocent people. …In the case of a major trading company it can affect its customers and suppliers and the livelihood of many thousands of persons employed by other companies whose viability is threatened by the collapse of the company in liquidation. An insolvent liquidation cannot be dismissed as 'just a case about money.'[153]

(ii) **Explicit Value Approach (EVA)**. Unsatisfied with the drawbacks of traditionalists and proceduralists theoretical frameworks, Finch (1997) developed the EVA.[154] According to her proceduralists are enmeshed in the myopic focus on creditor's interests while the traditionalists failed to provide reliable measures of the values that need to be considered in the insolvency law. To overcome these limitations, she proposed four values "as appropriate measures of the insolvency law. They are:

- <u>Efficiency</u>, referring the securing of democratically mandated ends at lowest cost.
- <u>Expertise</u>, meaning the allocation of decision and policy functions to properly competent persons.
- <u>Accountability</u>, suggesting the control of insolvency participants by democratic bodies or courts or through the openness of processes and their amenability to representations.
- <u>Fairness</u>, accounting for issues of justice and propensities to respect the interest of affected parties by allowing such parties access to, and respect within, decision and policy processes.

Finch noted that the inevitable challenge of EVA remains the difficulty of determining each value when trade-offs between the values is present. Such trade-offs arise chiefly from the fact that EVA considers "the public and private, the procedural and substantive, and the contractarian and democratic dimensions of insolvency." A typical example of the challenge of trade-off has to do with "protections for secured creditors and employees with their differing interests in the financially distressed

[153] Re Barlow Clowes Gilt Managers Ltd (1991) BCLC 750, at p. 760.
[154] Finch, V. (1997). The Measures of Insolvency Law. *Oxford Journal of Legal Studies, 17,* 227-251.

company, as dependent on the weightage and priorities that were accorded to each value in a particular society and political setting."[155]

Moreover, Mokal (2003), who developed **Authentic Consent Model** (ACM)[156] criticised EVA which he said, "failed to differentiate between the procedural and substantive objectives in the insolvency law."[157] By substantive objectives of law it is meant the "goal or end which the law strives to attain." In light of this, examples of the substantive objective of corporate insolvency law will include:

- To be just to all the relevant parties.
- To treat parties as equals.
- To provide a fair scheme of co-operation under the circumstances peculiar to insolvency.
- To show equal concern and respect for the interests of all those facing such circumstances.

Considered in light of the examples, out of the four values only 'fairness' matches the criteria and meets the qualification of the substantive objectives of insolvency law. This leaves the other values (efficiency, expertise, and accountability) at the level of procedural objective, which is concerned with the methods employed to secure the achievement of substantive objectives of insolvency law. Thus, fairness represents the ends or objectives which the law seeks to attain; 'efficiency, expertise and accountability represent the means to achieve the goals.[158]

1.3.2 The Philosophy and Principle of Insolvency Law

According to Armour (2001):

> Policymakers, judges and scholars disagree as to which goals it is appropriate for insolvency law to seek to further. These differences occur at several levels, and consequently proponents of particular positions often end up talking past one another. First, there are conflicting views on the positive question of which goals or values

[155] Chen, et al, op cit, p. 180.
[156] Mokal, R.J. (2001). The authentic consent model: contractarianism, creditors' bargain, and corporation liquidation. *Legal Studies, 21*, 400-443. Mokal had argued that the proceduralists' view, specifically creditors' bargain theory, is too idealistic, unsupportable, and unsustainable in a real-life context. The ACM rests on justice and reciprocity as its foundation. Justice enjoins all stakeholders affected (or to be) affected by insolvency law to be treated equally. It assumes equality of treatment of all parties. Reciprocity assumes that since all parties are "free and equal, and as fully co-operating members of society, each party has a vested interest "to reciprocate the treatment accorded by others in the same group who are affected in the insolvency proceedings. In this way the aims of ACM founded in reciprocity is a form of fairness would be upheld.
[157] Mokal R.J. (2003). On Fairness and Efficiency. *The Modern Law Review, 66, 452-467.* Cited in: Chen, et al, ibid, p. 180.
[158] Ibid. p. 181

> insolvency law does reflect. Secondly, there is a normative debate over which policy goals insolvency law ought to target. Finally, there are prescriptive differences over questions of implementation – how the law should be structured so as to reach a given goal.[159]

On the one hand, Armour used positive legal analysis based on the works scholars to find support for the proposition that insolvency law is "a collective debt collection mechanism" that exists to maximise returns to creditors.[160] For example, the interests of creditors trump all other stakeholders interests once a company begins to struggle financially. The directors would owe their duties of loyalty to the creditors, not the company. The directors labour under the pain of liability for wrongful trading if, knowing or ought to have known, that there was no reasonable prospect of avoiding insolvent liquidation they continued trading.[161] Notwithstanding, creditor maximisation stance is open to challenge. For instance, in a liquidation preferred debts rank in priority over unsecured creditors. This example can be criticised as half-hearted since the interest of secured creditors remain unaffected.[162] The first of the hierarchically ordered objectives of administration (which is rescue) does not support creditor centric position. On the other hand, Armour engaged normative prescriptive criteria (theories) to seek out the goal of insolvency law. You have studied some of the theories[163] and need not be repeated here.

Anderson (2016) alludes that insolvency is propped on the philosophy of the indispensability of credit in a modern free market economy. Where there is credit the potential for default is inevitable. The prospect of default implicates the need for efficient mechanism to deal with the outcome. It is only an efficient mechanism outlining how the assets of the financially troubled debtor should be handled that can curb the "grab rule of first-come first-served", which can potentially kill viable entities.

Adler (1997) noted that "if a debtor firm is more valuable as a going concern than in piecemeal liquidation, bankruptcy law is beneficial to the extent it protects a debtor from dismemberment." Were it not so, the grab rules of non-bankruptcy law and their allocation of assets on the basis of first-come, first-served would create an incentive on the part of the individual creditors to levy execution against the assets of the debtor and thereby precipitate premature liquidation. This usually happens

[159] Armour, J. (2001). The Law and Economics of Corporate Insolvency: A Review. Working Paper No. 197. ESRC Centre for Business Research, University of Cambridge, p. 10. Available online at https://www.cbr.cam.ac.uk/wp-content/uploads/2020/08/wp197.pdf. Accessed 12/6/2023

[160] You may wish to revisit the theories of insolvency discussed above.

[161] Section 673(2(b) CAMA 2020

[162] Section 657(6) CAMA 2020

[163] See Paragraph 1.3.1 above.

when the creditors sense that a debtor may have more liabilities than assets (see balance insolvency test). If this happens, it could precipitate insolvent liquidation, which can potentially hurt the creditors as a group. An efficient insolvency legal framework blunts the chances of this fate befalling the debtor and provides a way to make the diverse individuals (creditors) act as one (since they would be better off if they held the assets together) by imposing a collective and compulsory proceeding on them.[164] This is the philosophical configuration of the US Chapter 11 bankruptcy regime propped on debtor in possession paradigm. Similarly, it makes it possible to implement a monitor-driven recovery plan,[165] or to adopt a hierarchically ordered objectives to save the company[166] or to institute a holistic rehabilitation of a financially troubled debtor entity.[167]

Further, the bankruptcy law functions to promote the realization of the assets of the debtor for onward distribution among competing creditors and claimholders.[168] The insolvency helps to manage "the wide spectrum of the deleterious effects of business failure especially with the prospect of imminent failure of the defaulting entity." The function of insolvency is underpinned by the philosophical aims or objectives of the law governing insolvency regime. The finding for the philosophy or objective of insolvency law is facilitated by the theories propounded in a search for the objectives of the law.

Apart from the theories on insolvency law helping our understanding of the purposes or objectives of the law, the work of the Cork Committee[169] cannot be overlooked. The Cork Committee Report developed objectives which are said to be intentionally vague to capture an array of situations yet contain enough substance to protect specified interests. They are:

a) To underpin the credit system and cope with its casualties;
b) To diagnose and treat an imminent insolvency at an early, rather than a late, stage;
c) To prevent conflicts between individual creditors;
d) To realise the assets of the insolvent which should properly be taken to satisfy debts with the minimum of delay and expense;

164 Adler, B.E. (May 1997). A Theory of Corporate Insolvency. *New York University Law Review. Vol 72, 343*. Available online at https://www.nyulawreview.org/wp-content/uploads/2018/08/NYULawReview-72-2-Adler.pdf

165 See Chapter 1-8, UK Insolvency Act 1986, providing for a moratorium.

166 See Chapter 18, Companies and Allied Matters Act 2020, providing for administration.

167 See Chapter 6 South Africa Companies Act 2008 (as amended) on business rescue.

168 For example, see CAMA 2020, section 207 (preferential payment to debenture holder in certain cases), section 643 (distribution of property of company, and section 657 (preferential payments).

169 The Report of the Review Committee on Insolvency Law and Practice (1982) Cmnd 8558, otherwise known as the Cork Report. The committee commissioned by the UK Labour government in 1977 was chaired by Sir Kenneth Cork. The government in 1984 released a whitepaper on the Cork Report, A Revised Framework for Insolvency Law (1984) Cmmn 9175. These culminated in the enactment of Insolvency Act 1986.

e) To distribute the proceeds of realisations amongst creditors fairly and equitably, returning any surplus to the debtor;
f) To ensure that the processes of realisation and distribution are administrated honestly and competently;
g) To ascertain the causes of the insolvent's failure and, if conduct merits criticism or punishment, to decide what measures, if any, require to be taken; to establish an investigative process sufficiently full and competent to discourage undesirable conduct by creditors and debtors; to encourage settlement of debts; to uphold business standards and commercial morality; and to sustain confidence in insolvency law by effectively uncovering assets concealed from creditors, ascertaining the validity of creditors' claims and exposing the circumstances attending failure;
h) To recognise and safeguard the interests not merely of insolvents and their creditors but those of society and other groups in society who are affected by the insolvency, for instance not only the interests of directors, shareholders and employees but also those of suppliers, those whose livelihoods depend on the enterprise of the Community;
i) To preserve viable commercial enterprises capable of contributing usefully to national economic life;
j) To offer a framework of insolvency law commanding respect and observance, et sufficiently flexible to cope with change, and which is also:
    (i) Seen to produce practical solutions to commercial and financial problems
    (ii) Simple and easily understood
    (iii) Free from anomalies and inconsistencies
    (iv) Capable of being administered efficiently and economically
    (v) To ensure due recognition and respect abroad for English insolvency proceedings.

Commenting on the objectives of insolvency law, Wood (2013) emphasises that corporate rescue must strive to bridge the divergences between theory and application. Achieving this aim however involves understanding that corporate rescue was embraced in a politico-legal dimension, thereby providing a transdisciplinary flavour to the concept.[170]

Azmi and Razak (2013)[171] noted that principles of corporate insolvency law based on the objectives or aims of insolvency law of the Cork Committee Report were developed. They principles are:

1. <u>Principle 1</u>: it aimed to promote the protection of communitarian and creditors' interests. Such values can be seen where it is included

[170] J.M. Wood (2013). Corporate Rescue: A Critical Analysis of its Fundamentals and Existence. PhD Thesis. School of Law, Centre for Business Law and Practice. The University of Leeds, p. 53.
[171] Azmi and Razak, op cit.

in Cork's list of aims that insolvency law is to provide the means for survival of viable business and to recognize and safeguard the interests of creditors and those parties who are affected by the corporate insolvency (Cork Report, 1982). This conduces to the position that insolvency laws were treated by the trading community as an instrument in the process of debt recovery. It constitutes in many cases the sanction of last resort for the enforcement of obligations.[172]

2. Principle 2: Cork's list of aims took on board that insolvency law should protect the diversity of interests. This includes not only creditors but also shareholders and employees whose 'livelihoods depend on the enterprise and the community' (Cork Report, 1977). Indeed, Cork's statements of aims recognize that distributional issues involved the insolvent company where it highlights that insolvency has wider repercussions not only for those intimately concerned with the conduct of the business but also to other interests of society (Cork Report, 1982).

3. Principle 3: despite no clear guidance being given by Cork on which interests and values to concentrate on and which should take precedence in the insolvency process, where conflicts between different objectives occur, broadly Cork's formulation has made it clear that it emphasized the agenda of survival of the viable enterprise or corporate rescue. As noted, the Cork Report sees the function of insolvency law as being to cater for the continuation or rehabilitation of a viable company. The aim of encouraging the continuation and disposal of a corporate debtor's business as a going concern in order to preserve the jobs of at least some of the employees is considered a starting point on the promotion of 'rescue culture' in the UK (Cork Report, 1982).

4. Principle 4: the Cork arrangement of aims of the insolvency process and decisions is established according to the four particular rationales to support insolvency rules, namely efficiency, accountability, fairness, and expertise (Finch, 2002 & 2009). The application of the explicit values that emphasize trade-offs between different ends revealed that Cork's formulation has no explicit explanation on the need of those objectives to be traded off and weighed up amongst each other, and no clear assertion in terms of the priorities for the protection of different interests in insolvency. However, the trade-off issues absent in Cork do remain 'a problem and one cannot expect easy answers when dealing with a process whose essence is the

[172] The Report of the Review Committee on Insolvency Law and Practice. Wikipedia. https://en.wikipedia.org/wiki/Report_of_the_Review_Committee_on_Insolvency_Law_and_Practice. Accessed 25/6/2023.

balancing of multiple objectives'. (Finch, 2002 & 2009). The application of explicit values should therefore extend to construing insolvency laws as the means by which the demands of commercial morality can be met, through the investigation and the disciplinary measures and restrictions imposed on the bankrupt.[173]

1.3.3 Tests of Insolvency

The term 'insolvency' refers to inability to pay debts. Section 572 defines inability to pay debts in the following terms:

(a) a creditor, by assignment or otherwise, to whom the company is indebted in a sum exceeding N200,000, 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 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;

(b) execution or other process issued on a judgment, act or order of any Court in favour of a creditor of the company is returned unsatisfied in whole or in part; or

(c) the Court, after considering any contingent or prospective liability of the company, is satisfied that the company is unable to pay its debts.

Most unsatisfactorily the statutory prescription leaves much to be desired. Paragraph (a) and (b) are merely procedural, whereas paragraph (c) reckons with contingent or prospective liability. In effect the section failed to lay out any discernible test of insolvency, especially when compared with the UK Insolvency Act 1986. Briefly considered, the tests are balance sheet (liability) and cashflow (liquidity) tests:

(a) <u>Cash flow (Liquidity) test</u>. The test of cashflow arises where a company is deemed unable to pay its debts. It is proved by satisfying the court that the company is unable to pay its debts as they fall due.[174] The cashflow test becomes highly speculative if it depends upon predictions of future liquidity to prove its presence.

The Australian courts[175] therefore warned that:

> (Inability to pay debts) is to be judged by a proper consideration of the company's financial position, in its entirety, based on commercial reality. It is not to be found or inferred simply from evidence of temporary lack of liquidity. Nor should it be assessed as if the company had to keep cash reserves sufficient to meet all outstanding indebtedness, however distant the date of payment

[173] Ibid.
[174] Section 123(e) Insolvency Act 1986
[175] Sandell v Porter (1996) 115 CLR 666; Cuthbertson v Thomas (1998) 28 ACSR 310

> might be in the fullness of time. But nor can directors rely on some faint hope that help is at hand and that all will be well. The word 'reality' in the phrase 'commercial reality' has a bite. Commercial reality dictates that the assessment of available funds is not confined to the company's cash reResources. It is legitimate to take into account funds the company can, on a real and reasoned view, realise by sale of assets, borrowing against the security of its assets, or by other reasonable means. It is a question of fact to be determined in accordance with the evidence.[176] (Words in bracket mine).

(b) Balance Sheet (Liability) test. CAMA 2020 provided for balance sheet test of insolvency is proved to exist if the value of the company's assets is less than the amount of its liabilities, considering its contingent and prospective liabilities.[177] The balance sheet test is not about whether contingent liabilities exceed the present value of assets but rather whether those liabilities will exceed the value of the assets when they mature for payment.[178] Along this line, the liability test includes contingent and prospective liabilities but not contingent and prospective assets.[179]

To ascertain a company's inability to pay its debts, the two tests, described as "free-standing" are applied. Either test is enough to prove insolvency, even though both may be present at the same time. To satisfy the test is not straightforward as it may sound. Hence, Anderson reveals that:

> it might be thought that both tests would turn on the state of the company's affairs at the precise time when solvency had to be determined but that is not so. As interpreted by the courts, neither test is satisfied simply by a contemporaneous snapshot; it is necessary to look into the future. The case of a company which is already in default of some undisputed payment obligations is straightforward but the case of a company which may default in the future is much less so.

That is to say the two tests go hand in hand as part of a single exercise of determining whether a company was unable to pay its debts. Consequently, if a company is only able to pay its debts by incurring further debts, it is to be considered commercially insolvent."[180]

Obvious difficulties will likely arise in practice in relation to the determination of the tests. This is especially "in marginal cases where

[176] Per Owen J in Cuthbertson v Thomas (supra)
[177] Section 572(c) CAMA 2020; Section 123(2) Insolvency Act 1986
[178] Op cit, Anderson, p, 21; BNY Corporate Trustee Services Ltd v Eurosail-UK 2007-3BL plc [2013] 1 WLR 1408 (SC).
[179] Evans v Jones (2016) EWCA Civ 660
[180] Vaccari E. and Ghio E. (2022). English Corporate Insolvency Law: A Primer. Elgar, London, p. 17. See, Re Casa Estates (UK) Ltd (in liquidation) (2014) EWCA Civ 383.

contingent or unquantifiable risks arise, or when considering how far into the future to look or forecast when applying the tests."[181] Put in another way, the common element of futurity in the two tests tends to blur the distinction between them, implying that it "can make their practical application a question of some difficulty with the result sometimes turning upon the burden of proof.[182] The current position in the UK, and this will have a strong persuasive force in Nigeria, is that debts falling due in the reasonably immediate future are considered relevant for the cash flow test (not just debts that are due now) and a company's accounts are only a starting point to determine balance sheet insolvency.[183]

Anderson distinguished between legal test of insolvency and accounting test of insolvency. According to him, the latter is applied in determining whether a company's accounts should be prepared on a going concern basis.[184] It is directed to whether a company will be able to discharge its liabilities as they fall due in the foreseeable future, usually a minimum period of 12 months. This is apparently similar to legal cashflow test, but directors are expected to consider all available information about the future. The information includes non-binding letters of comfort from parent companies and the prospects of future capitalisation.

1.3.4 Indicia of Insolvency Proceeding

How do you know when insolvency proceeding has commenced or is ongoing? How do you identify an insolvency proceeding? What are the signposts (indicia or indicators) to look out for? Different jurisdictions adopt different approaches to corporate. Anderson (2016) writes that the form of an insolvency proceeding depends on the goal in mind – whether it is focussed on liquidation or rehabilitation. He states that "it is possible to identify a series of signifiers the presence of which serve to indicate that the subject is an insolvency proceeding." The signifiers include:

(a) Collectivism. The commonest signifier is that the procedure should be collective. In other words, the insolvency process operates for the benefit of creditors generally. This function reinforces the CB

[181] Ashurst Quickguides. (2020). A Brief Guide to Corporate Restructuring and Insolvency in England and Wales. Available online at https://www.ashurst.com/en /news-and-insights/legal-updates/quickguide---abriefguide-to-corporate-restructuringandinsolvency-in-england-and-wales/. Accessed 26/5/2023.

[182] It is for the person seeking to establish insolvency, or the person seeking to rebut a presumption of insolvency, to do so on a balance of probabilities. Ibid, p. 21.

[183] In the Matter of Cheyne Finance Plc (in receivership) [2007] EWHC 2402 (Ch) and BNY Corporate Trustee Services Ltd v Eurosail UK 2007-3BL Plc & Ors (supra)

[184] Anderson advises that accounts should only be prepared on a liquidation basis if management either intends to liquidate the company or to cease trading (or has no realistic alternative but to do so). Op cit, p. 22

theory. In Cambridge Gas Transportation Corporation v Official Committee of Unsecured Creditors of Navigator Holdings plc,[185] Lord Hoffman brought out the function, nay purpose, of insolvency proceeding:

> The purpose of bankruptcy proceedings, on the other hand, is not to determine or establish the existence of rights, but to provide a mechanism of collective execution against the property of the debtor by creditors whose rights are admitted or established…The important point is that bankruptcy, whether personal or corporate, is a collective proceeding to enforce rights and not to establish them.

(b) Triggered by real or imagined insolvency. The proceeding is precipitated by debtor's actual or anticipated insolvency. It is usually a public process and results in "a stay of individual creditor action." Providing further insights, Anderson writes that:

> Conferring rights of participation in a collective scheme involves identification of the composition of the insolvent estate which becomes subject to those creditor rights. There is a cut-off date to determine the composition of the estate and another to determine the class of participating creditors (often the same date for both purposes). The cut-off date to identify the composition of the estate is supported by transaction avoidance rules to negative transactions which deplete the estate. Finally, liabilities incurred in the course of administering the estate are treated as expenses to be paid in priority to the claims of the pre-proceeding creditors.[186]

(c) Debtor in possession. In some jurisdictions, like the United States, debtor in possession can be one of the indicia of insolvency proceeding. However, under the Nigerian as well as English this paradigm is strongly discouraged. Thus, the management powers of the company are displaced on the appointment of an insolvency practitioner (for administration) or the receiver or manager (in the case of receivership). The insolvency practitioner takes ownership and administers the insolvency proceeding.

(d) Universalism. The procedures purport to address the assets and liabilities of the debtor worldwide. The rights of foreign creditors to participate in the proceeding, and the governing law of obligations does not affect their ranking. This indicator may not apply to every jurisdiction as much as it applies to Nigeria and UK.

1.3.5 Corporate Insolvency Mechanisms or Processes

Different jurisdictions adopt different approaches to corporate insolvency. The approach may be focused on liquidation or rehabilitation. For example, Nigeria, Malaysia, and the UK jurisdictions provide for rehabilitation as well as liquidation. The US approach,

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[185] (2007) 1 AC 508 (PC); Singularis Holdings Ltd v PricewaterhouseCoopers (2015) 2 WLR 971

[186] Op cit, Anderson, p. 23.

founded on debtor in possession paradigm, supports rehabilitation. Specifically, Malaysia adopts two approaches, namely company voluntary arrangement (CVA) and judicial management (JM). While each will be treated in greater detail, the corporate insolvency regimes known to Nigerian law are:

(a) Company voluntary arrangement (CVA) allows a financially troubled entity in the vicinity of collapse but with a likelihood of survival if its debts were restructured, to repay some, or all, of its historic debts out of future profits, over an agreed period of time. The CVA is legally binding.[187]

(b) Administration is an approach that protects the struggling entity from a from creditors actions. Meanwhile an administrator takes over the management of its affairs. The administrator takes steps to pursue the statutorily ordered objectives of the administration .

(c) Receivership is initiated by the company's creditors, not the company itself. Depending on the debt contract, a receiver, appointed out of court or by the court, must look to recover as much money as possible in order to settle the claims made by creditors. Since the interests of the creditors supplant the interests of the company's survival, is it possible for the receiver to act altruistically? This question is explored further in the Unit on receivership.

(d) Liquidation. The assets of a company are placed under the control of a liquidator. In most cases, a company in liquidation ceases to trade, and the liquidator will sell the company's assets and distribute the proceeds to creditors. There are two forms: voluntary liquidation brought about by the company itself or compulsory liquidation brought about by court order.

Self-Assessment Exercise 14

p) *Identify two strong objections against Explicit Value Approach as a theory of corporate insolvency law.*

q) *Mokal (2003) itemised what he considered to be fitting examples of "substantive objectives of corporate insolvency law." State them.*

r) What is *fallitus ergo fraudator? Recount the condition of the bankrupt with reference to the phrase. Has this perception changed today?*

s) *What is the argument of Mokal (2001) that led to the development of alternative theory called Authentic Consent Model? Briefly summarise the ACM as a theory of insolvency law.*

[187] Legal Practice Areas: Restructuring and Insolvency Law. https://www.law.ac.uk/employability/legal-practice-areas/restructuring-and-insolvency-law/. Accessed 12/2/2023.

1.4 Summary

In this Unit you explored several aspects of the course. You studied a brief history of insolvency. The various theories of insolvency, of which they are generally two schools of thought, namely traditionalists and proceduralists. Alternative models represented by Finch and Mokal were similarly studied. Further the tests of insolvency, benefits and function of insolvency, the markers or indicia of insolvency and the approaches to corporate insolvency were discussed. Finally, the practical stages to business recovery as proposed by ICAEW were studied.

1.5 References/Further Readings

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Legislations and Statutory Instruments

Business Facilitation (Miscellaneous Provisions) Act 2022
Companies and Allied Matters Act 2020
Insolvency Regulations 2022

Foreign legislations

South Africa Companies Act 2008
UK Companies Act 2006
UK Insolvency Act 1986

1.6 Answers to Self-Assessment Exercises

Self-Assessment Exercise 14

a) The limitations of EVA theory of insolvency law are:

i. The challenge of EVA remains the trade-offs between the values, arising chiefly from the fact that EVA considers "the public and private, the procedural and substantive, and the contractarian and democratic dimensions of insolvency.

ii. It failed to differentiate between the procedural and substantive objectives in the insolvency law.

b) The examples provided by Mokal (2003) are:

i. To be just to all the relevant parties.
ii. To treat parties as equals.
iii. To provide a fair scheme of co-operation under the circumstances peculiar to insolvency.
iv. To show equal concern and respect for the interests of all those facing such circumstances

c) The phrase *fallitus ergo fraudator means* "insolvent thus a swindler." The condition of the bankrupt or insolvent was that he was stigmatised, chastised and severely punished. Then the creditor had the privilege of *de debitore in partes secando* "to cut the debtor's body into pieces and share it out proportionately, according to the size of debts." This condition no longer existed as the law today adopts more accommodating attitude that seeks to rehabilitate the bankrupt or insolvent debtor where it is reasonably feasible to do so.

d) The argument of Mokal (2001) against the proceduralists' view, specifically creditors' bargain theory, is that it is too idealistic, unsupportable, and unsustainable in a real-life context. This led him to develop alternative theory in response. Called Authentic Consent Model (ACM), the theory rests on justice and reciprocity as its foundation. Justice enjoins all stakeholders affected (or to be) affected by insolvency law to be treated equally. It assumes equality of treatment of all parties. Reciprocity assumes that since all parties are "free and equal, and as fully co-operating members of society, each party has a vested interest "to reciprocate the treatment accorded by others in the same group who are affected in the insolvency proceedings. In this way the aims of ACM founded in reciprocity is a form of fairness would be upheld.

UNIT 2 COMPANY VOLUNTARY ARRANGEMENT

Unit Structure

2.1 Introduction

When the law provides that the directors of a company may make a proposal to its creditors for a composition in satisfaction of its debts or a scheme of arrangements of its affairs it gives the impression that company voluntary arrangement (CVA) and scheme of arrangement (and compromise) are one and the same thing.[188] It gives a misleading impression as this is not the case.[189] In the same vein, CVA is not the same thing as administration but there is a nexus between the two. Hence, CVA is one of the proposals the administrator can make in his efforts to rescue and restore the going concern basis of the company.[190]

2.2 Learning Outcomes

At the end of this unit, you should be able to the meaning and application of company voluntary arrangement as an insolvency process aimed at rescuing the company and restoring its going concern situation.

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[188] Section 434(1) CAMA 2020.
[189] See section 710 CAMA 2020 making provisions for arrangements and compromise, defined "arrangement" as any change in the rights or liabilities of members, debenture holders or creditors of a company or any class of them or in the regulation of a company, other than a change effected under any other provision of this Act (like CVA) or by the unanimous agreement of all parties affected.
[190] Section 486(3)(a) CAMA 2020.

2.3. Company Voluntary Arrangement (CVA)

According to Ashurst Quickguides:

> Company voluntary arrangement (CVA) is a procedure which enables an over-indebted company to agree with its creditors how its debts should be dealt with. Section 1 of the Act[191] defines a voluntary arrangement as either a composition in satisfaction of its debts or a scheme of arrangement of the company's affairs. In essence, a CVA gives the company a "second chance" to restructure its business on a voluntary consensual basis (but with certain cram down possibilities) without having to file for a terminal insolvency process. Alternatively, a CVA can be used by a company as a distribution procedure where it is desirable to avoid liquidation proceedings. A company need not be technically insolvent in order to implement a CVA.[192]

In other words, CVA is not necessarily an insolvency process, since cash-strapped companies as well as the ones in the vicinity of insolvency could utilise the mechanism to walk their way out of financial distress, which results from the "second chance" it offers to a business to restructure is undertaking and business.

On the other hand, Anderson (2016)[193] compared the popularity of CVA with schemes of arrangement and compromise and said:

> Company voluntary arrangements were intended to offer a more flexible and informal alternative to schemes of arrangement under the Companies Acts[194] but such schemes remain the preferred restructuring tool for large and larger mid-cap companies even though there too there is no stay. This may be because such restructurings are likely to be directed to effecting arrangements between a company and its financial creditors, leaving trade creditors being paid in full in the ordinary course of business. In such circumstances there may well be no commercial need for a stay. Other reasons for preferring Companies Act schemes may be the certainty resulting from the court order approving a scheme (in contrast to the post-approval challenge period in a company voluntary arrangement) and issues of recognition in foreign jurisdictions. In the case of smaller companies, where a stay may be more important, there appears to be a clear preference for the certainty and office-holder control of administration.

[191] UK Insolvency Act 1986. See section 434 CAMA 2020 with identical provision.

[192] Quickguides, Ashurst. (2020). A Brief Guide to Corporate Restructuring and Insolvency in England and Wales. Available online at https://www.ashurst.com/en /news-and-insights/legal-updates/quickguide---abriefguide-to-corporate-restructuringandinsolvency-in-england-and-wales/

[193] Anderson, H. (2016) 'An Introduction to Corporate Insolvency Law', *Plymouth Law and Criminal Justice Review, 8*, p. 36

[194] See Chapter 27 – Arrangements and Compromise (ss 710-717) CAMA 2020

In Nigeria the CVA is a new tool which was birthed by CAMA 2020. So, it is too early in time to test its popularity and use among companies of this officeholder-in-control restructuring mechanism. However, in the UK Anderson (2016) decries that albeit there is no available statistics, "anecdotal evidence is consistently to the effect that the procedure is rarely used." He imagined that a "contributing factor may be that the nominee is required to undertake significant responsibilities in satisfying himself as to the funding of the company and monitoring its activities whilst it continues to trade under its own management."[195]

2.3.1 The Persons behind the Proposal for a CVA

The proposal may be made by any of the following:

- the directors of the company.[196]
- the administrator if there is a subsisting administration order in relation to the company.[197]
- the liquidator if the company is in the process of being wound up.[198]

To supervise the implementation of the proposal, a nominee is usually appointed under the proposal. The nominee must be qualified to act as an insolvency practitioner.[199] The nominee is the supervisor of the CVA, with powers and duties usually set out in the CVA. The CVA is not disabling, so directors can still retain control and exercise the powers of the board during a CVA.

2.3.2 Contents of a CVA Proposal.

A proposal for CVA contains particulars of the concerned company, explains why the proposer thinks the CVA is desirable, states why the creditors are expected to agree to a CVA and has to be authenticated and dated by the proposer.[200] For an exhaustive content of a CVA proposal, you should refer to Insolvency Regulations 2022, particularly Regulation 2.02 thereof. Among others it includes particulars of assets and liabilities, fees and expenses of the nominee, the timing of the CVA, handling of funds arising from the CVA, guarantees and proposed guarantees in respect of the company's debts, how the business will conducted during the CVA, particulars of additionally proposed credit facilities for the company, and other matters.

[195] Anderson, op cit
[196] Section 434(1) CAMA 2020
[197] Section 434(3(a) CAMA 2020
[198] Section 434(3)(b) CAMA 2020
[199] Sections 434(2), 704, and 705 CAMA 2020
[200] Regulation 2.01 Insolvency Regulations 2022

2.3.3 Steps at implementing the Proposal.

The steps to take depends on whether the nominee is a nominee simpliciter or the nominee doubles either as the administrator or liquidator of the company. For present purposes, the nominee not being the liquidator or administrator, is bound to following the following steps:

a) Within 28 days after he receives notice of the proposal for CVA, he must submit a report to the Court stating whether, in his opinion, meetings of the company and of its creditors should be summoned to consider the proposal; and if, in his opinion, such meetings should be summoned, the date on which, and time and place at which, he proposes the meetings to be held. If he desires a longer period, he must seek and obtain leave of the Court. For the information the nominee requires to prepare the report, see section 435(3) CAMA. If the nominee failed to submit the report, the person making the proposal may apply to the Court for his replacement.

b) Except otherwise directed by the Court, the nominee shall summon a meeting of the company and of its creditors to consider and if thought fit to approve the proposal, with or without modifications.[201] What modifications do you think could be made to the proposal? Any such modification must not change the character of the proposal as a CVA within the meaning of section 434 CAMA.[202]

   Whether the meeting of the company or that of the creditors, there are statutory constraints to the approval capable of being given under the circumstances. Consequently, the meeting cannot purport to approve:

   i. Except with the express consent of the concerned creditors, an approval of a proposal that purportedly constitutes an invasion of the rights of secured creditors and thereby limit or claw back their security leverage is invalid.
   ii. The meeting cannot purport to approve any variation to the priority ranking of the rights of preferential creditors, whether as against other non-preferential debts or as against as among other preferred debts.

c) Following approval, the next is implementation phase of the CVA proposal. The proposal will spell out the functions of the supervisor. Any creditor or person dissatisfied with any act or omission, or

[201] Section 436 CAMA 2020
[202] See section 437(2) CAMA 2020 for a guidance.

decision of the supervisor can apply to the Court for redress. Interestingly, the supervisor can, among other applications he can make, apply to the Court for winding up of the company or for an administration to be made in relation to the company.[203] Under what circumstance do you think the supervisor can make such an application? It is where the CVA suffers a setback, the supervisor can apply for winding up or for the company to be put into administration.

2.3.3 Effect of an approved CVA.

Once the CVA is approved by both meetings of the company and the creditors, it becomes effective. Thus, a CVA takes effect as if made by the company at the time the creditors decided to approve the CVA and binds every person entitled to vote at the meeting at which the creditors approved the CVA or would have been so entitled if he had notice of it as if he were a party to the voluntary arrangement.[204]

The law entertained the practicability of a company in administration or liquidation going into and putting in place a CVA.[205] Things will be seamless if the administrator or liquidator is the supervisor of the CVA. If the supervisor is different from the administrator or the liquidator, the supervisor in this case must deliver to the administrator or liquidator an undertaking to discharge any balance (a) by way of fees or expenses incurred and payable to the administrator or liquidator, and (b) on account of any advances made in relation to the company including interest on such advances at the date on which the company entered administration or slipped into liquidation. The supervisor must deliver the undertaking before taking possession of the assets comprised in the CVA. Subsequently, on taking possession he must take steps and discharge the balance. In other words, the administrator or liquidator has ranking priority because the assets included in the CVA is deemed to be charged to the sums comprised in such balance, subject only to the deduction if the proper costs and expenses of realisations by the supervisor.

However, it is possible for the decision of the company's meeting to be at variance with the resolution reached at the creditors' meeting. In a case where both decisions inconsistent, the law empowers a member of the company to apply to the Court within 28 days of the creditors'

[203] Section 442(4) CAMA 2020
[204] Regulation 2.26
[205] Regulation 2.27

meeting. The Court may give order overriding the decision of the creditors' meeting and instead upholding the decision of the company or it may make such other order as it deems fit.[206]

Following approval of the proposal, the next is the implementation stage. This is where the supervisor steps in, as the person charged with implementing the proposal. While the decision or act of the supervisor may be challenged by application to the Court in that respect, the supervisor apply to the Court for directions in relation to any particular matter arising under the CVA. The application the supervisor includes applying to the Court for the winding up of the company or for an administration order.[207]

The CVA may be challenged[208] on unfair prejudice grounds in relation to the interests of a creditor, member, or contributory of the company. It may also be challenged where there is "some material irregularity at or in relation to either of the meetings." This is understandable because the law was insistent that such meetings must be conducted according to its rules.[209] It will be manifestly a breach of the rules if the decision was a consequence of an inquorate meeting.[210] Similarly, the rule will be observed in breach if the notice summoning a meeting of the company is delivered less than 14 days before the day fixed for the meeting[211] or creditors were given less than 14 days' notice.[212] The application envisaged in both cases must be made within 28 days. Who are the persons to make the application challenging the decision of the meeting? And what orders can the Court make in a case where either of the grounds are satisfied? Check out section 440 CAMA 2020 for guidance here.

Generally, CVA is not collective because it does not act as a stay to the right of secured creditors. On this it is said that a CVA "does not restrain creditor action and may itself cause creditors to take precipitative action against a company." This is why a CVA is better combined with administration to take benefit "of the automatic moratorium that takes effect on administration." The lack of stay is a major drawback of CVA. Importantly, the supervisor holds the assets included in the CVA subject

[206] Section 438(5) and section 439(2) CAMA 2020
[207] Section 442 CAMA 2020
[208] Section 440 CAMA 2020
[209] Sections 437(5), (6), 438(2) and 439(2)(b) CAMA 2020
[210] For example, Regulation 2.12 states that the quorum for creditor's meeting shall be a majority (in value) of creditors whose proof of claim has been admitted.
[211] On this, see Regulation 2.18.
[212] Regulation 2.17.

to the priority ranking of the interests of administrator or liquidator on such assets. That is, the administrator or liquidator has a charge over such assets.[213] This also whittles the value of CVA.

2.3.4 Offences in relation to CVA.

An officer of A company that makes any false representation or fraudulently does or omits to do anything to procure obtain the approval to a proposal of the members or creditors of a company commits an offence. On conviction such an officer is liable to imprisonment for a term of one year or a fine as the Court as deems fit or both.[214] Who is an officer of a company? An officer of a company has been statutorily conceptualized to include a director, manager, or secretary.[215]

Self-Assessment Exercise 15

a) Who can initiate a CVA by way of a proposal?
b) List the offences in relation to a CVA and the consequences of commission.
c) What are circumstances warranting the challenge to a proposal?
d) Identify one benefit of a CVA and one disadvantage of a CVA.

2.4 Summary

In this Unit, you learned of a CVA is a second-chance mechanism designed to help financially troubled companies walk their way out of trouble and by so doing avoiding insolvency. However, it is not a foolproof mechanism since it does not operate as a stay to secured creditors' rights and could possibly precipitate such actions that facilitate the happening of premature insolvency. It is a punishable offence to make false representation or to do or fail to do any act as a consequence of which approval was secured to a CVA proposal.

2.5 References/Further Readings

Books, Journals, Online Resources and Other Publications

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[213] Regulation 2.27(4).
[214] Section 441 CAMA 2020
[215] Section 868(1) CAMA 2020

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Legislations and Statutory Instruments

Companies and Allied Matters Act 2020
Insolvency Regulations 2022

Foreign legislations

UK Companies Act 2006
UK Insolvency Act 1986

2.6 Answers to Self – Assessment Exercises (SAEs)

Self-Assessment Exercise 15

a) *The following persons can initiate a CVA by way of proposal may be made by any of the following: (a) the directors of the company. (b) the administrator if there is a subsisting administration order in relation to the company. (c) the liquidator if the company is in the process of being wound up.*
b) *These are the offence of false representation or fraudulent act or omission to enable the procurement of approval to a proposal of the members or creditors of a company commits an offence. The punishment on conviction is one year or a fine or both.*
c) *The circumstances are where unfair prejudice grounds in relation to the interests of a creditor, member, or contributory of the company is alleged. It may also be challenged where there is some material irregularity at or in relation to either of the meetings.*
d) *One benefit is that it enables an over-indebted company to agree with its creditors how its debts should be dealt with. It gives the company a second chance. On the other hand, one disadvantage is that it is not*

UNIT 3 ADMINISTRATION

Unit Structure

3.1 Introduction

Company administration is defined as “a formal insolvency process that is designed to protect a company from its creditors while a solution is sought to its financial di6culties. When a company enters administration, an insolvency practitioner is appointed to take over the management of the company, with the aim of preserving its value and maximising the return for its creditors.”[216] It has been described as a “means to an end”, which may be to preserve the company as a going concern (rescue) or to steer it into receivership, or to bring an end to it. That is, the ‘end’ may be one of the hierarchically ordered objectives of administration. Like the CVA discussed earlier, you should note that what is presented here is a synoptic outline, as against an exhaustive treatment, of the corporate insolvency mechanism of administration.

3.2 Learning Outcomes

By the end of this unit, you will be able to:

- explain the concept of company administration as a hybrid insolvency process
- gain a brief history of company administration
- discuss the objectives or purposes of company administration
- discuss the process of placing a company in administration.

[216] Business Insolvency. Available online at https://business-insolvencyhelpline.co.uk/companyadministration/. Accessed 24/6/2023.

3.3 Administration

When a company comes face to face with financial distress, one of the mechanisms for managing and resolving the problem is administration. Although believed to hold the key to rescuing otherwise ailing and financially hopeless companies in the zone of insolvency, administration as a hybrid insolvency process rarely, in practice, achieved its objective of restoring the going concern situation of companies.[217] This is understandable because the process, when activated, merely results in a temporary suspension (not outright cancellation) of creditor remedies. Hence, other objectives are on the table, if the objective of rescuing the business as a going concern is not feasible.

3.6.1 A brief history

Anderson (2016)[218] offers an interesting historical background to introduction of administration into the UK jurisdiction, where Nigeria transplanted the administration process under CAMA 2020:

> Administration was introduced into English insolvency law by the Insolvency Act 1985, which was immediately consolidated into the 1986 Act. The procedure was a response to the perceived utility of Chapter 11 of the US Bankruptcy Code, which had been enacted a few years earlier as a business rescue procedure (but administration is markedly different in that Chapter 11 is a debtor in possession procedure). Before 1986 the principal means of preserving a viable business(,) which was owned by an insolvent company was for the business to be sold as a going concern by a receiver. The receiver was appointed for that purpose by a secured creditor, usually a bank, which held security over all the assets and undertaking of the company through a combination of fixed and floating charges. Although such receiverships (called 'administrative receiverships' in the 1986 Act) in some ways resembled an insolvency proceeding, they were not a true insolvency proceeding because they were security enforcement for the exclusive benefit of a secured creditor. They were nonetheless perceived to be beneficial in saving businesses, but not the companies that owned the businesses, from liquidation. Administration was originally introduced in order to provide a means of enabling businesses to be sold as going concerns when there was no secured creditor which was able to appoint an administrative receiver. Administrative receivership and administration were mutually exclusive and secured creditors with the power to appoint administrative receivers were in a position to veto administration. This meant that administration was relatively little used in its early years. The position was dramatically changed by a series of amendments to the 1986

[217] Ashurt Quickguides pointed to companies that went through the process and still failed, including Lehman Brothers International Europe, Woolworths, etc.
[218] Op cit, p. 32.

> Act which resulted from the Enterprise Act 2002 and as part of which administrative receivership was outlawed in all but a few special cases. The underlying policy then being pursued was that administration should take over as the principal means of business rescue. Secured creditors who would otherwise have been able to appoint an administrative receiver were compensated by being given power to appoint an administrator; the practical difference between the two forms of appointment being that an administrator is required to act in the interests of the creditors as a whole rather than in the particular interests of the appointing secured creditor. In the terminology of the new legislation, a secured creditor who would have had the power to appoint an administrative receiver is called the holder of a 'qualifying floating charge'.

The mechanism of company administration first appeared in CAMA 2020. It would appear, expectedly, that Nigeria did not totally transplant the UK brand of business rescue. Unlike the UK for example, there is limitation or control to the deployment of institution of receivership under the current law. Since there is a compelling attraction to deploying receiverships, it is really doubtful if financial creditors (banks) would allow the business rescue mechanism of administration to take a foothold.

3.3.2. A hierarchy of objectives

The administration process is propped on hierarchically ordered objectives. Why do you think the objectives are described as hierarchically ordered? For example, the law is clear that the primary objective of the administration is the restoration of the going concern situation of the entity.[219] It simply implies that the administrator must follow a sequential process in pursuing the objectives of the administration. In other words, the administrator, always an insolvency practitioner, must consider the first objective before going to the second and the last. What are the objectives? The objectives are to be discovered from the purpose of administration, which is, here, called hierarchy of objectives. In order of priority or sequence, the objectives or purposes are:

a) Objective 1. In the performance of his functions, the administrator must be focused on pursuing, first and foremost, rescuing the company as a going concern. The phrase "going concern" is an accounting term that refers to a company's ability to make enough money to stay afloat or to avoid insolvency or bankruptcy. If a business is not a going concern, it means it's gone bankrupt and its assets were liquidated.[220] Generally, the concept is an underlying basis used to prepare financial

[219] Section 444(2) CAMA. Compare Paragraph 3(4) Schedule B1 Insolvency Act 1986
[220] Investopedia. What Does Going Concern Mean? Available at https://www.investopedia.com/terms/g/goingconcern.asp. Accessed 10/1/2023.

statements. As a result, it is assumed that the entity has neither the intention, nor the need, to liquidate or curtail materially the scale of its operations.[221]

b) Objective 2. Where the first core objective is not feasible, the administrator is enjoined, statutorily, to pursue the next objective., which is attempting to achieve a better result for the company's creditors as a whole than would likely if the company were wound up, without first being in administration.
c) Objective 3. If it would not be feasible to achieve equality of treatment of creditors as whole, the administrator would focus now focus on realizing the property of the troubled entity to make a distribution to one or more secured or preferred creditors.

How does the administrator proceed about his duties to pursue the objectives or purposes of the administration. The law requires him to make a statement setting out **proposals** for achieving the purposes.[222] Specifically, the proposal must contain statement, where this is the case, explaining why the administrator believes that objectives 1 and 2 cannot be achieved. Generally, the proposal may include a proposal for a CVA, or for a scheme of arrangement and compromise. Within 30 days the administrator is expected to send a copy of the statement of proposals to creditors, shareholders, and the Commission. It is important to note the various but different statements required to prepared in pursuance of the administration. These are the statement of proposals,[223] statement of affairs of the company,[224] the Proposed administrator's statement and consent to act,[225] and the statement of concurrence.[226]

Bearing the duty on the administrator to perform his functions in the interests of the company's creditors as a whole, What normative theoretical perspectives can you use to explain the objectives? Is it possible to achieve equality of treatment as between creditors of a company in administration? Except the first objective succeeds, it is hardly possible to use the mechanism of administration to overreach the discrimination by exclusion which security interests entrenches. Thus, the animal farm situation is inevitable in an entity in administration. Specifically, for example, while the law gives power to the administrator to make a distribution to a creditor of the company, it clawed back that power by outlawing, save on the permission of the Court, distribution to a creditor of the company who is neither secured nor preferred.[227] In fact, the administrator cannot purport to invade the pristine position of

[221] ACCA. Going Concern. Available online at https://www.accaglobal.com/gb/en/student/exam-support-reResources/fundamentals-exams-study-reResources/f8/technical-articles/going-concern.html. Accessed 3/1/2023.
[222] Section 486 CAMA and Regulation 3.23
[223] Ibid
[224] Section 484 CAMA and Regulation 3.27
[225] Regulation 3.02
[226] Regulation 3.28
[227] Section 502 CAMA 2020

secured creditors by including in his statement of proposals any action which tended to upset and distort that position.[228] In other words, administration is not tool for curing the principle of discrimination by exclusion which the presence of security interest creates amongst the class of creditors.

3.3.3. The Administrator: qualifications, appointment, etc.

In relation to a company, an administrator is a person appointed by the Court, creditor with a floating charge, the directors, or the company to manage the affairs, business, and property of the company. To be an administrator of a company, you must be duly accredited insolvency practitioner (IP). See Unit 7 for further discussion on IP.

Certain of categories of persons are disqualified from acting as administrator. It is immaterial that they satisfied the requirements as to accreditation. They include an infant, a person of unsound mind, a body corporate (except statutory corporations), an undischarged bankrupt (except with leave of the Court), a director or auditor of the company, a connected person and any person convicted of any offence involving fraud, dishonesty, official corruption, or unethical conduct or who is disqualified under the section 280 CAMA 2020.[229]

There are three modes by which an administrator may be appointed, namely by the Court,[230] the holder of a floating charge or the company,[231] or its directors.[232] An out of court appointment requires an *ex parte* application to the Court for approval if the administration has a cross border element.[233] In the same vein an administrator appointed *extra curia*, must give statutory notice to the Court of his appointment, accompanied by an *ex parte* application to the Court for a formal order of the court.[234] Significantly, a holder of a floating making the appointment must restrain deluding himself that the administrator stands in a position analogous to a trustee, whose preoccupation is pursuit of the interests of his appointors. Contrariwise Armour (2011) observed that the enthusiasm of the holder of qualifying floating charge to appoint an administrator is or "will be tempered by the fact that the officeholder (administrator) will be under a statutory duty to all creditors, and that the costs of their efforts are payable out of floating charge assets." You are

[228] Section 510 CAMA 2020
[229] Regulation 1.08
[230] Section 443(1)(a) and 449 CAMA 2020, and Regulation 3.03ff
[231] Section 443(1)(b), 452 and 472 CAMA 2020, and Regulation 3.16ff
[232] Section 443(1)(c) and 459 CAMA 2020, and Regulation 3.20ff
[233] Section 443(2) CAMA 2020
[234] See sections 443(3) and 457 CAMA 2020

expected to read up and be familiar with the three modes of appointing an administrator.

The administrator is an agent of the company and stands in a position analogous to a trustee. He is also an officer of the court, despite his mode of appointment.[235] The administrator has omnibus powers to do anything necessary or expedient for the management of the affairs, business, and property of the company. In addition to the powers contained in Eleventh Schedule, the administrator can remove or appoint a director, call a meeting of shareholders or creditors, and can make a distribution to a creditor of the company. Interestingly, the interests of third parties dealing with the administrator in good faith and for value are protected. In fact, a defect in the appointment or qualification of the administrator would not invalidate his acts or relieve the company.

The administrator, who can be replaced following resignation, removal, or disqualification, is not above challenge. Thus, a creditor or shareholder can apply to the Court claiming among others that the administrator is acting or has acted so unfairly as to harm the interests of the applicant, whether alone or in common with some or all other members or creditors. Upon such application, the Court may grant a relief, dismiss the application, make an interim order, etc.[236]

3.3.4. Placing a Company in Administration

When does a company go into administration? At this point it is important to bear in mind that there is a world of difference between when a company <u>enters administration</u> and when a company is <u>in administration</u>. As to the latter, it occurs while the appointment of an administrator of the company has effect; while in the case of the former, it is when the appointment of an administrator takes effect.[237] This difference is very critical. For instance, the law[238] provides that if a company <u>enters administration</u> by virtue of an administration order or an appointment under section 450 of this Act where, before the requirements of section 464 of this Act are satisfied,—(a) the appointment under section 459 of this Act shall not take effect; and (b) section 467 of this Act shall not apply. You should take your time to go through the provisions.

[235] Sections 446, 504 and 506 CAMA 2020
[236] Section 511 CAMA 2020
[237] Section 549(2) CAMA 2020
[238] Section 471 CAMA 2020

There are two ways of placing a company in administration. The first is an out of court administration process, which in terms of cost is less expensive and should be preferred. Nevertheless, an out of court administration requires filing certain prescribed documents with the Court, including obtaining a formal order of the Court. The other way arises by reason of a formal application made to the Court for an Administration Order. For example, the liquidator of a company may make an application for placing a company in administration.[239]

3.3.5. Effect of Administration

Once a company is put in administration it displaces the power of the management to act or exercise its powers. Administration displaces management.[240] Also, actions are stayed. Hence, landlords cannot distrain on the company's assets and cannot forfeit the lease, creditors cannot pursue court judgments against the company, or seek to enforce a judgment that they have already obtained, winding up petitions cannot be issued against the company, and hire purchase and lease companies cannot recover their assets except as provided in the law. Thus, if an administrator is appointed, the effect on enforcement by secured creditors is immediate and dramatic: there is a moratorium on the enforcement of security.[241] Will this address the vulnerabilities of unsecured creditors and other stakeholders? It depends on the outcome of the administration. For example, if the first objective in the hierarchy fails, it is not likely that other interests will escape hurt.

Administration comes to an end if the appointment of an administrator ceases to have effect. However, it does not cease to be in administration merely because an administrator vacates office or is removed from office. Vacation of office can occur by resignation, death or otherwise – as is when the administrator becomes disqualified.[242]

3.3.6. End of Administration

Except renewed, the administration ends or ceases to have effect at the end of the period of one year beginning with the date on which it takes effect. The extension of office takes one of two forms – on the application of the administrator the Court may extend it for a specified

[239] Section 475 CAMA 2020
[240] Section 501 CAMA 2020
[241] Gullifer, L. & Payne, J. (2011). Corporate. Finance Law: Principles and Policy, London: Hart, p. 90
[242] Section 549(2)(c) and (d) CAMA 2020

period or by consent it can be extended by a period not exceeding six months.

Further, the administration comes to an end where the objective of the administration has been sufficiently achieved and the administrator files a notice with the Court and the Commission, or where the administrator applies to the Court that he thinks the purpose of administration cannot be achieved or that the company should not have entered administration.

It is possible to move administration to creditor's voluntary winding up, or to dissolution. Also, a petition for winding up on grounds of public interest can be presented against a company in administration. If either of these events occur, the administration ceases to have effect.[243]

3.3.7. Offences and Penalties

Generally, a person who commits an offence with reference to administration is liable on conviction to a fine of no less than NGN200,000.00. Additionally, a person who commits an offence under specifically identified sections dealing with administration shall be liable on conviction to a daily fine of at least NGN5,000.00.[244]

Self-Assessment Exercise 16

a) *Specify the various statements which can arise in relation to a company in administration.*
b) *What do you understand by the concept of going concern?*
c) *Without explaining, state the purposes of administration.*
d) *What do you understand by "animal farm situation" with reference to the treatment of creditors of an insolvent entity?*

3.4 Summary

In this unit, you studied the insolvency mechanism of administration. In this connection, you studied a brief outline of its history, the objectives or purposes to be pursued by the administration, the qualifications of an administrator and how he can be accredited to practice as an insolvency practitioner by the Commission, how to place the company in administration, the effects thereof and how it comes to an end.

3.5 References/Further Readings/Web Resources

[243] Sections 520, 521, and 522 CAMA 2020
[244] Section 544 CAMA 2020

ACCA. Going Concern. https://www.accaglobal.com/gb/en/student/exam-support-reResources/fundamentals-exams-study-reResources/f8/technical-articles/going-concern.html

Anderson, H. (2016) 'An Introduction to Corporate Insolvency Law', *Plymouth Law and Criminal Justice Review, 8*, pp. 16-47. Available at: https://pearl.plymouth.ac.uk/handle/10026.1/9038.

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Onamson, F.O, (2017) Law and Creditor Protection in Nigeria. Malthouse Law Books, Lagos.

Quickguides, Ashurst. (2020). A Brief Guide to Corporate Restructuring and Insolvency in England and Wales. Available online at https://www.ashurst.com/en /news-and-insights/legal-updates/quickguide---abriefguide-to-corporate-restructuringandinsolvency-in-england-and-wales/

Legislations and Statutory Instruments

Companies and Allied Matters Act 2020
Insolvency Regulations 2022
UK Companies Act 2006
UK Insolvency Act 1986

3.6 Answers to Self-Assessment Exercises (SAEs)

Self-Assessment Exercise 16

a) There are four statements. They are the statement of proposals, statement of affairs of the company, the Proposed administrator’s statement and consent to act, and the statement of concurrence.

b) The concept of going concern is an “going concern” is an accounting term that refers to a company's ability to make enough money to stay afloat or to avoid insolvency. It us used to prepare financial statements, which assumes that the entity has neither the intention, nor the need, to liquidate or curtail materially the scale of its operation.

c) The purposes or objectives of administration are rescuing the company as a going concern, or achieving a better result for the company’s creditors as a whole than would belikely if the company were wound up, without first being in administration, or realising property in order to make a distribution to one or more secured or preferential creditors.

d) Animal farm situation refers to a situation which obtains in relation to the estate of an insolvent debtor. The situation allows secured creditors to take realise their interest before unsecured creditors. This could potentially leave unsecured creditors with nothing to look up to. Security interests creates animal farm situation which operates on the paradigm of discrimination by exclusion targeted at unsecured creditors.

UNIT 4 RECEIVERSHIP

Unit Structure

4.1 Introduction

In this unit, attempt will be made to take you through the institution of receivership as provided for under the law. The principal law in this area is CAMA 2020. Receivership is different from administration. It is focused more on realization of security and may, despite the altruistic configuration of the law requiring accommodation of larger interests in certain cases, leave the debtor beaten, battered, and wasted. This is because the law is clear that a receiver appointed to realise the security of a debenture holder, subject only to an order of the Court, has:

> power to take possession of the assets subject to the mortgage, charge or security and sell those assets and, if the mortgage, charge or security extends to such property collect debts owed to the property enforce claims vested in the company, compromise, settle and enter into arrangements in respect of claims by or against the company, on the company's business with a view to selling it on the most favourable terms, grant or accept leases of land and licences in respect of patents, designs, copyright or trademarks and recover any instalment unpaid on the company's issued shares.[245]

This is additional to the power to any other powers conferred on the trustee or debenture holder and power realise the security by a foreclosure action or by commencing a winding up proceedings[246] This whittles the provisions on business rescue and represents legislative unwillingness to take the bull by the horns. One would have thought that the business rescue mechanism of administration would be promoted

[245] Section 233(5) and 233(3) CAMA 2020
[246] Ibid 233(2)(b)

over and above receivership as a creditor mechanism. If this was the case, creditors would be disincentivized from activating the mechanism as an option of first resort. As you will see in the course of the Unit, except strict controls are put in place as to the exercise of this power to put a company in receivership, the other insolvency approaches tending to promote business rehabilitation and rescue under the law, would be hardly realised. What are those business rescue insolvency approaches earlier discussed?

4.2 Learning Outcomes

By the end of this unit, you will be able to:

- define receivership and discuss various types of receivers
  - explain the nature of receivership as an insolvency approach.

4.3 Receivership

The appointment of a receiver is the strongest remedy the law provides for the debenture holders.[247] It is the most attractive creditor protection mechanism in that it empowers the creditor to appoint out of court subject to a provision in the debt instrument in that respect. Due to the attraction of this mechanism, it is doubtful whether the business rescue mechanisms of CVA and administration will ever have a scintilla of opportunity to breathe and make an impact. The power of the creditor to appoint an administrative receiver under the UK insolvency jurisdiction has been drastically diluted and in time will be a relic of history. The Nigerian legislative saw it differently and still retained the expansive powers of the creditor through the institution of receivership, the unrestrained of which can easily precipitate insolvent liquidation.

4.3.1 Definition

Section 868 defines a receiver to include a manager. The same section defines official receiver as an officer by whatever name called or known charged with control of affairs in bankruptcy and if the appointment is vacant for any reason whatsoever, means the sheriff. No doubt the definition of a receiver is unsatisfactory and conveys no reliable meaning. Ejuwunmi JSC described a receiver and manager as one who is appointed for the protection of the estate and for the benefit of all concerned, and in sanctioning the receiver taking proceedings the court has regard to what it considers right and proper in the interest of

[247] Section 233 CAMA 2020

all parties.[248] Identifying this description as "judicially fabricated altruistic role,"[249] Onamson (2017) posits that the phrase "all concerned" and "all parties" in that judicial definition would include the company since the appointment does not abate its title to the goods in receivership but only its right to deal with the assets[250], the secured creditor who made the appointment or at whose behest it was made by the court, and residual claimants, the unsecured creditors. In other words, the definition gives life to communitarian conceptions of insolvency law. Do you think this idea that the receiver and manager undertake altruistic role can apply in all situations?

4.3.2 Types of Receivers under CAMA

Onamson (2017) came up with three categories receivers capable of being appointed. They are receiver simpliciter; the second is a manager over the whole or substantially the whole of undertaking of the company (otherwise lip service manager); and the third is a receiver or manager over the whole or substantially the whole of the company's property (otherwise authentic receiver and manager).

(a) Receiver simpliciter.[251] This type is the default position of the law because if he is not in office there can be no manager or any appointment of a manager is void.[252] He cannot carry on the business of the company, albeit the scope of his appointment could be expanded to include management powers (i.e., power to carry on any business or undertaking).[253] Among others Onamson (2017) criticized the provision as "mundane, outmoded and out of touch with current commercial realities in an already globalized economy." According to him the provision should have required that a manager must be appointed before considering the appointment of a receiver. The fact that this kind of receiver can be appointed under the current law, means that the business

[248] Unibiz Nig Ltd v CBCL Ltd (2003) 2 SC 23
[249] Section 553 tends to support this when it provides that a receiver and manager appointed for the whole or any part of the undertaking of a company is deemed to stand in a fiduciary relationship towards the company and must observe utmost good faith towards it in any transaction with it or on its behave.
[250] Central London Electricity Ltd v Berners & Ors (1945) 1 KB 160; Newhart Developments v Co-op Commercial Bank (1978) 2 All ER 901; Intercontractors v NPFMB (1988) NWLR (Pt 76) 280.
[251] Section 556(1) CAMA
[252] Section 556(1) stating that "unless the receiver is an appointed manager, he does not have power to carry on any business or undertaking." and section 233(5) providing that "a manager of the business or of any of the assets of a company may not be appointed for the benefit of debenture holders unless a receiver has also been appointed and has not ceased to act."
[253] Ponson Enterprises (Nig) Ltd. v. Njigha (2000) LPELR-6805 (CA)

rehabilitation mechanisms of CVA and administration may not have the space to be implemented, improved, and entrenched.

(b) Lip-service manager (manager under lip-service provision). The lip-service manager is one appointed over the whole or any part of the undertaking of the company.[254] His schedule of duty is restricted to "managing the undertaking" with the view to the realisation of the security of those on whose behalf he is appointed. He is so called because there cannot be such a manager without a receiver simpliciter. What is the difference between the manager under lip-service provision and a receiver simpliciter? The receiver simpliciter is normally appointed in respect of a specific or single item of property as against the undertaking or the entire business of the company. His prime object is to get in and realise the property and settle the debt.

The lip-service provision manager is appointed over the whole or any part of the undertaking of the debtor. His object is to manage the undertaking. However, the receiver simpliciter has a life distinct from the manager. He can exist without the manager. But this is not the case with the manager who has no life without the receiver simpliciter. The manager needs the umbilical cord of the receiver to live, but the receiver can exist independent of the manager. In fact, the scope of the receiver simpliciter can be expanded to include carrying on (managing) the business or undertaking of the company. To expand his powers, he can be appointed a manager. On the other hand, the manager cannot be in place except and only if there is a receiver simpliciter.

(c) The true receiver and manager. Although the section providing for receiver and manager used the word "or", it makes better sense if it is construed conjunctively. Does it mean it is not possible to have one person holding the office of a receiver and another person holding the office of a manager? The legislature thinks it is possible.[255] Whether this thinking squares with commercial reality is a different matter entirely. Meanwhile there appeared to be legislative inconsistency and confusion in this regard. For example, the margin notes it titled[256] "receivers and managers appointed out of Court" "appointment of receivers and

[254] Section 233(5) and 556(2)
[255] Section 553(1) CAMA 2020.
[256] Section 206, 233, 552, 553, 556, 557 CAMA 2020

managers by the Court" "disqualification for appointment of a receiver or manager" and "duties and powers of receivers and managers" but the body of the law in some places carried "receiver or manager"[257] and in another carried "receiver and manager."[258]

The UK equivalent of the Nigerian receiver and manager is administrative receiver, defined as a manager of the whole (or substantially the whole) of a company's property appointed by or on behalf of the holders of any debentures of the company secured by a charge which, as created, was a floating charge, or by such a charge and one or more other securities.[259]

The receiver and manager must observe other persons' rights to the company's property if the rights were acquired prior to crystallisation. This is because the appointment does not operate as a stay of execution.[260] Hence, "if there is another floating charge over the same asset and it was created before the charge under which (he) was appointed then it is still a prior charge on those assets if and when it crystallises".[261] After the appointment, execution cannot be levied on the property subject to the charge.[262] The receiver and manager cannot utilise any property subject to fixed charge to pay the debt secured by the floating charge under which he was appointed.[263] He could overcome this encumbrance by electing to redeem the prior fixed charge. Where the fixed chargee had notice of the floating charge, his interest will lose priority. Where the receiver is withdrawn and the chargee agrees, the crystallised floating charge (identified in this work as contingent specific charge) refloats to become deemed floating charge. In the same vein, the receiver and manager cannot obtain goods that the company has pledged without paying the debt secured by the pledge.

[257] Section 206, 552(2), 553(1), 554(1), 557(1), etc
[258] Section 355(2)(h), 552(1), 704
[259] Section 29(2)(b) Insolvency Act 1986
[260] Section 557(2); Intercontractors Nigeria Ltd v UAC Nigeria Ltd (supra)
[261] Re Morrison, Jones & Taylor Ltd (1914) 1 Ch 50.
[262] Omojasola v Plisson FIsko Nigeria Ltd (1990) 5 NWLR (Pt 151) 434
[263] English & Scottish Mercantile Investment Co Ltd v Brunton (1892) 2 QB 700

4.3.3 Power to Appoint Receivers

The following persons have power to appoint:

(a) Mortgagee/chargee, can appoint under certain enabling legislations, to wit section 123(1)(iii) Property and Conveyancing Law 1959; section123(1)(c) Kaduna State Property Law 1990 and section 19(1)(iii) Conveyancing Act 1881. The conditions for the mortgagee to be entitled to the power to appoint a receiver are (a) the mortgage must be by deed; and (b) the mortgage sum must be due. The power is deemed to be provided in the mortgage deed. With respect to a debenture covered by mortgage, the power to appoint must be expressly provided in the instrument.

(b) Debenture holder or trustee of debenture holder. The debenture holder or a trustee under a debenture trust deed has power to appoint a receiver of any assets subject to a mortgage, charge, or security. The power to appoint a receiver becomes automatically exercisable on the occurrence of any of the prescribed statutory events, and the power to appoint avails in addition to, and not in substitution for, any other powers and remedies, which by agreement, are provided in the instrument of debenture or debenture trust deed.[264] When the debenture holder or trustee under a debenture trust deed makes the appointment, one of three types of receivers will be appointed.

Upon appointment, the receiver must, before assumption of duties, apply to the court for any direction respecting the performance of his functions.[265] What do you think is the rationale for this position. Ejuwunmi JSC stated that it is based on the well settled principle of law to the effect that:

> in a mortgagee's action where a receiver and manager has been appointed, it is for the court to determine whether proceedings shall be taken at the expense of the mortgaged property. The receiver cannot do this of his own initiative but would run the risk of his cost being disallowed if he did not obtain the direction of the court, and neither mortgagor nor mortgagee has any absolute right to insist upon an action being brought or to prohibit it being brought by the receiver at the expense of the mortgaged property.[266]

Similarly, the Commission must within 14 days of appointment be notified. Otherwise, the receiver or manager runs the risk of

[264] Section 232 and 233 CAMA 2020
[265] Section 554 CAMA 2020
[266] Unibiz Ltd. v. C.B.C.L. Ltd (supra)

conviction for an offence the liability of which is a penalty for every day during which the default continues in such amount as the Commission shall specify in its regulations.[267]

(c) Power of AMCON to appoint. AMCON can act as a receiver or appoint one in its stead. If AMCON acts or one is appointed by it, the receiver has power to realise the assets of the debtor company, enforce the individual liability of the shareholders and directors of the debtor company and manage the affairs of the debtor company.[268] The AMCON receiver is then in a special class compared to the receiver appointed under CAMA.

(d) Power of the Court to Appoint. Under certain circumstances, the court has power to make an order for the appointment of a receiver. The court has power to appoint a receiver or a receiver and manager of the property or undertaking of the company if the principal money or the interest thereon falls in arrears or the security or the subject matter of the security is threatened or in jeopardy. Usually, the application is made by a person interested, which will include secured creditors, debenture holders and trustees. It is important to note that naked debenture holders do not have the power to appoint a receiver. By the same token, they cannot overcome this limitation through the court.

(e) Case notes and references. See **Lawson & Ors v POLFA (Nig) Plc & Ors**[269] Duty on a party challenging the registration of a deed of appointment of a receiver with the CAC; effect of failure to register deed of appointment of receiver with CAC in compliance with the law, the case of **Brewtech Nig Ltd v Akinnawo & Anor**[270] in relation to the effect of faulty appointment of a receiver/manager, the case of **Solar Energy Advanced Power System Ltd v Ogunnaike & Anor**[271] on the consequential effect of the appointment of a receiver, the case of **Uthman v Canvass Farms (Nig) Ltd & Ors**[272] on whether AMCON or a receiver appointed by AMCON is required to give notice of such appointment to the debtor company; position of the law where there is a conflict between the AMCON Act and the

[267] Section 555 CAMA 2020
[268] Section 48 Assets Management Corporate of Nigeria Act 2010
[269] (2019) LPEL-48931 (CA)
[270] (2016) LPELR-40094 (CA)
[271] (2008) LPELR-8470 (CA)
[272] (2021) LPELR-54653 (CA) and AMCON v Canvass Farms (Nig) Ltd & Ors (2021) LPELR-54651 (CA)

Companies and Allied Matters Act, the case of **Obielum & Anor v Intercntinetnal Homes Savings & Loans Ltd & Anor**[273] on the effect of failure to give notice of appointment of a receiver/manager under CAMA

4.3.4 Legal Position of a Receiver and Manager

The receiver and manager may be an agent of his appointor, an officer of the court and a fiduciary towards the company.

(a) Agent of the appointor. Under the common law, the principle is that the receiver is the agent of the mortgagor, although he is appointed by, and for, the mortgagee. However, under CAMA a receiver or manager of any property or undertaking of a company appointed out of court under a power in a debenture or trust deed shall be deemed to be an agent of the person or persons on whose behalf he is appointed.[274] On the legal effect of this statutory provision, Onamson (2017) it makes the mortgagee directly and personally liable for the acts and omissions of the receiver. This places the mortgagee in a position analogous to a mortgagee in possession. In light of this position, the mortgagee bears enhanced and continuing liability, unlike the common law where the mortgagee's liability for the acts and omissions of the receiver arises in liquidation "when the receiver stops being agent of the mortgagor and becomes agent of the mortgagee if the latter treats him as such"; and "where the mortgagee specifically directs the receiver to do the act on which liability is based.[275] How do you think the mortgagee can overcome the enhanced duty or liability? The debt instrument can provide that the receiver shall be the agent of the mortgagor, or the mortgage document can the appointment subject to the relevant provisions under the general law. If this is done, the receiver or manager shall be the agent of the mortgagor.

(b) Officer of the court. Every court appointed receiver is an officer of the court. As officer of the court, he is subject to the directions and instructions of the court, including submitting to the court, instead of the CAC, statement of affairs with his comments thereon. The official receiver is an officer of the court too. He is

[273] (2016) LPELR-45788 (CA)
[274] Section 553(1) CAMA
[275] American Express International Banking Corporation v Hurley (1986) BCLC 52 and Standard Chartered Bank v Walker (1982) 1 WLR 1410

charged with the task of investigating the causes of company failure leading up to insolvency. He can act as a provisional liquidator in compulsory liquidation and also as a receiver.

(c) Fiduciary towards the company. The receiver stands in fiduciary relationship towards the company once he is also appointed as the manager.[276] Impliedly a receiver simpliciter cannot be a fiduciary of the company. This can work injustice, having regard to the possibility that the mortgagor and other parties similarly interested are still entitled to the equity of redemption. Where the property is sold, the equity of redemption becomes locked up in the surplus.

Once a receiver is additionally appointed a manager over the whole or substantially the whole of the property of the company, his powers include to carry on, not necessarily to dispose of it as a going concern, the business of the company including to establish subsidiaries. It makes sense that the highest standard of duty is on the trustee as in the case of the alter ego. The appointment suspends the authority of the directors to act or deal with the charged property. They will remain in office and liability still attaches to them as directors. They cannot interfere with the work of the receiver as regards the property subject to receivership.[277]

It is not surprising that the receiver and manager should be placed in fiduciary position having regard to the expansive powers donated to him under the law. As fiduciary, he must execute his duties with fidelity and reasonable diligence[278] as a faithful, diligent, careful, and ordinarily skillful manager would act in the circumstances and doing so in the best of the company as a whole.[279]

4.3.5 Duties and Powers of a Receiver and Manager

The duties and powers of a receiver and manager derive their being from the statute and under the general law. Where it is a receiver simpliciter

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[276] Section 553(1) CAMA;
[277] In Newhart Development Ltd v Co-operative Commercial Bank Ltd (supra), it was held that the appointment of a receiver does not divest the directors of their power to commence action in the name of the company.
[278] Charitable Corp v Sutton (1742) 26 ER 642; Foley v Hill (1848 2 HLC 28; Ultraframe (UK) Ltd Fielding (2005) EWHC 1638
[279] Section 553(2) CAMA.

the duties will not extend beyond possessing, realising and selling the property to pay the underlying obligation.[280]

(a) Duties of a receiver and manager. The duties include to take possession and protect the property, to manage the undertaking of the company, and to prepare and submit reports and returns. Apart from the foregoing, there is the general duties of the receiver and manager. The components of the general duties of the receiver and manager include the duty of skill and care, duty of good faith and duty to act in the best interests of the company at all times entail the manager acting honestly and fairly. The best interest duty relies on what he believes to the best interests of the company as a whole. This is, it is submitted, a subjective duty as it rests on what he the receiver or manager believes to be the best interest of the company. Despite this, the receiver is not at liberty to act unreasonably or unconscionably under the guise of his subjective belief. Further, the receiver and manager must avoid situations of conflict and is bound by the self-dealing and fair-dealing rules. If he sells the assets to himself or to a person in whom he is interested, whether or not it was at a fair price or true market value, the sale would be set aside.

(b) Powers of the receiver and manager. The powers of a receiver simpliciter cannot be the same as the powers of a receiver and manager. For a receiver simpliciter, the powers will largely be found in the various laws respecting property[281]; and may be set out in the mortgage or charge instrument, which normally is a recast and extension of the duties under the various property laws.

On the other hand, the powers of a receiver and manager for the whole or substantially the whole of a company's property are copiously encapsulated in the Eleventh Schedule of the Act. The powers include carrying on the business of the company, establishing subsidiaries, to raising or borrowing money, or defending action or other legal proceedings in the name and on behalf of the company, among other far-reaching powers. Apart from the omnibus provision which donates power to him to do all other things incidental to the exercise of the foregoing powers, these powers are substantial in effect. For instance, the power to establish subsidiaries empowers the receiver and manager to

[280] Section 556 CAMA
[281] Section 131 PCL 1959; Section 24 CA 1881; Section 131 KSPL 1990

undertake "hiving down"[282] procedure, whereby he sells the assets under his control to a new company. The shares of the new company are normally held by the nominees of the receiver and manager in trust for the company in receivership. This procedure makes it possible for the receiver and manager "to create a convenient package of assets to be offered for sale and payment to the company in receivership is not made until the hive-down company is sold.

Self-Assessment Exercise 17

a) What evidence can you adduce to support the proposition that receivership usually leaves the debtor beaten, battered, and wasted*?*

b) Discuss the power of the court to appoint a receiver

5.4 Summary

In this Unit you have been able to study the various aspects of the topic of receivership, including definition, types of receivers, power to appoint receivers, when the power to appoint arises, legal position of a receiver and manager, and duties and powers of a receiver and manager.

5.5 References/Further Readings/Web Resources

Onamson, F.O, (2017) Law and Creditor Protection in Nigeria. Malthouse Law Books, Lagos.

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Thorne, J. (Ed.) (2002). Butterworths Company Law Guide, fourth edition. Butterworths LexisNexis, London.

Legislations:
Asset Management Corporation of Nigeria Act 2010
Companies and Allied Matters Act 2020

[282] See generally, Mayson, et al, op cit, p. 513.

5.6 Answers to Self – Assessment Exercises (SAEs)

Self-Assessment Exercise 17

(a) It is focused more on realization of security. Specifically, the law provides that a receiver appointed to realise the security of a debenture holder, subject only to an order of the Court, has power to take possession of the assets subject to the mortgage, charge or security and sell those assets and, if the mortgage, charge or security extends to such property collect debts owed to the property enforce claims vested in the company, compromise, settle and enter into arrangements in respect of claims by or against the company, on the company's business with a view to selling it on the most favourable terms, grant or accept leases of land and licences in respect of patents, designs, copyright or trademarks and recover any instalment unpaid on the company's issued shares.

(b) The court has power to appoint a receiver or a receiver and manager of the property or undertaking of the company if the principal money or the interest thereon falls in arrears or the security or the subject matter of the security is threatened or in jeopardy. Usually, the application is made by a person interested, which will include secured creditors, debenture holders and trustees. It is important to note that naked debenture holders do not have the power to appoint a receiver. By the same token, they cannot overcome this limitation through the court.

UNIT 5 ARRANGEMENTS AND COMPROMISE

Unit Structure

5.1 Introduction

They are various reasons why companies will engage in one form of restructuring[283] or the other. It might be to vary the rights and obligations between the company and its members or creditors. Another reason may the need for diversification and expansion, which can occur by way of vertical integration (with companies performing other functions in the production process chain) or horizontal integration (with companies at the same stage in the production process).[284]

5.2 Learning Outcomes

- By the end of this unit, you will be able to:Define and differentiate between the various forms of corporate restructuring.
- Explain the situations in which each can be activated.
- State the steps or procedure for implementing each type.

[283] For the purpose of this course, the word "restructuring" is used to refer to a change in the structural patterns of the company, whether internally (between the company and its members or creditors) or externally (between two separate companies). The scope of the course will not examine in detail all forms of corporate structuring like mergers and acquisitions.
[284] Sealy L. and Worthington S. (2010). Sealy's Cases and Materials in Company Law, ninth edition. Oxford: OUP, p. 698

5.3 Corporate Restructuring

As noted earlier there are many reasons a company engage in corporate restructuring. Whatever the motivation, it may take the form of arrangements, compromise, reconstruction, mergers, acquisitions or takeover. From the point of arrangements, there are basically two types of restructuring provided under CAMA 2020. This marked an improvement over CAMA 2004, where provision was made for only intracompany restructuring. Before discussing the various types, it is important to examine some terms.

5.3.1 Definition of terms

The terms arrangement and compromise, reconstruction and merger or amalgamation have been defined below to provide clarity to you. Note however that the concern for this course is arrangement and compromise. Other forms of corporate restructuring will not be discussed further.

(a) Scheme of arrangement. Statutorily arrangement has been rendered as any change in the rights or liabilities of members, debenture holders or creditors of a company or any class of them or in the regulation of a company, other than a change effected under any other provision of this Act or by the unanimous agreement of all parties affected. It can be argued that a scheme of arrangement can be deployed by companies "to effect mergers and amalgamations and also to alter the rights of its members or its creditors, with the sanction of the Court. The provisions are sufficiently wide to accommodate schemes having a considerable diversity of objectives and range of complexity, which may involve more than one company."[285] Does the provision for a scheme of arrangement under CAMA overreach, and therefore conflict with, a kindred enactment (ISA 2007) provisions on mergers? Strictly speaking, arrangement and merger are the same event. Weighing in on this **in the context of s 538 CAMA 2004, Idigbe, Chiwete and Kalu (2012)**[286] submitted that:

> The Section 538 provisions are similar to the M&A schemes envisaged under Part XII of the Investments and Securities Act, except that in a typical M&A transaction, a liquidator is not

[285] ibid.

[286] A. Idigbe, C. Chiwete, and O. Kalu. (Aug 2012). "Scheme of arrangement as a business rescue tool." Lexology. https://www.lexology.com/Commentary/Insolvency-Restructuring/Nigeria/Punuka-Attorneys-Solicitors/Scheme-of-arrangement-as-a-business-rescue-tool. Accessed 12/6/2023

appointed; rather, the transferor is dissolved, not wound up by order of the court, and shares are allocated to its shareholders in the transferee's company. In the scenario envisaged under Section 538, the rescue aspect is that although the company is wound up, the business is to some extent preserved - or, at least, a better realisation of assets is achieved than would have been possible in liquidation.

(b) Hiving down. This appears much like the opposite of a merger or amalgamation which when concluded constitutes two or more companies into one "aggregated venture." With hiving down, it involves a company taking steps and forming a subsidiary and vesting parts of its assets and undertaking in the new entity, or transfers the assets to an existing subsidiary, and selling the shareholding in that subsidiary to new owners. On the other hand, it may a case of "*division*", "*demerger*" *or* "*scission*", which, according to Sealy and Worthington (2010) may be a simple sale of the assets, ether for cash or in consideration of the allotment of shares in the purchasing company to the vendor, or to the shareholders of the vendor if it is a company.[287] Part of the powers of an administrator and receiver and manager is power hiving down.[288]

(c) Merger or amalgamation. The ISA 2007 defines a merger as any amalgamation of the undertakings or any part of the undertakings or interest of two or more companies or the undertakings or part of the undertakings of one or more companies and one or more bodies corporate. It can be achieved through purchase or lease of the shares, interest or assets of the other company in question, or amalgamation or other combination with the other company in question. The law empowers SEC to establish bases for categorizing mergers into "a small merger", "an intermediate merger" and "a large merger."[289] Sealy and Worthington (2010) clarify that a merger or amalgamation takes place where the assets and undertakings of more than one company are brought under the ownership and control of a single company, which may be one of the companies involved or a new one. The result is that the shareholders who were members of the several amalgamating

[287] Op cit, p. 699-700
[288] See Eleventh Schedule, paragraphs 15 and 16 thereof.
[289] See ss 119 and 120 ISA 2007

companies now together own and control the same enterprises as one aggregated venture.[290]

(d) Takeover/Acquisition. ISA 2007 ordains that takeover occurs where any person acquires shares (whether by a series of transactions over a period of time or not), which, taken together with shares held or acquired by persons acting in concert with him, carry 30% or more (or any lower or higher threshold as may be prescribed by SEC from time to time of the voting rights of a company or where a person together with persons acting in concert with him, holds not less than 30% but not more than 50% (or a lower or higher threshold as SEC may prescribe from time to time) of the voting rights and such person or any person acting in concert with him, acquires additional shares which increase his percentage of the voting rights, such a person shall make a take-over bid to the holder of any class of equity share capital in which such. Person or any person acting in concert with him holds shares.[291]

On the other hand but materially in similar terms, **Investopedia defines takeover in** the following terms: A takeover occurs when one company makes a successful bid to assume control of or acquire another. Takeovers can be done by purchasing a majority stake in the target firm. Takeovers are also commonly done through the merger and acquisition process. In a takeover, the company making the bid is the acquirer and the company it wishes to take control of is called the target. Investopedia outlines the types of takeovers including:

- ◊ A welcome or friendly takeover,
- ◊ An unwelcome or hostile takeover,
- ◊ a poison pill, which allows the target's shareholders to purchase more shares at a discount to dilute the potential acquirer's holdings and voting rights.
- ◊ A reverse takeover happens when a private company takes over a public one.
- ◊ A creeping takeover occurs when one company slowly increases its share ownership in another.

[290] Op cit, p. 699
[291] Section 131

On the other hand, takeover and acquisition, although capable of being used interchangeably, has a slight difference. Hence, the **major difference between acquisition and takeover** is that a takeover is a special form of acquisition that occurs when a company takes control of another company without the acquired firm's agreement.

Case notes and references: On how to prove the acquisition of a company, see **Keystone Bank Ltd v Ebuh & Ors**;[292] in relation to the rule governing the acquisition of shares in companies and takeover of one company by another, see **Kiko (Nig) Ltd & Ors v African International Bank Ltd & Ors;**[293] on what to show to prove a company has been acquired by another company, see the cases of **Afolabi & Ors v Western Steel Works Ltd & Ors**[294] and **Skye Bank v Dalami (Nig) Ltd**;[295] and whether one who acquires a company acquires its liabilities, see **Dantata Foods & Allied Products Ltd v AG Leventis (Nig) plc**.[296]

(e) Reconstruction. Sealy and Worthington (2010) state that reconstruction usually involve the transfer of the undertaking and business of a company (or, sometimes, several companies) to a new one company specifically established for the purpose. The old company is put into liquidation. The members will usually agree to take equivalent shares in the new company. This is as against being repaid their capital in cash by the liquidator. This implies that the same members will carry on the same or some part of the enterprise through the medium of a new company.[297] In other words, reconstruction behaves like arrangement under CAMA.[298] What circumstances do you think would move or compel a company to embark on the journey of reconstruction?

5.3.2 Intercompany arrangements

Basically, two forms of intercompany corporate restructuring arrangements can be discovered from CAMA 2020. One relates to the undertaking or business of the company while the other relates to the shares of the company. These will be examined here.

[292] (2021) LPELR-52773
[293] (2017) LPELR-43574 (CA)
[294] (2012) LPELR-8340 (SC)
[295] (2017) LPELR-49140 (CA)
[296] (2022) LPELR-56734 (CA)
[297] Ibid.
[298] See s 714 CAMA 2020

(a) <u>Arrangements relating to the undertaking of the company</u>[299]

This is an arrangement contemplated or executed between two or more companies. The law provides that the whole or any part of the undertaking or the property of any company in a scheme ("the transfer of company") may be transferred to another company pursuant to:

- a scheme proposing or evincing a compromise, arrangement, or reconstruction between two or more companies or
- the merger of any two or more companies.

To take effect the order of the Court must be sought and obtained. In this regard, the Court may, on the application in summary way of any of the companies to be affected, order separate meetings of the companies to be summoned in such manner as the Court may direct.

Other conditions to be met include (but subject to the order of the Court for separate meetings) the attendance and voting (either in person or by proxy) of shareholders holding not less than three fourths in the value of the company's shares. In other words, seventy five percent of the shareholders must agree to the scheme. Thereafter an application is made to the Court sanctioning the scheme. The transfer of company becomes binding on the companies once the Court sanctions the scheme.

There are other collateral or consequential orders,[300] the Court may give in the circumstances including but not limited to the transfer to the transferee company of the whole or any part of the undertaking and of the property or liabilities of any transferor company; the allotting or appropriation by the transferee company of shares, debentures, policies or other like interests in that company which under the compromise or arrangement are to be allotted or appropriated by that company to or for any person; the continuation by or against the transferee company of legal proceedings pending by or against any transferor company; the dissolution, without winding-up, of any transferor company.

In appropriate cases the power of the Court to make a consequential order is limited by the law. For example, the Court will not make an order dissolving, without winding up, any transferor company unless certain conditions are fulfilled and met. They include that (a) the whole of the undertaking and the property, assets and liabilities of the transferor company are being transferred into the transferee company;

[299] S 711 CAMA 2020
[300] S 711(3)-(4) CAMA 2020

and (b) the Court is satisfied that adequate provision by way of compensation or otherwise have been made with respect to the employees of the company to be dissolved.

(b) <u>Arrangements relating to the shares of the company</u>[301]

This aspect involves a scheme or contract involving the transfer of shares in a company as against the first one considered above – relating to a scheme involving "the transfer of the whole or any part of the undertaking or property of any company." Both schemes are called "transfer of company." The provisions of the law here is *impari materia* with section 129 Investments and Securities Act (ISA) 2007. Thus, the law approves a scheme or contract involving transaction by way of transfer in shares between two companies, where one is the transferor company and the other transferee company. It works in this way:

(a) There must be a scheme or contract, the subject of which is the transfer of shares in a company to another company. The transaction of this nature qualifies as "the transfer of company."
(b) The company making the offer to buy the shares in another company is known as the transferee company.
(c) The scheme or contract must be approved by holders of at least nine-tenth in value of the shares of the company. The shares already held by a nominee for the transferee company, or its subsidiary does not count in determining the nine-tenth.
(d) The approval of the 90% of members must be done within four months of receipt of the offer by the transferee company.
(e) Within two months after the expiration of the statutory four months, the transferee company give notice to any dissentient shareholder indicating its desire to acquire the shares of the shareholder. This is known as **cramdown provision**. Compare the cramdown provision with its kindred in section 130 ISA 2007.

You are required to read up the law to acquaint yourself with the position of the law as regards what happens where notice is given by the transferee company and the dissentient shareholder makes an application to the Court or where notice has been given and the Court has not ordered to the contrary.[302] In the same vein, the position of the dissenting shareholder is not hopeless. Despite the cramdown provision, the law made specific provisions to protect the minority.[303] Do you think the provision is adequate and can efficiently disincentivize the transferee company from treating the minority in an unfairly, prejudicial, and

[301] S 712 CAMA 2020
[302] See s 712(2)-(4) CAMA 2020
[303] S 713 CAMA 2020

discriminatory manner? At this point you should bear in mind that the scheme or contract discussed here is not the same thing as takeover within the meaning of ISA 2007. What then is takeover under ISA 2007?

By way of distinction, it is a takeover under the ISA 2007[304] where any person acquires shares, whether by a series of transactions over a period of time or not, which (taken together with shares held or acquired by persons acting in concert with him) carry 30 per cent or more (or any lower or higher threshold as may be prescribed by the Commission from time to time) of the voting rights of a company; or together with persons acting in concert with him, holds not less than 30% but not more than 50 per cent (or a lower or higher threshold as may be prescribed by the Commission from time to time) of the voting rights and such person or any person acting in concert with him, acquires additional shares which increase his percentage of the voting rights, such person shall make a take over offer to the holder of any class of equity share capital in which such person or any person acting in concert with him holds shares.

5.3.3 Intracompany arrangements

There are two forms of intracompany arrangements: arrangements to put the company in members' voluntary winding up and compromise between the company and its creditors or any of them.

(a) <u>Arrangement to put the company in voluntary winding up</u>[305]

The arrangements and compromise contemplated here is the same as that contained under the old law.[306] It occurs where the company passes a special resolution to put the company into members' voluntary winding up, having as its principal and sole purpose the implementation of any "arrangement"[307] within the provisions of the law. Such arrangement must relate to any change in the rights or liabilities of members, debenture holders or creditors of a company or any class of them or in the regulation of a company. This is what makes it an intracompany arrangement.

However, it is not all arrangements that will begin and end within the company. Hence it is possible for an arrangement to involve another

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[304] S 130 ISA 2007
[305] S 714 CAMA 2020
[306] See sections 537-538 CAMA CAP C20 LFN 2004 (repealed by CAMA 2020)
[307] S 710 CAMA 2020

company. This is why it is required that the winding up resolution for must authorise the liquidator to sell the whole or part of the company's undertaking or assets to another body corporate, normally in consideration or part consideration of fully paid shares. Usually, the outcome is to distribute the shares among the members of the company (being wound up) in accordance with their rights in the liquidation.

While the law deems binding any sale or distribution as a consequence of the special resolution, the arrangement for the sale and distribution may be impeached and thus invalidated by an order of the court against the company relating to reliefs on the grounds of unfairly prejudicial and oppressive conduct or for the winding up of the company under creditors' voluntary winding up. The order must be made within one year from the date of the special resolution for members' voluntary winding up. Similarly, the arrangement will be affected by the presence of any member formally dissenting to it. Where the member communicates his dissent to the liquidator, which must be done with 30 days after the passing of the resolution, the liquidator must either abstain from giving effect to the resolution or purchase the shares of the members in line with the provisions of the law.[308] However, deemed acceptance will be imputed to the member who failed to signify his dissent accordingly.

It is possible to use the mechanism of arrangement to overreach the capital maintenance rule against a company purchasing its own shares. Thus, where a company goes into an arrangement involving the sale of the whole or part of its undertaking or assets to another in consideration or part consideration of any shares, debentures, policies or other like interest and distribute the same in specie among its members (whether in liquidation or by way of dividend). How does the risk arise? It arises where there is a dissentient shareholder, normally required to give notice to the company in writing within 30 days of the resolution authorising the distribution. In the notice the dissenting member will request the company to either abstain from given effect to the resolution or to purchase any of his shares at a price to be determined by agreement[309] or by Securities and Exchange Commission.[310] When the law requires the shares of the dissenting to be purchased it does not by that entitle the

[308] S 714(4) CAMA lays down the procedure for purchase of the shares.
[309] For a private company in which there is no alien participation. See the proviso under s 714(4) on how to determine the price by agreement.
[310] For a public company or a private company with alien participation.

company to purchase the shares or to make distributions except in line with the Act.

(b) <u>Compromise between company and its creditors</u>[311]

To compromise is to make a deal between different parties where each party gives up part of their demand.[312] Under CAMA a compromise or arrangement between a company and its creditors or any class of them takes place:

◊ Where either
    - the company or
    - any of its creditors or members or
    - if the company is undergoing winding up, the liquidator,

  applies in a summary way to the Court.

◊ The application seeks order of the Court to summon a meeting of the creditors or a class of creditors, or of members of the company or class of members as the Court may direct.

◊ There are irreducible contents of the notice of a meeting summoned in pursuance of a proposed compromise or arrangement.[313]

◊ To be effective for sanction or approval, not less than seventy five percent in value of members or class of members or of the interest of creditors or class of creditors must be present and vote (in person or by proxy) in favour of the compromise or arrangement. The approval simpliciter of the compromise is not conclusive. In other words, the fairness of the compromise or arrangement must be unimpeachable.

◊ Thus, after approval the compromise must be referred to the Court or Securities and Exchange Commission to appoint one or more inspectors to investigate the fairness of the compromise or arrangement and to make a written report on it to the Court within a time specified by the Court. Why should the Court be involved the process has passed voting of members or creditors? Does this not amount to statutory invasion of internal management principle? Does not amount to picking the fight for the minority? Comparing the provision with right available to minority in an arrangement involving shares of the company, does not the provision not constitute an overreach?

◊ If the Court is satisfied as to the fairness of the compromise or arrangement, it will sanction the scheme, which thereafter shall bind all the creditors the members or the class of either of them.

5.3.4 Effect of a scheme of arrangement[314]

[311] S 715 CAMA 2020
[312] https://en.wikipedia.org/wiki/Compromise
[313] Section 716 CAMA 2020
[314] Section 717 CAMA 2020

It acts as a stay. Once a company has commenced a process of arrangement or compromise with its creditors, a minimum of six months moratorium is placed on any action by creditors, secured and unsecured, against the company. The moratorium starts from the time the company by way of affidavit provides the Court with relating documents, setting out the terms intended to be proposed to the creditors in an arrangement or compromise; a statement of the company's affairs containing the particulars of the company's creditors and its debts and other liabilities and of its assets; such other information as the Court may require ; and a statement that the company desires a protection from a winding-up process pending the completion of the arrangement or compromise.

Notwithstanding this provision, a secured creditor can still discharge the moratorium if by application to the Court filed within 30 days of the notice of the arrangement and compromise the secured creditor can show:
(a) the asset of the company sought to be enforced by the creditor does not form part of the company's pool of assets to be considered under the arrangement and compromise proceeding; (b) the asset sought to be enforced by the creditor is a perishable goods or commodities which may depreciate or dissipate before expiration of the six months moratorium period; (c) the secured creditor enforces its security over the assets before receiving notice of the company's proposed arrangement and compromise; or (d) the company consents in writing for a secured creditor to enforce its right over the company's asset within the six months moratorium period. However, the secured creditor may be chasing after the wind if the assets subject to security have been dissipated. This is because the company, after securing approval or consent of the members or creditors or class of either of them, can file a further affidavit updating the Court of the dissipation of the asset.

Self-Assessment Exercise 18

f) The approval simpliciter of a compromise or arrangement is not conclusive and therefore does not become binding. Discuss.
g) What is the difference between "hiving down" and "scission"?

5.4 Summary

In this unit, you studied about business restructuring from the point of arrangements and compromise. To help your understanding, such terms as scheme of arrangement, merger or amalgamation, reconstruction, hiving down and scission (also known as demerger or division) were defined. Arrangements can occur between companies and within companies. The mechanics of how these occur have been well explained in the unit. Also, the unique position and interest of the minority of a company undergoing arrangement was discussed. Lastly, the effect of a company undergoing arrangement and compromise was discussed, which is moratorium on creditor actions.

5.5 References/Further Readings/Web Resources

Onamson, F.O, (2017). Law and Creditor Protection in Nigeria. Malthouse Law Books, Lagos.

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Legislations:

Asset Management Corporation of Nigeria Act 2010.

Companies and Allied Matters Act 2004 (repealed).

Companies and Allied Matters Act 2020.

Investments and Securities Act 2007.

6.7 Answers to Self – Assessment Exercises (SAEs)

Self-Assessment Exercise 18

f) *It is not conclusive because the fairness of the compromise or arrangement must pass through the scrutiny of the Court or SEC as the case may be. Thus, after approval the compromise or arrangement it must be referred to the Court or Securities and Exchange Commission to appoint one or more inspectors to investigate the fairness of the compromise or arrangement and to make a written report on it to the Court within a time specified by the Court. The Court sanctions the compromise if it is satisfied as to its fairness. This us when it becomes binding.*

g) *Hiving down involves a company forming a subsidiary and vesting parts of its assets and undertaking in the new entity, or transfers the assets to an existing subsidiary, and selling the shareholding in that subsidiary to new owners. On the other hand, scission involves a simple sale of the assets, ether for cash or in consideration of the allotment of shares in the purchasing company to the vendor, or to the shareholders of the vendor if it is a company.*

UNIT 6 COMPANY LIQUIDATION

Unit Structure

6.1 Introduction
6.2 Learning Outcomes
6.3 Company Liquidation
 6.3.1 Compulsory Winding up
 6.3.2 Voluntary Winding up
 6.3.3 General Provisions
6.4 Summary
6.5 References/Further Readings/Web Resources
6.6 Answers to Self-Assessment Exercises

6.1 Introduction

This Unit assumes that you have the basic or foundational knowledge of, and therefore acquainted with, the principles of company liquidation. On this footing, you will be introduced to the legal provisions in line with CAMA 2020, the new legal regime for company liquidations in Nigeria.

6.2 Learning Outcomes

By the end of this unit, you will be able to:

- discuss various types of winding up
- list the grounds for compulsory winding up
- explain the circumstances for voluntary liquidation.

6.3 Company Liquidation

When a company faces liquidation the prospect of continuing as a going concern is not only threatened but cannot be sustained. It is a fate no company wishes to befall it. According to Sealy and Worthington (2010) in winding up the company gives up its business, sells off its assets, pays its debts (or, if it is insolvent, does so to the extent that its funds allow) and distributes whatever surplus remains amongst its members or otherwise as its constitution may provide.[315]

While the process is ongoing, its corporate personality remains intact. In other words, the company qua company is still existing despite the phase it is currently going through and the fate that will thereafter befall it.[316] As such during this period all corporate actions, such as the transfer of property and the institution of legal proceedings, are done in its name rather than by the liquidator in his own name. A company is said to be extinct (or to cease to exist) only by the formal act of dissolution, usually after conclusion of the liquidation procedure.[317] Is it possible to dissolve a company without first winding up the same company? Or is it the case that every company must be wound up first before dissolution? Assuming your answer is that it is possible to dissolve a company without liquidating the same company, what will be the effect of such dissolution on pending, antecedent and contingent actions and events in relation to the dissolved but not liquidated company?[318] See s 522(6) CAMA 2020 for on deemed dissolution of a company. It occurs without the company going through winding up processes.

A company may be wound up compulsorily or voluntarily. The critical aspects of each of the winding up modes will be discussed. This is bearing in mind that you are already, it is assumed, familiar with the subject.

6.3.1 Compulsory Liquidation

Compulsory winding up is one instituted by the Court following the success of a petition by an interested person or party.

(a) Grounds for liquidation. The grounds on which a company may be wound up by the Court are clearly spelt out in the law.[319] One of the ubiquitous grounds is the inability to pay debt ground.[320] The new law has improved on the threshold amount by making it flexible and determinable by the Commission.

[315] Sealy and Worthington, p. 744
[316] Ecobank v Admiral Environmental Care Ltd & Ors (2021) LPELR-56130
[317] See ss 617, 623, 631 and 641 CAMA 2020 and Oredola Okeya Trading Co & Anor v Bank of Credit & Commerce International & Anor (2014) LPELR-22011 (SC) and Oboh & Anor v Nigeria Football League Ltd & Ors (2022) LPELR-5686 (SC).
[318] See Spring Bank plc v ACB International Bank & Anor (2016) LPELR-53014 (CA).
[319] Section 571 CAMA 2020
[320] Durumugo ReResources Ltd v Zenith Bank plc (2016) LPELR-40487 (CA)

Hence a company in Nigeria is deemed to be unable to pay its if, among other criteria, it is indebted in a sum to be determined by a regulation issued by the Commission[321] and three weeks after notice of demand it still neglected to pay the sum or to secure or compound for it to the reasonable satisfaction of the creditor.[322] The extant **Company Regulations is that issued by the Commission in 2021**, before the amendment of section 572(a) CAMA 2020. It is hoped that the Commission will take steps to issue guideline in this direction. The creditor must be comply with the law before he can qualify to petition for winding up on this ground. Under what circumstances can you say a creditor has complied with this provision? On this, read the following authorities: AMCON v Capital Oil & Gas Industries Ltd (2017) LPER-50201 (CA), Bellview Airlines Ltd v South African Airways (Proprietary) Ltd (2019) LPELR-4786 (CA), and NICON Insurance v NNPC (2020) LPELR-50464 (CA). Still on this ground, would it make any difference if the letter of demand is signed by the creditor's solicitor? Read up the case of Eaglewood Integrated ReResources Ltd v Orleans Investment Holdings Ltd (2017) LPELR-43542 (CA).

Thorne (2002) strongly believes that "persistent non-payment of a debt that is properly due and owing may be treated as evidence of unable to pay its debts.[323] While a dispute of a debt will bar the Court from allowing a petition for winding up a company which has failed to pay its debts,[324] the same would not apply where the precise amount owed is in dispute.[325] That is a winding up order will be refused where inability to pay the debt is the ground for the petition of the alleged debt in dispute.[326]

The "just and equitable" ground can turn up an inexhaustive list of cases in which it can be said to be just and equitable for a company to be liquidated.[327] The Supreme Court[328] has held that a petition on

[321] The phrase "a sum to be determined by regulation…" was introduced by Business Facilitation (Miscellaneous Provisions) Act 2022 that substituted paragraph (a), which formerly provided as "a sum exceeding NGN200,000.00."
[322] Section 572 CAMA 2020
[323] Cornhill Insurance plc v Improvement Services Ltd (1986) BCLC 26
[324] Durumugo ReResources Ltd v Zenith Bank plc (supra)
[325] Suburban Broadband Ltd v Intelsat Global Sales & Mktg Ltd (2016) LPELR-4033(CA)
[326] Global Eagles West Africa Ltd v Stonecraft Marble & Granite CFTZ (2022) LPELR-56561 (CA)
[327] Ebrahimi v Westbourne Galleries Ltd (1973) AC 360 is a case on point here.
[328] Ado Ibrahim & Co Ltd v Bendel Cement Co Ltd (2007) LPELR-188 (SC)

this ground must disclose facts upon which the court would rely in concluding that it is just and equitable to wind up the company.

Apart from the just and equitable ground, which is more appropriate in privately held companies, the law has made provisions empowering the Court to make a winding up order for a company in administration on grounds of "public interest."[329] What constitutes (or qualifies for) public interest is left to the prescription of the Chief Judge of the Federal High Court or under an enactment.

(b) <u>The Petition</u>. The persons that may present a petition for winding up are listed under the law.[330] It may be presented by the company, the directors, a creditor (contingent or prospective), the official receiver, a contributory, a trustee in bankruptcy to or a personal representative of, a creditor or contributory, the Commission[331], or a receiver if authorised by the instrument under which he was appointed. All or any of the parties acting together or separately can petition.

A company may pass a resolution for voluntary winding up. The Court may, if petitioned, order such a voluntary winding up to continue subject to the supervision of the Court. Such a petition for continuance of a voluntary winding up subject to the Court's supervision is deemed a petition for winding up by the Court.[332]

The Commission has power to present a petition for winding up.[333] This is usually the offshoot of the inspector's report.[334] Hence if it appears to the Commission that it is expedient in the public interest that a company should be wound up, the Commission is empowered to petition for winding up. The Court will not refuse the petition if it considers it just and equitable to do so.

A supervisor of a CVA,[335] or an administrator,[336] has the power to bring the petition. If the creditor's interest is contingent or prospective, he must satisfy the condition set under the law to be

[329] Sections 477(2), 479(3)(a) and 520(1) CAMA 2020
[330] S 573 CAMA 2020. NDIC v Financial Merchant Bank Ltd (1997) LPELR-2001 (SC)
[331] Under section 366 CAMA 2020
[332] Sections 649, 650 and 651 CAMA 2020.
[333] Section 366 CAMA 2020
[334] Section 363 CAMA 2020.
[335] Section 442(4) CAMA 2020
[336] Section 497 and Paragraph 21 Eleventh Schedule CAMA 2020

entitled to bring the petition.[337] Can an administrator be appointed while a winding up petition is pending in respect of the same company? Read s 462 CAMA. Where the Court makes an administration order, what would be the fate of a petition for winding up? Would it make any difference if petition for winding up is in relation to a company in administration? Read ss 477 & 479 CAMA. It is possible to treat a petition for appointment of administrator as a winding up petition.[338]

Who is a contributory? It means every person liable to contribute to the assets of a company on winding up, including those alleged to be contributories prior to determination of such claims.[339] For the purpose of the definition, it includes its present members, certain past members and in certain cases a director or manager.[340] Where a contributory[341] presents a petition for winding up, the Court held that to succeed in the petition, he ought to allege and prove, at least, to the extent of a prima facie case, the existence of assets which would give him a tangible interest.[342] Also, it is important to note that the contributory must meet the conditions set under the law before he can validly bring the petition.[343]

(c) The Court.[344] On hearing the petition, the Court may dismiss it, adjourn the hearting conditionally or unconditionally or make any interim order or any other order that it deems fit. Under certain circumstances but on the application of the company or any creditor or contributory, the Court may stay or restrain the proceedings. On commencement of the winding up, the consequences of winding up order read **ss 578 and 579 CAMA**. On the general powers of the Court in a court winding up, **read sections 601-619 CAMA 2020**.

6.3.2 Voluntary Liquidations

Voluntary liquidations (or winding up) are made up of members' and creditors' voluntary liquidations. Drawing the differences between the two forms of voluntary liquidations, Thorne (Ed) states that:

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337 Section 573(2)(c) CAMA 2020
338 Section 451(e) CAMA 2020
339 Section 566 CAMA 2020
340 Thorne (Ed), op cit, p. 644
341 Defined in Ado Ibrahim & Co Ltd v Bendel Cement Co Ltd (supra)
342 Williams & Anor v Williams (1995) LPEL-3483 (SC)
343 Section 573(2)(a) CAMA 2020
344 Sections 573 and 574 CAMA 2020

> "… a members' voluntary liquidation is one where the directors have made a declaration of solvency; every other voluntary liquidation is a creditor's voluntary liquidation. The distinction is important since it affects the ability of creditors to influence the course of the liquidation, although many of the procedures are common. If it subsequently turns out that a company in a members' voluntary liquidation is insolvent, there is a procedure for its conversion to a creditors' voluntary liquidation.[345]

You will now briefly see the provisions of the law in respect of each type of voluntary winding up of a company.

(a) Grounds for voluntary winding up. The grounds are generally two and will be found in s 620(1) CAMA 2020. One the period fixed in the articles for the existence of the company has passed, and the general meeting passes a resolution that the compound be wound up. Two, if the company without any precondition passes a special resolution that the company should be wound up. Under the UK regime a third ground is if the company by extraordinary resolution affirming that the company cannot continue its business by reason of its liabilities. These grounds are applicable to both voluntary liquidations.

(b) Members' voluntary winding up. Specific to members' voluntary liquidation is the requirement of 'declaration of solvency.' It is a statutory declaration usually made by the directors at its meeting stating among others that they have made full inquiry into the company's affairs and have by reason of that formed the opinion that the company will be able to pay its debts in full, together with statutory interest, within a period not exceeding 12 months from the commencement of the winding up. Note that there time period within which the declaration must be made otherwise it will be void.[346] A director who makes such a declaration recklessly runs the risk of conviction to a fine as the Court deems fit or to imprisonment for a term of three months or to both.

    At this point, you should read up the provisions of CAMA specifically applicable to members' voluntary winding up.[347]

(c) Creditors' voluntary winding up. CAMA has specific provisions which apply in relation to creditors' voluntary winding up only. You should read up the provisions.[348] Without prejudice to the grounds for commencing creditors' voluntary winding up, it is important to draw your attention to the possibility of having what has been called

[345] Thorne (Ed), op cit, p. 653.
[346] Section 625(2) CAMA 2020
[347] See ss 626-632 CAMA 2020
[348] See ss 634-641 CAMA 2020

'deemed resolution' leading to commencement of a creditors' voluntary winding up. Its operative effect is automatic once the preconditions in the preceding provisions are met.[349]

6.3.3 General Provisions

Briefly there are common provisions which relate to and affect all types of winding up, albeit their functions may be different as between one type of winding up and another.

(a) Liquidation Committee. A liquidation committee is usually appointed in respect of a compulsory winding up[350] or creditors' voluntary winding up[351]. The overall function of the committee is to supervisor and assist the liquidator in the discharge of his functions. Who do the committee members represent? Thorne (Ed) stated that they "represent the interests of the general body of creditors (and , in the case of a solvent compulsory liquidation or a creditors' voluntary liquidation, contributories) from which they are elected."

(b) Officers in winding up and their powers. These are the official receiver, and other liquidators. On this and the activities of liquidators, **read sections 582, 583, 584, 586, 587, 588, 589, 590-600, 629, 630, 640, 644, 646, 654, CAMA 2020.** Meanwhile see the case of **General & Aviation Services Ltd v Thahal** [352] on the procedure of appointment of a provisional liquidator, the case of **NDIC v Financial Merchant Bank Ltd**[353] on whether a provisional liquidator has the same power as a liquidator as well as the effect of appointment of a provisional liquidator, the case of **Dematic (Nigeria) Ltd v Utuk & Anor**[354] on whether a provisional liquidator/liquidator can apply to set aside the sale of property of a company carried out before his appointment, and the case of **PEFTI (Nigeria) Ltd v Utuk & Anor**[355] on the effect of appointment of a liquidator or provisional liquidator on the powers of directors.

(c) Distributions. The property of the company is usually applied in satisfaction of its liabilities pari passu. Except the articles otherwise

[349] Section 521(5)(b) CAMA 2020
[350] Section 596 CAMA 2020
[351] Section 637 CAMA 2020
[352] (2004) LPELR-1317 (SC)
[353] (1997) LPELR-2001 (SC)
[354] (2022) LPELR-5678 (SC)
[355] (2023) LPELR-59991 (SC). Also see, Tony-Anthony Holdings Ltd & Anor v Commercial Bank for Africa (2013) LPELR-20286 (CA) providing authority on whether a company in liquidation can be appointed a liquidator/receiver/

provides, the remaining assets are usually distributed among members according to their rights and interests in the company. However, note that all distributions are subject to preferred payment under **section 657 CAMA 2020**.

(d) Antecedent transactions, liabilities, and offences. You are expected to read up and familiarize yourself with the following topics:

(i) Antecedent transactions – transactions at an undervalue[356] and fraudulent preference[357]; floating charges; executions or attachments and distress[358], and disclaimer of onerous property.[359]

(ii) Personal liabilities of directors and other officers with respect to antecedent liabilities of the company in winding up. They include transactions at an undervalue and preference, fraudulent trading[360]; wrongful trading[361]; and fraud prior to winding up.[362]

(iii) Offences antecedent to or in the course of winding up in relation to acts or omissions of directors, officers, and liquidators.[363]

Self-Assessment Exercise 19

a) Explain briefly the phrase "claw back provisions".

b) What is deemed resolution in relation to creditors' voluntary winding up?

6.4 Summary

In this unit you studied about company liquidations (otherwise called winding up). Two types of winding up were discussed – namely compulsory winding up and voluntary winding (subdivided into creditors' voluntary winding up and members' voluntary winding up). General provisions affecting all types of winding up was also discussed.

[356] Section 659 CAMA 2020
[357] Sections 658 and 660 CAMA 2020
[358] Sections 666 and 667 CAMA 2020
[359] Section 663 CAMA 2020
[360] Section 672 CAMA 2020
[361] Section 673 CAMA 2020
[362] Most of these represent what is called "claw back provisions". They include transactions at an undervalue and preference, fraudulent trading, floating charges, wrongful trading, etc.
[363] Sections 668-671 and 675 CAMA 2020

6.5 References/Further Readings/Web Resources

Orojo, J.O. (2008). Company Law and Practice in Nigeria, fifth edition. LexisNexis, South Africa

Sealy, L. and Worthington, S. (2010). Sealy's Cases and Materials in Company Law, ninth edition. Oxford, Oxford, UK.

Thorne, J. (Ed.) (2002). Butterworths Company Law Guide, fourth edition. Butterworths LexisNexis, London.

Companies and Allied Matters Act 2020

6.6 Answers to Self – Assessment Exercises (SAEs)

Self-Assessment Exercise 19

h) *Claw back provisions cover statutory stipulations which empower the liquidator to unwind and avoid certain categories of transactions entered into in the twilight period. Examples include transactions relating to floating charge, fraudulent trading, wrongful trading, transactions at an undervalue, etc.*

i) *Deemed resolution arises where the winding up of a company commences following a notice by the administrator to the Commission that the total amount which each secured creditor of the company is likely to receive has been paid to him or set aside for him and a distribution is made to unsecured creditors of the company (if any), which activates the application of s 521 CAMA 2023. After sending to the notice the administrator subsequently files a copy of the notice with the Court and sends a copy of the notice of each creditor of whose claim and address, he is aware. After registering the notice, the administrator's appointment ceases. It will be deemed that a special resolution for voluntary winding up (under s 620(2) CAMA) has been passed on the day the notice was registered in Court, just as the company will thereby be wound up.*

UNIT 7 US CHAPTER 11 BANKRUPTCY PROCEDURE

Unit Structure

7.1 Introduction

Since the theories of insolvency were largely the products of American scholarship it becomes necessary to introduce the US insolvency approach. This will form facilitate the understanding of the theories and help you to relate to them in a practical setting. The insolvency approach is based on Chapter 11 of the Bankruptcy Reform Act.

7.2 Learning Outcomes

At the end of this unit, you should be able to gain an insight into the US insolvency approach and thus be able to distinguish between the Nigerian and US approaches.

7.3 US Chapter 11

It is known as Chapter 11 of the United States Bankruptcy Reform Act of 1978. The said Act has eight odd-numbered (1 through 15) and one even-numbered (12) chapters. The key ones are Chapters 7 and 11. Chapter 7 contains details for liquidating a failed firm and it comes into effect as soon as it is determined that a fair, equitable and feasible basis for reorganising a failed firm does not exist; while Chapter 11 outlines the procedures for reorganising a failed or failing firm, whether is petition is filed voluntarily or involuntarily.

7.3.1 Types of Reorganisation Plans

According to Megginson and Smart (2006) there are two types of plans under the Chapter 11 Reorganisation Procedure. The first is unanimous consent procedure (UCP) which is a plan instituted by consent of all creditors and equity classes. The other is cramdown procedure which is used when the UCP fails to meet the standard for approval by all classes. However, one class of creditors must have voted for a reorganisation plan. It is also used where the company is clearly insolvent, and the existing share capital has no value.[364] Ultimately, a restructuring arrangement is crammed down the throats of the creditors, any objections from creditors will go to no effect.

7.3.3 The Reorganisation Procedure

Generally, the procedure entails five separate steps, which are:

(a) filing of petition (voluntary by the company or involuntary by creditors);

(b) appointment of the insolvent entity as debtor in possession (DIP);

(c) submission of a fair and equitable reorganisation plan;

(d) upon approval of the bankruptcy court, the plan and disclosure statement are given to the company's creditors and shareholders to accept; and

(e) upon approval (or disapproval) of the plan the parties to the proceedings whose services were beneficial or contributed to the approval or disapproval of the plan file a statement of expenses subject to court's approval.

The aim of the parties (the creditor and the debtor) under Chapter 11 procedure is to "reorganise the business and get it back to its feet in order to become profitable again and repay its debts". The Nigerian equivalents of Chapter 11 procedure are CVA, administration and arrangements and compromise.[365]

What plausible rationale can you defence for the debtor-in-possession stance of Chapter 11 procedure? It seems that the law took the view that only the debtor is in the best position to protect its interests as against the creditor whose interest is the realisation of the security to repay the facility. Therefore, larger community interest will be better protected. However, if the debtor failed due to endogenous factors, it is doubtful whether the debtor can efficiently manage its affairs.

[364] Megginson, L. & Smart, S.B. (2006). Introduction to Corporate Finance. Ohio, USA: Thomson, South-Western, p. 908

[365] See Chapter 17, Chapter 18 and Chapter 27 CAMA 2020

Self-Assessment Exercise 20

a) The insolvency approach though not hierarchically ordered is process based driven. Do you agree?
b) From the point of transplantation there is no connection between the Chapter 11 procedure and the insolvency mechanisms under CAMA. Nevertheless, one can still establish some relatedness.

7.4 Summary

In this Unit, you have been able to have an idea into the US insolvency approach. The approach emphasises and is propped on debtor in possession principle. Arguably, this may the only real insolvency mechanism that wholeheartedly supports debtor rehabilitation and rescue.

7.5 References/Further Readings/Web Resources

Megginson, L. & Smart, S.B. (2006). Introduction to Corporate Finance. Ohio, USA: Thomson, South-Western

Miller, R.L. & Jentz, G.A. (1997). Business Law Today: Text and Summarized Cases – Legal Ethical, Regulatory, and International Environment (4th ed.). New York: West Publishing

Companies and Allied Matters Act 2020

7.6 Answers to Self – Assessment Exercises (SAEs)

Self-Assessment Exercise 20

a) The steps are:
- filing of petition (voluntary by the company or involuntary by creditors);
- appointment of the insolvent entity as debtor in possession (DIP);
- submission of a fair and equitable reorganisation plan;
- upon approval of the bankruptcy court, the plan and disclosure statement are given to the company's creditors and shareholders to accept; and
- upon approval (or disapproval) of the plan the parties to the proceedings whose services were beneficial or contributed to the approval or disapproval of the plan file a statement of expenses subject to court's approval

b) The points of relatedness between the US approach and the Nigerian insolvency mechanisms lie in the fact some of the approaches found in the Nigerian regime mimics or presents an appearance similar to the US Chapter procedure. For example, the only mechanism that allows debtor in possession is the CVA. All other mechanisms administration and receivership displace the management.

UNIT 8 THE INSOLVENCY PRACTITIONER

Unit Structure

8.1 Introduction

reResources include things like national will, international goodwill, courage, intellect, or even fanaticism. Intangible reResources are in that they often are not measurable or are volatile.

8.2 Learning Outcomes

By the end of this unit, you will be able to:

- state who is an insolvency practitioner
- apply and get accredited as insolvency practitioner.

8.3 The Insolvency Practitioner

The Insolvency Regulations 2022 defines an insolvency practitioner (IP) as "one or more persons duly accredited by the Commission to undertake insolvency proceedings. What constitutes insolvency proceedings is, unfortunately, not defined in the regulations but the principal legislation appears to have answered the question when it provides that "a person acts as an insolvency practitioner in relation to a company by acting as its liquidator, provisional liquidator, or official receiver; administrator or administrative receiver; or receiver and manager, or as nominee or supervisor of a company's voluntary arrangement."[366] Impliedly the environment of business rescue and receivership has been fully professionalized in Nigeria. On account of

[366] Section 704 CAMA; Thorne (Ed), op cit, p. 693.

this, except one is a professional qualified to be, and duly, accredited as an IP he cannot engage in insolvency practice in Nigeria.

8.3.1 Qualification of an Insolvency Practitioner

To be qualified to act as an IP in Nigeria, the prospective IP must meet the irreducible criteria set out in the law. In light of this, the person must:

(a) obtain a degree in relevant discipline, including law and accountancy.
(b) possess a minimum of five years post qualification experience in matters relating to insolvency.
(c) be registered a member of Business Recovery and Insolvency Practitioners Association of Nigeria (BRIPAN), or any professional body recognised by the Commission to act by or under the rules of that body.[367] For the time being, the professional bodies so recognised by the Commission are Nigerian Bar Association (NBA), Institute of Chartered Accountants of Nigeria (ICAN), Association of National Accountants of Nigeria (ANAN) and Institute of Chartered Secretaries and Administrators of Nigeria (ICSAN).[368]
(d) hold an authorisation granted by the Commission. The authorisation is a consequence of due accreditation by the Commission.

8.3.2 The Process of Accrediting an Insolvency Practitioner

Except one is duly accredited by the Commission one cannot engage in insolvency practice in Nigeria. In other words, a person qualified to practice as an IP but not accredited by the Commission cannot engage in insolvency practice. To be accredited a person must belong to a professional body recognised by the Commission. This means that belonging to a professional body is not enough. Such a professional body must be one recognised by the Commission.

For a professional body to be recognised, the law requires that such a body must be one that regulates the practice of the profession and maintains and enforces rules for securing that its members:

(a) are permitted by or under the rules to act as Insolvency Practitioners
(b) are fit and proper persons to act and
(c) meet acceptable requirements as to education and practical training and experience.

[367] Section 705 CAMA 2020
[368] Regulation 1.07 Insolvency Regulations 2022

Once you meet the above criteria or belong to a professional body recognised by the Commission, you can take the steps to apply for accreditation as an IP.[369] The following are required to accompany your application for accreditation as an IP:

(a) Duly completed Form CAC-MISC 02
(b) Payment of prescribed fee
(c) Evidence of membership of relevant professional body
(d) Evidence of appointment as liquidator, provisional liquidator, official receiver, administrator, administrative receiver, receiver and manager, nominee or supervisor, not less than five years preceding the application date
(e) Where the requirement para (d) is impracticable, evidence of active tutelage in insolvency practice not less than five years preceding the date of application and letter of confirmation of tutelage by the principal or managing partner of the firm where the applicant was or is engaged
(f) Evidence of eligibility to practise issued by relevant professional body and
(g) Evidence of completion of accreditation course of continuing education administered by the relevant professional body in the preceding year in the case of renewal of accreditation.
(h) Note that accreditation is renewable every three years.

The power to grant, refuse or withdraw application is the discretion of the Commission to exercise. Thus, the Commission may withdraw accreditation if the IP becomes disqualified from practice by the relevant professional body or the IP is convicted of any offence relating to fraud, dishonesty, official corruption or unethical conduct under s 280 CAMA 2020 or the IP is adjudged by an Administrative Panel[370] set up by Commission to have obtained accreditation by fraud, dishonesty, official corruption or committed gross misconduct in official transactions with the Commission or it appears to the Commission that the IP is no longer a fit and proper person.

However, the law is clear that where the Commission refuses an application or withdraws an authorisation, it shall notify the party in writing stating the reasons for the refusal or withdrawal of the authorisation. This must be done within seven days. The applicant has 21 days to apply to the Court for a review of the decision. The Court of Appeal is the terminal court in matters related to the application.[371] How can you reconcile Regulation 1.07 and section 709 CAMA 2020? Meanwhile, read and familiarise yourself with section 851 CAMA.

[369] Sections 706 and 707 CAMA and Regulation 1.07
[370] Regulation 1.07(4)(c) talks of Administrative Panel. This is incorrect because the Principal Act at section 851 CAMA called it Administrative Committee. Section 709 provides for judicial review of the
[371] Section 709 CAMA 2020

8.3.3 **Disqualification of an Insolvency Practitioner**

It is possible for a person to possess the qualifications for accreditation and yet be disqualified from acting as an IP. A member of the ICAN or NBA is possesses the qualification meriting his accreditation. However, if the person, despite his membership of the relevant professional is an undischarged bankrupt or a connected person he cannot act as an IP.

The regulations[372] stipulates that the following persons shall not be appointed to act as IP (even if in certain cases he is duly accredited):

(a) an infant. An infant is a person under 18 years of age.
(b) any person found by a Court of competent jurisdiction to be of unsound mind.
(c) a body corporate except statutory corporations. A company, other than a firm or statutory corporation cannot act as an IP.
(d) an undischarged bankrupt unless he is given leave to act as an Insolvency Practitioner of the company by the Court by which he was adjudged bankrupt.
(e) a director or auditor of the company. This implies that a director or auditor who is accredited to practise as an IP cannot be appointed to act as an IP in respect of the company of which he is s director, or he is holding an office as auditor. In other words, he can act as an IP in relation to other companies.
(f) a connected person. A connected person is widely defined to include a director or shadow director of the company or an associate of such a director or shadow director or the company.[373]
(g) any person convicted of any offence involving fraud, dishonesty, official corruption, or unethical conduct or who is disqualified under s 280 CAMA. The section made provisions relating to restraint of fraudulent persons.

From the foregoing, it is clear and commendable that the climate of insolvency practice in Nigeria has a taken a turn for the best. However, it now behooves the institutional and regulatory framework (in this case the Corporate Affairs Commission) to take steps to sanitize the Nigerian climate battered by negative practice of receivership. Hitherto it is an all-comers environment, where any person can be appointed receiver or manager to go with one aim in mind: to go a dismember, destroy, and

[372] Regulations 1.08
[373] Regulations 1.01. Compare s 550 CAMA (disqualification from appointment as a receiver and manager) silent on the issue of a connected person and s 676 CAMA (disqualification from appointment as liquidator) ostensibly permitting a connected person to be so appointed.

dissolve the debtor, no matter the prospect of rescue. Despite the promise, it remains to be seen whether creditors will prefer the route of CVA or administration to the fast-moving destructive mechanism of receivership. In the UK this quagmire was solved by removing and restricting the resort to receivership with the aim of completely disusing it in future.

Self-Assessment Exercise 21

Afeez Soliu Esq is a lawyer trained and practising in Canada and is not a member of the NBA or of BRIPAN or any professional body in Nigeria. His area of practise is insolvency law, corporate law, and international commercial law. A commercial bank with based in Lagos appointed him receiver and manager of the undertaking and assets of Messrs Drillers Nig Ltd. The debtor company intends to challenge the appointment of Mr Soliu Esq. What do you think?

8.4 Summary

In this unit, you studied about the insolvency practitioner, his qualifications, the process of applying and receiving accreditation from the Commission and qualifying factors.

8.5 References/Further Readings/Web Resources

Thorne, J. (Ed.) (2002). Butterworths Company Law Guide, fourth edition. Butterworths LexisNexis, London.

Companies and Allied Matters Act 2020.

8.6 Answers to Self – Assessment Exercises (SAEs)

Self-Assessment Exercise 21

The debtor company can successfully challenge the appointment. This is because Mr Soliu must first be qualified to act as an insolvency practitioner in relation to a company before he can be validly appointed as a receiver and manager or in any other capacity with respect corporate insolvency. He is not qualified because he is not a member of any professional body for the time being recognised by the Commission. Assuming he is a member but not conceding, if he is not duly accredited by the Commission, the disability will still haunt him in that respect. Consequently, the challenge to his appointment is meritorious. Thus, Messrs Drillers Nig Ltd stand a chance of