RETHINKING BUSINESS RESCUE IN NIGERIA: BORROWING VIRTUES FROM CHAPTER 11 OF THE US BANKRUPTCY CODE.

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Dedication

To my parents James I. Mba (late) and Adeline K. Mba both of whom instilled life skills in me for which I did not have to pay.

Acknowledgement

The task of acknowledgement usually does not turn out an enjoyable one. It is often a reminder of the world of debt which we owe. But if the least we can do is to acknowledge people who have made our tasks less burdensome, it is worth the while and certainly not an unbearable moral burden.

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Abstract

As human and commercial intercourse in society and market transactions increased, the need for credit and the latitude for suspended payments have also increased. But something else also increased- the tendency of default by the debtor in making good the promise to repay. The predominant trend had been to liquidate or wind up the business, pay up (as much as possible) the creditors of the business and then the "owners" of the business (residual claimants) may have the remainder (if any) for themselves. This in itself was a result of some refinement from the very hostile disposition by different societies to insolvent persons whether in business or otherwise. In more recent times however, the emphasis appears to be shifting and the considerations also now seems to go beyond just the creditors but also to include other interests in the decision of what to do with an insolvent business. The growing attitude is to ask: "is the business better alive than dead"? "Will saving or rescuing the business not be more beneficial than allowing it wither away"? If there is some agreement that more benefits inure to the system by keeping an otherwise viable business alive, this will very well need the imprimatur of law.

Nigeria is an emerging economy and presently "wears the garb" of Africa's largest economy. The implication of this is that businesses ranging from corporations to MSMEs are setting up shop and seeking to corner their share of the market. The prospects of the economy notwithstanding, the lack of certain fundamentals may militate against the chances of many a business and one does not need to be a fortune teller or soothsayer to predict that such businesses will sooner or later be faced with illiquidity or cash flow challenges. Again, the question to be asked is whether to have such businesses go through the path of liquidation, leaving all other unsatisfied stakeholders to go home and cry. Or should the law provide a means of effecting the rescue of such businesses?

This thesis aims to characterize the business rescue regime in Nigeria in the light of its inadequacy and the lack of a concrete policy of the law as presently constituted to rescue ailing businesses. It points out that although there exists some business rescue provisions in the relevant statutes, their practical relevance have been called into question. A case is therefore made for the adoption of tools provided for in Chapter 11 of the US Bankruptcy Act (as against those of the English law) considered to be pertinent in the quest for a business rescue regime for Nigeria. The thesis proposes the provision of a sweeping moratorium from creditor enforcement (automatic stay), the adoption of the principle of debtor-in-possession, and the legislative incentivizing of post insolvency financing for the distressed business by way of creating a super-priority position for the financer. In cases where the business has several creditors, creditor classification and voting will be key in achieving a successful re-organization plan and what to do with dissenting impaired creditors will arise. Hence the thesis explores the provision of necessary safeguards for the "impaired minority" in the imposition of the "will of the majority" in the interest of rescuing the business. The adaptation of these measures are proposed without losing sight of their applicability, especially in view of idiosyncratic differences that exist between both jurisdictions, the difference in societal sophistication and the comparable English law provisions.

List of Abbreviations

Am. Bankr. Inst. L. Rev.	American Bankruptcy Institute Law Review
BCLC	Butterworth Company Law Cases
Com. L.J.	Commercial Law Journal
CAMA	Companies and Allied Matters Act (Nigeria)
Comp. Law. Journal	Company Lawyer
CBN	Central Bank of Nigeria
CCLR	International Company and Commercial Law Review
CFRN	Constitution of the Federal Republic of Nigeria
COB	Compliance Officer Bulletin
DIP	Debtor-in-Possession
EBOR	European Business Organization Law Review
FHCLR	Federal High Court Law Report (Nigeria)
Fordham L. Rev.	Fordham Law Review
GDP	Gross Domestic Product
Harv. Bus. L. Rev	Harvard Business Law Review
I.L. & P	Insolvency Law and Practice
IMF	International Monetary Fund
ISA	Investment and Securities Act (Nigeria)
JAL	Journal of African Law
J. Corp. L	Journal of Corporate Law
LFN	Laws of the Federation of Nigeria
Marq. L. Rev.	Marquette Law Review
Mich. L. Rev	Michigan Law Review
Miss. C. L. Rev	Mississippi College Law Review
MSMEs	Micro, Small and Medium scale Enterprises
NDIC	Nigerian Deposit Insurance Corporation
N.C.J. Int'l L. & Com. Reg	North Carolina Journal of International Law and Commercial Regulation
NLII	Nigerian Legal Information Institute
NWLR	Nigerian Weekly Law Report

N.Z. L. Rev	New Zealand Law Review
OJLS	Oxford Journal of Legal Studies
SMEs	Small and Medium scale Enterprises
SCNJ	Supreme Court of Nigeria Judgment
TARP	Troubled Assets Relief Program
The NY Times	The New York Times
TBTF/TITF	Too Big To Fail/Too Important To Fail
U. Chi. L. Rev.	University of Chicago Law Review
U. ILL. L. Rev	University of Illinois Law Review
Vand. L Rev.	Vanderbilt Law Review
VALR	Virginia Law Review
Wash & Lee L. Rev.	Washington and Lee Law Review

Introduction

Insolvency law[1] -like many fields of law- is unarguably of practical application in many societies of the world today and hence is of interest to both lawyers and non-lawyers alike whether in developed or emerging market economies. One reason that accounts for this is the propensity of its fallout to be far reaching, transcending the immediate object of the insolvency, and impacting households, creditors (by whatever name they are known), communities and even an entire nation[2].

Insolvency has been defined as "the inability to pay debt as they fall due or in the usual course of business"[3] or as "the inability to pay debt as they mature."[4] With focus on the business, these definitions provide a basis for deductions on the traditional players in insolvency law. First, it points to the business debtor (who for one reason or the other is unable to fulfil his financial

[1] Insolvency law is here used in a loose sense and in reference to insolvency of businesses (both corporations and individuals). English law (as well as most systems which developed from it) is more familiar with the use of corporate insolvency to refer to business insolvency while the use of the term "bankruptcy" (until recently) was used to refer to individual insolvency- See Fiona Tolmie, *Corporate and Personal Insolvency Law* (2nd edn, Cavendish Publishing, 2003), 7. This is unlike in the US where bankruptcy law was originally used in reference to the relief of the creditors of a merchant who has committed "an act of bankruptcy" and "insolvency law" which was reserved for the provision of relief for an impoverished debtor. Presently and by virtue of legislation, the distinction is hardly countenanced as bankruptcy law properly covers both creditor and debtor relief of both the individual and corporate debtor – see Charles J. Tabb *the Law of Bankruptcy* (Foundation Press, 1997), 14. The terms "insolvency law" and "bankruptcy law", for the purpose of this thesis shall be used to mean the same thing, however, a conscious attempt shall be made to use the terms as appropriate in the respective jurisdictions.

[2] Vanessa Finch
, in the introductory remarks of her book writes on the likelihood of insolvency law impacting other sectors of the economy, such as company, employment, tort, environmental pension and banking law. Vanessa Finch, Corporate Insolvency Law, (2nd edn, Cambridge University Press, 2009), 1. See also Charles. J. Tabb, "The History of the Bankruptcy Laws in the United States", (1995)*3* Am. Bankr. Inst. L. Rev. 5. Even beyond these is the systemic risk which the insolvency of financial corporations may impose on society as a whole. John Eatwell & Lance Taylor describes the effect on society as follows: "*Not only do many financial dealings resemble the cliché house of cards, but one house going up in flames can spark a financial firestorm as loss of confidence sweeps away the entire street"* – See John Eatwell & Lance Taylor *Global Finance at Risk: The Case for International Regulation* (Polity Press, 2000), 17.

[3]Black's Law Dictionary, 9th edn (hereafter "Black's Law, 9th edn").

[4]Id. It is worthy of note that certain tests have been formulated for the purpose of determining insolvency to wit: the cash flow insolvency test, the balance sheet insolvency test and capital adequacy test. For a detailed analysis on their application in bankruptcy law, see J.B. Heaton "Solvency Tests", (2007)62, The Business Lawyer, 983-1006.

obligations and who may require relief from the harassment of his creditor(s) and possibly, rehabilitation). Secondly, it talks of the creditor(s) (to whom the debt obligation is owed). The third prong is the society (which provides the needed regulatory framework which strives to achieve a fair distribution of the assets of the debtor amongst the creditors as well as forestall any untoward behavior on the part of the business debtor which may be inimical to the interest of his creditors.[5] In addition, we see the role of society in providing the regulatory framework which provides the debtor respite from the harassment of his creditors).[6]

Overall, it is pertinent that given the critical role of businesses, the necessary role of the credit providers and the potential effects of the insolvency of the business debtor adumbrated above, there is indeed a justified need for a purposeful advancement in this area of the law dealing with debtor businesses.

A Volte-Face in the Reaction to Business Debt

Generally speaking, Anglo-American business insolvency law has come a long way up from the time when it was anathema for a debtor to owe debt and be unable to satisfy the desire of his creditors to have the debt obligation settled.[7] One lesson which we have learnt is that the proclivity

[5] Writing early in the 20th century, Louis Edward Levinthal succinctly stated these as the fundamental goals of bankruptcy law. In his words:

See L. E. Levinthal "Early History of English Bankruptcy" (1918)66 University of Pennsylvania Law Review and American Law Register, 223, at 225. Available at http://www.jstor.org/stable/3314078 accessed 12/10/2014. See also Tolmie, (n1), 7.

[6] In present times, certain indicia have been outlined as what society should aim for in its regulation of insolvency, based on general law and statute, Goode dedicates Chapter 3 of his text to this issue- See Roy Goode, *Principles of Corporate Insolvency Law* (4th edn, Sweet& Maxwell, 2011), 93-107.

[7] Charles J. Tabb and Brubaker give an example of the fate of a debtor who was unable to pay his debt under the Roman Laws of the Twelve Tables (circa 450 B.C.). The result of default included: 1) delivery of debtor into creditors' custody; 2) imprisonment and slavery of the debtor and possibly alongside his family; 3) literally (or figuratively) cutting debtor's body into proportionate shares. See Charles J. Tabb and Ralph Brubaker, *Bankruptcy Law – Principles, Policies and Practices* (Anderson Publishing, 2003), 57. See also Harvey R. Miller and Shai Y. Waisman, "Does Chapter 11 Reorganization Remain a Viable Option for Distressed Business for the Twenty-First Century" (2004)78 Am. Bankr. L.J. 153 at 153 (the authors paint a picture of the debtors plight in the hands of

had favored the initiation of liquidation proceedings upon which the business of the debtor ceases, its assets are realized, the debts and liabilities owed by the business to each of its creditors are offset according to the extent of exposure and if the members of the business are lucky (which is hardly ever the case), they have the residual assets to themselves. More pertinent is the fact that the initiation of the process of liquidation had been the exclusive preserve of the creditors – an indication of the policy of insolvency law to protect creditor interests. However, with regard to the treatment of business debtors, times have changed and so have policy considerations too.

In these days it is recognized that businesses may become financially distressed by factors which merely affect their ability to meet their obligations in the short term. The question that arises is whether it is best to tear the debtor business apart by reason of a liquidation sale or resort to measures that will remodel the financial and organizational structure of the business so as to permit the recovery and continued existence of the business. Justice Posner in his highly cerebral treatise gives an economic analysis of the financially distressing situation in which a business may find itself and the possibilities that exist outside liquidation. He posits that:

> …the firm may find that its revenues do not cover its total costs, including fixed costs of debt. But they may exceed its variable costs in which event it need not liquidate yet. And maybe in the long run the firm could continue in business indefinitely with a smaller plant. In that event, it might not have to replace all of its debt when the debt was retired, its total costs would be lower, and its (lower) demand and (lower) supply curves might once again intersect. In short, the company may have a viable future, short or long, which it can get to if it can just wipe out its current debt….[8]

merchant creditors drawing from different times in human civilization); Tabb, (n2), at 8 (the author provides a historical account of the early Anglo-American bankruptcy law and policy).

[8] Richard Posner, *Economic Analysis of Law* (6th edn, Aspen, 2003), 421 quoted in G. McCormack, *Corporate Rescue Law- an Anglo-American Perspective* (Edward Elgar Publishing Ltd, 2008), 9.

Although not all scholars are agreed on this business rescue role afforded by insolvency law (as we shall see in Chapter 1), there is more forceful argument and factual basis for rescuing businesses and protecting a broader range of interests which is inclusive of the creditor.

Nigeria in Perspective: Matters Arising

Today, in terms of population[9] and reported economic growth, Nigeria is Africa's largest economy[10]. In recent years, certain sectors have seen rapid growth and the inflow of foreign investors both in the production and service sectors. A typical example can be found in the telecommunications industries which provides over 7% of the country's GDP[11]. But this cannot be the whole story as the data apparently does not take into account the informal sector which is currently also on the rise. Although there is no apparent data on the size of the Nigerian informal sector, it is often acknowledged that the informal sector "constitutes a significant segment of the Nigerian economy and thereby contributes to the Gross Domestic Product (GDP) and also contributes significantly to the reduction of unemployment as well as economic development of Nigeria in general".[12] Owing to various reasons which will range from inadequate start-up capital to outstanding uncollectible receivables sudden increase in operating costs (due to currency fluctuation), to government regulations; some businesses may experience liquidity challenges and

[9] 140,431,790 (Based on 2006 census figures) - see http://www.population.gov.ng/ accessed on 11/14/2014. Although recent estimates have put the population at over 170,000,000 – see http://www.worldometers.info/world-population/nigeria-population/ accessed on 11/14/2014, http://worldpopulationreview.com/countries/nigeria-population/ accessed on 11/14/2014.

[10] This is based on the recent rebasing of the nation's Gross Domestic Products (GDP) - accounting for previously uncounted industries which are now players in the economy- by the National Bureau of Statistics (NBS). See http://www.bbc.com/news/business-26913497 Accessed on 11/14/2014, also http://www.bloomberg.com/news/2014-04-06/nigerian-economy-overtakes-south-africa-s-on-rebased-gdp.html accessed on 11/14/2014.

[11] Data obtained from the Nigerian Communication Commission website. Available at http://www.ncc.gov.ng/index.php?option=com_content&view=article&id=68:industry-overview&catid=65:industry-information&Itemid=70 accessed on 11/14/2014.

[12] I.O. Fasanya & A. B. Onakoya "Informal Sector and Employment Generation in Nigeria: An Error Correction Model". Available at: <www.iiste.org/Journals/index.php/RHSS/article/download/2620/2635> accessed on 11/04/2014.

thus may become financially distressed and unable to meet their obligation to creditors in the short term. The system will be faced with the dilemma of what to do with such businesses- liquidate or device a means by which debtors can possibly achieve business recovery and then repay the debts thereby preserving the going concern value of the business and protecting other important values which the continued existence of the business will preserve.

It is submitted that the sustenance of the growth of big businesses and the various Micro, Small and Medium Scale Enterprises (MSMEs) taking advantage of the niches created by the economic expansion will largely depend on, amongst other things, the quality of Nigeria's business rescue[13] laws.

Inadequacy of Nigeria's Business Rescue Provisions and the Need for Reform

Given the apparent benefits of business rehabilitation, it goes without saying that there is the need for a regulatory framework which provides a basis for rescuing businesses in Nigeria. Presently, other than private arrangements and workouts between unincorporated businesses and their creditors, there is no formal legal framework which encourages the rescue of their businesses. This is apparently because of the lack of attention devoted to these businesses by government and policy makers.[14] The story may be somewhat different for companies (entities with distinct legal personality).

[13] In this chapter, the use of the term "business rescue" will be used in the general context of what is known as "re-organization" in the US and will be considered as the alternative to liquidation or winding up. As it will be observed, business rescue is used in the place of corporate rescue as the consideration in the thesis is not restricted to incorporated business entities with limited liability but also unincorporated business forms such as the sole proprietors and partnerships.

[14] See Business day (Nigeria's top business newspaper) report of 07/18/2014: "SMEs in Nigeria are still struggling". Available at http://businessdayonline.com/2014/07/smes-in-nigeria-are-still-struggling/#.VHsA7THF-UY accessed on 09/20/2014.

Regarding business vehicles with legal personality the possible business rescue options afforded them are those that may be found in the leading company law legislations – the Companies and Allied Matters Act (CAMA)[15] – and perhaps in the Investments and Securities Act (ISA). However and quite unfortunately, the legislations which provide for some semblance of business rescue are hardly of significant practical value for the purpose of rescue. As shall be seen in Chapter 2, one of such reasons for example will be the absence of a stay on enforcement creditors' rights for a company that may wish to explore the use of arrangement and compromise which is afforded under CAMA.[16] The clear implication of this is that even where the process to rescue the company is ongoing, creditors who are not agreeable to the plan may proceed with litigation or any other rights which they have under non-insolvency law. A legal mortgagee of the business debtor for instance may opt to execute the mortgage deed even when attempts at rescue by the debtor and other creditors may be ongoing. This may be obstructive of any meaningful arrangement or compromise. The filing of proceedings under Chapter 11 of the US Bankruptcy Code[17] by a business debtor brings into place an automatic stay which not only serves to provide some respite for the business debtor, but also stops the possibility of a creditor run in its tracks.[18] What is more, it applies across all forms of enterprises that file under the Chapter.

[15]Cap C20, Laws of the Federation of Nigeria ("LFN"), 2011.
[16] Section 537 of CAMA and generally, Part XVI of CAMA.
[17] Chapter 11 of the US Bankruptcy Act ("the Act") is concerned with business re-organization. Some countries that have enacted legislations on business rescue inspired by the US model are: Australia, Germany and even recently, South Africa through specifically, Chapter 6 (Business Rescue) of the Companies Act 71 of 2008.
[18] Commenting on the importance of an automatic stay, the US House Report pointed out as follows:

> The automatic stay is one of the fundamental debtor protections provided by Bankruptcy laws. It gives the debtor a breathing spell from his creditors […] It Permits the debtor to attempt a repayment or re-organization plan, or simply to be relieved of the financial pressures that drove him into bankruptcy. – HR Rep No 595, 95th Cong, 1st Sess. 340 (1977).

See also Sheridan Downey III, et. al "The Proposed Bankruptcy Reorganization Provision: A Comparison of the Current Law with Chapter 11 of H.R. 8200 and S. 2266" (1978) 18 No. 3 Santa Clara Law Review, 568-607 (provides a general analysis of Chapter 11 of the Code and how it affects classes of creditors, especially the secured creditor).

Furthermore, CAMA still retains the receivership system in Part XIV which essentially entitles secured creditor to appoint a receiver over the company's assets upon default on its obligations. It is worthy of mention that the receivership system has been viewed with suspicion in the US for instance, given its tendency to benefit the appointing creditor at the expense of all other interested parties.[19] In the US unlike -in the UK (which developments in Nigerian law still tracks), the consequence of the application of the Debtor in Possession (DIP) provision is that the management of the company may continue to run the business.[20] As will be argued in Chapter 3, amongst other gains, this DIP control approach will suit Nigeria as it provides incentives for the business management to initiate rescue process at an early stage while the business can still be rescued and a wider stakeholder interests better protected.

In view of the fact that agreement to the plan for re-organization will be key to the rescue, how to deal with dissenting creditors who may be impaired by the plan will necessarily be an issue of concern. Presently, the provisions of Part XVI of CAMA does not provide any sophisticated reaction to the possibility of a holdout. While the "arrangement and compromise" provision (similar to the English "scheme of arrangement") allows for a kind of "cramdown" on any class of creditors or shareholders, it yet shies away from lending itself to the variation of a creditor's right that may arise from the procedure.[21] This is perhaps because the Act does not have clear provisions for protecting the dissenting creditors from any adverse implication of the "cramdown".

[19] Private receivership was considered as being abusive and often skewed in favor the appointing creditor to the detriment of the other creditors. Hence, the introduction of the reorganization provisions of federal Bankruptcy Act were regarded "as designed to prevent the notorious evils and abuses of consent receiverships"- see *New England Coal & Coke Co. v. Rutland R. R.* (1944)143 F.2d 179, 185.

[20] It is worth mentioning that that although a trustee may be appointed in place of the DIP under s. 1104, but this will be in rare cases. This detail will be treated in Chapter 3.

[21] Section 539 of CAMA expressly provides that "[n]othing contained in this section shall authorize any variation or abrogation of the rights of any creditor of the company."

If a business is said to be in financial straits, it follows that it will need access to credit for survival.[22] But no shrewd creditor in Nigeria today will be willing to extend credit to a business undergoing distress. Even if the lender wishes to take security over an asset of the business, a subordination to existing secured creditors may not even be sufficiently comforting. This is essentially because the state of the law does not provide any incentive whatsoever to justify undertaking such risk. A creditor who braves such risk will have to queue behind existing secured creditors of the business as the law does not afford such lender a subordination to or priority over the secured creditors.

Given the realization that most of the business debtors are already financially distressed at the time of bankruptcy filing, and the facility obtained may ultimately result in the success of the re-organization, Chapter 11 (unlike in the UK) provides super-priority for the creditor advancing credit under given circumstances prescribed by law.[23] This represents a justified violation of the absolute priority rule and is telling of the incentive offered the lender in such circumstance.

The choice of looking to Chapter 11 of the US Bankruptcy Code no doubt owes to the fact that of all the insolvency jurisdictions, it is reputed to be the most debtor-friendly and may just be what Nigeria needs. Commenting on the utilitarian value of chapter 11 of the US Bankruptcy Code, it has been stated that:

> […] the debtor-friendly chapter 11 in the United States has been instrumental in preserving the going concern value not only of small family enterprises but also of companies whose survival is critical to the economy as a whole….[24]

It need be emphasized that given the scope of this work, a comprehensive coverage of the issues at stake is indeed unrealistic. However, whether a piecemeal amendment of the relevant

[22] McCormack (n8), 85.
[23] 11 USC 364.
[24] Mallon and Waisman (n7) 214.

legislations or a holistic overhaul will be adopted by the Nigerian legislature, the aim of this thesis is to examine and propose the adaptability of key provisions like a wide ranging automatic stay to be applicable to the rescue framework, a DIP approach for the purpose of managing distressed businesses and the legislative incentivizing of DIP credit by way of creation of super-priority for the financing creditor where the need arises. In the alteration of the rights of the creditors, the thesis analyzes the possibility of adopting the US "cramdown" protection device to protect the minority interest. Specifically, if a holistic overhaul is to be undertaken, a case is strongly made for a business rescue law accessible to all forms of businesses, the business vehicle or size notwithstanding as presently afforded under the Chapter 11 of the US Bankruptcy Code.

The Roadmap of the Thesis

Business rescue is a part of insolvency law and that is the interest of the thesis. As such, Chapter 1 will start with an overview of insolvency law in a market economy. We proceed from the point that insolvency law responds primarily to the interplay between debt and default but plays a much more prominent role as bankruptcy theorists have identified. As such, the goals or role of insolvency law is considered in the light of the analysis of the desirability of rescuing businesses in distress. This analysis will be viewed through the lens of the view that holds the creditors as the pre-eminent and only interest deserving of protection and the view that allows for the protection of a wider interest.

The foundation laid will now usher in a discussion on the rescue culture. Further to the above, the options outside insolvency law open to be exploited by distressed debtor businesses unable to meet its obligations will also be analyzed, in the light of their likely short comings with regard to the reach of their applicability. Some of these options may involve the business looking to external sources (bail outs) or inwards (bail-ins) or even the use of workouts with the creditors of the business which is a much more commonplace, beneficial but do have their challenges.

In Chapter 2, the thesis will dwell on the available business rescue options under CAMA and the subsequent ISA. The relevant provisions of the legislations which have been identified as business rescue options will be examined with the aim of pointing out their inadequacies as tools for business rescue especially in the light of their inflexibility and the absence of core provisions which have formed part of the insolvency legislations of debtor friendly jurisdictions, using the United States as the paradigm. Given the inadequacies of the law as they stand, it follows that reform is imperative.

Chapter 3 will commence with a consideration of the appropriate approach to be considered by Nigeria in the quest for providing an amendment of Nigeria's subsisting business rescue initiatives or the enactment of a new Act on the subject. Importantly, as will be emphasized in Chapter 3, the purpose of this thesis is not to canvass a wholesale adoption, but the adaptation of identified ingredients of rescue from Chapter 11 of the US Bankruptcy Code. As such, Chapter 3 will make a case for, and will propose the replacement of the present receivership system with the Chapter 11 DIP, the introduction of automatic stay across board for all businesses (like is afforded in Chapter 11) for the purpose of ensuring peaceable rescue negotiations. In providing financing for the business, it will be canvassed that in the process of the rescue proceedings, priorities be re-ordered where necessary to provide super-priority for the provider of DIP financing. A case will also be made for the adoption of the "cramdown" provision of Chapter 11 given its safeguards which engenders a balance between the interest of the class of creditors in rejecting the plan/scheme and the need for rescue. Much more crucial will be the proposal that a business rescue law which is inclusive for all business vehicles need be adopted.

Chapter 1

Insolvency Law in a Market Economy

> "Risk, along with profit, are the essence of a market economy. While no law can eliminate risk, commercial laws should attempt to make outcomes as predictable as possible, without unnecessarily sacrificing flexibility." - J. L. Westbrook.[25]

In established market economies of the West like in emerging market economies in Central and Eastern Europe, Asia or Africa, there has been the growing need to strengthen insolvency laws to meet the challenges of doing business.[26] Westbrook's coinage of the term "*de-governmentalization*"[27] as one of the reasons for the heightened interest in strengthening insolvency laws is of practical application as the Nigerian example will show. It used to be the case in Nigeria that public enterprises were previously run without any regard for financial costs or returns, hence these government owned enterprises were buoyed by the expectations of government subventions to keep them afloat[28]. Presently, the situation reflects a remarkable

[25] "The globalization of insolvency reform" (1999) N. Z. L. Rev. 401 at 406.

[26] This cause has even been taken up by various international organizations. One of such efforts is seen in the work of the United Nations Commission on International Trade Law (UNCITRAL) titled the "Legislative Guide on Insolvency Law" with the stated aim of the document being "to foster and encourage the adoption of effective national corporate insolvency regimes". For more on this, please see <www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf> accessed on 12/10/2014.

[27] Ibid at 403 (the term refers to the drift away from government regulation and protection of enterprises to avoid default).

[28] Prior to the World Bank Structural Adjustment Program (SAP) introduced in the 1980's, Nigeria had a mixed economy with a deliberate government policy which was inclined to government ownership of heavy industries and these industries were largely sustained through the provision of government protection and subsidies. – see generally, L.O. Obokoh "Trade liberalization and Small and Medium sized Enterprises (SMEs) failures in Nigeria", (2008)3, Banks and Bank Systems. <http://businessperspectives.org/journals_free/bbs/2008/BBS_en_2008_3_Obokoh.pdf> accessed on 12/10/2014. The same is true for the former Communist Central and Eastern European (CEE) countries which until fairly recently had centrally planned economies, with government owning and controlling the means of production and distribution and was at the forefront in planning the actions of key economic players and institutions. The protectionist role of government in the creation of economic stability (albeit artificial) prevented failure of corporations. See Michael Kim, "When Nonuse is Useful: Bankruptcy Law in Post-Communist Central and Eastern Europe", (1996) 65 Fordham L. Rev. 1043.

withdrawal of this government interventionism, making for efficiency, profitability and a heightened recognition given to the private sector in the quest for economic development. Since the businesses (now in private hands) are faced with competition and now have to take their destinies in their own hands whilst contending with market forces, the role of the government has now shifted to amongst other things, the development of private sector oriented programs which will translate into encouraging the entry of not only foreign direct investments but also Micro, Small and Medium Scale Enterprises (MSMEs) into the market.

1.1.The Imperatives of Debt-Credit Interplay for Businesses

Any discourse on debt and credit presupposes that one party (the creditor) is willing to extend credit to another (the debtor) for which the contractual repayment obligation will arise sometime in the future. Private individuals like businesses require credit to carry out activities which their immediate resources may be unable to cover and this lies at the heart of business operations. A vibrant market economy will often be characterized by the availability of credit. Whether the MSMEs or the large corporations, credit plays a pivotal role in enhancing their operations and profitability. Thus for businesses to thrive and contribute to society in the creation of employment opportunities, generation of income which will be subject of tax and even carry out their corporate social responsibilities, such businesses will need access to credit.[29]

As it is often the case, these businesses may not be able to muster all the funds needed to undertake their business concerns whether in their daily operations or in the bid to expand (taking advantage

[29] Writing on the importance of credit for businesses, Professor Goode states that :
"Credit facilitates the smooth running and expansion of business and, in good trading conditions gives a company leverage to increase its profits by undertaking more business than would be possible if it were restricted to using its own funds."- See Goode, (n6), 2.

of economies of scale). As the businesses continue to seek to drive themselves towards the path of profitability, they will seek to enter voluntarily into credit transactions or may find themselves in a situation where they have to answer involuntarily to a class of persons who together with the former will constitute the creditors. [30]

While it is clearly true that Nigeria is yet to join the league of countries with reformed secured credit laws – a fact which may well have affected access to credit in the country.[31] Yet, however unreformed the present credit system is, there has always been the interface between credit and debt. This is even truer when we consider that even before the era when formal lending institutions took the center stage, credit has always been a part of business in society.[32] In these days where businesses are eager to access credit, however cautious the creditors are, the credit debt relationship will often result and will require proper insolvency laws which will not stifle business by leaning so much on the side of the creditors. What role should insolvency law then play in this credit-debt relationship?

1.2. Debt, Default and the Role of Insolvency Law in a Market Economy

Accessing the much needed credit by businesses does not come free of the possibility of default in repayment. The business may make strategic miscalculations, misfortunes may arise, even government economic policies may adversely affect the output of the business, its profitability and

[30] Thomas Jackson gives us a vivid illustration of those who may constitute the creditors of the business. He points out that "[t]he prototype creditor may be a bank or other financial institution that lends money, but that is only one of many ways in which credit is extended. An installment seller extends credit. So does a worker who receives a paycheck on the first day of December for work performed in November. The government in its role as tax collector, also extends credit to the extent that taxes accrue over a year and are due at the end. Similarly, a tort victim who is injured today and must await payment until the end of a lawsuit extends credit of sorts, although involuntarily and (probably) unhappily."- T. H. Jackson, *The Logic and Limits of Bankruptcy Law* (Cambridge: Harvard University Press 1986), 7.

[31] See Heywood Fleisig et al, *Reforming Collateral Laws to Expand Access to Finance*, (World Bank/International Finance Corporation, 2006)

[32] Goode (n6) ibid.

its ability to meet obligation to its creditors that may have arisen[33]. The resulting financial distress[34] for the business may mark the beginning of the end for the business or it may be survived and the business nursed back to health. The enactment of laws (substantive and procedural) to regulate this inability to pay and to ensure a framework within which the business may seek to regain its financial health. Indeed the loss which may arise from this financial distress (or the eventual collapse of the debtor business) would be borne not only by the creditors but by other stakeholders interested in the business.

1.2.1 Theorizing on the Role of Insolvency Law

In addressing the role played by insolvency law, attempts have been made by insolvency law experts to provide theoretical justifications for the role insolvency law plays in a market economy. Before proceeding with this analysis, it is relevant to state that theories bear significance on the approach which insolvency laws take and have some bearing on the policy leaning of those laws- whether they are pro-rescue or not. Again while admittedly these theories have been largely shaped by US scholars over the years, their postulations are of relevance and influence the discourse of business rescue in the context of an emerging market like Nigeria which shares a similarity with the US being a federal system.[35] Thus for instance, while CAMA and the Bankruptcy Act apply

[33] Aghiona, et al highlight the important role played by public policy in variables such as fiscal deficits in the occurrence of currency crisis and how same coupled with nominal price rigidity in the short run can affect the profitability of a business and have a telling effect on the ability of firms (which owe foreign currency debts) to repay their debt obligations. See Phillip Aghiona, et al, "Currency Crises and Monetary Policy in an Economy with Credit Constraints" (2001)45 European Economic Review, 1121–1150.

[34] Wruck defines a firm in financial distress as one which is insolvent on the basis of its cash flow i.e. "it is unable to meet current cash obligations thereby giving unpaid creditors the right to demand restructuring because their contract with the firm has been breached"- see Karen H. Wruck "Financial distress, reorganization and organizational efficiency" (1990) 27 Journal of Financial Economics, 419 at 421 <http://ac.els-cdn.com/0304405X90900636/1-s2.0-0304405X90900636-main.pdf?_tid=5469600a-98c7-11e4-b4cc-00000aacb360&acdnat=1420894441_325d58597c9e0d82e1247686fdf4e68f > accessed on 1/03/2015.

[35] Contrast Andrew Keay and Peter Walton *Insolvency Law, Corporate and Personal* (2nd Edn, Jordan Publishing Ltd), 24, where the authors argued on the relevance of the theories in England (and some commonwealth countries) given that a unitary system of government as against a federal one operates.

as Federal legislations, there is in operation State level contract laws which bear relevance on the question of debt collection.

Now, at the core of business rescue is the realization that just like various interests are affected by the insolvency of the debtor's business, so also varying interests seek prominence in the question of whether a distressed business need be rescued or liquidated, and what end or interest the rescue should serve.[36] To be clear, as pointed out by Warren[37], businesses usually do not fail after they have neatly wrapped off their affairs. Rather, their failure happens when they are active, leaving in their trail a horde of "contracts in various states of performance and nonperformance; owing past-due bills along with contingent future obligations; and disappointing legions of suppliers, employees, customers, creditors, and others who fear that they will not get all they had expected from their dealings with the debtor".[38] It thus follows that the losses resulting from the failure of the business is very much likely to impact a wide class of persons or interests. However, the question of who should bear or be spared (as much as possible) of the losses arising has pitched interests of creditors against that of the other stakeholders interested in the affairs of the business. Closely linked to this is also the question of who controls the decision of liquidating the business or allowing for the rescue (re-organization) of the business. Let us take a look at the position canvassed in favor of the creditors and then the arguments by the proponents of insolvency law serving a wider goal (which includes the accommodation of the rescue of the business).[39]

[36] See generally, Elizabeth Warren "Bankruptcy Policy", (1987) Vol. 54, No. 3, The University of Chicago Law Review, 775, at 776. In this regard also, Finch gauges the expectations of company directors, shareholders, employees and corporate creditors in the determination of what a good rescue should entail. See V. Finch "Corporate Rescue Processes: the Search for Quality and the Capacity to Resolve" (2010) J. B. L. 502 at 504.
[37] Elizabeth Warren "Bankruptcy Policymaking in an Imperfect World", (1993) 92 Mich. L. Rev. 336, at 341.
[38] Ibid.
[39] In addressing these wider goals, the arguments of different theorists will be addressed together. The reason for this is that the thread which runs through their theories (although to different degrees) are supportive of a case for business rescue.

1.2.1.1 The Creditors Bargain Theory

This theory was propounded by Thomas Jackson[40] and since then has gained followership among the law-and-economics scholars[41]. Hence, the creditor bargain theory postulates that the role ascribed to insolvency law should be limited to addressing the issues that arise as a result of several uncoordinated creditors who may wish to satisfy their claim individually based on the principle of first in time, first in right when the debtor business is faced with financial distress. Ordinarily, non-insolvency law provides a plethora of "grab law" remedies for creditors[42] which engenders the race of creditors trying to outwit and outpace each other in the quest to recover from the assets of the business debtor- (the common pool) from which all the creditors ought to have their debt liquidated from. Thomas Jackson's expression of this goal of insolvency law deserves to be quoted. He states that:

> The basic problem that bankruptcy law is designed to handle, both as a normative matter and as a positive matter, is that the system of individual creditor remedies may be bad for the creditors as a group when there are not enough assets to go around. Because creditors have conflicting rights, there is a tendency in their debt-collection efforts to make a bad situation worse. Bankruptcy law responds to this problem….[43]

The author further asserts that insolvency law serves the purpose of a debt recovery tool and as such is reflective of the bargain which would have been made by the creditors before the inability of the debtor to satisfy his obligation to the creditors arises.

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[40]Thomas H. Jackson "Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain", (1982) 91, Yale LJ, 857. Jackson (n31).

[41] See also D. G. Baird & T. H. Jackson, "Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy" 51 U. Chi. L. Rev. 101 (1984), 97 at 101. Other writers in this school include: R. K. Rasmussen, "An Essay on Optimal Bankruptcy Rules and Social Justice", (1994) U. ILL. L. REV. 1, 33 (where he provided justification for the economic analysis of business insolvency law); Alan Schwartz "A Contract Theory Approach to Business Bankruptcy" (1998) 107, Yale L. J., 1807 (where relying on economic grounds, he argues for the privatization of bankruptcy law); Irit Haviv-Segal, "Bankruptcy Law and Inefficient Entitlements" (2005) 2 BBLJ, 355 (supportive of the economic efficiency role of bankruptcy law).

[42] These remedies will include devices such as attachment, garnishment and execution. For more on the remedies afforded creditors outside insolvency law, see Tabb and Brubaker (n7) 41.

[43] Ibid at 10.

Bankruptcy law achieves the creation of this creditors' common wealth in two ways. On one hand, it puts at abeyance the right of the creditors to pursue their non-bankruptcy law remedy which will otherwise deplete the common pool.[44] On the other hand, it allows for a process in which the "best use" of the common pool can be determined.[45] It therefore follows by the analysis that bankruptcy law serves the purpose of providing the mechanism for the disposition of the common pool of the debtor's assets, to obtain the best possible price which maximizes creditor's interest.[46] Hence those rights which accrued prior to the insolvency proceedings need be kept intact without any room for redistribution of rights or creation of new rights within insolvency.[47]

In furtherance of this stance, the argument is that the sole *raison d'être* of insolvency law is to benefit the creditors of the debtor by solving the common pool problem and nothing more and any other interests such as that of the employees, shareholders, customers or even the community should be given consideration only so far as members of such group(s) are creditors with rights enforceable against the debtor under non-bankruptcy law.[48] Hence for these theorists, the litmus test of every insolvency law is whether it "enhances the collective benefits of the creditors".[49] Charles Mooney takes the arguments even further by stating that the consideration of other interests other than that of creditors with a claim against the assets of the business is on its face tantamount to thievery. [50]

[44] Ibid at 14-15.
[45] Explaining "best use" in economic terms, Donald Korobkin states that it means "deploying the assets through the process of exchange or 'sale' so as to maximize their economic value". See Donald R. Korobkin "Rehabilitating Values: A Jurisprudence of Bankruptcy", (1991)91 Columbia Law Review, 771 at 729.
[46] Jackson (n31), 210-213.
[47] Thomas H. Jackson and Robert E. Scott "An Essay on Bankruptcy Sharing and the Creditors Bargain" VALR, 155, at 159.
[48] Jackson (n47), 210.
[49] Keay and Walton (n36)26.
[50] Charles W. Mooney, Jr. "A Normative Theory of Bankruptcy Law: Bankruptcy as (Is) Civil Procedure" (2004) 61, Wash. & Lee L. Rev. 93 at 964.

In the Nigerian context, this theory may be representative of the present state of the law with regard to the pre-eminence of the creditors in the entire process of business insolvency. An indication that a business is distressed will naturally result in the race by creditors to exploit the relevant remedies afforded by state law.[51] As the creditors' bargain theory goes, this race is halted by insolvency law allowing the assets to be collected into the common pool and distributed amongst the creditors in accordance with their rights prior to the distress of the business. The argument that the rights of the creditors prior to insolvency be respected is clearly reflected in the provisions of CAMA which refuses to lend itself to the alteration of creditors' rights even when the business is distressed.[52] This policy of non-interference expressed in the law fits the description of the creditors' bargain theory, albeit not in all of its sophistication.

This characterization of the role of insolvency law by the creditors' bargain theorists has not gone without criticisms.[53] It is noteworthy that proponents of this theory belong to the law and economics school of thought who are generally wont to making a case "for the strict enforcement of the creditors' priority rights, even when this diminishes the likelihood of re-organization or rescue, based on the assumption that clear priorities increases the certainty (and ultimately, the efficiency) of the security market."[54] In this regard, the theory has been criticized as one which promotes the notion of the survival of the fittest for businesses faced with financial problems.[55] It

[51] Apart from the pre-judgment remedies known to English law, some creditors go the extra step of enlisting the assistance of anti-graft agencies such as the Economic and Financial Crimes Commission (EFCC) to recover their debt. See for example Everest Amaefule "EFCC may recover N40bn debt for Unity Bank" (October 10, 2014). <http://www.punchng.com/business/business-economy/efcc-may-recover-n40bn-debt-for-unity-bank/> accessed 01/17/2015.
[52] Section 539 of CAMA expressly provides that "[n]othing contained in this section shall authorize any variation or abrogation of the rights of any creditor of the company."
[53] For a helpful summary of these criticisms may be found in V. Finch (n2) 34-35.
[54] David A. Skeel Jnr. *Debt Dominion: A History of Bankruptcy Law in America* (2001, Princeton University Press), 224.
[55] Karen Gross "Taking Community Interest into Account in Bankruptcy: An Essay" (1994) 72 Washington University Law Quarterly, 1031 (the writer treats the creditors bargain theory as "bankruptcy Darwinism", at 1035).

follows that seeing insolvency law as merely an orderly debt collection procedure for the creditors overlooks two important aspects that has come to form a part of many an insolvency law to wit: the treatment of insolvency as "a problem of business failure and to place value on assisting firms to stay in business."[56] This brings us to the more inclusive theories that have factored other stakeholders in their postulations.

1.1.1.1 Beyond the Secured Creditors: Taking Account of Wider Interests

As previously stressed, some theorists have taken an approach that takes into consideration all other interests impacted by the distress and eventual liquidation of the business. In providing a normative explanation and an alternative to the law and economics account, Donald Korobkin proffers what he calls a "value-based account" for bankruptcy law. In sharp contrast with the position of the creditor bargain theorists, the learned author states that bankruptcy law responds to the problem of "financial distress-not only as an economic, but as a moral, political, personal, and social problem that affects its participants."[57] This financial distress does not only affect the business which only suffers in terms of economic values but may instigate a larger crisis involving the economic and social community of which the business is part. In the face of this financial distress, the interests of the stakeholders and the attendant value considerations of each class of stakeholders differ. Given the value crisis that ensues, the issue that arises and which bankruptcy law lends itself to is providing the context within which the resolution of these competing values- occasioned by the financial distress of the business- may be addressed. In doing so, the alteration of rights obtained prior to the financial distress of the business often becomes inevitable.[58] In

[56] Vanessa Finch "The Measures of Insolvency Law" (1997) 17 OJLS 227 at 231.
[57] Korobkin, (46) at 762.
[58] Ibid at 7

dealing with the financial distress and resolving the crisis value, Korobkin states that insolvency law makes possible the rehabilitation of the business as against the liquidation of same.

Contrary to the creditors' bargain theorists (which view the individual creditors as being rational), the communitarian theory takes into account a wider range of interests which may be impaired by the distress of the business debtor and as such it considers the individuals as being mutually dependent on each other, necessitating their acting in the best interest of the community notwithstanding that so acting impairs their liberty to insist on their strict legal right.[59] As Karen Gross -a proponents of the communitarian approach- crucially point out, the communitarian approach does not translate to attempting to rescue all or any business which have exceeded its useful life and the attempt at rescue which may amount to a sheer waste of time and money.[60] The communitarian theorists reason that since the individual players are inhabitants of society, it follows that they owe each other duties within the society and the redistribution which insolvency law undertakes (in the process of rescue) is only a reflection of this.[61]

The various theorists indeed have shown convictions in their arguments and truly much of the theory find some support in the way insolvency laws have been designed although it must also be pointed out that the "wider interest" approach is much representative of modern insolvency law such that some law and economic scholars have situated their theories within the insolvency

[59] Gross (n56)1033.
[60] Ibid. Other legal writers who have considered interests other than simply that of the creditor and thereby making a case for the rescue of the business include: Elizabeth Warren "Bankruptcy Policy" (1987) 54 University of Chicago Law Review, 775 at 778 ("as I see it, no one [bankruptcy] value dominates, so that bankruptcy policy becomes a composite of factors that bear on a better answer to the question, How shall the losses be distributed?" Samuel E. Etukakpan "Business Rescue and Continuity of Employment: Analysing Policy through the Lens of Theory" Comp. Law. Journal (2011) 32, 99 Journal (the author argues that in the face of conflicting interests of the stakeholders, trade-offs necessarily have to be made in the interest of the overall welfare of all stakeholders).
[61] Keay and Walton (n36) 28.

statutory framework.[62] First we must be clear on the role of the government in the market economy which is to (through legislations and deliberate policies) create a balance between the desire for businesses to grow and to encourage or somehow inspire the willingness of creditors to continue to extend credit. This the government must achieve through insolvency law also. Adler, Baird & Jackson have aptly captured the requisite balance to be facilitated by insolvency law when they opined that:

> …Much turns on how well crafted those [insolvency law] rules are. If they are cumbersome and ineffective, creditors will be more reluctant to lend and debtors will find it harder and more expensive to borrow. On the other hand, if these rules allow creditors to behave in a way that is arbitrary and capricious, people as well as firms will be less likely to borrow. Potential creditors, like potential borrowers, will again be worse off.[63]

It follows from the above that the role of insolvency law in a market economy is comparable to that played by credit law and this is essentially because how well insolvency matters are handled determine hugely if creditors would continue to lend credit[64]. In keeping with this need, insolvency law necessarily provides for predictability in the process by which the creditors of the debtor business may enforce their rights and have their claims satisfied in a collective manner, through the provision of a structured system of liquidation of the debtor business. But this is only a part of the story as insolvency law in a market economy needs also take into account the interest of other stakeholders whilst not overlooking the need to provide the debtor business the opportunity to

[62] Fairly recently, Kenneth Ayotte and David Skeel have argued that in addition to the creditors bargain theory, another role played by bankruptcy law is to solve the problem of illiquidity that a firm may face. In canvassing this position, they argue that certain bankruptcy rules (such as highest priority of unsecured bankruptcy lender over other unsecured lenders and priming of existing security interest) already seek to create liquidity for firms by providing solutions to the problems of debt-overhang and asymmetric information with which a firm may be faced. For further analysis on this goal of bankruptcy law, see K. Ayotte, and D. A. Skeel, "Bankruptcy Law as a Liquidity Provider" (2013) 80 U. Chi. L. Rev., 1557.

[63] B. E. Adler, D. G. Baird & T. H. Jackson, *Bankruptcy, Cases, Problems and Materials* (New York: Foundation Press, 2007) 1.

[64] Specifically dealing with personal property security law (PPSL), Tibor Tajti hints at the close link between insolvency law and PPSL when he agreed with Ulrich Drobnig that the yardstick for determining the status and efficacy of a security is the treatment it gets in the insolvency of the debtor. See Tibor Tajti "Could Continental Europe Adopt a Uniform Commercial Code Article 9-type Secured Transactions System? The Effects of the Differing Legal Platforms" (2014) 35, Adelaide Law Review, 149, at 157.

survive its liquidity problems without necessarily going through liquidation. This way, modern business insolvency law does not only serve the purpose of facilitating credit in commercial transactions but also as we have seen, it serves to protect certain interests and values which the State finds to be critical to economic growth[65]- chief of which is the provision of another opportunity for businesses which undergo financial distress to survive the distress and start again.

1.1.2 Achieving Business Rescue through Insolvency Law

As already hinted above, the "wider interests" appear to be winning. Much more important than this theoretical adventure is the fact that in more concrete terms, there has been mounting concerns even by States to rescue business for varying reasons which range from the preservation of employment to the yielding of better returns for the creditors collectively, and even for the sake of economic protectionism.[66] More specifically, the argument has been made that giving a business the opportunity to re-organize and continue as a going concern will be more beneficial to the stakeholders than a fire sale disposal of the assets of the business in liquidation.[67]

The importance of the preservation of the "going concern" value of a business ought to be given credit in view of the advantages which it has over the forced sale that characterizes liquidation. As

[65] See Evan D. Flaschen and Timothy B. DeSieno "The Development of Insolvency Law as Part of the Transition from a Centrally Planned to a Market Economy" (1992) 26, The International Lawyer, pp. 667-694.
Vanessa Finch provides a concise articulation of the task of business insolvency law in addition to those already canvassed. These tasks include: "the provision of management for companies faced with crises and the facilitation of business recovery for companies that are faced with financial crisis and the stimulation of the rehabilitation of insolvent companies and businesses as going concerns; the encouragement of good management of companies by the imposition of sanctions on directors who are responsible for financial collapses where there has been malpractice and by providing for the investigation of the causes of corporate failure; and the dissolution of the company where necessary."- Finch (n2) 27.

[66] See generally, Catherine Bridge "Insolvency – a Second Chance? Why Modern Insolvency Laws Seek to Promote Business Rescue". Available at <http://www.ebrd.com/downloads/research/law/lit13ee.pdf> accessed on 10/110/2014 (highlights the various considerations influencing business rescue legislations in several countries such as France, the UK and Ireland).

[67] In support of this proposition is the oft quoted part of the report of the US House of Representatives that: *"…the premise of business reorganization is that assets that are used for production in the industry for which they were designed are more valuable than those same assets sold for scrap"*- HR Rep No 595, 95th Congress, 1st Sess. 220 (1977).

McCormack argues, it is no mean feat to grow a business from the scratch. A piecemeal sale of the business through liquidation will result in the loss of transaction costs incurred in the course of creating and developing the network of relationships that already existed and new costs will be incurred in the creation of new relationships and the starting of the business again.[68] Arguments like this account for the apparently growing dominance of the rescue culture[69] and the renewed interest of States in protecting the going concern value of businesses through insolvency law even where it results in the alteration or redistribution of rights through the instrumentality of insolvency law.

1.2 Avoiding the Path of Insolvency Law: Any Rescue Option(s) for the Business Debtor?

Owing to the strategic importance of certain businesses, the use of insolvency law may not seem to be the best means of resolving the liquidity issues with which such businesses are faced. A typical example will be financial institutions[70] as well as certain other businesses whose outright

[68] G. McCormack (n8) 7. See also L. M. LoPucki "The Nature of the Bankrupt Firm: A Reply to Baird and Rasmussen's The End of Bankruptcy" (2003) 56 Stan L Rev, 645 (a reply to the contentions of Baird and Rasmussen's contention that re-organization or corporate rescue has outlived its usefulness in the face of current economic changes).

[69] For the purpose of this thesis, the definition of "rescue culture" as formulated by Hunter will be adopted. He defines a rescue culture as "[…] a multi-aspect concept, having both a positive and protective role, and a corrective and a punitive role. On one level, it manifests itself by policies, legislative and judicial, directed to the more benevolent treatment of insolvent persons, whether they be individuals or corporations, and at the same time to a more draconian treatment of true economic delinquents" – see M. Hunter "The nature and functions of a rescue culture"(1999) 104 Com. L.J. 426, at 435. In this chapter, the use of the term "business rescue" will be used in the general context of what is known as "re-organization" in the US and will be considered as the alternative to liquidation or winding up. As it will be observed, business rescue is used in the place of corporate rescue as the consideration in the thesis is not restricted to incorporated business entities with limited liability but also unincorporated business forms such as the sole proprietors and partnerships.

[70] The researcher acknowledges that different legal systems provide different rules and institutions which play specific roles in the liquidation or transfer of assets of distressed financial institutions (specifically deposit banks). In the US for instance, the Banking Act, 1933 designates the Federal Deposit Insurance Corporation (FDIC) as the official receiver for national banks and in the event of their failure, FDIC may be appointed as either receiver or liquidator. This role is performed with a lot of discretion and control granted to the FDIC (with limited court supervision) in disallowing claims, repudiation of contracts, etc. See E. Hupkes "Insolvency – why a special regime for banks?" Available at http://www.imf.org/external/np/leg/sem/2002/cdmfl/eng/hupkes.pdf accessed on 01/12/2014. See also Chapter 7 of the FDIC Resolution Handbook, available online at https://www.fdic.gov/bank/historical/reshandbook/

liquidation may have a ripple effect and result in collateral damage to other business entities operating within the sector[71] more so, since time often is of the essence for some of these businesses, the use of insolvency law may not provide the requisite speed in providing aid for them. On the other hand, it has been argued too that insolvency law provides for a higher level of transparency given that it provides for *ex ante* defined criteria for the determination of priorities and also provides creditors with the chance or opportunity to seek judicial remedy when they feel that they have been shortchanged of their contractual rights acquired before the distress of such businesses.[72]

Taking the arguments in support of applying insolvency law as against the other rescue options, it has been pointed out that as against the other options, insolvency law through its loss allocation mechanism stems the tendency of moral hazards on the part of creditors (who unlike equity holders and management enjoyed protection from the losses occasioned by the financial distress) especially when they may as well have been culpable if for nothing else, for failure to monitor the

(discussing the differences between FDIC resolution and Bankruptcy Law especially in the light of the special grant of powers). It may be stated here that the situation is somewhat different in Nigeria as although the Nigerian Deposit Insurance Corporation (NDIC) plays the role of receiver and liquidator for failed banks in Nigeria under the NDIC Act, it is still subject to the supervision of the courts. The bottom line however is that the rules applicable to the resolution of deposit banks are usually against the general background of insolvency law and this justifies the mention of financial institutions in the discussion of alternatives to bankruptcy.

[71] It is worthy of note that one of the arguments proffered by car manufacturers for the bail-out (as will be discussed) of the big three US car manufacturers (General Motors, Chrysler and Ford) was to prevent the likelihood of insolvency in the auto-parts supply industry which other car manufacturers also relied on for the supply of auto parts in their production lines and this might have led to disruptions in manufacturing. For more on this, see C. Isidore *Why Toyota wants GM to be saved*", CNN Money, 12/16/2008. Available at http://money.cnn.com/2008/12/15/news/companies/overseas_automakers/?postversion=2008121517 (accessed on 12/17/2014).

[72] See Thomas. H. Jackson, David. A. Skeel, Jr., "Dynamic resolution of large financial institutions" (2012) 2 Harv. Bus. L. Rev. 435, at 447. The authors however admit and rightly so that the fact of honoring priorities is not absolute as courts have had cause to tinker with priorities at debtor request through "critical vendor motions" to cater for certain creditors who will play a critical role in the success of a re-organization plan. Thus for instance, in *re Just for Feet, Inc*. (1999)242 B.R. 821, 43, Collier Bankr.Cas.2d 476, the Delaware bankruptcy court approved post-petition payment to critical vendors (sneaker makers) who could have withheld fresh supplies of stock from the debtor and hampered the debtors re-organization.

businesses.[73] Also, it is argued in support of insolvency law that it may prove more efficient in resolving the financial distress as it enables the parties who are better seized of information on the business debtor and have a stake in the business to make the relevant decisions.[74] The financial crisis that hit economies of the world from 2007 resulted in the use of two measures whose levels of successes will be discussed below, to wit, bailout and bail-in. It is however submitted that these means of resolving distressed businesses are indeed selective (sector specific) in terms of the businesses to which they lend their support and cannot be of general application.

1.2.1 Bailout of Debtor Business

Even in free market economies, the government has a history of coming to the aid of certain private sector business enterprises[75] especially where their insolvency would pose systemic risk[76] to the economy. The financial crisis which started in 2007 with the sub-prime mortgage crisis and

[73] Jackson and Skeel, Jr. (n73), 447. Connected to this moral hazard on the part of the creditors as pointed out by Coffee is the perception that some businesses are too big to fail and that government will come to the aid of the businesses to avoid their failure. The result is that creditors charge the businesses less interest than they ought to on the borrowed capital and since they are charged little on the borrowed capital, there is the incentive to take on too much leverage than they ought to. See J. C. Coffee see J. C. Coffee "Bail-Ins Versus Bail-Outs: Using Contingent Capital to Mitigate Systemic Risk", Columbia Law and Economics Working Paper No. 380, 5. Available at Available at SSRN: <http://dx.doi.org/10.2139/ssrn.1675015> accessed on 01/12/2014.

[74] *Id* at footnote 18. Indeed, Ayotte and Skeel have tenuously argued that the US bankruptcy law in itself sufficiently deals with financial distress through its provisions that have dealt with the issues of "creditors run" (especially in the financial sector) and "debt overhang" through specific provisions like the debtor-in-possession (DIP) financing, the provision for sale of assets free of lien and the automatic stay provision afforded by Chapter 11 of the Bankruptcy Act. See K. Ayotte and D. A. Skeel, Jnr. "Bankruptcy or Bailouts", (2010) 35 *J. Corp. L*. 469, at 476.

[75] N. Schwartz "In a Crisis, US Businesses Get Help", The NY Times (September 8, 2008), 14 (traces government rescue effort (bailout) from the provision of loan guarantees for the defense contractor Lockheed and distressed car maker Chrysler in the 1970's).

[76]The growth in size, intricacy and interrelatedness of some businesses (especially financial institutions) result in their being viewed as Too Big to Fail (TBTF) or Too Important to Fail (TITF) – I. Ötker-Robe, *et al* "The Too-Important-To-Fail Conundrum: Impossible to Ignore and Difficult to Resolve", IMF Staff Discussion Note (2011) <http://www.imf.org/external/pubs/ft/sdn/2011/sdn1112.pdf> accessed on 01/12/2014. Essentially, this is because their failure may result in systemic risk. Levitin in his analysis of the available definitions of "systemic risk" starts with a general definition of systemic risk as the "risk of a single firm's failure having substantial negative effects on the broader economy"- See A. J. Levitin "In defense of bailout" Georgetown Law Journal, (2011)99, 435 at 443. Coffee proffers a broader definition of systemic risk as "the risk that a localized economic shock can have worldwide repercussions because of the interconnections between financial institutions"- see John C. Coffee Jr. "Bail-Ins Versus Bail-Outs: Using Contingent Capital to Mitigate Systemic Risk", Columbia Law and Economics Working Paper No. 380, 1. Available at SSRN: <http://dx.doi.org/10.2139/ssrn.1675015> accessed on 01/12/2014.

investor's loss of confidence in the sub-prime mortgage market brought with it credit contractions as financial institutions began to tighten their credit standards in the face of declining balance sheet figures. The attendant liquidity crisis that ensued dealt a devastating blow not only to the American economy but like a contagious flu, its effect spread to other advanced as well as emerging economies across the world.[77] Given the immediate response required, governments of countries of the world took quick and prompt decisions and in some cases ad-hoc measures in providing rescue packages to save businesses which were operating in critically important sectors of the economy and to stem the tide of the looming financial collapse.[78]

One of the major criticisms of bail out has been not only that it is selective in terms of the beneficiaries thereof, but that it failed those entities and investors who reposed confidence in the stock market to act within the bounds of reason as those entities and investors eventually ended up the biggest losers.[79] On the other hand, it has also been argued that it might be impossible for

[77] In 2009, the IMF highlighted the severe impact of the financial crisis on economies around the world which was characterized by a slump in economic activities and a decline in real GDP in advanced economies and emerging economies at the rate of 7½ percent and 4% respectively in the fourth quarter of 2008, with further decline in output in the first quarter of 2009. See "IMF World Economic and Financial Surveys" (April, 2009). Available at <http://www.imf.org/external/pubs/ft/weo/2009/01/pdf/text.pdf> accessed on 01/12/2014.

[78] One of such business enterprises that saw massive government intervention in the wake of the crisis are the deposit banks and certain other financial institutions. The US naturally took the lead in providing relief for the business operating in the financial sector. Under the Emergency Economic Stabilization Act of 2008, the Troubled Assets Relief Program (TARP) was created and authorized to administer the $700 Billion approved under the Act to rescue the distressed firms. The sum which was eventually reduced to about $475 Billion (under the Wall Street Reform and Consumer Protection Act also known as the Dodd-Frank Act) went not only to rescue the firms in the financial sector but also other areas such as the automotive industry. For the details on this, see the US Department of the Treasury website, available at <http://www.treasury.gov/initiatives/financial-stability/TARP-Programs/Pages/default.aspx#> accessed 01/11/2015. Specifically in the case of Nigeria, the global events set off a crisis which first affected the capital market as a result of divestments of foreign investments portfolios which as at 2007 stood at US$15.73 billion and -owing to amongst other factors, poor regulatory and corporate governance issues- certain banks were severely balance sheet deficient with very high toxic asset portfolio. Thus, amongst other measures taken by the regulators of the financial sector, 10 banks were bailed out to the tune of about ₦620 Billion (about $4Billion). See Nigerian Deposit Insurance Corporation (NDIC) circular of 05/08/2011 titled "Resolution of failing banks through the establishment of bridge banks" <www.cenbank.org/Out/2011/.../NDIC%20PRESS%20RELEASE.pdf> accessed on 01/12/2014.

[79] Carrying this point further, Colesanti states that "the most harmful bow struck by the bailouts may have been to the faith of the retail investor, who has come to realize that, in times of exigency, he shall be last on the lifeboats"- J. S. Colesanti "In favor of a 'bail-In': How a trillion dollars might be better used to start a recovery". (2011) St John's Journal of Civil Rights and Economic Development, 1. Available at <http://ssrn.com/abstract=1880894> accessed 01/11/2015. Also commenting on the downsides of a bailout especially in the face of financial crisis, Aviram argues

governments to create a standardized resolution procedure into which every crisis situation which fit into and as such, bailout will always be a useful tool in achieving resolution in such cases.[80]

1.2.2 In the Place of Bailouts: Bail-In

Given the hue and cry that followed government bail-out programs during and post the financial crisis period, bail-in has become a veritable tool in the transfer of tax payers losses (which characterizes a bailout) to the private sector participants (particularly the shareholders and creditors) interested in the financial institution undergoing financial distress.[81] Clearly, while bail-out with its attendant moral hazard continued to see the protection of shareholders' funds and the settlement of creditors of the financial institutions[82], the strains of this largesse by government was felt by the economy and there was need for a seemingly self-contained regime that did not have to continue to use (or rely on a first resort basis) on tax payers money to subsidize the financial sector in a manner best described as "robbing Peter to pay Paul"[83]. In providing for a framework to

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that economic realities of bailouts lead to the conclusion that it presents very high costs to public funding. On these costs, he states as follows:

The financial crisis typically reduces the government's tax revenue, creating or exacerbating a budget deficit even before the cost of a bailout is considered. Never-popular tax increases are particularly resented when taxpayers feel the pinch of a crisis and may also hinder recovery by reducing taxpayer spending. Borrowing more money, another method of financing a bailout, risks raising interest rates and crowding private borrowers out of the capital markets, which may also hinder recovery. Finally, "printing money" (i.e., having the central bank purchase government bonds) may spur inflation. The costs associated with each of these financing alternatives limit the funds a government can allocate to supporting victims of a crisis.-

See Amitai Aviram "Bail-Ins: Cyclical Effects of a Common Response to Financial Crises" (2011)5, University of Illinois Law Review, 1633, at 1642.

[80] Levitin is of the opinion that bailouts are important and is a part of "modern economic life". He however argues for standardization, transparency and political accountability in the process - Levitin (n77) at 443.

[81] H.-Y. Chiu "Corporate Governance: the Missing Paradigm in the Mandatory Bail-In Regime for Creditors of Banks and Financial Institutions", (2014) 8, Journal of Business Law, 611.

[82] In arguing that the bail-out program did fail to distinguish saving the banks and saving the bankers and a class of claimants (equity holders), Stigiltz points out that the program succeeded in further enriching the bankers and shareholders who benefitted from the days of soaring stock prices prior to the burst of the bubble. See J. E. Stiglitz "The Current Economic Crisis", (2009) 35, Eastern Economic Journal, 281, at 289.

[83] In very simplified terms, Gleeson describes the rationale of a bank bail-in as "to provide a mechanism to return an insufficiently solvent bank to balance sheet stability at the expense of some of its creditors without the necessity for external capital injection". See Simon Gleeson "Legal Aspects of Bank Bail-Ins" (2011) 5 Law and Financial Markets Review 264, at 267.

empower resolution agencies to take quick and drastic measures, countries have provided the resolution agencies especially in the case of financial institutions, key discretionary powers (albeit under court supervision) to distribute the losses first as between the shareholders and creditors of the business.[84]

1.2.3 Creditor/Business Debtor Workouts

A creditor who has a monetary claim against the debtor is often usually within his rights to exercise any or in some cases all of those rights to which he is entitled to in satisfying his claim. Sometimes however, insisting on the exact claim or right when the debtor is insolvent or at the verge of it may be imprudent. Outside the confines of the court and insolvency law, the creditor(s) may sit with the debtor to reach some negotiated settlement. Thus a workout entails the "a debtor's agreement, usually negotiated with a creditor or creditors out of court, to reduce or discharge the debt."[85]

[84] The EU has recently passed the Directive 2014/59 ([2014] OJ L173/190) which establishes a framework for the recovery and resolution of credit institutions and investment firms, otherwise named as the Bank Recovery and Resolution Directive (BRRD). The purport of the Directive is to address on an EU-wide basis the risks posed by deposit banks as well as financial firms of some significance and one of the measures adopted under the Directive is that such institutions have a credible plan on ground such that when there is some financial stress they are able to recover their financial position. The resolution rules under the Directive ensures that taxpayers' monies are not resorted to in the course of resolving failing banks rather, they ensure that shareholders and creditors of the banks pay their share of the costs through a bail-in device. Where this does not stabilize the bank, the resolution funds set up under the Directive may be resorted to. However, it is of great moment to note that these funds are only meant to facilitate the orderly resolution of the banks and are not bailout funds for the purpose of rescuing the banks. For further information on this, please see http://ec.europa.eu/finance/bank/crisis_management/index_en.htm#141021. In the UK, the Financial Services (Banking Reform) Act 2013 (c.33) which amended parts of the Banking Act, 2009 provides (following the recommendations in the Independent Commission on Banking's (ICB) final report in relation to the special resolution regime) inter alia for a special bail-in provision which allows resolution authorities to cancel, modify or change the form of any liability owed by the institution However, the power of resolution authorities to make special bail-in provision is exercisable for the purpose of reduction, deferment or cancellation of the indebtedness of provided the liability is not excluded under the Act. For details on the bail-in provision of the Act, see A. Bainbridge, et al, "The Banking Reform Act 2013" C.O.B. (2014)114, 1-3. In Nigeria, there is no specific bail-in provision in the resolution framework. Section 39(1) of the Nigerian Deposit and Insurance Corporation (NDIC) Act empowers the NDIC and the CBN to set up bridge banks to purchase the assets of a failing bank. The sale of the bank which is without regard to the interest of the shareholders or creditors (of course other than the depositors) has raised issues of due process as it denies the stakeholders the first shot at rescuing the bank. This is presently subject of litigation and it remains to be seen the position to be taken by the courts.

[85] Black's Law Dictionary, 9th Edn. A workout has also been defined as "the financial rescue of a business that takes place outside the confines of formal insolvency law"- see "Resolving Financial Distress: Justice as Fairness and

Essentially, the business debtor and his creditors can utilize this collaborative effort as a cost cutting and time saving measure that may be presented by rescuing the business through insolvency proceedings. In fact as the Honorable Conrad Duberstein puts it, the possible "slice-of-pie" available for each of the stakeholders will be more compared to the filing of re-organization proceedings.[86] Now the reason for this is not far-fetched: "[t]he 'voluntary' readjustment process is said generally to produce a lower cost for all participants and society than does bankruptcy reorganization."[87] This very well explains why even the courts encourage parties to undertake such steps in requisite cases for the purpose of propping up distressed firms and helping them survive business failure.[88]

Having highlighted the useful role of workout in rescuing businesses, is also important to state that although it has proved beneficial, workouts cannot conclusively serve as replacement of the rescue provisions of insolvency law. Firstly, the efficacy of a workout is its dependence on the acquiescence of the creditors. This essentially means that without this agreement, the workout may be bound for failure. This contrasts the compelling power which insolvency law brings to bear on

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Reciprocity" (2004) 11 UCL Juris. Rev., 230 at 230. Melvin Shimm gives a functional description of the attributes of a workout describing it in terms of two of its important attributes. He says:

> "The oldest, simplest, and perhaps the most satisfactory state-sanctioned technique for comprehensively resolving the insolvent debtor's difficulties with his creditors is the informal, out-of-court settlement, which may take the form of either of two common law contractual devices: the **composition** or the **extension**."

- See Melvin G. Shimm, "The Impact of State Law on Bankruptcy", (1971) Duke Law Journal, 879 at 881.

[86] Hon. Conrad B. Duberstein "Out-Of-Court Workouts" (1993) 1 Am. Bankr. Inst. L. Rev. 347

[87] Victor Brudney, "Corporate Bondholders and Debt Opportunism: In Bad Times and Good", (1992) 105 Harvard Law Review 1821, at 1827.

[88] It is indeed worthy of note that the Bankruptcy Act takes a favorable disposition towards a workout. See 11 U.S.C.A. § 305 which entitles a Bankruptcy Judge to dismiss or suspend bankruptcy proceedings if it is in the interest of the creditor and debtors to do so. In *re Colonial Ford*, (1982)24 B.R. 1014, the Utah District Bankruptcy Court while dismissing a Chapter 11 Bankruptcy filing extensively highlighted the advantages of a workout as being expeditious, economic and sensible and the court went on to say at 1014 that "[t]he Bankruptcy Code contains several provisions which promote the private, cooperative, negotiated rebuilding of financially distressed debtors."

the dissenting creditors.[89] Even where the workout succeeds but is inadequate to achieve the desired rehabilitation of the business, the rescue provisions of insolvency law serves this purpose.[90]

We have also seen that outside the ambits of insolvency law, other measures have been found handy in dealing with the problem posed by the default of the business debtor, all in a bid to rescue businesses. Bailout played an important role in the last decade in providing solace not just for businesses but for economies across the world. However, its *ad hoc* nature resulted in a barrage of criticisms which led many countries to the adoption of the bail-in option which if for nothing else reduced the costs imposed on tax payers and required creditors and shareholders to bear the brunt of the failure of the business. But these alternative resolution methods have shown to be selective in their reach and cannot apply to just about every business. In the same vein, while workout is time favored and has the quality of being the simplest of all the options offered outside insolvency law, it cannot sufficiently oust or diminish the importance of the business rescue provisions provided by insolvency law. First because it suffers from the lack of force, compelling dissenting creditors to accept or buy into the negotiations.

However, the chances of rescue of businesses afforded by insolvency law provides not only for a predictable resolution regime and outcome but also gives the force of law to negotiations carried out within the ambits of insolvency law. The reach of insolvency law is not limited to the big

[89] As discussed in Chapter 3 of the thesis, the Chapter 11 of the US Bankruptcy Act provides for cram down which compels the agreement of creditors.

[90] The House Report on the Bankruptcy Act summarizes lends support to the argument canvassed above. It states that a workout :

> […] requires near universal agreement of the business's creditors, and is limited in the relief it can provide for an overextended business. When an out-of-court arrangement is inadequate to rehabilitate a business, the bankruptcy laws provide an alternative. An arrangement or reorganization accomplished under the Bankruptcy Act binds non-consenting creditors, and permits more substantial restructuring of a debtor's finances than does an out-of-court work-out.

See HR Rep. No. 95–595, 95th Cong., 1st Sess. 220 (1977), US Code Cong. & Admin News 1978, pp. 5787, 6179–6180.

institutions considered to be too big to fail. In many countries of the world like Nigeria, the bulk of businesses employing more people are not the TBTF but the several MSMEs that dot the streets and corners. Again in a society like Nigeria the need for effective business rescue provisions will serve an efficiency purpose. This is because instead of waiting for the workout to fail and then deciding to resort to insolvency proceedings (where the mill of justice has the reputation for grinding slowly), parties may commence rehabilitation proceedings even while continuing with the workout. The foregoing explains why the emphasis in this thesis is on the use of insolvency law as a means of business rescue. But what do the relevant Nigerian insolvency statutes know for business rescue? This is what the next chapter address

Chapter 2

Examination of Business Rescue under Nigerian Law(S): A Critique

> "… [T]hree principal characteristics desirable for a reorganization mechanism [are]: speed, low cost, and a resulting sound capital structure. Other desirable characteristics are accuracy in valuation and compensation, predictability, and fairness" – Mark J. Roe[91]

So far, we have seen market economies using insolvency law as a tool for driving business rescue. Although the creditors have always had their pride of place, policy reasons have also dictated that States lend the instrumentality of law to the preservation of businesses given the greater good their existence portends for the various interests represented by the continued existence of the business. Nigeria, -being Africa's largest emerging market economy- has apparently been lost in the crowd of countries which have taken deliberate and calculated steps in the protection and promotion of entrepreneurialism and the provision of a fresh start for ailing businesses using the instrumentality of insolvency law. Below we examine the possible business rescue options for business incorporated or otherwise and how much the rescue tools measure up to the parameters outlined above.

2.1 The Bankruptcy Act[92]: Grim Prospects for the Rescue of Businesses

Although the Nigerian Bankruptcy Act is designed for individuals, its reach essentially extends to proceedings brought by creditors of businesses which do not enjoy limited liability status and this will include the sole proprietors and partnerships which dot the MSME landscape in Nigeria. Most "one-man businesses" and partnerships will fall under the regime of this Act following the scope

[91] Columbia Law Review (1983) 3, 527 at 529.
[92] Bankruptcy Act in this chapter refers to the Nigerian Bankruptcy Act, Cap B2, LFN 2011. Available at http://www.nigeria-law.org/BankruptcyAct.htm. Accessed on 1/26/2015.

of its application.[93] However, the rather trenchant provisions of the Act and what it portends for this class of business debtors irrespective of the cause of the insolvency is reflective of the general perception and prevalent attitude to insolvency in Nigeria. First, a look at Section 1 of the Act gives the impression that the Act is a penal legislation the prevalent culture is one which appears to be punitive and vindictive of the debtor.[94] More so, the fact of having been declared bankrupt under any law in force in Nigeria is ground to disqualify a person from contesting elections into the legislative or executive arms of government whether at the Federal or State level.[95] Commenting on the effect of bankruptcy proceedings in Nigeria, one legal writer gives an overview which is quite telling. He states that:

> [o]n the eventual discharge of a bankrupt by the court, he is restored to the status quo ante and thereby relieved of any liability or claims of the creditor which formed the basis of the bankruptcy proceedings instituted against him. However, the social consequences of having been once declared a bankrupt endure as they attach a stigma either on the personality or on corporate image of the person affected by the order. It ordinarily conveys the impression that a bankrupt notwithstanding the fact that he has been discharged is incapable of conducting his private or financial affairs now or in the future. Consequently, he is shunned by clients, professional or business colleagues and potential creditors who may be unwilling to engage in any form of commercial transaction with any person who has once been ad-judged bankrupt.[96]

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[93] By virtue of Section 108 of the Act, the provisions of the Act applies to individuals and entities not registered under CAMA. It is not unusual to find that most "one-man businesses" (especially sole proprietorships and partnerships) are usually not registered under CAMA and thus fall within the ambits of this Act. To further buttress the point, section 5 empowers a creditor of the firm (not registered under CAMA) a creditor of the firm to present a bankruptcy petition against the firm, following which a receiving order may be made against the firm in respect of an act of bankruptcy committed in reference to the business of the firm by any partner of the firm or by any person having control or management of the business of the firm.

[94] Act commences by saying that a person "**commits** the Act of bankruptcy if…" Given that the Act has English origins, one necessarily agrees with Muir Hunter's description of previous English bankruptcy as having a quasi-penal jurisdiction. See "The Nature and Functions of a Rescue Culture" (1999)104, 426 at 427.

[95] Sections 66(1) (e), 107(1) (e), 137(1) (f), 182(1) (f) Constitution of the Federal Republic of Nigeria, 1999 (CFRN) (as amended). Notably, the purpose of the Act is to "…make provisions for declaring as bankrupt any person who cannot pay his debts of a specified amount and to disqualify him from holding certain elective and other public offices or from practicing any regulated profession (except as an employee)". See also section 253 of CAMA which disqualifies such a person from acting or holding the office of a director.

[96] O. Akanle, *Bankruptcy Law and Practice* quoted in Dr. O. Agbakoba (SAN) & T. Fagbohunlu "Bankruptcy and Winding-Up Proceedings: Potential Mechanisms for Speedier Debt Recoveries". Available at:

It therefore means that the guiding policy is not essentially one meant to rescue the business but the demonstrated intent of the Act is to achieve the repayment of the business debtor's creditors. In this regard, let us consider the provisions of the Act which in providing for workout between the business debtor and his creditor(s) may be incidentally beneficial to the business debtor by affording it some breathing space.

2.1.1 Composition and Schemes of Arrangement under the Bankruptcy Act

Under the provisions of the Act, the business debtor who is undergoing bankruptcy proceedings is allowed to –within a specified period of time- enter into some form of composition or to draw up a scheme of arrangement with its creditors.[97] Although a stay of proceedings comes into place upon the filing of the bankruptcy proceedings, which prevents action by other creditors, the Act curiously excludes from the application of the stay secured creditors. So if Bank X has a secured interest over the sawmill machine used by YZ Millers (a partnership firm involved in sawmill business), Bank X has a choice to stay out of any bankruptcy proceedings whether filed by the YZ Millers or the other creditors of the business. The telling effect of this is that the secured creditor is given the opportunity to deal with the assets in any manner which it deems fit without any let or hindrance.

The idea of a composition between the debtor business and its creditors as envisaged under the Act gives the impression that there exists some avenue available to the debtor from where funds can be raised by the debtor to satisfy the creditor(s) with whom he enters into the composition. Given the stigma that follows the filing of the bankruptcy proceedings, it is clear that no potential lender will be willing to extend credit to the debtor business and this the Act fails to take into

http://www.agbakoba-associates.com/media/articles/Bankruptcy-and-Winding-Up-Proceedings.pdf. (Accessed on 11/17/2014).

[97] Section 18 Bankruptcy Act.

account. The Act apparently treats the non-payment of debt by a business debtor as a mere refusal, unwillingness or omission to pay debt.

If the financial distress is occasioned by some externality that has impacted the cash flow of the firm, the only remedy offered by the Act is the opportunity for composition and scheme of arrangement between the debtor and its creditors whereas more could have been done by encouraging lenders to extend credits to the business. In addition, the exclusion of the secured creditor may make bankruptcy inevitable for the business debtor if the assets with which it intends recover from distress have been seized and disposed of by the secured lender over whom the bankruptcy court has no control. In the light of the foregoing, it may be concluded that the Act has nothing to offer in rescuing distressed business debtors who fall within its jurisdiction.[98] It is thus safe to conclude that the Bankruptcy Act as presently constituted works against the rehabilitation of entrepreneurs who has experienced failure apparently knows nothing of an enterprise culture.[99]

2.2 The Business Rescue Options in CAMA

"Part A" of CAMA ("the Act") essentially regulates the commencement of business for incorporated businesses, the regulation of the affairs of the business as a going concern, the liquidation and eventual dissolution of the business where the need for same arises. For the purpose of resolving the indebtedness of the business, the Act has elaborate winding up provisions characterized by the cessation of the business, assets realization, the payment of its debts and

[98] In fact, this provision for composition is comparable to John Tribe's chronicle of the compelled composition of 17th Century English courts were he stated of Francis, Lord Verulam, that he even went so far as to threaten creditors with imprisonment if they did not come to a composition with the debtor"- see "Company voluntary arrangements and rescue: a new hope and a Tudor orthodoxy" J.B.L (2009) 5, 454 at 461; see also J. Tribe and D. Graham, "Bacon in Debt--The Insolvency Judgments of Francis, Lord Verulam" (2006) 22(1) I.L. & P. 11

[99] See generally Bryan Gladstone and Jennifer Lane Lee "The operation of the Insolvency System in the U.K.: some Implications for Entrepreneurialism" (1995) 7 Small Business Economics, 55 at 56 (highlighting the need for building an entrepreneurial culture in the UK (of course prior to the enactment of the Enterprise Act of 2002)).

liabilities in the order prescribed by law and the distribution of the remnant to the members of the company. The liquidation of the company is followed by dissolution after which the corporate entity ceases to exist.

It is very common today in Nigeria for creditors to commence winding-up proceedings[100] against debtor companies for recovering debts, which have become due and unpaid. While sometimes this may be a mere bluff to force payment by the business debtor, some other times, such proceedings are pursued vigorously by the creditor(s) as an alternative to commencing debt recovery proceedings. The resort to winding up proceedings as the first option by creditors in Nigeria has certain critical implications. First, it overlooks the benefits- such as job creation/opportunities, continued tax revenue, corporate social responsibility contribution, dividend payout[101]- that accrue to society from the continued operation of the business upon rescue. Second, it might turn not to be a smart move for a creditor who might end up with a less favorable standing in the redistribution of the proceeds of the assets realized from the wound up business and may well have benefited more in the long run from the continued stay in business by the company. The possible business rescue options afforded a distressed debtor with limited liability are those that may be found in the

[100] Section 408(e) of the Companies and Allied Matters Act (CAMA) makes the inability of a company to pay its debts a ground for winding up by a creditor. But beyond that, section 409(a) sets the financial threshold entitling the creditor to seek winding up at a paltry ₦2000 (Nigerian Naira) which has been demanded and the company has failed to pay within 3 weeks of the demand. Commenting on this provision, Anthony Idigbe, a consummate Nigerian insolvency expert has opined that "… clearly to liquidate a company today which is not balance sheet insolvent because of failure to pay ₦ 2000 after 21 days' notice will cause social upheaval and defeat the very purpose of the law." – See Anthony Idigbe (SAN) "Using Existing Insolvency Framework to Drive Business Recovery in Nigeria: the Role of the Judges". Paper presented at the 2011 Federal High Court Judges Conference at Sankuru Hotel Sokoto, Nigeria on 10/11/2011. Available at: http://www.punuka.com/uploads/role_of_judges_in_driving_a_business_recue_approach_in_existing_insolvency_framework.pdf. (Accessed on 11/17/2014).

[101] A. Idigbe (SAN) "Using Existing Insolvency Framework to Drive Business Recovery in Nigeria: The Role of the Judges". Paper presented at the 2011 Federal High Court Judges Conference at Sankuru Hotel Sokoto, Nigeria on 10/11/2011. Available at: http://www.punuka.com/uploads/role_of_judges_in_driving_a_business_recue_approach_in_existing_insolvency_framework.pdf. (Accessed on 11/17/2014).

leading company law legislations – the Companies and Allied Matters Act (CAMA)[102] – and perhaps in the Investments and Securities Act (ISA). These we shall deal with anon.

2.2.1 Arrangement and Compromise as a Rescue Device

Given Nigeria's historical ties to the British as a common law country, the laws of the latter has greatly influenced and still bears some influence on the legislations of the former. CAMA[103] happens to be one of such legislations which share such semblance with the English Companies Act. This perhaps explains why the Nigerian arrangement and compromise[104] provisions of CAMA is traceable to the English "schemes of arrangement" which still forms part of the English Company law today.[105]

CAMA recognizes certain types of arrangements and compromise for the purpose of restructuring the affairs of a company to wit: "arrangement on sale"[106] and "creditors and shareholders' compromise or arrangement".[107] Before considering the general procedure prescribed under the

[102]Cap C20, Laws of the Federation of Nigeria ("LFN"), 2011. Given the fact that these procedure relate to businesses with limited liability, the term "corporate rescue" will feature in this part of the thesis.

[103] Company law in Nigeria started with the enactment of the Companies Ordinance of 1912 and went through several pre and post-colonial amendments which have now culminated in the present CAMA (2004). For perspectives on the historical evolution of Nigerian company law, please see Akinola Bukola "A Critical Appraisal of the Doctrine of Corporate Personality under the Nigerian Company Law" (NLII Working Paper Series 002); Bolanle Adebola "The Nigerian Business Rescue Model: An Introduction". Available at: <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2297824> accessed on 10/10/2014.

[104] An arrangement is defined under the Act as "a 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 provision of this Act or by the unanimous agreement of all parties affected thereby". Although there is no definition provided for a compromise in the Act, compromise should be seen in the light of the relinquishment of rights by the parties for the common benefit of all the parties concerned. See: *Re Alabama New Orleans Texas & Pacific Junction* [1891] 1 Ch. 213 at 243.

[105] See section 425 of the Companies Act, 1985 which is now embodied in Part 26 of the Companies Act, 2006. The arrangement and compromise first came to light in English law following the enactment of the English Joint Stock Companies Arrangement Act of 1870 which sought "to facilitate compromises and arrangements between creditors and shareholders of joint stock and other companies in liquidation."- see Joint Stock Companies Arrangement Act 1870; 33& 34, Vict c.104. For detailed discussion on the English law on schemes of arrangement, see: Vanessa Finch (n2) 484-493.

[106] Section 538 CAMA

[107] Sections 539 and 540 CAMA. It is worthy of note that other forms of business combinations such as mergers, acquisitions, takeovers and other forms of business combinations are catered for under the Investments and Securities Act (2007) which shall be referred to in later part of the thesis.

Act for arrangement and compromise, it is worthy of mention that the arrangement on sale presupposes the voluntary winding up of a company with the authorization of the liquidator to dispose of the whole or part of the undertaking of the business to another incorporated company (a transferee company).[108] Clearly, what happens here is not the rescue of a business but the sale of assets by one company ("Transferor Company") to another ("Transferee Company"). The arrangement on sale presupposes that the assets of the liquidating business is sufficient to cater for all its liabilities. This is because as a requirement for voluntary winding up under CAMA, the company is obligated to file a statutory declaration of solvency to the effect that the company is able to pay up its debts within not more than 12 months of the commencement of winding up proceedings.[109] It therefore follows that the rationale for this procedure is definitely not to serve as a form of business rescue and may not be looked upon as such.[110] Therefore the attention here is focused on the arrangement and compromise carried out between and amongst creditors and shareholders to internally restructure the business for the survival of the company.[111]

2.2.2 Arrangement and Compromise Procedure

The procedure under CAMA starts with an application to the court for meetings to be held by the company making the arrangement.[112] This application may be made by the company, its creditors, a member or even the liquidator of the company in the case where the company is being wound

[108] Section 538(1) CAMA
[109] Sections 462 CAMA.
[110] See Allen, Kraakman and Subramanian *Commentaries and Cases on the Law of Business Organization* (Aspen-Wolters Kluwer, 2007), 453.
[111] It is admitted that this thesis is biased towards the American conception of business re-organization which does not involve the liquidation or sale of the company to effect a rescue. See Nathalie Martin "Common Law Bankruptcy Systems: Similarities and Differences" (2003) 11 American Bankruptcy Institute Law Review, 367 at 397 (on the American idea of rescue culture where the sale of a business as a going concern is considered as liquidation).
[112] Section 539(1) CAMA.

up.[113] At the court's direction, the classes of interested members or creditors is summoned.[114] At the meeting(s), the proposed arrangement or compromise will be deliberated upon. As part of the notice summoning the meeting, it is required that a document containing a statement which explains the effect of the scheme, as well as any material interest of the directors which may be affected by the scheme in a way different from that of other interested persons with a shared or similar interest.[115] If at the close of the meeting, the relevant members or creditors agree to a compromise or arrangement by a majority which is not less than three-quarters in value in respect of the shares held by such members or the interest of such creditor as the case may be, the company may now approach the court for the second time for its sanction of the arrangement and compromise reached with the majority.[116] However, this sanction does not come free of the court's own perception of the fairness of the scheme as in spite of the majority approval, the court may yet refer the scheme to the Nigerian Securities and Exchange Commission (SEC) for the latter's assessment of the fairness of the scheme and the preparation of a written report on same.[117] Upon satisfying itself on the fairness of the scheme, the court may now sanction it and the arrangement and compromise becomes binding on the members, creditors or the relevant class of them. The implication of this is a cram down on the dissenting minority which may have voted against the scheme.[118] This device is essentially meant to achieve some form of internal restructuring involving the stakeholders of the business but as will be revealed below, its efficiency may well have been hampered by various challenges.

[113] Ibid.
[114] Ibid.
[115] Section 540 CAMA.
[116] Section 539(2) CAMA
[117] Ibid.
[118] Section 539(3) CAMA. The term cram down is here used cautiously in reference to the compelling of the dissenting creditors to accept what the majority has agreed. As we shall see in Chapter 3, this cram down does not have comparable consequence as that in Chapter 11 of the US Bankruptcy Act.

2.2.3 Assessing the Arrangement and Compromise Procedure: Missed Opportunities

From what can be deciphered above, the arrangement and compromise procedure described above starts with an application to the court for an order to convene a meeting of the relevant stakeholders or a class of them. This is followed by the convening of the meeting if the court grants the order. Now, the cases of *In re Interfinance & Securities Ltd*[119] and *Andruche Investment Plc. v. Financial Mediators & 7 others*[120] are instructive as they give a picture of the appreciation of the procedure by the court and also how the entire process of arrangement and compromise can be scuttled even before the process commences.

In *Interfinance*, the debtor business brought an application before the Federal High Court seeking amongst other things, the grant of an order by the court to convene a meeting of the creditors of the business. In line with section 539, the essence of the meeting was to consider (and if agreeable to the creditors) adopt the scheme of arrangement drawn up by the debtor with or without modification. In refusing the debtor's application, the learned Federal Judge reasoned that the proposal being put forward by the debtor did not have the character of a compromise since it was unilaterally drafted by the debtor. The court stated that "a unilateral proposal made to Court by a Company stipulating how the Company intends to settle its indebtedness cannot constitute a 'Compromise' under Section 539 of the Companies and Allied Matters Act, 1990 so as to propel the court to order a meeting to be summoned".[121] The court spiced up its opinion further by stating that "[t]o act on a one sided proposal by a Company, the Court will be unwittingly lending its aid to a fraud on the public".[122] Also in *Andruche*, the same learned Judge in a case on all fours[123] with

[119] (1993) FHCLR, 421.
[120] (1994) FHCLR, 51.
[121] Footnote 119 at 424.
[122] Ibid.
[123] The only slight variation in the facts of this case was that the scheme drawn up by the debtor included only 9 of the 119 creditors of the business.

the *Interfinance* maintained the same reasoning. The court reiterated the position that the fact that the debtor alone had drawn up the scheme of arrangement deprived the debtor of the right to approach the court for an order for the meeting of the creditors.[124]

As can be gleaned from the provision of CAMA on the relevant procedure, there are three stages which a scheme goes through to be approved by the courts. The first being the application to court for the convening of the meeting. Secondly, the meeting is convened and the scheme is presented for approval (in this case by the creditors or a class of them). In the event that the scheme is approved, the scheme need be presented to court for its sanction.[125] The Applicants were still at the first stage of the procedure where they sought the order of the court to convene the meeting. However, the court on its own proceeded to look into the substance of the scheme drawn up by the debtor.

With respect, the learned Judge pre-empted the creditors who were yet to complain on the acceptability or otherwise of the scheme. The procedure under CAMA still provided for the opportunity to test the fairness or otherwise of the scheme but this is at a later stage. Besides, if 75% of the creditors or a class of them were agreeable to the scheme, perhaps, there would be no basis for the court being overly protective of the creditors or the said class, especially at a premature stage. While it is understandable that the court was particularly concerned about the nature of the businesses in in question (non-banking financial institutions), it is also true that the creditors were still capable refusing the scheme, amending it and voting against it if dissatisfied with it.

[124] Footnote 120 at 56.
[125] For an analysis of the importance of each of these stages, see the English case of Re Hawk Insurance Company Ltd [2001] 2 B.C.L.C. 480.

The trend in the UK for instance shows that the courts will exercise restraints in exchanging its judgment for that of the creditors especially where appropriate disclosure has been made by the majority regarding their interest. In *re London Chartered Bank of Australia*,[126] 544-45, the court reasoned that if the creditors decide on the basis of adequate information and time to grasp the purport of the scheme, coupled with candor, they-rather than the court- are better placed to determine what better favors them commercially.[127] Thus, "the court ought to be slow to differ from them. It should do so without hesitation if there is anything wrong; but it ought not to do so, unless something is brought to the attention of the court to show that there has been some material oversight or miscarriage".[128]

The learned Judge in the Nigerian cases unfortunately deprived the parties of this opportunity and deprived the practitioners a test case of the functionality of arrangement and compromise as a rescue device. It is puzzling that that the Applicants did not pursue an appeal of the decision of the trial court. On the other hand, it is argued that the Applicants may well have omitted the details of the scheme in their application for a court ordered meeting and only presented same at the point when the creditors have made their inputs and a compromise reached. At least in reality, there is nothing in the Act that compels the filing of same.[129] Perhaps this way, the court may well have reached a different conclusion.

[126] [1893] 3 Ch. 540.
[127] Ibid at 544.
[128] Ibid at 545.
[129] See footnote 116 above. This also compares to the provision of section 897 of the English Companies Act, 2006 which requires that the effect of the plan and all likely conflicts of interest accompany the notice of general meeting of the creditors.

2.2.4 Weaknesses of the Arrangement and Compromise Procedure

Arrangement and compromise like its scheme of arrangement counterpart in the English Companies Act have been dogged with criticisms that render it somewhat undesirable in its present form as a corporate rescue device.[130] Apart from the cases analyzed above, a question that will bother any percipient observer will be why over the years, the arrangement and compromise provision has been hardly explored by businesses. Several reasons have been identified by practitioners and the academe alike for its non-suitability in rescue.

2.2.4.1 Complicated and Difficult Procedure to Organize

The arrangement and compromise procedure is regarded as not only composite but also possessing the tendency to be difficult to organize.[131] In the case of Nigeria, the cases analyzed above demonstrate how its complex nature may derail the process. Beyond the complexity is the implication of the absence of the imposition of a moratorium on creditors' rights for the duration of the process.[132] Bolanle Adebola, one of Nigeria's leading lights on the subject of corporate insolvency opines that the absence of a provision putting the rights of the creditors in abeyance pending the exhaustion of the process is further worsened by the complex nature of the arrangement and compromise procedure coupled with Nigeria's "complex judicial system".[133] The

[130] The Cork Committee had published its report in 1982 which had outlined the problems and challenges that had plagued the comparable provision in the applicable British Act at the material time. With regard to the scheme of arrangement and other procedures such as receiverships and winding up, the Cork Committee came to the considered conclusion that that these procedures were responsible for the failure of several companies but that "all insolvency schemes must be aimed at saving a business."- see Kenneth Cork *Cork on Cork* (Macmillan, London, 1988), at 203. However for a contrary opinion, see: Goode (n6), 484 (schemes of arrangement come in handy in the cases of companies with complex capital structure in which secured debts are involved and the company is faced with the difficulty of getting the secured creditors to agree to the scheme); "Companies Act Schemes of Arrangement and Rescue: the Lost Cousin of Restructuring" (although reaching a conclusion for the simplification of the procedure, he argues that the scheme of arrangement is beneficial without a moratorium on creditor's action).
[131] See McCormack (n8) at 276.
[132] This is unlike the liquidation process where the leave of the court supervising the liquidation need be sought to continue or commence action against the debtor. See section 417 CAMA.
[133] Bolanle Adebola "Conflated Arrangements: A Comment on the Company Voluntary Arrangements in the Proposed Nigerian Insolvency Act, 2014". Available at <http://ssrn.com/abstract=2565491> accessed 02/27/2015.

reasoning is quite sound. Under the Nigerian federal constitution,[134] the Federal High Court has jurisdiction with regard to the operation of CAMA[135] and as such is the court seized with the administration of the arrangement and compromise provision in CAMA. However, since debt recovery can be commenced unrestrained in the State High Courts, this makes the process a lot more challenging.

2.2.4.2 Cost Implication of the Procedure

The propensity of cost inefficiency has also been identified as another challenge posed by the use of the arrangement and compromise procedure in the rescue of financially distressed businesses.[136] It is conducive to reason that a business in distress will be under budgetary constraints. However, it appears that the provisions of the Act does not take cognizance of this. For instance, the procedure requires that the debtor approach the court twice, first for the purpose of the order to convene the meeting and secondly for the sanction of the procedure. In doing this, the services of a legal practitioner will also be sought. Not also forgetting the meeting (or several meetings) which will need to convened. As one commentator points out, "[t]hese expenses could easily run into millions of Naira or other amounts beyond the reach of small companies in financial distress".[137] In the decision of whether to allow the business liquidate or survive, the question of the most cost effective procedure- liquidation or rescue- will be important. Consequently, the recovery of the business ought to be cost effective otherwise it will not do.

[134] Constitution of the Federal Republic of Nigeria (CFRN), 1999 (as amended).
[135] Section 251(1)(e) CFRN.
[136] A, Adeniran, Akingbolahan "Mediation-Based Approach to Corporate Reorganizations in Nigeria" (2003-2004)29 N.C.J. Int'l L. & Com. Reg. 291, at 325.
[137] Ibid at 326

2.2.5 Receivership as a Business Rescue Device in Nigeria

2.2.5.1 Background

Like much of Nigeria's legislations, the Nigerian receivership has its root in the English receivership which is another debt recovery tool in the arsenal of the English secured creditor by which he may enforce his security against the debtor.[138] Sir Jessel MR proffered what may be referred to as a time honored definition of a receiver as meaning:

> a person who receives rents or other income paying ascertained outgoing, but who does not … manage the property in the sense of buying or selling or anything of that kind. We were most familiar with the distinction in the case of partnership. If a receiver was appointed of partnership assets, the trade stopped immediately. He collected debts, sold the stock-in-trade and other assets, and then under the order of the court the debts of the concern were liquidated and the balance divided. If it was desired to continue the trade at all it was necessary to appoint a manager, or a receiver and manager as it was generally called. He could buy and sell and carry on the trade.[139]

Significantly, this definition gave a clear distinction between a mere receiver and manager (or better still a receiver/manager) under the common law. Thus while the former is appointed to take over the control of the property of the debtor and to receive the earnings from the said property, the latter has in addition to these responsibilities, the task of carrying on the business of the debtor.

Under the Common Law, the receiver/manager may choose to undertake a rescue but it need be borne in mind that by its very nature, the receivership is generally a creditor-oriented procedure, which has at its core, the protection of the interest of the debenture holder who has appointed the receiver. Hence so far as he has acted bona fide, he owes no duty in negligence to the company or

[138]Goode (n6)315 (the author traces the history of the English receivership from when mortgagees applied to the court for the appointment of income receivers upon the default of the mortgagors to the time when the mortgagors themselves did the appointment to avoid the application to court by the mortgagee and back again to the appointment of the receivers by the mortgagees but this time with the receiver so appointed acting as the agent of the debtor/mortgagor).

[139] (1880) 14 Ch. D 645, at 653.

subsequent debenture holders.[140] Also notably, the debenture holder is regarded as the agent of the company in the carrying out of his duties and this agency does not stop until the company goes into liquidation.[141] The implication of this is that the appointor i.e. the debenture holder does not assume any liability for the actions of the receiver even where he has appointed the receiver under the debenture deed.[142]

2.2.5.2 A Rescue Oriented Receivership under CAMA

The legislative reforms that preceded the enactment CAMA heralded a conceptually different view of the role of the receiver/manager in, giving him a more prominent role which is more conduced to rescuing the business over which he is appointed.[143] Thus a receiver as defined under the Act includes a manager.[144] The implication of this statutorily imposed dual role is that in carrying out

[140] *Downsview Nominees Ltd v First City Corp Ltd* [1993] AC 295 where the court restated the principle (at 298) that "A receiver's primary function is to take control of the company's property for the purpose of repaying the debt owed to the appointing debenture holder".

[141] *Gosling v. Gaskel* [1897] AC, 595 (even after the termination of the receiver's agency, the receiver's right over the charged asset continues).

[142] The receiver at common law does not assume liability for the actions of the receiver and any such liability arises only when the debenture holder clearly meddles in the activities of the receiver to the extent as to make the receiver act as his agent. See *American Express Int'l Banking Corp v. Hurley* [1985] 3 All E. R. 564.

[143] In 1987, the Nigerian Law Reform Commission had the mandate to undertake a holistic review of the Companies Act of 1968. As part of the painstaking effort by the Commission at reforms, it undertook a holistic consideration of different company law legislations from the English, the US, Australia and even neighboring Ghana, in a bid to work out for Nigeria the best possible and most socio-economically suitable company law. This the Commission achieved although it had to retain the English law structure to which Nigerian lawyers and business men alike were already attuned to. The resulting Companies and Allied Matters Decree, 1990 (which coincided with a period of economic downturn and declining businesses) had a modified receivership procedure that largely deviated from the English conception of it with the aim of the modification being to somehow preserve businesses that were distressed. These innovations markedly differentiated the Nigerian receivership from the administrative receivership and bearing a functional semblance to the English "administration". Although it remains to be seen how much in practice, this procedure has been useful in rescuing businesses. See generally: Nigerian Law Reform Commission, "Report on the Reform of Nigerian Company Law and Related Matters" (Volume 1, Review and Recommendation, 1988); E. O. Akanki "Company Law Development Through the 1990 Legislation", in Akintunde O. Obilade '*A Blueprint for Nigerian Law: A Collection of Critical Essays written in Commemoration of the Thirteenth Anniversary of the Establishment of the Faculty of Law of the University of Lagos*' (Faculty of Law, University of Lagos, 1995); J. Olakunle Orojo, *Company Law and Practice in Nigeria*, (5th edn, Lexis Nexis Butterworths, 2006); Bolanle Adebola (n105) Available at: <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2297824> accessed on 10/10/2014.

[144] Section 567 CAMA, 2004 (formerly section 650 CAMA 1990). Unfortunately, this definition is lost on the court which still insists on the common law distinction between a receiver and a receiver/manager. In *Ponson Enterprises Nig. Ltd v Njigha* [2000] 15 NWLR (Pt. 689) 46, the Court of Appeal insisted that as the applicant had applied to the lower court for the appointment of a "receiver", the court exceeded its jurisdiction when it also granted managerial

his duties, the receiver is laden with the obligations, which the Act imposes on a receiver/manager. The Act recognizes that a receiver/manager may be appointed by the court or by the debenture deed executed between the debtor and the debenture holder.[145] In the case where the receiver is appointed by the court, then such receiver/manager is an officer of the court and is required to act in accordance with the direction and the supervision of the court.[146] The implication of this appointment and supervision by the court is that the receiver/manager may not pander to or be subject to the whims and caprices of the debenture holder on whose behalf he has been appointed. On the other hand, where the receiver/manager is appointed under the debenture deed, CAMA – unlike the common law approach- considers him an agent of the debenture holder on whose behalf he has been appointed.

Beyond being an agent of the appointor who assumes liability for his misdeeds, the receiver/manager is deemed under the Act to stand in a fiduciary relationship to the company with a duty to observe utmost good faith in his transactions with or on behalf of the company in the case where he is appointed over the whole assets of the company.[147] The receiver/manager is further mandated to always act in a manner he believes to best serve the interest of the company as a whole "so as to preserve its assets, further its business, and promote the purposes for which it was formed, and in such manner as a faithful, diligent, careful and ordinarily skilful manager would act in the circumstances".[148] The Act further sets the parameters in determining whether a transaction undertaken by the receiver/manager serves the best interest of the company as a whole.

powers. The court at p. 48 stated that "[t]he fact that the word 'receiver' is interpreted in section [567] of the Companies and Allied Matters Act as including 'a manager'... does not invest a receiver with the powers of a manager. The interpretation does not change the legal character, connotation or comprehension of the two concepts."

[145] See sections 389 and 390 of CAMA.

[146] Section 389(2) of CAMA.

[147] Section 390(1) of CAMA

[148] Section 390(2) of CAMA

Regard must thus be given to the interests of the employees, as well as the member of the company, and, when his appointment is by a special class of the members or the creditors, although he is allowed to pay special attention to that class, the receiver however cannot devote his attention to that class exclusively.[149] Also deducible from this provision is that if the receiver can achieve his task without effecting the sale of the company, such a goal is desirable.[150]

2.2.5.3 Assessment and Challenges of the Nigerian Receivership in Business Rescue

The challenges of the arrangement and compromise procedure identified above still apply to the receivership procedure in Nigeria albeit with slight modification. For instance, while the procedural difficulty may not be present as in the case of the arrangement and compromise procedure, the absence of a stay and the possibility of other creditors to take steps to recover their claims even when a receiver has been appointed cannot be ruled out[151] and where the debenture holders are more, it can only be hoped that the creditors agree to jointly appointing a receiver. Otherwise, one can only imagine the scale of the disorder that will ensue which will invariably defeat the rescue possibilities offered by the CAMA receivership provisions. Furthermore, the appointment of a receiver does have cost implications and as shall be seen below does affect the floating charge holders as well as unsecured creditors. Let us consider more specific issues that will relate to the receivership procedure.[152]

[149] Section 390(3) of CAMA.
[150] See Bolanle Adebola "Common law, judicial precedents and the Nigerian receivership procedure" J.A.L. (2014)1, 129 at 141.
[151] In the case of *Inter Contractors v. Nigeria Ltd v. UAC* (1988) 2 NWLR (Pt. 76) 303, the Nigerian Supreme Court held that the appellant (debtor) could not stay the execution of a judgment on the company even when it is undergoing a receivership, neither could the receiver seek the stay. It further stated that a receivership is not a legal event that would stay action or execution.
[152] In the course of identifying such issues, any one which relates to the arrangement and compromise procedure will be identified.

2.2.5.3.1 Displacement of Company Management by the Appointment of a Receiver

The implication of the appointment of a receiver whether pursuant to the debenture deed or by the court is that he assumes the role of the management of the company, carrying out the functions which the directors may otherwise have had to carry out with regard to specific property over which he is appointed or over the entire undertakings of the company.[153] It thus naturally follows that the board of directors of the company cannot govern or oversee his actions,[154] likewise the junior creditors who also ought to have a stake in the business.[155] The first problem is that the receiver is often pitched against the management which is not only unwilling to relinquish control of the company but will take all steps – legal and sometimes extra-legal – to resist the receiver.[156] Another problem is with the mandate of the receiver/manager. Although CAMA makes commendably stringent provisions aimed at protecting other interests and stakes in the company, the introduction of the receiver imposes an additional layer of administrative costs which trump

[153] This is confirmed by section 393(4) of CAMA which provides that upon the appointment of the receiver, the powers of the directors to deal with "the property or undertaking over which he is appointed shall cease unless and until the receiver or manager is discharged." In *Solar Energe Advanced Power System Ltd v. Ogunnaike & Anor* (2008) LPELR-8470(CA), the Court of Appeal held amongst other things, that "[t]he directors of the company are not by virtue of receivership rendered *functus officio* for all purposes of the first defendant company".

[154] In the more recent case of *Fredrikov Petroleum Services Company Limited v. First bank of Nigeria Plc. & Another* (2014) LPELR-22538(CA) at 27, the Nigerian Court of Appeal commented on the effect of the appointment of a receiver to oversee the affairs of the company. It stated that: "[n]o Company [management] has any *locus standi* to sue where it has already entered receivership. It is the Receiver/Manager, who, by operation of law, should sue on behalf of the Company. Indeed the powers of the Directors of the Company became paralyzed because of the appointment of the Receiver /Manager. The Assets of the Company remain with the Receiver/Manager and he alone has the right to deal with these assets as long as he remains the Receiver Manager. The rights to deal with the assets inherent in the receivership can only be revived at the end and /or termination of the Receivership".

[155] See generally John Armour and Sandra Frisby "Rethinking Receivership" (2001) 1 Oxford Journal of Legal Studies, 73 at 78.

[156] The case of *Unibiz Nigeria Limited. V. Commercial Bank (Credit Lyonnais (Nig.) Limited)* (2005) LPELR-3381(SC) illustrates this. The respondent applied to the court for the appointment of a receiver over the appellant (debtor), a decision which the debtor appealed. While the debtor's appeal was pending, the appellant, through its Managing Director, broke the gate of the appellant's premises under receivership, in company of armed men in plain clothes, and moved away all cars and vehicles along with other assets in the premises under receivership.

that of floating debenture (charge) holders and that of trade creditors in the event that the company happens to go on to wind up its affairs.[157]

2.2.5.3.2 Funding the Distressed Debtor in the Rescue Process[158]

It is elementary that a distressed business, which seeks to continue as a going concern, will require some financing even while seeking to reach some arrangement and compromise with its creditors. This however appears not to be in the contemplation of the provision for arrangement and compromise. Regarding the receivership procedure, the receiver/manger may require the injection of fresh funds to complete ongoing projects, to pay critical suppliers or even its employees.

Generally, the funds may serve as a means of achieving better results for the business as a going concern. Although there is no elaborate, statutory framework endorsing the provision of financing for the distressed firm, in the case of a receiver/manager, CAMA provides the receiver/manager with power to raise or borrow money and to grant security over the property of the company.[159] Although the Act does not stipulate the priority position to be offered the lender of such money, in practice, this borrowing is treated as part of the administrative expense of the receiver/manager.[160] However, in view of the provisions of CAMA on the duties and powers of

[157] Although the provisions of the CAMA is far from clear in in the creation of priorities in liquidation, the combined effects of sections 484 and 494 of CAMA is that in the event of the liquidation of the affairs of the company, of course, holders of legal mortgage or debentures over fixed assets of the company i.e. fixed charges are treated with preference. This is followed by the expenses and fees, which arise from the insolvency proceedings (this will include receivership, winding-up and liquidation). The Act gives equal status to state revenue and issues relating to labor payments. As expressed under section 494(4) of CAMA, "so far as the assets of the company available for payment of general creditors are insufficient to meet them, [the aforementioned debts shall] have priority over the claims of holders of debentures under any floating charge created by the company and be paid accordingly out of any property comprised in or subject to that charge".

[158] The discussions under this subhead will apply equally to the case of arrangement and compromise, the alternative rescue device in CAMA.

[159] Eleventh Schedule CAMA (Powers of receivers and managers of the whole or substantially the whole of the company's property).

[160] In the case of *Femi Aribisala & 2 others v. AMCON & another* Suit No. FHC/L/CS/435/2012 (unreported), a receiver/manager appointment which had gone awry, Plaintiff (a renowned receive/manager) filed a suit restraining

the receiver/manager, it appears that only the appointor of the receiver/manager (where he is privately appointed) may be willing to provide the funds needed.[161] Any subsequent lender will worry that the mandate of the receiver/manager and his allegiance rests with his appointor and since there is no statutory protection afforded this subsequent lender, his remedy against a default will lie in contract. More so, given the possibility of the existence of negative pledge clauses[162] inserted by unsecured creditors in their covenants preventing the receiver/manager from granting security interests over the assets of the business, the receiver/manager may be hard put to take such steps as to amount to a breach of the covenant.

To this end, it may even be more tolerable for subsequent willing lenders in circumstances where the receiver/manager is one appointed by the court. In that case, the receiver/manager is answerable to the court as its appointor and such lender may have some assurance that at least, the receiver/manager is not acting as agent of another creditor but as an officer of the court. But as we shall see in Chapter 3, a lender to a distressed business in Nigeria may not be satisfied with the treatment of its position as an administrative expense neither will taking a floating charge suffice,[163] given its implication in winding up proceedings. Hence, such subsequent creditor may and usually wants more- a secured position over a fixed charge.

the 1st Defendant from amongst other things, interfering with his appointment. The Plaintiff in his pleadings alludes to this practice.

[161] Section 393(2) CAMA expressly provides that "[a] person appointed manager of the whole or any part of the undertaking of a company shall manage the same with a view to the beneficial realization of the security of those on whose behalf he is appointed". The fiduciary duties imposed nonetheless, receiver's allegiance is to the appointor.

[162] Black's Law Dictionary, 9th edn defines a negative pledge clause as "A provision requiring a borrower, who borrows funds without giving security, to refrain from giving future lenders any security without the consent of the first lender".

[163] But also see footnote 157 above.

2.3 Business Rescue: What Does the Investment and Securities Act (ISA) Offer?

ISA is the primary statute that regulates the corporate restructuring in Nigeria of firms in Nigeria.[164] The Securities and Exchange Commission (SEC) is empowered by ISA to oversee all forms business combinations including mergers, takeovers, amalgamations and acquisitions.[165] While the opinion has been expressed that the Mergers and Acquisition (M&A) procedure of ISA is a business rescue device,[166] it is here submitted that they are not. The goals of an M&A and indeed any other form of business combination are not to rescue businesses but at least generally revolves around the integration of corporate assets as a source of value enhancement. Thus, the merger of two corporations may result in one stronger and healthier entity with the attendant economies of scale, scope and the benefits that come with the integration of the businesses.[167] However, a distressed business certainly does not have the wherewithal to acquire another company and for an acquisition to be successful at all, it will depend on the ability of the acquirer to access sufficient financing to effect the acquisition.[168] In fact, in some instances, a business combination may precipitate the insolvency of the acquiring company.[169] In the light of the

[164] This is in addition to the Securities and Exchange Commission (SEC) Rules made pursuant to ISA. SEC is given the power to regulate the securities market and maintain the competitiveness of the market in general.48 Pursuant to the latter power or duty, the SEC is to '*review, approve and regulate mergers, acquisitions and forms of business combinations*'.
[165] See section 313(1) (e) ISA, 2007.
[166] A. Idigbe (SAN) (n103) at 14. The learned writer opines that "[t]he [M&A] is the most business rescue friendly procedure and requires very little intervention of the court".
[167] See Allen, Kraakman and Subramanian (n112) 454.
[168] Bolanle Adebola (n105), at 8.
[169] Using an American example, in the case of a takeover through a leveraged buyout, unless the target corporation generates sufficient revenue to pay the debt incurred in actualizing the takeover, the firm may default in the payment of the debt and thus may find itself filing for bankruptcy. For a discussion on this, see David A. Skeel Jr. *Debt's Dominion, A History of Bankruptcy Law in America* (Princeton University Press, 2001), 214.

foregoing, one no less agrees that in "discussing business rescue models, focus is on mechanisms by which a company can restructure itself or its business to avoid ultimate failure."[170]

The overview of Nigeria's law on business rescue/reorganization -which has been the crux of this chapter- is revealing. Compared to what Mark Roe[171] considers as the principal characteristics of a desirable business rescue mechanism, what stares us in the face is the apparent insufficiency of the present Nigerian framework as presently constituted. In the quest for a model that provides for the identified gaps, there are of course lessons to be learnt from the US and the UK. It is to these issues that we turn to in the next chapter.

[170] Ibid. See also O.O. Oladele and M.O. Adeleke "The Legal Intricacies of Corporate Restructuring and Rescue in Nigeria" I.C.C.L.R. (2009) 20(5), 182-189 (the authors treat restructuring and rescue as different processes with different goals).
[171] See the introductory quote to Chapter 2.

Chapter 3

Business Rescue under Chapter 11 of the US Bankruptcy Act: Some Lessons for Nigeria and Recommendations

> Congress envisioned the objectives of Chapter 11 reorganization to allow a debtor, usually a business, "to restructure a business' finances so that it may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for its stockholders.'"... Creditors, employees and equity holders all benefit by allowing the business to operate and reorganize. The end result sought in a reorganization is a confirmed plan and a profitable business - Jerome R. Kerkman.[172]

While Chapter 11 has been attended by criticism by US bankruptcy scholars especially of the law and economics school.[173] There criticisms have been met by a thorough and rigorous empirical work which supports the case for the retention of Chapter 11.[174] In fact, this piece of legislation has been considered as deserving of a pride of place in 'the pantheon of extraordinary laws that have shaped the American economy and society and then echoed throughout the world"[175] and for good reasons, the value of this piece of legislation cannot be wished away as many other

[172] "The Debtor in Full Control: A Case for Adoption of the Trustee System" (1987)70 Marq. L. Rev. 159 at 161.
[173] M. Bradley and M. Rosenzweig, 'The Untenable Case for Chapter 11' (1992) 101 Yale LJ 1043, 1047 (the authors argue that bankruptcy is significantly an endogenous event and the prospects of re-organization creates the incentive for corporate managers to burden their firms with '"too much" debt or "impossible" debt-payment obligations' and proposing the abolition of Chapter 11 court-supervised re-organization); Stephen J. Lubben "The Direct Costs of Corporate Re-organization" (2000) 74 American Bankruptcy Law Journal, 509 (author suggests that the large companies re-organizing in Chapter 11 incur direct cost that may be up to 3 percent of its entire assets); Douglas G. Baird & Robert K. Rasmussen, "The End of Bankruptcy" (2002)*55* Stan. L. Rev. 751 (the authors observe that big firms no longer use Chapter 11 to re-organize but as "a convenient auction block" to sell off their assets and to divide the proceeds); Douglas G. Baird & Robert K. Rasmussen, "Chapter 11 at Twilight" (2003) 56 *STAN. L. REV*. 673 (the authors restate their earlier argument that going-concern sales and the execution of deals negotiated prior to Chapter 11 filing now dominate the process of Chapter 11 re-organization); George W. Kuney "Hijacking Chapter 11"(2004) 21 Emory Bankr. Dev. J. 19, at 28 (he argues that the tactics employed by secured creditors "have established large chapter 11 proceedings as ones that do much to benefit secured creditors, insiders, their counsel and other professionals and very little to benefit unsecured creditors, shareholders, and employees-precisely those who are held up as the intended beneficiaries of the bankruptcy system."); Douglas G. Baird "The New Face of Chapter 11" (2004) 12 Am. Bankr. Inst. L. Rev. 69, at 77 (he argues that unlike in the railroad bankruptcy cases, "the value of keeping …business[es] intact is far less obvious with businesses in chapter 11 today";
[174] Elizabeth Warren and Jay Lawrence Westbrook "The Success of Chapter 11: A Challenge to the Critics" (2009) 107 Mich. L. Rev. 603.
[175] Ibid at 604.

countries have been able to draw useful inspiration from the elements of the re-organization provisions of Chapter 11.[176]

As we have seen in Chapter 2, the propinquity in the pattern of much of Nigeria's laws to the English law and approach owes to the fact of her colonial experience. Thus apart from structural changes made to CAMA for instance, the larger part of the structure still remains patterned after the English law. While it is observed that English law has also moved on, taking closer steps to a more rescue oriented business rescue regime, Nigeria still lags behind. Given Nigeria's legislative antecedents, it is believed that the English system will be the jurisdiction of first resort in terms of its business rescue laws and Nigeria will track developments there. However, the considerations in this thesis are such as have not been taken up by English law. However, the fact that the English business rescue regime has not adopted these measures does not ipso facto translate to their inapplicability in Nigeria.

This chapter is thus focussed on identified principles which are considered to be necessary in Nigeria's business rescue drive and for which the case for the US Chapter 11 approach is commended to Nigeria. The starting point in this analysis will be the philosophical underpinnings of Chapter 11 where the feature of its applicability to all enterprises will be pointed out and then go on to examine the utility of the US style automatic stay for Nigeria, the value of a DIP approach to the rescue of the distress of business debtors, the provision of DIP financing with incentive for providers of rescue finance and the protection of existing creditors in the face of a "cramdown". Because Nigeria will be more inclined to tracking the development in English law, an analysis of

[176] Jay Lawrence Westbrook "A Global Solution to Multinational Default" (2000) 98 Mich. L. Rev. 2276 at 2278.

the English law position on the principles will be pointed out where necessary and a case made for the US position.

3.1. The Philosophical Underpinnings of Chapter 11[177]

Literatures on insolvency law the world over seem to agree on the characterization of the US bankruptcy law as the most debtor-friendly regime.[178] One rationale for this leniency to debtors, especially the business debtor is the desire to encourage entrepreneurial quests. The foregoing notwithstanding, at least one historical account has it that the legal system evolved from an entirely creditor controlled insolvency regime that was attuned to protect creditors only, to one that is accommodating of honest debtors thereby giving rise to a bankruptcy law that catered for the rehabilitation of distressed businesses.[179] The practical manifestation of this attitude is telling on the entire US bankruptcy system and especially on the underlying values of the Chapter 11 re-organization provisions. As David Skeel points out, businesses in the US no longer hold a jaundiced view of bankruptcy as something to be avoided by all means and even though businesses may not set out wanting to wind up in bankruptcy, entering bankruptcy became viewed as "a means to a healthier end" rather than as "the End."[180]

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[177] Note that the focus here is not on the historical origin of Chapter 11. For a historical perspective on the origin of Chapter 11, please see Douglas G.Baird, *the Elements of Bankruptcy* (5th edn, Foundation, 2010), at 62 – 63. See also David A. Skeel Jnr. *Debt Dominion: A History of Bankruptcy Law in America* (2001, Princeton University Press), 1.
[178] David A. Skeel, Jr. "Creditors' Ball: The "New" New Corporate Governance in Chapter 11"University of Pennsylvania Law Review, (2003) 2, 917 at 921 ("Chapter 11 is still remarkably debtor friendly by international standards…"). See generally, Kuney "(173).
[179] Tabb states that the US Bankruptcy Act of 1898 heralded the period of liberality in the treatment of debtors and with the depression era, the US Congress tinkered with several legislations that eventually saw to the strengthening of pro-debtor sentiments in Congress- See Charles J. Tabb, "The History of the Bankruptcy Laws in the United States", 3 Am. Bankr. Inst. L. Rev., 8 (providing a historical account of the early Anglo-American bankruptcy law and policy). Also, writing in 1971, Melvin Shimm states that the years that followed the Bankruptcy Act of 1898 saw the expansion of the scope of the Bankruptcy Act from "debtor dissolution to debtor rehabilitation". See Melvin G. Shimm, "The Impact of State Law on Bankruptcy", (1971) 5 Duke Law Journal, 879 at 880.
[180] See David A. Skeel Jnr. *Debt Dominion: A History of Bankruptcy Law in America* (2001, Princeton University Press), 1.

Driven by the need to encourage and incentivize entrepreneurism, the stigmatization of failure in business gave room for the reasoning that in wealth creation, failure may result and an opportunity for a fresh start in deserving cases was desirable.[181] It is therefore to this extent that one no doubt necessarily need agree with Lawrence Westbrook et al that whilst insolvency law is often mistaken for a kind of "legal mortuary" where the remains of a "sick business" is deposited for some form of subsequent internment, it is in fact a hospital "where the assets and the expertise of a business injured by management mistakes or the vagaries of the free market are recapitalized or rechanneled to renewed productivity and social benefits."[182] Chapter 11 achieves these effects as we see in the subsequent parts of this chapter by restraining creditors from invoking their state law remedies (through the automatic stay) and binding dissenting creditors to the terms of the plan agreed upon by the majority.[183] It has been opined by some US bankruptcy scholars that the tangential effect of the liberality of Chapter 11 is its use by debtors and even creditors alike to gain strategic advantages.[184] Even at that, it is also true that the courts have not been hesitant to throw out Chapter 11 filings which they find fail to meet the good faith requirement and wanting in a re-organizational purpose.[185]

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[181] Gilmore opines that the Bankruptcy Act of the US is based on "the theory that it is a desirable social policy to allow debt-burdened individuals and ***business enterprises*** the opportunity to make a fresh start"- G. Gilmore *Security Interests in Personal Property* (Boston: Little, Brown & Company, 1965), at 1281. "[Emphasis supplied].
[182] Jay Lawrence Westbrook, et al, *A Global View of Business Insolvency Systems* (2010, IBRD/World Bank), 5.
[183] See Charles J. Tabb and R. Brubaker, *Bankruptcy Law* (Anderson Publ., 2003), at 597.
[184]Skeel tells of the case of Texaco's filing for bankruptcy in 1987 following the over $10 Billion jury verdict in favor of Pennzoil to stay Pennzoil's collection efforts. – See *Debt Dominion: A History of Bankruptcy Law in America* (Princeton University Press, 2001), 1. On his part, Kevin J. Delaney illustrates – using Manville (the asbestos company), Continental (airliner) and Texaco cases- the manipulation of balance-sheet figures to enable them properly fall within the designation of a "bankrupt firm" and to avoid financial burden. See *Strategic Bankruptcy* (University of California Press, 1998).
[185] Note that although the initial filing good faith requirement included in section 541 of Chapter X was removed in the 1978 Code, the courts revived it as a basis for dismissal for cause under section 1112(b). See *in re Little Creek Dev. Co.* (1986) 779 F.2d 1068 at 1072 ("Requirement of good faith prevents abuse of the bankruptcy process by debtors whose overriding motive is to delay creditors without benefitting them in any way or to achieve reprehensible purposes."). Also see: *Carolin Corp. v. Miller*, (1989)886 F.2d 693, the Court of Appeal held that a Chapter 11 petition may be dismissed if it was filed in subjective bad faith and if the proposed reorganization is objectively futile. In *re SGL Carbon Corporation*, (1999) 200 F3d 154, on an appeal by the unsecured creditors'

3.1.1. Deliberate Business Rescue Legislation Accessible By All Business Vehicles

Any observer of the Chapter 11 procedure, nay the Bankruptcy Code, will agree that it does not draw any particular distinction between business debtors operating as individuals or as a corporation with a distinct legal personality. The Chapter provides the statutory framework under which partnerships, corporations, and even individuals not engaged in business may re-organize their affairs.[186] This according to one commentator owes to the philosophical notion that everyone has the prospect of being an entrepreneur and as such may be availed of the opportunity to have his business re-organized under Chapter 11.[187] Although the corporate form has its benefits to which many businesses may avail themselves,[188] it cannot be gainsaid that businesses still operate in the non-corporate form and also play an important economic role in any given economy. As such, the emphasis on the business rather than the business vehicle (corporate or otherwise) makes for ease in the management of business by the same court.

In Nigeria, given the fact that many business enterprises operate outside the corporate form either as sole proprietorships or partnerships, a business rescue legislation for Nigeria need not be tied to the corporate form. Given the fact that the Nigerian Federal High Court already exercises jurisdiction over personal bankruptcy[189] as well as matters relating to the operation of CAMA[190]- the legislation which presently embodies much of the rescue options identified in Chapter 2.

committee (anti-trust claimants) of the debtor, the Court of Appeal remanded the debtor's Chapter 11 filing for dismissal, having found that the debtor only filed under Chapter 11 "to protect itself against excessive demands made by plaintiffs in civil antitrust litigation and in order to achieve an expeditious resolution of the claims against it."

186 *Toibb v. Radloff* (1991)111 S. Ct. 2197.

187 See Nathalie Martin "The Role of History and Culture in Bankruptcy and Insolvency Systems: the Perils of Legal Transplantation" (2005) 28 B. C. Int'l & Comp. L. Rev. 1 at 3.

188 John H. Farrar *et al*., *Farrar's Company Law* (3d ed. 1991), 3. "… it is a characteristic of the modern economy that production is typically carried out by firms, not by individuals."

189 Section 142 (Nigerian) Bankruptcy Act defines court in the Act to mean the "Federal High Court sitting in its bankruptcy jurisdiction".

190 Section 251(1)(e) CFRN, 1999 (as amended).

Certainly this recommendation will better fit into a new statute on business rescue as it may be pretty difficult to situate the rescue of unincorporated businesses into the current CAMA which is primarily a company law statute but incidentally provides for business rescue. While it is conceded that it more simpler provisions may be worked out for this class of business debtors who will be pre-dominantly small, but recognizing and providing for the rescue of such businesses which abound in present Nigeria has its own values and will contribute in changing the perception of debt in Nigeria and spur entrepreneurship in the country.

3.2. Automatic Stay for Chapter 11 Filing: Negotiating In Peace

The condition of financial distress and the legal events that follow such condition will no doubt have some effect on the parties which have an enforceable claim of property or contractual rights over the business.[191] The automatic stay of Chapter 11 has been described as one of the fundamental debtor protections provided by bankruptcy law.[192] Generally, it works as a temporary restraining order which suspends all collection activities, foreclosures, assets repossession and other remedies which may be pursued by the creditors on debts which arose from the debtor's activities before filing of the petition.[193] This device is essentially designed "to prevent a chaotic and uncontrolled scramble for the debtor's assets in a variety of uncoordinated proceedings in different courts."[194] Given the importance ascribed to re-organization under Chapter 11, the court *In re Alyucan*[195] succinctly opines that the automatic stay:

[191] David Milman "Moratoria on Enforcement Rights: Revisiting Corporate Rescue" [2004] Conv. 89, at 89.
[192] See *Midlantic Nat. Bank v. New Jersey Dept. of Environmental Protection* (1986) 474 U.S. 494 at 503, citing the following reports S.Rep. No. 95–989, p. 54 (1978); H.R.Rep. No. 95–595, p. 340 (1977), U.S. Code Cong. & Admin. News 1978, pp. 5787, 5840, 5963, 6296.
[193] Daniel B. Bogart "Games Lawyers Play: Waivers of the Automatic Stay in Bankruptcy and the Single Asset Loan Workout" (1996)43 UCLA Law Review 1117, at 1126.
[194] *Fidelity Mortgage Investors v. Camelia Builders, Inc.,* (1976) 550 F.2d 47, at 55.
[195] (1981) 12 B.R. 803.

> […] grants a "breathing spell" for debtors to regroup. It shields creditors from one another by replacing "race" and other preferential systems of debt collection with a more equitable and orderly distribution of assets. It encourages rehabilitation: debtors may seek its asylum while recovery is possible rather than coasting to the point of no return; creditors, realizing that foreclosure is useless, may rechannel energies toward more therapeutic ends.[196]

Notably, this stay continues until the end of the re-organization process unless pursuant to the provisions of the Code or an order of the court, which alters its terms or terminates it.[197]

3.2.1. Adequately Protecting the Holders' Property Right during the Pendency of the Automatic Stay

While it is granted that the property in possession of the debtor may be essential for the purpose of the rescue efforts, it is certainly not out of place to ensure that the interest of the secured creditors and other holders of property rights are given proper consideration. This is because there exists the possibility that in the course of the automatic stay imposed under Chapter 11, the assets over which their debt will be repaid may undergo depreciation which will invariably affect the value of their interest in the asset. In the light of this realization, section 362(d) clearly stipulates grounds on which a party interested in property (for our purpose, a secured creditor holding a legal or equitable interest)[198] the stay may apply to have the stay lifted and specifically starts by providing that:

[O]n request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay—

[196] Ibid at 806.
[197] Ibid.
[198] Notably, the legislative history makes mention of only "the interest of a secured creditor or co-owner of property with the debtor" with regard to the issue of adequate protection. See H.R.Rep.No.95-595, 95th Cong., 1st Sess. 338 (1977).

(1) for cause, including the lack of **adequate protection** of an interest in property of such party in interest …. [Emphasis supplied].[199]

Although the term adequate protection is not defined in the statute, section 361 gives pointers on how adequate protection may be provided to the extent that the automatic stay will result in depreciation in the value of the secured creditor's property interest. First, it refers to periodic cash payments to such a party.[200] Secondly, it provides for additional or a replacement lien.[201] Thirdly, it provides for the grant of other relief that will enable the interested party to recover an "indubitable equivalent" of its interest in the property.[202]

It therefore follows that the essence of the automatic stay imposed under Chapter 11 does not operate without the recognition of the interest of the secured creditor as much as it fits into the rehabilitative role of the legislation. As such, the secured creditor is appropriately catered for by the provision of the Chapter 11.

3.2.2. The Automatic Stay in the English Insolvency Law and the Nigerian Need: Does it suffice?

First the scheme of arrangement under the Companies Act, 2006 does not provide for moratorium or automatic stay from enforcement by the creditors of the business. On the other hand, the Insolvency Act - unlike Chapter 11 - does not provide a blanket stay for the corporate debtor in the course of the initiation of rescue efforts. For instance, while the administration procedure is

[199] 11 USC 362(d)(1).
[200] Section 361(1).
[201] Section 361(2).
[202] Section 361(3).

commenced, the moratorium sets in, preventing creditors from exercising their rights acquired pre-administration. In the case of Company Voluntary Arrangement (CVA), it may be proposed with or without a moratorium. While the business may benefit from a moratorium on enforcement in two different ways. First, a winding up proceedings[203] or an administration[204] will have to have been commenced. By this, the CVA therefore attracts "the statutory moratorium."[205]

It is observed that winding up presupposes that the company is nearly "dead and to be buried". On the other hand, the administration procedure following earlier discussions often precipitate the fire sale of the assets of the business and may not result in the rescue of the business.[206] It is therefore somewhat safe to conclude the automatic stay obtained through this means does not foster the ends of business rescue but only facilitates the winding up of the business. The second way by which a company may benefit from a moratorium is where such company qualifies as a small company and undertakes a stand-alone CVA.[207]

As we have seen from the above, the "scheme of arrangement" and the CVA without the automatic stay may cause creditors to explore the possibility of enforcing their individual claims by for

[203] Section 1(3) Insolvency Act, 1986.

[204] Section 1(3) Insolvency Act, 1986. Note that in the case of the administration procedure, the end of the administration procedure after one year, except extended by the court (Schedule B1, para 76, Insolvency Act, 1986) will cause the moratorium on enforcement to equally cease.

[205] Goode (n6), 496.

[206] See Scott Simpson and Jay M. Goffman, *Emergency Sales in the US and the UK, in:* Christopher Mallon and Shai Y. Waisman (eds.), *the Law and Practice of Restructuring in the UK and US* (Oxford, 2011), section 2.30.

[207] To be eligible for this moratorium, Paragraph 3(2) of Schedule A1, Insolvency Act, 1986 provides that must satisfy two or more conditions for constituting a small company under section 382(3) of the Companies Act, 2008. Thus the company must have had a turnover of not more than 6.5 million Pounds per year, not more than 50 employees and a balance sheet with total not exceeding 3.26 million Pounds. The rationale for the restriction of this moratorium to the small companies is not very clear, Ian Fletcher has opined that it may well "have been the desire to channel all rescue proceedings involving larger companies through the … administration procedure."- I. F. Fletcher, "UK Corporate Rescue: Recent Developments – Changes to Administrative Receivership, Administration and Company Voluntary Arrangements – the Insolvency Act 2000, the White Paper 2001 and the Enterprise Act 2002" (2004) 5 EBOR 119 at 131. If as stated, the administration procedure tends to lead to a fire sale of the assets of the business, it is safe to assume that the moratorium in administration may well be just for the purpose of facilitating the sale or winding up of the company.

instance, effecting the disposition of the debtor's assets. Sarah Paterson[208] lends an explanation for the absence of this protection and provides an explanation for the fact that the English system works well without the need for a moratorium. In this regard, the author points out the availability of a "distressed debt market".[209] This distressed debt [market] provides a means for [financial creditors] who no longer wish to remain invested in a firm with a new risk profile to exit without the cost and risk of enforcement and sale."[210]

In the light of what has been canvassed above, it is important to point out that the situation in Nigeria is remarkably different from what obtains in the UK. Nigeria, unlike the UK does not have a distressed debt market. Hence, lenders may be unable to dispose of their investment in the Nigerian distressed firm and may only have the benefit of seeking to enforce their individual claims against the debtor. Even where there is a distressed debt market, there are no guarantees that a creditor will obtain the right price for his investment in the market and there is no telling what steps such a creditor may take, whether enforcing his property right, the sale of the asset or even filing for the winding up of the company. This is given the fact that any or all of these are rights to which he is entitled to exercise. Hence, the Chapter 11 style automatic stay will play a better role in allowing the parties negotiate without the threat of creditors breaking rank.

[208] "Rethinking the Role of the Law of Corporate Distress in the Twenty-First Century" (2014) LSE Law, Society and Economy Working Papers 27/2014.
[209] This market which developed in the US is described as one which specializes in the purchase of the debt of distressed companies. The traders in this market are on the lookout for companies with prospects which may be experiencing financial difficulty for the purpose of extending credit or purchasing their debt and then exploiting "the leverage associated with the underlying debt instruments to acquire ownership of the company through a debt-for-equity exchange or credit bid in a sale of the company's assets." For more on this, please see Michelle M. Harner, "Activist Distressed Debtholders: The New Barbarians at the Gate? "(2011) 89 Washington University Law Review, 156 at 158. See also Sarah Paterson "Rethinking the Role of the Law of Corporate Distress in the Twenty-First Century" ibid at 10-11.
[210] Ibid at 12.

It is submitted in essence that what Nigeria needs is the US style automatic stay which cuts across all business types their size notwithstanding. The stratification of companies or businesses will be of no significance in Nigeria as all business enterprises non-corporate or corporate, small or large will equally need the benefit of the automatic stay to work out the resolution of the distress of the business.

3.3. The US "Debtor-In-Possession": A Useful Piece in the Rescue Effort

One significant event which occurs upon a Chapter 11 filing is the change which occurs in the business entity. The filing entity now assumes a legal appearance that is best described as a new juridical entity to wit, a DIP which in effect means that the debtor remains in possession. This whole arrangement is essentially based on the concept that the debtor is generally in the best position to administer the process of the re-organization of the business.[211] Thus the management apparatus of the debtor continues in place, not merely in its previous status- as the face of the debtor- but as a quasi-trustee. Upon the filing for re-organization under Chapter 11, the debtor becomes the DIP[212] of the estate and as a functional trustee, he assumes the rights, powers, and also takes on the fiduciary duties of a trustee.[213] This in effect means that his duty is now owed to the entire estate and not just to the equity interest holders.[214] To this extent, the Delaware district

[211] *Tradex Corp. v. Morse* (2006) 339 B.R. 823 at 830.
[212] 11 USC 1110(1) generally defines a DIP as the debtor.
[213] Some of the responsibility assigned to the DIP trustee include that of caring for the estate and its property, claims resolution, and the provision of information and filing of reports with the court and other interested parties. See generally sections 1101, 1107, 1106 and 1108 of the Bankruptcy Act. See also CFTC v. Weintraub, (1986)471 U.S. 343, at 355. Note however that the duties of the DIP as trustee does not include those duties which it may be unable to perform without bias as trustee. Such duties are provided for in section 1106(a)(2), (3), and (4). On this, please see Thomas G. Kelch "The Phantom Fiduciary: the Debtor in Possession in Chapter 11" (1992) 38 Wayne L. Rev. 1323, at 1327.
[214] In fact, Gregory V. Varallo and Jesse A. Finkelstein opine that the corporate assets of an insolvent or near insolvent business "become impressed with a constructive trust for the benefit of corporate creditor" with the duties of the directors owed to the creditors of the business. See, Gregory V. Varallo and Jesse A. Finkelstein "Fiduciary Obligations of Directors of the Financially Troubled Company" (1992) 48(1), The Business Lawyer, 239 at 244. See

court in *LaSalle Nat. Bank v. Perelman*[215] aptly captures the debtor's new duties when it stated that:

> [t]he debtor in a Chapter 11 bankruptcy has a fiduciary duty to act in the best interest of the estate as a whole, including its creditors, equity interest holders and other parties in interest… The fiduciary duties that a debtor owes the estate are comparable to the duties that the officers and directors of a solvent corporation owe their shareholders outside bankruptcy….[216]

The DIP has a distinct advantage of creating the avenue by which the business may take immediate or proactive steps when management begin to get signals of financial distress.[217] Ordinarily, when a business goes into distress and it turns out impossible to salvage it through chapter 11, the other option will be a Chapter 7 liquidation under which the management will invariably lose their job and shareholders may get little or nothing as residual claimants. Since actual insolvency of the business is not a requirement to file under Chapter 11,[218] the managers of the business will naturally not be hesitant to seek the help of Chapter 11 early enough to keep their jobs. This underlies a presumption that the structural arrangement of Chapter 11 itself allows for the presumption that Congress intended for the continued running of the business by the debtor upon filing the petition.[219]

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also *Geyer v. Ingersoll Publications Co.*, (1992)621 A.2d 784, 790 (Del.Ch.) (Where the court held that "fiduciary duties to creditors arise when one is able to establish the fact of insolvency").

215 (2000) 82 F.Supp.2d 279.

216 Ibid at 292.

217 This is distillable from the House Reports in the course of the drafting "proposed Chapter 11 recognizes the need for the debtor to remain in control to some degree or else debtor will avoid the re-organization provisions in the bill until it will be too late for them to be an effective remedy." – see HR Rep No 595 95th Cong, 1st Session 231 (1977). But see Barry Adler, et al "Value Destruction in the New Era of Chapter 11" J Law Econ Organ (2013) 29 (2):461at 462 (referring to the new control exercised by secured creditors over management and equity holders, the authors argue, has "induced managers to have firms take on increased amounts of debt, including secured debt, whatever strings are attached, rather than file for bankruptcy at an earlier stage of financial, and perhaps economic, distress."

218 Baird (n177) 8.

219 See Robert **J.** Berdan and Bruce G. Arnold **"**Displacing the Debtor in Possession: the Requisites for and Advantages of the Appointment of a Trustee in Chapter 11 Proceedings" (1983-1984)67 *Marq. L. Rev*. 457 at 458. (The authors rightly observe that by providing that the trustee may run the business (unless the court orders otherwise) (in section 1108) and by vesting the DIP with the rights and powers of a trustee (in section 1107), Congress raises the impression that it favored a DIP.

3.3.1. Displacement of the "DIP" Management under Chapter 11

Creditors as well as other interested parties who seek to displace the management upon the Chapter 11 petition are not entirely without remedy. Given certain conditions, a bankruptcy court on the application of interested persons (in this case a creditor(s)) or the United States trustee, may appoint a trustee under Chapter 11 to take charge of the management of the business of the debtor and to oversee its re-organization. However, this displacement is not as of right and courts have shown unwillingness (as we shall see shortly) to effect such displacement at the slightest act of management indiscretion[220], on the basis "that not every business decision of a reorganization debtor will reflect exemplary business acumen."[221] More so, certain statutory requirements necessarily need be fulfilled. One reason for the imposition of these conditions is to prevent the displacement of management by a self-serving creditor whose eyes is set on the proposition of the re-organization plan.[222] However, the courts have also been required to balance the reluctance to displace management with the need not to deprive creditors of the protection offered by such displacement.[223] Section 1104(a)[224] provides the basis for the statutory requirements for the

[220] Supra at 469. The authors have also attributed this unwillingness of the courts to the structure and legislative history of Chapter 11 which points to the clear intention of Congress to have the debtor continue in possession. See also *in re Hotel Associates, Inc***.** (1980) 3 B.R. 343 at 345 where the court stated that it must weigh the various considerations and competing interests carefully under subsection of s 1104(a) and (b) "because the appointment of a trustee is an extraordinary remedy and [imposes] an additional financial burden to a hard pressed debtor seeking relief under Chapter 11."

[221] *In re Sea Queen Kontaratos Lines, Ltd.* (1981) 10 B.R. 609, at 610.

[222] Generally, 11 U.S.C. § 1121 provides for the time when re-organization plans may be filed. Section 1121(a) allows the debtor to file the plan whether at the commencement or in the course of a voluntary or involuntary case. However, § 1121(b) gives the debtor in possession the exclusive right to file a plan during the 120 day period after the date of the order of relief under Chapter 11.however,Although the DIP ordinarily has the exclusive right to file the requisite plan within 120 days but the displacement of management terminates this right and allows any other interested party to propose the plan (11 U.S.C. § 1121(c)).

[223] *In re V. Savino Oil & Heating Co., Inc* (1989) 99 B.R. 518 at 525 the court reasoned that section 1104(a) "represents a potentially important protection that courts should not lightly disregard or encumber with overly protective attitudes towards debtors-in possession."

[224] For an account of the legislative history of this section, see: Berdan and Arnold (n219); Glenda M. Raborn "Setting the Standards for Appointment of a Chapter 11 Trustee under § 1 104(a) (1) of the Bankruptcy Code: Can a Debtor Cooperative Remain in Possession?" (1997-1998)18 Miss. C. L. Rev. 509.

removal of the DIP[225] from which the “for cause” and “best interest standards.”[226] To these standards we turn to in the following two sections.

3.3.1.1. Trustee Appointed “For Cause” -1104(a) (1)

By the express wording of the subsection under reference,[227] it is clear that the list of items that may operate as cause for the appointment of a trustee is not exhaustive. In other words, although it includes causes such as “fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management”, it however does not restrict the term to those listed derelictions.[228] It therefore follows that the court has some discretion in deciding what may amount to cause and that is on a case by case basis. Let us consider a case law example on the application of the “for cause” requirement under the subsection.

In re V. Savino Oil & Heating Co., Inc.,[229] the debtor filed a voluntary petition for re-organization under Chapter 11 of the Bankruptcy Code which authorized it to manage and control the business as DIP. Meanwhile this was after two remarkable incidents had occurred. First, this was after its secured creditors had obtained foreclosure order over the assets of the debtor collateral which

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[225] Under the section, the court is required to grant an order for the appointment of a trustee—
“(1) for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause, but not including the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor; or
(2) if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate, without regard to the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor.”
[226] See generally Berdan and Arnold (n219).
[227] See n 225 above.
[228] Hence the Bankruptcy Appellate panel i*n re Casco Bay Lines, Inc.*(1982) 17 B.R. 946 at 950 (footnote 4) justified the reliance on alternative facts not listed in the subsection to determine the existence of cause for the appointment of a trustee and discountenanced debtor’s arguments based on those listed in the subsection. Also i*n In re Ford* (1983) 36 B.R. 501, the bankruptcy court on the application of two secured creditors appointed a trustee. Although the actions of the debtor had semblance of the derelictions in section 1104(a), the court treated the “debtor's commingling of estate and non-estate assets without Court approval [as] not only mandat[ing the] appointment of a trustee for cause but [as] satisf[ying] the discretionary criteria for appointment of a trustee” at 504; *In re* Brown (1983) 31 Bankr. 583 at 583 (“chronic failure to develop property for more lucrative uses”).
[229] (1989) 99 B.R. 518.

included the debtor's customer list and accounts receivable. Secondly, this was after the debtor had executed an agreement with a newly formed corporation. The said agreement was intended and designed to transform and reduce the debtor to a service arm of the new corporation and to effectively transfer the debtor's customers list and letters of credit previously obtained by the new corporation. The creditors' committee sought the appointment of a Chapter 11 trustee which was vigorously opposed by the debtor. In its ruling, the court pointed out the duty of the debtor to keep the Court and creditors fully and fairly informed about the nature, status and condition of the business undergoing reorganization. This duty the debtor failed to discharge but rather concealed the facts from the court and the creditors. On the question of "cause" the court reasoned that:

> [I]n this case it is not necessary to delineate whether the cause consists of fraud, dishonesty, incompetence, gross mismanagement "or similar cause". The result is the same since the finding of any one of these causes within the penumbra of fiduciary neglect, as defined, mandates appointment of a trustee. Here, the Debtor's pre-petition conduct, post-petition non-disclosures and misrepresentations… singularly and in the aggregate, constitute "cause" within the meaning of 1104(a)(1) for appointment of a reorganization trustee.[230]

3.3.1.2. Trustee Appointed under the "Best Interests" Standard - 1104(a) (2)

Under section 1104(a) (2), the court is obligated to make an order for the appointment of a trustee where such appointment "will be in the interests of creditors, any equity security holders, and other interests of the estate." As such, it has been held that the provision grants to the court "broad equity powers to engage in a cost-benefit analysis in order to determine whether the appointment of a trustee would be in the interests of creditors, equity security holders, and other interests of the estate."[231] In the consideration of this interest, the court is also mindful in ensuring that the self-

[230] Ibid at 527.
[231] *In re Anchorage Boat Sales, Inc.,* (1980) 4 Bankr. 635 at 644.

interest of a creditor seeking the displacement of the DIP is not given the appearance of representing the interest of the estate or that of the general body of creditors. Thus in *In re Sea Queen Kontaratos Lines, Ltd*,[232] the court refused to oust the debtor from possession at the instance of the moving creditor as the step taken by the debtor (although detrimental to the movant) was in the best interest of the estate and creditors and they were well served by it.

3.3.2. Will The DIP Bode Well in the Case of the Nigerian Business Debtor?

As we have seen in Chapter 2, when a secured creditor appoints a receiver/manager, the existing management is displaced. The realities in the US - which resulted in the adoption of the DIP and the jettisoning of the immediate replacement of management with a trustee - is still prevalent in Nigeria. The insolvency practitioner may and usually does not have sufficient knowledge of the workings of the debtor's business as much as the management. In addition, the receiver/manager is typically a legal practitioner or a professional accountant. Where the receiver/manager is a lawyer, he naturally will have to engage the services of an accountant to carry out the accounting tasks and if he is an accountant, the services of a legal practitioner will also be enlisted. The receiver/manager like the trustee will often not retain the lawyer or accountant who had been used by the corporation. This is in addition to the other experts which may be engaged by the receiver/manager. The business will bear this cost and this makes the process even more expensive. It is further submitted that given the fact that financial distress in Nigeria is more often a result of business reversals and factors beyond management control, retaining management in place will serve the purpose of encouraging the management to take quick steps to steer the business out of

[232] (1981) 10 B.R. 609.

distress by seeking help as promptly and timeously as possible. The resort to rescue practitioners may arise when the situation so demands, but not as the first option.

3.3.2.1. A Case against the English Insolvency Act Remedy for Nigeria

Following the reforms of the English administrative receivership system[233] the enhanced administration appears to be the predominant management displacing[234] rescue device in the English insolvency law.[235] Even under the present administration regime -the higher realizations notwithstanding- experts have pointed out that the costs have also increased with the bulk of the benefits going to the insolvency practitioners rather than to the unsecured creditors.[236] Beyond this is the fact that the administration procedure -apart from providing moratorium (as we have seen) and the services of a neutral third party to protect the interest of unsecured creditors- is not a stand-alone procedure and has been described as less of a restructuring process that may need supplementation of a scheme of arrangement or a Companies Voluntary Arrangement (CVA),[237] the latter not coming free of its own costs.

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[233] Roy Goode describes the administrative receiver as a statutory name which replaced the receiver and manager. See (n6) 319. The major criticism against the administrative receivership and which resulted in the administration as we know it today is as captured by the UK Government White Paper titled *Insolvency- a Second Chance*. The report stated that:

> [a]dministrative receivership which places effective control of the direction and outcome of the procedure in the hands of the secured creditor is now seen by many as outdated. There are many other important interests involved in the fate of such a company, including unsecured creditors, shareholders and employees. We propose to create a streamlined administration procedure which will ensure that all interest groups get a fair say and have an opportunity to influence the outcome.

Available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/263523/5234.pdf accessed on 10/10/2014.

[234] Under para 64, Sch. B 1, Insolvency Act, 1986, the directors and officers of a business in administration cannot act without the consent of the administrator.

[235] It need be noted that the administrative receivers may still be appointed with regard to certain financing transactions listed in sections 72B-G of the Insolvency Act, 1986.

[236] See Goode (n6) 473-474; Finch (n2) 392; John Armour et al "Corporate Insolvency in the United Kingdom: the Impact of the Enterprise Act 2002" (2008) 5 European Company and Financial Law Review, 135.

[237] See Reinhard Bork *Rescuing Companies in England and Germany* (OUP, 2012), 57; Goode (n6) 393.

Indeed the administrator under the English Insolvency Act, 1986 is to perform his tasks for the general benefit of the creditors and not solely for his appointor.[238] This role is a somewhat similar solution to that which the Nigerian CAMA has already provided for even where the receiver/manager is appointed pursuant to the debenture deed as was seen in Chapter 2.[239] This leaves the problem of the cost of change in management (as the first resort) unattended to. Besides as has been argued by Scott Simpson and Jay M. Goffman[240] the administration procedure is still the end of the road for many distressed businesses "resulting in an insolvency fire-sale of the business."[241]

Interestingly, what both the English and Nigerian system have in common is the influence which the floating charge holder may still bear over the administrator (even where appointed by the business)[242] or the receiver/manager in the case of Nigeria. Where the appointment of the administrator has been influenced by the floating charge holder, it may be difficult for the former to ignore the wishes of the latter, especially if the former will need more jobs in the future.[243] The same is true for Nigeria where the receiver/manager is appointed by the floating charge holder. It

[238] Insolvency Act 1986 Sch. B1 para. 3(2). To this extent, Ian F. Fletcher has described administration as a "hybrid procedure combining the exceptional powers of floating charge receivership with an altered set of objectives, based on collectivity of approach and a rescue-oriented mission." – see "UK Corporate Rescue' (2004) 5 European Business Organization Law Review 119 at 125. It is submitted that same is already largely true of the CAMA receiver/manager.
[239]See footnote 148.
[240] See Simpson and Goffman, (n206) section 2.30.
[241] Ibid at 20. Very instructive is the reasoning of Gerard McCormack on the favored position given to the rescue of the business as a going concern by the administrator in the statutory objectives of the Insolvency Act, 1986 and what plays out in reality. He says that "the person who decides what is likely to produce the best result for company creditors is the administrator. Remember that the administrator, if not appointed by the main secured creditor, is going to be a person acceptable to that creditor and in tune with the creditor's way of thinking." – *Corporate Rescue Law- an Anglo American Perspective*, at 299.
[242] Relying on empirical analysis of Dr. Sandra Frisby, Gerard McCormack points out that although the floating charge holder (the banks) may be unwilling to appoint the administrator but would rather influence the choice of the appointee. See Gerard McCormack "Control and Corporate Rescue–An Anglo-American Evaluation" (2007) 56, *International and Comparative Law Quarterly*, 515 at 519.
[243] See John Armour and R Mokal 'Reforming the Governance of Corporate Rescue: the Enterprise Act 2002' Lloyds Maritime and Commercial Law Quarterly 2005, 1, 36-37.

is therefore submitted that as it stands in Nigeria, while the problem may partly with the determination of the loyalty of the receiver/manager- although having been solved by CAMA- a major cause for concern is the attendant costs which displacement of management may result in, and the greater chance that the rescue of the business is eventually not achieved.

Another seeming justification for a DIP in Nigeria is what may be considered as peculiar to Nigeria. The appointment of a receiver/manager is often met with aggression and resentment by management and employee[244] and will usually necessitate the receiver/manager enlisting the support and assistance of law enforcement agents to even secure and take control of the premises and property of the debtor. The administrator will undergo the same fate in the hands of the management of the company and given the limited time within which the administration should run,[245] the administrator may be effectively frustrated by a scheming management which will make the entire process an exercise in futility.

Finally, although Finch criticizes the DIP as tending to fuel litigation expenses owing to "mistrust between creditors and management."[246] In truth, this litigation expense may be worse in a federal system like Nigeria where action may be commenced by the creditors in both State and Federal courts. However, even where this is the case, at least, combined with the automatic stay, there is the benefit that any such litigation arising is centralized in the court overseeing the rescue of the business- in the case of Nigeria, the Federal High Court.

It is admitted that "It is not easy for a debtor-in-possession, corporate or individual, to serve two masters-juggling the personal needs and desires of the debtor itself, with its clear fiduciary

[244] See footnote 156.
[245] Under para 76(1), Sch B1, Insolvency Act, 1986, the administration has a one year life span.
[246] Finch (n2) 284.

responsibilities to unsecured creditors, other parties in interest and the court."[247] It is however submitted that creditors are not left without protection with the adoption of a DIP system. If there is cause or the benefit of the stakeholders demand a change in management, it is proposed that a rescue practitioner in the mold of a trustee may then be appointed by the court to pursue the re-organization of the business.

Understandably, some creditors advancing funds to the business will fear that funds may be misused by the management which has already led the business into financial straits. But again, most of the difficulties which the business in Nigeria will be faced may necessarily not be the function of mismanagement and even if it is so, then it constitutes a good ground or cause for seeking the displacement of management. More so, in the case of businesses with distinct legal personality, CAMA already creates -in addition to the liability of the company- personal liability for directors and officers who have mismanaged funds obtained for specific purposes.[248] This provides some form of deterrence for directors and officers in the proposed DIP regime who will have every reason to ensure that funds advanced are put to appropriate use.

3.4. Rescue Finance for Distressed Businesses/Corporations Under Chapter 11

Financing for the distressed firm is an important piece in the panoply of rescue devices that facilitate the process of re-organization. This financing is weaved around the conception that such

[247] *In re Harp*, (1993) 166 B.R. 740, at 747.
[248] Section 290 CAMA provides that "(1) Where a company- (a) receives money by way of loan for specific purpose; or (b) receives money or other property by way of advance payment for the execution of a contract or project; and (c) with intent to defraud, fails to apply the money or other property for the purpose for which it was received, every director or other officer of the company who is in default shall be personally liable to the party from whom the money or property was received for a refund of the money or property so received and not applied for the purpose for which it was received."

funds have value enhancing effects on the possible resuscitation of the business.[249] If such finance is unavailable, the business, no matter how potentially profitable it may be, may be unable to for instance, maintain inventory supplies, supply its customers and pay its employees. In this situation, the firm may be better off in a liquidation than undergoing the process of re-organization.[250]

When the business has gone into insolvency or rescue efforts are on, it will usually prove a herculean task to access financing for the business.[251] The reason for this is obvious. Once the debtor commences a Chapter 11 filing, previous (pre-petition) or potential (post-petition) lender(s) will be wary to advance credit. While the pre-petition lender will fear further exposure, the post-petition lender may be wary to put its money into what may, with the benefit of hindsight be regarded as "a sinking ship". There was thus the need for a balance of the rehabilitative policy of Chapter 11 against the protection of the interest of unsecured creditors for instance who may be knocked off their position in the bankruptcy pecking order.[252]

Another balance touches on post-petition lenders who may venture into the somewhat uncertain waters which the provision of such financing may portend or the existing unsecured creditors who may agree to have their interest subject to that of the post-petition lender. The protection of such lenders in concrete terms translate to the statutory incentive to encourage them to provide the

[249] In a study conducted by Sandeep Dahiya et al, it was found that firms which obtained DIP financing spend less time resolving their filing under Chapter 11 and this did not only apply to successful re-organizations but also re-organizations that ended up in liquidation. See "Debtor-in-Possession Financing and Bankruptcy Resolution: Empirical Evidence" Journal of Financial Economics 69 (2003) 259 at 261.

[250] In expressing the trite nature of financing for the post-petition debtor, the Bankruptcy Court in *re Ames Dept. Stores, Inc*. (1990)115 Bankr. 34 states at 36 that "[i]t is given that most successful reorganizations require the debtor-in-possession to obtain new financing simultaneously with or soon after the commencement of the Chapter 11 case".

[251] Lijie Qi, "Availability of Continuing Financing in Corporate Re-organizations: the UK and US Perspective" Comp. Law. 2008, 29(6), 162-167.

[252] Bruce Henoch opines that this financing serves the purpose of unsecured creditors as it is often the case that without this financing, they may be unable to get anything of their claim and this is probably why they will usually not be opposed to such financing. See "Postpetition Financing: is there Life after Debt?" (1991) 8 Bankr. Dev. J. 575, 584.

needed rescue funds to the distressed business and one such potent device is contained in Section 364 of Chapter 11.[253]

3.4.1. The DIP Financing and Priority System of 11 USC 364

Section 364 (a) to (d) of the Code empowers the business debtor to issue new post-petition debts for the purpose of financing the continuation of projects of the business. The section creates a form of stratification of levels of priority to which a post-filing financier may be entitled. These priorities as a threshold matter all rank ahead of the claim of unsecured creditors. They are discussed below.

3.4.2. Administrative expense (Section 364 (a))

This represents the lowest form of priority in the DIP financing.[254] Section 364(a) enables the DIP to obtain credit -for which no security is given- from a lender, in the ordinary course of the business of the DIP. The fact of being obtained in the ordinary course of the debtor's business does away with the need for the approval of the court before same is obtained.[255] When the unsecured loan or debt is obtained in the ordinary course of business, it is treated as an administration expense, otherwise the approval of the court is to be sort.[256] The pertinent question that requires answer with regard to this type of priority touches on whether the credit has been obtained in the "ordinary

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[253] McCormack identifies other incentives provided for DIP financiers as the combined effects of UCC Article 9-205 and 11 USC 552. While the former has the effect of creating a floating lien on shifting collateral, the latter curtails the effect of the collateral upon the filing of a bankruptcy petition. The implication of this is that a financier post-filing may be able to take security over debtor property free of pre-filing liens. See McCormack (n8), at 183.
[254] Maria Carapeto "Does debtor-in-possession financing add value?" (January 15, 2003), 5. Case Business School working paper. Available at <http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.197.6324&rep=rep1&type=pdf> accessed on 03/07/2015.
[255] In *re James A. Phillips Inc***.** 29 B.R. 391, 393-394 the court reasoned that if the payments in the case were transactions "in the ordinary course of business," it obviated the need for notice or hearing under the Bankruptcy Code and the court even went further to state succinctly that "payments in the ordinary course need not be authorized by a Bankruptcy Court at all."
[256] Section 364(a) states expressly as follows "(a) If the trustee is authorized to operate the business of the debtor under section 721, 1108, 1304, 1203, or 1204 of this title, unless the court orders otherwise, the trustee may obtain unsecured credit and incur unsecured debt in the ordinary course of business allowable under section 503(b)(1) of this title as an administrative expense." See also *G.* McCormack (n8) at 184.

course of the business" as prescribed under the provision. As Bruce Henoch opines, although the standard to be met in the subsection is whether the provision of the credit itself was in the ordinary course of the DIP's business, it may also be important to look at the identified uses to which the credit is to be put to come to this conclusion.[257] Thus as an example, in a decided case, [258] the court upon lender's application refused to approve a post-petition credit as administrative expense, finding that an "extension of over $600,000.00 over a two-year period to a business generating virtually no income cannot be considered in the ordinary course of business."[259] Further, the court found that the said borrowed money were used for purposes -such as the payment of prepetition (payroll and tax obligations) debts and the purchase of several expensive pieces of equipment- which could not be conceivably regarded as being used in the ordinary course of business.[260]

3.4.3. Administrative Priority under Section 364(b)

Here and unlike that afforded under subsection (a), the debtor may obtain unsecured credit in respect of expenditure incurred outside the ordinary course of the business of the debtor. To be accorded administrative priority, this credit will require the approval of the court after notice to

[257] Henoch (n251), at 585. Although the Code does not provide a definition of what "ordinary course of business" means, Michael Rochelle proffers a general definition for "ordinary course" as that which the debtor does every day in its business. He thus excludes from such activities the following: "(1) debt service, however disguised ; (2) buying a capital asset; (3) making atypically large purchases of supplies;(4) advancing funds to a debtor in contemplation of purchasing it later under a plan'; or (5) advancing funds to assist in the liquidation of the business." – see Michael Rochelle "Post-Filing Loans to the Chapter 11 Debtor: Good Money after Bad" (1990) 107 Banking L.J. 344 at 345.

[258] *Re Lite Coal Mining Co*. 122 B.R. 692.

[259] Ibid at 695

[260] The courts have developed two tests to determine whether a debt or credit meets the "ordinary course of business" requirement. First, the vertical dimension test views the transaction from the perspective of a hypothetical creditor who questions "whether the transaction is ordinary as compared to the debtor's own pre-petition operations". The second of the tests, the horizontal dimension test takes a comparative approach by contextualizing the use to which the facility is put into by the debtor, in comparison with what obtains in the industry in which it operates. See Charles J. Tabb, *The Law of Bankruptcy* (1997), 791 and 804; McCormack (n8), at184; Qi (n251), at 163.

other creditors and a hearing in the court.[261] It is here observed that the nature of this form of lending may prove problematic given that the priority here created is subject to some other exigencies, such as the existence of sufficient unencumbered assets to cover the administrative expenses as a whole. This is because "if the total amount of administrative expenses exceeds the value of the estate's unencumbered assets, normal priority expense treatment for a Chapter 11 loan will entitle the lender only to a pro rata share of those assets."[262] Given the nature of this type of lending, a learned author has stated that the lender who allows his claim under this section may either be one who is acquainted with the debtor and the proposed transaction and feels at home with it or is simply "crazy".[263]

3.4.4. Super-priority under Section 364(c)

Under the provisions of section 364(c) (2) and (3), the lender is entitled to enjoy a super-priority lien over all or any administrative expense(s) provided for under sections 503(b) as well as 507(b).[264] As a pre-condition to the approval of such super-priority position, the debtor needs show that it had been unable to find a lender willing to provide financing with more liberal terms as under either sections 364(a) or (b).[265] While this has created no security interest over the property of the debtor, it places the lender in a more favorable position over administrative expenses as well as well as unsecured creditors. This favorable position notwithstanding, it has

[261]Section 364(b) provides that "the court, after notice and a hearing, may authorize the trustee to obtain unsecured credit or to incur unsecured debt other than under subsection (a) of this section, allowable under section 503 (b)(1) of this title as an administrative expense.
[262] Qi (n251) 162.
[263] Michael Rochelle "Post-Filing Loans to the Chapter 11 Debtor: Good Money after Bad" (1990) 107 Banking L.J. 344 at 346.
[264] Section 364(c) (1). The administrative expenses provided for under Sections 503(b) include the costs of preserving the estate, including taxes and penalties relating to taxes, wages, and fines; compensation; various expenses incurred by creditors; fees for professional services rendered; compensation for services of indenture trustees; fees and mileage charges. On its own part, section 507(b) provides for super-priority over administrative expenses for claims that fall under section 364.
[265] See section 364(c).

been argued that such administrative super-priority may mean nothing much to a secured pre-petition lender who may wish to provide post-petition financing to the debtor.[266] The argument continues that although this form of priority may be considered by a previously unsecured pre-petition lender who enjoys the protection of the restrictive covenant regarding the creation of secured debts, most post-petition lenders will prefer to have a security interest.[267]

In the light of the above, section 364(c) (2) and (3) create the opportunity for the creation of security interests for a post-petition lender. The debtor may grant liens on its property which is free of any prior interest or encumbrance. Also, it may grant lien over the estate on which there exists a pre-petition or some form of prior lien, such lien ranking junior to the pre-petition lien. It need be noted that it is most unlikely that the debtor has valuable assets which are free of encumbrance, so this may make the creation of such lien infeasible. On the other hand, creating a junior lien for the potential lender may be attractive to the extent that the property over which the security exists is over-collaterized. Otherwise, the lender may be left with nothing. It thus behooves a diligent lender to carry out proper due diligence on the property over which such lien is to be created.

3.4.5. Super-priority over Secured Creditors under Section 364(d)

As was pointed out in the preceding paragraph, given the possibility that mere priority of the potential lender over unsecured creditors and administrative expense or even the prospects of junior lien creation, may not just do, we now examine the highest form of priority which a post-petition lender may be get. The court is empowered after the notice and hearing under this section to approve a DIP financing which is secured by the priming or the subordination of the lien of a

[266] Rochelle (n262) at 347.
[267] Ibid.

post-petition lender over that of the existing secured creditors.[268] However as vital requirements, the inability to access financing by any other means and that the interests of the existing lienholders of the property are adequately protected have to be shown and the burden of proof rests squarely on the shoulders of the DIP.[269]

3.5. Protecting Pre-petition Secured Creditors

The rationale for adequately protecting the pre-petition secured creditors is to insure that they are not deprived of what they have bargained for[270] and when faced with such potential threat to their interest, the courts do not make a short shrift of this. A ready example of this fact is highlighted in *re Shaw Industries Inc*[271]. The debtor who had filed under Chapter 11 sought an emergency order from the bankruptcy court to raise a working capital line of $600, 000 by creating senior secured debt primed over the interest of pre-petition secured creditors. Although the pre-petition secured creditors were over-secured, the court refused the grant of the order as it found that the equity cushion of the debtor was rapidly eroding owing to significant losses which did not appear to abate in the future. The court also made pointed remarks as touching the propriety of relying on only asset valuation to determine adequate protection for the pre-petition creditors. It considered it "improper to look at valuation of assets in a vacuum. While the present value of a debtor's assets may be sufficient to constitute adequate protection, a debtor's future operational plans may result

[268] Section 364(d) (1).
[269] Ibid.
[270] *In re Lane, 108 B.R. 6.* See also the Senate Report No. 989, 95th Cong 2d Sess 53 (1978). Also note that section 361 provides some guides on the provision of adequate protection of the secured creditors. With specific reference to section 364, it provides that the DIP may make adequate protection available by 1) requiring the trustee to make a cash payment or periodic cash payments to such entity,… to the extent that the lien under section 364 of this title results in a decrease in the value of such entity's interest in such property; 2) providing to such entity an additional or replacement lien to the extent that such … grant results in a decrease in the value of such entity's interest in such property; or 3) granting such other relief, other than entitling such entity to compensation allowable under section 503(b) (1) of this title as an administrative expense, as will result in the realization by such entity of the indubitable equivalent [emphasis supplied] of such entity's interest in such property."
[271] (2003) 300 BR, 861.

in a rapid deterioration of the collateral. Where an equity cushion is insufficient in size or likely to erode, it cannot, standing alone, constitute adequate protection."[272]

3.6. Financing the Distressed Debtor in Nigeria: Lessons from the US

Nigerian distressed businesses face the same challenges as their counterparts in other parts of the world. Fresh funds will always be needed to prop up the business and help it come out of the bad times. First it need be admitted that Nigeria's bank dominated financial system is a far cry from what financing ought to be in comparison with other emerging market economies.[273] Even with the dominance of banks, it is the case that most of the banks are risk averse and hardly will want to be involved in transactions that may turn out unsuccessful hence their preference for asset-based lending.[274] As we have seen in the previous chapter, the CAMA already grants the receiver/manager the right to create security over the property of the company. Notably however, the Act does not address the issue of what happens where such asset is already subject to a prior security interest, the provision does not stipulate the position to be granted to such a financer, although the practice as we saw in Chapter 2 is to treat the financing provided as an administrative expense. Again, this provision is limited to a receiver/manager. There may well be need to extend

[272] Ibid at 866.

[273] In a 2009 World Bank document on financing in Nigeria, certain pointed remarks were made of Nigeria's financial system which to a large extent still holds true. It was stated that "Nigeria's weak financial sector has been a bottleneck to growth, in particular, in the non-oil economy and has resulted in a lack of local financing for private sector development ... Despite significant consolidation in the banking sector, Nigeria's financial system remains shallow and considerable benefits will result from continued financial deepening …."- see "Making Finance Work for Nigeria", November, 2009, available online at https://www.google.hu/url?sa=t&rct=j&q=&esrc=s&source=web&cd=7&cad=rja&uact=8&ved=0CDwQFjAG&url=http%3A%2F%2Fsiteresources.worldbank.org%2FINTAFRSUMAFTPS%2FResources%2FMaking_Finance_Work_for_Nigeria.pdf&ei=rmIBVYb_Ecj5ywPBvIC4Cg&usg=AFQjCNGXQ4WM9qpHFzaiwOsc6lC5at6EWw accessed on 03/02/2015.

[274] In a study conducted on credit availability for SMEs in Nigeria, it was found that the asset based lending rule is the pre-dominant lending technology in Nigeria. This type of lending bases lending decision on the quality of the collateral presented to the lender. For more on this, please see K. K. Ogujiuba, *et al* "Credit Availability to Small and Medium Scale Enterprises in Nigeria: Importance of New Capital Base for Banks – Background and Issues" African Institute for Applied Economics (AIAE) Working Paper, November, 2004. Available at <http://128.118.178.162/eps/mac/papers/0411/0411002.pdf> accessed on 03/02/2015.

the powers to create such priority positions in the case of the proposal for internal restructuring as in the arrangement and compromise provision or even with the proposed DIP. Besides, there is the need to provide for the possibility of priming existing secured creditors provided that the loan would be used for the purpose of effectuating the rescue of the business.

Alternatively, a new legislation which embodies the other rescue devices may make elaborate and well spelt out provisions that not only spells out the right to create securities but also the right to alter priorities in the creation of such securities. This will first give legislative impetus to the present practice of the treatment of this financing as administrative expense by practitioners. It will also clarify -as 11 USC 364(a) to (d) has done- the type of security which may be created. It will also make room for the adequate protection of the interest of already existing secured creditors to ensure that they do not get less than what they have bargained for prior to the later financing transaction.

3.6.1 No Provision for New Financing with Super-Priority in English Law

Although super-priority financing was part of the considerations in the build up to the Enterprise Act, it turned out that that it did not make it as part of the provisions of the Act. As McCormack points out, parliament was disinclined to give statutory impetus to the provision of super-priority for financing of the administration procedure even though the grounds for such financing were specified.[275] He goes on to stated that government rather left the decision whether to lend or not to lend to the business judgment of the lending market where lenders will have to "take into account the availability and priority of any security as well as the viability of the rescue plan."[276] In refusing to assure the new lender of returns through a super-priority position, the ability of the

[275] Gerard McCormack "Super-priority new financing and corporate rescue" (2007) JBL, 701 at 713.
[276] Ibid.

administrator to access funds is greatly impaired and may make access to funding for the administrator a lot more difficult.[277] The absence of this financing may justify the retention of the administrative receivership in the case of huge finance projects where the original lending banks may exercise their “step in” rights and thereby provide financing for the completion of the projects.[278] Thus it appears that the English system may be doing well without this solution but it is not necessarily so for Nigeria. The incentives of a protected position will provide Nigerian lenders better incentive to finance rescue efforts. It may also help in preventing the obstruction of the rescue of the business by secured creditors who may be unwilling to provide financing in the hope that they can quickly swoop on the asset and effect a sale of it as soon as possible.

Although it has been opined by Ayotte and Morrison that the priming of a DIP lender over existing pre-existing secured lenders engenders value diversion from the latter,[279] the authors also agree that the post-petition lenders are often the same institutions that extend the DIP lending, thus the priming of the lien is over their pre-existing lien. In the case of Nigeria, even where the financer of the distressed business is a new entity, the priming of the lien over secured creditors (of course with the safeguards in place), may provide the incentive needed for new financers to make available rescue credit. While the conception of the DIP financing has been subject of criticism, it is notable that the criticism is not essentially hinged on its usefulness but on the advantages which the lender may wish to exert (through contract) on the debtor business especially as it has to do with control.[280] It is submitted that the exercise of such control by the finance provider may help

[277] See A. McKnight “The Reform of Corporate Insolvency Law in Great Britain” (2002) JIBL 324 at 327.
[278] McCormack (n8), at 194.
[279] Kenneth M. Ayotte and Edward R. Morrison “Creditor Control and Conflict in Chapter 11” Journal of Legal Analysis (2009) 1(2), 511, at 525.
[280] In *re Tenney Village Co., Inc,* (1989)104 B.R. 562 the Bankruptcy Court in the district of New Hampshire after a due consideration of the financing agreement to be executed between Tenney Village Co. Inc. (“the Debtor”) and Maine Savings Bank (“The Bank”) refused to approve of same. In stating its reasons, the court at 568 reasoned as follows:

to keep management on its toes and strengthen corporate governance in Nigeria. In deserving cases however, Nigerian courts may have to come in at this point to determine the unconscionable nature (or otherwise) of the contracts where they are such as to remove control from management and ultimately derail the rescue process. Besides, the court may only authorize a "cross-collaterization",[281] a "roll-ups"[282] or other sweeteners/protection for the distress financers in cases where they are crucial for the purpose of attracting such financers.[283]

3.7 Protecting the Minority in the US "Cramdown": Adapting for the Nigerian Dissentient Creditors.

One of the hallmarks of the Chapter 11 "debtor-friendliness" is the exclusivity (at least initially) of the plan formulation by the DIP.[284] At the core of the success of Chapter 11 is the confirmation

> "Under the guise of **financing** a reorganization, the bank would disarm the debtor of all weapons usable against it for the bankruptcy estate's benefit, place the debtor in bondage working for the bank, seize control of the reins of reorganization, and steal a march on other creditors in numerous ways. The financing agreement would pervert the reorganizational process from one designed to accommodate all classes of creditors and equity interests to one specially crafted for the benefit of the Bank and the Debtor's principals who guaranteed its debt. It runs roughshod over numerous sections of the Bankruptcy Code."

[281] The court *In re Texlon Corporatio*n 596 F.2d 1092, at 1094 defines "cross-collaterization" as arising in the situation where:

> "In return for making new loans to a debtor in possession under Chapter **XI,** a financing institution obtains a security interest on all assets of the debtor, both those existing at the date of the order and those created in the course of the Chapter XI proceeding, not only for the new loans, **. . . ,** but [also] for existing indebtedness to it."

[282] This arises where the post-petition lender and debtor agree to apply "the proceeds of postpetition financing to pay, in whole or in part, prepetition debt or which otherwise has the effect of converting prepetition debt to postpetition debt." – see presentation at the 2009 American Bar Association (ABA) Annual Meeting, Chicago Business Law Section Commercial Finance Committee Subsection on Creditors' Rights, at 7. Available at https://apps.americanbar.org/buslaw/committees/CL190006pub/materials/2009/annual/dip-financing.pdf accessed on 03/10/2015.

[283] See generally Kuney (n173), at 58.

[284] On the value of this exclusivity, Karen Gross and Patricia Redmond have opined that this period of exclusivity is perceived as encouraging the re-organization by giving the debtor what it needs to take charge of its destiny. See Karen Gross and Patricia Redmond "In Defense of Debtor Exclusivity: Assessing Four of the 1994 Amendments to the Bankruptcy Code" (1995) 69 American Bankruptcy Law Journal, 287 at 291.

of the plan formulated in line with the provisions of section 1129 of the Code.[285] One power which has been granted the bankruptcy court is that by which it may "approve plans of reorganization that impose significant concessions on dissenting creditors, shareholders, and others."[286] This power granted to the court is what is so often referred to in the US as the "cramdown" power.[287] The need to "cramdown" arises where certain dissenting impaired creditors or equity holders vote in opposition to the plan proposed.[288]

However, to exercise this "cramdown" power requires the fulfillment of certain conditions as prescribed under sections 1129(b)(1) and 1129(b)(2)(A). Section 1129(b)(1) imposes a dual requirement to wit, that the plan must not discriminate unfairly and that the plan must be fair and equitable. The requirement that the plan does not discriminate unfairly presupposes that the plan does not stipulate disparate treatment for creditors who are classed together. On the other hand, the fair and equitable standards -which bears relevance to secured creditors- is said to combine both the implicit and explicit standards of section 1129(b)(2)(A). Let us examine both requirements a little more.[289]

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[285] In *Bank of America v. 203 North LaSalle Street Partnership* (1999) 526 US 434 at footnote 4, the court reasoned that "Confirmation of a plan of re-organization is the statutory goal of every Chapter 11 case. Section 1129 provides the requirement for such confirmation, containing Congress' minimum requirement for allowing an entity to discharge its unpaid debt and continue its operation."

[286] Jack Friedman "What Courts Do to Secured Creditors in Chapter 11 Cram Down" (1993) 14 *Cardozo L. Rev.* 1495.

[287] A very helpful comment on its origin may be found in the case of *St. Joe Paper Co. v. Atlantic Coast Line R.R.*, (1954) 347 U.S. 298, 314 where the Supreme Court

> [T]he so-called "cramdown" clause.., was added to § 77 of the Bankruptcy Act in 1935 ....because under the prior law a plan had to be accepted by at least two-thirds (in amount) of each class of creditors and stockholders affected by the plan. This enabled a small dissentient minority to block any plan of reorganization, no matter how "fair and equitable," in order to exact inequitable adjustments as the price of its acquiescence. Under the "cramdown" provision the district court may, under the appropriate circumstances and after making certain required findings, confirm a plan despite the disapproval of more than one-third of each class affected.

[288] Note that to effect a creditor class approval, at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by the creditors should have voted for it (11 U.S.C. § 1126(c)). In the case of equity holders, the relevant number is two-thirds in amount (11 U.S.C. § 1129(d)).

[289] Jack Friedman (n286), at 1501.

3.7.1. The Plan must not Discriminate Unfairly – Section 1129(b)(1)

For starters, it is worthy of note that the provision does not prohibit all discrimination but those which discriminate unfairly.[290] Although the Code does not provide concrete guidance as to the application of the "discriminate unfairly " standard, the courts have led the way in shedding light on this issue. For instance, the courts have laid a four-step for the purpose of determining whether a plan discriminates unfairly. The tests are: whether there exists a reasonable basis for such discrimination; whether there exists the likelihood of the confirmation and consummation of the plan without necessarily discriminating against the said class(es); whether the discrimination is proposed in good faith; and how the classes discriminated against are treated.[291] Thus, where a holder of a claim or equity is singled out for special treatment, the courts have held such to discriminate unfairly against the cram down provision.[292]

The courts have had to deal with the issue of different payments made out to different members of the same class of secured creditors. In finding the plan *in re Dilt*[293] unfairly discriminatory for providing junior creditor with a higher interest rate than that imposed on the senior creditor, the court reasoned that:

> We find no support in the Code for the proposition that debtors may impair an oversecured creditor, over its objections, by reducing the interest rate and extending the term of the repayment period while a junior mortgageholder on the same property is to receive payment in full over an extended period at a higher interest rate than that proposed to the first mortgageholder.[294]

[290] *In re Internet Navigator Inc*., (2003)289 B.R. 128.
[291] Ibid at 132; In *re 11,111, Inc.* (1990)117 B.R. 471 at 478; *In re Rochem, Ltd.,* (1985) 58 B.R. 641; *In re Ratledge*, (1983) 31 B.R. 897.
[292] *In re Tucson Self-Storage, Inc.*, (1994)166 B.R. 892.
[293] (1989) 100 B.R. 759.
[294] Ibid at 761.

The court in *re Buttonwood* [295] took a somewhat different position in holding that even where the plan proposes to pay a slightly higher rate of interest to a junior creditor, the plan needed to be confirmed. Considering the factors already set forth above,[296] the court reasoned that the bargain arrived at was a product of good faith and involved compromises on the part of the other creditors. Besides, the court justified the discrimination on the ground that "the difference in interest rates can be attributed to a slightly higher degree of risk that the [junior claimant] bears because of its second priority status."[297]

What is quite glaring from the foregoing is the fact that the courts have always allowed themselves to be guided by the facts of particular cases in the determination of the unfairly discriminatory nature of the case.

3.7.2. The Fair and Equitable Requirement - Section 1129(b) (2) (A)

The explicit requirements under section 1129(b) (2) (A) gives a picture of what the requirement that the plan be fair and equitable may entail. As such it has been pointed out that even where these grounds exist, the plan may still not be regarded as fair and equitable.[298] In the first case, a plan may be regarded as fair and equitable where it allows the holders of the secured asset to retain the security, over the asset, even where the asset is transferred to a third party with the holder receiving at a deferred time, payment in cash which in the minimum totals the amount to of his claim.[299] Again, the value of the deferred cash payment must as at the effective date of the plan be equal to the secured holder's interest in the asset.[300] Another option provided for by the statute is for the

[295] (1990) 111 B.R. 57
[296] See foot note 260 above.
[297] (1990) 111 B.R. 57, at 63.
[298] Friedman (n286), at 1504.
[299] See section 1129(b)(2)(A)(i)(I) and (II).
[300] Ibid.

sale of the property free of the encumbrance of the secured holder's interest, rather the interest attaches to the proceeds received from the sale.[301] In this case, except the court states otherwise, the holder of the security interest may even take part in the bid for the asset and simply set-off his claim from against the purchase price.[302] This way, the secured creditor may achieve a faster and seamless payment of his claim. The third option entails the provision of the secured creditor with an indubitable equivalent of its claim[303]; or for the creditor's receipt of the "indubitable equivalent" under clause (iii).

3.8. Cramming Down Dissenting Creditors in Nigeria: Lessons from Chapter 11

Presently, the arrangement and compromise" procedure in CAMA is the available procedure that allows the debtor to "cramdown" the minority class of creditors or debtors who vote against the plan or restructuring proposal. However, as we have seen in Chapter 2, the procedure is fraught with a number of challenges, one of which is the absence of the moratorium.[304] How this plays out therefore is that a minority, which feels dissatisfied with the proposal, may proceed to litigation. This may operate to stall the whole procedure and ultimately render the exercise futile. Besides, such a secured creditor may simply take the asset over which he has a security and dispose of same without taking part in an arrangement which it considers less favorable to its interest. If the arrangement and compromise provision is to be amended, then amongst the other amendments, it may be necessary to provide for concrete statutory criteria -as has been done in sections 1129(b)(1) and 1129(b)(2)(A) of Chapter 11- which will enable a dissenting creditor to properly challenge the fairness of the plan/scheme through the process.

[301] Section 1129(b)(2)(A)(ii).
[302] See section 363(k).
[303] Section 1129(b)(2)(A)(iii).
[304] See Chapter 2 above.

It is recommended that the formulation of the criteria need not be left entirely to the discretion of the court. However, the courts will still have a role to play. While no doubt it may be necessary for business exigency to discriminate in favor of a set of creditors (such as the suppliers for instance), such a discrimination may be allowed to fly if they meet the US court-developed tests on the reasonableness of the discrimination, the possibility of consummating the plan/scheme without such discrimination, whether the plan/scheme is proposed in good faith and how well the class discriminated against is treated. Such concrete provisions will guide the court in deciding on the fairness or otherwise of the plan, for which a "cramdown" may be imposed on the minority. With a statutory basis for altering the rights of the creditors in the plan, the role of the judge would therefore be to analyze the individual cases before him on the basis of the laid down statutory standards and not purely on his whim.

What is important to a minority secured creditor who has been crammed down is that he gets the value to of his claim to which he is entitled. Thus it is important that where the lien over the asset is retained and cash payment deferred, the value of the deferred payment at the effective date of the scheme need be equal to the value of the collateral. This makes sense where the secured creditor is himself over-collaterized.

Chapter 4: Conclusion

This thesis has taken into focus severally interrelated topics with regard to the idea of business rescue in Nigeria. From a broad perspective, the role of insolvency law in a market economy was analyzed in the light of the increasing change in State reaction to the debt of businesses. One important point highlighted is the importance of law in response to the challenges of doing business. As more and more countries have continued to move towards the path of market liberalization and striving to attain the status of a market economy, the previous accommodation granted State Owned Enterprises (SOEs) which resulted to inefficiencies are gradually giving way to active private participation geared towards profit making.

The withdrawal of government intervention succeeded in providing greater room for entrepreneurial adventures and risk taking. But business successes are usually subject to the interplay of debt and credit and in the shadows of this mix of debt and credit lurks the likelihood of default. Resolving the issues arising from this default is the role of insolvency law. While some have tenuously argued against the consideration of any other interests other than that of the creditors in the event of the insolvency of the business – an argument which tends to favor the dissolution of the firm if creditor(s) interests so demand- some others have taken a broader view of the interests at stake in the face of the financial distress of the business.

The chances of rescue of businesses afforded by insolvency law provides not only for a predictable resolution regime and outcome but also gives the force of law to negotiations carried out within the ambits of insolvency law. Again in a society like Nigeria the need for effective business rescue provisions will serve an efficiency purpose. For instance, instead of waiting for a workout to fail and then deciding to resort to insolvency proceedings (where the mill of justice has the reputation for grinding slowly), parties may commence rehabilitation proceedings even while continuing with the workout. The foregoing explains why the emphasis in this thesis is on the use of insolvency law as a means of business rescue.

With Nigeria in perspective, the thesis gives an overview of the climate of business rescue in Nigeria. First, the present situation presents grim prospects for the rescue of enterprises not operating in the corporate form. The fact that Nigeria still measures low in the scale of debtor-friendliness is most felt by the provisions of her personal Bankruptcy Act whose provisions regulate the insolvency of unincorporated enterprises. Even where the Nigerian Bankruptcy Act provides for composition and arrangement between the debtor and his creditors, the applicable provisions of the Act leaves no one in doubt that the process is meant to benefit the creditors, without any considerations for the other interests that may be affected by the insolvency.

As such it has been recommended that in building this entrepreneurial spirit amongst Nigerians and with the abundance of factors that also militate against these businesses, any business rescue legislation to be enacted may have to allow for equal access like the American system presently does. This is even easier as one court (the Federal High Court) already exercises jurisdiction in respect of bankruptcy proceedings as well as in matters relating to operation of CAMA.

In view of the problems which characterize the rescue provisions in Nigerian law, the choice of which jurisdiction to turn to for guidance will often be an issue. Given the selected themes of the thesis, the preferred approach was to look to the US, which differed in approach from that of the UK to which Nigeria has a proclivity to follow. While Chapter 11 has suffered much criticism, it is still has fundamental provisions which may still be relevant to the circumstances of an emerging market like Nigeria.

The analysis of the US DIP approach and the role it may play in aiding the rescue of businesses brought to the fore its value in incentivizing management of a distressed business to take pro-active steps and seek help before the business gets to the point where rescue may be impossible. Notably, the fact of the DIP did not translate to the fact that management may not be displaced as we saw the US court do in several cases but on the basis of statutorily defined grounds which would have to go through the courts. The UK administration procedure which like the Nigerian receiver/manager effects the displacement of management has its cost implications. This is more so as the administration has been described as not being a stand-alone procedure and will need another procedure like the CVA to be able to effect a rescue. Again for the Nigerian system where the receiver/manager already faces very hostile management, the DIP will be a more suitable option.

In advocating for the US style automatic stay for Nigeria, the analysis of both systems bear the similarity of both having a federal structure with State courts offering remedies which creditors may resort to in the absence of an automatic stay. The case in the UK is somewhat different as the automatic stay is reserved for certain restructuring procedures such as the administration procedure and the CVA for small companies. While it has been argued that the English system works well without the automatic stay, the same may not be said of Nigeria as unlike the UK, it does not know of a distressed debt market. And even where there is one, a creditor may wish to exercise all of its rights which may include the winding up of the business. As such a non-discriminatory moratorium remains the best option to protect the process of resolving the distress of the debtor business.

In the consideration of distressed financing for Nigeria, Chapter 11 provides for forms of priority which may necessarily encourage providers of finance to make same available to the business. While the receiver/manager procedure already has such a provision which entitles the receiver/manager to borrow money on the estate, the practice is to grant it an administrative expense position. However, in a country where asset-based lending is the norm, more needs to be done and as such the recommendation of a super-priority provision which may rank the provider of the rescue finance well enough will play a vital role in ensuring that the lack of financing does not derail the process of rescue. The provision of such financing need to also be extended to apply to the proposed DIP too. A new business rescue statute unlike what CAMA presently provides will need to further provide for clear priorities where a lender provides new finance and where and also provide modalities for a super-priority position to encourage such distressed lending.

Since the rescue process is not meant to punish the creditors who have dealt with the business debtor prior to the distress, the "cramdown" of their rights need be done with considerations of its fairness to them. As such, as the Nigerian "arrangement and compromise" provision provides for the "cramdown" of the dissenting minority or as any such procedure is to be adopted in a new statute, it may be necessary to take some lessons from Chapter 11 on the protection of the minority to be subjected to the will of the majority. While any such plan must not unfairly discriminate against the dissenting class, it must also meet the requirement of being fair and equitable.

The foregoing notwithstanding, Nigeria has always looked to the leading of English law. Even when the CAMA was to be enacted, the point justifying this leading was again made.[305] There are

[305] See n144 above. The Law Reform Committee of the Companies Act still had this at the back of their mind while fashioning the Act. The Committee stated that "… we must stress that Nigerian company law is part of the received English legal principles and that we have operated those principles now for over a century. The businessmen, the lawyers, the accountants and company secretaries who have operated the system over the years were trained under

no signs that this continued reliance on the English law will change. A testimony to this is the present Bill before the Nigerian National Assembly which seeks the enactment of Nigeria's first Insolvency Act.[306] Not surprisingly, the proposed Act has been described as having largely "transplant[ed] the modern insolvency law of England and Wales into the Nigerian system."[307]

It does appear that the draftsmen have only succeeded in keeping pace with developments in England and Wales rather than undertaking a full undertaking a study of the problem faced by business on ground already and developing solutions based on the review of available laws on business rescue. Again, since the Bill has emanated from the Nigerian insolvency practitioners industry,[308] it may well be a hard task to adopt certain proposals, chief of which is the introduction of the DIP. One can only hope that the hearings at the National Assembly will provide the opportunity for the submission of memoranda by other interested parties.

this system." - "Report on the Reform of Nigerian Company Law and Related Matters" (Volume 1, Review and Recommendation, 1988), 5.

306 The long title of the Bill is: "A Bill for an Act to Consolidate the Enactments Relating to Company, Individual and Cross Border Insolvency and to Make Provisions for Business Rescue and other Related Matters". Please see Bolanle Adebola "Conflated Arrangements: A Comment on the Company Voluntary Arrangements in the Proposed Nigerian Insolvency Act, 2014". Available at <http://ssrn.com/abstract=2565491> accessed 02/27/2015. I will like to thank Dr. Bolanle Adebola whose paper brought the fact of the existence of the Bill to my attention (although after this thesis had already taken shape), for our subsequent exchanges and for her willingness to help with information.

307 Ibid at 1.

308 The Business Rescue and Insolvency Practitioner Association of Nigeria (BRIPAN) is a body of insolvency law experts (legal practitioners and accountants) involved in the practice of business recovery and insolvency. For more on the body, please visit: <http://www.bripan.org/aboutus.php> accessed on 3/10/2014.

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