A COMPARATIVE ANALYSIS OF CORPORATE INSOLVENCY LAWS: WHICH IS THE BEST OPTION FOR KENYA?

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A Thesis Submitted in Partial Fulfilment of the Requirements of Nottingham Trent University for the Degree of Doctor of Philosophy

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ABSTRACT

This research makes a comprehensive review of insolvency laws and reforms in the selected jurisdictions namely Kenya, the UK and Mauritius with a view of understanding how Kenya can benefit from the experience of others. The main aim is to evaluate whether Kenyan insolvency laws supports modern businesses and to consider what, if any, legal reforms might be desirable to better achieve this end. The study commences from a conceptual approach to the legal concepts of corporate insolvency laws then attempts to understand the justification for the existence and role of insolvency law from a theoretical perspective. It then undertakes an in-depth evaluation of the current Kenyan corporate insolvency framework using international benchmarks; in particular by reference to the UNCITRAL Insolvency legislative guide. The exploration of the Kenyan insolvency framework reveals the underlying weaknesses and underscores the need for reforms. It also investigates whether there are any recognizable informal mechanisms that may enable the weaknesses in the formal mechanisms to be overcome. Subsequently, the thesis explores whether Kenya can benefit from the experiences of the UK and Mauritius, who may be regarded as successful reformers. It examines the historical evolution of UK corporate insolvency laws and identifies the driving forces behind the successful reform engagements. This exploration of the wellspring of legal traditions and fundamental principles that underpin corporate insolvency provides great insights. The study attempts to understand the potential problems that frustrate reform efforts in Kenya by identifying the insolvency law reform drivers in Kenya and contrasting the influence of the same drivers in Mauritius. Such a comparison offers a perspective that has been lacking in the current scholarship and reform engagements in Kenya and provides theoretical insights and understanding on how best Kenya can undertake successful reforms.

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LIST OF ABBREVIATIONS

ARD	Acquired Rights Directive
BER	Business Environment Reform
BIS	Business, Innovation and Skills
BRRU	Business Regulatory Reform Unit
BSPS	Business Sector Programme Support
BizCLIR	Business Climate Legal & Institutional Reform
CRD	Collective Redundancies Directive
CDO	Collateralized Debt Obligations
CVA	Company Voluntary Arrangement
CMP	Common Market Protocol
COMESA	Common Market for East and Southern Africa
CCAB	Committee of Accountancy Bodies
CBT	Creditors Bargain Theory
DIP	Debtor in possession
DPT	Development Partnership Forum
DTI	Department of Trade and Industry

EAC	East African Community
EAC	Economic Commission for Africa
ECA	Economic Commission for Africa
EU	European Union
EEC	European Economic Community
EHYA	European High Yield Association
ESAF	Enhanced Structural Adjustment Facility
EBDR	European Bank for Construction and Development
FDI	Foreign Direct Investment
FSD	Financial Sector Deepening
G20	Group of Twenty
IPA	Insolvency Practitioners Association
IMF	International Monetary Fund
IFC-	International Finance Corporation
KLRC	Kenya Law Reform Commission
KEPSA	Kenya Private Sector alliance
NARC	National Rainbow Coalition
NSE	Nairobi Stock Exchange

OECD	Organization for Economic Co-operation and Development
PIP	Practitioner in Possession
PTA	Preferential Trade Area
ROSC	Report on the Observance of Standards and Codes
SIB	Standard Investment Bank
SSA	Sub-Saharan Africa
USAID	United States Agency for Aid and Development
UNCTAD	United Nations Conference for Trade and Development
UNCITRAL	United Nations Commission for International Trade Law
TPT	Team Production Theory
TUPE	Transfer of Undertakings (Protection of Employment)
WTO	World Trade Organization

TABLE OF LEGISLATION

United Kingdom

Bankruptcy Act of 1604

Bankruptcy Act of 1623

Companies Act 1862

Companies Act 2006

Enterprise Act 2002

Enterprise and Regulatory Reform Act 2013

Insolvency Act 1986

Insolvency Practitioners Regulations 2005

Joint Stock Companies Winding Up Act 1844

Limited Liability Act 1855

Statute of Bankrupts, 34 &35 Henry VIII

Small Business, Enterprise and Employment Act 2015

The Bankrupt Act of 1571

The Deregulation Act 2015

Insolvency (Amendment) Rules 2015

The Insolvency (Protection of Essential Supplies) Order 2015

Kenya

Bankruptcy Act Cap 53

Companies Act cap 486

Judicature Act Cap 1967

Law Reform Commission Act of 1982

The Constitution of Kenya 2010

The Reform Commission Act 2013

The Companies Act 2015

The Insolvency Act 2015

Mauritius

Insolvency Act 2009

Law Reform Commission Act, 2009

Thailand

The Act Establishing the Bankruptcy Court and Bankruptcy Case Procedure ('the Act’) 1999

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BNY Corporate Trustee Services Ltd v Eurosail [2013] UKSC 28

C-382/92 *Commission v United Kingdom* [*1994*] ECR I-2435

Cheyne Finance Plc Re [2007] EWHC 2402 (Ch)

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Dollar Land (Feltham) Ltd, Re [1995] 2 B.C.L.C 370

Ebrahimi v Westbourne Galleries Ltd Westbourne Galleries Ltd [1973] AC 360

Farnborough-Aircraft.com Ltd Re [2002] EWHC 1224 (ch)

Flagstaff Silver Mining Co of Utah, Re (1975) 20 eq. 268

Great Northern Copper Co, Re (1869) 20 LT 264

High berry Ltd v Colt Telecom Group Plc Re [2002] EWHC 2815

Inland Revenue Commissioners v Goldblatt [1972] 1 Ch 498

Medforth v Blake and others - [*1999*] *3 All ER 97*

On Demand Information Plc & Ors v Michael Gerson *(Finance) & Ors* [2002] UKHL 13

Powdrill v Watson [1995] 2AC 394

Ricketts v Ad Valorem Factors Ltd [2004] 1 All ER 894

Taylor Industrial Flooring Ltd v M & H Plant Hire (Manchester) Ltd [1990] B.C.L.C. 216

Tweeds Garages Ltd, Re [1962] 1 Ch 406

Yate Collieries Co, Re [1883] WN 171

Kenya

Adrian Spencer Dearing & Another v James Abiam Isabirye Mugoya [2007] eKLR 42

Aviation and Allied Workers Union v Kenya Airways Limited & 3 others [2012] eKLR

Fina Bank v Spares & Industries [2000] 1 EA 57

Invesco Insurance Company Limited v In the matter of Companies Act Neptune Credit Management Limited, Re the Matter of [2009] eKLR

Jambo Biscuits (K) Limited v Barclays Bank of Kenya Limited & 2 Others [2009] eKLR

Madhupaper *International Ltd & another V Kenya Commercial Bank Ltd & 2 Others* [2003] KLR 31

Obongo v Municipal Council of Kisumu [1971] EA 91

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CHAPTER ONE

CONTEXTUAL FRAMEWORK OF THE STUDY

1.1 INTRODUCTION

Reforming insolvency laws has increasingly become a subject of global interest and it will predictably remain so, as part of the processes under which the jurisdictions of the world are becoming more integrated. In essence, the intensity of integration and interdependence among the jurisdictions of the world, much as it comes with significant benefits, inevitably makes many jurisdictions susceptible to financial crisis. This reality has made the consideration of insolvency reforms imperative in many jurisdictions. In fact, reforms to domestic corporate insolvency laws have been scheduled into the legislative agendas of many countries as part of efforts that are aimed at building an efficient insolvency system. These efforts commonly consist of jurisdictions summarizing the experiences and lessons from other countries and taking full consideration of their own unique domestic situations.[1] The big question then is how are the Sub-Saharan African ('SSA') countries, which are as vulnerable as any other jurisdictions, adjusting to these global developments? In particular, how can Kenya best realize a realistic programme of insolvency law reform? The main focus of this study is on answering this second question.

This chapter sets out the context in which the study is conducted. The chapter starts with the background of the research, followed by the aims which guide the entire study. It then elabo-

[1] Katarzyna Gromek Broc, and Rebecca Parry (eds), *Corporate Rescue: An Overview of Recent Developments from Selected Countries* (2nd edn, Kluwer Law International, 2006) pg.333

rates on fundamental concepts in corporate insolvency laws and concludes with an organizational structure of the thesis.

1.2 BACKGROUND

Recent years have witnessed a phenomenal increase in corporate failure prompting many jurisdictions to reconsider the adequacies of their insolvency laws. The need for efficient procedures becomes marked as the impact of bankruptcy is felt not only by the debtor company but also the people directly involved and associated with it, such as creditors and employees, or indirectly affected, such as the society, town or country. In the advent of crisis, companies inevitably consider employing corporate reorganization procedures, which include formal procedures provided by legislation and 'informal' activities, such as negotiating with creditors individually. In essence, legislative frameworks are vital in governing corporate failure, economic restructuring and firm rehabilitation. This reality poses a challenge to states and international organizations to set about forging institutions and laws that will enable future crisis to be forestalled or, at least, enable the duration of crisis to be limited. For instance, the 1997 East Asian crisis got the international community and the World Bank concerned over inefficiencies in the insolvency laws in many jurisdictions. Consequently, a set of principles have been developed to provide benchmarks for evaluating the effectiveness and adequacies of bankruptcy laws.[2]

However, while there have been many initiatives to develop and reform insolvency law to support businesses that have been undertaken in developed economies, less has been done in developing economies. Besides, the reform efforts that have been attempted in developing

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[2] Barry Eichengreen, *Towards a New International Financial Architecture: A Practical Post Asia Agenda* (Institute for International Economic, Washington D.C, 1999) pg. 28-30

economies have been very slow and some governments have even seemed to lack the will power to engage in tangible reforms. In fact an assessment of insolvency systems in some SSA countries within the context of the IMF's Financial System Stability Assessment Programmes[3] as well as periodic consultations with Bretton Wood institutions' member countries[4] reveals that much statutory law in SSA is obsolescent and in need of modernization. The inadequacies found in the laws were described as 'symptoms of deeper structural impediments to private lending.'[5] In particular the 2008 IMF Report, while making reference to Kenya, was categorical that its insolvency laws needed to be modernized and the commercial courts be strengthened.[6]

In essence, Kenya's existing Insolvency Law is archaic leaving much to be desired as to its ability to meet the needs of modern business. The key legislation, Companies Act (Cap 486 Laws of Kenya) is based on the UK Companies Act 1948 and it may be noted that UK legislation has moved on significantly from the 1948 statute. The UK enacted its own dedicated Insolvency Act as far as back as 1985-6, which it updated further on several occasions, notably by the Enterprise Act 2002. Kenyan law has remained static during this time and it is therefore not in step with modern trends regionally and internationally, and no efforts have been made to study how best it can be reformed. There have been many attempts by the Kenyan legislature to enact a new insolvency law; however, at the time of writing this re-

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[3] PD's Investment, Competition and Business Development Services Team, *Approaching International Financial Standards and Codes* (December 2003) <http://www.sed.manchester.ac.uk/research/iarc/edais/word-files/HowtoApproachInternationalFinancialStandardsCodes.doc> accessed 20 January 2013

[4] IMF, *Uganda: Financial System Stability Assessment* (April 2003) <http://www.imf.org/external/pubs/ft/scr/2003/cr0397.pdf> accessed 23 February 2013; World Bank, *Investment Climate Assessment Kenya: Enhancing the Competitiveness of Kenya's Manufacturing Sector: The Role of the Investment Climate* (November 2004) <http://www.ifc.org/ifcext/economics.nsf/attachmentsbytitle/ic-kenya.pdf/$file/ic-kenya.pdf> accessed 23 February 2013

[5] Ibid

[6] IMF, *Kenya, Uganda, and United Republic of Tanzania: Selected Issues* (October,2008) <http://www.imf.org/external/pubs/ft/scr/2008/cr08353.pdf> accessed on 23 Feb 2013

search, none had yet borne fruit. In fact those attempts do not appear to have been informed by any substantial research. Instead they have all been prompted by the daunting reality that virtually all businesses that plunge into crisis in Kenya end up being liquidated. This is detrimental to business because some of the commercial entities that encounter crisis are viable and can potentially be restructured for the benefit of their creditors, debtors and the economy at large. As pointed out by Flynn, a transparent and predictable system of law is important in dealing with financial failure and its consequences, and as part of the encouragement and attraction of those who invest and provide credit, both in the first place and on a continuing basis.[7]

To emphasize, it is argued that inadequate legislation to properly balance and protect creditors' and debtors' rights negatively affects inward investment and increases the cost of doing business. In fact, Kenya's former President Mwai Kibaki in one of his speeches to the Parliament during the debates on the Insolvency Bill emphasized that there was a critical need for a new insolvency law, to enhance Kenya's competitiveness for business and investment.[8] In a nutshell, there is recognition that Kenyan insolvency law needs reforming and this beckons an investigation as to why reforms have not yet been achieved? What are the barriers to reforms? How inadequate is the existing Kenyan insolvency framework? Can Kenya learn from other jurisdictions that have successfully reformed? What factors might drive reform forwards? It is largely acknowledged that governments are very vital drivers of reforms. However, as elaborated in chapter six of this thesis, politics and the priorities of the

[7] D Flynn, 'Comparative Legal Analysis' (2003) 32 European Media Law 86

[8] Available in <http://www.parliament.go.ke/parliament/download/tenth_forth_sess/SPEECH/%20HIS%20EXCELLENCE%20HON.pdf> accessed 15/2/2013

government in power influence the pace of reforms. Besides, international institutions and interest groups can influence the governments' engagements.

This research addresses the questions above by first assessing the present Kenyan insolvency framework in the light of international benchmarks and later by exploring the approaches taken in other jurisdictions in addressing similar problems. Generally, reforms in many jurisdictions over the world have borrowed ideas from others with varying levels of success and acceptance. In this respect, legal systems, policies and legal solutions are borrowed from foreign jurisdictions as a means of advancing legislation quickly and effectively.[9] It is appreciated that bankruptcy laws in the respective jurisdictions have been shaped by different circumstances and therefore it would be naïve to seek to learn from their experiences without considering historical, cultural, economic and political realities. In fact, a popular view in insolvency reform is that the underlying realities and matters peculiar to each jurisdiction should be given due consideration as they are useful in understanding particular institutions and mechanisms of insolvency law as well as policies.[10] In the same respect, such realities have been expressed as the main reasons as to why it is not feasible to effect a wholesale legal transplantation of another country's system.[11] Notably, the international players such as the World Bank could only provide guidelines on insolvency proceedings because of the varying circumstances of jurisdictions, which must be taken into account in designing a system of insolvency laws.[12]

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[9] Alan Watson 'Aspects of Reception of Law' (1996) 44 American Journal of Comparative Law 335

[10] Kingsley TW Ong, and Colin R Baxter 'A Comparative Study of Fundamental Elements of Chinese and English Company Law' (1996) 48 ICLQ 88, 89

[11] Rebecca Parry, and Haizheng Zhang, 'China's New Corporate Rescue Laws: Perspectives and Principles' (2008) 8 Journal of Corporate Law Studies 1

[12] World Bank, UNCITRAL and INSOL, amongst others have developed insolvency rules or principles that can be tailored to fit the different circumstances a typical evidence of jurisdictional divergence

1.3 AIMS OF THE RESEARCH

The overarching purpose of this thesis is to evaluate whether the present Kenyan insolvency law supports modern business and to consider what, if any, legal reforms might be desirable to better achieve this and to this end; international benchmarks are used to evaluate the law. The first aim is assessing current Kenyan law from the standpoint of encouragement of external and internal investment. In evaluating any legal framework, practitioners and scholars have become increasingly interested in finding better ways of assessing the performance of legal systems and the success of reform engagements.[13] Once a mechanism of evaluating is developed, the extent to which it is used is generally an indication of its influence and the extent to which it has been accepted;[14] and this is arguably true in the field of insolvency law. For instance, UNCITRAL offers a Legislative Guide on Insolvency which assists in the establishment of an efficient and effective legal framework.[15] In addition, the World Bank[16] considers countries' investment climates and ranks them according to their performances. The benchmarks of these international bodies provide an evaluative framework which is arguably acceptable and they are in common usage. The acceptability of the international benchmarks is because they are recommendations, guidelines championed by multilateral institutions in the form of the so-called 'soft law approach' rather than legally binding trea-

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[13] World Bank, *'Performance Measures Topic Brief'* (2012) available in http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTLAWJUSTINST/0,,contentMDK:20756997~menuPK:2036351~pagePK:210058~piPK:210062~theSitePK:1974062,00.html accessed on 14/11/2014

[14] Ibid

[15] See for example The UNCITRAL Legislative Guide on Insolvency Law 2004, available in <www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf >accessed 25/03/2011

[16] Generally the World Bank is involved in many critical aspects of evaluating and reporting on countries' investment climates. See for example World Bank, *Investment Climate Assessment Kenya: Enhancing the Competitiveness of Kenya's Manufacturing Sector: The Role of the Investment Climate* (November 2004) < http://www.ifc.org/ifcext/economics.nsf/attachmentsbytitle/ic-kenya.pdf/$file/ic-kenya.pdf> accessed on 6/3/2013; Also see World Bank, *World Bank Assistance to Agriculture in Sub-Saharan Africa: An IEG Review* available in https://ieg.worldbankgroup.org/Data/reports/agdevelopment_approach_paper.pdf (October 11, 2007) accessed 3 June 2015

ties. This is important as national governments are not willing to relinquish sovereignty of their states to the world and besides, the national systems are diverse. A soft law therefore offers an interactive alternative to the formal, legally enforceable treaties at international level.[17]

Second, the thesis also explores whether there are any informal approaches to corporate rescue in Kenya that may enable present weaknesses in the formal laws to be overcome. Such approaches may go some way to addressing defects in the formal laws which have given rise to concerns which have been documented in the literature. For example the World Bank (2004) in their assessment of the Kenyan investment climate found the insolvency regime to be costly and subject to lengthy delays.[18] In addition, the system was found to suffer from infrastructural inadequacies, legally and institutionally, and to have a legislative regime that is fragmented, outmoded and incomplete.[19]

Third, this research undertakes a comparative analysis between Kenya, the U.K and Mauritius with an aim of reflecting upon the experiences and lessons from these jurisdictions with a hope of informing Kenya's reform pathway. In particular, it focuses on the reform drivers. The trend under which the nations of the world exchange ideas on how best to organize an economy, how best to encourage investment and economic growth has grown significantly, with some jurisdictions converging to near uniformity in their laws. However, there is no research that has been done to explore how best the Kenyan insolvency institutions and pro-

[17] Nilgun Onder , 'Global Finance Governance: 'Soft' Law and Neoliberal Domination' (Paper for the Canadian Political Science Association Congress, June 2-4 2005 London)available in <http://www.cpsaacsp.ac/papers-2005/Onder.pdf> accessed 24/09/2012

[18] World Bank, *Doing Business Report 2004*, (World Bank, 2004)

[19] Ibid

cedures could benefit from the experiences of other jurisdictions. The big question of how these aims will be achieved is detailed below.

1.3.1 Research Methodology

This thesis employs a doctrinal legal research methodology which is primarily library based. Therefore, it involves a comprehensive review of primary and secondary sources of law which are essentially pre-existing secondary sources of data. The primary sources used are legislation, case law, policy and government reports. The secondary sources range from text books, journal articles and magazines from law societies, and reports from respected and recognized international organizations like the World Bank. The research is a comparative study raising important methodological questions that must be addressed. The first is whether the comparative legal method used is appropriate to the topic and its adequacy to address the aims of the research. The second is as to the choice of jurisdictions being compared.

1.3.2 Is it appropriate to carry out a comparative research on the topic of insolvency laws?

Corporate entities in any jurisdiction with a competitive market may face financial difficulties and insolvencies. This is because market dynamics encourage the optimal use of resources and consequently the competitiveness of companies to maximize the economic value. Therefore, insolvency law is an indispensable component of the laws of states and has been acknowledged to define the characteristic of a market economy.[20] Since insolvency problems do not exclusively belong to one jurisdiction, no country can claim a monopoly

[20] Terence C Halliday, & Bruce G Carruthers, *Bankrupt: Global Law Making and Systematic Financial Crisis* (Stanford University Press 2009) pg. 1

over the creation and development of insolvency laws.[21] It is appreciated that the stages of development, systems of law and regulation and overall institutional frameworks are very different in almost all jurisdictions and can greatly affect how well a given jurisdiction's insolvency system works. Nonetheless, given that the roles of insolvency law in all jurisdictions are very similar, learning from other jurisdictions cannot be inhibited by the differences. Therefore, it is appropriate to do a comparative analysis of the insolvency rules, that is, the laws which performs similar functions in this regard in different jurisdictions. It is argued that a comparative analysis of insolvency law will be of academic value and practical significance to Kenya, especially in its reform efforts.

The law is an 'indissoluble amalgam of historical, social, economic, political, cultural, and psychological data, a compound, a hybrid, and a 'monster', an outrageous and heterogeneous collage'.[22] In addition, the law is wide and deep, its dimensions range from the written law to the institutions and enforcement mechanisms, just to mention a few. Ruhl argues that a complex system cannot be understood fully by breaking it into smaller parts because a reduction ignores a lot, instead it is necessary to embrace a holistic view which leads to a deeper meaning of interactions.[23] Arguably, the insolvency laws of any country are not an exception to such realities and such laws also significantly vary because of the different cultural, historical as well as economic contexts of individual states. Therefore, in order to develop a deeper understanding of the laws of any given jurisdiction, it is essential to move beyond the strict knowledge of the legal norms and examine the social and political context

[21] Ong and Baxter (n 10)

[22] Pierre Legrand, 'How to Compare Now' (1996) 16 Legal Studies 232-242 at pg. 236

[23] JB Ruhl, 'Complexity Theory as a Paradigm for Dynamical Law and Systems: A Wake Call for Legal Reductionism and Modern Administrative States' (1996) 45 Comparative Law Review 900

of the rule.[24] In fact, different functions of legal rules and different attitudes towards legal institutions of corporate insolvency law are captured through a comparative study. In essence, comparative legal method is an appropriate methodology because it is a valuable tool for the legal analysis of national legal systems, stimulating awareness of the cultural and social character of the law in any given country.[25] Besides, comparative legal method is comprehensive because it considers the cultural differences between legal systems as well as the potential arbitrariness in the selection of the objects of study.[26] It is argued that by using such a method that permits a holistic approach, the research avoids the danger of putting too much trust in laws and institutions to achieve the desired results, and instead allows a consideration of the practical limitations of the law and the social context of their implementation.

1.4 WHY DOES THIS RESEARCH CHOOSE KENYA, ENGLAND, WALES AND MAURITIUS AS RESEARCH OBJECTS?

A comparative study requires the identification of objects of comparison which, in our context, are legal jurisdictions. The reasons for selecting Kenya as a research object are not only because the author is Kenyan and endeavour to make a contribution to Kenyan legal construction but also because Kenya's circumstances arguably represent those typical of a group of emerging economies, majorly from Africa, that have lagged behind in many aspects. The emerging economies, according to the dominant view of the multilateral institutions and the international community, are responsible for the occurrence of financial crises for the reason

[24] Otto Kahn-Freund, 'On Uses and Misuses of Comparative Law' (1974) 37 Modern Law Review 1-27 at p.27
[25] John C Reitz, 'How to Do Comparative Law' (1998) 46 American Journal of Comparative Law 617
[26] Ibid

of poor quality of their legal and institutional infrastructures for financial matters.[27] Therefore, the characteristics of Kenya, as an emerging economy with huge economic potential but with a glaring need for modernization of its insolvency laws, mean that it is a striking jurisdiction that can benefit greatly from the kind of research undertaken in this thesis. Besides, there is substantial evidence that Kenya's is now a dualistic economy, consisting of both the formal and informal sectors.[28] In fact, the informal sector has become more significant and has substantially increased through micro-businesses, a shift from earlier circumstances. Such changes raise concern as to the adequacy of the insolvency system to deal with current concerns brought forth by the informal sector, which have been positively encouraged through government measures in bid to provide opportunities to generate wealth for Kenyan citizens.

Besides, in 2004, the World Bank assessment of the Kenyan insolvency regime revealed many weaknesses and in 2012 another World Bank report documented that there had been no reforms to address the concerns.[29] For instance, a corporate rescue regime is lacking despite rescuing businesses being an indispensable component of the bankruptcy laws of states and a process which 'defines the character of market economy'.[30] This absence of such laws is detrimental because insolvency systems have been acknowledged as vital for the economic growth and attraction of investment. It is essential for Kenya to attract investors as well as to nurture an entrepreneurial spirit within itself using the formal mechanisms, as well

[27] Onder, (n 17); See UNCTAD, *Trade and Development Report 2001*, (United Nations, New York 2001); Also see IMF and World Bank, *Assessing the Implementation of Standards: A review of Experience and Next Step* January 11, 2001 (World Bank, Washington 2001)

[28] Gibson Nabuteya Amenya, 'The informal sector in Kenya' (A paper presented at Youth Micro Finance Forum Held at University of Nairobi, on 12th October 2007)

[29] World Bank (2004) (n 18); Also World Bank, *Doing Business Report 2012:Doing Business in a More Transparent World* (World Bank, Washington, 2012)

[30] Halliday *and* Carruthers(n 20)

as developing workable alternatives to formal insolvency processes in line with the key characteristic of flexibility of an effective insolvency system. In doing this, it is imperative for Kenya to engage in reforms that are informed by the kind of research done in this thesis, capable of suggesting solutions to identified problems without undermining the peculiarities and cultural context of African insolvency systems. Besides, this thesis will, in a small way, contribute to addressing a glaring lack of literature on insolvency law both in Kenya and in Africa at large. Further, the existing insolvency law theories, as well as the international insolvency benchmarks that have emerged in recent years, have almost exclusively been developed and addressed from the viewpoints of developed economies. This is unsatisfactory because the same international benchmarks are the platforms that developing nations use to nurture their reforms and therefore the view of developing nations deserves to be considered.

The choice of the UK as an object of research in this thesis is underpinned by a number of reasons. To start with, the imported English law is still in use in Kenya as a residual law. Much as Kenyan law has not been static but has actually evolved from the inherited colonial rules through enactment of much legislation, the tradition English Common Law is still very influential. In fact, the doctrine of judicial precedence, a feature of common law, is practiced in Kenya. It is submitted that Kenya, as a jurisdiction, is arguably used to the English approach to issues generally. It is therefore considered that it might be a good option for Kenya to follow the British footsteps in its law reform. In addition, there is a widespread acceptance and reference to the English insolvency laws in other jurisdictions, making the UK a suitable subject of study when considering the central rules and policies in insolvency. Besides, the UK has enjoyed a relatively long history of bankruptcy laws, since the enactment

of the Bankruptcy Act (statute of Henry VIII) in 1542.[31] Such a long history, coupled with active reviewing of its laws, captures a unique aspect of how the law should advance with the economy, as well as always addressing the concerns of each phase of development. It is acknowledged that other jurisdictions have even longer histories and might easily have been selected but the UK, as a jurisdiction, has been an influential pace setter in insolvency reform. For example the famous London Approach pioneered the modern workout which had influences the world over. In addition, schemes of arrangements, which may be regarded as among the first rescue oriented approaches, were started in the UK in 1870 and have greatly influenced insolvency reforms elsewhere.[32] Most importantly, in the wave of corporate rescue laws initiated by the US Chapter 11, the UK led the way in promoting its insolvency reforms towards a modern corporate rescue culture.

Mauritius is similar to Kenya in many relevant aspects and, most importantly, is an equally emerging economy. However, unlike Kenya, Mauritius has successfully undertaken insolvency reforms in the recent past. It is notable that this jurisdiction hugely benefited from legal transplants in enacting its recent new law and its experience is a good example upon which to draw and learn how to negotiate the terrain of legal transplanting in insolvency law. Mauritius therefore provides a good comparative example as to how a developing economy can borrow experiences from developed and sophisticated economies and fashion them to its own circumstances. Despite this selection, the study is not exclusively limited to these three jurisdictions but it will draw examples from any other jurisdiction whose approach or experience can be relevant and informative to the research venture.

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[31] Roy Goode, *Principles of Corporate Insolvency Law* (3rd edition, Sweet &Maxwell, 2005) Para 1.05

[32] For details on Schemes of Arrangements see Companies Act 2006 part 26 and for details on its history and how it operates see Rebecca Parry *Corporate Rescue* (Sweet and Maxwell, 2008) Chapter 17

1.5 A CONCEPTUAL FRAMEWORK FOR UNDERSTANDING CORPORATE INSOLVENCY LAW

Corporate insolvency law refers to the law concerned with companies who are debtors and who are unable to pay their debts.[33] It can be said to be a collection of laws and processes for the resolution of the financial affairs of companies in financial difficulties.[34] Much as in Kenya, the terms 'insolvency' and 'bankruptcy' are understood and used interchangeably to refer to both individual and company insolvencies, technically, individuals become bankrupt and go into bankruptcy, as governed under Bankruptcy Act (Cap 53 laws of Kenya), and companies go into winding up or liquidation, as governed by Companies Act (Cap486 laws of Kenya). Firms encounter financial distress for myriad reasons which range from poor management to and external economic forces. Whenever financial distress occurs, it gives rise to many questions concerning a company's prospects. Is it capable of being rescued or at least brought into better shape before finally being liquidated? Or is it beneficial to facilitate liquidation promptly? One company might be fatally flawed: it has an interesting idea, but can never make money pursuing it while another firm might have assets that are out of scale with its business, such as the airline that has more planes than it needs to serve its customers.[35] Yet another firm might be quite viable but for the debt it acquired in a leveraged buyout.[36] Insolvency laws should therefore be able to look beyond the immediate position of

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[33] Ruzita Azmi and Adilah Abd Razak, 'Theories, Objectives and Principles of Corporate Insolvency Law: A Comparative Study between Malaysia and UK' (A paper presented in 3rd International Conference on Management on 10 - 11 June 2013. Hydro Hotel, Penang, Malaysia)

[34] Ian Fletcher & Letitia Crabb, *The law of insolvency* (Sweet & Maxwell, 1990) pg.33; Also see Henry Hansmann and Reinier Kraakman, 'What is Corporate Law?' Available at SSRN: http://ssrn.com/abstract=568623 accessed on 21/March 2015 for a general discussion on a functional analysis of corporate law as a branch of law

[35] Oscar Couwenberg and Stephen J. Lubben, 'Essential Corporate Bankruptcy Law' (March 24, 2013), Seton Hall Public Law Research Paper No. 2238613; University of Groningen Faculty of Law Research Paper No. 04/2013. Available at SSRN: http://ssrn.com/abstract=2238613 or http://dx.doi.org/10.2139/ssrn.2238613 accessed on 21/March 2015

[36] Ibid

the company and should be sufficiently accessible to democratic influence to allow consideration of factors beyond the narrow confines of the firm or the strictly economic.[37] In addition it should arguably have a capacity to address the various potential problems a firm can encounter. Such a reality underscores the importance of laws that facilitate both liquidation and corporate rescue as each plays a crucial role in promoting the best use of resources.[38] In particular the laws that facilitate liquidation are useful to an economically distressed company which cannot be rehabilitated, while the rescue provisions provide a legal platform for financially distressed but economically viable companies to reinvigorate.[39] In corporate insolvency laws, particular concepts that are of importance are explored below.

1.5.1 Corporate Failure

Entrepreneurship has a beautiful side, of business creation, firm growth, market expansion and a dark side, of risks and failures of firms. In fact, in a market based economy, it is generally recognized that corporate failures are at times inevitable and that a business that cannot compete successfully with its competitors and fails generally has no choice but to leave the market and give new businesses a chance.[40] Equally, failure provides an opportunity for business resources such as capital and manpower to be reallocated efficiently. In addition,

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[37] Vanessa Finch, Corporate Insolvency Law: Perspectives and Principles (2nd edn, Cambridge University Press, 2009) pg. 144

[38] Paterson Sarah 'Rethinking the Role of the Law of Corporate Distress in the Twenty-First Century' (November 18, 2014). LSE Legal Studies Working Paper No. 27/2014 available at SSRN: http://ssrn.com/abstract=2526677 or http://dx.doi.org/10.2139/ssrn.2526677 accessed June 3, 2015accessed on 20 March 2014

[39] Ibid

[40] Reuven Glick, 'Country Crises and Corporate Failures: Lessons for Prevention and Management?'(2002) 18 FRBSF Economic Letter, June 14

some failures have led to advancements in necessary organizational changes.[41] In essence, corporate failures happen and are painful but are a routine feature of a market economy and ought to not necessarily give to rise to legislative intervention.[42]

However, corporate failure can destabilize the economic system in various ways such as increasing unemployment by throwing workers into the labour market, increasing the level of poverty, depriving people, especially creditors, of their legitimate dues as well as potentially intensifying the crime rate and contributing to a reduction in the volume of tax earnings.[43] Such devastating effects make the need for an efficient corporate insolvency law imperative. The consequences of corporate failures justify legislative intervention as an attempt to prevent or make its occurrence less devastating. Generally, where a business failure may be attributed to mismanagement by a person in control of the company affairs, one concern of the law is making those responsible for such mismanagement accountable for their actions. However, where the failure is due to temporary financial difficulties or external economic factors, the law facilitates rehabilitation and preserves its business as a going concern wherever possible. Given the vital role that the law plays in the occurrence of failure, the law should be shaped in a way that, so far as possible, the law does not contribute to undesirable failures or prove deficient in processing failed companies.[44]

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[41] Malami M Maishanu, 'Corporate Failure and Turnaround Strategies in Banking Industry ' available in https://www.academia.edu/260070/CORPORATE_FAILURE_AND_TURNAROUND_STRATEGIES_IN_BANKING_INDUSTRY accessed on 27th August 2014

[42] Andrew Gracie, 'Resolution through the lens of corporate restructuring' A Speech given during International Association of Deposit Insurers' conference, Russia (5 June 2012) available online at www.bankofengland.co.uk/publications/Pages/speeches/default.aspx accessed on 1 /11 /2014

[43] David O Mbat & Eyo I Eyo 'Corporate Failure: Causes and Remedies' (2013) 2 Business and Management Research 4

[44] Finch (n 37)

Legally, a company is deemed as a failure or insolvent if it is unable to meet its current obligations and settle outstanding debts.[45] In corporate insolvency law, the term 'insolvency' is most commonly used such that a company is considered insolvent if it does not have enough assets to cover its debts and, in particular, if it is unable to pay its debts as they fall due. The term corporate failure is times confused with insolvency mostly because they are closely linked but strictly speaking are actually different. Both insolvency and corporate failure are significant aspects of a company in distress. However, corporate failure is broad and can be a consequence of poor performance; firms underperform as they compete in the market whereas insolvency is a distinct legal concept that refers to financial aspects,[46] a matter of law as explored in-depth in 1.5.3 below. Corporate failure begins most of the time by mismanagement and unmarketable products, which may cause a decline in sales over several years and eventually insolvency.[47]

As a concept, corporate failure has a wide meaning, therefore its interpretation and application can vary. For example, corporate failure could be seen in terms of the inability of a corporate organization to achieve its strategic aim of growth and development, to attain its economic and financial objectives as well as legal obligations.[48] Equally, corporate failure can be viewed from a managerial point of view such that there are irreconcilable disputes between leading stakeholders resulting in a management deadlock and where there has been failure of substratum in terms of the underlying business objective.[49] In this view, a corporate entity could be successfully formed but technically fail despite having financial en-

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[45] Statutory provisions may use different wording to define the term insolvent and the example used is the Insolvency Act 1986, s 123(1)
[46] Nadine Levratto 'From Failure to Corporate Bankruptcy: A Review' (2013) 2 Journal of Innovation and Entrepreneurship 20
[47] Ibid
[48] Mbat & Eyo (n 43)
[49] Ibid

dowment and a conducive business environment. In essence a company can experience failure from a managerial standpoint before it is an economic failure and certainly long before it is legally deemed as a failure.[50]

In addition, corporate failure can be seen as a threatening decline in performance which leads to destruction of shareholder value in the long run, failure could be as a result of poor managerial decisions, or high interest rates, recession-squeezed profits and heavy debt burdens as argued by economists.[51] Besides, industry-specific characteristics, such as government regulation and the nature of operations, can contribute to a firm's financial distress.[52] In this thesis, the term 'corporate failure' is used and understood as the unfortunate circumstance of a firm's inability to stay in business and more precisely a business failure in the context of financial distress.[53] The concept of financial distress is significant in the realms of corporate failure and will be explored and distinguished from economic distress in 1.5.2 below.

1.5.2 Financial Distress versus Economic Distress

Conceptually the two are variable terms used to describe a number of situations in a firm, relating to either a recent internal or external event, or a series of on-going problems that have not been resolved.[54] However financial distress is distinct from economic distress and

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[50] Maishanu (n 41)
[51] Andreas Charitou, Evi Neophytou, & Chris Charalambous 'Predicting corporate failure: empirical evidence for the UK' (2004) 13 European Accounting Review 3, 465-497; Also see Finch,(n 37) Pg.172; See John Argenti, Corporate Collapse: The Causes and Symptoms (McGraw-Hill Inc.,1996) pg.170
[52] Ibid
[53] William Megginson, and Scott Smart, *Introduction to Corporate Finance* (Thomson Learning, 2006) pg. 898
[54] John M. Wood, 'Defining Corporate Failure: Addressing the "Financial Distress" Concept: Part 1' (2014) 27 Insolvency Intelligence 3, 38-40

the survival strategies in response to these two types of distress are very different. On the one hand, financial distress means that the firm's promises to creditors are broken or honoured with difficulty.[55] However, such firms, much as they are currently facing difficulty repaying debts, are viable as going concerns; as they are entities without fundamental problems, but have high leverage.[56] On the other hand firms facing economic distress also have difficulty repaying debts, and are also characterized by very low or negative operating performance and they are therefore entities with fundamental problems.[57] In essence, financial distress describes the situation of a firm faced with a temporary lack of liquidity and with the difficulties that result in fulfilling financial obligations on schedule and to the full extent.[58] In essence, a firm may have a viable operation of real assets and thus not be economically distressed. For instance, an all-equity firm can be economically distressed, but can never be financially distressed because there are no creditors involved.[59]

The interrelations between financial distress, economic distress and insolvency law especially when making or reforming the law are crucial. Stiglitz in his analysis of the Asian crisis noted that the policy makers failed to appreciate these interrelations, and as a result implemented policies that exacerbated the crisis.[60] Accordingly, the macroeconomic effects

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[55] Lemma W Senbet and Tracy Yue Wan, 'Corporate Financial Distress and Bankruptcy: A Survey' (2010) 5 Foundations and Trends in Finance 4
[56] Michael Lemmon, Yung-Yu Ma and Elizabeth Tashjian,'Survival of the Fittest? Financial and Economic Distress and Restructuring Outcomes in Chapter 11' (2009) University of Utah, Working Paper; also see G McCormack, *Corporate Rescue Law-An Anglo-American Perspective* (Edward Elgar Publishing Ltd, 2008) pg.9
[57] Ibid
[58] M J Gordon, 'Towards a Theory of Financial Distress' (1971) 26 The Journal of Finance, 2, 347-356
[59] Senbet and Wan, (n 55)
[60] Joseph Stiglitz, *Globalization and its Discontents* (Penguin Press, 2003) pg. 89

should be taken into consideration when a bankruptcy law is designed, and bankruptcy and distress should be taken into consideration when macroeconomic policy is implemented.[61]

When a firm encounters distress, there is a significant possibility that, at some point, the firm itself should be shut down and its assets put to better use or the firm should be rehabilitated. The decision as to whether to most appropriately liquidate or rehabilitate depends on the distinction of whether a firm is economically distressed or financially distressed. A financially distressed entity can restructure its debt and reach an appropriate level of solvency. This may require filing for bankruptcy as a strategic response by the management or owners to financial problems.[62] It can also employ an informal strategy such as negotiating and reaching a compromise with the creditors as far debt payments are concerned. For an economically distressed firm, the challenges the firm faces are of a high magnitude to a point that the firm can become a casualty of an impending bankruptcy. Such an entity will need an efficient legal framework to facilitate the engagements. Primarily, corporate insolvency law is an outlet for distressed firms but its role is not to save all companies from failure but to provide a collective procedure for the resolution of impaired contractual claims held against the firm either in financial or economic distress.[63] Besides, it is widely accepted that insolvency laws play important roles in disciplining financially distressed firms and influencing corporate financial decisions.[64]

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[61] Javier Suarez and Oren Sussman 'Financial distress, Bankruptcy Law and the Business Cycle' (2007) 3 Annals of Finance, Springer1

[62] Lisa R Gilbert, Krishnagopal Menon, and Kenneth B Schwartz, 'Predicting Bankruptcy for Firms in Financial Distress' (1990) 17 Journal of Business Finance & Accounting, 161-171

[63] Finch (n 37) pg. 144

[64] Joseph Fan, Jun Huang and Ning Zhu, 'Financial Distress Without Bankruptcy: An Emerging Market Perspective' (February 2009) Available at http://ssrn.com/abstract=136087accessed on 7th November 2014

1.5.3 Insolvency as a Fact and as a Legal Concept

One of the most significant threats that any business can encounter, despite its size and the nature of its operations, is insolvency. In fact, according to a recent survey on entrepreneurship, people from a range of social and demographic groups rank the possibility of going bankrupt as the greatest fear associated with starting a business. In colloquial sense, insolvency consists of a debtor's ultimate inability to meet his or her financial commitments[65] which must be distinguished from a mere refusal or omission by the debtor who otherwise has an ability to pay debts at their due date. Much as an unpaid invoice issued to the latter is one of the grounds that can trigger insolvency proceedings, the former is a less readily resolvable legal position in so far as the future of the firm is concerned, with 'the likelihood of bankruptcy depending on the level of liquid of its assets as well as on credit availability'.[66] The transformation from a solvent to an insolvent state happens only on the date of maturity of a claim if the terminal value of the company's assets is lower than the face value of debt.[67] In an actual sense, a company can be distressed without defaulting. However, in most instances insolvency is preceded by financial distress to an extent that a firm defaults on its payments of debts as they fall due.

Conceptually, insolvency consists of a debtor's ultimate inability to meet financial commitments[68] but defined in different ways for different purposes.[69] Accordingly, Armour, while

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[65] The OED Online provides a definition of insolvency as ' the fact of being unable to pay one's debts or discharge one's liabilities' available in http://dictionary.oed.com accessed on 7th April 2014

[66] Igor Hendel, 'Competition under Financial Distress' (1996) 54 The Journal of Industrial Economics 3, 309-32

[67] Amiyatosh Purnanandam, 'Financial Distress and Corporate Risk Management: Theory and Evidence' (2008) 87 Journal of Financial Economics 3, 706-739

[68] Ian Fletcher, The Law of Insolvency (4th edn, Sweet & Maxwell, 2009) pg. 1

[69] Goode (n 31) pg. 92

alluding to this reality, provides different meanings of insolvency.[70] First is the definition based on the accounting concepts of balance sheet insolvency and cash flow insolvency, then economic failure on the one hand and the judicial aspects of default on the other hand and lastly from an insolvency proceedings of reorganization on one hand and liquidation on the other.[71] To other scholars such as Wood, much as he acknowledges that the meaning of insolvency can be derived from divergent circumstances, often some confusion is caused because the word 'insolvent' is often used as a synonym for financial distress.[72] Legislatively, the term insolvency is not typically used such that in jurisdictions such as UK, it is represented by the term 'unable to pay its debts as they become due' which connote a state of affairs whereby a debtor is in financial distress.[73] In essence, the wide berth that insolvency has been afforded leaves its meaning, at best, as vague and imprecise.[74]

Despite the ambiguity on the concept of insolvency as noted above, a company, as a matter of fact, can become unable to pay its debts and become distressed to such an extent that it cannot escape from action which is taken by its creditors. Insolvency however, is not a condition to which legal consequences automatically attach unless a formal process such as appointment of a receiver is done. In practice, determining whether a company is in financial trouble or on the verge of becoming insolvent is vital and insolvency law provides, as a guideline, two tests that, if satisfied, amount to sufficient evidence for insolvency proceed-

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[70] John Armour, 'The Law and Economics of Corporate Insolvency: A Review' (WP: ESCR Centre for Business Research, University of Cambridge, 2001) pg. 197

[71] Ibid

[72] John Wood, 'Defining Corporate Failure: Addressing the "Financial Distress" Concept: Part 2' (2014) 27 Insolvency Intelligence 4, 56-58; Also see Karen Hopper Wruck, 'Financial Distress, Reorganization and Organizational Efficiency' (1990) 27 Journal of Financial Economics, 419, 421

[73] In the United Kingdom the definition of Insolvency is prescribed in the Insolvency Act 1986 Sect 123 (1) (e); Also see IA 1986 sec 240 (3); Also see, Fletcher, (n 68) pg. 1

[74] Wood (n 72)

ings to be initiated.[75] A foremost test and a main ground for liquidating companies is that of cash flow insolvency, which exists if a company cannot pay its debts as they fall due.[76] In this test, it is inconsequential if the value of a company's assets exceeds that of its liabilities. If a company cannot pay a debt as it falls due, then there is no reason why a creditor should have to wait until the company can realize assets, some of which may not be in a form that can be readily liquidated.[77] This test however serves to protect the current and short-term creditors leaving out future creditors. This is because the inability in this test basically focuses on the scenarios whereby an invoice has been sent to the company, and if the amount has not been disputed but is not yet paid within a specified time, then this can amount to evidence of a company unable to pay its debts.[78]

Arguably, a cash flow test is in so many aspects 'shallow' when used to determine the viability of a company in financial distress. This is because; establishing whether a company is cash flow insolvent is a question of fact which can easily be proven since it is an inability inferred from a company's failure to pay on demand a debt which is due. For instance, if a company has a large amount of outstanding debts and unsatisfied judgments then this may be something that the court may take as evidence that establishes that a company cannot pay its due debts.[79] Equally, a company admission by itself or its solicitors that they are unable to pay is sufficient evidence.[80] In addition, the absence of assets on which execution can be

[75] John Michael Wood, 'Corporate Rescue: A Critical Analysis of its Fundamentals and Existence' (PhD Thesis Submitted to The University of Leeds May 2013) pg.39
[76] Insolvency Act 1986, s.122(1)
[77] Wood (n 72)
[78] See *Taylor Industrial Flooring Ltd v M & H plant Hire (Manchester) Ltd* [1990] B.C.L.C. 216 for an elaborate interpretation of the cash flow test. Also see *Re Tweeds Garages Ltd* [1962] Ch 406
[79] *Re Tweeds Garages Ltd* [1962] Ch 406
[80] *Great Northern Copper Co* Re (1869) 20 LT 264

levied suffices.[81] A company demonstrating any of the aforementioned cash flow challenges is considered insolvent for purposes of insolvency proceeding and administration order or winding up order is then made. Nonetheless, a company can be able to presently meet its debts as they fall due but persons may still have serious concerns about the company's state of affairs. This reality has long been recognized as vital in evaluating the solvency of the company. Traditionally, in the UK, contingent and future liabilities are statutorily considered in assessing a company's present inability to pay debts.[82] In essence, the scope of consideration in inferring inability shifts from the current liquidity reality to the structure of repayments under the outstanding debt obligations and the nature of the assets available to satisfy them. The alternative test for determining insolvency is therefore the balance sheet (or asset) test which is satisfied if the company has total liabilities that exceed the value of its assets, therefore the debtor has insufficient assets to discharge his liabilities.[83] This test emphasizes that it is not sufficient for such a company to realize its assets to satisfy its liabilities, since the ultimate liabilities would not be satisfied upon the realization of the company's assets.[84] Much as the court takes into consideration the financial obligations at that time, the term 'liabilities' has a much wider meaning than 'debts',[85] such that debts refers to borrowed money but liabilities refers to an obligation of any kind in relation to the company. In particular, for the purposes of winding up, rule 12.12(4) of the Insolvency Rules 1986 provides that it is immaterial whether the liability is present or future, whether it is certain or contingent, or whether the amount is fixed or liquidated, or is being capable of being ascertained by fixed rules or as a matter of opinion.

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[81] *Re Flagstaff Silver Mining Co of Utah* (1975) 20 eq. 268; *Re Yate Colleries Co* [1883] WN 171; *Re Douglas Griggs Engineering Ltd* [1963] Ch 19

[82] Insolvency Act 1986 Section 123(2)

[83] Ibid

[84] Wood, (n 72)

[85] Ibid

The balance sheet test arises if, on a book or market valuation basis, the account of the company shows that its liabilities exceed its assets. The test is fact specific focussing on whether there is or will be eventually deficiency in meeting liabilities. However, this does not mean that a company which is balance sheet insolvent should stop trading immediately. Insolvency is viewed as a set of situations of failure, such as the non-repayment of a debt, the inability to pay dividends to the shareholders, which can all lead, or not, to the beginning of a judicial proceeding.[86] Of significance, the Supreme Court's recent decision in *BNY Corporate Trustee Services Ltd v Eurosail* [2013] UKSC 28, has helped to clarify the meaning of s123(2). The Supreme Court rejected the "*point of no return*" formulation, holding instead that the balance sheet insolvency test requires the court to be satisfied, on the balance of probabilities, that a company will have insufficient assets to be able to meet all of its liabilities, including prospective and contingent liabilities, as and when they eventually fall due.

1.5.4 Liquidation

Financial distress has an impact on the performance of a firm. Such that, when a firm enters a state of financial distress, an important initial challenge is to distinguish between economically viable firms and firms that should be liquidated. What then is liquidation? As a term, liquidation, also referred to as winding up, is a formal legal process which a company undergoes as a means of bringing it to orderly dissolution.[87] In principle, liquidation is a collective insolvency process leading to the end of the company's existence[88] and the principal role of a liquidator is to collect in and realize the company's assets, ascertain claims, and

[86] Levratto, (n 46)
[87] Fletcher (n 68) pg. 611
[88] Goode, (n 31) pg.24

investigate the causes of failure and, after covering all the expenses of the liquidation, distribute the net proceeds by way of dividends to creditors as statutorily provided.[89]

The procedure of liquidating a company can take a number of modes. In the UK, for example, there are three procedures namely voluntary winding up,[90] a compulsory winding up[91] and winding up through administration.[92] It is worth noting that, much as administration gives the company some breathing space from any action by creditors, a company may enter administration to enable it to get a better result than in an immediate winding up; or even to realize property for the benefit of one or more secured or preferential creditors. In such instances, it is arguably a mode of winding up. Each of the aforementioned procedures, much as they all have one goal, has some unique aspects that distinguish it.[93] The principal difference between the voluntary and compulsory modes of winding up is attributable to the fact that the former is commenced with the passing of a resolution at a duly convened meeting while the latter is initiated by a court order upon a petition, often presented by a creditor. Besides, voluntary winding up is predicated upon the assumption that the company is, ultimately, solvent, a fact that has to be duly attested to by a formal, statutory declaration.[94] However, compulsory liquidation is forced upon the company on the grounds of indebtedness to creditors where there is no reasonable prospect of being able to repay the debt as they fall due.[95]

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[89] Ibid
[90] Insolvency Act 1986 section 84
[91] Insolvency Act 1986 section 73(1)
[92] Enterprise Act 2002, Schedule 16
[93] For details on each of the winding up procedures, see Ian Fletcher The Law of Insolvency (4th edition, Sweet & Maxwell, 2009) Chapters 17,18, 19 and 20
[94] Insolvency Act 1986 section 89
[95] Generally see Harry Rajak, *Company liquidations* (Sweet & Maxwell, 2006)

1.5.5 Corporate Rescue

Companies, in their business engagements, can encounter financial difficulties from which they can either survive or fail to. In fact, in a capitalist economy, a certain level of corporate demise has been acknowledged as both inevitable and necessary for the efficient functioning of the market.[96] However, some companies, despite their financial distress, are viable, such that drastic remedial action is deliberately taken at a time of corporate crisis for the benefit of those who have a stake in the company. As such, according to Belcher, corporate rescue is a crucial intervention necessary to prevent the eventual failure of the company.[97] Corporate rescue enables the avoidance of distress and failure, such that all activities that are constantly done and repeated in ensuring that a company maintains or recovers its financial well-being are to an extent to be regarded as rescue attempts.[98] In essence, the concept of rescue is not limited to legal rescue but extends to include intervention from the companies' management or other interested stakeholders.[99] This definition demonstrates that corporate rescue is very broad, as it encompasses both formal and informal rescue procedures, aimed at both avoiding crisis arising and at addressing it when it does arise.

Given the breadth of the term 'corporate rescue', caution should be exercised. The term, as observed by Parry, is potentially misleading.[100] In essence, the term can connote the restoration of a company to financial health, such that a company as an entity survives without change of the company's ownership, while, at the same time; it may simply mean the preservation of the value of a company facing financial distress in order to achieve a better result

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[96] John Argenti, *Corporate Collapse: The Causes and Symptoms* (McGraw-Hill Inc.,US,1996) pg.170
[97] Alice Belcher, *Corporate Rescue*, (Sweet & Maxwell, 1997) pg.12
[98] Ibid
[99] Belcher, (n 97) pg. 11
[100] Rebecca Parry, *Corporate Rescue,* (Sweet & Maxwell, 2008) at p. 2

than in an immediate winding-up.[101] Most importantly, a distinction should be drawn between rescuing the company and rescuing the business of the company.[102] The main difference is that, while the former involves a rescue attempt which results in the company emerging intact from the rehabilitation engagement, the latter often entails a sale of the viable parts as a going concern to a third party and the liquidation or dissolution of the remainder.[103] Previously in UK, company rescue was difficult and in most instances a rescue engagement entails reorganization such that a company is restored to profitability and, much as the company may have the same name, it will be different in many respects.[104] The latest statistics shows that companies are sold especially through administration and such sales are more likely to succeed where they have purchased a business in a pre-pack, rather than after a period of trading in an administration.[105] The odds of failure were 2.4 times higher in a purchase from a trading administration than in a pre-pack purchase.[106] Admittedly, several factors such as market conditions, mismanagement, under capitalization/excessive debts affect the outcome of the sale.[107] Never the less the general purpose of a drastic intervention during the period of crisis is to avoid failure and it does not necessarily imply that the company will be restored back to its previous position, pre-financial distress.[108]

[101] Ibid
[102] Finch, (n 37) Pg.244
[103] Ibid
[104] Andrew Campbell, 'Company Rescue: The Legal Response To The Potential Rescue of Insolvent Companies' (1994) 5 ICCLR (1) 16-24
[105] The Insolvency, *Graham review into Pre-pack Administration* available https://www.gov.uk/government/publications/graham-review-into-pre-pack-administration accessed on 9th March 2016
[106] Ibid
[107] Ibid
[108] Ibid

1.6 THESIS STRUCTURE

The study is structured in seven chapters. Chapter One (the present chapter) provides a contextual framework of the study. It contains an elaboration of the scope of corporate insolvency law with a focus on specific key concepts that are fundamental in this field. Chapter Two provides a theoretical perspective by exploring insolvency law theories. It is considered a prerequisite to understanding and appreciating why these laws exist and what they do. The target in this chapter is to understand the purposes served by insolvency law and theories that provide that platform and to explore how the existing insolvency law theories apply to the realities of a developing economy. Therefore, the chapter starts by illuminating Kenya's historical and socio-economic background, that of a typical emerging economy. It then gives a brief discussion of the development of insolvency law theories and captures the ideological divide embedded in the debate. Subsequently, it discusses leading theories with some selected few being explored in detail. Afterwards, it applies the theories to Kenyan circumstances to appreciate how far the insolvency theories mirror the realities of a developing economy.

Chapter Three provides a detailed analysis of the existing Kenyan insolvency framework. In addition, by reference to international benchmarks as set by UNCITRAL and the World Bank, it undertakes an evaluative insight into the current Kenyan insolvency framework. It starts by building a comprehensive set of background issues; it traces the historical development then gives an overview of the legislative framework. It then constructs a comprehensive evaluation of the substantive aspects of insolvency and detailed procedures from the

standpoint of encouragement of external and internal investment. The chapter reveals the Kenyan business culture and ideologies, historical development and internal economic pressures which represent the realities facing corporate entities in Kenya. The existing inadequacies, challenges and strengths are revealed and the next chapters explore how best they can be addressed.

Chapter Four explores informal mechanisms which may address the gaps left by formal mechanisms. Informal mechanisms have been documented as significant in contributing to a holistic approach towards corporate insolvency.[109] In consideration of the fact that informal restructuring activities come in a variety of forms and different modes of actions, the scope of interest is the engagement of corporate restructuring outside the formal statutory insolvency procedures. This chapter details the relationship between the formal and informal mechanisms and explores internationally recognized informal workout strategies. The London Approach is explored in depth as an example of workouts and equally the UK pre-pack is explored. The last part details the Kenyan approach to informal mechanisms and, because there is no notable informal strategy documented, it explores whether a workout such as a London Approach equivalent can be nurtured.

Chapter Five explores the development of corporate insolvency laws in the UK and looks at reform efforts in order to understand what drives the reforms. A number of drivers are identified and their roles and influence established in an attempt to demystify whether Kenya can learn from the UK in its reform endeavour. Given that the history of UK insolvency laws spans decades, the chapter starts with an investigation into the earlier centuries. However, in

[109] IMF, *Orderly & Effective Insolvency Procedure: Key Issues* (IMF 1999) pg.13

the later centuries, a number of drivers of reform are identified and each is independently explored.

Chapter Six revisits the Kenyan insolvency framework. It identifies and investigates the reform drivers of insolvency law in Kenya within the wider area of business reforms. In particular, the role and influence of the government, the business community and international organizations on the pace and content of legal reforms is undertaken. In addition, a comparative analysis of how the same drivers have successfully influenced the reforms in Mauritius is also undertaken.

Chapter Seven, as a conclusion chapter, entails a summary of the research undertaken and details the main insights that have emerged from the study. The chapter also elaborates on the contribution to knowledge that the study claims to make, states the limitation of the research and points out any areas that would benefit from further research.

CHAPTER TWO

THEORETICAL PERSPECTIVES OF CORPORATE INSOLVENCY LAW

2.0 INTRODUCTION

To understand and appreciate insolvency laws, it necessary to ask why these laws exist and why they do what they do. Much as this might at first glance appear to be a very simple task, it is in fact a difficult one since policy makers, judges and scholars disagree as to which goals are appropriate for insolvency law to further.[1] Equally, lawyers and economists have been documented to view the bankruptcy system differently. Lawyers view bankruptcy as being concerned with the equitable treatment of creditors when the debtor's assets are insufficient to pay all of his creditors in full – an approach that may be regarded as concentrating on distributive aspects of insolvency law – whereas the economists often tend to concentrate on the allocative impact of bankruptcy.[2] The quandary is whether insolvency law should focus on the creditors' interest or whether it has more roles to play and if so, how they should be prioritized. However, there is consensus that corporate bankruptcy laws play the economic function of reducing the cost of default by having a government-sponsored procedure that facilitates the resolution of debts.[3]

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[1] John Amour, 'The Law and Economics of Corporate Insolvency Law: A Review' in Reinout D Vriesendorp, Joseph A McCahery and Frank MJ Verstijlen (eds), *Comparative and International Perspectives on Bankruptcy Law Reform in the Netherlands* (Boom Juridische Uitgevers 2001).

[2] Philip Shuchman, 'Theory and Reality in Bankruptcy: the Spherical Chicken' (1977) 41 Law and Contemporary Problems 4

[3] Roy Goode, Principles of Corporate Insolvency Law, (Thomson Reuters, 2005) pg. 4; William H Meckling, 'Financial Markets, Default, and Bankruptcy: the Role of the State'(1977) 41 Law and Contemporary Problems 4; Todd J Zywicki, 'Bankruptcy Law as Social Legislation' George Mason Law & Economics Research Paper No. 01-18 available at SSRN: http://ssrn.com/abstract=273988 or http://dx.doi.org/10.2139/ssrn.273988 accessed on 7th August 2015

This chapter examines corporate insolvency law from a theoretical point of view. It starts with an exploration of the existing theories of corporate insolvency laws. It then analyses and compares the objectives and principles of corporate insolvency law in Mauritius, the UK and Kenya. Lastly, it considers how the theories can be applied in Kenya and how such application might be used to inform policy in the light of the current insolvency reform process in Kenya.

2.1 BACKGROUND OF CORPORATE INSOLVENCY LAW THEORIES

A corporation is an entity established for several purposes, one of which is to be used objectively as an investment vehicle.[4] Greenfield argues that corporations are hugely important and successful engines of wealth creation but they can be amoral behemoths that foul the environment, worsen political inequalities and take advantage of horrible injustices for their own financial gain.[5] As an economic entity, a corporation fundamentally serves as a linkage of contracts; a single contracting party that coordinates the activities of providers of inputs and of customers of products and services.[6] However, when a corporation fails, a new dilemma of ownership sets in; in a typical problem in insolvency, when a debtor is insolvent and its assets are potentially not enough to meet its obligations to all of its creditors, there is inevitably a problem of co-operation and competition for the available assets.[7]

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[4] Larry C Backer, 'Sovereign Wealth Funds as Regulatory Chameleons: The Norwegian Sovereign Wealth Funds and Public Global Governance through Private Global Investment' (2009) 41 Georgetown Journal of International Law 2.

[5] Kent Greenfield, 'There's a Forest in Those Trees: Teaching About the Role of Corporations in Society' (November 12, 1999) Boston College Law School Research Paper No. 2000-01. Available at SSRN: http://ssrn.com/abstract=195048 or http://dx.doi.org/10.2139/ssrn.195048 accessed on 12 October.

[6] Hansmann, Henry and Kraakman, H Reinier, 'What is Corporate Law?' available at SSRN: http://ssrn.com/abstract=568623 accessed on 5th October 2012.

[7] Roy Goode, *Principles of Corporate Insolvency Law* (Sweet & Maxwell, 2011) pg. 68

For decades, economists and legal scholars have engaged in controversy over the nature and purpose of the corporation.[8] This controversy mirrors the divergence of opinions concerning the role of insolvency. A number of theories emerged in the company law literature, heavily emphasizing two main theories, namely: the shareholder and stakeholder theories, which are normative theories of corporate social responsibility, dictating what a corporation's role ought to be. On one hand, the shareholder theory (also referred to as shareholder primacy) asserts that shareholders advance capital to a company to be spent only in ways that have been authorized by the shareholders.[9] The shareholders are the sole residual claimants of corporations and corporate directors are therefore required to serve only shareholders' interests.[10] As Milton Friedman explains:

> 'There is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it … engages in open and free competition, without deception or fraud.' [11]

Under this approach, it is a legitimate expectation of the shareholder of a corporation's that the primary goal is to maximizing their wealth.[12] On the other hand, the stakeholders' theory asks what the responsibility of the management is to stakeholders. In answering this question, stakeholder theory asserts that managers have a responsibility to both the corporation's shareholders and other constituencies that contribute to the company's wealth-creating capacity and, as such, are to be treated as potential beneficiaries as well risk bearers.[13] The ideological position of the stakeholders in this theory is advanced and is justified in the

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[8] Ibid
[9] Thomas Donaldson and Lee Preston, 'The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications.' (1995) 20 Academy of Management Review 1
[10] Lynn Stout, 'Bad and Not-So-Bad Arguments For Shareholder Primacy' (2002) 75 Southern California Law Review 1189.
[11] Milton Friedman, *Capitalism and Freedom* (University of Chicago Press, 1962) pg 133.
[12] Greenfield, (n 5)
[13] James E Post, Lee E Preston and Sybille Sachs, 'Managing the Extended Enterprise: The New Stakeholder View' California Management Review 45, no. 1 (fall 2002): 5–28

management literature by describing a corporation as a constellation of cooperative and competitive interests possessing intrinsic value.[14] In essence, the stakeholders' contribution is vital for the organizational success of the company and therefore their interests cannot be wished away. The theory suggests that managers/directors should deliberately formulate and implement processes that take account of all of the groups who have a stake in the business.[15] However, the scope of the group interest to be considered is debatable. Some scholars arguing in favour of the groups without whose support the organization would cease to exist and others are suggesting the inclusion of those groups or individuals who are affected by the organization as well as those who can affect the corporation.[16]

Of significance to the area of focus is the influence of these ideologies on the corporate insolvency law theories. For instance, the creditors' bargain theory is built on the shareholders' primacy theory. The shareholders primacy theory asserts that the role of company directors is primarily to act in the interests of shareholders and maximize the wealth of shareholders.[17] In an insolvency scenario, a typical example of administration, the administrators will take the position of the directors and as they handle the affairs of the company they consider the interest of creditors. In essence, shareholder primacy is substituted for a creditor

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[14] Donaldson and Preston, (n 9)

[15] Edward Freeman and David Reed, 'Stockholders and Shareholders: A New Perspective on Corporate Governance' (1983) 25 California Management Review 88 pg 106

[16] Fran Ackermann, and Colin Eden, 'Strategic Management of Stakeholders: Theory and Practice (2011) 44 Long Range Planning 3, 179–196; Also see John M Bryson, Gary L Cunningham and Karen J Lokkesmoe 'What to do When Stakeholders Matter: The Case of Problem Formulation for the African American Men Project of Hennepin County, Minnesota' (2002) 62 Public Administration Review 568-584.

[17]Malcolm Edward Anderson, Meredith A Jones, Shelley D Marshall, Richard Mitchell, and Ian Ramsay, 'Evaluating the Shareholder Primacy Theory: Evidence from a Survey of Australian Directors' U of Melbourne Legal Studies Research Paper No. 302. Available at SSRN:http://ssrn.com/abstract=1031301 or http://dx.doi.org/10.2139/ssrn.1031301accessed on 15th May 2014

primacy.[18] However, it is a simplistic and unrealistic view to replace the role and objectives of the directors in a solvent entity with that of administrators of an insolvency scenario. There is a noteworthy divergence between the circumstances and approach of managers on a day to day management of a company, with that of administrators in an insolvency scenario. The former is that of a regular engagement while the latter is a response to a potentially capricious scene rife with conflicting economic interests.

Besides, corporations act through human agents; which introduces problems of agents' fealty, which are frequently encountered.[19] It is customary to find a board of directors presiding over the actual management of the company.[20] They will have extensive management powers delegated to them by the articles and they will typically have service contracts with the company, which together with the articles delimit their powers and responsibilities.[21] This presents the first basis for contractual agreements for the agency theory. In principle, the agency theory suggests a fundamental solution for absent or distant owners/shareholders who employ professional executives to act on their behalf. The root assumption is that the agent will not serve their own interests but rather those of the principal. There are challenges and dynamics which are part of the corporate governance which will not be elaborated in this thesis. In a nutshell, agency in a corporation actually introduces a new level of interest to be prioritized.

[18] Samuel E Etukakpan, 'Transfer of Undertakings : The Tension Between Business Rescue and Employment Protection in Corporate Insolvency' (PhD Thesis, Nottingham Trent University, 2012) pg. 62
[19] Margaret Blair, 'A Team Production Theory of Corporate Law' 85 Virginia Law Review 2
[20] Brenda Hannigan, *Company Law* (2nd edn, Oxford University Press, 2009) pg. 116
[21] *Ibid*

An alternative view is presented by the team production theorists, who argue that shareholders are not the only group who provide specialized inputs into corporate production. Under this approach, team members are expected to give up important rights in the common interest, such as property rights being given up by shareholders for the benefits of all team members.[22] They maintain that non-shareholders, such as employees, suppliers, amongst others who are constituents of such firms are particularly vulnerable to opportunism.[23] To protect them, corporate law ought to mandate the directors to serve not only the shareholders' interest but also those of the employees, consumers and other 'stakeholders'.[24] Such arguments mirror the debates advanced by the stakeholders' theorists.

Generally, the stakeholder verses shareholders debates connote the impression of a contest between two factions with competing interests. In reality, an insolvency scenario is not a contest of any two groups but rather numerous interests competing for limited assets. Besides, the genesis of insolvency is debt default such that one would easily assume that the conflict is between the creditor and debtor. Interestingly, an insolvency scenario entails many procedural engagements as well as divergent interest that should not be simply grouped into two. As such, bankruptcy law may be regarded as socially desirable and it exists not because it protects debtors from creditors, but rather because it equally protects creditors from one another.[25]

[22] Blair, (19)
[23] Ibid.
[24] Lawrence Mitchell, 'A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes' 70 Texas Law Review 579
[25] Stanley D Longhofer, 'Protection for Whom? Creditors Conflicts in Bankruptcy' (September 1999) available at SSRN: http://ssrn.com/abstract=64 accessed on 11 October

2.2 THEORIES OF CORPORATE INSOLVENCY LAW

The jurisprudence on corporate insolvency has resulted in several theoretical explanations as to why insolvency law exists. Generally, the theories may be divided into two groups, or two schools, originally named the 'social' and 'economic' but characterized in literature as 'Proceduralists' and 'Traditionalists'.[26] The former groups are those whose main focus in an insolvency process is on creditors' interests. To this group, bankruptcy laws are solely for the purpose of maximizing the debtor's economic value for creditors' interests or creditors' economic recoveries.[27] The latter groups are theorists and policy makers who emphasize as to the debtor's diversified values, hence viewing bankruptcy as the procedure for addressing the vast range of social problems caused by business failure.[28] The discussion starts by exploring the pro-creditors theory, starting from the creditors' bargain theory. It then focuses on the pro-traditionalist group which includes theorists who have developed theories including the value- based theory, visions theory, multiple approaches, team production and the authentic consent model. It is notable that some of the arguments or issues advocated by these theorists, especially those concerned with social welfare in corporate bankruptcies, are very similar. Therefore, some of the theories will be discussed more briefly than others, but the main views at the heart of corporate insolvency law debates will be captured.

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[26] Douglas G Baird, 'The Uneasy Case for Corporate Reorganization' (1986) 15 Journal of Legal Studies 127,133

[27] Ibid

[28] Christopher Frost 'Bankruptcy Redistributive Policies and the Limits of the Judicial Process' (1995)74 N. C. L. Rev. 75

2.2.1 The creditors' bargain theory (CBT)

The Creditors' Bargain Theory was proposed in 1982 and as name of the theory suggests, it is creditor-focused.[29] Accordingly, the CBT, as championed by Jackson[30] and Baird,[31] maintains that insolvency laws exist primarily and exclusively for the benefit of the creditors of the insolvent company.[32] In fact, the law functions to maximize the collective return to creditors through a compulsory collective system and to solve the 'common pool' of assets problem, arising from diverse claims to limited assets.[33] As such, all insolvency laws are to be tested by one principal question: does a law enhance the collective benefit of creditors?[34] The key rule is to consider only those entitlements that were created pre-insolvency. Therefore, insolvency rules that enable shareholders and junior creditors to gain from company rehabilitation are seen as creating inappropriate incentives.[35]

Much as CBT theorists advocate for insolvency law to take creditors' pre-insolvency negotiated rights as it finds them, and honour both the powers and limitations under non-insolvency law without modifying them;[36] they do not deny the existence of other interests in insolvency. However, they hold the view that when a company is insolvent, the creditors' interests should take primacy over other interests. As such, the interests of any other con-

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[29] Thomas H Jackson, *The Logic and Limits of Bankruptcy Law* (Harvard University Press, 1986) 64 b
[30] Ibid
[31] Baird (n 26)
[32] Thomas H Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain' (1982) 91 Yale Law Journal 857
[33] Douglas G Baird & Thomas H Jackson, 'Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy' (1984) 51 University of Chicago Law Review 97
[34] Jackson, (n 29) at 103
[35] Gerard McCormack, *Corporate Rescue Law-An Anglo-American Perspective* (Edward Elgar Publishing Ltd, 2008) pg.79
[36] Samuel E Etukakpan, 'Business Rescue and Continuity of Employment: Analysing Policy Through the Lens of Theory' (2011) 3 Company Lawyer 4

stituency are only considered to the extent that the particular members of those groups are creditors with enforceable legal rights against assets of the insolvent company under non-insolvency law.[37] Besides, they take the view that non-creditor interests should be addressed outside insolvency law and that insolvency law should not concern itself with the public interest.[38] The payment of debts in accordance to the pre-insolvency entitlements ensures orderly proceedings. This is an advantage that enhances a crucial element of predictability. However, as acknowledged by Korobkin, an economic approach cannot realistically address the non-economic values, such as moral, political and social issues, especially following insolvency. However, corporate insolvency law must be explained 'not as a maxi miser of economic outcomes but as a system for rendering richer, more informed decisions in response to financial distress.'[39]

The creditors' bargain theorist (CBT) employs a neo-Rawlsian contractarian notion to explain and justify the structure of insolvency law.[40] Because of this, the theory is grounded on the concept of 'dramatic ignorance', such that the parties to the creditors' bargain are not only ignorant of their own attributes but also on insolvency outcomes.[41] It assumes that in a bankruptcy scenario, there is a common pool of assets to which creditors would have recourse, and that all parties are free and equal to enter into a bargain that is fair and just.[42] Besides, it also assumes that the essential features of insolvency law were not chosen by the

[37] Jackson, (n 32)
[38] Andrew Keay and Peter Walton, *Insolvency Law: Corporate and Personal* (Pearson Education Limited, 2003) pg. 23
[39] Donald R Korobkin, 'Rehabilitating Value: A Jurisprudence of Bankruptcy' (1991) 91 Columbia Law Review 717, 762.
[40] Thomas H Jackson, 'Avoiding Powers in Bankruptcy' (1984) 36 Stan. L Rev 725
[41] Ibid
[42] Ibid

creditors but rather imposed on them, and that the various players act in an economically rational manner according to a single set of criteria.[43]

Corporate insolvency law, in Jackson's view, is a collective debt device.[44] The merit of ensuring that creditors' act collectively provides a crucial platform to negotiate and reorganize. Besides, in Jackson's view, 'a single inquiry into recurring collection questions is likely to be less expensive than a multiple inquiries that happen in an individualistic remedies system'.[45] In addition, a collecting procedure discourages duplicative monitoring. Further, it promotes administrative efficiencies which are essential for the maximization of the debtor's economic value, since the debtor's assets may be worth more if administered together either in a going concern liquidation or reorganization.[46] The corporate insolvency law that functions as collective device, as championed by Jackson, has merits, such as being favourable for the risk-averse creditors, as they get better returns on their investment under a collective process.[47] In addition, it eliminates the wasteful and potentially inefficient liquidation of the company assets by individual creditors pursuing their own claims individually.

The potential merits that a law fashioned on creditors' bargain theory would bring may be viewed as vital in an efficient and effective bankruptcy law of dynamic market. A good example is ensuring an orderly process that facilitates efficiency. The collective approach to insolvency is perhaps the foundation of the automatic stay on creditors' actions, which is vital in the preservation of insolvent estates. Besides, the underlying idea of respecting pre-

[43] Ibid
[44] Baird and Jackson (n 33) at 103
[45]Jackson (n 32)
[46] Jackson (n 29) 866-69
[47] See Robert Pindyck and Daniel Rubinfield , *Microeconomics* (4thedn, Prentice Hall, N J 1997) Chapter 5 for a detailed discussion on risks aversion

insolvency entitlements is fundamental, especially to the secured creditors. In essence, the secured creditors' property rights should not be sacrificed for the benefit of unsecured creditors and preventing secured creditors from enforcing their collateral during rescue, without providing full compensation, is regarded as outrageous.[48] Secured creditors are considered important since the credit they offer is crucial in starting and improving enterprises, which in turn encourages certain benefits of the society as a whole. In fact, Goode explains it succinctly: that investment security is necessary as it enhances the debtor's ability to raise funds and engage in market operations.[49] It is undeniable that economies are likely to advance if the secured creditors are certain as to the laws respecting their rights. This is because insolvency law, just like all investor protection laws and institutions, affects investors' behaviour.[50] For instance, the legal powers of creditors are likely to determine the availability of credit and, more crucially, the ease with which the lenders can force repayments, grab collateral or even gain control of the business.[51]

Despite the merits that can be potentially realized through an insolvency law fashioned on the ideologies of the CBT, this theory also has been heavenly criticized. For instance, Mokal, in his attempt to apply the model to a significant feature of insolvency law– the automatic stay– concluded that the model fails, as it has neither descriptive nor moral force.[52] He criticizes the model for relying on nothing but creditors' preferences, without any justifica-

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[48] Ibid
[49] Roy Goode, *Legal Problems of Credit and Security* (4thedn, Thomson Reuters Ltd, 2008) Pg. 2
[50] Rima T Ariss, 'Institutions, Investor Protection, and Corporate Choices in Developing Economies' (March 14, 2011) available at SSRN: http://ssrn.com/abstract=1785699 or http://dx.doi.org/10.2139/ssrn.1785699 accessed on 23rd September 2012
[51] Ibid
[52] Rizwaan Jameel Mokal, *Corporate Insolvency Law Theory and Application* (Oxford University Press, 2005) pg. 34

tions as to why the preferences ought to be considered binding.[53] Equally, Finch correctly points out that the theory fails to value the continuation of business relationships that have not necessarily been formalized in contracts and omits from consideration those who are equally affected in the context of financial stress.[54] In addition, the theory is based on assumptions far removed from reality because certain problems that face non-creditors only arise in the context of insolvency and hence their interests need be protected.[55] Further, it insinuates that all creditors are equal in terms of knowledge, experience and power; failing to take into consideration the fact that creditors are not uniform, some being stronger than others.[56]

2.2.2 Communitarian theory

The communitarian theory is an inclusive approach and hence emphasizes a variety of constituent interests, especially the public interest.[57] To this theory, insolvency law should not focus solely on protecting the private rights of creditors but should also consider the employees, suppliers, customers and the wider community.[58] Central to this theory, are distributional concerns, because redistribution is seen not as a deviation from the protection of creditors' rights, but as a core and unavoidable function in insolvency law.[59] Accordingly, it allows the distribution of values on insolvency, such that high priority claims may give way to others, including those of the community at large. In addition, this theory sees individuals as interdependent on each other and considers that it is important for them to act in the best

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[53] Ibid
[54] Vanessa Finch, 'The measures of Insolvency (1997) 17 Oxford J Legal Studies 2:227-251.
[55] Roy Goode, *Principles of Corporate Insolvency Law* (2[nd]edn, Sweet & Maxwell, 1997) at 38
[56] Keay and Walton (n 38) pg. 25
[57] Karen Gross, 'Taking Community Interests into Account in Bankruptcy: An Essay' (1994) 72 Washington University Law Quarterly 1031
[58] Keay and Walton (n. 38) pg. 25
[59] Elizabeth Warren, 'Bankruptcy Policy' (1987) 54 University of Chicago Law Review 775

interests of others, even if this necessitates limiting their own individual freedom.[60] Besides, one of the main considerations for communitarians is the economic life of a region in which the insolvent debtor is located, and this has to be given important consideration in the design of insolvency laws.[61] In essence, the law should permit the rehabilitation of a commercial entity where this would have a better result for the community in protecting jobs, even at the expense of some other rights.[62]

The expansiveness of the concerns embraced in this theory may be viewed as a problem in themselves. The theory has been criticized as lacking the degree of focus necessary for the design of insolvency law, as it is hard to select the interests that are worthy of legal protection.[63] Schemer, while articulating the same critique, adds that choosing the interests worthy of legal protection from the variety that might be considered is bound to create substantial argument.[64] This complexity creates inefficiency, since one cannot lay down parameters for the proposed community interest which could conflict, making it cumbersome for tangible legal protection to be offered.[65] Inevitably, it leads to reliance on insolvency judges, who may not be the best persons to decide on what should be the community's best interest.[66] However those in support of it dispute this criticism, arguing that it will be for the courts to undertake the balance to resolve such conflicts, since they often do similar exercises.[67]

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[60] Gross, (n 57)
[61] On social contract theories generally see Samuel Freeman, *Justice and the Social Contract,* (OUP, 2007) pg. 17
[62] Vanessa Finch, *Corporate Insolvency Law, Perspectives and Principals*, (2nd ed. Cambridge University Press, 2009) pg 37
[63] Finch, (n 54)
[64] Barry Schemer, 'Response to Professor Gross: Taking the Interest of the Community into the Account in Bankruptcy' (1994) 72 Washington University Law Quarterly 1049 at 1051
[65] Ibid
[66] Ibid
[67] Andrew Keay, 'Insolvency Law :A matter of Public Interest' (2000) 52 Northern Ireland Legal Quarterly509

2.2.3 Value based Theory

This theory, in its attempt to offer a rich and full exposition of corporate insolvency law, embraces the views of the 'Traditionalists' group. The main proponent of this theory, Donald Korobkin, while disapproving the idea of taking the debtor as a pool of assets, views it as a personality with dynamic potential.[68] As such, the debtor's estate reflects the character of a human life which, in its quest for a good life, is not achieved once. In reality, the dynamics of life can be challenging, and therefore success comes out as a contribution of each small achievement at a time. This is comparable in a corporate life to the contributions of the many stakeholders. As such, the theory considers insolvency law to be a response to addressing the 'failure of collective autonomy' and 'supplying the reflective capacity that the enterprise [now] lacks'.[69] Corporate insolvency law must inevitably involve itself in wider concerns. For example, it may 'address the concerns of the employee who fears the loss of employment'.[70] It must be mindful of the plight of 'an employee who [entered] the corporation without skills or training and is thus viewed by her supervisors as especially dispensable.'[71] In addition, insolvency law must, if necessary violate the pre insolvency rights of those with direct financial concerns in the company.

2.2.4 Visions theories

There are two 'visions' theories, namely, the 'forum vision' and 'ethical vision'. These two theories champion an inclusive approach to insolvency processes. The forum vision, as de-

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[68] Etukakpan (n 36)
[69] Donald R Korobkin , 'Rehabilitation Values : A Jurisprudence of Bankruptcy' (1991) 91 548
[70] Korobkin (n 69) 555
[71] Korobkin (n 69) 558

scribed by Finch, is that of the insolvency process establishing a 'forum' in which all interests– not just monetary– that are affected by business failure would be recognized.[72] The focus is shifted beyond creditors to all participants in the company's financial distress. The theory requires the law to establish 'space' and should provide 'not just interested parties' with a 'medium of …discourse'.[73] The justification for this argument is that enterprise is more than the physical assets and stock, but it entails the interest (contribution) and concerns of all participants in the financial distress.

The ethical vision, as promoted by Shuchman,[74] brings in a new dimension by introducing moral concerns. The theory does not broaden the number of members or actors, and champions the idea that the philosophical foundation of formal insolvency rules should not disregard the moral issues.[75] As such, the situation of the debtor, the moral worthiness of the debt and the size, the situation and intent of the creditors ought to be considered in laying the foundations for insolvency law.[76] To achieve this, however, reliance on the Judiciary to evaluate the moral needs and desserts of creditors, and the moral worthiness of the debtor is necessary; which in essence results in placing a large degree of faith on the individual's (judge's) moral judgment.[77] It is argued that both the forum vision and ethical vision raise important aspects that attempt to solve conflicts that may be encountered in an insolvency scenario. In fact, most insolvency legislation contains provisions necessary to stipulate the expected qualifications of insolvency practitioners, as well as to regulate their conduct.

[72] Vanessa Finch, Corporate Insolvency Law Perspectives and Principle, (Cambridge University Press, 2002) 28-33 is the name of the book required to be in italics as in footnote 73?
[73] Vanessa Finch, *Corporate Insolvency Law, Perspectives and Principles*, (2[nd]edn, Cambridge University Press, 2008) pg. 38
[74] Philip Shuchman, 'An Attempt at a Philosophy of Bankruptcy' (1973) 21 University of California Los Angeles Law Review 403
[75] Finch (n 73) pg. 38
[76] Ibid pg. 38
[77] Finch (n 73) pg.39

However, it is difficult to understand how the moral aspect can be part of a philosophical foundation of insolvency law without deviating from the substantive concerns that are central to the realities of those entangled in insolvency. This is because morality itself is a highly contested notion in any given society. Even though morality may not be ignored, it cannot be a central aim of insolvency. Besides, the substantive issue goes hand in hand with the procedural and as such effective insolvency regimes should arguably have clear procedures with precise targets to achieve.

2.2.5 Multiple Value Approach

This particular theory opposes the CBT and has similarities to the communitarian approach and is thus broader, as it asserts the fact that the effects of failure are wider than the impacts upon creditors' interests.[78] The proponents of this approach see insolvency processes as attempting to achieve such ends as distributing the consequences of financial failure amongst many actors, establishing priority between creditors, enabling rehabilitation and protecting the interest of the employees, amongst others. The main proponent of this theory, Prof Warren, dismissed a single unifying theory of corporate law as vague and out of touch with complex reality. However, she identified four goals of an insolvency system. These are: enhancing the value of a distressed business entity, distributing that value according to multiple normative principles, internalizing costs of business failure among parties involved in the company and finally promoting reliance on private monitoring arrangements.[79] For this approach, a judge is pivotal, having to balance a number of values, such as fairness and jus-

[78] Keay and Walton, (n 38) pg. 28

[79] Elizabeth Warren 'Bankruptcy Policy making in an Imperfect World' (1993) 92 Michigan Law Review 336 at 344

tice, as well as efficiency, when making decisions.[80] This theory, as acknowledged by its proponents, is ‘complex, dirty and elastic’ since it is problematic to predict its outcome or even fully articulate all the relevant factors to a policy decision.[81] Besides, it offers little assistance to decision makers on the management of contradictions between different values.[82] In addition, there are no core principles that emerge to guide those decisions, determine trade-offs or establish weightings.[83] However, every purpose that a law seeks to attain has two facets. The substantive aspect, which justifies the existence of that particular law by showing it in its best light, and procedural features, which are those concerned with how the law goes about attaining its substantive goals.[84] Therefore, much as this theory fails to provide clear principles, it has contributed greatly to identifying the substantive aspects that an insolvency procedure should pursue. The interests that this theory seeks to include in the insolvency process are similar to most of the inclusive approaches and are useful in giving a window into the broad economic and social transformation that is necessary in a developing economy, as will be discussed in detail later in the chapter.

[80] Ibid
[81] Warren, (n 79)
[82] Gerald E Frug, ‘The Ideology of Bureaucracy in American Law’ (1984) 97 Harvard Law Review 1277 at 1379
[83] Finch (n 54)
[84] McCormack (n 35) pg. 35

2.2.6 Team Production Theory

This theory derives its name from the team production concepts in institutional economics literature.[85] The team production theory (TPT) of corporate law dates back to 1999 when it was developed by Margaret Blair and Lynn Stout as a powerful contractarian theory of the public corporation.[86] However, Professor Lynn LoPucki applied the same theory to bankruptcy, developing it into a normative and alternative theory of analysing insolvency law.[87] In applying TPT to insolvency law, the reorganization ceases to be a regulation imposed by the government and in its place, becomes a contract term by which the shareholders and creditors agree to subordinate their legal rights to the preservation of the going concern.[88] Therefore, this theory opposes the view that the main obligation of the firm is to maximize the wealth of its creditors. As such, it implies that preservation may necessitate that the team production obligations are honoured by giving them priority over legal obligations. Team production theory, in effect, supports the non-legally enforceable entitlements of team members over the legally-enforceable claims of creditors and interests of shareholders.[89]

The basis of team production is mutual trust and recognition of the fact that the resources essential in team production do not, in a sense belong to one individual.[90] Some targets require joint efforts; hence corporations should seek to maximize the joint welfare of all its stakeholders, which include shareholders, managers, employees and even the local commu-

[85] Armen A Alchian & Harold Demsetz, 'Production, Information Costs and Economic' (1972) 62 American Economic Review 777
[86] Margaret Blair & Lynn Stout, 'A Team Production in Business Organization: An Introduction' (1998-1999) 24 Journal of Corporate law, 743,745
[87] Lynn LoPucki 'A Team Production Theory of Bankruptcy Reorganization' (April 23, 2003) UCLA School of Law, Law & Econ Research Paper No. 3-12. Available at SSRN: http://ssrn.com/abstract=397801 or http://dx.doi.org/10.2139/ssrn.397801 accessed on 30th September
[88] LoPucki (n 87)
[89] Ibid
[90] Alchian and Demsetz (n 85)

nity. In the same regard, insolvency should be a collective proceeding that accounts for the rights of all those involved because, besides contributing, they also have various degrees of economic interest. Much as this theory strives to disapprove the narrowly focused creditors' bargain theory, hence incorporating wider concerns, both theories are contractarian, though the basis of their contracts varies. For instance, the creditors' bargain is based on a hypothetical contract but the TPT is grounded on actual contracts entered to by the firms' team members.[91]

Another assumption underlying this theory is that the economically efficient institutions are those that contracting parties would choose. In addition; there is a presumed understanding among the team members that all their interests will be served by those in authority. The creditors and shareholders deliberately commit themselves to dealing with the board of directors, which in a manager-displacing insolvency context will be the insolvency practitioners. In essence, the bankrupt firm should honour its obligations to all who made firm-specific investments at the invitation of the firm but it is not able to protect them in other ways. In this theory, reorganization law allows the team production arrangement to continue during reorganization almost unchanged.

TPT theory carries an important and popular view that insolvency law should not focus on only creditors, since creditors are just a part of a big team involved in the running of a corporate entity. It looks at those forms of co-operative behaviour that can be mutually advantageous for all interested parties in an insolvent scenario to engage in. For instance, a business is highly dependent on skills, and technical knowhow, as opposed to capital assets, and

[91] Lopucki (n 87)

all these are arguably sealed off in its good will and going concern values.[92] The TPT envisions that, during insolvency, consideration of all team members' interests should be catered for. As such, the debtor should continue trading if the total benefits accruable to team members exceed those accrued in liquidation. This approach will allow reorganization, where viable, and continuation of employment, even where a business changes ownership. As such, bankruptcy policy should take into account the distributional impact of business failure on both the direct financial interest, as well as non-financial claims. This view is beneficial to any economy and more so to a developing one, where closing a business has dire consequences.

2.2.7 The Authentic Consent Model

The Authentic Consent Model theory (ACM) arose from dissatisfaction with the creditors' bargain theory and other theories subscribing to 'Traditionalist' views. Mokal, the proponent of this theory, criticizes the CBT as 'arbitrary, incoherent, lacking justificatory force and unable to describe a central part of insolvency'.[93] He then proposes a collective contractarian approach, which assumes that the insolvency process offers a voice to all creditors.[94] This contractarian approach has its foundation in early social contracts, where citizens would agree with the government and empower it to maintain order and protect citizens' rights.[95] The citizens of a social contract have to co-operate with the government, just like the co-operation expected of each participant in an insolvency scenario. As such, each party that complies with the publicly recognized rules is to benefit in an appropriate way, for instance

[92] Karen Gross, 'Taking Community Interest into Account in Bankruptcy: An Essay' (1994)72 Washington University Law Quarterly 1031 at 1033

[93] Riz Mokal, 'The Authentic Consent Model: Contractarianism, Creditors' Bargain and Corporate Liquidation'(2001) 21 Legal Studies 400-443

[94] Ibid

[95] Brian Bix, *Jurisprudence: Theory and Context,* (6th edition Sweet and Maxwell, 2012) pg. 110

by being given an opportunity to advance their own view of what is good in the circumstances.[96] The fundamental issues of a social contract are the characterization of the original state and the rationality of the contractors.[97] Arguably, it is difficult to determine the original state in a social contract, such that pinpointing the exact time when people entered into the social contract and chose to sacrifice their physical freedom to do whatever they please is problematic.

The application of social contract to insolvency law is based on the concept of 'dramatic ignorance' as discussed under the CBT. However, Mokal's model involves a movement away from traditional contractarianism that was based on trust to a methodical contractualism approach of analysing insolvency law.[98] Contractualism, unlike contractarianism, is not trust-based. 'Contractarianism holds the view that persons are primarily self-interested. When applied to the company, contractarianism sees the company essentially as a 'nexus of contracts' among those that constitute it'.[99] Besides, CBT is different from ACM in the sense that inasmuch as they are all based on contracts, not all classes of creditors can have a say in actual insolvency proceedings in the type of agreement CBT proposes. Mokal believes that his ACM offers a voice to all creditors in insolvency. In essence, the position taken by the ACM is totally at variance with that of the CBT; which champions the prioritization of the interests of the company's creditors with legal rights to its properties to the exclusion of all non-right holders' interests.

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[96] Mokal (n 94)
[97] Thomas Hobbes, *The Leviathan* (Penguin 1985) pg. 35
[98] Etukakpan (n 18) pg. 69
[99] Ibid

In fact the ACM, as advanced by its proponent, is intended to accommodate and resolve the substantive goal of fairness with the procedural goal of transaction cost efficiency.[100] This theory has however been criticized as not being in connection with facts.[101] For instance, the actions of creditors in an insolvency scenario are triggered by wider considerations than pure economic rationality and, as such, creditors do not and cannot act rationally all the time.[102] The model also regards all parties as free and equal, while in real life the parties may not be blessed with ideal qualities.[103] In fact the individual conceptions of fairness or justice may differ considerably as influenced by religious and philosophical beliefs.[104] It also argued that this theory fails to propose precise principles on how the conflicting interests should be accommodated, Further, it is argued that this theory is actually based on assumptions, such as everyone being ignorant, which are far from reality. This is primarily because the series of presuppositions can hardly replicate the complex realities of a business life or the many possible decision makers and the matrix of circumstances in which the decisions have to be reached.[105]

2.3 OBJECTIVES AND PRINCIPLES OF CORPORATE INSOLVENCY

The significance of the theories of corporate insolvency analysed is to demystify the proper purpose of the law. It is appreciated that the goal or objectives 'depend somewhat on what theory of insolvency law is adopted.'[106] The following discussions will briefly elucidate comparatively the objectives and principles of corporate insolvency law between the UK, Mauritius and Kenya.

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[100] Mokal (n 94)
[101] Goode (n 7) pg. 78
[102] Ibid
[103] Riz Mokal Corporate Insolvency Law: Theory and Application (Oxford University Press, 2005) pg. 87
[104] McCormack (n 35) pg. 30
[105] Ibid
[106] Keay & Walton (n 38)

2.3.1 Mauritius

Mauritius has a hybrid legal system which combines both civil and common law practices, due to its history of having been both French and a British colony. The nature and character of their legislation reflects the historical influences. For example, all types of security provided for under the Civil Code are available, but the fixed and floating charges are preferred by banks.[107] The corporate insolvency framework in Mauritius was previously governed by multiple laws which included: the Bankruptcy Ordinance 1888, the Protected Cell Companies Act 1999, the Companies Act 1984, the Companies Act 2001 and the Insolvency Act 1982. All these Acts were oriented almost exclusively towards liquidation, which in practice produces little or no return to unsecured creditors, and a comparatively low return even to non-bank secured creditors.[108] However, the reforms brought in by the Insolvency Act 2009 changed the focus of the Mauritian insolvency framework. This statute came into force in June 2009 with a thrust to principally consolidate and modernize the insolvency legal framework by updating and integrating a modern and comprehensive regime.[109] Notably, the statute embodies four insolvency procedure options namely restructuring and workouts, administration, receivership and liquidation.[110]

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[107] World Bank, Report on Observance of Standards & Codes Mauritius Insolvency and Creditor Rights Systems (Washington, world Bank, 2004) pg. 4

[108] World Bank, *Report on Observance of Standards & Codes Mauritius Insolvency and Creditor Rights Systems* (Washington, world Bank, 2004) pg. 4

[109] Gilbert Noel, 'Recovery Options Against Mauritius Incorporated Entities' (2011) available in http://www.applebyglobal.com/articles-2011/recovery-options-against-mauritius-incorporated-entities-(gilbert-noel)-october-2011.pdf accessed on 18/2/2014; Also see Prabha Chinien, 'The Mauritius Insolvency Act: A New Approach' (2014) 4 INSOL World 32

[110] See Insolvency Act 2009 sec Part III and Iv which establishes and details the procedures

The predominant objective of the Mauritian insolvency framework is spelt out in the Insolvency Act 2009 as '… to amend and consolidate the law relating to insolvency of individuals and companies and the distribution of assets on insolvency and related matters'.[111] This objective was a result of the weaknesses experienced by having the relevant laws spread out in a number of statutes. It must however be appreciated, that the reforms sought to achieve more than consolidating and modernizing the insolvency framework. The other objectives that can be gleaned from the Insolvency Act are as follows:[112]

a) to establish straightforward and fair procedures for resolving insolvency;
b) to provide alternatives to bankruptcy procedures for the rehabilitation of businesses, in particular options for workouts and administration as alternatives to their outright winding up;
c) to give greater protection to employees;
d) to address the issue of cross-border corporate insolvencies.

The out-of-court restructuring guidelines for Mauritius published in 2013 provide further indications of the underlying principles of the insolvency framework.[113] For instance, the guidelines were intended to provide debtors and their creditors with a framework based on international best practices in this field.

Hitherto, the Mauritian insolvency framework was not completely lacking in business rescue mechanisms. However, restructurings were conducted under the company legislation, which

[111] See the Insolvency Act 2009 on the introduction page of the legislation which explains why the statute was enacted. (Mauritius)
[112] Generally see the Insolvency Act Part III which details on winding up and alternatives(Mauritius)
[113] See the Insolvency Out of Court Guidelines available in http://companies.govmu.org/English//DOCUMENTS/NIPG.PDF accessed on 18/2/2015

permits amalgamations, takeovers and compromises which were markedly inadequate.[114] The deliberate introduction of rehabilitation procedures as an alternative to winding up is a clear indication of the scope of interest the law seeks to protect. This eradicated a major weakness of the previous legal framework for corporate insolvency in Mauritius. In essence, the law sought to embrace a pronounced rescue culture and so to provide a better platform for the negotiation of restructuring viable businesses. Besides, the law has defined the rights and obligations of creditors and in particular redefined the priority of claims in the distribution of assets in liquidation and gives workers' unpaid salaries higher priority than the claims of secured creditors.[115] The reform realized through enactment of the Insolvency Act of 2009 inculcates a broad objective of an efficient insolvency regime that effectively balances the interests of the stakeholders affected by insolvency.

A reflection on the Mauritius corporate insolvency laws, evaluated against the theories discussed in 2.2 above, leads to a general conclusion that the older regime was aligned with the creditors' bargain propositions. This is because the law was oriented almost exclusively towards liquidation which in practice is a collective procedure. It is recognized that liquidation is not ordinarily a debt collection device but is primarily a procedure of bringing a business to a close. Arguably, it can be a very powerful debt collecting device in its own right because it is one of the ways of enforcing a judgment after a claim. Conversely, the latest reforms are more aligned with the traditionalist theories, primarily because of addressing the social problems, such as the needs of employees. However, each of the theories can apply to varying levels of generalization.

[114] Company Act 2001, sections 245 and 246; Takeovers under the Company Act 1984, Schedule 15, remain applicable under CA 2001.
[115] Insolvency Act 2009 Schedule Four (3)

2.3.2 United Kingdom

Goode summarizes the aims of English corporate insolvency law as addressing the questions of priority and control.[116] Basically priority concerns the order of distribution of assets of an insolvent company, whereas control is essentially procedural in nature and is designed to safeguard the assets by placing them in the hands of a manager.[117] The objectives of the English insolvency law, in contrast to those of Mauritius and Kenya, are easily discernable as the statutes clearly state them. For instance, the purposes of administration are specified in the Insolvency Act 1986 with a hierarchy of three objectives, which may be paraphrased and simplified as (a) rescuing the company as a going concern, (b) achieving a better result for the creditors as a whole than would be possible in an immediate liquidation (c) realizing property to make distributions to one or more secured or preferential creditors.[118] It will be appreciated from the list of objectives that the purpose of administration takes on a holistic approach, whereby it attempts to bring about an alternative result to that of liquidation.[119]

It should be added that a consideration of the purpose and objectives of the UK corporate insolvency regime is incomplete without the mention of the Cork Report[120] which laid down the foundations for the insolvency framework as well as the values that should be pursued when a company is in financial distress. It is acknowledged that it has been many years since the Cork Report was published but arguably the objectives envisioned in the report are

[116] Goode (n 3) pg. 60
[117] Ibid
[118] Insolvency Act 1986, Schedule B1, paragraph 3
[119] John Wood, 'The objectives of administration' (2015) 36 Company Lawyer 1, 1-7
[120] Cork Report (Report of the Review Committee on Insolvency Law and Practice) (1982), Cmnd 8558

'alive' in the current UK insolvency laws. In summary, the aims of an insolvency process as envisioned by Cork included the following, amongst others:[121]

a) A law that recognizes that, since the creation of wealth depends on systems of credit, the system should, as a correlative, have an insolvency procedure that helps the casualties. In essence, the effects of insolvency are not limited to the private interests of the insolvent and his creditors, but other interests of society or other groups in society are also vitally affected by the insolvency and its outcome.[122]
b) A need for law that facilitates the efficient closure of non-viable businesses but yet provides means for the preservation of viable commercial enterprises capable of making a useful contribution to the economic life of the country.[123]
c) A looming threat of insolvency should be recognized and dealt with at an early, rather than a late stage.
d) A regard to the rights of creditors, including the unsecured.
e) The assets of the insolvent, which should properly be taken to satisfy his debts, with minimum delay and expenses.
f) A distribution of the proceeds of the realizations among the creditors in a fair and equitable manner, returning any surplus to the debtor;[124]

Collectively, the proposals by the Cork Committee and subsequent inclusion in the objectives in Sch.B1, as noted above, demonstrate an underlying principle that has fundamentally shifted from facilitation of liquidation to a new way in which the company is managed in

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[121] Cork Report: Report of the Review Committee, Insolvency Law and Practice (Cmnd 8558, 1982); Also see a detailed outline on Ruzita Amri and Adilah AbdRazak, 'Theories, Objectives and Principles of Corporate Insolvency Law: A Comparative Study Between Malaysia and UK' A paper presented in 3rd International Conference on Management on 10 - 11 June 2013. Hydro Hotel, Penang, Malaysia
[122] See para 198 and amplification in paras 203-4
[123] See para 198(j) and amplification in para 204
[124] See para 232

insolvency. In essence, the reforms embraced a rescue culture which was further fostered by the Enterprise Act 2002, which virtually abolished administrative receivership in an attempt to build a more efficient model, better suited to rescuing a distressed company.[125] As is typical, the English law offers two alternative routes to an insolvent company: reorganization, on one hand and liquidation in another. The two alternatives are very specific objective starting with restoration of a viable company to profitability. This is achieved through administration or workouts. The maximisation of returns to creditors is achieved through a collective debt collection procedure, a significant aspect of both the administration and liquidation procedures. Besides, the interests of creditors are in principle given precedence over those of others. For example in administration in the UK, two objectives focus on creditors namely:[126]

a) achieving a better result for the company's creditors as a whole than would be likely if the company were wound up; and
b) Realising property of the company in order to make a distribution to one or more secured or preferential creditors.

A reflection on the UK corporate insolvency law against the theories considered above leads to a conclusion that the law has always promoted the protection of communitarian and creditors' interests at almost all stages with varying levels. To start with, the UK laws have been traditionally regarded as 'creditor friendly' because of the strong priority given to the protection of creditors' interests.[127] In particular, prior to the enactment of the Insolvency Act 1986 the law contained the administrative receivership procedure and a scheme of arrangement. A

[125] Sandra Frisby, 'Making a Silk Purse out of a Pig's Ear -Medforth v. Blake &Ors' (2000) 63 MLR 413-423
[126] Insolvency Act 1986, Schedule B1 as updated by the Enterprise Act 2002
[127] Stuart Gilson, Creating Value Through Corporate Restructuring: Case Studies in Bankruptcies, Buyouts and Break ups 2nd edition (John Wiley & Sons, New Jersey, 2010) pg.442

receiver can best be described as 'an independent contractor whose primary responsibility is to protect the interests of his appointer'.[128] At the same time, he also owes a duty to his deemed principal, the company which entails refraining from conduct that damages the goodwill, and a separate duty, by statute, to observe the priority given to preferential creditors.[129] Arguably, if receiver approaches an insolvency scenario carrying the aforementioned obligations, the administrative receivership can potentially be used to address more than the interest of the appointing creditor.

Nevertheless, the existence of such obligations cannot prevent a receiver manager from promoting only his appointer's interests and ignoring other unsecured creditors. In fact, the two procedures were criticized as inadequate, basically because in administrative receivership, the floating charge holder wielded more power and in schemes of arrangement the procedure was too 'procedurally cumbersome and failed to safeguard sufficient and effective protection for the company'.[130] It should however not be lost that, much as the administrative receivership procedure has always been regarded as creditor friendly, it was not designed to be a collective procedure, but rather a debt enforcement remedy available to a creditor holding a floating charge. In essence, it is an individual debt collection device that fails to fit in neatly to the creditors' bargain ideologies.

The reforms that were championed, starting from Cork's list of aims, are more articulate that insolvency law should promote the survival of viable businesses. If this is achieved, other

[128] See *Medforth v Blake* [1999]3 All ER 97
[129] See *IRC v Goldblatt* [1972] 1 Ch 498
[130] Rebecca Parry, 'United Kingdom: Administrative Receiverships and Administrations' in Katarzyna GromekBroc, and Rebecca Parry, *Corporate Rescue in Europe: An overview of Recent Developments from Selected Countries in Europe* (Kluwer Law International, 2004) at p.265

interests such as those of employees and the economy at large are equally protected. Such engagements endorse the aspects of communitarianism. Besides, the recognition in the Cork Report[131] of private interests of the insolvent, the creditors, the public and employees who are affected by company insolvency demonstrates a clear inclination towards the communitarian view. The same proposals were realized through the enactment of the Insolvency Act 1986, which introduced more elaborate corporate rescue procedures. In particular it introduced alternative measures such as the Company Voluntary Arrangements (CVAs). Traditional CVA was done without moratorium and was documented to be relatively rare because the company remains vulnerable to attack by creditors while the proposals are being put together.[132] Later, CVA with Moratorium was introduced for eligible companies in order to remedy a perceived weakness in the traditional CVA procedure. It was hoped that the availability of a moratorium during the period of formulating and presenting a CVA proposal to creditors and such proposal being approved would address this weakness and, as a result, increase the use of CVAs and the incidence of corporate rescue.[133] On the contrary, the CVA with moratorium procedure is in fact very little used.[134] Generally, the existence of a CVA is one of the pointers of general ideologies of a traditionalist view of insolvency law designed not just to enhance and allocate an insolvent firm's value among existing entitlement holders but also protect interests, other than those of creditors, of those who are likely to have been particularly harmed by the debtor's insolvency

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[131] Cork Report (n121)
[132] Simon Parker 'Pre-pack Administration vs Company Voluntary Arrangement (CVA)'available in www.tcii.co.uk assessed on 8th August 2015
[133] Adrian Walters and Sandra Frisby, 'Preliminary Report to the Insolvency Service into Outcomes in Company Voluntary Arrangements, (March 23, 2011) available at SSRN: http://ssrn.com/abstract=1792402 or http://dx.doi.org/10.2139/ssrn.1792402 accessed on 9th March 2016
[134] Ibid

2.3.3 Kenya

As far as Kenya's theoretical framework is concerned, no attention has been given to the theories of insolvency law. Besides, the law has been static, as detailed in Chapter Three of this thesis. As such, the basic objective that stands out from the relevant sections, which are Part VI- IX of the Companies Act is to facilitate closure of a company. In consideration of this, the focus of discussion below will primarily be a reflection of what each of the theories could offer to Kenya, as an emerging economy.

2.3.3.1 Application of Creditors' Bargain Theory

Attraction of direct foreign investment is crucial for Kenya, as articulated in the development programme branded 'Kenya Vision 2030'.[135] The policy has clear objectives of boosting economic activities geared towards making Kenya a globally competitive and prosperous nation with a high quality of life by 2030.[136] One of the areas specified is globalization and technological innovations; which are considered critical in creating new and more investment opportunities for local enterprises. Second is to increase Kenya's competitiveness in attracting foreign direct investment. The idea envisioned is to enable Kenya to bring in more business and employ more Kenyans. This is anchored on a widely acknowledged trend that high value foreign investment tends to make the greatest contribution to the national economy of the host country. In fact, in contrast with developed countries and other developing countries, the stock and flow of foreign direct investment to Kenya and Africa at large has always been small.[137] That trend continues today, as shown by the yearly reports of global FDI and the reasons for this decline could be numerous, ranging from inadequate leg-

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[135] Kenya Vision 2030, A Globally Competitive and Prosperous Kenya (Nairobi, Kenya, 2007

[136] Ibid

[137] Kojo Yelpaala, 'Cost and Benefits from Foreign Direct Investment: A Study of Ghana' (1980) 72 N. Y. J. INT'L & COMP 2, 81-82 (1980)

islation or inefficient enforcement mechanisms, to limited entrepreneurial spirit.[138] In the same spirit, there is a growing trend among developing economies to reform their insolvency laws with a view to attracting and facilitating foreign investment, as part of the activities in the poverty reduction strategy.[139]

Therefore, for Kenya to improve its attractiveness to foreign investment, legislative reforms have to be used as a key incentive of creating a favourable legal environment. Evidence shows investors' decisions as to where to invest are influenced by financial and political risks, as they are key to stable and predictable business environments.[140] In essence, investors are keen on the existence of efficient institutional and legal systems as they provide a degree of predictability.[141] An approach based on the CBT arguably offers that crucial predictability. In particular, the focus on creditors' entitlements has merits, especially in a liquidation where a business has little left than to ensure a fair distribution of assets of an insolvent business.

It is notable that the existing insolvency framework in Kenya has an outstanding nature of reflecting the CBT views courtesy of the colonial history. In reality, insolvency fundamentally leads to liquidation and this resonates through the existence of receivership and liquidation procedures whose main agendas are to protect the interest of creditors.[142] However, the limitation of CBT, as discussed earlier, is/will be more pronounced in a developing econ-

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[138] UNCTAD, *World Investment Report 2009: Transnational Corporations, Agricultural Production and Development* (United Nations, 2009) pg. 42-46
[139] U Miller and S Ziegler, *Making PRSP Inclusive Project* (Project Print, Munich 2006) 4
[140] Ibid
[141] Giuseppina Talamo, 'FDI, Mode of Entry and Corporate Governance: Geography, Structural Change and Economic Development: Theory and Empirics, (2010) available at http://ssrn.com/abstract=1984530 accessed on 16th Nov 2012
[142] Companies Act cap 486 sections 212 and 228

omy. The primacy of the creditors' interests will result in undermining other interests vital to boosting the economy. For example, evidence shows that firms experience a reduction of corporate innovation and intensity of patterns when creditors' rights are strong.[143] As such there is a need for a regime that balances between protecting the interests of creditors without ignoring the impacts of insolvency. In fact, many jurisdictions have recognized that rehabilitation of business is a legitimate factor to be considered in insolvency decision making.[144] For instance, the US Congressional record on the Bankruptcy Code says that:

> '...the purpose of business reorganization is to seek to restructure business finances so that it may continue to operate, provide its employees with jobs pay its creditors and provide for its stock holders.'[145]

Elsewhere, similar sentiments were expressed and in particular; the objectives of Ch 11 have been described in the following terms:

> 'In proceedings under the reorganization provisions of the Bankruptcy Code, a troubled enterprise may be restructured to enable it to operate successfully in future. By permitting reorganization, Congress anticipated that the business would continue to provide jobs, satisfy creditors' claims and to produce return to its owners. Congress presumed that the assets of the debtor would be more valuable if used in a rehabilitated business than if sold for scrap'.[146]

[143] Viral Acharya, Krishnamurthy Subamanian, 'Bankruptcy Codes and Innovation' (2007) 22 Review of Financial Studies 4949-4988
[144] Korobkin (n39)
[145] Gerard McCormack, `Control and corporate rescue - an Anglo-American evaluation' (2007) International & Comparative Law Quarterly 56(3) 515-551
[146] McCormack, (n 144)

As such, the fundamental purpose of reorganization is to prevent a debtor from going into liquidation with attendant loss of jobs and possible misuse of economic resources.[147] Therefore, it is crucial that the laws facilitate innovations and ensure continuity of businesses, so that those whose livelihoods depend on it do not join the millions wallowing in unemployment, a burden every developing economy struggles with.

2.3.3.2 Application of Communitarian Theory

The application of this theory to a developing economy will be a challenge. As noted in section 2.2.2 above, the interests that insolvency law should protect, according to this theory, are so wide that they cease to be identifiable. Undoubtedly, community interests are the objects of desired social welfare goals that policy makers the world over ought to consider when designing insolvency laws, a flexibility offered by the communitarian approach. Accordingly, insolvency law should operate in a manner from which the community can benefit; it should rescue viable businesses whenever possible and facilitate liquidation where necessary. However, stretching the law to unknown limits makes it vague, besides presenting complexity as to how such a law should be structured to cover all interests– a challenge to policy makers. Further, inasmuch as such a law may enjoy flexibility, it will lack predictability and so investors will not be able to assess the risk of investment. As such, the law should strike a balance between the rights of those willing to invest and those who become victims as a result of those investments. Furthermore, a system that relies on the courts to balance the conflicting interests cannot be effectively implemented in a developing economy where specialised bankruptcy courts are lacking. Besides, the general courts that engage in all manner of legal matters will be ill-equipped to provide a reliable balance. In essence, the

[147] Goode (n 102 or n 7 if you have changed it at 102) pg. 75

establishment of a legislative framework for a developing economy must be in tandem with realities of insolvency practice and what can feasibly be achieved through effective regulation.

2.3.3.3 Application of Value Based Theory

This theory contradicts the CBT and corresponds to the communitarian approach. The underpinning philosophy is that corporate insolvency laws should protect wider considerations than the creditor's interests. The Kenyan circumstances of nurturing businesses that can provide employment and be part of the process of elevating the living standards of its citizens will easily be accommodated in the wider scope it incorporates. However this theory introduces a unique aspect of considering the human attributes that a corporate business can embody. It might help to bear in mind for policy makers that a corporate body can play out its moral, political and social values. The question is whether the bankruptcy system is suited to such a task. The restructuring of the corporation, for example, may inevitably entail a change in the ownership structure of the company as well as the redistribution of losses between various stakeholders, including employees. Legal systems can attempt to create a balanced and legitimate insolvency regime which enables corporate restructuring and which includes employee participation to a varying degree. Such a precise goal can be pursued. However, how will insolvency legislation cater for the political aspects of a corporation? It is appreciated that corporations can participate in politics by financing political agendas. In fact such engagements can be beneficial but may never be devoid of instances where corporations are manipulated to pursue political interests that are detrimental, hence becoming vehicles of injustice. Therefore, it is submitted that insolvency law, like any other legislation, can only address a certain number of issues in any given society. As such, while this

theory presents an interesting possibility, it is difficult to comprehend it actually applying in an insolvency scenario.

2.3.3.4 Application of TPT

LoPucki's view that a collective insolvency proceeding should account for all those with various degrees of economic interest in the company, resonates well with the Kenyan goals of creating job opportunities as a means of empowering its citizens to be able to adequately earn a living. In particular, the TPT position that the team contract has to continue during bankruptcy allows for reorganization of the business and more importantly, should the business be sold to a new owner, it supports the retention of the employees in their employment. This is a good view that the law should reflect. Besides, business survival of viable entities should be one of the key objectives that a developing economy's insolvency law should embrace. This is because insolvency reforms, where they have been done effectively, have led to significant developments in economies being experienced, particularly in Latin America and Asia.[148] To a Kenyan scenario such an approach would allow both locally grown business, as well as multinational firms to participate in promoting the government's agenda of securing employment. Besides, both local and multinational firms could face financial distress and the liquidation of these firms is often neither desirable nor socially efficient.[149] Serious social issues may erupt due to large scale redundancies of workers, and this could also increase the burden of social security. In extreme cases, it has the potential to threaten stability through protests or crimes, which inevitably invoke political crisis and social chaos.

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[148] Stephen Lubben, 'Financial Distress and Emerging Markets' (October 10, 2008) Seton Hall Public Law Research Paper No. 1282355 available at SSRN: http://ssrn.com/abstract=1282355 accessed on 7th September 2012

[149] Lubben, (n 149)

2.3.3.5 Application of Multiple Approaches

The merit that the Multiple Approach theory offers to Kenya, is illuminating the issues that the law makers should consider. The arguments advanced in this theory substantially demonstrate the danger of focusing on creditors alone. However, this theory fails to give clarity on how the law should address the issues. Therefore, Kenya, like all emerging markets, should attempt to balance effective facilitation that increases consumer lending and attraction of investors, with limiting the impact that corporate failure can leave on individuals and the national economy. In addition, because of its reliance on the courts, achieving its full potential necessitates the existence of legal institutions that are stable and efficient. It is submitted that this theory voices current realities that the jurisdiction faces and a critical examination of many jurisdictions validates the concerns about the consequences of business failure. Kenya's, approach to corporate insolvency law is fully aligned to the protection of creditors, which practice has led to closure of businesses, leaving many jobless.

In contrast, the UK, from which Kenya inherited the law, has moved away from that prior approach. The UK administration's main purpose is, amongst others, to rescue the company and the whole of its undertaking as a going concern.[150] Another good example is the US Chapter 11, whose purpose is to provide the debtor with legal protection necessary to give it the opportunity to reorganize and thereby to provide creditors with the going concern value; rather than the possibility of a meagre satisfaction that Chapter 7 liquidation offers.[151] Further, it is interesting to observe that bankruptcy objectives in jurisdictions like France are

[150] Insolvency Act 1986 sec 8(3)
[151] McCormack n (35) pg.79

safeguarding the business, maintaining firm operations and lastly discharging liabilities.[152] As such, they have for a long time operated a system of heavily rescue centred laws, primarily for the protection of employees. Nonetheless, France acknowledged that its initial rescue agenda was too ambitious and it has subsequently allowed companies to directly proceed to winding up in some cases.[153]

This divergence of approaches of the aforementioned jurisdictions clearly indicates that none of the proceduralist or traditionalist approaches offers a clear-cut solution as to what the insolvency law should seek to achieve. The different theorists are responding to different concerns and it may be observed that these theorists are often describing disparate aspects of the same phenomenon, rather than disagreeing about certain simple claims about law. Legal systems are extremely complex and inevitably a theory about law can capture only a portion of the relevant fact. As such, a realistic approach that borrows the best from each school and develops an appropriate view that reflects a jurisdiction's particular circumstances is necessary.

For instance, it is prudent to consider legislating along the lines of approaches that are not exclusive to creditor's wealth maximization, despite its merits. Emphasis too should be placed in creating an institutional framework that encourages international co-operation with multinational enterprises. The policy should also address and eliminate transaction costs which discourage foreign investors and hamper the expansion of domestic ventures. Most

[152] Robert Weber 'Can the Sauvegarde Reform Save French Bankruptcy Law?:A Comparative Look at Chapter 11 and French Bankruptcy Law from an Agency Perspective' (2005) 27 Michigan Journal of International law 257

[153] Katarzyna Gromeck and Rebecca Parry Corporate Rescue: An overview of Recent Developments from Selected Countries in Europe (Kluwar Law International, 2004) pg. 5

importantly, for any tangible result to be realized through legislative reform, the law should be cognizant and true to the challenges facing developing economies with poor information acquisition technologies and bank-based financing systems.[154] In addition, account should be taken of unique realities, such as limitations of equity markets in developing economies and a lack of diversity in financial instruments resulting in relatively small and nominal resources being invested.[155]

2.4 Relevance of theories to insolvency reforms

Various views on corporate insolvency law have been effectively articulated and communicated using theories as a platform. One might ask, of what value are such views to the development of insolvency law, especially to the jurisdiction in focus? It is appreciated that the theories discussed are primarily based on western economies and philosophies of advanced legal systems. The dilemma that immediately crops up is how relevant these theories are to a Sub-Saharan African country with its unique circumstances. In fact, a number of reasons could be advanced against their relevance. To start with, it has been recognized that bankruptcy laws are a vital indicator of the attitudes of a legal system.[156] As such the theories will reflect the attitudes of the jurisdiction on which their development was based. Besides, insolvency systems have been described as social tools, which are not only value-laden but require formulation with care in order to reflect the particular values of a culture.[157] Undoubtedly, variances in culture and values exist. For example, the UK had a popular negative attitude towards debt and bankruptcy which influenced the creditor-friendly nature of

[154] Lemma W Senbet , Tracy Y Wang, 'Corporate financial Distress and Bankruptcy: A Survey' (2012) available at http://ssrn.com/abstract=2034646 Accessed on 3rd Nov 2012
[155] Ricardo J Caballero 'The Future of the IMF' (January 7, 2003) MIT Department of Economics Working Paper No. 03-03. Available at SSRN: http://ssrn.com/abstract=372840 accessed on 19 October 2012
[156] Nathalie Martin 'The Role of History and Culture in Developing Bankruptcy and Insolvency Systems :The Perils of Legal Transplantation' (2005) 28 BC Int'l & Comp Law Review1,4
[157] Keay and Peter (n 38)

the insolvency procedures and perhaps the prevalence of equity over debt financing.[158] In contrast, in the US, business failure is thought of as a misfortune rather than wrongdoing and the US therefore more forgiving towards bankrupts and perceived as debtor friendly.[159] The distinct divergence between the UK, having negative attitudes in contrast to America, is arguably no longer so marked, as evidenced a number of reforms which promote rescue and reorganization and a rise in creditor influence in the US.[160] Nevertheless, it serves to demonstrate how attitudes influence the law. Further, the extent to which the law of a particular country observes or departs from the principle of collective maximization of returns for creditors in insolvency is directly related to its pre-insolvency economic and social policy.[161] As such there is an obvious connection between national insolvency policy and the social context in which it is implemented.

On the surface, it may be gleaned from the foregoing discussion that there is no merit in applying the existing theories developed using western economies to an African context. However, theories in the natural and social sciences attempt to describe the world in a way that we can understand why the past events occurred or predict how the future events will unfold.[162] In essence, it involves the use of past experiences which are likely to be so different from the prevailing circumstances, and equally far removed from the future reality. However, the divergence does not necessarily negate the utility. Arguably, legal theories, just like scientific theories are based on historical inclinations, and they can still be informative.

[158] McCormack (n 35) pg. 126-130. It details how the attitudes in different jurisdiction in relation to how the law reflects.
[159] Gabriel Moss, ‘Chapter 11: An English Lawyers Critique’ (1998) 11 Insolvency Intelligence 17: 18-19
[160] David A Skeel, ‘Creditorst Ball ‘Creditors' Ball: The 'New' New Corporate Governance in Chapter 11’ (2003) Faculty Scholarship, Paper 29
[161] Goode, (n 49) at 2-09
[162] Bix (n 96) pg.13

Moreover, once it is clear what the purpose of the claim is, it helps in advancing an agenda. For instance, the understanding of the law and ability to predict its impact are crucial to an effective functioning of any law. Therefore, theories are arguably useful in enhancing a constructive interrogation of a legal pathway, considering that they are developed using existing legal realities.

Besides, it is important to highlight that there is evidence indicating trends in legal systems using foreign ideas to reform their own regimes, or to measure the effectiveness of their own laws against those of other jurisdictions. In fact, is widely accepted as an efficient means of learning about other legal cultures and improving on one's own legal system.[163] A perusal of reforms in the area of corporate rescue across many nations will identify the pervasive influence of Chapter 11.[164] In France for instance, the Sauvegarde procedure is analogous to the US Chapter 11 with a number of key similarities, such as existing management remain in place, an automatic stay on enforcement action, ipso facto provisions that are unenforceable by the counterparty and the ability to bind creditors. These features are based on similar majorities as those required under Chapter 11.[165]

In addition, New Zealand's efforts to reform its laws acknowledged that the changes were driven by the Australian experience and culminated in the adoption of Australia's voluntary administration regime as an alternative to liquidation for companies capable of being reha-

[163] Edward J Eberle 'The Method and Role of Comparative Law' (2009) 8 Washington University Global Studies Law Review 3:451
[164] David Milman, *National Corporate Law in a Global Market: The UK Experience in Perspective* (Edward Elgar Publishing Ltd, 2005) pg 9
[165] Adam Plainer, Sally Willcock, 'Comparative Guide to Restructuring Procedures' available in http://eurorestructuring.weil.com/wp-content/uploads/2013/02/Comparative-Guide.pdfacssed on 8th August 2015

bilitated.[166] China, when reforming its insolvency laws, took account of models in the US and Europe, and developed a distinct law with Chinese characteristics, reflecting its own economic, legal and cultural peculiarities.[167] Closer home is the Tanzanian example which has borrowed largely from the UK in its recent insolvency law reforms.[168] All the aforementioned are typical examples of jurisdictions adopting and adapting foreign models. It is argued, therefore, that since there is substantial evidence that the modern way of reforming legislation involves a lot of borrowing from other jurisdiction, the foreign theories can equally be borrowed, with modifications, to help in understanding a domestic law.

Theoretical debates which are actually about social policies underlying the insolvency procedures have arguably influenced court opinions and legislative enactments in many jurisdictions.[169] In the United States, for instance, the rescue attempts that are akin to a rebirth of a business in trouble are available only to 'honest debtors.'[170] This reflects a moralistic pressure in fresh start analysis. It was noted in the 'ethical vision' theory that the philosophical foundation of insolvency has to consider morals. To a developing economy, a theoretical and philosophical basis for insolvency law provides a lens through which a critical analysis of legislative agendas can be weighed, considering that all parties affected by insolvency law are important to the economy. The Creditors' Bargain argument is useful in identifying and explaining why the law should promote a collective device. Jackson articulated clearly that it would reduce strategic costs if creditors were required to co-operate. This is essen-

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[166] Blanca C Mamutse, 'The Paripassu Principle in Insolvency Law: An Analysis of the Judicial Construct and its Suitability for Modern Needs' PhD thesis awarded by the University of Westminster 2009

[167] Rebecca Parry and Haizheng Zhang, 'China's New Corporate Rescue Laws : Perspectives and Principles' (2008) Journal of Corporate Law Studies 113

[168] For details on Tanzanian Insolvency Law Reforms, See S Rajani & FS Ringo 'Tanzanian Updates Corporate Insolvency Legislation' 2007 23 IL and P 76

[169] Frost (n 28)

[170] Ibid

tially an accounting aspect of insolvency which the law must be cognizant with. Besides, the CBT's central idea that the creditors' bargain is solely for maximizing creditors' pre-existing interests is an approach that most creditor-friendly jurisdictions have been following. Much as honouring pre-insolvency agreements may negate wider interests, like efforts to reorganize, as articulated through inclusive theories, it has its own merits grounded in lenders' behaviour. For example, lending institutions will limit credit creation for businesses if lenders are at risk of their status as secured creditors being interfered with upon the liquidation of their debtors. Besides, a general objective of corporate insolvency law has been acknowledged as the reduction of uncertainty, promotion of efficiency and fair and equitable treatment of participants.[171] It is crucial therefore for a developing economy to ensure that its insolvency regime promotes certainty as well as helps to simplify risks associated with lending, as this will affect the availability of credit essential for investments to increase. The UK has benefitted from recent improvements to its law and, as such, the recent shift to a more rescue oriented system is a response to dynamics that have shifted in the society. It has dawned on many that the preservation and growth of value are important and that the social significance of insolvency law requires much more than the enforcement of private rights. As such, a theory like the Team Production Theory agitates for recognition of all the stakeholders' contributions. To the Kenyan jurisdiction, a reflection of the existing laws through the lens of insolvency theories is worthwhile as it helps in appreciating what role the law needs to prioritize.

[171] See Report of G-10, Report of Contact group on the Legal and Institutional Underpinning of the International Financial System(September 2002) Available in http://www.bis.org/dcms/fd.jsp?p=1&uri=/publ/gteno6.htm accessed on 1st Nov 2012

2.4.2 Important insights

The divergence of views captured in the theoretical debates reflects an actual reality noted earlier by legal scholars like Rawls, who noted that life creates differing self- interests.[172] Nonetheless, a deeper reflection on these theories on the foundations and appropriate policy objectives of insolvency law exposes a number of mutual points. To start with, the theories share the understanding that efficiency considerations justify the enforcement of contractual bankruptcy arrangements.[173] Therefore, a function that insolvency law serves is to provide the procedural and substantive framework to ensure efficiency. Secondly, the proponents of these divergent theories generally agree that preservation of the debtor's value is a key goal of bankruptcy. There is no attempt to dispute the suggestion that, if greater value can be realized by keeping a firm trading than by permitting it to be dismantled, then keeping the business alive is an appropriate use of bankruptcy process. Receiving the same unanimity is that insolvency systems should have a collective nature. As such, the primary role of an/the insolvency system is to replace the 'free for all' pursuit of individual claims with a statutory regime necessary for orderly collection and realization of assets.[174] Notwithstanding the debate on the choice of beneficiaries, in which of course each view would prefer to maximize their favoured beneficiary; insolvency law has a distributional role which requires cooperation from all the parties involved. Because of this, the insolvency system is regarded as laying down the fair terms of cooperation amongst all the parties affected by the peculiar circumstances brought in by insolvency.[175]

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[172] See Bix, (n 96) pg.111 where he refers to Rawls: *A Theory of Justice* (Revised edition, Oxford University Press, 1999)
[173] Irit Haviv-Segal, 'Bankruptcy Law and Inefficient Entitlement' (2005) 2 Berkeley Bus LJ 355
[174] (n 102 or n 7) pg. 8
[175] Mokal (n 52) pg.2

It is also notable that creditors are the common contenders and, as such, even those who are keen to pursue the communal interest must address how best to accommodate the creditors, to avoid the creditors making a bad situation worse. This is because creditors have legal rights to the properties of the debtor. For instance a charge holder can, with precision and using the law, realize the security, in contrast to other interests, such as the impact to the economy, which equally suffers the consequences of a failed corporation.

Further, despite the fact that these theories have a potential to influence policy objectives of diverse jurisdictions, the views do not take into account differing levels of economic development. It exposes the divergence of insolvency systems that exist in the world, as reflected by the emphasis that each theoretical views accentuates.[176] In reality an insolvency system of a well-developed jurisdiction might not necessarily be appropriate to an emerging economy. Therefore, Kenya would need to consider this divergence in the context of a developing economy with a view to developing a system that will not only be workable but also appropriate in boosting its national economy. Lastly, there is an evident emphasis on efficiency and an assumption that the protection of entitlements that arose prior to insolvency will maximize aggregate efficiency.[177] It is considered that the enforcement of prior entitlements secures the efficient planning of credit transactions by solvent corporations.[178] Insolvency law seeks to ensure that there is a fair and orderly procedure that handles the affairs of the insolvent debtor in a predictable way and guarantees that debts are satisfied as far as possible with as little delay and expense as possible.[179]

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[176] Robert K Rasmussen, 'Transnational Insolvencies Through Private Ordering' (1999-200) 98 Michigan Law Review 2252,2253
[177] Haviv-Segal, (n 174)
[178] Ibid
[179] Keay & Walton (n 38) pg. 21

2.5 CONCLUSION

The most controversial theory considered above is the CBT for its bias towards the protection of creditors' interests and upholding pre-insolvency rights. The rest of the theories largely agree that insolvency law's role should not be merely confined to maximizing returns to creditors, but that it should include other roles such as rescue (where viable), protection of employment, the public interest etc. It is acknowledged that the theoretical debate as to what the role of insolvency ought to be will remain vibrant and will still be evolving. However, insolvency law is a crucial tool in modern economic times. The results of empirical studies that have been done, suggest that the quality of domestic governance has an important quantitative impact on a country's ability to attract foreign investors who prefer to invest in countries with good governance.[180] In effect, the quality of governance is associated with efficient regulations as well as enforcement mechanisms. Amongst the most crucial pieces of legislation are those directly related with businesses, such as insolvency laws.

It was noted that different theories that explain the usage of insolvency law exist at different levels of generality and have varying applications and uses as explanatory tools. It became evident that bankruptcy laws must attempt to achieve different, sometimes incompatible goals, given that this legislation must determine what to do with the insolvent company and, at the same time, must not be a hindrance to credit flow for investment. Besides, there is not one theory that adequately reflects all the ideals, and, from the theoretical point of view, developing a bankruptcy law requires understanding and achievement involving a lot of trade-offs in the many interest to be balanced. While some theorists are creditor focused, resulting in an exclusive approach, others are inclusive, proposing that the bankruptcy law should

[180] Talamo (n 142)

consider the wider interest. Depending on which option – inclusive or exclusive – the policy makers embrace, it will be inevitable that the sphere of insolvency law will be extended beyond the protection of creditor interests, given the magnitude of impact that accompanies corporate failure. The extent of inclusion will be very subjective to the circumstances of any given jurisdiction. The theories illuminate the realities that the insolvency legislation has to struggle with.

The UK insolvency law, as evidenced from the aims championed by the Cork Report and reflected in the objectives of the Insolvency Act 1986 and Enterprise Act, can be regarded as reflecting aspects of the communitarian and multiple values approaches. The law caters for interests such as those of employees and provides an opportunity for the rehabilitation of a business entity. In fact, it is evident that the issue of corporate insolvency and the mechanisms for its resolution established in bankruptcy regulations can influence the financial decisions of firms and investors, even in those situations in which financial distress are not expected. Equally, the Mauritian insolvency laws in the recent reforms mirror generally the inclusive views. However, the Kenyan insolvency system employs an exclusive approach with a pronounced emphasis on creditor interest protection. In addition, the realities that Kenya as a nation has to consider in its insolvency reforms are, in a way, opposing. For example, the need for predictable and precise legislation that will attract investors naturally leans more on the CBT's approach. However, the glaring poverty, unemployment and other challenges would be better catered for in an inclusive approach. Nonetheless, Kenya will have to engage in a trade-off, as done in other jurisdictions, especially the western economies which have modern restructuring procedures. In a nutshell, these theoretical debates have highlighted the interests at stake. It was noted that culture has for a long time, and in

many jurisdictions, influenced the law, yet the new wave of reforms are not premised on cultural dynamics. As such, Kenya in its legislative reforms can experiment and learn from experiences of other jurisdictions as it undergoes the modern economic transformation.

CHAPTER THREE

3.0 IN-DEPTH ANALYSIS OF KENYAN INSOLVENCY LAW AND POLICIES BASED ON INTERNATIONAL BENCH MARKS

INTRODUCTION

Insolvency law is considered an essential tool in modern economies as it structures the flow of credit that fuels developments. As such, countries the world over have been actively engaging in reviewing, re-evaluating and reforming their laws in this area. There is an increased interest in the design of insolvency systems from a perspective of resource allocation, efficiency, and stability as well as equality and fairness.[1] In this quest for reform, the motivating factors that led to any reforms are crucial in understanding the intricacies of the approaches taken. In fact, literature reveals that reforms in developing economies are mainly undertaken as part of the initiatives by countries to create a favourable environment to attract foreign investment.[2] In broader terms, the underlying reasons for such activity are the need to facilitate growth of trade and investment, and attract direct foreign investment with view to reducing poverty.[3] As such, it is a credible course of action but arguably wanting in urgency if other local needs and priorities are neglected. Kenya should not be left behind if it has to fit and benefit in the global market. Actually, the changing economic climate and pressure from multilateral institutions have emphasized the need to have efficient and effec-

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[1] Joseph E Stiglitz, 'Bankruptcy Laws: Some Basic Economic Principles' in Stijn Claessens, Simeon Djankov, and Ashoka Mody, (eds.) *Resolution of Financial Distress* (World Bank Institute, Washington, D.C, 2001) pp. 1-23

[2] Eric Neumayer & Laura Spess, 'Do bilateral investment treaties increase foreign direct investment to developing countries?' (2005) 33 World Development 1567-1585

[3] Martin Whitehead, 'A New Insolvency ACT IS Coming…..So Lenders, Borrowers and Insolvency Practitioners Get Ready'2009 Financial Focus 1,8 http://www.pwc.com/en_Ke/ke/pdf-financial-focus.pdf> accessed on 10/09/2012

tive insolvency laws in Kenya.[4] But unless we first appreciate what Kenya's insolvency law currently entails, its culture and ideologies, historical development and internal economic pressures, it is hard to propose any tangible reforms. This chapter will therefore seek to provide an evaluative insight into the current Kenyan insolvency framework with an interest in its inadequacies and strengths.

The chapter starts with an overview of the Kenyan insolvency legislative framework. It will then detail the insolvency procedures. The second part will analyse and evaluate Kenyan insolvency law from the standpoint of encouragement of external and internal investment. To achieve this, international benchmarks will be used to evaluate the law. For instance, UNCITRAL offers a legislative guide on insolvency which assists in the establishment of an efficient and effective legal framework. Besides, the World Bank considers countries' investment climates and ranks them according to their performances. For a long time, their 'Doing Business' report focused on capturing the time, cost and outcome of the most likely in-court proceeding involving a domestic debtor in each economy.[5] However, they have introduced a new component, the strength of insolvency framework index which tests whether an economy has adopted internationally recognized good practices in the area of insolvency.[6] Notably, the new indicator has been documented to be based on the World Bank's Principles for Effective Insolvency and Creditor/Debtor Regimes and the United Nations Commission on International Trade Law's Legislative Guide on Insolvency Law.[7] The

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[4] Christine Agimba, Global Trends in the Four Doing Business Indicators-Closing a Business: A Kenya Reform Experiences' (Paper Given at Doing Business 2011 in Africa: Sharing Reform Experiences 2011 < http//www.wbginvestmentclimate.org/loader.cmf?csModule=security/getfile&pageid=16717 > accessed on 22 September 2012

[5] World Bank, *Doing Business 2015: Going Beyond Efficiency*, October 2014 (World Bank, Washington, 2014)

[6] Ibid

[7] Ibid

benchmarks of these international bodies[8] provide an evaluative framework which is widely accepted and they are in common usage because, much as they are a global standard, neither their conditions of formulation are as demanding, nor their conditions of implementation as severe, as a convention.[9] Besides, the benchmarks are responsive to the particular needs of a given state as it may implicitly permit states to exclude or modify some provisions.[10] It is noteworthy that compliance must be voluntary and countries are assessed on the basis of the progress they make towards compliance rather than their absolute compliance.[11]

But as Berkowitz *et al* argue, the quality of laws, as often measured by the country's legal origin, is only a crude proxy for the effectiveness of legal systems.[12] Rather, it is the effective enforcement of laws, rather than the quality of laws, that matters.[13] Cambodia's legal system is a good example where, despite adoption of a modern and comprehensive insolvency law, the country has experienced low recovery rates, indicating that a modern law is not enough in itself to achieve an efficient insolvency practice; since effective implementation and a developed judiciary framework are also essential.[14] The evidence of the quality of the law on the statutes suggests that this is at best a partial story, including the dynamic of the reform process and its impact on the development of effective institutions to enforce the new law.[15] Therefore, it is equally necessary to have a viable enforcement mechanism that

[8] Ibid
[9] Block-Lieb Susan, and Terence C Halliday, 'Legitimacy and global lawmaking' Fordham Law Legal Studies Research Paper No 952492 (2006)
[10] Ibid
[11] Nilgun Onder, 'Global Finance Governance: 'Soft' Law and Neoliberal Domination' (Paper for the Canadian Political Science Association Congress, June 2-4 2005 London)<http://www.cpsa-acsp.ac/papers-2005/Onder.pdf> accessed 24/09/2012
[12] Daniel Berkowitz, Katarina Pistor and Jean-Francois Richard, 'Economic Development, Legality and the Transplant Effect' (November 1999)Available at SSRN:<http://ssrn.com/abstract=183269> or http://dx.doi.org/10.2139/ssrn.183269 accessed on 11 September 2012
[13] Ibid
[14] World Bank (n 5)
[15] Katarina Pistor 'Patterns of Legal Change: Shareholder and Creditor Rights in Transition Economies' (2000) 1European Business Organization Law Review1, 59-107

has the ability to translate laws from the statute books to practical results with expediency.[16] Undeniably, there is tangible evidence from many countries that the lack of adequately trained specialized bankruptcy judges is a critical shortcoming in the efforts to reform.[17] For instance, Russian administrators have been alleged to have manipulated the bankruptcy procedure, in order to expropriate tax revenues from the central government and this does little to alleviate the distress of a failed firm.[18] In Hungary too, the bankruptcy procedure, much as it is similar to the US Chapter 11, which has been hailed as being effective, has been said to produce inefficient going-concern value, due to a lack of effective judicial oversight.[19] Accordingly, laws and regulations that fail to take into account weaknesses of the agencies that are supposed to enforce them can create more problems than they solve. In consideration of how vital the enforcement aspect is to the law, this thesis will briefly discuss the Kenyan judicial system in so far as enforcement of the law is concerned, though to a limited extent in this in this chapter. Finally, it will consider the existing reform initiatives and their potential implications.

3.1 BACKGROUND

According to the author's best information, corporate insolvency laws in Kenya are appropriately described as archaic; and the laws are not in tandem with the modern demands of commercial practices. As such, an approach to law reform, based on the basic idea that it is necessary to have legal review regularly to keep in conformity with real life, as expressed by

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[16] Anthony Saunders, Anand Srinivasan, Ingo Walter and Jeffry Wool, 'The economic implications of international secured transactions law reform: A case study' (1999) 20 (2) University of Pennsylvania Journal of International Economic Law, 309-352.
[17] Kenneth Ayotte, and Hayong Yun, 'Matching Bankruptcy Laws to Legal Environments' (2009) 25 Journal of Law, Economics, and Organization 1:2-30
[18] Ibid
[19] Julian Franks, and Gyongyi Loranth, 'A Study of Inefficient Going Concerns in Bankruptcy (2004)' Available at SSRN: <http://ssrn.com/abstract=676356 or http://dx.doi.org/10.2139/ssrn.676356 > accessed on 10 September 2012

ever changing social economic and cultural trends, is lacking. In addition, the public domain is awash with tales of failed business and shattered ambitions of many young entrepreneurs and their employees. The relevant laws could be destroying more than they support and inevitably, the net effect in such circumstances will be detrimental to economic development. Besides, insolvency law is a subject that has gained considerable attention in states worldwide but more significantly in developed economies. From this, there can be an appreciation that law and regulatory institutions play a central role in the development of financial markets and in corporate finance. The attention accorded could have varying reasons but can majorly be seen to arise as a result of the impact of insolvency in commercial life, undermining business relations and the obligations arising through contract. As a result, jurisdictions have been actively involved in legislative reforms aimed at building a well-tailored and efficient corporate insolvency system. In fact, a wide range of jurisdictions have been formulating their insolvency frameworks towards a rescue culture.[20] Conceptually, an insolvency system has certain features that are essential to its functioning.[21] For instance, it may subject a debtor's freedom to continue engaging in credit related transactions to an external control.[22] Secondly, insolvency regimes typically provide a legal regime in which creditors' rights and remedies are suspended and a process established for the orderly collection and realization of debts.[23] Thirdly, insolvency systems provide relief for the 'honest but unfortunate' debtor while properly identifying and punishing those who culpably exploited the trust

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[20] Katarzyna Gromek Broc, and Rebecca Parry (eds), *Corporate Rescue: An Overview of Recent Developments from Selected Countries* (2nd edn, Kluwer Law International, 2006), p333
[21] For a broader discussion on functions of corporate insolvency systems see P J Omar, International Insolvency Law; Themes and Perspectives (Ashgate Publishing Limited, 2008) pg 3
[22] Vanessa Finch, 'The Measures of Insolvency Law (1997) 17 OJLS 227
[23] Gerald McCormack, 'Bankruptcy Forum Shopping: the UK and US as Avenues of Choice for Foreign Companies' (2014) 63 International & Comparatively Law Quarterly 4, 815-842

of their creditors.[24] Fourth, insolvency laws are concerned with attempting to discharge a debtor from all debts and restoring it as a functioning entity.[25]

Legally and procedurally, an insolvency framework provides a predictable and conducive environment where business transactions can be carried out in the knowledge that the framework will provide, in the advent of crisis, a platform to resolve it. Besides, an insolvency regime should also deliver an ex-post efficient outcome, in that the highest total value is obtained for the distressed firm with the least direct costs and loss of going concern value.[26] In doing this, a functioning and efficient system nurtures the confidence of local investors as well as attracting foreign investment. However, this does not undermine the fact that there are competing theories that are found in literature that compete and even conflict in attempts to justify the roles of insolvency laws and that disagree as to what the key focus ought to be, as already detailed in Chapter Two. Besides, jurisdictions tend to prioritize their objectives differently.

For a country to attract both foreign investment and encourage local investments, its world image and standing ought to be appealing. Therefore, current positions both in the region and globally are very informative. For instance, according to the 'Doing Business 2009' report offered by the International Bank for Reconstruction and Development and the World Bank, Kenya ranks 95th out of the 183 economies surveyed, worldwide, on their ease of doing business.[27] This helps not only in appreciating how Kenya's environment compares to

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[24] Ian Fletcher, 'Spreading the Gospel: the Mission of Insolvency Law, and Insolvency Practitioners, in the Early 21st Century' (2014) 7 Journal of Business Law 523-540
[25] Ibid
[26] Stijn Claessens, and Leora F Klapper, Bankruptcy around the World: Explanations of its Relative Use (July 2003) World Bank Policy Research Working Paper No. 2865. Available at SSRN: http://ssrn.com/abstract=405240 accessed 20 September 2012
[27] World Bank, *Doing Business Report, 2009* (World Bank, Washington, 2009)

those of other jurisdictions, but also provides a measure of any progress when considering contextual reforms. The aforementioned report tracks aspects of the business-closing process which is liquidation to identify problem areas in insolvency regimes. The issues it focuses on include the time it takes, on average, to complete the process, expressed in years; the average cost of the procedure, expressed as a percentage of the value of the debtor's estate; and the average recovery rate, expressed in cents in the dollar. Such a report offers a valuable evaluation of an insolvency regime, in particular liquidation, and in fact gives a clear picture of how the laws support or frustrate investment and it is therefore informative to any reform quest. However, to promote the understanding and evaluation of the Kenyan insolvency framework, an exploration of its history as well as an in-depth analysis of the current insolvency framework is necessary. After all, an important aspect of a country's insolvency regime is the ability to reflect the ideals and uniqueness of that jurisdiction, its specific features and degree of enforcement.

3.2 AN OVERVIEW OF THE KENYAN CURRENT INSOLVENCY LEGISLATIONS; AND A BRIEF HISTORY.

The Kenyan legal system, and in particular the present insolvency framework, is traceable to the historical colonial legacy. As such, the principles of English law and English concepts are still generally applicable in Kenya, subject to compatibility with the local circumstances. This is evidenced by section 3 of the Judicature Act Cap 8 of 1967[28] which sets out the sources of law applicable in Kenya. They are basically the Constitution and Acts of Parliament and include foreign laws named in the First Schedule of the Judicature Act. In addition, the sources include the substance of the common law, doctrines of equity, English Stat-

[28] See http://www.kenyalaw.org:8181/exist/kenyalex/actview.xql?actid=CAP.%208 accessed on 22nd September 2012

utes of general application, and procedure and practice observed in courts in England until 12 August 1897, so far only as the circumstances of Kenya and its inhabitants permit and subject to such qualifications as those circumstances may render necessary.[29]

From the aforementioned section of the Judicature Act, it is clear that the Constitution and all other local written laws are the principal sources of law in Kenya and therefore, English law operates subordinate to the local written laws and may be resorted to only where the local legislation does not extend or apply.[30] Unfortunately the Judicature Act Cap 8 is out dated as it has not been reformed to reflect the changes introduced by the Kenyan Constitution 2010. For instance the judiciary has a higher court, the Supreme Court.[31] Equally, international law is also a source of law though it is not listed under the Judicature Act but is recognized in Articles 2(5) and 2(6) of the Constitution of Kenya, 2010,[32] as a valid norm within the legal system.

Moreover, insolvency legislation that is currently in force in Kenya, i.e. the Companies Act (1962) Cap 486 was taken from the English Companies Act 1948. In fact, the statute was adopted almost in its entirety and actually, other investment-related laws are based on that founding legislation. The imposition of the English laws was done through a process described as an involuntary transplant through re-enactment of reception clauses, local ordinances and in some instances the entire colonial legislation.[33] Reception clauses are provisions meant to adopt the common law approach and English legal statutes as the basis for

[29] 12 August 1897 is the official date when these English laws were received and recognized as laws to be applied in the Kenya colony.
[30] Michael Nyongesa Wabwile, 'The of English Common Law in Kenya' (2003) 3Oxford U. Commw. L.J. 51, 63
[31] The Constitution of Kenya 2010 article 163
[32] See http://kenyalaw.org/kl/index.php?id=398 accessed on 22nd September 2012
[33] Generally during colonial times, colonial masters imposed their laws on its protectorate through Ordinances and in Kenya there are three very significant ones.

judicial decisions.[34] The reception of these laws, as was typical among all former British colonies, comprised the English common law, the doctrines of equity and statutes of general application then in force in England.

The main problem experienced with the Kenya Companies Act 1962 is that it provides for the procedure and practices as they pertain in England to apply to companies facing crisis in Kenya. It has not been reformed and as such Kenya continues to base its insolvency practices on codes drafted by the colonial power and in the authors view to probably meant to serve the master's interest. Unfortunately the United Kingdom has since completely overhauled its insolvency legislation and introduced dedicated legislation with the Insolvency Act 1985, consolidated as the Insolvency Act 1986, and the 1986 Act was further improved on subsequent occasions, in particular with the Enterprise Act 2002. Kenyan law has not kept pace with these reforms. In essence, the Kenyan laws have not changed to reflect current business reality in Kenya and therefore do not reflect the culture and business dynamics within the Kenyan jurisdiction. There are two insolvency procedures embodied in the Companies Act 1962 namely receivership[35] and winding up.[36] However, the receivership and liquidation of enterprises varies in accordance with the statute that governs its registration and activities, as shown in the table below.

[34] Adam H Bakari, 'Africa Paradoxes of Legal Pluralism in Personal Law: A Comparative Case Study of Tanzania and Kenya' 1991 (3) Africa Journal of International and Comparative Law 545

[35] Companies Act 1962 Part VII (Kenya)

[36] Companies Act Part 1962 VI (Kenya)

Table 1[37]

Type of Enterprise	Governing statute	Modes of receivership and liquidation
Companies	The Companies Act (Cap 486)	As specified in the Companies Act (part vi and vii)
Cooperatives Societies	The Cooperatives Societies Act (Act No.12 of 1997)	The Cooperatives Act read together with Companies Act.
Banking institutions (Including non-bank financial institutions)	The Banking Act (cap 488)	Central Banking Act (cap 491) read together with the Companies Act
Insurance Companies	The Kenya Insurance Deposit Act 2012	The Insurance Act read together with Companies Act.
Building Societies	The Building Societies Act (Cap 489)	The Building Societies Act read together with Companies Act.

As the table illustrates, the principal law that explicitly sets out procedures that apply to receivership and liquidation is Companies Act Cap 486. However, depending on the other leg-

[37] Republic of Kenya National Development Plan (1997-2001) pg 53

islations that are concerned with their registration, some aspects of engaging in an insolvency procedure will be slightly different. For example, with commercial banks, the central bank of Kenya initiates the receivership process as regulator. Likewise, the Commissioner of Building Societies would have rights of audience in the petition concerning any such society.

Another piece of legislation that contributes to regulating insolvency is the Bankruptcy Act originally passed in 1930, which is extensive, with 164 sections and numerous amendments. It is acknowledged that this legislation focuses on individual bankruptcies and therefore has little to do with corporate insolvency, the core research area. It must also be noted that the Kenyan legislature has attempted to address the problems facing the businesses in Kenya and as a result a number of bills are underway but, at the time of writing, it remains to be seen whether they will become laws. Nevertheless the Insolvency Bill 2010[38] at least in theory was set to establish a clear framework for insolvency regulation. The Bill was initially rejected in 2010 and referred back to stakeholders for further review. After incorporating their amendments, the Bill was introduced as Insolvency Bill 2012 but equally failed to be enacted. In 2014, a new Insolvency Fill was proposed by the Cabinet Secretary of Treasury. The 2014 Bill just like the 2010 Bill gives priority to the revival of distressed firms rather than auctioning and liquidating them. For in-depth analysis on on-going effort to reform the relevant legislation see sec 3.5 of this chapter.

[38] See http://kenyalaw.org/kl/fileadmin/pdfdownloads/bills/2014/InsolvencyBill2014.pdf accessed on September 2014

3.3 CURRENT KENYAN INSOLVENCY FRAMEWORK.

The insolvency framework in Kenya addresses both personal and corporate insolvencies. On one hand, the individual insolvency provisions, or bankruptcy laws as they are commonly known, are contained in Bankruptcy Act (Cap 53 laws of Kenya). The legislation is silent as to what types of procedures are involved in the bankruptcy process. Arguably, the civil procedure rules Cap 21 laws of Kenya addresses this concern. Besides, it can also be argued that the Act contains two, one being the insolvency procedure which is initiated either by a creditors' or debtors' petition, although it is not given any name in the legislation[39] and a composition or scheme of arrangements contained in section 18.[40] It is notable that a debtor can exercise his discretion and make a proposal for a composition in satisfaction of his debts, or a proposal for a scheme of arrangement of his affairs by expressing his intentions in writing to the official receiver. This however happens once a petition has been made and the conditions stated in section 6 as are satisfied, the court issues a receiving order which has an effect of appointing an official receiver.[41] It admittedly forms part of the main insolvency procedure albeit the process takes a different form if a scheme or a composition is proposed and accepted by the creditors. This research will not consider personal bankruptcies in more detail as they are not the core area of focus.

On the other hand, corporate insolvencies are governed by Companies Act Cap 486 and it encompasses two basic insolvency procedures namely winding up and receivership. It is necessary to explore each procedure independently.

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[39] See sections 6 and 7 on creditors petition; section 8 for debtors petition

[40] Bankruptcy Act Cap 53 part (ii) section 18 and part (IV) sections 74-77 (Kenya) details the procedures respectively.

[41] Some the conditions includes that a) the existence of a debt, (b) the debt be a liquidated sum, payable either immediately or at some certain future time, (c) the act of bankruptcy on which the petition is grounded has occurred within three months before the presentation of the petition

3.3.1 Winding up

The winding up of a company is a prologue to its ultimate demise.[42] (Refer to 1.5.4 for a detailed discussion of the concept). The legislation provides for this procedure in part (vi) section 212 of the legislation and has two kinds of winding up: creditor's voluntary winding up and a compulsory winding up by the court.[43] For a compulsory winding up, although the court allows a broad range of persons to initiate the proceedings, the most prevalent petitioners are creditors. A petitioner is not entitled to a winding up order without showing some good cause to it. This procedure is the oldest and most traditional way of dealing with corporate entities and exists in many different jurisdictions. In England for instance, legislative provisions require the presence of similar grounds in support of the petition to those required in Kenya, as mentioned above, with a requirement to advertise the petition.[44] Besides, a court can actually dismiss a petition if not duly advertised in accordance to the governing rules.[45]

Section 219 enumerates a number of circumstances under which the winding up order can be made. A notable ground is the company's inability to pay its debts as elaborated later in the chapter and another is where the court is of the opinion that it is just and equitable that the company should be wound up. These two conditions are by far the most important and most commonly invoked. The inability to pay debts is considerably easier to establish, since the just and equitable requirement relies on the court's interpretation and discretion. In fact, Kenyan courts have not delved into this aspect in depth. The existing precedent in this re-

[42] Roy Goode, Principles of Insolvency Law (4th edition Sweet & Maxwell, 2011) pg. 149
[43] Companies Act Cap 486 sections 212 (Kenya)
[44] For details of the procedure involved in presentation and service of the petition, see Insolvency Rules 1986, rr 4.7- 4.19
[45] Practice Direction [1996] 1 WLR 1255

gard is the old English case of *Ebrahimi v Westbourne Galleries Ltd,*[46] where the court explained that for a petitioner to be able to rely on the just and equitable clause, it is necessary go to court with 'clean hands', such that the cause of dispute between him and the other parties is not due to his misconduct. Otherwise, such a petitioner cannot insist on the company being wound up if others in the company wish for it to continue. The details of the administration of voluntary winding up follow the same pattern as for the creditors' compulsory winding up, although there are some differences but interestingly, they are a replication of the UK version.[47] As such, they entail using liquidators with powers of sale and distribution of assets with court supervision.

3.3.2 Receivership

Receivership is a process initiated by a creditor to recover amounts outstanding under a secured loan in the event of the company defaulting on its loan payments. In practice, the banks as a secured creditor holds a floating charge over part or the entire undertakings of the company with a right to appoint a receiver manager out of court or by a petition to the court.[48] The receiver manager would then be deemed an agent of the company and liability for any actions of the receiver would fall upon the company rather than the appointing creditor.[49] In Kenya, this procedure is contained in Part VII of the Companies Act Cap 486 which starts by disqualifying a body corporate from appointment as a receiver manager. This procedure can be initiated in two ways. The first is through a court order when applied on be-

[46] [1973] AC 360

[47] The Kenyan winding up procedure is similar to that of the UK, which is discussed in Roy Goode, Principles of Corporate Insolvency Law 4th edition (Sweet & Maxwell, 2011) pg. 149-176, Also see the Companies Act Part VI

[48] Chrispas Nyombi, Alexander Kibandama, David J Bakibinga, 'The motivations behind the Uganda Insolvency Act 2011' (2014) 8 Journal of Business Law 651-666

[49] Ibid

half of the debenture holders or other creditors of a company which is being wound up.[50] The second is an out of court appointment, where a receiver is appointed under the powers contained in any instrument of the company.[51] A receiver manager who is appointed out of court may apply to the court for directions in relation to any particular matter arising in connection with the performance of his functions. Once appointed, a receiver will be personally liable on any contract entered into by him in the performance of his functions except in so far as the contract otherwise provides.[52] A notification that the company is in receivership is then issued to all the creditors and other stakeholders. The company within fourteen days after receipt of the notice, or such longer period as may be allowed by the court or by the receiver manager, must prepare and submit a statement of affairs of the company in the prescribed form. These accounts are then forwarded by the receiver manager to the registrar with his comments, if he so wishes to add any. The legislation is limited and has very little details as to what more happens in a receivership process.

3.4 IN DEPTH ANALYSIS/EVALUATION OF THE KENYAN INSOLVENCY LAWS AND POLICIES ON THE BASIS OF THE INTERNATIONAL BENCH MARKS

A Kenyan story narrated in any forum is never complete without the mention of its colonial past. It is tempting to attribute some of the realities in Kenya, to the colonial impact that greatly shaped Kenya's legislative history. Kenya may have been involuntarily consigned by the colonial process to its position, but to continue following that same legislation today in the 21st century voluntarily, deliberately, and on its own accord is a total failure. *Prima facie*, Kenya is an active business hub but underneath it has a story of insufficient reforms to

[50] Companies Act Cap 486 section 347 (Kenya)
[51] Companies Act Cap 486 section 348(Kenya)
[52] Companies Act Cap 486 sec 348(2)(Kenya)

support and encourage these economic efforts. The current state of Kenya from the legal context and economic standards is in many ways a result of poor leadership and not necessarily the negative impact of colonialism. If anything, jurisdictions like Botswana, South Africa and Mauritius, despite being colonized have achieved economic growth by adopting good policies. It is documented that Botswana sustained the minimal public service that it inherited from British and developed it into a meritocratic, relatively non-corrupt and efficient bureaucracy.[53] As such, one of the most important legislative policy agendas for Kenya is to eliminate, or at least reduce, the inefficiencies of its legislation. To comprehend these inadequacies and weaknesses, a critical assessment of the law is mandatory, as well as a review of how its provision reflects insolvency law ideas found in other parts of the world.

However, assessing the law is an ambiguous task that warrants more clarity. Finch argues that, it is impossible to evaluate any area of law, suggest reforms or even develop the law unless there is clarity concerning the values and objectives that such a law seeks to achieve.[54] The objectives underlying any law are important statements of a national policy. The legislative history and the legislation itself reveal important principles and assumptions.[55] Conversely, the principles and objectives underlying Kenya's insolvency law are not easily noted from the legislation because they are littered throughout a bulky document (Companies Act Cap 486). Nevertheless, they can be deduced from the legislation after a critical examination. In contrast, in the insolvency bill 2010 the objective is clear and apparent, even from its title, which states as follows:

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[53] Daron Acemoglu, Simon Johnson and James A Robinson, 'An African Success Story: Botswana' (July 2001). MIT Department of Economics Working Paper No. 01-37 available at SSRN: http://ssrn.com/abstract=29079 accessed on 12 June 2014

[54] Vanessa Finch, Corporate Insolvency Law; Principles and Perspectives (2nd Edition, Cambridge University Press, 2009) pg.25

[55] Ibid

> 'An Act of Parliament to amend and consolidate the law relating to receiverships, insolvency, provisional supervision, winding up and individual bankruptcy, to provide for corporate and individual insolvency, to provide for the rehabilitation of the insolvent debtor and for connected purposes.'

In addition, insolvency regimes are complex and varying in design as they try to balance several objectives, including protecting the rights of creditors, which are crucial to the mobilization of capital for investment and working capital and other resources and obviating the premature liquidation of viable firms.[56] Therefore, the substantive objectives and procedural terms, as well as the extent to which a statutory mandate is efficiently implemented, ought to be accorded weight.

Besides, the existence of competing theories as to what insolvency law's role and key focus is, as already elaborated in Chapter Two, adds to the ambiguity. Further, jurisdictions tend to prioritize their objectives differently. However, the multilateral institutions, driven by the collective will of G7 have developed global insolvency norms to benchmark the development of effective insolvency law systems around the world. Generally, developing countries are perceived as having weak crisis resolution systems and consequently they are regarded as a major threat to stability of the entire globe.[57] Therefore, special regard is given to emerging nations in the multilateral institutions' deliberations.[58] A key feature of the response of multilateral institutions is the UNCITRAL Legislative Guide on Insolvency Law, which contains nine key objectives to be used for the evaluation of insolvency systems.[59]

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[56] Claessens and Klapper (n 26)
[57] Onder (n11)
[58] Ibid
[59] The UNCITRAL Legislative Guide on Insolvency Law 2004, 10-13 available in <www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf > assessed on 25/03/2011

The aforementioned UNCITRAL Legislative Guide on Insolvency Law contains detailed information as well as precise key objectives that are fundamental in attaining a comprehensive evaluation of the law. Incidentally it must be noted that domestic insolvency laws and resulting international insolvency standards that developing countries are pressed to comply with owe much to the best practices prevailing in developed countries.[60] In addition, there is a wide divergence of national insolvency law systems but nevertheless there exist common and uniform aspects of best practices within these systems, and these different insolvency systems have therefore been utilized to develop a global standard of best practices to benchmark the development of effective domestic insolvency regimes.[61]

These standards offer an important base for evaluation of existing systems as well as for the development of modern insolvency systems which could be tailored to the needs and circumstances of the countries. The identifications of such principles and usage have been central in enacting new corporate insolvency laws in other parts of the world. For instance, in China, much as its Enterprise Bankruptcy Law 2006 resulted from internal debates, these international efforts were reflected in those debates.[62]

The aforementioned international insolvency standards provide recommendations, guidelines and reference for respective national policy and lawmakers, in a non- binding nature of 'soft law', rather than through legally binding treaties.[63] This is important as national governments are not willing to relinquish sovereignty of their states to the world and besides,

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[60] Terence C Halliday, & Bruce G Carruthers, Bankrupt: Global Law Making and Systematic Financial Crisis (Stanford University Press, 2009) pg. 18

[61] Sergei A Davydenko & Julian R Franks, 'Do Bankruptcy Codes Matter? A Study of Defaults in France, Germany, and the UK' (2008) 63 The Journal of Finance 565

[62] Roman Tomasic, 'The Conceptual Structure of China's New Corporate Bankruptcy Law' in China's New Enterprise Bankruptcy Law; Context, Interpretation and Application eds (Ashgate , 2010)

[63] The UNCITRAL Legislative Guide for example, indicates that it is, 'intended to be used as a reference by national authorities and legislative bodies when preparing new laws and regulations or reviewing the adequacy of existing laws and regulations'

the national systems are diverse so a soft law offers an interactive alternative to the formal, legally enforceable treaties at international level.[64] It therefore gives the states room to undertake an assessment of any modifications in either law or administrative practice that may be necessitated. Despite their non-binding nature, these standards have a strong persuasive leverage. Not infrequently, leverage proceeds through persuasion, when international organizations and professionals in their circle host conferences, write articles, and give speeches in regional meetings about the merits of particular scripts or other national models that adhere to those scripts.[65] The persuasion can be coupled with systems of reward or incentives; sometimes financial, as in foreign aid or technical assistance loans, and sometimes moral, where for instance the international organizations suggest that a country's reputation will be enhanced or diminished by its conformity to global standards.[66] In these ways, the multilateral institutions that monitor observance and intricacies of the globalised economy use them as a strong force of reform.[67]

This Chapter will now seek to identify the key principles and assumptions that are reflected in Kenyan insolvency laws and to contrast them with the ideas reflected in the international benchmarks. In particular, from section 3.4.1 onwards, the nine objectives identified in the UNCITRAL Legislative Guide will be used in this analysis.

[64] Onder (n 11)
[65] Terence C Halliday, 'Legitimacy, Technology, and Leverage: The Building Blocks of Insolvency Architecture in the Decade Past and the Decade Ahead' (2007) 32 Brooklyn Journal of International Law 3
[66] Ibid
[67] Halliday and Caruthers (n 60) at 108

3.4.1 Provision of certainty in the market to promote economic stability and growth

The nature of the legal environment is widely acknowledged as one of the important factors that determines the inflow of foreign investment in a country.[68] Ramcharran, points out that regulation and risk reduction play central roles in Foreign Direct Investment (FDI) and that an unaccommodating legal environment is the main deterrent of FDI.[69] Besides, legal stability is crucial for stimulating FDI inflows and increased transparency regarding the legal framework of a country affects FDI decisions.[70] In essence, foreign investors are most concerned with the presence of a transparent, reliable and efficient legal system by which to conduct their business. Interestingly, a critical look into the insolvency legislative framework in Kenya leaves much to be desired. To start with, in Kenya, just like in most developing countries, bank lending is the prime source of credit to enterprises. However, the facilitation and provision of finance for start-up and reorganization of business is hampered by legal regulatory and operational constraints.[71] In particular, the creation of security interests, perfection of such interests through informing the public of their existence and priorities as well as enforcement of the securities are costly. This is majorly because the registering and updating of public records is not efficient, making searches difficult and expensive. These obstacles make the starting of a business difficult, expensive and in some instances result in limiting it

[68] Alexander Peter Groh & Matthias Wich, 'A Composite Measure to Determine a Host Country's Attractiveness for Foreign Investment' available on http://www.iese.edu/research/pdfs/DI-0833-E.pdf accessed on 15/11/2014; Also see UNCTAD, *World Investment Report 2009:Transnational Corporations, Agricultural Production and Development* (United Nations, 2009)

[69] Harri Ramcharran, 'Foreign Direct Investments in Central and East Europe: An Analysis of Regulatory and Country's Risk Factors (2000) 18 American Business Review 2

[70] Andrzej Baniek, Jacek Cukrowski & Jan Herczynski 'On the Development of Foreign Direct Investment in Transition Economies' (2005) 48 Problems of Economic Transition 2

[71] FSD Kenya 'Costs of Collateral in Kenya: Opportunities For Reform' (September 2009) available at www.fsdkenya.org accessed at 1pm of 20/6/2011

to larger and established firms. This is detrimental, especially in the current trends where credit is the lifeblood of an economic development.[72]

Furthermore, continuing financing is the crucial and troublesome problem bedevilling every corporate re-organization regime.[73] Without a set of post- petition financing provisions which clearly define the hierarchy of priorities for potential post-petition lenders, other great efforts to cast an effective rescue regime may prove fruitless.[74] On this front, a problem with Kenyan legislation is that it does not provide for a regime of 'super-priority' funding as part of its restructuring process. As a result, companies in Kenya, in any potential rehabilitation process face this central problem of a lack of funds in order to allow a turn around to be effected or facilitate an efficient liquidation.

However, a critical look at the sections of the legislation dealing with the receiver manager's duties and obligations,[75] in so far as the company in receivership is concerned, implies that book debts,[76] as they are known in UK, are often the only funds available for the purposes of financing continued operations through the receivership periods. This is because there is no other stipulated provision allowing post-petition financing. In other jurisdictions, super-priority financing can be used which is basically a type of credit financing available to insolvent companies, where the credit finance given to a company during insolvency will be regarded as a claim superior to other claims hence given priority in payment.[77] Besides, the

[72] IFC, 'Credit Bureaus Enabling Economic Growth and Prosperity'(2007) http://www.ifc.org/ifcext/gfm.nsf/Content/FinancialInfrastructure accessed on 2 April 2010
[73] Lijie Qi, 'Managerial Models During the Corporate Reorganization Period and their Governance Effects: the UK and US Perspectives' (2008)29 (5) Company lawyer, 131-140
[74] Ibid
[75] For a detailed provision on the implied use of money generated during the receivership, see Sections 351 (2), 351(6), and 353 of the Companies Act Cap 486. In fact, the entire provision on part VII needs be considered to construe the implied availability of this mode of funding.
[76] Finch, (n 54) pg. 410
[77] Vatsal Gaur, 'Post Petition Financing in Corporate Insolvency Financing: A Comparative Study Across Various Jurisdiction' (2012) SCL 17

aforementioned book debts is not very clearly stated but the provisions (Part VII of Cap 486) allowing the receivers or liquidators powers to handle all receipts and payments in their managing the company, and as well to enter into contracts, can be interpreted as giving access to use this cash to facilitate the necessary processes during that period.

Similarly in the winding up procedure, there is no provision as to how the process will be funded, save for section 302, which states that the costs, charges and expenses incurred in winding up shall be payable from the company assets.[78] This provision caters only for the liquidation cost and is very limited. This is detrimental, considering that the success of any insolvency proceeding depends on two fundamental questions: first, what arrangements should be put in place for new money or loans required by the troubled company?[79] Secondly, what arrangements shall be put in place for existing loans and financial accommodation to the troubled company (bearing in mind that one fundamental aim of all corporate rescues should be to bring high levels of debt down to levels that the company can cope with)?[80]

It is submitted that the Kenya's post-petition funding measures are not adequate and may not provide sufficient incentives for potentially interested parties to effectively fund restructuring efforts. Second, an efficient framework should have laws and institutions that promote restructuring of viable business and efficient closure of those that are beyond salvage. Kenya's current insolvency laws have two crucial procedures, as already detailed in 3.3 above. In so far as effective closure is concerned, Kenya has established procedures for the winding-up of companies that have been applied consistently over a long period of time,

[78] There is very little mentioned on post-petition financing and in fact the few sections like the Kenyan Companies Act 1948, Section 302 refer to a voluntary winding up of a solvent company

[79] Denis Petkovic, 'Corporate rescues and restructurings in Hong Kong' (1991) 6 Journal of International Banking Law 7, 264-275

[80] Ibid

hence making the system recognizable and this system may be functional for all the stake-holders. Nonetheless, the efficiency and effectiveness of these procedures are questionable. Part VI of the Companies Act 1962 stipulates the process. There are a number of grounds for winding up the company stated in the legislation.[81]

The insolvency test is stated as one of the reasons why a company can be wound up. The legislation refers to cash flow insolvency, as opposed to balance sheet insolvency.[82] The two tests are fundamental in determining the solvency of a company but they are not the same and establishing cash flow insolvency is arguably easier. The balance sheet test is potentially more complicated and refers to the value of the company's assets being less than the amount of its liabilities.[83] In fact Slade J in *Re Capital Annuities Ltd*, described it as a question of whether the debtor is in 'possession of assets insufficient to meet its existing, contingent and prospective liabilities'[84] However, it is not a mechanical exercise of comparing the value of a company's assets against the value of its liabilities, but a more sophisticated test requiring a judgment as to whether the present assets of a company will reasonably enable the company's present and future liabilities to be met.[85] Noteworthy, the recent court decision has provided more clarity on the two tests. In particular, cash flow test as provided for in s 123 of Insolvency Act 1986) was interpreted by Briggs J in *Cheyne Finance Plc* that test is

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[81] For a detailed list of reasons to wind up a Company, see sections 219 and 220 of the Kenya,(1962) Companies Act cap 486 (Kenya)
[82] Companies Act Cap 486 section 220 (Kenya)
[83] Richard Fisher, 'Euro Sail and Balance Sheet Insolvency: Are We Any Clearer?' (2013) 4 Corporate Rescue and Insolvency 83
[84] [1979] 1 WLR 170 at 185
[85] Peter Walton, 'Inability to Pay Debts — Beyond the Point of No Return' [2013] 2 Journal of Business Law 212; Also see case of Euro sail (BNY Corporate Trustee Services Ltd and others v Neuberger Berman Europe Ltd and others [2013] All ER (D) 107, the 'balance sheet' test insolvency of the IA 1986, s 123 was described as more than a mechanical exercise of comparing the value of a company's assets against the value of its liabilities

not a snapshot of debts due here and now but requires an element of futurity[86] and the former is when a debtor is over indebted.[87] In Eurosail, the Supreme Court approved this decision and emphasized cash flow test is concerned not simply with the petitioner's own presently-due debt but also with debts falling due from time to time in the reasonably near future.[88] Arguably though what is the reasonably near future will depend on all the circumstances as well as the nature of the company's business.

In older times, little attention was paid to the difference between cash flow and balance sheet insolvency when determining the solvency of the company. However, modern trends have paid due diligence to the distinction and embraced the cash flow test as the most appropriate for efficiency and value maximization of the insolvent debtor's estates, as well as encouraging early resort to insolvency proceeding.[89] Undoubtedly, the question of whether a company will be able to pay its debts when they ultimately fall due is of significant importance whenever the court is asked to make a winding-up order and the balance sheet test plays a crucial role when considering a practical recognition of the company's potential.

On the issue of restructuring or rescuing a company, Kenya has numerous challenges. The problems facing receivership have their foundation in the law that governs the procedure, the Companies Act. To start with, the legislative regime is fragmented, outmoded and incomplete.[90] Kenya's entire legal order rests on values and principles based on the common law, as agreed in the independent constitutional settlement of 1963. This implies that the insolvency law, like many other statutes that have not been reformed, is out-dated and does

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[86] [2007] EWHC 2402 (Ch)
[87] Ngaundje Doris Leno, 'Rwanda Legal Framework on Insolvency: Problems and Proposals for Reform' (2015) 24 International Insolvency Review 2:122-129
[88] BNY Corporate Trustee Services Limited v Eurosail [2013] UKSC 28
[89] UNCITRAL 2004 (n 59) para 45 and 46
[90] World Bank, *Financial Sector Assessment Kenya* (World Bank, Washington, 2005) at pg. 18

not meet the needs of modern business. These laws have been criticized as not being in touch with realities and dynamics prevailing in Kenya today. In contrast, many jurisdictions have reformed insolvency laws dramatically in the last 30 years. For instance the People's Republic of China, which originally had a very basic and limited bankruptcy law, has, through several attempts, enacted and reformed its legislation.[91] In that jurisdiction there was a bankruptcy law passed in 1935 but later abolished and, later, in 1986 and the Enterprise Bankruptcy Law was enacted on a restricted and trial basis, this was reformed by a new Bankruptcy Law passed in 2006.[92] To emphasize, the entire globe has been a hub of insolvency reforms and, for example, in the past 8 years, 'Doing Business' recorded 126 insolvency reforms, most of them in OECD high-income economies and in Eastern Europe and Central Asia.[93] It was noted that, much as different jurisdictions focused their efforts on different aspects of insolvency, these reforms still shared some common features, like promoting reorganization, regulating the profession of insolvency administrators and strengthening the rights of secured creditors.

Kenya has failed to make any reforms to insolvency law, and it can therefore be regarded as lagging behind in the development of its legal infrastructure to support business, which brings the risk of under-performance in the global market. In addition, the existing legislation is bulky, complicated and time consuming. The fact that insolvency legislation forms a part of a law concerned with other issues is the first pitfall. This makes it cumbersome to access the relevant sections. This is further worsened by its disorganization. The sections are not arranged in a manner that reflects the normal chronology of insolvency proceedings. For

[91] Roman Tomasic and Margaret Wang, 'Reforming China's Corporate Bankruptcy Laws ' (2005) 18 Australian Journal of Corporate Law 220
[92] Ibid
[93] The World Bank, *Doing Business 2012 Report* available http://www.doingbusiness.org/data/exploretopics/resolving-insolvency/reforms>accessed on 24 October 2012

instance, the statute addresses the issues of liquidation and winding up in Part VI before addressing the procedure that applies to the appointment of a receiver in the subsequent Part VII. In fact, the sections keep referring to the receivers before they introduce who they are and what their duties are.

Besides, sections of the Companies Act cap 486 that govern the entrenched insolvency procedures overlap, making it difficult to distinguish how either receivership or liquidation is undertaken.[94] For example, section 236 titled the 'Appointment and Style of Receivers/liquidators' states that the official receiver shall, by virtue of his office, become the provisional liquidator and shall continue to act as such until he or another person becomes liquidator. There is an interchange in the use of the terms 'liquidator' and 'receiver' yet in principle the two should have distinct roles in relation to the company. It is submitted that the law governing applications for receivership should be consolidated to enable an orderly process and enhance clarity to the interested parties.

It must be noted though that some of the aforementioned weaknesses in the legislation have been acknowledged and given attention in the Insolvency draft bill of December 2010. For instance, the draft consolidates all the information necessary in an insolvency procedure into one statute. Its sections are well arranged, and most importantly ingrain a well pronounced rescue culture. It seeks to introduce administrations[95] and company voluntary arrangements.[96] This is well elaborated under section 3.5 on 'on-going reforms'.

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[94] Companies Act cap 486 (part vi sections 212-252, part vii sections 345-355 and part xi section 358-362) (Kenya)
[95] Insolvency Bill 2010 part x (Kenya)
[96] Insolvency Bill 2010 part ix (Kenya)

3.4.2. Maximization of value of assets

To maximize the value of assets for the benefit of creditors requires a number of well-tailored approaches to be entrenched in legislation as detailed below.

3.4.2.1 Timing of insolvency proceedings

The commencement date of insolvency proceedings will impact and even determine how much can be realized by stakeholders in an insolvency process,[97] as may the length that the insolvency process takes. Because of this, it is important that stakeholders have the incentive to behave in ways that will maximize their return from a company in an insolvency proceeding.[98] As such, an efficient and effective way of influencing the creditors' behaviour is through an introduction of a mechanism that denies the creditors other alternative choices of conduct than those that are part of the collective process.[99] Essentially, outside an insolvency situation, a secured creditor whose debtor has defaulted in payment can seize the collateral, sell it and keep the money up to the amount owed to him.[100] Should the amount realized be less than the debt, he can still proceed to pursue the remaining sums from the debtor and, if the proceeds from the sale are of high value, refund the excess.[101] Such an action will have negative consequences for the debtor as well as other stakeholders in the company.

On the aspects of time, the legislation does not incorporate a clear time frame to guide the plans of a distressed company in receivership, although it has very detailed provisions on winding up. The Act does not stipulate the anticipated duration of proceedings. An example

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[97] Omar (n 21) pg. 83

[98] Douglas G Baird and Donald S Bernstein, 'Absolute Priority, Valuation Uncertainty, and the Reorganization Bargain' (September 2005),University of Chicago Law &Economics, Online Working Paper No.259, available at SSRN: http://ssrn.com/abstract_id=813085 accessed on 22/6/2011

[99] Dal Pont & L Griggs, 'A Principled Justification on Business Rescue Laws: A Comparative Perspective (Part II)' (1996) 5 International Insolvency Review 47

[100] Lawrence P King, and Michael L Cook, *Creditors' Rights, Debtors' Protection and Bankruptcy* (3rd edn, Matthew Bender, 1997), p. g 107

[101] Ibid.

is section 351(1) (b) by which the managers of the company are to submit a statement of affairs to the receiver within a stipulated period. Another rare instance is the duration of the period given to the receiver to submit financial reports in sections 351(2) and 353(1). The absence of a clear time frame for other steps is very detrimental because it leaves the official receivers with a lot of discretion that can be abused to the detriment of the entire receivership process. For instance, prolonged proceedings increase the cost of bankruptcy in terms of administration costs. It must be remembered that formal insolvency procedures involve both direct costs, such as fees for accountants, bankruptcy lawyers, auditors and other professional and 'indirect costs' which includes a prolonged procedure. A distressed company is likely to incur considerable 'indirect costs' from functioning inefficiently during insolvency proceedings.[102] These costs include conflicts of interest, foregone investment opportunities, a loss of competitiveness, costs of suboptimal use of resources, losses of sales and as well as management of time.[103] Unfortunately, because all of these costs are borne by an already distressed company, they diminish the returns to creditors, so that the maximum value of assets cannot be realized. Therefore, an expeditious handling of the insolvency process, which includes strict time limits being imposed, is necessary. In practice, literature documents that it takes an average of 4.5 years to complete formal insolvency proceedings in Kenya.[104] It is however not clear whether this refers to liquidation or receivership. Besides, there are no documented statistics to corroborate this and therefore it is unclear to both foreign and local investors what they may anticipate in the event of their ventures being insolvent, and this uncertainty undermines confidence in Kenya as an investment destination.

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[102] Robert M Lawless, and Stephen P Ferris, 'The Expenses of Financial Distress: The Direct Costs of Chapter 11' (2000) 61University of Pittsburgh Law Review, 629. Also see E I Altman, A Further Empirical Investigation of Bankruptcy Cost Question,(1984) 39 Journal of Finance 4

[103] James S Ang, Jess H Chua and John McConnell 'The Administrative Costs of Bankruptcy Law: A Note' (1982) 37 (1) Journal of Finance 219-226.

[104] World Bank and the International Finance Corporation, *Doing Business in Kenya 2010* (Washington, 2009)

3.4.2.2 Automatic stay

In insolvency, a unique feature that an effective and efficient procedure benefits from is an automatic stay.[105] In principle, the automatic stay stops all the collection activities against the debtor with an economic goal of protecting assets that have 'going concern value'.[106] This legal freeze on all activities against the debtor redresses the bargaining power of all creditors and encourages an organized redistribution of resources where necessary.[107] The Kenyan insolvency legislation has an equivalent of the automatic stay, although it is not termed so. The Companies Act section 224, stipulates that, once a winding up petition has been filed, the property of the company cannot be disposed of or dealt with adversely, no action or proceeding shall be proceeded with or commenced against the company except by leave of the court and subject to such terms as the court may impose. This means that the creditors cannot engage in the chaotic race to protect their interests when the company has filed for a winding up procedure. Unfortunately, this automatic stay, as stipulated, refers to a winding up process and nothing is mentioned in so far as receivership is concerned. Moreover a moratorium to facilitate reorganization is presently lacking.

In practice though, receivership has enabled the successful rescue of companies in some instances, supported by a consensual stay by creditors. For illustration, in Uchumi, a unique story of success in Kenya, the receiver manager Ciano acknowledges that he had to persuade bankers and creditors to provide a breathing space.[108] In essence, it was an informal arrangement and had no legal backup. It was a rare scenario where the creditors, out of good

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[105] Gerard McCormack, *Corporate Rescue Law-An Anglo-American Perspective* (Edward Elgar Publishing Ltd, 2008) pg. 79

[106] Lucian A Bebchuk, & Jesse M Fried, A New Approach to Valuing Secured Claims in Bankruptcy' (2001) 114 Harvard Law Review 2386-2436

[107] Pont and Griggs (n 97)

[108] Geoffrey Njenga, *Thriving on Borrowed Time: Reviving Invesco Assurance: Case for Reforming the Insurance Industry* (Hope Centre International Publisher, 2011) pg. 66

will, consented to be patient with the receiver manager but the same cannot easily happen in all cases, hence the need for a legislation to provide for an automatic stay.

Notwithstanding such clear statutory provisions, as far as the automatic stay in winding up is concerned, some directors still attempt to engage in defeating or diverting the cause of justice. A good example was in the case of *Re matter of Invesco Insurance Company Limited v In the matter of Companies Act Neptune Credit Management Limited*[109] where a director of a company which had instituted a winding up process deliberately disposed of shares owned by the company. He denied having sold the shares in question and further denied having benefited from the proceeds of the sale of the said shares. However, the court was able to establish that the directors were attempting to put the assets beyond the reach of creditors and ordered the director to return the proceeds of the sale. It is submitted therefore that, in addition to the stipulation of adequate legal rights, there is a need for an efficient judicial system to enforce these rights, or at least to serve as a credible threat to deter wrong doing, and to speedily conduct the process of winding up or restructuring when so desired. Certainly, a heavily supervised insolvency procedure like the Kenyan one (refer generally to sec 3.3 of this thesis) performs best when its courts are equally performing efficiently.

3.4.2.3 Transaction avoidance

The provisions that govern transaction avoidance have been considered necessary to compliment the general aims of insolvency law.[110] In fact the provisions have been documented as key features of an effective insolvency framework, basically because they may be used to

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[109] [2009] KLR

[110] Rebecca Parry, James Ayliffe , and Sharif Shivji, *Transactions Avoidance in Insolvencies*(2nd edition, Oxford University Press, 2011) pg.8

maintain and enforce schemes set out under the insolvency laws for the distribution of the estate of the insolvent company. It is widely recognized that when a company is established, the shareholders are the owners of the property and therefore have rights over the property of the company. However, the property of an insolvent company, as a matter of law is supposed to be readily available to be distributed to the creditors with shareholders only being entitled to the residual value (if any). Conversely, there is a significant potential that the estate can be badly depleted prior to the filing for insolvency to an extent that hardly anything is left for distribution. To address this potential risk, transaction avoidance provisions are meant to help liquidators to maintain and enforce the scheme of distribution.

The UNCITRAL Legislative Guide on Insolvency Law states three types of avoidable transactions that are available in most legal systems: transactions intended to defeat, hinder or delay creditors from collecting their claims; transactions at undervalue; and transactions with certain creditors that have the effect of preferring them over all other creditors.[111] Each of these avoidable transactions has some specific characteristics, depending on the circumstances of the transaction.[112] However, a particular transaction may fall within the conditions of avoidance under more than one provision, and thus the insolvency representative may be able to choose on which basis to challenge it.[113] Basically, two main forms of behaviour that can undermine the scheme set out in legislations are targeted. First, the scarcity of assets of a distressed company presents an incentive for the company managers to engage in distribution prior to the company being put under insolvency proceedings, which could be by preferring creditors by paying them ahead of others, or granting security over previously unse-

[111] Insolvency Guide, Part two, Para. 170
[112] Irit Mevorach, 'Transaction Avoidance in Bankruptcy of Corporate Groups' (2011) 8 European Company and Financial Law Review 2
[113] Ibid

cured debts.[114] The second is where managers remove assets from the estate entirely either by gifting, entering into a transaction in respect of which the company receives value that is lower than that which it gives, or by fraudulent conveyance.[115]

The Kenyan law contains transaction avoidance provisions, which are arguably limited, considering that vulnerable transactions must have been entered into within a period of only six months prior to the commencement of the insolvency proceedings.[116] A contrast with the time frame given in other jurisdictions supports this criticism. For instance, in China the range and breath of the transactions that can be voidable includes those that took place within one year prior to the acceptance of the insolvency case.[117] In the UK, the legislation is more detailed and distinguishes the undervalue transactions from preferences. Specifically, so far as undervalue is concerned, the law provides for a 'relevant time' which refers to a time period as well as the financial condition of the company at that time. The period is two years prior to the onset of insolvency proceedings and the company must have been unable to pay its debts, or the transaction must have caused this dire financial state of affairs.[118] The time frame for avoidance of preferences is generally six months prior to the onset of insolvency, under section 240(1) (b) but, where the creditor is connected to the company, it is extended to two years.[119]

However, in Kenya the transaction avoidance provision covers a wide range of transactions and states as follows:

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[114] Rebecca Parry, 'Transaction Avoidance' in Rebecca Parry, Yongzian Xu, and Haizheng Zhang, *China's New Enterprise Bankruptcy Law: Context, Interpretation and Application* (Ash gate Publishing Ltd, Surrey, 2010) Chapter 8
[115] Ibid
[116] Company Act Cap 486 section 312(1) (Kenya)
[117] The Enterprise Bankruptcy Law 2006 Article 31 (China)
[118] Insolvency Act 1986 section 240(3) (UK)
[119] Insolvency Act 1986 section 240(1)(a) (UK)

> '(1) Any transfer, conveyance, mortgage, charge, delivery of goods, payment, execution or other act relating to property made or done by or against a company within six months before the commencement of its winding up which, had it been made or done by or against an individual within six months before the presentation of a bankruptcy petition on which he is adjudged bankrupt, would be deemed in his bankruptcy a fraudulent preference shall in the event of the company being wound up be deemed a fraudulent preference of its creditors and be void accordingly.
>
> (2) Any transfer, conveyance or assignment by a company of all its property to trustees for the benefit of all its creditors shall be void to all intents'.[120]

A critical observation on the Kenyan provision leads to two main conclusions. One, sub-section one of the above quoted provision does not connote fraudulent preferences but rather fraudulent transfers though both defraud creditors. Secondly, the section and the legislation generally arguably do not cover all other types of transaction that would normally be voidable, as anticipated in the UNCITRAL Guide. Admittedly, the legislation does not expressly mention transactions at undervalue as well as those intended to defeat, hinder or delay creditors. However, given the breadth of the Kenyan provision, as quoted above, it can be inferred that it encompasses a variety of transactions. However, the Insolvency Guide proposes that the law should specify the particular characteristics of the transactions to be avoided either as 'fraudulent' or 'preferential',[121] a specification which is presently lacking.

Transactions avoidance provisions must help to ensure that the scheme of assets distribution applicable to insolvency is observed and that contractual certainty is not undermined un-

[120] Companies Act Cap 486 Sections 312 (1) and (2) (Kenya)
[121] Insolvency Guide (n 109), Part two, Para. 171

duly.[122] The timing of a transaction is a crucial aspect in the avoidance provisions and jurisdictions like the UK have specified the time period within which a transaction must have taken place, as already mentioned above, as well as requiring evidence of a diminution in assets available to creditors, among other conditions to be met to avoid a transaction.[123] This aspect is missing in the Kenyan provision. Nonetheless, the law in Kenya permits that the person preferred shall be subject to the same liabilities, and shall have the same rights, as if he had undertaken to be personally liable as surety for the debt to the extent of the mortgage or charge on the property or the value of his interest, whichever is the least.[124]

In addition, the UNCITRAL provision proposes that the design of avoidance provisions requires a balance to be reached between competing social benefits. In essence, in respect of actions to restore assets to the insolvency estate, legislatures should consider issues like whether the transaction will be beneficial to the estate and whether the taking of an avoidance action may disrupt reorganization proposals, and account should be taken of the likely cost of avoidance proceedings to the estate.[125] The law should also provide avenues to mitigate the negative effects of avoidance, such that some transactions may not be avoided if certain conditions are satisfied, for example where the beneficiary acted in good faith or where the transaction was entered into for the purpose of carrying on the debtor's business. In this latter instance, evidence of reasonable grounds for the belief that the transaction

[122] Parry, Ayliffe & Shivji (n 107) pg.15; Also see World Bank, Principles For Effective Creditor Right System (2005), c 11.3
[123] For a comprehensive discussion on transaction avoidance see R Parry (n 82) pg.50-219
[124] Companies Act Cap 486 See section 313 for the rights and obligations of certain fraudulent preferred person
[125] Insolvency Guide (n 109)

would benefit the debtor's business would be required.[126] However, the Kenyan avoidance provision does not give any details as to how the balance of the competing interest is struck.

3.4.3. Striking a balance between liquidation and reorganization

Companies and other business entities are undoubtedly the vehicles for commercial development. Their existence and vitality is therefore a very basic need to any economy. In a society and at times when the use of credit to fund businesses has become a norm, more mechanisms are required to support businesses. Therefore, an environment that has adequate relevant legislation is a fundamental. In addition, such legislation ought to be in stride with the expectations and challenges facing business. It must equally be appreciated that the impact of business failure goes far and wide. The worry and the misery that is caused by collapsed entities was best captured by Kariuki's expression,

> '……Seeing the company going down it's like when your daughter has been taken to hospital and admitted in ICU, and you are just there waiting. The effects on me were very painful. I went into depression.'[127]

Sadly, Kenyan corporate history is littered with companies that have gone into receivership but only handfuls have successfully emerged from it. In fact, those few that emerged, had either political muscle or certain rules were overlooked to enable them operate again.[128] For instance, the revival of Uchumi Supermarkets under a state rescue package, and that of Invesco Assurance Company through the injection of capital by Matatu Owners Association are good evidence. To detail this, Invesco Assurance Company[129] is an insurance company

[126] Insolvency Guide (n 59), Part Two, Ch. II, Para. 174–76
[127] Njenga (n 106) pg. 52
[128] Mwaniki Wahome 'Learn From West Receivership Laws MPs told' *Daily Nation* (Nairobi, 6 March 2010)
[129] To read more on Invesco Assurance company and its rescue efforts read Njenga, (n 101) pg. 29

formed in 1998 and which achieved great success in its operations until 2005, when it started experiencing financial problems. A care taker board was appointed to probe its activities. However, it was not until 2008 when it was placed under statutory management, which lasted up to 2010, that it was licenced to operate again. In addition, Uchumi Supermarkets[130] went into receivership in 2006 and the issues acknowledged as having contributed to its fall were mismanagement, political interference, and competition. However, the supermarket was able to recover as well. The happenings in these few successful cases could be a very helpful platform from which to progress the Kenyan insolvency structure but the details of what transpired remain a guarded secret.

Nevertheless, the available information in respect of such successful rescues as well as many written off entities indicates that there is much to desire as to whether the insolvency law strikes a balance between liquidation and reorganization. On the surface, the stipulated provisions do not anticipate financial distress, due to temporary extraneous factors over which a company has no control. In addition, the insolvency legislation does not contain a corporate rescue mechanism that can be used to save ailing but viable companies. It is notable that provisions for Prosecution of delinquent officers and members of a company are entrenched.[131] This is commendable as such provisions have a vital role in an insolvency scenario especially in dealing with insolvent trading. However, it must be appreciated that business failure is not always the fault of management and could be as a result of market dynamics, for example a product losing value because of a new discovery by a competitor.[132] Such realities require a law that facilitates rescue, whenever the business is viable and liquidation

[130] For details on Uchumi receivership, read Njenga (n 106) pg. 66
[131] Companies Act Cap 486 Sec 325(1)
[132] Karen Hopper Wrunck , Financial Distress, Reorganization and organizational Efficiency' (1990) 27 Journal of Financial Economics 419 at 421

when it is not. Unfortunately the law in Kenya fails to achieve this, considering that there is evidence that almost all companies which enter into receivership are being liquidated.[133] It is argued therefore that current Kenyan insolvency laws have a liquidation culture, giving creditors the leeway to liquidate companies that could be saved by proper management. However, as noted, the current legislation is not completely devoid of provisions that may facilitate rescues, as those relevant to receivership have been used as form of corporate rescue although the depth and details of how such has been done remain scanty and purpose built rescue procedures are lacking.

Rescued entities are very rare in contrast to the many businesses which have been liquidated. This reality arguably indicates that the laws fail to achieve an appropriate balance between restructuring and liquidation. The deficiencies and the strengths of the law are ultimately reflected by the attempted rescues and liquidation operations. It is important to state that, whereas it is acknowledged that not all businesses are worth rescuing, businesses facing factors such as bad management choices or temporary financial strain may still be capable of being turned around. For instance in Kenya between 1990 and 2002, interest rates rose to levels which many businesses could not afford. Such businesses experienced financial distress, a typical example of temporary problems.[134] Therefore, keeping viable businesses operating should be one of the important goals of an insolvency system.[135] In fact, keeping viable businesses alive may be the most efficient outcome as the creditors get a chance to recover a larger part of their credit, more employees keep their jobs and the economy is boosted. However, liquidation, whenever a business has little left to be redeemed, should be

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[133] *Jambo Biscuits v Barclays Bank* [2001] LLR 1381 (CCK)

[134] The Standard Investment Bank (2010) weekly bulletin dated March 5 as downloaded on 4th February 2011 at http://sib.co.ke/media/docs/SIB%20NEWSLETTER%2005032010.pdf

[135] Simeon Djankov, Oliver Hart, Caralee McLiesh, and Andrei Shleifer 'Debt enforcement around the world' (2008) 116 Journal of Political Economy 6

facilitated by the law, despite it being a dreaded outcome any business man would wish to avoid. It is essential that the law ensures that the proper functioning of insolvency law enhances maximizing the collective return to the creditors.[136]

Besides the formal procedures that many jurisdictions use in insolvency, there are informal options that contribute to solving business problems and are not regulated by the insolvency law and will generally involve voluntary negotiations between the debtor and some or all of its creditors. The importance of these procedures is acknowledged in the UNCITRAL Legislative Guide on Insolvency Law.[137] The IMF in its study of insolvency and debtor protection regimes has also acknowledged the importance that informal structuring mechanisms play in a holistic approach towards corporate insolvency.[138] This implies that, informal restructuring cannot be ignored in its contribution to corporate rescue. In Kenya, there are no well-developed informal approaches to corporate insolvency, as detailed in chapter 4.5 of this thesis. In essence, stakeholders are obliged to use existing structures, even if they are ineffective and unsuited to ensuring a company rescue. This can be contrasted to the English system that is diverse in having a number of rescue processes and gateways (formal and informal).[139] Such procedures, in particular the informal, would give companies a flexible opportunity to attempt to resolve their troubles outside the rigid, lengthy and even time-consuming formal approaches.

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[136] Terence H Jackson, The Logic and The Limits of Bankruptcy Law (Harvard University Press,Cambridge,1986) pg. 86
[137] The UNCITRAL Legislative Guide on Insolvency Law 2005, pg. 22 available in <http://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf>assessed on 25/03/2011
[138] World Bank, *Orderly & Effective Insolvency Procedure: Key Issues* (Washington, IMF, 1999) pg.13
[139] English corporate insolvency enjoys a variety of approaches, the company voluntary arrangement, as provided for in Schedule A1 of the Insolvency Act 1986, administration, as provided in Insolvency Act 1986, Schedule B1, and Schemes of Arrangements as provided for in CA 2006,section 895.

Furthermore, the ease with which a winding up petition can be issued in Kenya and the lack of moratorium in receivership are detrimental as this implies that even business entities that are viable and which can be restructured are not given a chance of survival. In addition, the stipulated insolvency test of failing to pay a debt requires only a small sum of one thousand shillings to be unpaid and this worsens the situation.[140] As a result, creditors who are entitled to exercise their authority in light of a lack of alternatives can abuse their authority and engage companies in endless legal battles. As already mentioned, the Company Act of 1962 contains fairly detailed provisions on winding up a company and even though there are provisions to challenge winding up petitions in court in section 223 of the same legislation, they are affected by a lack of coherence in the rules dictating the procedures that are to be followed. In view of these weaknesses, Kenya can be said to be out of touch with modern trends without a rescue culture. Whereas it is important to appreciate the need to safeguard creditors' interests, winding up, particularly of public companies, tends to yield more dire economic repercussions for the country in terms of employment, lost business opportunities and loss of the initial investment in setting up the business.

3.4.4 Ensuring equitable treatment of similarly situated creditors

The extent to which creditors are susceptible to serious harm in their debtor's insolvency is only one of numerous important considerations in determining their proper ranking in corporate liquidation. It is important and necessary that the law is clear on how the claims are to be treated and which claims deserve to be favoured without causing ambiguity. This clarity and predictability is what every investor, both local and foreign, desires to see and every credit lender wants to understand. It must also be appreciated that, in as much as the law at-

[140] Companies Act CAP 486 section 220 (a) (Kenya)

tempts to address legal problems, there is also a market dynamic that seeks to stretch the law. Nonetheless, insolvency laws all over the world entrench exceptions to most legal principles. For instance the rules such as *pari-passu* and insolvency set-off amongst other.

To start with, *pari- passu* is often said to be the fundamental rule in corporate insolvency law. It holds that in winding up, unsecured creditors shall share rateably in those assets of the insolvent company available for distribution.[141] Basically, it is a distributive principle that expresses collective justice, designated in ensuring fairness and gives legitimacy to the mandatory insolvency regime.[142] In addition, insolvency set off is where the law provides for the taking of an account of what is due from each of the insolvent company and its creditor to the other, for the setting off of those sums against each other and the payment only of the net balance.[143] In essence, if it is provable in the favour of the company, it is payable to the liquidator and if in favour of the creditor, the liquidator pays it on behalf of the company. English laws provides for insolvency set-offs in Insolvency Rules.[144] In principle, English insolvency set-off is automatic and mandatory upon insolvency of one counterpart in a mutual creditor/debtor relationship.[145] Such rules play certain roles in insolvency and in fact, English insolvency set-off has been recognized as one of the most important protection offered by English law in relation to commercial and financial activity.[146] However, critics of insolvency set-off insolvency argues that such arrangements creates for the unsecured creditor a position comparable to that of secured creditors without the need for a charge

[141] Finch, (n 54) at 599
[142] Peter Kojdic, 'Insolvency Set-off Under the English Law: Lessons for Serbia' (A Master Thesis Submitted to the Central European University, Budapest, Hungary, 2012) pg 22
[143] Shantanu Majumda, 'Insolvency Set-Off and Security: Anomaly or Principled Exception?'(2009) Butterworths Journal of International Banking and Financial Law 652-654
[144] See Rule 4.90 for Liquidators and Rule 2.85 for Administration
[145] Francis Collaço Moraes, 'Insolvency set-off: The mutuality of assignment in subordination' (2014) 5 Corporate Rescue and Insolvency 187
[146] Kojdic (n 140) at 1

over assets, because it guarantees that his claim, up to the value of his debt to the insolvent, is paid in full.[147]

Nonetheless, these two aforementioned insolvency principles arguably allow preference. In reality certain attempts to gain preference are undesirable, because they undermine the benefits associated with collective decision-making. However, structured preference permitted through clear legal framework are beneficial and both the insolvency set-off and *parri-passu* are good examples. For instance, insolvency set-off is deliberately intended to do substantial justice between the parties; its application is not limited to particular categories of claim, but rather applies to all cross claims provided they are mutual and measurable in money terms.[148]

The UNCITRAL Legislative Guide in so far as creditor conflict is concerned, suggests that the role, rights, and governance of creditors in proceedings should be clearly defined and, where a committee is established, its duties and functions, and the rules for the committee's membership, quorum and voting, and the conduct of meetings should all be specified by the law.[149] In addition, there is evidence from literature, that affirms that to be able to treat creditors equitably, it is first necessary to categorize them into groups and the most recognized groups are, secured creditors, unsecured creditors, preferential debts and liquidation expenses.[150] It is noted that the Kenyan legislation does not refer to the creditors in the specific terms of the aforementioned categorization but they all exist in different sections of the

[147] Joanna Benjamin, *Financial Law* (Oxford University Press, 2008) pg 35
[148] Moraes, (n 143)
[149] World Bank *Principles for Effective Creditor Rights and Insolvency Systems*, Revised draft Part C 2005 http://www.worldbank.org/external/default/WDSContentServer/WDSP/IB/2009/04/20/000334955_20090420051400/Rendered/PDF/48 accessed on September 2012
[150] Finch (n 38) pg.425

statute with different names. In fact, they are grouped into more less those recognized general categories.

In addition, in most reputable insolvency processes around the globe, the achievement of an equitable treatment of creditors has been dealt with using a fundamental rule called *pari passu* as a foremost principle.[151] In essence, the unsecured creditors' claims are satisfied *pro rota* to the extent of their pre-insolvency entitlements or the sums they are owed. The proponents of this principle argue that it often constitutes a fundamental rule of corporate insolvency law, as a way of collective dealing with unsecured creditors as a class, and enhances efficiency in so far as avoiding the time and cost of dealing with each claim on individual merit is concerned.[152] Goode supports the *pari passu* principle but notes that 'the principle has been gravely diminished, first by the extensive range of security rights and analogous devices that have evolved over the years, and, secondly by a massive expansion of the range of debts made preferential by statute.'[153] Besides, the Cork report in the UK, while acknowledging the exceptions to this principle, reiterated its fundamental importance to an orderly and fair liquidation of an insolvent business.[154] And accordingly, the committee proposed the following:

> ' ….principle of *pari passu* distribution of the insolvent's estate should continue to form a cornerstone of any new insolvency legislation……..We accept that no one

[151] Andrew Keay & Peter Walton, 'The Preferential Debts Regime in Liquidation Law: in the Public Interest?' (1999) 3 Company Financial and Insolvency Law Review 84-105
[152] Vanessa Finch, 'Is paripassu passé?' (2000) 5 Insolvency Lawyer 194-199
[153] Roy Goode, Principles of Corporate Insolvency Law (3rd edn, Sweet &Maxwell, 2005) p.99
[154] Insolvency Law and Practice: *Report of the Review Committee (The Cork Report)* Cmnd 8558 (1982) para. 1220

> should be able to contract out of insolvency law, and *pari passu* distribution in particular.' [155]

However, other scholars like Mokal disagree and argue that the principle is less important than it is sometimes made out to be and it does not fulfil often any attributed function.[156] Nonetheless he acknowledges that the principle represents formal equality in insolvency law and seeks to be informative on how insolvency law decides on the treatment of different types of creditors.[157] Elsewhere, it has been submitted that it would be a serious misconception to suppose that the *pari passu* principle operates in a comprehensive way because the *pari passu* principle is applied sequentially in relation to certain, discrete groups of claims, ranked into categories according to a fixed system of priorities.[158]

Nonetheless, regardless of which side of the debate one subscribes to, it is appreciated that the *pari passu* principle cannot easily be overlooked. The entrenchment of the principle in Kenyan merits applauding as an effort to ensure that creditors are treated equitably. This provides a glimpse to investors as to what to anticipate should they find the debtor in the winding up procedure. However, because there are other dynamics that are significant in any insolvency process, there are exceptions to this rule, which are also recognized in the statute. A good example is the treatment of preferential creditors, which are more favoured than other creditors. The list of the preferential payments such as taxes and local rates due, government rents and wages and salary are specified in Section 311 of the Companies Act. Such claims are ranked ahead of general claims, such that all preferential debts must be discharged in full before general unsecured creditors are paid anything.

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[155] Ibid
[156] Riz Mokal, Priority as Pathology: The *Pari Passu* Myth (2001) 60 Cambridge Law Journal 3
[157] Ibid
[158] Ian Fletcher, *The Law of Insolvency* (3rd ed, Sweet & Maxwell, 2002) pg.21

3.4.5. Provision for timely, efficient and impartial resolution of insolvency

The success of a rescue procedure and survival of business depends on when the rescue process is started. Equally the maximization of value realized in a liquidation process depends on when the necessary measures are taken. A rescue process that could be initiated without the requirement of a company being insolvent may potentially be initiated earlier during the distress cycle when the rescue prospects are more likely to be successful.[159] On the other hand, a company should be protected from being forced into an insolvency procedure in inappropriate circumstances. This was demonstrated clearly in the case of *High berry Ltd and another v Colt Telecom Group Plc*[160] where a creditor, keen to put a company into administration, filed a petition when the company was cash flow solvent and balance sheet solvent in order to achieve a selfish interest. The particular creditor wanted to effect a debt for equity exchange hence gaining full value from the notes they had purchased. Relying on a fall of the company share price over the preceding year, they argued that the company would be unable to repay a substantial amount of capital which was to be due four years later, as it was unclear how the company would be able to generate enough cash. The judge, on rejecting the petition, described the petition as having no substance and considered the allegation of insolvency as a serious matter that requires serious foundation.

In Kenya, the receivership procedure can be started through a court application by the creditors or just by a debenture holder through the powers contained in an instrument.[161] It is however unclear what key reasons or circumstances have to be there before the process is triggered. Interestingly, the legislation states that the company which is being wound up

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[159] Riz Mokal, 'The Floating Charge-An Elegy' in S. Worthington (ed.), *Commercial Law and Commercial Practice*, (Hart, 2003) Chapter 17, Section III.
[160] [2002] EWHC 2815
[161] Companies Act Cap 486 Sections 347 and 348 (Kenya)

(section 347) can have a receiver appointed if an application is made by the debenture holder or any other creditor. In practice, an application tends to be made when the company is unable to pay its debts. It is argued that the unclear triggering factors present a risk that the receivership process could be started too early and it is equally probable that it may in some cases come rather too late. It has been documented that the key to enhancing the success rate of reorganization is to encourage the directors to recognize the problem early and take appropriate actions.[162] This is however made possible only if the legislation has the right incentives for the company to easily access the use of reorganization alternatives.

For instance, in other jurisdictions a policy of 'debtor in possession' has been embraced as a way of encouraging a company to invoke the reorganization procedures when there are signs of financial distress, rather than waiting until the problems are advanced and possibly irreversible.[163] A typical example is the US which has a policy of debtor in possession to go hand in hand with encouraging a company to invoke the Chapter 11 reorganization procedure early.[164] The rationale behind DIP is that, the possibility to remain in managerial control encourages the directors that Chapter 11 protection will safeguard their position, as well as providing them with the exclusive right to propose a reorganization plan.[165] Managers who believe that their jobs will be preserved in a Chapter 11 context will be more likely to put their company into Chapter 11 at an early stage while the company may still be viable. It may benefit the company that those most acquainted with the company will continue handling it. As a side note it must be added that there has been evidence from the literature that

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[162] Qi (n 73)
[163] David Hahn, 'Concentrated Ownership and Control of Corporate Reorganizations' (2004) 4 Journal of Corporate Law Studies 117. See also Vanessa Finch, 'Control and co-ordination in corporate rescue' (2005) 25 Legal Studies 374; Oliver Brupbacher, 'Functional Analysis of Corporate Rescue Procedures: A Proposal from an Anglo-Swiss Perspective' (2005) 5 Journal of Corporate Law Studies 105.
[164] Gerard McCormack, 'Control and corporate rescue - an Anglo-American evaluation' (2007) 56 International & Comparative Law Quarterly 3, 515-551
[165] Ibid

the position in practice is different. In fact, it been stated that 'the Chapter 11 of the 1980s', where the directors and managers seemed to dominate bankruptcy no longer exists and instead a new approach has taken over where the creditors have converted existing contractual tools into important governance levers.[166] Therefore, the extent to which Chapter 11 is DIP in practice is debatable.

In contrast to Chapter 11, the relevant statute in Kenya does not have any incentives or provisions that can enable the company to start a rescue process early, which is arguably detrimental to businesses. This means therefore that a business will continue to keep running without addressing visible problems which could be ameliorated to enhance long time benefits so that it ultimately becomes insolvent. Besides, the management is not allowed to stay in place once such proceedings are started. The question of who remains in control inevitably influences the early filing of rescue procedures. In addition, business failure is perceived negatively and liquidators/receivers are empowered with the consent of the attorney general to investigate the actions of directors. It may be noted that risk averse management may become less motivated to work hard under a strictly enforcing regime which not only removes them from office upon business distress but also severely penalizes them as a bonus if they are later found to have effectively resigned too late.[167] But it must be noted that the DIP, just like the PIP model, has its own strengths and limitations and both models are developed and influenced by existing risk attitudes and market dynamics. The diversity of management orientation, as reflected by the two, shows the complex, multifaceted nature of the insolvency process in which conflicting interest are adjusted.[168] In this regard, policy makers may have

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[166] David A Skeel, 'Creditors' Ball: The "New" New Corporate Governance in Chapter 11' 2003 (152) University of Pennsylvania Law Review 2
[167] McCormack (n 160)
[168] Qi (n 73)

to employ a unique approach that can coax and not threaten the managers so as to take action early but still be able to change the management if its enhances better results.

The receivership procedure is essentially an appointment of the official receiver (displacing the company directors) in one of the following ways. The first is through a court order, when an application is made to the court to appoint a receiver on behalf of the debenture holder or the other creditors of a company being wound up.[169] This court appointed receiver is an officer/agent of the court. Second is the out of court appointment where they are appointed through the powers contained in the company instruments.[170] The effects of the receiver's appointment are twofold: any floating charges 'crystallize' and the director's powers to control the company are suspended as the receiver takes over management functions and the company directors' powers to deal with assets of that company are suspended and taken over by the receiver.[171] When appointing the receiver, the debenture holder is entitled to prefer his own interests to those of a company and so his position is adverse to that of the company.[172] Besides, the receivers' first power relates to the possession and realization of the security and in this role he is deemed as an agent of the debenture holder.[173] This raises the concern whether a receivership procedure can be efficient, given that it is likely to fail to maximize the value for all creditors. Undoubtedly, there will always be a divergence between the interest of the appointing debenture holder, to whom the receiver owes principal duties, and the general unsecured creditors.[174]

[169] Companies Act cap 486 section 347 (Kenya)
[170] Companies Act cap 486 section 348 (Kenya)
[171] H K Saharay, *Company Law (* 5th edn, Universal Law Publishing Co. Pvt. Ltd, 2008) pg. 250
[172] Roy Goode, *Principles of Corporate Insolvency Law* (4th edn, Sweet & Maxwell, 2011) pg. 342
[173] Ibid
[174] Goode (n 170) pg 342

The availability of an out of court means of appointment of the official receiver gives receivership a merit of flexibility. A debenture holder in the course of the lending relationship acquires information about the company's financial standing. With the benefit of this privileged position, receivership gives them a principal advantage to act on the information without interference from other less informed creditors. This opportunity, if used appropriately with a conscious commitment to rescue the company, can actually enhance the benefit of having had early resort to the rescue mechanism. The pitfall however is that, where the company's assets are worth more than the bank is owed, nothing obliges the bank to do anything to save the business.[175] In addition, the legislation is silent as to whether the company can object to the appointment of a receiver but there is evidence from the judicial decisions that a borrower can move to court seeking an injunction restraining the receiver from taking over the company affairs. This is however at the considerable discretion of the court.

In, fact, for a long time the position in Kenya was that the Courts would not generally interfere with the appointment of a receiver. This was explained in the *Madhupaper International case,*[176] where the directors brought a suit to challenge the appointment of receivers. They pleaded that the receivership would gravely prejudice the company's investment in its Thika Plant. The trial judge decided the balance of convenience as favouring the appointing creditor. The Court of Appeal after conceding that the terms of the debenture were draconian affirmed the decision in the following words:

[175] John Armour, and Riz Mokal, 'Reforming the Governance of Corporate Rescue: The Enterprise Act 2002' 2005 (1) Lloyds' Maritime and Commercial Law Quarterly 28-64
[176] *Madhupaper* International Ltd & another V Kenya Commercial Bank Ltd & 2 Others [2003] KLR 31

> 'It is correct law that a debenture holder which has a right to appoint a receiver is under no duty to refrain for exercising its rights because doing so might cause loss to the company or its unsecured creditors.'[177]

Notwithstanding the view expressed above, the appointment of a receiver has been subject to considerable judicial scrutiny in recent times. The debenture holder's privilege to appoint a receiver has weakened. This was reflected in the *Fina Bank case*,[178] where the Court compelled the receivers to vacate the borrower's premises and stated that, where a party exercises a statutory right 'oppressively' the Court would have a right to interfere. Justice Tunoi in this case seemed to consider the wider impact and stated as follows:

> 'The issue of receivership is an emotive one and I understand why the respondent had to resort to litigation. It destroys the business. It is expensive.'

Much as the decision given was a good precedent, it failed to lay down any objective guidelines as to what amounts to oppression.

In addition, the *Jambo Biscuits case*[179] shows how the appointment of receivers can be challenged. Justice Ringera, in upholding an application to restrain receivers in a number of rather technical grounds, stated that:

> `'I find that the company has made out a prima facie case with a probability of success at the trial that the appointment of the receivers/managers was illegal and invalid...'

[177] Ibid
[178] Fina Bank v Spares & Industries [2000] 1 EA 57
[179] *Jambo Biscuits (K) Limited v Barclays Bank of Kenya Limited & 2 Others* [2009] eKLR

The technical grounds expressed were that the debenture was not drawn up strictly in accordance with provisions of the Advocates Act Cap 16 and that the letter of the appointment of the receiver was ineffective for lack of attestation. It is rather obvious from the above cases that impartiality enhances creditors' confidence that the insolvency process will be fair. However, the preferential treatment given to the debenture holder over other creditors to appoint the receiver has led to receivership being manipulated to serve interest of a few. It is argued therefore that the law has made it difficult for companies placed under receivership to return back to profitability with appointed managers acting more like undertakers rather than managers keen to revive the ailing companies. This sentiment was best captured in *Jambo Biscuits v Barclays Bank (2002),* where Justice Ringera, at his analytical best, stated that:

> 'I think it is notorious facts of which judicial notice may be taken that receiverships in this country have tended to give the kiss of death to many a business.'[180]

In addition, according to Standard Investment Bank (SIB), receivership law provides leeway to entities owed money and whose chief concern is recovery of their debt, to appoint receiver managers who more than often have overstepped their mandate when executing court orders leading to eventual collapse of companies that could have been saved by proper management.[181] It must be noted that similar sentiments were expressed in relation to the English administrative receivership procedure which Kenya inherited. Administrative receivership was widely regarded as giving an unhealthy amount of power to creditors holding floating

[180] [2001] LLR 1381 (CCK)
[181] The Standard Investment Bank (n 131)

charges, which, because of their secured status, lacked sufficient incentives to rescue failing companies.[182]

It must also be noted that receivership presently lacks moratorium, a very significant feature of many rescue processes and whose importance is acknowledged in jurisdictions with successful rescue ventures. This means that the creditors can still engage in the chaotic race to protect their interests despite the company going into an insolvency procedure, giving rise to inefficiencies and unfairness and even making the receiver's work difficult. In view of these weaknesses it must be observed that Kenya's rescue culture is at a stage of development that lags behind those of recognized and successful approaches in other jurisdictions. In the United States for example the automatic stay on creditor enforcement action is an intrinsic feature of Chapter 11. The purpose of the stay is to give the company a breathing space to allow survival prospects to be assessed and a restructuring plan to be put in place. English law has two types of moratoria-a moratorium for the period that the company is in administration and, prior to that, an interim moratorium pending the disposal of an administration order application or the coming of an out of court appointment of an administrator in the period following the giving of notice of an intention to make such an appointment.[183] The moratorium during administration is intended to provide a breathing space and allow a company an opportunity to negotiate with its creditors. The interim moratorium protects the company during the appointment process, a time when it is vulnerable to hasty action by creditors.

[182] The Cork Report (n 152), Para 233

[183] See Enterprise Act 2002 section 42, 43 and 44; Also see Insolvency Act 1986 Schedule 1 para 2; Insolvency Act 2000 section 1 Finch 2nd edition (n 54) pg. 405

An efficient law should provide an appropriate structure for the supervision of an insolvency process by professionals, such as receivers, statutory managers and liquidators. Besides, it has long been acknowledged globally that insolvency practitioners play a key role in the management of insolvencies. However, jurisdictions vary in their approaches to insolvency procedures and equally to their practitioners. In fact, some jurisdictions have heavily regulated professionals while in others their practitioners' skills are unregulated and lightly supervised. The Kenyan statute does not contain any professional or other qualification requirements that must be met for a person to be appointed as receiver. In practice, accountants generally handle insolvency matters. This can be contrasted with the regime in the UK, where there is a requirement that an insolvency practitioner must either be a member of a recognized professional body or obtain authorization to act under section 393.[184] Accordingly, the liquidators and administrators in the UK are both officers of the court and licenced insolvency practitioners who are subject to an intense and severe regulatory system.[185] Interestingly, the most the Kenyan legislation does is to stipulate the ineligibility of a body corporate[186] and an un-discharged bankrupt[187] from being appointed. The legal position of a receiver or manager is dependent on the manner in which the appointment is made. If the receiver is appointed by the court, then the receiver is an officer of the court and is not deemed to be an officer of the company. In such a case the receiver is bound by the directions and instructions of the court.[188] Where the receiver is appointed out of court he or she is regarded as an agent and officer of the company and must act in accordance with the terms of the instrument on the basis of which he or she has been appointed, in addition he

[184]The Insolvency Practitioner Regulations 2005 (SI 2005/524) which supplements the provisions of Insolvency Act 1986 Part XIII
[185] K Scott, 'A fair deal?' 2009 (159)New Law Journal 421
[186] Companies Act Cap 486 Sections 345(Kenya)
[187] Companies Act Cap 486 Sections 346 (Kenya)
[188] Companies Act Cap 486 Section 347 (Kenya)

may apply to court for directions in connection to the performance of his functions.[189] In practice, official receivers and liquidators are normally accountants.

In addition, it must also be noted that the legislation has no mechanism in terms of which the receivers can be held accountable for the estates that they administer. Besides, there is even no manner in which to gauge how much work has been conducted by the insolvency administrator, or whether the administration has been conducted efficiently. This, coupled with the lack of a clear time frame on when and how an insolvency procedure should unfold, is not only detrimental to a rescue venture but also increases the cost because it can run on for too long. In contrast, other jurisdictions like the UK have legislative controls which entail a requirement that insolvency practitioners holding a licence must have in place security for the proper performance of their functions.[190] The security takes the form of a bond issued by a surety that covers a liability of £250,000 pounds for an enabling bond and a further £5000 of specific penalty. In addition insolvency practitioners are required by the IPA Professional Indemnity Insurance (PII) Regulations to have PII cover; and by the statutory Insolvency Practitioners Regulations to have a general penalty bond for £250,000, together with specific penalty bonds in relation to individual insolvencies to which he/she is appointed.[191] However to have professional indemnity insurance is not unique to insolvency practitioners as many profession require the same as part of their respective industry body's regulatory requirements.

[189] Companies Act Cap 486 Section 348(1) (Kenya)
[190] Insolvency Act 1986 and The Insolvency Practitioners Regulations *2005*
[191] Association of Business Recovery Professional, *Setting Yourself Up in Practice*: *A guide for newly-qualified insolvency practitioners* (GTI Specialist Publishers Ltd, 2008) pg. 10

On the remuneration of receiver managers and liquidators, the Kenyan court may, on an application by the liquidator/receiver fix the amount to be paid.[192] There is however no obligation to make such an application, leaving room for speculation and uncertainties as to what will happen should they not apply to court. Such loopholes give room for exploitation of the insolvency process which should be a safety net for both the creditors and the debtor. It is noteworthy, that the current insolvency law, in many aspects, stipulates the involvement of the court through the insolvency procedure. This, when adequately and efficiently used, can provide a good supervisory structure. There is however a general perception that Kenyan court is not impartial and hence is not to be trusted to expedite the insolvency process.[193] Besides, the courts always have a backlog of cases, resulting in cases taking too long to be decided and, when they are decided, this is too late for any meaningful recovery to take place.[194]

3.4.6. Preserve the insolvency estate to allow equitable distribution to creditors

A fundamental objective of collective insolvency regimes is to preserve the value of the insolvent estate and ensure that this value is then distributed in harmony with the appropriate and efficient statutory procedure.[195] In fact the UNCITRAL legislative guide states that the preservation of the estate involves prevention of premature dismemberment of the debtor's assets by individual creditor actions to collect individual debts and a stay on creditors' action. Despite it being one of the key tasks of an insolvency procedure, there are different reasons that can be attributed to the inability of a regime to preserve effectively the insol-

[192] Companies Act Cap 486 Section 350 (Kenya)
[193] FSD Kenya, *Costs of Collateral in Kenya ,Opportunities For Reform* (Nairobi 2009) pg. 13 available at www.fsdkenya.org accessed at 1pm of 20/6/2011
[194] Ibid
[195] Riz Mokal, 'What Liquidation Does for Secured Creditors, and What it Does for You' (2008)71 Modern Law Review 699-733

vency estate, which will be discussed here. Liquidation, being a collective process, requires cooperation amongst creditors achieved through the law. Therefore, individualistic enforcement of action by creditors, a move contrary to the collective approach, dismembers the corporate estate and thus destroys value. Basically, the provisions that allow for a stay on enforcement actions by creditors are vital as they ensure that the estate is preserved.

The law is clear, as contained in Section 316, that, in a winding up by the court, any disposition of the property of the company, including things in action, and any transfer of shares, or alteration in the status of the members of the company, made after the commencement of the winding up, shall, unless the court otherwise orders, be void. This is supported by Section 228 which equally stays actions once a winding up order has been issued.

Automatic stay is a common practice in many jurisdictions. In Australia for example, the appointment of the administrator under Part 5.3A of the Corporations Act automatically commences stay on creditors' claims subject to certain exceptions.[196] The actions for recovery of property in the possession of the insolvent company are stayed, together with other litigation but the fact remains that notices of termination can be given under the company's contracts with third parties. The debtor company in Australia is not divested of the property upon entering insolvency and the debtor will therefore retain the capacity to perform legal acts and so liquidators or administrators can act on behalf of the company as agents.[197] There is an expectation that the liquidators will do everything in their power to collect any disposed assets of the company using the various powers for recovering debts.[198] It is argued that this approach might prove costly as the liquidators' pursuit to recover assets

[196] Corporation Act 2001 section 440D; Also see Christopher F Symes, and John Duns, *Australian Insolvency Law* (LexisNexis Butterworths, 2009) pg. 4
[197] Ibid
[198] Symes & Duns (n 194) pg. 5

will inevitably entail a lot of litigation and the cost will be on the debtor and this requirement is inconsistent with the idea of preservation. Besides, the aforementioned exception allowing termination of contracts due to insolvency negates the benefits of automatic stay. It has been documented that the absence of an automatic stay deters usage of bankruptcy.[199]

Some jurisdictions, for instance the UK, in addition to disabling certain types of dealing with the company, also empower the liquidator/receivers with investigation and re-curative tools.[200] In Kenya, similar powers of liquidators are detailed in Section 241 of the Company's act Cap 486 but subject to the control of the court, as stated in the subsequent provision. The importance of such empowerment was seen in the case of *Adrian Spencer Dearing & Another v James Abiam Isabirye Mugoya*[201] where the receivers had to apply to court requesting that the respondent be compelled to submit and verify the statement of company affairs. In addition he was instructed to attend to the application given by receiver managers, to give a precise and concise account of all missing plant and machinery of the company, amongst other prayers.

The learned judge, while granting the receiver's prayers, acknowledged that the applicants were discharging their statutory duties under the Companies Act and that the duties were not incompatible with seeking prohibitory and mandatory orders, as long as the orders sought were limited to facilitating their statutory commands. As such, an insolvency practitioner cannot be effective without support of a court whenever their functions are challenged, as they were in the above case. Undoubtedly, the court plays a vital role. However, an ambiguity that needs to be noted when it comes to prosecution of delinquent officers and members

[199] Claessens & Klapper (n 26)
[200] Mokal (n 157)
[201] (2007) eKLR 42

of company in criminal liabilities (section 325(1)), the liquidator needs the consent of the Attorney General, or he must report to the Attorney General, who will take the necessary action. It is unclear what purpose this requirement serves and its inclusion in the provisions is wanting. Besides, the establishment of the office of the Director of Public Prosecution in article 57 of the Constitution of Kenya 2010 makes this requirement obsolete. It is submitted that the involvement of the Attorney General is an unnecessary hurdle to the effective functioning of a liquidator. It limits the powers of the liquidator and even delays or prolongs the investigation. The court already plays a considerable supervisory role in as far as the powers and functions of the liquidators are concerned, which it is submitted provide a sufficient check and balance.

Another, key weakness of the Kenyan liquidation process is that most of its provisions consistently mention voluntary winding up.[202] The detriment of this is that many companies that are being wound up in reality are insolvent companies that are in crisis, contrary to what the statute anticipates. There is a gap between the needs that the legislation addresses and problems that need legal attention. However, the availability of an option to manage the company while in liquidation, where necessary or the room to engage in a receivership process is in itself a provision that allows for preservation, if properly used. It is submitted that an efficient restructuring procedure in itself is preservation as this gives room for a business to be, at the least, preserved as a going concern whenever possible. The lack of such provision in Kenya's laws has already been emphasized. Lastly, the provision that stipulates how the creditors and their rights are treated ensures that there is an equitable distribution of assets. Under section 311 of the Companies Act Cap 486, the respective rights of secured and unse-

[202] The statute unnecessarily dedicates most of its Sections to winding up provisions and in particular to voluntary winding up, which is mentioned many times. To see this further see the following sections, 272,273,274,275,276,292,295,296,297 and 298 amongst others. (Companies Act cap 486 Kenya)

cured creditors, and as to debts provable, and to the valuation of annuities and future and contingent liabilities, as are all recognized and are to be treated under the law of bankruptcy.

The ability of a Kenyan liquidation system to perform any of the functions necessary for preservation of the insolvency estate, as it stands now, is dependent on the support of a sound judicial system. This is because the entire insolvency process has an extensive involvement of the court system, which has numerous merits. The greatest challenge is when the judiciary lacks efficiency or has lost the confidence of the general public and investors alike; it becomes a problem. Unfortunately, the Kenya judiciary is burdened with a loss of public confidence and trust, due to rampant corruption, inefficiency and incompetence.[203] In addition, it struggles with a backlog of cases, causing delays. With such a negative image, there is little expected in as far as supporting the insolvency processes and boosting investors' confidence is concerned. It is notable that a great number of reforms have been initiated in the Judiciary since the Constitution of Kenya 2010 came into force. However, the evidence available so far demonstrates that the public still has mixed views of and degrees of confidence in the Kenyan Judiciary.[204]

3.4.7. Ensure a transparent and predictable insolvency law that contains incentives for gathering and dispensing information

The legislation provides room for the gathering of information in so far as both liquidation and receivership are concerned. In fact, the reports submitted to the liquidator and receiver have the input of the officers of the company, as well as anyone in the employment of the

[203] ICJ Kenya*, Strengthening Judicial Reforms –Performance Indicators: Public Perceptions of the Kenya Judiciary* 2001' available http://pdf.usaid.gov/pdf_docs/PNACW007.pdf accessed on 12/11/2014. It details all the challenges and weaknesses as well as necessary reforms in the judiciary

[204] ICJ Kenya, *Promoting and Protecting Human Rights, Democracy and the Rule of Law* (September 2012) available in www.infotrakresearch.com accessed on 13/11/2014

company wishing to give an opinion, and even creditors, by petition to the court.[205] All these persons are sources for official receivers to gather relevant information. The receiver's first duty, just like that of a liquidator, is often to do a preliminary assessment of the company's financial position using the statement of affairs submitted to him. It is expected that within two months from the day that he received the statement, he will forward the statement to the court, registrar and the creditors together with his comments, if he so wishes to comment.[206] At this point, the receiver will not yet have taken any managerial duties but once he has made his decision on the best option that can be pursued, he is empowered to apply to court on performance of his functions.[207] The statute does not explicitly direct the receiver on his next move but there is an implied power that, through this application, he may either request to manage the company, if he finds the business viable, or recommend it be liquidated.

The precise duties assigned to the liquidator, as well as the time stipulation, foster transparency as well as predictability. These will not only serve the interest of the creditors engaged in an insolvency procedure but they will also ensure that the local and foreign investors who are keen on investing can easily understand what to anticipate should they need to resort to such procedure. The statute gives no further details on what actually is anticipated in the receivership process. This implies that even the holding of a creditors' meeting need not necessarily happen. Besides, there is no time limitation on the formulation of the rescue strategy, which raises concern as to whether receivership provides an acceptable level of transparency and accountability to all those interested in the company affairs.

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[205] The sections of the Companies Act that detail the winding up and receivership procedures in their content provide for the process in which information is submitted as statements and even verified by other persons. As such even the insolvency practitioners are expected to forward the statements and even make further reports where necessary.

[206] Company Act Cap 486 Section 351(c) (Kenya)

[207] Companies Act Cap 486 Section 348 (Kenya)

Much of what the statute stipulates by way of financial transparency arises through the report that the receiver must submit within every twelve months, or such longer period as the court may allow after the expiration of the period of twelve months from the date of his appointment, to the registrar, trustee of the debenture holders and the company.[208] This should detail the financial transactions that have been undertaken during that period. However, the receiver appointed under the powers contained in an instrument must submit the financial reports every six months.[209] In both instances, there is lack of accountability to the creditors as a whole, supporting the view that the receivership is a procedure beneficial only to debenture holders. Besides such lapses in communication with creditors can prompt other creditors to apply to court for liquidation order which, if granted will undermine the rescue efforts.

Once appointed, a receiver must notify the company of his appointment.[210] This is necessary where the receivership is initiated without court orders. Upon the receipt of this notice, the company has to prepare and submit to the receiver a statement of affairs of the company verified by an affidavit, within 14 days or such longer period as may be allowed by the court.[211] Equally, the other creditors will be notified of the appointment of the official receiver.[212] The statement of affairs has to show the position as at the date of the receiver's appointment, including the particulars of company assets, debts and liabilities, names, postal address and occupation of creditors, and the securities held by them respectively.

In the liquidation process, a well-detailed provision on the effects of opening proceedings requires that, once the winding up order has been issued by the court, the liquidator shall not

[208] Company Act Cap 486 Section 351(2) (Kenya)
[209] Companies Act Cap 486 Section 353(1) (Kenya)
[210] Companies Act Cap 486 section 351(1)(a) (Kenya)
[211] Companies Act Cap 486 section 351(1)(b) (Kenya)
[212] Companies Act Cap 486 Sec 349(1) (Kenya)

only become an official receiver but shall summon a meeting with creditors and other contributors of the company for the purposes of dispensation.[213] He also has powers to do a number of things, including bringing legal proceedings, carrying on business as may be beneficial for winding up, and making compromises or arrangements with creditors, amongst other things.[214] There is a requirement for both liquidators and receivers alike, to notify the company and trustees of their appointment, as well as sending a statement to the registrar. These are all avenues of disseminating information. In addition, the requirement in section 349 that every invoice, or order for goods shall contain a statement that a receiver has been appointed ensures that unsecured creditors are notified. In summary, the legislation facilitates continued and transparent communications with all the creditors. It is emphasized that this extensive dissemination of information is limited to the liquidation process. There is a requirement to hold a meeting with creditors in a liquidation procedure and also to ascertain their wishes.[215] The statute does not mention any creditors' meeting in a receivership process.

3.4.8 Recognize existing creditors' rights and establish clear rules for ranking of priority claims.

It must be appreciated that an essential feature of the security that the secured creditor enjoys is a right to priority of payment from the sale of the collateral on enforcement.[216] In essence, it is important to do an investigation into the company's details first to ascertain not only the financial standing of the business but also to establish all the rights and liabilities

[213] Companies Act Cap 486 Section 236(a),(c) (Kenya)
[214] Companies Act Cap 486 Section 241 (Kenya)
[215] Companies Act Cap 486 Section 268 (a), and 281(Kenya)
[216] John Armour, 'The Law and Economics Debate about Secured Lending: Lessons for European Law making?' (2008)5 European Company and Financial Law Review 3

necessary for repayment purposes. Unless this is done, it will be difficult to gain entitlements that rank the claims in priority. The standard set by the UNCITRAL Insolvency Guide suggests more than the recognition and ranking of these claims by adding an aspect of predictability and consistent application of the rules, as well as ensuring that the claims are based upon commercial bargains.[217] As a result, all the creditors and contributors meetings which are statutorily held are of benefit, as this will ensure that their wishes and rights are recognized. The law should appreciate that some rights, for example those of secured creditors, confer entitlements, which relate respectively to priority of payment and to control of the collateral.[218] This does not imply that they are exempted from procedural restrictions imposed by insolvency law.[219] This is because the collective nature of insolvency proceedings is meant to ensure that secured creditors do not opt out of the insolvency proceedings but instead participate in them without giving up the benefit of their security.[220] Securities are necessary for reasons of cost effectiveness and in fact, some securities are very vital for continued trading in the business.

Besides, a company has two main groups of creditors; secured and unsecured. In this aspect, the legislation must strive to recognize the existing rights of each category. Sections 309-311 of the Companies Act detail the proof and ranking of claims and this is done without allowing unjust enrichments, as the law embodies provisions on voidable transactions.[221] However, there are loopholes within the legislation that a debenture holder, as a secured creditor, can use to the dismemberment of the debtor's business. This is because the enforcement of such a security interest can involve the sale of all of the debtor's assets, either

[217] UNCITRAL 2005 (n 135)
[218] Goode 3rd (n 151) pg 1-3
[219] Such as the stay on all proceeding against the debtor as provided by the law
[220] Mokal (n 157)
[221] See 3.4.2 of this thesis

together as a going concern, or broken up on a piecemeal basis, as is appropriate. A similar approach is available in the UK for the holders of floating charges covering all, or substantially all, of a debtor company's assets, in an 'administrative receivership', although administrative receivership was virtually abolished under the Enterprise Act 2002.[222]

A legislative recognition of the existing rights of the debenture holder; the right to appoint a receiver manager to proceed with enforcement of the debenture holder's rights, has its own demerits.[223] In fact, it undermines the interest of other creditors, recognized already in the same law. Because of such a problem, the English jurisdiction virtually abolished the administrative receivership procedure from 2003, and replaced it with an entitlement for a floating charge holder to initiate a more collective mechanism, administration.[224] This reform has safeguarded the interests of all creditors through the appointment of an administrator running the case under a fiduciary duty to act in the interests of all creditors, with a requirement to refer his proposals to a vote of the unsecured creditors.[225] Nevertheless, a receiver in the Kenyan context has a duty of managing the company's business so as to enhance the realization prospects[226] but should the liquidation process be started while still in office, he may act as a liquidator and he is obliged to distribute the proceeds of realization to creditors in accordance with the priorities set by the law.[227] In fact, the assets are distributed *pari passu* among the creditors according to their rights and interest in the company. There are also de-

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[222] Enterprise Act, UK Laws chapter 40, and Schedule 16 ; Also see Gavin Lightman and Gabriel Moss, The Law of Administrators and Receivers of Companies, (4th ed. Sweet & Maxwell, 2007) pg. 54

[223] See generally Companies Act cap 486 Section 347 on the powers of the official receiver as a receiver of a debenture holder.

[224] Sandra Frisby, 'In Search of a Rescue Culture—The Enterprise Act 2002' (2004) 67 Modern Law Review 247

[225] John Armour and Riz Mokal, 'Reforming the Governance of Corporate Rescue: The Enterprise Act 2002' (2005) Lloyds' Maritime and Commercial Law Quarterly 28

[226] Companies Act cap 486 section 351(2) (Kenya)

[227] For details on all provisions in so far as distribution of assets among creditors and members read Companies Act 486 section 241,296,302, and 311

tails on how preferential payments are to be ranked in addition to clear provisions that show respect to the rights of secured creditors.[228] Lastly, the costs, charges and expenses incurred in the winding up, including the remuneration of the liquidator, are payable out of the company's assets in priority to all other unsecured claims. Virtually all existing creditors' rights are recognized and the legislation categorically states, in section 311 of the Companies Act Cap 486 that, in an insolvent company, the same rules shall prevail and be observed with regard to the respective rights of secured and unsecured creditors and to debts provable. However, gauging the predictability and consistent application of aforementioned provision on creditors' rights in practice is difficult.

3.4.9 Establishment of a framework for cross-border insolvency.

There is little literature on Kenya's involvement in international insolvencies and evidence as to the implementation of measures that may assist business entities in any cross-border insolvencies is equally limited. Intrinsically, there are theories that attempt to explain these docile legislative and judicial situations in Africa in so far as insolvency and cross border insolvencies are concerned. One of the theories attributes the limited development of law to the inherent weaknesses of the process of transplantation of the relevant law.[229] The other theory attributes the inactivity to the failure of economic forces to trigger sufficient local growth and economic activities as well as international commercial ventures that could generate the application of insolvency law.[230] An additional theory attributes the under devel-

[228] Companies Act sec 311 (5) Kenya

[229] Sally Engle Merry, From Law and Colonialism to Law and Globalization (2003) 28 Law & Social Inquiry 569

[230] Alex Nguluma, 'The Court of Appeal of Tanzania and the Development of Insolvency Law in Tanzania: A Historical Perspective' in CM Peter and HK Bisimba (eds), *Law and Justice in Tanzania: Quarter of a Century of the Court of Appeal of Tanzania* (Mkuki na Nyota Publishers, Dar es salaam 2007) 176

opment of insolvency law to the radical institutionalized policies that came with political independence.[231] These radical, socially inclined, policies frustrated foreign investment resulting in a remarkable negative impact on the development, application and enforceability of insolvency law. It is submitted that each of the mentioned theories are feasible and all could have contributed in different measures.

However in the recent times, there has been an accelerated growth of foreign investment, trade, globalized production and distribution of goods and services. As a result, it is unavoidable that Kenya will be faced with more cross border insolvencies in the near future. Cross border insolvency may result from a company which has branches in more than one jurisdiction facing challenges in meeting the claims of its creditors. The crucial question then is how to address such a scenario, since the case crosses national borders and each territory has its own legal system. Inevitably, crucial aspects such as jurisdiction, choice of law, recognition and enforcement must be pondered.[232]

The legislative provisions concerned with cross border insolvencies in Kenya are contained in the Kenya Companies Act.[233] As far as the administration of cross border corporate insolvencies is concerned, there are a lot of gaps that the law fails to address. To start with, the only provision that could be linked with cross border insolvencies is section 359 which is concerned with the winding up of a foreign company by a Kenyan court when it ceases to carry on business in Kenya. However Kenya can refer to English provisions, as explained in

[231] David Himbara, 'The Failed Africanization of Commerce and Industry in Kenya' (1994) 22 World Dev 469-482. Also for more explanations on all the mentioned theories, see Benhajj S Masoud, 2011, Legal Challenges of Cross-border Insolvencies in Sub-Sahara Africa with Reference to Tanzania and Kenya: A Framework For Legislation and Policies' (PhD Thesis, Nottingham Trent University, 2012) pg. 200
[232] Irit Mevorach, *Insolvency Within Multinational Enterprise* Groups (Oxford University Press, 2009) Pg. 62
[233] Companies Act Chapter 486 of Laws of Kenya

the early part of this chapter[234] which implies that Kenya is still largely reliant on the English common law in dealing with its cross border insolvencies. Unfortunately, the extent and manner in which the relevant common law will be invoked remains uncertain and unpredictable.[235] Besides, there is little that has happened regarding cross-border insolvency proceedings in Kenya, denying the courts a chance to expound on this.

3.5 THE ON-GOING REFORMS AND THEIR POTENTIAL IMPLICATION

A well-balanced insolvency system that distinguishes companies that are financially distressed but economically viable from inefficient companies that should be liquidated has been very elusive for the reasons already discussed. However, as at the time when this research was in progress, the Kenyan legislature has had a number of Insolvency Bills drafted and published. To detail it, there has been Insolvency Bill 2008, 2010, 2012, 2013, 2014 and lastly 2015 is currently at a second reading stage in parliament. Arguably the drafting of an independent legislation concerned with insolvency issues is a good start.

Generally, these Insolvency Bills have advanced in many respects though the several drafts but for purposes of the discussion the Insolvency Bill 2015 is referred to. The persistent efforts to reform the insolvency regime are a demonstration of the keen desires for change, as well a testament of the inadequacies of the current corporate insolvency framework, as embodied in Companies Act Cap 486. To start with, the Bill consolidated all of the information necessary in an insolvency proceeding into one statute. It actually combines provision for personal bankruptcy and corporate insolvencies into one statute, making it a very bulky document with seven hundred and thirty five section and five schedules. Despite the size of

[234] See 3.2 of this thesis
[235] *Obongo v Municipal Council of Kisumu* [1971] EA 91, 94

the document, the sections are well arranged making it easier to navigate the document. The objective of the Insolvency Bill 2015 is set out in its preamble that it seeks to amend and consolidate the law relating to the insolvency of natural persons, and incorporated and unincorporated bodies as well as to provide an alternative to liquidation procedures.

In a number of respects, the Bill embraces the international benchmarks. For example, the UNCITRAL Legislative Guide, in its objective number three, provides that an efficient insolvency framework should strike a balance between liquidation and reorganization.[236] The Bill has enhanced provisions for liquidation, with a number of winding up procedures, namely voluntary liquidation, members' voluntary liquidation, creditors' voluntary liquidation and liquidation by the Court.[237] Notably, section 384 states the circumstances in which a company is unable to pay its debts to include one, where a creditor to whom the company is indebted for hundred thousand shillings has served on the company, and the company has for twenty-one days afterwards failed to pay the debt or to secure a reasonable satisfaction of the creditor. Second, if it is proved to the satisfaction of the Court that the company is unable to pay its debts as they fall due.[238] This is in contrast to the requirement in Cap 486 where the debt due was at the lower limit of a thousand Kenya shillings.[239] Arguably, this amount was too small and could potentially make the liquidation process open to abuse by creditors who could easily sue a company in petty disputes.

In addition, the Bill embraces a rescue culture with an introduction of two new procedures namely, the Company Voluntary Arrangement (CVA)[240] and Administration.[241] To detail

[236] UNCITRAL 2005(n 135)
[237] Insolvency Bill 2015 Part VI
[238] See section 384 generally for details of inability to pay debts
[239] See Section 219(e) Companies Act Cap 486
[240] Insolvency Bill 2015 Part IX
[241] Insolvency Bill 2015 Part VIII

the administration procedure, section 522 stipulates the objectives of the administration of a company as follows:

'(a) To maintain the company as a going concern:

(b) To achieve a better outcome for the company's creditors as a whole than would likely to be the case if the company were liquidated (without first being under administration);

(c) To realize the property of the company in order to make a distribution to one or more secured or preferential creditors'[242]

Arguably, the objectives are clear and gives corporate rescue due attention, replicating the established single hierarchy of objectives of the UK administration procedure.[243]

The Kenyan administration procedure is intended to be initiated with the appointment of an administrator which can happen through the following ways: by the company directors under section 541, by the holder of a floating charge under section 534 or by court upon application under section 530. Notably, the court is to exercise its discretion and it may make an administration order in relation to a company only if satisfied-(a) that the company is or is likely to become unable to pay its debts; and (b) that the administration order is reasonably likely to achieve an objective of administration.[244] As a result, the procedure will facilitate a possibility of an insolvency proceeding being started early, which has been recognized as enhancing the prospects of successful rescue.[245] Besides, section 522(3) obligates the administrator to perform his functions with the objectives of administration in mind unless the administrator believes that it is not reasonably practicable to achieve the objectives.

[242] Insolvency Bill 2015 section 522
[243] Insolvency Act 1986, Sch B1, para.3(1)
[244] Insolvency Bill 2015 section 531
[245] UNCITRAL 2004 (n 59) 45 and 46

Besides, the Insolvency Bill 2015 if it becomes law, the process of receivership will be abolished with the introduction of an administration procedure. However, the rights of a floating charge holder are still protected under Part VIII Division four, with a significant change such that the holder of a floating charge does not appoint a receiver manager but rather an administrator. Fundamentally, this procedure becomes part of administration procedure which is intrinsically an insolvency procedure tailored to facilitate corporate rescue. The underlying aim in the administration regime is to encourage collectivity and the administrator, whether appointed in or out of court, owes duties to the creditors as a whole, representing a shift from what currently happens in a receivership process. Similarly, in the UK, the Enterprise Act 2002 inserted a new section into the Insolvency Act 1986 which severely restricted the use of administrative receivership and allows the floating charge holders the power to appoint an administrator.[246] Arguably in this aspect, the Kenyan proposed law closely follows the UK approach.

Further, under the Insolvency Bill Part VIII Division 7, a moratorium is provided for as an effect of an administration order. Section 558 (I) is categorical that an application for the liquidation of the company may not be made while the company is under administration. Equally section 560 freezes the steps of a creditor who intends to enforce a security over the property of a debtor in administration. It however permits such action if the consent of the administrator is granted or the approval of the court is obtained. Further, a person may not repossess the goods under credit purchase without the approval of the court or consent of the administrator. It is submitted that the Bill adequately provides a breathing space to a company while in administration.

[246] Insolvency Act 1986 Section 72; To abolish administrative receiver, section 250 of Enterprise Act 2002 is inserted

Further, the introduction of company voluntary arrangements (CVA) that benefit from moratoria is also a positive effort to enhance the rescue culture.[247] The proposed CVA has an interesting aspect of having limited court supervision. This is achieved by permitting the directors or administrator when making a proposal (composition in satisfaction of its debts or a scheme for arranging its financial affairs) to provide for the appointment of a person to supervise the proposal. Besides, only an authorized insolvency practitioner may be appointed. This, it is submitted, is a good development on two aspects. One, the Kenyan courts have a backlog of cases and, coupled with their lack of confidence from public, such a development will enhance efficiency. Second, the involvement of experts allows the CVA to be attractive and poised to hopefully realize better results.

As far as the cross border corporate insolvencies are concerned, there are a lot of gaps that the current legal framework fails to address, as already alluded to. The new Bill is set to enhance cross border insolvency provisions, as found under s. 720 of the Insolvency Bill. This section specifically states that the United Nations Commission on International Trade Law (Model law on cross-border insolvency) has the force of law in Kenya in the form set out in the Fifth Schedule. This is done to promote cooperation between the courts and other competent authorities in Kenya and foreign states involved in cross-border insolvency and to ensure legal certainty for trade and investment. This section is compliant with Constitution of Kenya (2010), which recognizes and includes International Law as a source of law in the form and Spirit of Article 2(5) and 2(6) of the Constitution.

[247] Insolvency Bill 2015 Part ix

It is a breakthrough to have such an inclusion considering that the market dynamics are changing and businesses are expanding beyond borders, even amongst Kenya's immediate East African neighbours. Besides, the latest bill has addressed, partly, some reservations expressed in the 2010 Insolvency Bill. In particular, the USAID report had stated:

> 'Major legislation for a complete revamping of the bankruptcy process, including the adoption of a reorganization statute [which] has been pending for several years…..would be a complete revision of bankruptcy law in Kenya…..although a less ambitious revision (with a simple provision for the rehabilitation of a busi ness) would be very likely to be easier for the overworked court system to imple ment.'[248]

As already mentioned above, there are deliberate efforts to limit court involvement in CVAs in particular.

On the issues relating to insolvency practitioners, Part II of the Insolvency Bill 2015 is relevant. The circumstances and the qualifications required for a person who may act as an Insolvency Practitioner, and this includes a liquidator, a provisional liquidator, and supervisor of a voluntary arrangement or an administrator of the company, are elaborate.[249] In addition, the Bill anticipates establishment or recognition of existing professional bodies by the cabinet secretary to play the role of a governing body of the insolvency practitioners. Such an organ has a crucial role of regulating the practice of a profession as well as maintaining and enforcing rules authorizing members to act as insolvency practitioners. This proposal is similar to the UK equivalent of the Institute of Chartered Accountants in England and

[248] USAID, 'Kenya's Agenda for Action: Commercial Legal and Institutional Reform- Diagnostic of Kenya's Business Environment' (Business Climate Legal and Institutional Reform June 2009) < http://egateg.usaid.gov/sites/default/files/Kenya.pdf > accessed on 15/5/2014

[249] Insolvency Bill 2015 section 4(2)

Wales, which is one of the largest regulators of IPs in the UK.[250] This coupled with the requirement of insolvency practitioners to the meet acceptable requirements relating to education, practical training and experience, which will streamline the insolvency engagements. Besides, the Bill makes it a criminal offence for a person who does not meet the qualifications set, to act as an insolvency practitioner with a maximum fine of Kshs. 5 million as a penalty.[251] The regulation of the profession and the institution of a code of conduct are also informed by the need to ensure that Insolvency Practitioners do not overcharge their fees for services against the debtors, and then leaving them for dead.[252] Currently as structured in the Bill, the only sanction available to the oversight regulator who is the cabinet secretary is to de-recognize a regulator, meaning that it can withhold/suspend the regulatory body. It is argued that it is highly unlikely that such an approach will be effective considering the costs and disruption this would cause. This will limit the usage of such a step to only extreme cases. In contrast to Mauritius, the legislation as is tailored in such a manner that the equivalent oversight regulator (Director) engages directly with the insolvency practitioners themselves rather than the professional bodies which also exists.[253] In fact, the director has power to keep under review the conduct and performance of persons appointed to be Insolvency Practitioners and may require any document or information concerning an Insolvency Practitioner.[254] In essence, disciplinary measures whenever need be to undertake and director has reasonable ground to suspect that an Insolvency Practitioner has failed to comply the law in a manner which has or may materially affect creditors or contributories or persons dealing in

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[250] The Institute of Charted Accountants, 'The Role of Insolvency Practitioners: Picking Up the Pieces' available in http://www.aljuk.com/downloads/ICAEW_roleofanip.pdf accessed on 17th August 2015
[251] Insolvency Bill 2015 section 5
[252] Muriuki Murungi, 'Putting New Wine in New Wine Skins: Reforming Insolvency Law in Kenya' (2014)available in http://www.academia.edu/10462649/Reforming_Insolvency_Law_in_Kenya accessed on 17th August 2015
[253] Insolvency Act 2009 Section 375
[254] Ibid

good faith with a debtor etc. may inquire into the conduct of the Insolvency Practitioner. Arguably, the consequence of removing or suspending individuals is manageable compared to suspending an entire professional body. Nevertheless, it still remains uncertain whether the draft will become law and even if it does, whether the positive elements that it has will remain or whether it will be mutilated as it passes through the remaining procedural stages. Further, it will take the test of time to prove whether what this legislation introduced is what Kenya actually needs to remedy its situation.

CONCLUDING REMARKS

The history of a jurisdiction leads to embedded approaches. Thus, the development of Kenyan insolvency law and its business culture has been enormously shaped by its colonial past. The analysis revealed that Kenyan insolvency law has profound weaknesses but it is not devoid of strengths. To start with, there is no dedicated insolvency legislation. The legislative provisions governing insolvency form chapters of the Companies Act Cap 486, making it bulky, complicated and cumbersome to access. In addition, the legislative regime is fragmented, outmoded and incomplete. In fact, the sections of the statute governing insolvency procedures are not chronologically arranged. Besides, there is an interchange of key terms like 'receivers', 'managers' and 'liquidators', creating confusion. Besides, the impact of institutional and legal inadequacies has been felt and, therefore, there is a consensus that reforming it is mandatory. The quest, then, is how best this can be done to ensure that a practical and working solution is achieved. This challenge will be addressed further in the coming chapters.

The rationale behind the evaluation of the Kenyan insolvency law using international benchmarks proceeded under the conception that the UNCITRAL Legislative Guide on In-

solvency Law is a reflection of best practices of developed economies, who have been actively engaged in insolvency challenges in their respective jurisdictions. A good number have witnessed a vibrant and notable degree of success in transforming their economies as well as attracting and retaining international investors. This has proven a good platform from which to start engaging and calculating Kenya's next move. It has served to expose the ills and benefits in the current framework, which are useful in developing a framework in the light of existing global initiatives and appreciating the specific local needs and values. Undoubtedly, these international bench marks provide precise and practical proposals to policy makers to consider improving their weak and ineffective laws.

The on-going reforms are applauded as a positive sign that those in authority are pro-active. The current Kenyan insolvency framework is heavily court led, which has its merits as it forms a good check and balance of the procedures. It was also noted that there is no statutory provision specifying the professional qualification required of a person who wishes to practice as insolvency practitioner, raising concerns whether the procedures benefit from the appropriate expertise. Equally the proposed procedures are very court dependent and the ability to enforce legislation and the expediency with which it may be done cannot be over emphasized. However, the judicial system suffers from its own inadequacies, encumbered by a lack of trust from the public, due to rampant corruption, inefficiency and incompetence and this is likely to present a hurdle.

CHAPTER FOUR

4.0 RESTRUCTURING OUTSIDE THE LEGAL FRAMEWORK

INTRODUCTION

A corporate entity which is in financial distress can resolve its predicament in two broad approaches. The first is by engaging in a formal bankruptcy procedure, which commonly involves a court, and enables the debtor to deal with creditors collectively. Alternatively, it can engage in an out of court restructuring (in this thesis also referred to as informal strategies), based around negotiations with individual creditors. This chapter focuses on the engagements of corporate restructuring outside the formal statutory insolvency procedure and in particular pre-negotiated deals, private workouts and pre-packs. In essence, the chapter will concentrate on activities such as changing the composition of assets and liabilities of debtors in financial difficulty without resorting to a full judicial intervention. This is done with objective of promoting efficiency, restoring growth and minimizing the cost associated with the debtor's financial difficulty.

The first part explores how such procedures evolve by using game theory. It then discusses the relationship between informal mechanisms and formal insolvency processes. As it will be observed, informal rescues commonly involve negotiation with creditors on an individual basis although there are known models of collective informal procedures, such as the London Approach, which has been widely recognized as having enabled notable informal workouts. The famous London Approach will be discussed because of its wide recognition globally with an intention to understand the tenets underpinning such workouts. Besides, infor-

mal workouts, as proposed by international players such as the IMF, World Bank and INSOL will also be explored.

However, given the similarities in the principles underpinning the workout processes, as championed by the international players, it will arguably not serve any merit to focus on the proposals of each; rather the discussion will consider workouts generally. The term 'workout' will be used to refer to the collective negotiations between the debtor and its creditors and entails some contractual agreement. In addition, 'enhanced restructuring' will also be explored in this Chapter. The term 'enhanced restructuring' refers to mechanisms that combine the benefits of both formal mechanisms and informal insolvency procedures and a good example of this type of restructuring is the London Approach. The last part explores how the Kenyan jurisdiction, with its lack of any notable informal approach to business restructuring, can apply the widely recognized informal principles.

4.2 BACKGROUND TO THE OUT OF COURT RESTRUCTURING.

Informal restructuring has been around for long time, although many jurisdictions have not given them as much attention as the formal options. The significance of achieving business survival without recourse to courts has been linked to the broader social and governmental trends keen on adopting proactive risk management strategies.[1] In US for instance, a significant number of Chapter 11 cases start off as private workouts, with companies attempting to reorganize informally and whenever such efforts fail to achieve consensus, the debtor enters

[1] John Armour, and Simon Deakin, 'Norms in Private Bankruptcy: The 'London Approach' to the Resolution of Financial Distress' (September 2000). University of Cambridge ESRC Working Paper No. 173 available at SSRN: http://ssrn.com/abstract=258615 or http://dx.doi.org/10.2139/ssrn.258615

Chapter 11.[2] The UK's informal rescue practices can be traced back to the 1970s,[3] although the principles of the famous London Approach, which were developed in 1990s, and are operational entirely on informal footing on the basis of a set of principles providing a framework for bank support.[4]

The World Bank's Financial Crisis Survey done in 2009 in the EU, on the use of bankruptcy procedures revealed that the formal approaches were less frequent than the state aid and debt restructuring.[5] On average, 8.3 percent of European firms applied for state aid in the previous 12 months (as of June – July 2009), whereas, only 2 percent of all surveyed companies filed for bankruptcy.[6] Besides, there is substantial evidence that changes in business and finance in recent years have put strain on the legal mechanisms, prompting the development of alternative approaches to financial distress. For instance, the Asian crisis in 1997 prompted the Asian nations, with the assistance of the IMF, to develop workout rules targeted at enhancing business recovery. Besides, the extensive impact of corporate failure on the community and economy has necessitated an active and deliberate incorporation of the role played by social norms in business restructuring. The informal mechanisms in different jurisdictions have been acknowledged as being pivotal in contributing to solving financial distress in business entities. In essence, corporate insolvency is best addressed by a comprehensive and integrated system that has both formal and informal mechanisms. Admittedly,

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[2] Gerard McCormack, Corporate Rescue Law-An Anglo-American Perspective (Edward Elgar Publishing Ltd , 2008) pg. 13

[3]John Flood, 'The Vultures Fly East: the Creation and Globalization of the Distressed Debt Market' in *Adapting Legal Cultures*, D. Nelken, ed., (Hart Publishing,, 2001) pp. 257-278, Available at SSRN: http://ssrn.com/abstract=949581

[4] Vanessa Finch, 'Corporate Rescue in a World of Debt' (2008) 8 Journal of Business Law 756-777

[5] Elena Cirmizi, Leora Klapper, Mahesh Uttamchandani 'The Challenges of Bankruptcy Reform' available at http://econ.worldbank.org accessed on 29th July 2015

[6] Ibid

solving a firm's financial distress either through the formal or informal approaches, typically burdens a firm with direct costs, such as administrative expenses, or indirect costs, such as incentive distortion. Thus, the efficient choice is one that minimizes the costs in addition to ensuring that the firm's value is not eroded. Pursuant to this reality, evidence shows that a debtor and its creditors should generally use approaches that enable an agreement to be reached out-of-court; as such approaches enable a faster resolution, and minimize costs..

On an international level, there has been significant recognition of out of court workouts (a widely recognized informal strategy) as useful tools to expedite corporate insolvency challenges. Such workouts are regarded as an integral part of an efficient creditor-debtor regulatory system.This view of their importance was echoed by the IMF in its study of insolvency and debtor protection regimes that concluded that informal restructuring mechanisms play an important role in a holistic approach towards corporate insolvency.[7] As a result, the IMF recommended using pre-packages and pre-negotiated plans in its 'Orderly and Effective Insolvency Procedures' in 1999.[8] The importance of informal workouts was also recognized in 2000 by the publication of the INSOL Principles.[9] In addition, the World Bank in 2001 developed 'Principles and Guidelines for Effective Insolvency and Creditor Rights Systems',[10] later revised in 2005. These principles acknowledge the vital contribution of informal workouts and assert that a country's financial sector should promote the development of a code of conduct on an informal out-of-court process for dealing with cases of corporate financial

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[7] IMF, *Orderly & Effective Insolvency Procedure: Key Issues* (IMF, Washington,1999) pg.13 Available in http://www.imf.org/external/pubs/ft/orderly/index.htm accessed on 22 November 2012
[8] Ibid
[9] INSOL, *A statement of principles for a Global Approach to Multi-Creditor Workouts*, (INSOL International, London, 2000) available on the INSOL website <http://www.insol.org/page/57/statementof-principles accessed on 18 November 2012
[10] World Bank Principles available in http://www.worldbank.org/ifa/ipg_eng.pdf accessed on 20/6/2015 see principles 24-26

difficulty in which banks and other financial institutions have a significant exposure, especially in markets where enterprise insolvency has reached systemic levels.[11]

Further, the UNCITRAL through the 'Legislative Guide on Insolvency Law' of 2005[12] equally promotes informal mechanisms by encouraging voluntary restructuring negotiations and agreements. Much of these international initiatives consist of guidelines that do not give exact details and instead allow room in their recommendations to adjust to jurisdictional circumstances. Remarkably, they reflect the broad thrust that informal mechanisms are vital. In practice, informal approaches in many jurisdictions tend to be initiated by the company directors or a creditor, such as bank, who, because of its relation with the business can see overdraft limits being exceeded which is a typical red flag.[13] Generally, informal restructuring arrangements are purely contractual in nature and they are therefore not subject to any specific set of legal requirements but require affected creditors to agree to the proposed restructuring solution for it to be binding.[14]

4.3 DEVELOPMENT OF INFORMAL STRATEGIES

It is an undisputed fact that legislated rules are generated and drafted through the country's legislature under its democratic mandate, and such rules are often intended to be used to solve disputes, commonly through the courts. However, the informal practices will come into existence in a rather unique way. For instance, INSOL International produced a 'State-

[11] Ibid
[12] UNCITRAL, *UNCITRAL Legislative Guide on Insolvency* (United Nations, 2005)
[13] Vanessa Finch, *Corporate Insolvency Law, Perspectives and Principals*, (Cambridge University Press 2002) pg.213
[14] USAID, *Insolvency Systems in South Africa: Strengthening the Regulatory Framework* (December 2010) available in http://www.fsp.org.za/blog/wp-content/uploads/SOUTH-AFRICA-INSOLVENCY-SYSTEMS1.pdf accessed on 16th November 2012

ment of Principles for a Global Approach to Multi-Creditor Workouts, which was published in October 2000,which was stated as ‘a product of extremely painstaking work done over almost five years by a group of highly dedicated and skilled senior professionals comprised in the INSOL Lenders' Group’.[15] In essence, it is resorting to expertise to develop ‘soft’ norms which are possible solutions or approaches to existing challenges. It was acknowledged by Terry Bond, Vice-Chairman of the INSOL Lenders' Group, that the London Approach (see section 4.4.6.1) was a source of considerable inspiration to the INSOL Lenders' Group.[16]

In essence, one of the most obvious sources of informal strategies is as a result the work of the several international financial standard-setting agencies who are actively engaged in co-ordinating aspects of regulatory standards on a global basis.[17] One of the primary objectives of many of these agencies is to co-ordinate action to ensure international financial stability through both crisis prevention and crisis management.[18] It must be observed that informal strategies developed by the agencies are majorly guiding principles i.e. basically broad statements that apply to a range of acts and, in Common Law systems, tend to develop through a series of cases and experiences rather than being established in a single incident.[19] It must be appreciated that much as the informal strategies are championed by experts who have no direct democratic mandate to legislate, some of the international financial institutions are intergovernmental organizations, others have been created as a result of intergov-

[15] See Chief Editor, ‘International approach to workouts’ (2001) 17, IL&P 59
[16] Ibid
[17] See Pollack, ‘International Harmonization of regulation and supervision frameworks’ in Marion Giovanoli *International Monetary Law: Issues for the New Millennium,* (Oxford University Press, 2000)
[18] Anu Arora, ‘The global financial crisis: a new global regulatory order?’ (2010) 8 Journal of Business Law, 670-699
[19] Iain MacNeil, Uncertainty in commercial law (2009)13 Edinburgh Law Review 1, 68-99

ernmental initiatives; others still are sector-specific groupings of supervisors or regulators and hence are very influential stake holders.[20]

Internally, jurisdictions can also develop solutions to the challenges they face. Sunstein points out that in a typical society, challenges occur and connectedness among neighbours will necessitate discussion on how to resolve issues.[21] As such information will be shared among neighbours who share common values when making decisions; the rules they use generate norms, a clear example being that of a 'norm entrepreneur'.[22] Sugden argues that societies exhibit strong self-organizations in the presence of shared values about norms without necessarily engaging in formal rules.[23] Hence, human action can evolve into norms without conscious human effort and as well the norms maintain themselves without any formal machinery for enforcing them.[24]The famous London Approach came forth through relations, information sharing among the banking society in England and actually changed over time.

Besides, these mechanisms have been consciously borrowed by other jurisdiction such as Hong Kong[25] and Thailand[26] among others who are keen on developing their informal corporate rescue mechanisms. Moreover workouts inevitably require guidelines on how these

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[20] For a detailed discussion of the origins, roles and work of the various international standard settings agencies see Mario Giovanoli, 'A New Architecture for the Global Financial Market: Legal Aspects of International Financial Standards' in *International Monetary Law Issues for the New Millennium,* (Oxford University Press, 2000)
[21] Crass R Sunstein, 'Social Norms and Social Roles (1996) 96 Columbia Law Review 903
[22] Randal Picker 'Simple Games in a Complex World: A Generative Approach to the Adoption of Norms' (1997) 64University of Chicago Law Review 4
[23] Robert Sugden, 'Spontaneous Order'(1989) 3 Journal of Economic Perspective 4
[24] Ibid
[25] Hong Kong Association of Banks (HKAB) and the Hong Kong Monetary Authority 'Hong Kong Approach to Corporate Difficulties' available at http://www.hkma.gov.hk/media/eng/publication-and-research/reference-materials/banking/fa03.pdf accessed on 22/12/2012
[26] Tumnong Dasri 'Out-of-Court Corporate Debt Restructuring in Thailand' available in http://unpan1.un.org/intradoc/groups/public/documents/APCITY/UNPAN005376.pdf accessed on 22/12/2012

arrangements are negotiated. Consequently, in conducting informal workouts, many jurisdictions adopt methods similar to the London Approach or that of the INSOL Multi-Bank Workout Principles.[27] Such, informal insolvency strategies, and in particular workouts, are much more than natural self- evolving norms, although this does not fully negate the possibility that norms can genuinely be spawned naturally. In Kenya for example, the use of elders and traditional processes of resolving disputes or conflicts are common, especially in the rural areas. Neither the government nor does any external pressure plays a role in shaping how such a pattern emerges. Such a traditional process is a typical modern day informal mechanisms for addressing and resolving conflict. In fact, the relevance of these norms depends on the legal set up such that decisions that are made in these systems can be overturned by courts if they are deemed to be repugnant to justice, morality or any written law.[28]

4.3.3 Dynamics of Corporate Restructuring

A firm is in distress at any given time when there is a mismatch between its liquid assets and current liabilities this can be rectified through debt restructuring.[29] Corporate restructuring can take a variety of forms such as debt rescheduling, interest rate reductions, debt-for-equity swaps and debt forgiveness.[30] In essence, restructuring involves an adjustment of the assets side of a company's balance sheet in order to generate cash to meet current liabilities or an agreement of a compromise with creditors. However, to enhance the long term viabil-

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[27] The famous London Approach was developed by the Bank of England as an unofficial set of guidelines to assist banks and their borrowers in reaching an agreement to restructure their bank debt. The basic tenets of the London Approach have bred many variant models used in the context of financial crises (e.g. Indonesia, Malaysia, South Korea, Thailand, Turkey, and more recently Iceland and Latvia) or in use informally in other countries.

[28] The Bench Bulletin (2010) 1 Kenya Law Reports 12

[29] Robert Mooradian, Kose John, Edith Hotchtkiss, and Karin S Thornbun, 'Bankruptcy and the Resolution of Financial Distress, in Eckbo, B.E. (Ed.), *Handbook of Corporate Finance: Empirical Corporate Finance (* Elsevier, 2008), 2: 235-287

[30] Ibid

ity of a company, debt restructuring is often accompanied by operational restructuring geared to addressing the structure and efficiency of the firm's business through closures and reorganization of productive capacity.[31] There are several informal strategies that can be used, although the literature on firms in distress focuses on a few main types of response to distress. For example, firms can raise new capital through an assets sale; negotiate terms with creditors or they can address their difficulties by merging with another company or engaging in a workout, amongst others.[32] A debt for equity swap can be employed as part of an informal approach which is where a creditor agrees to exchange a debt for an equity share in the company with the hope that it will produce a greater return in future.[33] It is an approach that can enable a suitable compromise to be reached with creditors and can be useful especially where the defaulted debt is a loan which was offered without security. Such a conversion is advantageous to the company as it takes away the burden of interest repayment; it eases cash flow and working capital difficulties.[34] However, such a swap can be time consuming and expensive to negotiate because the consent of the company shareholders, as well as the main creditors is usually required.[35] Generally, leading lenders may be able to use their influence to force distressed companies to restructure by means of downsizing, management replacement or otherwise, [36]

[31] Thomas Laryea, 'Approaches to Corporate Debt Restructuring in the Wake of Financial Crisis' (2010) IMF Staff Position Note 10/02, Washington: International Monetary Fund Available in http://www.imf.org/external/pubs/ft/spn/2010/spn1002.pdf accessed on 23 Jan 2013
[32] Rajdeep Sengupta and Mara Faccio, 'Corporate Response to Distress: Evidence From Asian Financial Crisis' (2011) 93 Federal Reserve Bank of St. Louis Review 2
[33] Cagman Palmer, 'Debt-for-Equity Swap and Reorganization Law in the People's Republic of China' (September 4, 2010) available at SSRN: http://ssrn.com/abstract=1671909 accessed on 3rd December 2012
[34] Ibid
[35] Finch (n 13) pg. 230
[36] McCormack (n 2) pg.16

In some instances, more than one strategy can be used concurrently. Since restructuring does not take place in a vacuum and entails dealing with conflicting interests, there are there are many factors that influence the choice of restructuring strategy employed by a company. The main one is the structure of firm's liabilities.[37] A secured debt can easily be restructured through direct negotiation because their support during a corporate reorganization could be a request not to enforce their legal rights immediately or debt contract are modified.[38] Secured creditors may also be invited to inject new funds into the distressed company. It is worth noting that lending new funds to a business in financial distress is regarded by creditors as a very risky activity, as they can be repaid in full only if the rescue attempt is successful.[39] Accordingly, the injection of new funds into the traumatized business may not prove to be an easy task,[40] as reluctant creditors may seek to receive additional reassurances and incentives prior to granting their support.[41] Unsecured debt tends to need to be dealt with using exchange offers such that a firm offers cash securities in-exchange for an outstanding debt.[42] Besides, the more the number of creditors with multiplicity of interests the more difficult it becomes to engage in negotiations. In essence, corporate businesses which typically have multiple creditors need to carefully consider and choose an appropriate strategy. Generally, the approach that creditors take towards corporate rescue depends heavily on their philosophy and culture and also on 'market forces' and key lenders which are com-

[37] Paul Asquith, Robert Gertner and David Scharfstein, 'Anatomy of Financial Distress: An Examination of Junk of Bond Issuers' (1994) 109 The Quarterly Journal of Economics 3

[38] Michael Pomerleano, and William Shaw, *Corporate Restructuring: Lessons from Experience* (World Bank Publications, 2005) pg. 345; Also see Stuart C. Gilson 'Troubled debt restructurings: An Empirical Study of Private Reorganization of Firms in Default' (1990) 27 Journal of Financial Economics 315-353

[39] Vanessa Finch, *Corporate Insolvency Law- Perspectives and Principles* (Cambridge, 2009) pg. 405

[40] Gerard McCormack, 'Super-Priority Financing and Corporate Rescue' (2007) J.B.L. 701-732, at p. 706.

[41] Principle 8 of the INSOL International Statement of Principles For A Global Approach To Multi-Creditor Workouts, (2000), at p.33 available at http://www.insol.org/pdf/Lenders.pdf accessed on 10th August 2015

[42] Gertner Schafstein , 'A Theory of Workouts and the Effects of Reorganization Law' (1991) 46 Journal of Finance

monly the banks, would not wish to link their reputations with a corporate collapse.[43] Therefore, it could be said that banks are cautious and seek to protect their reputation by offering their support to ailing businesses.[44]

A good example is the London Approach, as used in companies with liabilities to multiple banks.[45] Besides, a combination of secured private debts and numerous public debts tend to limits the usage out of court restructuring. This is because secured creditors such as banks are well protected in bankruptcy, hence have no incentive to offer relief such that those with many public creditors each can easily free ride even in the midst of problems.[46] It is argued that if a restructuring strategy is to be successful it has to be tailored to the individual circumstance of a firm. A firm has to consider the number and size of debts, its internal policies, institutional framework, and its potential to facilitate a voluntary standstill, as well as coordination with its financiers. Such factors are essential as they are necessary in determining the feasible timing of restructuring and decisions on the firm's viability.

The choice of the strategy used to solve distress also depends on the relative costs and benefits of each mechanism.[47] Informal procedures are often more attractive than formal steps and participants hope that informality will avoid the negative repercussions associated with formal insolvency procedures.[48] For example, if the cost of restructuring involves a sale of

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[43] Alexandra Kastrinou, 'European Corporate Insolvency Law: An Analysis of the Corporate Rescue Laws of France, Greece and the United Kingdom' (A PhD Thesis Submitted to University of Leicester, 2009) pg. 247
[44] Ibid
[45] Nicholas Frome, 'Multi-creditor Restructurings in Transition Countries: Lessons from Developed Jurisdictions' available in http://www.ebrd.com/downloads/legal/insolvency/multicr.pdf accessed on 14/11/2015
[46] Ibid
[47] Hottchkiss, Mooradian, and Thornbun (n 29) pg. 248
[48] Finch (n 13) pg. 294

assets through efficient mechanisms such as an auction, the overall cost of resolving financial distress may be lower, encouraging the use of such an approach.[49]

Further, the choice of restructuring options depends largely on the degree of investor protection and labour laws of a jurisdiction.[50] Labour enjoying a strong legal protection is shown to acquire enough power relative to other stakeholders such as investors and managers to be able to impact corporate decisions and outcomes.[51] Positively, the likelihood of value-reducing asset sales increases as collective bargaining and labour relations' laws grant more power to labour unions, suggesting that these asset sales are countenanced by workers.[52] Negatively, strong protection of labour protects also underperforming managers hence resulting in firm value enhancing objectives being easily compromised.[53] For instance, restructuring measures such as large scale employee layoffs, top management turnover, and major asset sales which could be the necessary remedies to a troubled business and can improve stock price and subsequent operating performance could be frustrated.[54] The sacrificing stakeholders may seek to block these restructuring measures if labour laws grant sufficient power to workers to block such actions.[55]

In practice, the incumbent management may form an alliance with workers to maintain the status quo by foregoing value-enhancing restructuring measures resisted by workers. In a

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[49] Ibid
[50] Julian Atanassov, and Han E Kim, 'Labour and Corporate Governance: International Evidence from Restructuring Decisions' Journal of Finance, Forthcoming; Ross School of Business Paper No. 1044. Available at SSRN: http://ssrn.com/abstract=898702
[51] Mohamed Belkhir, 'Labor Protection and Corporate Debt Maturity: International Evidence' A paper Presented in Financial Management Association International (FMA) 2014 Annual Meeting, held in October 15-17, 2014 at Nashville, Tennessee, USA)
[52] Atanassov and Kim(n 50)
[53] Ibid
[54] Ibid
[55] Ibid

recent Kenyan case involving Kenya Airways, an attempt to downsize the number of employees, which was one of the intended restructuring strategies, triggered numerous court battles, frustrating restructuring efforts because the labour laws are arguably strong. The employees, through their union, filed a case and the issues arising included complains that the redundancies were done unfairly, that there had been discrimination on grounds of gender, there had been infringement of employees' rights to employment, amongst others.[56] The respondent adduced evidence of its firm experiencing financial distress. However, the court issued an order of reinstatement of the employees hence quashing the redundancy one off pay offered by the company to the employees in favour of the employee's salaries, allowances and damages. The case went on appeal and at the time of writing this thesis an appeal was pending. It is argued that such legal battles will inevitably delay restructuring and, unless the case is decided faster, the firm's viability will deteriorate.

In addition, the law determines the allocation of control over distressed firms and the extent to which market mechanisms are used to resolve financial distress.[57] The law can have incentives that can facilitate the out of court strategy.[58] For instance, the existence of a rule that is reliably binding on hold-out creditors is critical to the success of restructuring. Further, the existence of efficient bankruptcy laws discourages strategic behaviour by the creditors and debtors, causing those engaging in out-of court restructuring mechanisms to take their engagement seriously. The presence of an efficient legal framework provides a credible means of credit enforcement by directly impacting on the willingness of debtors to come to a negotiating table. In practice, the existence of an effective legal framework gives the credi-

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[56] *Aviation and Allied Workers Union v Kenya Airways Limited & 3 others* [2012] eKLR
[57] Hotchkiss, (n 22) Pg. 237
[58] Laryea (24)

tors an avenue of filling an insolvency suit against the debtor, which comes with cost as well as the likelihood to taint the company image and its credit worthiness depending on the outcome of the case.

A further important aspect was noted by Mooradian and Ryan in their examination of out-of court restructuring, namely that banks can play a very important role in facilitating debt restructuring.[59] This view is supported by the findings of Gilson, Kose and Lang that the likelihood of out of court restructuring is positively related to the firms' reliance on bank debt.[60] The explanation for this is that action by large creditors, such as banks, allows small creditors to coordinate more efficiently. This is linked to the fact that banks have superior information, as a result of which their decision to participate in restructuring injects a degree of 'strategic solidity' in credit markets. In addition, such asymmetric information enhances banks' confidence to avail rescue funds necessary for restructuring. Besides, bank participation in restructuring helps to mitigate hold out problems among the public debts holders.

4.3.4 Significance of informal/ out of court restructuring

Informal and formal corporate insolvency mechanisms have similar underpinning in that they all address many and, at times, conflicting creditors' interests in a situation of financial difficulty. For this reason, it is difficult to draw a clear dividing line between formal and informal operations. In reality numerous insolvency procedures tend to overlap and in some instances one procedure will be a continuance of another. In France for example, safeguard and conciliation proceedings are commenced by the commercial court but the negotiations

[59] Robert M Mooradian, Harley E Ryan, ' Out-of court Restructuring and the Resolution of Financial Distress : Section 3(a)9 Compared to Investment Bank Managed Exchange Offers (2005) 78 Journal of Business 4
[60] Stuart Gilson, John Kose, Larry H P Lang, 'Troubled Debt Restructuring : An Empirical Study of Private Reorganization of Firms in Default' (1990) Journal of Financial Economics 27, 315-353

for a restructuring via a compromise between the creditors and debtors are done out of court, with the agreed plan then being approved by the court.[61] In the US, a company will often have pre-arranged a Chapter 11 planning advance of filing for Chapter 11 and here the negotiations between the debtor company and the main creditors are done prior to filing for formal Chapter 11 proceedings. In the UK, much as their pre-pack is considered an informal procedure it is dependent on administration for implementation.[62]

It evident that informal workouts are negotiated in the 'shadow of the law' and therefore depend on the enabling legal environment having clear laws and procedures to facilitate disclosure or access to timely and accurate financial information regarding the distressed enterprise.[63] In addition, formal proceedings complements the informal mechanisms, as they address issues such as investigating directors' actions, and the enforcement of contractual agreements that can only be done using the formal frameworks.[64] Further, even in a scenario where there are effective informal restructuring arrangements, formal insolvency procedures are important as a last option largely resorted to when the informal strategies have been exhausted.[65] This positions the informal approaches as crucial immediate mechanisms that enterprises commonly employ in their attempts to circumvent looming failure. It is argued therefore that in a scenario where informal approaches to insolvency are successful in restructuring; there will be no need for the formal mechanism. It has also been appreciated that

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[61] Shinjiro Takagi, 'A Need to Establish an International Rule for Out of Court Workout Agreed By the Central Banks, the Bankers' Association and Other Organizations Worldwide' A Paper Presented at Twelfth Annual International Insolvency Conference in International Insolvency Institute Paris, France on June 21-22,201

[62] Chrispas Nyombi, 'An Examination of the Evolving Approach to UK Corporate Rescue and the Impact of Subsequent Legal Reforms' (February 28, 2011). Available at SSRN: http://ssrn.com/abstract=2012190

[63] World Bank , *Principles and Guidelines for Effective Insolvency and Creditor Rights Systems* (World Bank, Washington DC, 2001) pg.5 Available in <http://www.worldbank.org/ifa/ipg_eng.pdf>accessed on 9th Nov 2012

[64] Finch (n 13) pg.211

[65] Ibid

the existence of shortcomings in informal workouts and the inflexibilities of formal insolvency proceedings have generated efforts to combine the advantages of informal workouts with some of the effects of formal proceedings, resulting in the development of enhanced restructurings, or hybrid procedures, such as pre-packaging.[66] Therefore, informal mechanisms can generally reflect a variety of 'calculated technologies', disciplinary perspectives and even sets of negotiations.[67]

In many jurisdictions, the evidence indicates that a legal system influences informal procedures and to a certain extent determines the possibilities for out of court debt restructuring in any given jurisdiction.[68] In essence, effective formal insolvency becomes a warning to those who will not willingly participate in out of court arrangements. In jurisdictions such as the UK, where corporate failure is perceived negatively, and as a result creditors tend to desert a business once it has entered formal proceedings and debtors may suffer a rapid loss of goodwill, informal alternatives is a welcome alternative.[69] In addition, informal proceedings are known to provide cost-effective, efficient, flexible and contractually sustainable solutions when resolving a debtor's financial affairs. Much as the negotiation will not be costless, the expected cost of negotiation is lower than the cost of insolvency proceedings, even more so when done in secrecy, as indirect costs such as a loss of good will are curtailed.[70]

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[66] Jose M Garrido, `Out of Court Debt Restructuring' (Washington, World Bank, 2012)
[67] Ibid
[68] Garrido (n 66)
[69] John Armour, 'The Rise of the Pre-Pack: Corporate Restructuring in the UK and the Proposal for Reform (2012) available in http://ssrn.com/abstract=20931334 accessed on 7th November 2012(n 11)
[70] Robert A Haugen and Lemma W Senbet, 'The Significance of Bankruptcy Costs to the Theory of Optimal Capital Structure' (1978) 33 Journal of Finance 383-394

In addition, workouts are frequently used because creditors retain a measure of control over negotiation, something that they would not enjoy when a company is put into formal insolvency proceedings.[71] Directors also remain in control during the workouts and this has merits over alternative formal procedures in which directors are deprived of control.[72] Contractual workouts in contrast to formal procedures are considered flexible because the negotiations can be initiated by the debtor or the creditors and does not require evidence of financial difficulties.

4.3.5 Selected Informal Approaches

There are many informal approaches that can be used by a distressed company although only a few are popular and others are strategies that are used as part of other informal approaches. The forms of restructuring featured in the literature are debt for equity swaps, workouts, pre-packaging, debt restructuring, etc. However, a selected few will be detailed to comprehend the contribution of out of court mechanisms to corporate responses to financial distress.

4.3.6 Informal workout

According to Stewart, 'there is no formal definition or even a typical restructuring as all deals are different and when assessing the respective rights, remedies and options of the parties, the devil is always in the detail'.[73] In essence, workouts is a 'loose' term used to include a variety of approaches implemented differently in different jurisdictions and equally are

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[71] Lijie Qi 'The Rise of Pre-packaged Corporate Rescue on Both Sides of the Atlantic' (2007) 20 Insolvency Intelligence

[72] Ibid

[73] Gordon Stewart, 'The Business Case for Using Out-of-Court Workouts: The Creditors' and Debtors' Perspectives' (Vienna, 14 February 2012) available in https://www.wbginvestmentclimate.org/advisory-services/regulatory-simplification/debt-resolution-and-business-exit/upload/The-Business-Case-for-Using-OCW.pdf accessed on 15/11/2014

different in each restructuring circumstance (case). Nonetheless, in literature, an informal workout, also referred to as consensual out-of-court restructuring, is a non-judicial process through which a financially distressed business and its significant creditors reach an agreement for adjusting the obligations of the business enterprise.[74] Despite being termed as non-judicial, other literature explains the informal workout as a mechanism to reorganize troubled companies outside the bankruptcy court with minimal court intervention.[75] Fundamentally, the creditors agree on a 'coordinated approach' by seeking to work with each other to devise a collective response which is in their mutual self-interest. Notable divergences exist in so far as the implementation of the workout in different jurisdictions is concerned but not without similar main characteristics. An in-depth analysis of how a workout works and its principles are elaborated under the London Approach in 4.3.6.1 below.

In the UK for example, popular informal workouts include the famous London Approach and other informal rescue arrangements such as pre-packs and debt for equity swaps. In the US, private workouts tend to be less expensive or less time consuming and because of this a significant number of companies attempt to reorganise through private workouts.[76] The empirical evidence indicates that the shareholders and creditors are better off when debt is restructured privately than through Chapter 11.[77] In addition, private restructurings are more likely to accomplish something when a higher proportion of the company's debts are owed to commercial banks and complex investors such as insurance companies.[78]

[74] Frome (n 45)
[75]Qi (n 71)
[76] Ibid
[77] Julian Franks, and Walter Torous, `A Comparison on Financial in Distressed Exchanges and the Chapter 11 Reorganizations'(1994) 35 Journal of Financial Economics 349
[78] Ibid

Informal workouts have gained international recognition and regional groups such as the INSOL Lenders groups and international financial powers such as the World Bank have developed principles which they assert are non-binding guides and informal workouts generated from commentary of best practice.[79] The INSOL principles trace their roots to England and in many ways can best be described as a London Approach in a modern context. In fact, the ever changing business dynamics generate complexity of the capital structures of corporations. Besides, the advancements of businesses to a global scale and their exposure to a diverse range of financial creditors have necessitated deliberation on possible solution in an international context.

By comparison the workouts principles championed by all the international players are very similar. For instance, co-operation by the creditors is a notable requirement, since restructuring involves collective actions of many groups. As well, the financial institutions are expected to keep the funds flowing as the firms are still depending on them. INSOL, in its eight principles, has a requirement of additional funding to be provided during restructuring and be accorded priority status as compared to other indebtedness or claims of relevant creditors.[80] In the same spirit, the World Bank in principle 26 proposes that a country's financial sector should promote a code of conduct on an informal out-of-court process, essential in dealing with corporate financial difficulty.[81] In addition, it proposes eight conditions that must be present for a workout to be attempted.[82] It is evidently emphasised in these pro-

[79] Terence Halliday, Bruce Carruthers, *Bankrupt :Global Lawmaking and Systemic Financial Crisis* (Standford University Press, 2009) Pg. 84
[80] INSOL (n 9) see the eighth principle
[81] World Bank 2005 (n 10)
[82] Ibid

visions that the presence of an effective formal insolvency is crucial for the workouts to work.

4.3.6.1 London Approach

The London Approach is a brilliant example of how informal strategies can be developed and effectively used effectively in helping corporations in distress.[83] This approach to corporate financial distress emerged through the efforts of Bank of England to refine existing long-standing traditions to address corporate financial difficulties in the UK. It is by design that it has no formal code and relies on consensus, persuasion and banking collegiality to resolve the financial distress.[84] There are four notable phases in this informal procedure. The first is that the creditors adopt a 'standstill', a consensual moratorium, where none are to enforce individual rights and existing lines of credit are maintained. Meanwhile, a team of accountants appointed by the banks will investigate the company's financial condition and develop an independent review of its long-term economic viability. If rescue is feasible, one bank will lead the restructuring negotiations.[85] Negotiations were traditionally led by the bank which was the debtor firm's principal lender, although, over time, some banks developed expertise at mediating workouts, enabling them to offer their services for an appropriate fee. During the restructuring period, new finance is accorded priority and the losses and gains are shared pro-rota according to creditors' seniority and exposures at the time of standstill. A unanimity rule applies to voting.

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[83] For details on how London Approach works see John Armour and Simon Deakin, 'Norms in Private Insolvency Procedures: The 'London Approach' to the Resolution of Financial Distress' (September 2000). University of Cambridge ESRC Working Paper No. 173. Available at SSRN: http://ssrn.com/abstract=258615 accessed on 7th Nov 2012

[84] Colin Bird, 'The London Approach' (1996) 12 Insolvency Law & Practice 87

[85] Anrew Keay and Peter Walton, *Insolvency Law*: *Corporate and Personal* (Jordan Publishing Ltd, 2008) pg. 196

The London Approach benefits from special form of consensual 'moratorium' in the form of the standstill. However, creditors are not obliged to engage in any part of the process leading up to the restructuring agreements and these agreements only become legally binding once done. A corporation (debtor) can negotiate with some creditors hence there is danger that the debtor remains open to attack from other creditors.[86] Of particular importance, the trust and cooperation from the banks involved are vital components of a rescue under the London Approach.[87]

The ability of the London Approach to become a normative force was founded on two aspects. First, there was a perceived threat of regulatory sanctions from the Bank of England as the financial institution played a supervisory role as a banking regulator. In view of this role, parties strived to maintain a good working relation with the Bank of England giving it a degree of authority. Besides, the Bank of England had the reputation of being an honest impartial broker. The other banks, too, contributed to the ability of the London Approach to impact through decentralized enforcement mechanisms, such that there was the threat of exclusion from future business by other banks. The influence of the London Approach in multi-creditor workouts has however diminished, even in England, the country of its origin, because of a number of realities. First is the rise of debt trading, and the rise of hedge funds or the influx of the US-based 'Vulture fund' investors, which are relatively recent phenome-

[86] Keay (n 70) pg. 195
[87] John Flood, 'The Vultures Fly East: The Creation and Globalisation of the Distressed Debt Market' aavailable at SSRN: http://ssrn.com/abstract=949581

non in the UK.[88] Globalizations of financial markets have enabled borrowing from a variety of lenders such as insurance companies, bond holders and other specialist investors. This variety makes the positions of unanimity and standstill more difficult to reach. Besides, market practices and regulatory requirements which govern all those involved make the use of London Approach strategy harder.

The principles that are core to the London approach, as already mentioned, have gained popularity and have influenced the modern workouts. In fact, the INSOL Principles[89] replicate some of the details of the London Approach type workout. However, principle six, which requires that arrangements between relevant creditors relating to any standstill to reflect the applicable law and the relative positions of relevant creditors at the Standstill Commencement Date, was not well articulated in the London Approach. Generally, the co-ordinated response has-been applauded in particular for giving the parties' time to help manage the impact of debtor defaults and most importantly such approaches create an opportunity to explore and evaluate the options for consensual agreement outside a formal insolvency process.[90] However, like the many other informal strategies, workouts will only be most successful in facilitating rescues if an appropriate legal, regulatory and governmental policy framework supports them.[91]

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[88] On the future of London Approach, see generally P Kent, 'Corporate Workouts- A UK Perspective' Int. Insolv. Rev., 6: 165–182, Also see Peter Brierley and Gertjan Vlieghe 'Corporate Workouts, the London Approach and Financial Stability' (1999) 7 Financial Stability Review 168

[89] INSOL International website at http://www.ifecom.cjf.gob.mx/PDF%5Carticulo%5C4.pdf accessed on 29th August 2015

[90] INSOL International (2000) (n 6) pg. 4

[91] Ibid

4.3.7 Pre-packaging

A `pre-pack' is a process in which a troubled company and its creditors reach an agreement before a statutory rescue procedure starts and then implement the agreement during the procedure.[92] This definition typically fits the US pre-pack where it is a rescue process; primarily a pre-negotiated plan. However in UK, it is essentially a strategy for business sale.[93] Generally, a pre-pack may be regarded as a 'hybrid' procedure as it combines the features of informal mechanisms, such as negotiation, and formal mechanisms', such as involving the use of insolvency practitioners, as well as court involvement which varies in many jurisdictions. For instance, in the UK, pre-packs now commonly take place within out-of-court administrations. Under this process, a pre-packaged sale of the company's business is agreed prior to the opening of proceedings and an administrator is then appointed who will execute the sale on behalf of the company.[94] In the US Ch 11, the process is always court-driven.[95] Much as pre-packaging may involve the selling of a business to new owners, this is not always the case because in certain circumstances it may be commercially justifiable to sell it back to the management if, for example, they seem to be the only potential buyer.[96] Therefore pre-pack takes the form not of reorganization and company rescue but a management buyout of the company's business.[97]

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[92] Vanessa Finch, 'Pre-packaged administrations: Bargaining in the Shadow of Insolvency or Shadow Bargains?' (2006) Journal of Business Law, 568-588.
[93] Sandra Frisby, 'Report to the Association of Business Recovery Professional : A Preliminary Analysis of Pre-packaged Administration' (2007) Available in www.r3.org.uk accessed on January 2013 pg 4
[94] Finch, (n 92)
[95] David Brown, Unpacking the Pre-Pack Insolvency Law Bulletin July 2009, pp.164-167 available at SSRN: http://ssrn.com/abstract=2133067
[96] Sandra Frisby, 'Report on Insolvency Outcomes'(2006) Available http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/research/returntocreditors.pdf accessed on 21/11/2012
[97] Ibid

Pre-pack has a number of advantages especially because it embraces negotiations which often can start early. It also offers speedy routes to recovery, as well as keeping legal and other professional costs low.[98] In addition, it offers the prospects of a faultless transition to turnaround that limits disruption, reduces the risks of market falling, and losses of reputations, assets or business partner relationships.[99] It can be an appropriate action in a business with strong brand and intellectual property whose value would drastically reduce in the event of formal insolvency proceedings.[100] It has also been argued that pre-packs are a useful device in countering hold out problems with the growth of 'vulture funds' which, in many ways, have been a main impediment to informal reorganizations.[101] The pre-pack is also flexible because negotiation takes place outside the formal statutory framework and this gives room to a company to have a unique plan to suit its particular situation. As a hybrid, it considered cheaper, at least in theory as this reality is dependent on the company to adequately disclose its financial condition to creditors before filing.[102] The pre-pack has been herald as a freshly effective procedure to further rescue objectives, although others see it as a means by which powerful creditors bypass carefully constructed protections.[103]

Despite the long list of advantages, English pre-packs are not without fault. In practice, prepackaged negotiations are done in secret and this gives room for the debtor to hand-pick the potential buyers to negotiate the sale of business to; and this makes it susceptible to manipulation as well as locking out other potential buyer who may have offered a better deal.[104] Be-

[98] Ibid
[99] Finch, (n 92)
[100] Martin Ellies, 'The Thin Line in the Sand: Pre-packs and Phoenixes' (2006) Recovery (Spring) 19
[101] Ibid
[102] Qi (n 71)
[103] S Harries, 'The Decision to Pre-pack' 2004 Recovery 26
[104] Ibid

ing a predetermined sale of an ailing business, the pre-pack has raised concerns relating to the morality and effectiveness of insolvency practitioners in the pre-pack process and has become for many the subject of fierce criticism.[105] Since the pre-pack entails a quick business sale, often to an insider, practitioners are often criticized as failing to consult the wider market and it is contended that, as a result, they may not achieve the best possible price for the assets of a company in administration, and as a result they do not realize full value for creditors.[106] The criticism was validated by the findings in 2011 which concluded that 25 per cent of the 2,808 companies that entered administration used the pre-pack procedure; and that nearly 80 per cent of pre-pack sales were to connected parties.[107] In addition, the BIS Select Committee report of 2013 asserts similar sentiments and acknowledges the lack of transparency, resultant abuse of pre-pack administrations and their link to 'phoenix companies'.[108]

Importantly, in the summer of 2013 Vince Cable MP, Secretary of State for Business, Innovation and Skills, announced an independent review into pre-pack administration aimed to rectify as many of the problems and criticisms of the existing pre-pack procedure as possible. This culminated into Graham Review Report[109] which was published together with a report on pre-pack empirical research, 'Characteristic and Outcome Analysis of Pre-pack

[105] Peter Walton, 'Pre-packaged administration Trick or Treat' (2006) 19 Insolvency Intelligence 8
[106] Kerry Scott, 'A fair deal?' New Law Journal (2009)159 (421)
[107] The Insolvency Service, 'Annual Report on the Operation of Statement of Insolvency Practice 16', January/ December 2011
[108] House of Commons Business, Innovation and Skills Committee, 'The Insolvency Service', Sixth Report of Session 2012-13'
[109] Graham Review into Pre-pack Administration Report to The Rt Hon Vince Cable MP June 2014

Administration'.[110] The finding on the aforementioned Graham's report summarized the weaknesses on pre-packs in the following points:

'1. Pre-packs lack transparency

2. Marketing of pre-pack companies for sale is insufficient

3. More could be done to explain the valuation methodology

4. Insufficient attention is given to the potential viability of the new company

5. The regulation - and monitoring of that regulation – of pre-pack administration could be strengthened.' [111]

The same report made a number of recommendations namely: Pre-pack Pool such that connected parties approach a 'pre-pack pool' before the sale and disclose details of the deal, for the pool member to opine on; Viability Review such that on a voluntary basis, the connected party complete a 'viability review' on the new company; pre-pack comply with six principles of good marketing and that any deviation from these principles be brought to creditors' attention; that valuations must be carried out by a valuer who holds professional indemnity insurance amongst others.[112]

Generally, the finding corroborated criticisms previously echoed in pre-packs which as recommended can be improved on. In fact, the independent review endorsed pre-pack and admitted that as an insolvency procedure, it has a place in the insolvency field as it contributes in preserving jobs, cheaper than alternative upstream restructuring procedures as well as contributing to the economy. Noteworthy, the recommendations has found its way into law

[110] Pre-pack Empirical Research: Characteristic and Outcome Analysis of Pre-Pack Administration – Final Report
to the Graham Review, Prepared by Professor Peter Walton and Chris Umfreville with the assistance of Dr Paul Wilson, University of Wolverhampton, April 2014
[111] Ibid
[112] See Section 9 Grahams Review report of the report generally.

with the enactment Small Business, Enterprise and Employment Act 2015. Remarkable, Clause 126 is concerned with pre-packs to 'connected persons' and will hopefully enhance vitality of pre-packs as an efficient insolvency procedure.

4.4 CHALLENGES OF INFORMAL RESTRUCTURING

Informal mechanisms, just like formal mechanisms, do not guarantee the survival of a business but they lay down a framework under which the stakeholders may engage to consider rescue potentials. However, much as an informal strategy of corporate restructuring plays a crucial role in contributing to enhancing economic efficiency, there are notable impediments that may face those intending to use the informal strategies. To start with, informal rescue generally is not a perfect solution for every economic challenge in respect of all companies.[113] Besides, informal mechanisms cannot operate exclusively on their own as they rely on an enabling legal framework to facilitate investigate of corporate misbehaviour whenever necessary. Besides, a workout requires the unanimous consent of affected creditors, especially in a situation where a company has limited funds hence unable to pay hold-out in full a task which may often be too difficult to obtain.[114] This is because corporations entail the involvements of many individuals and the presence of many creditors may lead to the forming of coalitions and to conflicts of interests.[115] The different classes of creditors have different preferences as to the outcome of negotiations and as a result, these creditors may engage in opportunistic hold up behaviour so as to demand a larger share of overall returns as

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[113] Alice Belcher, *Corporate Rescue :A Conceptual Approach to Insolvency Law* (Sweet & Maxwell, 1997) pg. 127

[114] Pen Kent, 'Corporate Workout- A UK Perspective' (1997) 6 Int. Insolv. Rev 165-182

[115] Regis Blazy, Jocelyn Martel and Nirjhar Nigam, 'The Choice Between Informal and Formal Restructuring: The Case of French Banks Facing Distressed SMEs' available at http//ssrn.com/abstract=1836895 accessed on 17th November 2012.

the price for their agreements.[116] This is majorly done by lower rank creditors who may feel that their hold out has little impact on the restructuring process but actually this behaviour may cause the negotiations to fail. Secondly, creditors often have heterogeneous priorities and as this could trigger differences of opinion about the appropriate course of action, making it difficult resolve.[117] The US data shows that out of court negotiations are more likely to be effective where businesses have relatively homogeneous capital structures.[118]

Another impediment is the presence of asymmetric information.[119] Individuals involved in the restructuring will have varying levels of information concerning the firm's value, depending on the level of engagement. For example managers will have better information about the firm's assets and future cash flow than any other creditor. Armour and Deakin argue that creditors' willingness to negotiate a compromise, rather than insisting on payment in full, is based on the convictions that prospective gains are greater under an informal strategy than formal and they have to see the likely surplus gains from negotiations.[120] As a result, poorly informed creditors may prefer a formal court –supervised restructuring and may be reluctant to negotiate.[121] Furthermore, the lack of moratorium on creditor demands while the problems are being resolved is a challenge to workouts. The company lenders have to voluntarily agree to negotiate. However, in incidences where the lenders agree, trust is a delicate aspect, such that there is also the risk that the suppliers and other trade creditors could initiate legal proceeding should the confidentiality of the negotiations be lost. How-

[116] Robert Gertner, and David Scharferstein 'Theory of Workouts and the Effects of Reorganization Law' (1991) 46 Journal of Finance 4

[117] Ibid

[118] Stuart C Gilson, 'Management Turnover and Financial Distress' (1989) 25 Journal of Financial Economic 241-265,

[119] Blazy, Martel and Nigam (n 115)

[120] Armour (n 69)

[121] Maria Carpareto, 'Bankruptcy Bargaining with Outside Options and Strategic Delay' (2005) 11 Journal of Corporate Finance 736-746

ever, despite the existence of real impediments to out of court restructuring, there are means by which they can be mitigated. Negotiation tends to succeed where the firms have closer relationships with their banks and deal with a smaller pool of creditors.[122] Therefore, enhancing dissemination of information helps, since informed creditors are positive in their involvement and this impact on the outcome of negotiations.

4.5 THE PLACE OF INFORMAL RESTRUCTURING IN KENYA

As already discussed, informal restructuring mechanisms are common and of numerous varieties and include all efforts, ranging from crisis management and turnaround to the use of consultancy services to improve management. Kenya cannot be said to be devoid of informal mechanisms of corporate restructuring but, from the surface, the methods of resolving disputes out of court are less developed. Nonetheless, consistent with practices in many countries, companies employ a wide range of approaches in their attempts to restructure their companies' informally. Debt for equity swaps is common and the newspapers regularly have stories which are good evidence that this practice happens. For example, one institutional investor with Kenya's infrastructure investment firm called Trans Century opted to switch its holding of the firm's convertible bonds into equity.[123] The managers of the companies involved were confident that this conversion was going to improve the profitability of the company.[124] Besides such compromises, the usual managerial techniques that even solvent companies might engage in may be included in the category of informal rescues, such

[122] Stuart Gilson, John Kose, Larry Lang 'Troubled Debt Restructuring: An Empirical Study Private Reorganization of Firms in Default' (1990) 27 Journal of Financial Economics 315-353.
[123] Beatrice Gachenge, 'Kenya Trans Century Investor in Bond –Equity Swap' *Reuters* (Nairobi, Monday 22nd August 2012)
[124] Ibid

as cost cutting measures and downsizing the workforce, disposing of non-core assets or units of the business, and the taking of additional collateral to secure repayment.

The practices are common and useful to large businesses, but may leave small debtors very much under the threat of inevitable insolvency, owing to inadequate resources. For instance, carrying out employee lay-offs will require some degree of financial strength to pay for the redundancies. In all of these practices, there is a glaring lack of any documented evidence on how they are undertaken. However, the media report efforts to solve many disputes out of court which are not necessarily business related. The use of informal approaches as a way of solving business financial distress has not been explored fully. Nonetheless, there is tangible evidence that shows how, in the context of resource-based conflicts, such as in respect of land, forests, water and even political conflicts, there are examples of informal approaches having played a central role in the lives of the Kenyan people. A most notable example was the post-election crisis that engulfed Kenya during the 1997 elections.[125]

Besides, there is a general recognition in Kenya of the reality that taking every dispute to court burdens the judicial system and strains beneficial relations. The legal environment is conducive in nurturing out of court settlements of disputes. For instance the Constitution of Kenya, 2010, recognizes alternative dispute resolution and raises its status to a judicial principle.[126]In addition, arbitration is probably the best-known out of court mechanism in Kenya and the rules of the game are laid out in the Arbitration Act. In addition, the existence of in-

[125] John Ouch, 'Undercurrents of Post-Election Violence in Kenya: Issues in the Long-term Agenda' available in http://www2.warwick.ac.uk/fac/soc/crer/afrobrain/oucho/publications/john_oucho.pdf, accessed on 28 January 2013

[126] The Constitution of Kenya, Article 159 (2) (c) is clear that alternative forms of dispute resolution including reconciliation, mediation, arbitration and traditional dispute resolution mechanisms shall be promoted

stitutions such as Kenya's Dispute Resolution Centre (DRC),[127] which are independent, non-profit organisations that promote effective and economic resolutions of disputes through arbitration and predominantly mediation and expert determination are evidence that Kenya's multi-cultural business community can conduct business restructuring without the complexity and expense of court proceedings, or even arbitration.

The challenges facing a developing economy like Kenya make informal approaches a very attractive option. For instance, there are no specialist bankruptcy courts and it is notable as well that the physical location of general commercial courts and specialised bankruptcy lawyers is mostly in the capital city, which makes them beyond the reach of most Kenyans. Besides, the inevitable needs of financial resources to pay court fees and legal fees where they are represented, in addition to lengthy court processes that can run for years, are discouraging. Much as the aforementioned realities are more pronounced in aspects not necessarily related to business restructuring, they are a clear indication that informal approaches can serve to fill the gaps of the legal mechanisms.

In addition, there is the problem that formal procedures are perceived negatively in Kenya. This was captured clearly by this quotation, as explained below,

> 'For the first time in my life I realized the power of culture, 'Sopiato says. 'It does not matter what the laws say: neither is it significant that I am educated, understand my rights and can argue my case. My contribution to the acquisition of some of the property was not significant after all; it is men that acquire property, not women. My

[127] Brenda Brainch, 'The Climate of Arbitration and ADR in Kenya' (Paper given to the Colloquium on Arbitration and ADR in African States, King's College London, June 2003)

ability to hire the best lawyer in town and pursue the matter in the formal legal sys tem was not a welcome avenue even to my own family'.[128]

It is acknowledged that, much as the quotation relates to a family dispute, it provides an illustration of a negative perception of litigation harboured generally by Kenyans. This reality is equally faced by those in business ventures. The adversarial nature of the litigation process makes many give up their rights to legal enforcement, something that can be tapped to promote informal mechanisms. It is argued that, unless mechanisms that promote alternative avenues to business restructuring are considered, the existing perception will equally encourage a business in financial distress to continue trading on, until it is inevitable that it must start a legal process. Failing to take necessary measures to restructure a distressed business early enough undermines the chances of successful rescue.

Another important aspect that endears workouts to Kenya is the abundance of regional opportunity that will boost and nurture large as well as multi-national institutions. Kenya's participation in regional custom union is a good recognition that its economic growth will inevitably require greater integration with its neighbours. It is therefore imperative that its insolvency law, both through the local and informal mechanisms, operates efficiently. Central banks are already collaborating on supervision exercises across borders, stimulating learning and best practice,[129] which should be tapped into, and possibly developing the necessary informal workouts.

[128] Catherine M Mumma, 'Accessing Justice and Protecting the Rights of the Vulnerable through Cultural Structures: A Tool on Working with Elders in Communities' available in http://kelinkenya.org/wp-content/uploads/2010/10/Working-with-Cultural-Structures-A4FINAL.pdf accessed on 20th November 2012.
[129] USAID, 'Kenya's Agenda for Action: Commercial Legal and Institutional Reform -Diagnostic of Kenya Business Environment' (2009) available at http://www.bizclir.com/gallaries/county-assessment/Kenya.pdf accessed on 30th November 2012

It can be gleaned from this analysis that Kenya has auspicious circumstances that could promote informal corporate restructuring. Much as the well-known informal approaches analysed previously, such as pre-packaged bankruptcy, are foreign concepts to Kenya, their absence provides an opportunity to consider their possibilities. In consideration of the fact that a pre-packaged insolvency is a structured business sale, which is negotiated and agreed with a proposed buyer who must have its own structures and funding in place before the deal is completed, it is argued that the practice can easily be done in Kenya. In fact, the chances of success in the days to come are high, provided that the necessary reforms to the formal insolvency mechanisms, as proposed by the pending insolvency bill, take effect. The advantages that pre-packaged sales offer, such as parties being able to exercise greater control over the message being put across to suppliers, customers and others outside, reducing opportunities for such persons to disrupt the continuation of the business, is attractive. In addition, the merit of enabling a smooth hand-over of the business, both internally and in relation to third parties besides the employees retaining their jobs, agrees with the Kenyan vision 2030 agenda.[130]

A workout, as was detailed, has its vital role in restructuring. The mystery is whether the popular workout is a viable option in Kenya. A fundamental aspect to remember is that in Kenya, just like in most developing economies; bank lending is a prime source of credit to enterprises.[131]In addition, the credit relationships between banks and enterprises are inherently risky and therefore banks use collaterals in order to mitigate these risks. This is a practice common in many jurisdictions. England, as an example through its judicial and legisla-

[130] Kenya Vision 2030 is the country's new development blueprint covering the period 2008 to 2030. It aims to transform Kenya into a newly industrializing, ‘middle-income country providing a high quality life to all its citizens by the year 2030’
[131] FSD Kenya, *Costs of Collateral in Kenya, Opportunities for Reform* (Nairobi, Kenya, 2009)

tive policy, encourages financing through secured loans. Through this the UK firms' majority debts are financed through syndicated bank loans and are also bound by the terms of syndicate lenders.[132]As a result, the banks' behaviour is guided by the formal and informal authority of regulating agencies. Another similarity is the roles played by their central banks. The Kenyan central bank, just like the Bank of England, has existing relationships with lending institutions, such as commercial banks, and equally plays that vital role in coordinating the activities of these institutions. However, the Kenya Central bank does not have that historical role of orchestrating solutions to financial distress pronounced in the English equivalent; an extra role which is entirely separate from the Banks' role as the UK's banking supervisory authority.

Therefore, it is argued that the central bank of Kenya can use its authority as a state institution to play that important role of generating norms which can guide the process of restructuring in financial distress. Such a role will fit well with suggestions that the state institution may be able to influence parties by pure co-ordination.[133] It could as well induce social or economic change by altering the environmental constraints on individual decision making.[134]This was demonstrated clearly by the Bank of England through its early efforts to save businesses by developing a pattern which, over time, became self-enforcing. In Japan too, workouts involve a rescue package that is put in place by the company's main banker. The effectiveness of this will also depend on the existing insolvency procedure and equally on the closeness of the relationship that exists between the company and its principal banker. It is acknowledged that, much as the changing market dynamics, especially in the UK, have

[132] Armour, (n 69)
[133] Lessig Lawrence, 'The New Chicago School' (1998) 27 Journal of Legal Studies 661
[134] Picker (n 22)

profoundly destabilized the efficiency of the London Approach, its principles can still offer guidance in devising solutions that are appropriate to Kenya's circumstances. Besides, the changes, such as companies resorting less to bank loans in the UK and instead using disinter-mediated debt finance, such as bonds issues,[135] are not that common in Kenya.

However, of significant concern is the evidence that the value of the London Approach, developed from an advanced economy, has been largely confined to very large rescue attempts and with extensive borrowing.[136] It has been emphasized as appropriate for large companies because the cost of a successful workout can range up to £6million over its life time and can extend to ten years.[137] On the contrary, the Kenyan economy is small and still relies on traditional credit instruments, such as bank loans, leasing and investment lending. Besides, banks are corporations, just like elsewhere in the world, although Kenyan banks tend to be self-dealing, involving loans to shareholders, managers or politically important people. This is a serious impediment as it has been documented in other jurisdictions and in particular in Germany which once had similar bank dominating systems as poor at financing innovation and entrepreneurship.[138]

It may also be observed that a large percentage of businesses in Kenya, which range from small to medium businesses, cannot be said to have extensive borrowing.[139] Furthermore, the few large multinational firms with businesses in Kenya are increasingly concentrating

[135] Armour, (n 69)
[136] Finch, (n 13) pg.222
[137] See John Flood, and Robert Abbey, Eleni Skordaki and Paul Aber, *The Professional Restructuring of Corporate Rescue : Company Voluntary Arrangements and the London Approach* (ACCA, London, 1995)
[138] Richard Deeg, 'The Comeback of Modell Deutschland? The New German Political Economy in the EU'(2005) 14 German Politics 2
[139] Ibid

their efforts on branding and marketing, rather than production and so there is a developing trend towards out sourcing from the small local firms.[140] Therefore the context in which the London Approach was able to operate may be very different from the realities in Kenya, raising concerns as to whether such an approach is appropriate. Nevertheless, it is argued that this divergence of realities does not necessarily mean that the ideologies behind the London Approach are irrelevant. On the contrary, it is arguable that Kenya can borrow the idea behind this workout and develop a functional equivalent. For instance, the fundamental tenets behind the London Approach can be borrowed and fashioned to the Kenyan realities. However, it is foreseen that informal workouts in Kenya might be impeded by a lack of trust. Trust or good faith, as was noted, is a crucial aspect which workouts require which is unseen and unknown and is purely grounded upon the actions of others. In fact, Kenya businesses have in the recent past been plagued by mismanagement, amongst other challenges, sometimes to an extent that they have collapsed. The devastating losses that many creditors incurred as a result of these failures are still fresh; and the public is reluctant to give these organizations a second chance. There is a general lack of trust in the business community when it comes to working together to improve efficiency.[141]

It must however be noted that the current challenges facing the UK that are acknowledged as straining the operation of the London Approach in its home base will be faced in Kenya in the near future. This is because the sources of finances and commercial banking will have to grow in pace with economic expansion. It will therefore be necessary to factor those realities

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[140] USAID, *Understanding Micro and Small Enterprise Growth* (USAID, Washington DC, 2005) available in http://microlinks.kdid.org/sites/microlinks/files/resource/files/ML5505_mr_36_understanding_micro_and_small_enterprise_growth.pdf accessed on 28 November 2012

[141] USAID 2005 (n 140)

into the reforms such that they do not become emergency measures but rather long lasting solutions. A functional equivalent of the London Approach or workout will be ideal as it would be unrealistic to expect an emerging-market's insolvency regimes to both smoothly and effectively in corporate norms, legislative, regulatory, institutional and judicial practices that took decades to evolve in their the advanced economies that were their origin. Even the functional equivalent of the London Approach/pre-pack or workout would require time to be understood by policy makers, business leaders and practitioners before it could be assimilated into the overall legal system. It might also need appropriate modification for it to be implemented in the Kenyan context and enforced by entirely new or radically re-designed agencies and courts, and to be accepted by the general business and governmental culture.

4.6 CONCLUSION

Informal restructuring, just like its formal counterpart is the product of deliberate efforts to avert or at least minimize the impact of market dynamics upon a struggling business. In practice, there are fundamental differences between the informal and formal, the main one being the extent of court involvement in the latter and the absence in the former. Besides, informal restructuring does not entail dealing with creditors collectively while the formal procedures tend to be collective. In addition, formal procedures often involve statutory moratoria, while moratoria under informal mechanisms require a consensual standstill. It was also noted that the possibility of having an effective workout is hugely dependent on the existence of reliable formal mechanisms to at least act as a threat of enforceable legal approach, and the absence of effective mechanisms may be an impediment in Kenya. Although there have been reforms in the Kenyan judiciary, it remains to be seen whether the reforms have boosted the image and reliability of the courts. The lack of a modern insolvency law in

Kenya makes informal mechanisms a good alternative. In addition, the fact that Kenya is used to informal approaches to dispute resolution is a good justification for advocating workouts. The test is whether the principles or approaches championed by international institutions suit Kenya. The external supply of best practices can facilitate radical changes but the danger is that they might not be feasible in the circumstances of a developing economy. Besides, some critics have argued that these standards do not hold what they promise.[142] These standards that are derived from abstract principles rather than consisting merely of a synthesis of existing legislation. The disadvantage is that the principles from which they are derived may have little to do with existing practice, and the remedies they offer could therefore be quite ineffective. Admittedly, there is gap between theory and practice, between rules and their implementation.

It is argued that developing a functional equivalent of a workout is a realistic approach as this allows for the possibility of having mechanisms tailored on realities of a developing economy. These sentiments were echoed by Thomas, who proposed that tailoring a corporate debt restructuring strategy to individual country circumstances requires attention to a number of key factors, such as policy coordination, consideration of the reform of the legal and institutional framework for enforcement of credit, particularly the corporate insolvency law, government support to facilitate out-of-court restructurings and potential innovations to facilitate voluntary standstills amongst others.[143] Therefore legal reforms, such as the Insol-

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[142] Katharina Pistor, 'The Standardization of Law and Its Effect on Developing Economies' (2002) 50 The American Journal of Comparative Law 1

[143] Laryea, (n 31)

vency Bill, are only one requirement for an effective insolvency system and reforms to the wider infrastructure are equally important. In addition, it is prudent as a prerequisite for the new laws to become part of the continuous process of legal change, without which the formal legal system or informal approaches developed will remain largely irrelevant.

CHAPTER FIVE

5.0 DRIVERS OF CORPORATE INSOLVENCY REFORMS IN THE UK

'Bankruptcy laws, like the economies they serve, are not static and need to be amended and altered to serve the commercial reality of a particular country.'[1]

INTRODUCTION

The reform of corporate insolvency laws has been a concern around the world for some years. For example the United Kingdom has witnessed a number of legal reforms, especially in the recent past. In the UK and in other jurisdictions of the world, different forces may have a powerful influence over the shape, as well as progression, of their respective bodies of relevant law.[2] The increased activity in this regard is motivated by internal forces, as well as external, which in this thesis are referred to as drivers. This chapter discusses the development of corporate insolvency law in the UK and looks at reform efforts in order to understand what drives the reforms. This is considered necessary to the main objective of establishing whether Kenya can learn in its reform endeavour from the UK. As Finch articulates while proposing models of insolvency law reform, it is important to comprehend the factors that drive reforms and what ought to drive the reform agenda, because unless this is done, there is a danger of the law developing in an ill-coordinated and an incoherent manner.[3] In addition, she proposes three important issues, namely movements in market conditions, needs for new strategies, and adjustments of overall objectives as factors that drive reforms. In fact, the issues mentioned arguably summarize the core reasons for legal change. How-

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[1] European Bank for Reconstruction and Development, 'Legal Indicator Survey: Assessing Insolvency Law After Ten Years of Transition' Law in Transition Part 2 (EBDR, Spring 2000)
[2] John Armour and David A Skeel, 'Who Writes the Rules for Hostile Takeovers, and Why? The Peculiar Divergence of US and UK Takeover Regulation' (2007) 95 Georgetown Law Journal 1727
[3] Vanessa Finch, '*The Dynamics of Insolvency Law: Three Models of Reform'* (2009) 3 Law and financial markets review 5

ever, to actually understand, for example, how market changes drive insolvency law reform, it is necessary to delve further and comprehend what causes those market changes. Besides, it is argued that whenever a significant change occurs in the market dynamics, the objectives of the laws in a jurisdiction will have to be adjusted and so will the strategies. This chapter is organized into two main parts. The first part explores the historical development of insolvency laws. The English jurisdiction has a long history in insolvency matters and the historical evolution of corporate insolvency laws and procedures has been investigated in detail in a number of studies.[4] Therefore the analysis offered here is limited to highlighting the most significant issues for the argument of this chapter. The second part explores the developments in recent times i.e. in the twentieth and twenty first centuries. It seeks to understand the forces instrumental in shaping corporate insolvency in the UK-the drivers of reforms. It is evident that the reform efforts that started in the twentieth century were actualized in the twenty first century. Therefore, the second part entails an exploration of each driver as it developed through the centuries. The drivers that are examined in the second part have been categorized into two main groups. The first group comprises contextual themes, namely the development of a rescue culture, globalization, crisis, regional integration, competition and efficiency. These factors may necessitate reforms but the implementation of reforms is dependent on political will. The second category is the actors or players, who are the government, international institutions and interest groups. It is important to note that each of the drivers cannot be said to operate in isolation. For instance, changes in market conditions make the existing legal provisions inadequate, necessitating reform, but realizing this requires the government's deliberate efforts and political will to enact laws.[5]

[4] On historical evolution see, Duffy (1985), Hoppit (1987), and Lester (1995)

[5] Federico M Mucciarelli, 'Not Just Efficiency: Insolvency Law in the EU and Its Political Dimension' (2013) 14 European Business Organization Law Review 175-200

5.1 THE EARLY HISTORY AND REFORMS OF ENGLISH BANKRUPTCY LAWS

5.1.1 The Fourteenth to the Sixteenth Century

The roots of the UK insolvency laws may be traced back to the 14th century, a time when it was common practice for banks to deal with the economic fallout of financial crises.[6] A significant moment was when a general crisis in banking occurred, that involved most of the leading houses in Florence facing financial distress as a result of an over-extension of credit.[7] In particular, the failure of the Bardi Bank in 1345 shocked the financial stability of England and provided the 'wake-up call' for legislation in relation to those who caused such a crisis.[8] However, no legislation was enacted but literature documents that creditors attempted to collect their accounts using whatever means were available under the ordinary process of the courts.[9] In essence, there was no collective procedure for administration of an insolvent's estate and a disappointed creditor could seize the effects of his debtor and, later on, his person also.[10] It was during the reign of Henry VIII in 1542 when the Bankruptcy Act was enacted. It was intended to govern proceedings against absconding or concealed debtors amongst the merchants.[11] The Act enabled the aggrieved creditors to procure the seizure and sale and a rate able distribution of the debtor's property amongst his creditors.[12] At that particular time, insolvency law was concerned with effective debt collection and protecting trade and punishing rogues.

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[6] John Michael Wood, 'Corporate Rescue: A Critical Analysis of its Fundamental & Existence (PhD Thesis, University of Leeds, 2013),pg 45

[7] Norman Davies, *A History* (Pimlico Press, 1997) Pg. 401

[8] Michael Wood, (n 6) pg 45

[9] Elizabeth Welbourne, 'Bankruptcy before the era of Victorian Reform' (1932-34) Vol,4, p.51

[10] Roy Goode, *Principles of Corporate Insolvency* (4th edn, Sweet and Maxwell, 2011) pg 9

[11] Statute of Bankrupts, 34 & 35 Henry VIII

[12] Statute of Bankrupts 34 & 35 (Henry VIII, 1542 c.4)

It is notable that the character of this particular legislation reflected societal attitudes in England that were inclined to punish risk takers when the risks went wrong and side with creditors who lost out. Besides, the law has been said to be rooted in social institutions as well as in socio-economic networks and it plays an important role in the fulfilment of social needs. Social factors can influence the course of law or the direction of legal change,[13] as is supported by historical realities. In particular, during the medieval days in the UK, insolvency was seen as a disgrace and when an individual became insolvent, the cause was usually presumed as having been due to the fault of the debtor. Goode describes the life of a medieval debtor as 'likely to be nasty, brutish and short.[14] Just as the charging of usury by money lenders was regarded as contrary to the laws of God and was punished accordingly both by the church and by the powers temporal, so also falling into debt was considered mortal sin'.[15] Besides, credit and trade were largely personal processes and outstanding debt regarded as a breach of faith. Consequently, the English bankruptcy law remained exclusively an instrument of debt-collection with its final objective being to seize the debtor's assets against the strong protections to private property offered by the Common law.[16]

However, problems arose with this narrow approach i.e. the lack of collectively in the early 16th century, primarily as debtors discovered an increasing number of ways to avoid imprisonment, such that bankruptcy was considered a means of stemming creditor frustration and restoring some order to the management of outstanding debt.[17]Nonetheless, despite the harsh treatment of entrepreneurs facing severe risks to their life and health if their businesses

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[13] World Bank, *Principles and Guidelines for Effective Insolvency and Creditor Rights Systems* (2001) para 4
[14] Roy Goode, *Commercial Law* (3rd edn, Penguin, 2004) p 827
[15] Ibid
[16] Jerome Sgard, 'The History of Market Discipline: Bankruptcy, Renegotiation, and Debt Discharge in England and France (Sixteenth–Nineteenth Century)'(A Paper Presented in EHES Conference held on September 4-5 2009, in Geneva)
[17] Jay Cohen, 'The History of Imprisonment for Debt and its Relation to the Development of Discharge in Bankruptcy' (1982) 3 Journal of Legal History 153

failed, fraudulent bankruptcies increased. This reality necessitated reforms to make better provisions for suppressing them and to provide means for persons to be declared bankrupt.[18] The next legislation to be enacted was the Bankruptcy Act of 1571[19] which is noteworthy for two main reasons. First, it explicitly limited the statute on bankruptcy to merchants and second it created the position of commissioners of bankrupts, who were to be appointed by the chancellor to oversee each bankruptcy. Such persons were often lawyers or merchants, who served in their private capacity and were paid out of the proceeds of the bankrupt's estate.[20]

From the foregoing analysis, it is evident that, the legal advancement in that historic period was because of a need to develop a mechanism to assert the power and moral authority of the state through punishment; a solution to curb the evasive, delaying and often fraudulent practices of debtors. Generally the legislative reforms were attempts to deal with the problem of uncooperative bankrupts. In fact, the lawmakers intensified the threat of punishment of bankrupts, although some literature suggests that they had begun to realize the necessity of a debtor-friendly, 'carrot'-like, rather than 'stick'-like, discharge.[21]

5.1.2 The Seventeenth Century Reforms

The Seventeenth century is considered the era of credit, much as some literature contends that the use of credit started in the sixteenth century.[22] It was at this point that the economy was maturing more quickly and becoming complex. The rapid commercial growth, as seen by the expansion of trade, especially overseas, brought in new challenges. It became clear

[18] Louis Edward Levinthal, 'The Early History Of English Bankruptcy' (1919) 67 University of Pennsylvania Law Review 1
[19] The Bankrupt Act of 1571, 13 Elizabeth I, c. 7)
[20] Emily Kadens, 'The Last Bankrupt Hanged: Balancing Incentives in the Development of Bankruptcy Law' (2010) 59 Duke Law Journal 7; Also see, Duffy (1985), Hoppit (1987), and Lester (1995)
[21] Kadens, (n 20)
[22] Lynden Griggs and Gino Dal Pont, 'The Journey from Ear-Cropping and Capital Punishment to the Bankruptcy Legislation Amendment Bill 1995' (1995) 8 Corporate and Business Law Journal 155

that there was a need to create effective insolvency measures because of the risk of failure and its effect on the delicate order developing in commerce.

Appleby says:

> 'The seventeenth-century commercial order of England was exposed to a new battery of dislocating forces: international competition, monetary fluctuations, and discontinuities in the levels of supply and demand'[23]

The changes in the commercial order and the economy made the then existing legislative framework generally incomprehensible.[24] In fact, it has been documented that this era was the beginning of the British primacy in world trade and, the commercial sector of the economy was the most innovative one.[25] Importantly, three statutes were enacted namely: the Bankruptcy Act 1604, the Bankruptcy Act 1623 and the Bankruptcy Act 1662. Generally, the aforementioned legislations clarified aspects of the Bankruptcy Act 1571 and addressed particular issues, such as new acts of bankruptcy or the exclusion of certain categories of debtors from the legislation. These reforms were done in as a continuing effort to stem the tide of bankrupts. In this vein, the Parliament continued to increase the powers of the Commissioner to investigate fraud, under powers contained in the Bankruptcy Act of 1604. Generally, the notion that bankrupts were persons who practiced deceit led to bankruptcy reforms, which increased the rights and remedies of the creditors and the notion of punishing bankrupts remained a key characteristic of the enacted laws. However, the need to help creditors is demonstrated in the preamble of 1604 Act which states that 'An Act for better

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[23] Joyce Oldham Appleby, *Economic Thought and Ideology in Seventeenth-Century England* (Princeton University Press, 1978) 25–6
[24] Ibid
[25] David Ormrod, The Rise of Commercial Empires England and the Netherlands in the Age of Mercantilism, 1650-1770, (Cambridge University Press, 2003) pg. 10

relief of creditors against such as shall become bankrupt'.[26] Equally, the 1623 Act reflects similar sentiments as it was also described as an 'Act for the Further Description of a Bankrupt and Relief of Creditors against Such as Shall Become Bankrupts and for Inflicting Corporal Punishment upon the Bankrupts in Some Special Cases.'[27] It is notable that under this Act, a debtor indicted for fraudulent transfers was also subject to punishment by Pillory and the loss of an ear.[28] In essence, the legislators were dealing with a reality that the number of bankrupts had increased, as well as levels of fraud and deceit, as the debtors invented new practices to circumvent penalties entrenched in the laws. Many other statutes and bills came up in subsequent years. It is worth noting that between 1678 and 1698, around at least thirteen separate bills were presented in parliament, many of which were designed to provide the unfortunate insolvent with an attractive alternative to the bankruptcy laws.[29]

5.1.3 The Eighteen Century Reforms

The journey of reforming insolvency law in this era can best be described as a move from debtor repression to debtor protection, in which there has been a redefinition of the roles and focus of insolvency.[30] In contrast to the reforms of the preceding centuries, this era marked the start of a shift in focus from protection of creditors' rights to greater reflection of the debtor's interest.[31] It was at this point that a general recognition emerged that financial failure is the price society must pay for the lifeblood of the modern economy, namely credit.[32] Therefore, reforming the laws was a journey shaped by socio-historical, political and eco-

[26] Bankruptcy Act of 1604 1 Jac 1,c 15
[27] Bankruptcy Act of 1623 21 Jac 1, c 19
[28] Ibid
[29] Kadens, (n 20)
[30] European Bank for Reconstruction and Development, 'Insolvency – A Second Chance: Why Modern Insolvency Laws Seeks to Promote Business Rescue' Law in Transition (EBDR, 2013)
[31] Griggs (n 22)
[32] Ibid

nomic factors. In essence, the economic transformations, cultural change, and general institutional modifications had a massive impact on the structure and working of bankruptcy laws, procedures and enforcement mechanisms.[33] Besides, the rise of industrialization, technological advancement and globalization made the medieval laws that were meant to deal with the pre-industrial economy and relatively undeveloped credit markets inadequate.

A major reform was brought by the Bankruptcy Act of 1705, which introduced debt discharge as a normal conclusion of a bankruptcy process. This legislation is a very significant realignment of debtor-creditor relations, as it actually changed the status of a bankrupt from a quasi-criminal to that of an unsuccessful defendant in a civil action.[34] In essence, a bankrupt's actions or omissions which were previously handled as if they were crimes hence punishable before the law were treated as civil actions. Varying reasons have been offered as the motivations behind the enactment of this legislation. Friedman and Niemira contend that, 'the introduction of discharge was both cause and effect of a new attitude toward the bankrupt. From a crime, bankruptcy evolves into what we might rather call a commercial crisis'.[35] In addition, Duffy has referred to the Bankruptcy Act of 1705 as the 'initial meliorating statute' from the bankrupt's perspective.[36] There was therefore a gradual realization that in many cases the bankrupt might be properly an object of pity and that the unlimited internment of the debtor did not tend to reimburse the creditors at all.[37] However, a different

[33] Paolo Di Martino 'The historical evolution of bankruptcy law in England, the US and Italy up to 1939: Determinants of institutional change and structural differences' In Karl Gratzer and Dieter Stiefel (eds), *History of Insolvency and Bankruptcy from an International Perspective* (Södertörn Academic Studies, 2008) pp.263–279

[34] Ibid

[35] Lawrence M Friedman and Thaddeus T Niemira 'The Concept of the Trader in Early Bankruptcy Law ' (1958) 223 Saint Louis University Law Journal 236

[36] Ian Duffy, 'English Bankrupts 1571−1861' (1980) 24 American Journal of Legal History 283, 286

[37] Levinthal (n 18)

view was that the debtors' prisons were at capacity and this incarceration was creating a national problem in England.[38]

It is evident though that changing circumstances and the need for order had precipitated a change in the bankruptcy law. It is notable that discharge was not a universally accepted notion, and bankrupts were still generally viewed as frauds.[39]

Trieman maintains that the law experienced an important shift at this time:

> 'Instead of dealing primarily with the legal phenomenon involved in the debtor's conduct, it seeks to regulate the economic situation that arises out of the debtor's financial condition.'[40]

The legislation provided that honest insolvents be granted discharge if they complied with the requirements of the law, such as cooperating fully with their creditors by appearing before the bankruptcy commissioners and disclosing all of their assets after becoming bankrupts.[41] Nonetheless, fraudulent bankruptcy was still a capital offence and statutorily defined as such.

Later, the Bankruptcy Act of 1719 permitted the admissibility of bankruptcy examination as evidence in criminal trials.[42] Further reforms were brought in with the enactment of the Bankruptcy Act of 1732, which was substantively similar to the 1705 Act, although proce-

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[38] Steve Rhode, 'The History of Credit & Debt – Bankruptcy' available in http://getoutofdebt.org/14398/the-history-of-credit-debt-bankruptcy accessed on 27th June 2014

[39] Michael Quilter 'Bankruptcy and Order' (2012) 39 Monash University Law Review 1

[40] Israel Trieman , 'Acts of Bankruptcy: A Mediaeval Concept in Modern Bankruptcy Law' (1938) 52 Harvard Law Review 2 189-215

[41] Kadens, (n 20)

[42] Michael Levi, *The Phantom Capitalists: The Organization and Control of Long-firm Fraud* (Ash gate Publishing, 2008) pg. 145

durally much more detailed. The conditions precedent for a discharge was spelled out in detail in the 1732 Act, as was the method for enforcing the discharge. Generally, the statute incorporated prior elements in laws, such discharge and the felony provisions, and thereafter capital punishment for fraudulent bankruptcy remained a part of English law until 1820. The subsequent circle of reforms in this century, starting from the 1732 Act, which codified the whole respective legal body revolved around the question of how the debtors should be treated.

It is argued that the reforms in the eighteenth century were propelled by the dilemma of how to deal with the insolvent traders. Whereas, some debtors had been found to be too secretive, subtle and crafty, others were honest and deserving sympathy. One analyst gave an example of a dishonourable scheme:

> 'Thomas Pitkin met with his business partner, Thomas Brerewood, in the Swan Tavern in Cornhill, in the heart of the mercantile district of London. The men met to pull the trigger on a fraud that had been at least nine months in the making. After the meeting, Pitkin would leave London, absconding first to Scotland and later to Holland, and setting in motion an economic panic, an international man hunt, and a reform of English bankruptcy law.'[43]

5.1.4 The Nineteenth Century Reforms

The series of reforms in this century laid the foundations of the modern law of bankruptcy as it is today. An initial statute of note is the Insolvent Debtors Act of 1813, whose main purpose was to alleviate the plight of the non-traders and which established a specialist Court

[43] Kadens, (n 20)

for the relief of insolvent debtors.[44] Further reforms were brought in by the Bankruptcy Act 1824 and consolidated in Bankruptcy Act 1825. From this period, England entered a long series of reform which two main objects were to end prison for debt, and to reintroduce judicially sanctioned arrangements marked by creation of bankruptcy courts and the shift to an involuntary and voluntary procedure.[45] The Bankruptcy Act of 1825 permitted the debtor to initiate their own bankruptcy, in agreement with creditors. The pressure for depersonalization of business led to the enactment of the Joint Stock Companies Act 1844, which established a company as a distinct legal entity with unlimited liability for the shareholders and made it possible to make a company bankrupt just like an individual.[46] In addition, corporate insolvency was dealt with by means of special statutory provisions such as the Joint Stock Companies Winding Up Acts 1848 and 1849.

During the initial stages, corporate insolvency had aligned its identity with bankruptcy law but this later changed with the emergence of a limited liability company as a business vehicle, as created in the Limited Liability Act 1855. It was then that the UK witnessed the growth of the large corporation and the need for large-scale investment. Besides, there was a flow of outside finance and new and sometimes complicated capital structures emerged. As a result, the existing substantive legal rules and procedures gradually became inadequate. The stimuli to the insolvency reforms during that first half of the 19th century were the momentum imparted to the national economy by Industrial Revolution, the adverse effects of Napoleonic wars and ordinary hazards afflicting all sectors of the society. It was inevitable

[44] See Vanessa Finch, *Corporate Insolvency Law: Principles and Perspectives* (Cambridge University Press, 2002) Pg. 8-5 for a detailed history on the English corporate insolvency law
[45] Jérôme Sgard, 'On Market Discipline: Bankruptcy, Debt Discharge, and Renegotiation in England and France(17th -19th Century' (A Paper presented on ISNIE Annual Conference, June 2007, Reykjavik)
[46] Joint Stock Companies Winding Up Act 1844 s 1

that the law was adjusted and amended in the light of these experiences in an attempt to find satisfactory solutions.

It was also during this century that reforms grew from the dissatisfaction with the confinement of bankruptcy to traders, coupled with the need for an attitude change towards risk and credit.[47]A noteworthy statute is the Bankruptcy Act of 1861 which declared its provisions to be applicable to all debtors whether traders or not. In fact, this legislation included the possibility of a judicially-confirmed arrangement. At this point reforms started to draw a distinction in the treatment of corporate and individual debtors, although both shared common jurisprudential objectives, premised on protecting property rights and closing businesses where necessary in an efficient, accountable and fair manner.[48] This statute signified the shift in entrepreneurial structure, in the sense that a new business vehicle had been created whose character and abilities varied from the old personal way of commerce. This necessitated enactment of new law cognizant to corporate existence. Such changes were prompted by the notions that credit could be available on an institutional basis as well as capital through stocks.[49] The first modern company law statute was the Companies Act 1862 which contained detailed winding up provisions, including a provision for *pari passu* distribution.[50]

The second half of the 19th century also saw the birth of a new wave of reforms which can be described as generally representing a validation of the change towards a positive outlook in respect of bankrupts with a focus on the rehabilitation of the debtor. The earliest discussion on rescue was during the passage of the Bankruptcy Bill 1883, where the President of

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[47] Finch, (n 44) pg. 8
[48] Chrispas Nyombi, 'An Examination of the Evolving Approach to UK Corporate Rescue and the Impact of Subsequent Legal Reforms' (Feb 28, 2011) Available at SSRN: http://abstract=2012190 accessed on 27th February 2014
[49] Gerry Rubin and David Sugarman, *Law, Economy and Society1750-1914: Essays in the History of English Law* (Abingdon, 1984) pg. 43-4
[50] Companies Act 1862 s 111

the Board of Trade echoed that, in formulating the purpose of a good bankruptcy law system, 'Parliament had to endeavour, as far as possible, to protect the salvage and also to diminish the number of wrecks.'[51] This change of attitude can arguably be said to have been negated by the enactment of the Bankruptcy Act 1883 much as it was meant to deal with businessmen engaged in fraudulent deals and in particular those who had no funds to cover their investment. However, the Debtors Act 1869 reinstated the change of treatment of insolvent debtors by abolishing imprisonment for debt and the punishment of certain fraudulent debtors. Besides, the policy addressed the need to break away from the traditional model of corporate insolvency laws of merely discharging the function of liquidation while neglecting to settle the difficulties and rejuvenate the corporate entity and its business.

Noteworthy, the Bankruptcy Act 1914 which reinforced the harsh treatment of debtors is a product of the efforts a burning social issue. Most significantly, this act required the debtor to apply for bankruptcy in a public court, such that a debtor was embarrassed as the members of the public got to learn that a particular debtor was applying for bankruptcy and exposed details of the financial position. Corporate insolvency laws in the UK were further reformed with the enactment of the Companies Acts of 1929 and 1948 which were prompted by societal advancement and commercialization in the 20th century. At this point, no much change in bankruptcy law took place until much later, the oil crisis and economic recession in the 1970s would prompt the government to review the existing insolvency laws which had become unsatisfactory and ineffective. There are other modern statutes especially in the twenty first century which will be pointed out in the in-depth exploration of each driver below.

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[51] Hansard, March 1883, cols 621, 622

It is evident that reforms in the nineteenth century, as already detailed, were propelled by a number of factors that led the government towards active involvement. In essence, change occurs into two phases where the first phase are variety of factors such as challenges, circumstances etc which propels the second phase where the government drives reforms by engaging in mechanism/activities to realize change. The increase in the number of bankruptcies in the 19th century created unease about credit and debt. This reality made the law makers and businessmen realize that the consequences of commercial failure were impregnable barriers to economic development. Arguably, the increase in the number of bankruptcies was at that point a key driver that prompted the reforms. In essence, law and society exist in a relationship of action and reaction such that law constantly progresses as it adapts to the social realities. Basically, the bankruptcy and rescue law systems were weak and not capable of supporting t companies, enabling them to rehabilitate in the face of a high volume of enterprise distress and long term economic recession. As a result, a myriad of legal reforms were witnessed in the pursuit of new and coherent corporate insolvency laws, properly tailored to shepherd corporations through the commercialized world. In fact, according to Lester, substantial efforts to reform insolvency law happened between 1831 and 1914 as evidenced by the numerous reports of royal commission and parliamentary select committees and a government bureaucracy and budget.[52] This approach illustrates the role of the government in driving reforms and in-depth analysis will be dealt with later in the chapter.

The UK approach to corporate rescue has, however, only developed much more recently as influenced by several factors among them social realities and technological advancement resulting in the development of specialized statutory mechanisms for corporate rescue. A

[52] V Markham Lester, *Victorian Insolvency: Bankruptcy, Imprisonment for Debt and Winding up in Nineteenth Century England,* (Clarendon Press, 1995) pp2, 4-5

survey of the reforms 1980s to present reveals that they were prompted by the limitations and deficiencies of reforms brought in the 19th century, which proved inadequate when scandalous malpractices and abuses such as phoenix companies emerged. This abuse occurs where a company is allowed to be run down to the point of winding up only for its business to metaphorically rise up from the ashes as a new company formed and managed by an almost identical group of persons and utilizing a company name similar to that of a former company.[53]

5.2 REFORMS AND DEVELOPMENTS IN MODERN TIMES

The corporate insolvency laws have gained significant attention in modern times for various reasons. First, corporate insolvency law is seen and understood as a safeguard and anchor for the stability of a country's financial situation.[54] According to the IMF, insolvency law strengthens a country's economic and financial system.[55] Besides, there is an increased perception of insolvency law's importance as a primary factor for any investment interest in any jurisdiction, provided that this law is effective and guarantees an orderly proceeding with a fair, transparent, and predictable treatment for the stakeholder.[56] Orderly and effective insolvency laws wield a disciplining function on all actors on the stage. Insolvency law has also been said to influence the conditions for investment because banks tend to adjust their lending and reorganization practice in response to changes in insolvency law.[57] Further, it is

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[53] *See Ricketts v Ad Valorem Factors Ltd* [2004] 1 All ER 894; *Prest v Petrodel Resources Limited* [2013] All ER (D) 90; Ian Fletcher, *The Insolvency Law* (2nd edition , Sweet & Maxwell, 1996) pg. 500

[54] Christoph G Paulus 'Global Insolvency Law and the Role of Multinational Institutions' (2007) 33Brooklyn Journal of International Law 755

[55] IMF, *Orderly& Effective Insolvency Procedures: Key Issues* ((IMF, 1999) Foreword

[56] Paulus (n 54)

[57] Sergei A Davydenko & Julian R Franks, 'Do Bankruptcy Codes Matter? A Study of Defaults in France, Germany and the UK' (2008) 63 The Journal of Finance 2

generally accepted that it allows the market to do away with the inefficient businesses and reallocate capital to efficient businesses.

5.2.1The Rescue Culture

The major thrust of insolvency reform in many jurisdictions in the last three to four decades has been the development of legislation to facilitate business reorganizations. That is, the continuation of a business in the shadow of insolvency, which inevitably requires some additional funding and at the very least some cooperation from existing creditors to postpone and/or compromise their claims in the interest of the rescue efforts. Arguably, the more the jurisdictions revise their corporate insolvency law, the more that rescue culture is pursued. This phenomenon drives reforms. Rescue can be described as a major intervention which is necessary to avert the looming failure of a company.[58] As well, it can be seen as the drastic remedial action that is taken at a time of corporate crisis.[59] These actions go beyond the normal managerial responses to corporate troubles and may operate through informal mechanisms as well as formal legal processes.[60]

The Report of the Review Committee on Insolvency Law and Practice (1982) Cmnd 8558, commonly known as the 'Cork Report' was the basis for the reforms and modernization of insolvency laws in the UK. Ever since the publication of that report, the development of a rescue culture has been an endeavour in the jurisdiction of England and Wales. Its justification lies in the fact that corporate failure can have devastating effects. This reality was well articulated by Sir Kenneth Cork who was of the view that the livelihood and well-being of

[58] Alice Belcher, *Corporate Rescue* (Sweet & Maxwell,1997) pg.12
[59] Ibid
[60] Finch (n 44) pg.187

those dependent upon an enterprise could be the livelihood of a whole town or even a region and therefore a modern insolvency law must have regard to rescue culture.[61]

The Cork Report acknowledged the change in attitudes towards business failure that had occurred and sought to define the characteristics of a good modern insolvency law by looking at the existing procedures in place and seeing how they could be reformed to address the weaknesses in the law.[62] In particular, the report pioneered significant ideologies that have driven and advanced reform. For instance, it proposed that one of the aims of a good modern insolvency law was '...to provide means for the preservation of viable commercial enterprises capable of making a useful contribution to the economic life of the country'.[63] Essentially, the government's concern was with respect to the appointment of administrative receivers related to issues such as the extent to which the procedure provided adequate incentives to maximize economic value. The Commission engaged in discussions on how to develop a corporate insolvency system and came up with objectives which gave the English system a sense of direction as well as allowing the flexibility to add further if required.[64] It is notable that the subsidiary (second) purpose of the administration procedure, after rescue of the company, was the achievement of '.....a better result for the company's creditors as a whole than would be likely if the company were wound up'.[65]

The proposals of the Cork Committee were partially implemented in the Insolvency Act 1985, a piece of legislation which was consolidated as the Insolvency Act 1986. It is notable

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[61] Cork on Cork (1988) pg.189 as referred to in J Tribe, 'Company Voluntary Arrangement and Rescue: A New Hope and Tudor Orthodoxy' (2009) 5 J.B.L 454-489
[62] Michael Wood (n 6) pg 50
[63] The Cork Report (Insolvency Law and Practice: Report of the Review Committee), Cmnd. 8558, (1982) See paragraph 198(j). According to the this Report, fresh impetus for insolvency law reform in England and Wales came with membership of the European Economic Community in 1973
[64] Sandra Frisby, 'In Search of a Rescue Regime: The Enterprise Act 2002' (2004) 68 Modern Law Review 2
[65] Insolvency Act 1986 Sch BI, para 3(1)

that the Cork Report was not only comprehensive and rational but also that it marked a historic movement away from a punitive approach towards a more rehabilitative (rescue) based approach to dealing with business failure. The ideology of rescue became fundamental in the Insolvency Act 1986, as evidenced by the introduction of two rescue mechanisms namely the company voluntary arrangements[66] and administration orders procedures. Intrinsically, the enactment of the Insolvency Act 1986, with a variety of insolvency procedures, was to promote the rescue culture by facilitating reorganization with the hope of a better financial outcome than would be achieved through the immediate liquidation route. This culture was also apparent in other parts of the legislation but noteworthy among these are the constraints imposed by section 233 on actions of utility suppliers threatening to cut off essential supplies to a company in distress already put under trusteeship of official receivers.

The initial attempts to provide an effective rescue model were not very successful and in practice there were many technical problems not earlier anticipated. For instance, the administration regime was hampered by the requirement of an application to court, in accordance with Insolvency Rule 2.2, which proved to be expensive. In addition, the existence of the floating charge as a security gave the banks excessive privilege in the administration procedure. As a floating charge holder, the bank would appoint a receiver following a default by the corporate borrower. The appointment was purely contractual requiring the receiver to primarily realize the company asset to discharge the debt due to the secured creditor.[67]

Equally, the company voluntary arrangement has been documented as having been little utilized between 1987 and 1983 for the single most important reason that it lacked a statutory

[66] Insolvency Act 1986 Part I
[67] Brenda Hannigan, *Company Law* 2nd Edition (Oxford University Press, 2009) pg.593

moratorium, which may be regarded as a crucial aspect in rescue efforts. Similar sentiments were expressed in the 1993 Consultative Document entitled 'Company Voluntary Arrangements and Administrative Orders'.[68] Chapter two of the consultative document describes the barriers to the use of the company voluntary arrangement. A further consultation was done in 1995,[69] which is very significant since the proposals that were put forward in it were enacted in the Enterprise Act 2002. For instance, there was a perception that secured creditors, in particular banks, were too ready to put troubled companies into administrative receivership, a practice considered as hostile to enterprise and to the interests of unsecured creditors.[70] It has been documented that the Enterprise Act 2002 was passed in order to improve the insolvency procedures available to troubled corporations and to rejuvenate the broader rescue culture.[71] This is largely true since the provision in the Act addressed some shortcomings of the 1986 Act, such as making the insolvency procedure more accountable and transparent by: removing receivership; abolishing the preference for Crown debts; and attempting to implement an insolvency regime that reflected the modern realities in the business and financial worlds. In this pursuit, the Blair Government encouraged a movement towards a more US-style philosophy of enterprise that was less censorious of business failures and more encouraging of rescue.[72]

The need to prioritize rescue when dealing with companies in distress has been endorsed by a wide range of groups such as politicians, legislators as well as by the judiciary and bank-

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[68] DTI 'Company Voluntary Arrangement and Administrative Orders: A Consultative Document' (October, 1993)
[69] DTI 'Revised Proposal for a New Company Voluntary Arrangement Procedure' (April, 1995)
[70] The Insolvency Service, 'Regulatory Impact Assessment for Insolvency Provision in the Enterprise Act 2002'see para.2.3 Available atwww.dti.gov.uk/enterpriseact/pdfs/ria-insolvency.pdf accessed on 20th January 2014
[71] Vanessa Finch, 'Corporate rescue processes: the search for quality and the capacity to resolve' (2010) 6 J.B.L 502-521
[72] DTI, *A Review of Company Rescue and Business Reconstruction Mechanisms*, (DTI, 2000) pp.12-23; Also see M. Hunter, 'The Nature and Functions of a Rescue Culture' [1999] 491 Journal of Business Law 519

ers. Specifically, it is evident from a review of governmental statements leading up to the Enterprise Act 2002 that the desire to nurture a rescue culture was a significant driver of reforms. The 1998 White Paper, *Our Competitive Future: Building the Knowledge Driven Economy,*[73] together with a joint DTI and Treasury initiative that was formed in order to further the rescue culture and examines how it could be made to work more efficiently.[74] Generally, the published views of the Insolvency Service reveal that the Government's central aim was to promote 'a culture in which companies that can be rescued are rescued'.[75]

In addition, during the second reading of the Enterprise Bill, Patricia Hewitt, the then Trade and Industry Secretary, expressed that the Bill

'Strengthens the foundations of an enterprise economy by … establishing an insolvency regime that will encourage honest but unsuccessful entrepreneurs to try again.'[76]

Further, Melanie Johnson, her successor, said that

> 'The insolvency reforms will help to address the fear of failure that is a significant barrier to enterprise and helps to prevent companies in difficulty from going under unnecessarily. Together, the reforms will help to make the UK become a better place to do business …'[77]

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[73] DTI, *Our Competitive Future: Building the Knowledge Driven* Economy (DTI, December 1998, Cm.4176) paras 2.12 to 2.14.
[74] DTI, *A Review of Company Rescue and Business Reconstruction Mechanisms*, (DTI Interim Report , September 1999)
[75] DTI, 'An Update on the Corporate Insolvency Proposals' January 14, 2002
[76] HC Deb. April 10, 2002, col.44. Ms Hewitt was addressing the Parliament detailing the reasons why it was necessary to have reforms of corporate insolvency as was contained in the bill before parliament.
[77] Vanessa Finch, 'Re-invigorating corporate rescue' [2003] J.B.L. 527-557

The judiciary has equally added its voice to the rescue debate. Of its own accord, it has on numerous occasions attempted to reinforce the importance of a rescue culture in English insolvency law. In *Powdrill v Watson*,[78] Lord Brown-Wilkinson expressed that

> 'The Rescue Culture which seeks to preserve viable business was and is fundamental to much of the Act of 1986. Its significance in the present case is that, given the im portance attached to receivers and administrators being able to continue to run a business, it is unlikely that a parliament would have intended to produce a regime as to employers' right which renders any attempt at such rescue either extremely ha zardous or impossible.'[79]

Likewise, in *Farnborough-Aircraft.com Ltd Re*,[80] similar sentiments were echoed in the following words,

> '….. (T)he purpose of administration (involves) the rescue culture which was rela tively unknown in this country in relation to insolvency until the Insolvency Act 1986.'[81]

It is worth noting that the pursuit of a rescue culture has resulted in anticipatory approaches to corporate troubles being institutionalized. For instance, the ideology in the Enterprise Act 2002 is that of encouraging pre-emptive strategies to prevent the onset of financial distress; placing the obligation of ensuring that the financially distressed company seeks help at the

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[78] [1995] 2AC 294 HL at 422 A
[79] See further *Re Dollar Land (Feltham) Ltd* [1995] 2 B.C.L.C 370
[80] [2002] EWHC 1224 (ch)
[81] On judicial references to rescue culture see *Re Demaglass Holding Ltd* [2001] 2 B.C.L.C 633 ChD; Also see On *Demand In formation Plc (in Administrative Receivership) v Michaelson Gerson (Finance)* plc [2000] 4 EALL E.R 734 CA (CIV DIV)

right time firmly on the shoulders of those in charge of the company.[82] Besides, persistent audits and risk management have become key mechanisms to detect any potential problems with creditors keen to regularly monitor their investment to know the true financial position of the company.[83] In addition, a company is expected to comply with best practice for furthering the aim of rescue if any concerns are raised; seek intervention from outside of the company at the earliest opportunity if internal measures are insufficient in dealing with the matter.[84] Generally, the shift from 'debt collection' to 'risk management' has encouraged those involved in the process to think about insolvency risks in advance of the final crisis.[85] In essence, the rescue culture has driven reforms, as encouraged by the government and developed by lenders, and the market has responded by providing the skills that are designed to prevent corporate disaster.[86]

Noteworthy too is the role of banks in out of court restructuring. In fact, corporate restructuring begins in earnest only when banks and market players are willing and able to participate.[87] Besides, bank participation in the workout is important because it facilitates public debt exchange offers and in fact whenever such exchange offers are accompanied by bank concessions there is a higher likelihood of succeeding in restructuring.[88] Literature reveals that financially distressed firms hire an investment bank to manage their exchange offers

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[82] At the earliest sign of distress early intervention should be sought, but of course this does not always work so the emphasis remains on the conduct of directors See Rebecca Parry, *Corporate Rescue* (Sweet & Maxwell, 2008), at 14
[83] Anu Arora, 'The Corporate Governance Failings in Financial institutions and Directors' Legal Liability' (2011) 3 Company Lawyer 5
[84] Vanessa Finch, 'Corporate Rescue Processes: The Search for Quality and the Capacity to Resolve' (2010) 502 Journal of Business Law 506
[85] See generally Vanessa Finch, *Corporate Insolvency Law: Perspectives and Principles*, (2nd edition Cambridge University Press, 2009), Chapter 6
[86] Ibid
[87] Mark R Stone, 'Corporate Sector Restructuring: The Role of Government in Times of Crisis' (2002) Economic Issues 31
[88] Christopher James 'Bank Debt Restructurings and the Composition of Exchange Offers in Financial Distress' (1996) 51 Journal of Finance 2: 711–727

when the debt structure is complex and there is a greater need for help in mitigating potential impediments to an out-of-court restructuring.[89] In this capacity, banks offer critical leadership skills and expertise, such as strategic, tactical and managerial skills needed in restructuring.

5.2.2 Globalization

The literature on globalization gives varying accounts as to the precise time when it actually started. Some believe that the history stretches thousands of years, starting with Smith's primitive hunter-gatherers trading with the next village, others contends that the world economy was fragmented and completely de-globalized before the 19th century.[90] Specifically, it was not until the 1970s that the world witnessed the beginning of a new wave of financial integration. It may be noted that financial globalization is not a new phenomenon, but today's depth and breadth are unprecedented in the twenty first century. In particular, corporate bankruptcy law reform is no longer purely a national matter. This is because corporations and capital move around the world with increasing velocity. As a result, a global economic order has emerged. The movement from the national to the international and global levels of goods, services etc is becoming of increasing importance and often the driving force for transnational regimes and institutions.[91] In essence, there is an ever increasing dependence of all economies on international trade and consequently the rise of global tides of economic depression. As a result, there is a developing trend and need for insolvency proc-

[89] Edith S Hotchkiss, Kose John, Robert M Mooradian, & Karin S Thorburn 'Bankruptcy and the Resolution of Financial Distress' in *B. Espen Eckbo*eds *Handbook of Empirical Corporate Finance* (Elsevier, 2008) pg. 235
[90] Kevin O'Rourke, & Jeffrey Williamson, 'When did globalization begin?' (2002) 6 European Review of Economic History 1, 23-50
[91] Georges Enderle 'Three Major Challenges for Business and Economic Ethics in the Next Ten Years :Wealth Creation, Human Rights, and Active Involvement of the World's Religions (2011) 30 Business and Professional Ethics Journal 3/4

esses that have international recognition as more insolvencies become cross-border in nature.[92]

In so many aspects, the momentum of reform, the content of reform, the trajectory of reform proceeds from, or responds to, the transnational and global context. In essence, the more the boundaries in international trade disappear, and 'globalization' becomes a reality, the greater the need to modernize the insolvency laws of countries to keep abreast of the times and provide efficient solutions from an economic standpoint.[93] The globalization of trade and capital has a direct impact of opening up and connecting national markets across the globe. As a result, business entities are increasingly assuming more global outlooks. Inevitably, this consequently requires adjustment of domestic laws to facilitate trade and investment, especially to enhance the operations of multinational entities. An effective and efficient insolvency law that guarantees certainty, transparency and efficiency is considered a key factor that stimulates an efficient market exchange process, thus strengthening national and global economies.[94] Basically, strategic reforms of insolvency laws have been undertaken so as to conform to the requirements of the global market and in particular to attract investment as well as support the operations of credit systems.[95]

Globalization accelerates competition over 'best practices'[96] and as countries are exposed to competition in the global market they are compelled to adopt rules and approaches that are

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[92] DTI, *A review of the Company and Business Reconstruction Mechanisms* (London: TSO 1999)
[93] Michael Butter, 'English Fixed & Floating Charges in Germany Insolvency Proceeding: Unresolved Problems Under the New European Regulation on Insolvency Proceeding (2002) Singapore Journal of Legal Studies 271-301
[94] Sean Hagan, 'Insolvency Reform and Economic Policy' (2001-2002) 17 Conn J Int'l L 63
[95] Ben S Masoud, 'Legal Challenges of Cross-border Insolvencies in Sub-Sahara Africa with Reference to Tanzania and Kenya :a Framework For Legislation and Policies' (PhD Thesis Nottingham Trent University, 2011) pg. 50
[96] Henry Hansmann, and Reinier Kraakman, 'The End of History for Corporate Law' (2001) 89 Georgetown Law Journal 439-68

seen as being of a global standard. For instance, for a country to enable its firms to access capital from another country it may have to reform its law to comply with the regulatory requirements of that market, hence such external relations become a driving force. In addition, as firms get exposed to different institutional environments they are pressured to adopt practices that have institutional legitimacy for symbolic reasons.[97] The UK, as a global competitive economy, has benefited in the global wave in its reform. It is regarded as a significant trade partner and pace setter by many other jurisdictions, a reputation that has taken a long time to build and is constantly guarded. Therefore, whenever a development crops up in the global scene, the UK is either among the architects or first benefactors of it. For instance, the UK was influential in the design of the Organization for Economic Co-operation and Development (OECD) and the World Bank recommendations in the wake of the Asian financial crisis.[98]

It is noteworthy that globalization has brought a lot benefits but nonetheless it carries important risks. In essence, the more the financial systems become integrated and domestic markets are liberalized, the more a crisis in one jurisdiction will have impact in the other countries due to imperfections in financial markets or external factors. Crisis has driven insolvency reforms as policymakers attempt as to take advantage of the opportunities, while minimizing the risks. Crisis as a driver of reform in UK is explored in detail under subsection 5.2.4.

[97] Toru Shikawa, Abdul A Rasheed, 'Convergence of Corporate Governance: A Critical Review and Future Directions' (2008) 17 Corporate Governance : An international Review 3
[98] Keith Crawford, 'The Law and Economics of Orderly and Effective Insolvency' (PhD Thesis submitted to the university of Nottingham, 2012) pg. 7

5.2.3 Emergence of Trading blocks

The creation of economic blocs which resulted out of the desire to trade across national boundaries is one significant driver of reforms. In fact, legal history reveals that there is a tendency for integrated economic areas to develop common and harmonized laws.[99] Such dynamic attempts have been undertaken in Europe in a bid to level the regulatory framework. The EU initiatives were not focused on insolvency procedures initially but rather on subsidiary matters, such as employee protection as it engaged in promoting fair working conditions, for both economic and social reasons. The creation of a single market had merits and demerits as well which necessitated deliberations so that some countries did not suffer a disadvantage in offering better benefits to employees than other countries did. In essence, one of the EU influences on UK insolvency reforms is on the protection of employees in cases of insolvency. The reality is that in the field of employment and industrial relations, the European Union has created laws that have come to replace increasingly wide areas of national labour law. For instance the Council of the European Communities, in 1980 issued a Directive regarding the protection of employees in the event of their employer's insolvency.[100] This directive was later updated by the European Parliament in 2002[101] and again on 22 October 2008.[102] This directive requires guarantee institutions to secure claims related to employment.[103] Besides, member states were authorized to set limits on employee outstanding claims during insolvency as long as the commission was notified.[104] Since the

[99] Felix Steffek, 'Book Review: Current Issues in European Financial and Insolvency Law — Perspectives from France and the UK' (2011) 12 European Business Organization Law Review509–513
[100] The Council of the European Communities, Council Directive 80/987/EEC on the approximation of the laws of the Member States relating to the protection of employees in the event of the insolvency of their employer (1980)
[101] Social Policy: European Parliament Backs New Insolvency Directive, European Report (May 15, 2002)
[102] The Council of the European Communities, Council Directive 2008/94/EC of the European Parliament and of the Council on the protection of employees in the event of the insolvency of their employer(2008)
[103] Section 2 Art 3.1
[104] Section 2, Art 4.3

member states were not issued with a specific method of setting employee claims, the UK Government addressed the question of employee entitlement on the basis of social welfare while appreciating importance of companies to the UK economy.[105] The objective was to unite both corporate rescue and employment entitlements as prompted by the EU through the Collective Redundancies Directive (CRD)[106] and the Acquired Rights Directive (ARD)[107] and the Insolvency Directive.[108]

In addition, the decision of the European Court in *Commission v. United Kingdom*[109] was very significant. The Court held that, as a member state, the United Kingdom was required to create a system of worker representation where none existed. This was in accordance to the rights of workers under two directives 'which require Member States to take all measures necessary to ensure that workers are informed, consulted and in a position to intervene through their representatives in the event of collective redundancies [or the transfer of an undertaking]'.[110] Generally, such occurrences have inevitably propelled legal advancement and in fact the requirements of these directives were implemented by the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE).In recent years, EU has focused on cross border insolvencies because of the differences in the insolvency procedures in the member states.

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[105] Chrispas Nyombi '`Employees' rights During Insolvency' (2013) 55 International Journal of Law & Management 6, 417-428

[106] Collective Redundancies Directive, 98/59/EC 1998 OJ L 225/16

[107] Acquired Rights Directive, 77/187/EEC OJ L61/27 2001/23/EC OJ L 82, 22 March 2001

[108] The Insolvency Directive, 2001/C 221/19 OJ C 22 1/110, 7 August 2001 and Directive 2002/74/EC OJ L 270/10, 8 October 2002

[109] [1994] ECR 1-2435 C- 382/92 and Case C-383/92

[110] Generally, there are a number of; Directive 2009/38/EC of the European Parliament and of the Council of 6 May 2009 on the establishment of a European Works council or a procedure in Community-scale undertakings and community-scale groups of undertakings for the purpose of informing and consulting employees, Directives 94/45/EC (European Works Councils), 2001/86/EC (workers' involvement in the European Company) and2003/72/EC (workers' involvement in the European Cooperative Society)

Undoubtedly, increasing integration of the European economic area has driven member states to, inter alia, develop corporate insolvency laws that are characterized by an ever increasing European dimension. In particular, a major prompt for change in the UK's corporate insolvency laws happened in 1972 with the accession of the UK to the, then, European Economic Community (EEC). The accession itself had an obvious implication that the UK had expressed its intention to make the necessary adjustments in its way of operations for mutual benefits within the trading block. The EU made its Regulation on Insolvency Proceedings that was adopted by the council in May 29 2000 and entered into force in accordance with art.47 of the Regulation on May 31, 2002.

However, it is noteworthy that insolvency law for a long time was not considered a major part of the 'harmonization agenda'. This changed when an agenda for economic and social renewal for Europe was initiated at the Lisbon Summit of the European Council, held in March 2000.[111] The Summit was inspired by globalization and the new knowledge based economy and its main objective was to develop a strategy capable of enhancing Europe's ability to match the growth rate of the United States economy while at the same time reducing unemployment and social exclusion. This strategy required consideration to be given to possible reforms to corporate insolvency laws as part of the infrastructure to support enterprise.

Certainly, as a result of the UK involvement in the EU there has been a progressive reform to its market and legislation, geared to eliminating trade obstacles by the crafting of rules

[111] The Council in their discussion appreciated that businesses require a regulatory climate conducive to investment, innovation, and entrepreneurship if they are to be competitive and dynamic. See Presidency Conclusions Lisbon European Council 23 and 24 March 2000, para.14

that have an international element and nature.[112] According to the European Union law, the Regulation entered into force within the national legal orders of the Member States without any need for implementation through a domestic legislation as a matter of principle.[113] Moreover, the doctrine of supremacy of the European law is categorical that the Regulations take precedence over any inconsistent provisions of the domestic laws of the Member States.[114] Therefore, the UK, like every member state, had a legal obligation to ensure that its domestic system was in full compliance with the EU law which meant engaging in reforms necessary to minimize possible confusion where domestic law became explicitly incompatible with the EU regulation.

5.2.4 Crisis

English insolvency law, just like the laws of many other jurisdictions, has undergone many reforms prompted by recession. During an economic crisis, insolvency law inevitably obtains a much more prominent place in the social consciousness than usual. The main reason is because of the rise in the number of insolvency incidences during such times and there is a resulting public outrage as the impact is felt. In essence, public outrage about corporate failures often becomes the stimulus for policy makers to begin to address issues that they previously avoided due to the reassurances that all was well, received from industry lobby groups.[115] It seems that recession, whenever it occurs, is like a wakeup call to rethink the effectiveness of the mechanisms in place. This reality was captured in the following quotations from a letter published in the Times newspaper, January 2009,

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[112] Paul Omar, *European Insolvency Law* (Ash gate Publishing Ltd, 2004) Pg. 118-119
[113] Ian Fletcher, 'Living in interesting times - reflections on the EC Regulation on insolvency proceedings: Part 1' 2005 18(4), Insolv. Int. 49-54
[114] Ian Fletcher, *The Law of Insolvency* (Sweet & Maxwell, 2009) pg. 999
[115] Roman Tomasic, 'Company Law Modernization and Corporate Governance in the UK—Some Recent Issues and Debates' (2011) 1Victoria Law School Journal 1

> '…as the recession gets into gear, we urgently need to look into administration process. They are not pretty at the best of times, but they are disastrous in a recession when they destroy more than they recover'.[116]

Financial crisis provides an impetus to study and reform insolvency regulations. Dahan and Kirk categorically state that a crisis is a reminder of the importance for secured creditors to have an insolvency legal regime in place, which will act as the baseline for parties' private negotiations and debt restructuring.[117] During a crisis, countries find that their insolvency frameworks are tested, revealing underlying weaknesses. In particular, the long history of both formal and informal insolvency systems in the UK reveals that crisis has contributed as a driver of its reforms. Originally, the UK insolvency regime was relatively simple until a significant change was prompted by the economic downturn in the 1970s. Literature reveals that the principal stimulus for bankruptcy reforms in England, especially during the specific period was the increased rate of corporate failure.[118] During that recession, there were high levels of individual and corporate insolvencies to an extent that had never been experienced before. This in itself made the government acutely aware of the damage to public confidence inflicted by a succession of major financial and industrial scandals. Even during the recession of the British economy between 1989 and 1993 company insolvencies were widely regarded as a demonstrative both of a systemic failure on the part of the new insolvency legis-

[116] Mark Scibor-Rylski, `UK needs its own Chapter 11 for Recession' The Times 15 January 2009
[117] European Bank for Reconstruction and Development, 'Debt enforcement in Insolvency: What We Know and What We Do Not (yet) Know' Law in Transition (EBDR, 2010)
[118] Terence C Halliday, Susan Block-Lieb and Bruce G Carruthers 'Missing Debtors: National Law Making and Global Norm Making of Corporate Bankruptcy Regimes 'Available in http://ssrn.com/abstract=1265159 Accessed on 3rd June 2014

lation and of corresponding failure of the will on the part of those responsible for administering the law.[119]

Crises create significant reform opportunities by disrupting the interests of groups that previously resisted reform. The impacts of corporate failure, which include redundancies, shaking a nation's economic stability, are magnified during times of recession and these are issues that can be disquieting. Such reality prompts reaction in an effort to limit the magnitude of the impact of corporate failures. The failures of some notable companies, including a real property conglomerate, sent shockwaves through London's real estate and financial communities. Besides, the DTI reviews acknowledged that changes to insolvency law were necessary as an attempt to reduce the number of businesses and companies that were liquidated as well as to ameliorate the consequences of the unfettered operations of the market.[120]

In the recent past, during the 2007/2008 recession, the financial crisis has been documented to have spurred ad hoc policy cooperation on the international stage and energized efforts to strengthen the financial framework.[121] It actually led to dramatic changes in the national economic policies in the UK,[122] for instance, the passage of the Banking Act 2009 which is a major landmark in the development of legal tools for the handling of banks in financial difficulties in the United Kingdom. These developments exemplify how rescue mechanisms are severely tested in situations where there is a general economic downturn. It can be that, just when rescue is needed the most, the practical reality may be that businesses will not be saved if there is insufficient support available either by way of additional credit or because other creditors are so financially stressed themselves that they are unable or unwilling to

[119] Fletcher (n 53) pg. 478
[120] DTI/Insolvency Service, *Productivity and Enterprise: Insolvency—A Second Chance* (Cm 5234, 2001)
[121] Louis W Pauly, 'The Old and the New Politics of International Financial Stability'(2009) 47 JCMS 5
[122] Dermott Hodson, and Deborah Mabbett 'UK Economic Policy and the Global Financial Crisis: Paradigm Lost?'(2009) 47 CMS 5 pp. 1041–1061

support any potential rescue. The credit crisis of 2007 for instance stifled the access of distressed business to financial facilities that are so needed for successful restructuring, a reality that happens in any legal system, continents or country.[123] In essence financial crisis retrenches the access to financial facilities and, thus impacts negatively upon the prospects for preventing, or even ending, the bankruptcy procedure with reorganization instead of winding up of the estate assets.[124] Therefore, the lawyers, insolvency professionals, policy makers and all the relevant stakeholders' attention is drawn to the possible improvement of the insolvency legislative framework.

The Banking Act 2009 focuses on bank insolvency and not the insolvencies of general corporate entities but it is worth noting for the for the reason that its enactment was chiefly because the pre-existing laws in regard to bank failure and rescue were found to be so inadequate.[125] It is appreciated that this particular crisis threatened to bring about the total collapses of large financial institutions, the bailout of banks and other businesses by national governments, and downturns in stock markets around the world.[126] However, other corporate entities, most notably hedge funds but also pension and mutual funds and insurance companies, had causal primacy in the financial crisis.[127] In particular certain activities of these institutions in the pre-2007 period, notably the creation of collateralized debt obligations (CDO), were key and when the crisis occurred, there was a total collapse of the CDO

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[123] Reinout D Vriesendorp, Martin Gramatikov, `Funding Corporate Rescue: Impact of the Financial Crisis' (2010) 19 International Insolvency Review 3, 209-237
[124] Ibid
[125] Roman Tomasic, `Creating a Template for Banking Insolvency Law Reform after the Collapse of Northern Rock' (2009) 22 Insolvency Intelligence 5 & 6,
[126] Tom C W Lin, , `Too Big To Fail, To Blind To See' (2010) 80 Mississippi Law Journal 355
[127] Lysandrou Photis, and Anastasia Nesvetailova, "FESSUD" Working paper Series No.5 available in http://fessud.eu/wp-content/uploads/2013/04/The-Shadow-Banking-System-and-the-Financial-Crisis-A-securities-production-function-view-FESSUD_Working-Pap accessed on 4th May 2014

market raising the crisis onto a whole new level.[128] Another view is that, the activities of these institutions under shadow banking forced the accelerated rate of production of collateralized debt obligations to a scale of such sufficient proportions as to cause the money markets to go into financial meltdown.[129] According to this view, the institutions are then the instigators of the crisis. These developments illustrate how crisis reveals the weaknesses in the existing framework, providing impetus fora change to occur.

The financial crisis has also stirred vibrant debates which are significant in influencing reforms. For instance, in the wake of 2007-2008 crisis, there were suggestions that a new insolvency procedure was needed in order to deal with the new world of fragmented credit.[130] The proponents argued that the existing approaches failed to provide the rescue procedure that modern business restructuring really required and criticized the framework that was in place as addressing an out-dated set of challenges.[131] The EHYA contended that administration would have limited use in future because resort to a formal procedure is perceived as an indication of corporate failure; the ability of customers to abandon contracts frustrates purposes and destroys value and the lack of funding often impairs trading through the proceedings.[132] It was therefore contended that crisis brings a need to evaluate the efficiency and effectiveness of an existing mechanism.

According to the European Bank for Construction and Development, financial crisis highlights the fact that credit automatically flows to places where creditors are fairly treated.[133] As a result of such credit flows, jurisdictions constantly compete to attract investment by

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[128] Ibid
[129] Ibid
[130] Vanessa Finch, 'Corporate Rescue in the World of Debt' (2008) 8 Journal of Business Law 756-777
[131] Ibid
[132] Ibid
[133] See European Bank for Reconstruction and Development website where they explain why reforms are necessary at http://www.ebrd.com/pages/sector/legal/insolvency.shtml accessed on 10 July 2013

deliberately enhancing the efficiency of the legal regimes. Therefore, the leaders of these jurisdictions, in their attempts to forestall the impact of crisis on their economies, while appreciating the fact that their policies inevitably influence investor decisions, often respond to crisis by legislative changes to the business culture. Besides, there is evidence to the effect that reducing credit risk benefits the economy as a whole.[134] In fact, findings tend to suggest that the legal institution of secured credit is, on the whole, socially beneficial, and that such benefits are likely to outweigh any associated social costs.[135] It is accordingly important to promote access to credit and the legal framework for credit should be enabling and facilitative, while taking into account the specific contextual concerns. Achieving this would necessitate multiple strategies key among them is ensuring that a modern insolvency systems and debtor-creditor regimes are effective as it has been widely accepted as the cornerstones of sustainable economic development, since they provide a safety valve for financial failures.

5.2.5 Competition, effectiveness and efficiency

The existence of corporate insolvency law in a market economy is justified as a response to certain market failures.[136] However, its efficiency is fundamental in achieving any desired results. The efficiency of legal rules, in general terms, concerns the relationship between the aggregate benefit of a legal rule and the aggregate costs of a legal rule. In fact an efficient rule is one which is aimed at 'achieving desired results with the minimal use of resources and costs and the minimal wastage of effort'.[137] However, in the view of market develop-

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[134] Olivier De Schutter, Jan Wouters and Johan F Swinnen (eds*), Foreign Direct Investment and Human Development,* (Routledge, 2012) pp. 1-24
[135] John Armour, 'The Law and Economics Debate About Secured Lending: Lessons for European Lawmaking?' (2008) 5 European Company and Financial Law Review 3
[136] Michael Schillig 'Corporate Insolvency Law in the 21st Century: State-Imposed or Market-Based?' Available in http://ssrn.com/abstract=2198849 accessed on 14 November 2013
[137] Vanessa Finch, *Corporate Insolvency Law – Principles and Perspectives*, 2nd Edition, (Cambridge University Press, 2009)at 56

ments and innovation the same law in certain situations, may aggravate the problems it is meant to address.[138] This reality has been appreciated in many quarters, both within the UK and at an international level. For instance, the World Bank Principles and Guidelines for Effective Insolvency and Creditor Rights Systems were intended to encourage law reforms that would stimulate investment by improving returns to investors in the event of insolvency. This focus on enhanced returns clearly shows that the guidelines were strongly influenced by an efficient approach to insolvency. On this basis therefore, it is arguable that efficiency and effectiveness are among the factors that drive reforms. In essence, whenever the law is considered or thought to be inefficient, suggestions of needed reforms start in an attempt to prompt market based solutions.

Generally, reforming the law in order to enhance its efficiency and effectiveness has been done in many jurisdictions not only for the benefit of existing business but also for future businesses. In UK for instance, when receivership were found to impact substantially on the interest of unsecured creditors and the fact that administrative receivership fitted badly with international law which generally emphasized on collective procedures, agitation for reform began.[139] The government view was that on the grounds of both equity and efficiency time had come to:

> 'tip the balance firmly in favour of collective insolvency procedures-proceedings in which all creditors participate, under which a duty is owed to all creditors and in

[138] Ibid
[139] Brenda Hannigan, Company Law 2nd Edition (Oxford University Press, 2009) pg.616

> which all creditors may look to an office-holder for an account of his dealing with the company's assets.'[140]

An important impetus for this reform driver has been the expansion of foreign direct investment rapidly throughout the world economy over the past two decades, helped by the removal of many national barriers to capital movements. Admittedly, bankruptcy laws need to be considered within the wider cultural context as their effects on entrepreneurs' decision making may be diminished if they are not consistent with cultural values and norms.[141] In fact, if the law is inclined to excessively punish entrepreneurs for failure, they may let inherently high-risk but potentially high-return opportunities pass.[142] Laws are therefore reformed to ensure entrepreneur friendly bankruptcy law so as to encourage more active and vibrant entrepreneurship development.

Undoubtedly, efficiency of insolvency laws boosts confidence and inward investment as capital flows are driven by the public perception of a market by the investors. This reality was captured by the World Bank[143] in the following words,

> 'Transparency, accountability and predictability are fundamental to sound credit re lations. Capital and credit are myriads forms of the life blood of modern commerce. Investment and availability of credit are predicated on both the perception and reality of risks.'

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[140] DTI, *Productivity and Enterprise-Insolvency*: A *Second Chance* (White Paper, Cm 5234, London, HMSO, 2001) at *para 2.5*
[141] Seung Hyun Lee, Yasuhiro Yamakawa, Mike W Peng, and Jay B Barne 'How do Bankruptcy Laws Affect Entrepreneurship Development Around the World?' (2011) 26 Journal of Business Venturing (5): 505-520
[142] Ibid
[143] World Bank , *Principles and Guidelines for Effective Insolvency and Creditor Rights Systems* (World Bank, Washington DC, 2001) pg.2

Equally, a bankruptcy law can generate ex post barriers to *exit*. For instance the cost of bankruptcy is positively correlated with the length of time spent on the bankruptcy procedure such that the rating of how easy or difficult to resolve insolvency will influence investors' decisions. Generally, efficient justice systems can greatly contribute to reducing risks and legal uncertainties hence encouraging trade and investment.[144] Correspondingly, the law may escalate entrepreneurs' commitment to a losing course of action, which both delays failure and increases its cost when it eventually occurs.[145] In essence, there is a link between efficient insolvency laws and attracting foreign investment such that competing jurisdictions engage in reforms in an attempt to create and sustain a globally attractive and highly competitive business environment.

To achieve this, jurisdictions world over engage in building efficient insolvency systems as they are a fundamental part of supporting, restoring and reorganizing businesses. In the UK, the review of insolvency laws has been part of the many economic reforms meant to modernize the regulatory framework and make the UK more market friendly, as well as maintaining its competitiveness as an investment destination. The, then, DTI's press release after the enactment of the Enterprise Act 2002 indicated that competition drives reforms. In their statement, they were categorical that the reforms were intended to make UK the best place in the world to do business. In such circumstances, an assessment of efficiency serves a valuable role in determining what the law should be.

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[144] European Commission, 'Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee: A New Approach to Business Failure and In solvency' (Com 2012,742 Final) pg 3

[145] Dean A. Shepherd, Johan Wiklund J. Michael Haynie, 'Moving forward: Balancing the financial and emotional costs of business failure' (2009) 24 Journal of Business Venturing (2): 134-148

5.2.6 Agents/actors

To develop an insolvency system or even reform an existing one, the efforts of the drivers referred in this thesis as agents is vital. For instance, the government is a unique driver with substantive authority over the national institutional capacities and political systems which are fundamental in realizing reforms.[146] In fact, it has increasingly been recognized by law and finance scholars that the law is inherently 'incomplete' and reform efforts futile unless the government and local stakeholders are involved as the law is reliant heavily on the institutions of implementation.[147] Equally, the international organizations participate in driving reforms and in fact confine themselves to 'technical matters and avoid contentious policy issues because political matters lie outside their mandate or because policy conflicts would lead to international norm making a contentious stalemate.[148] Further, through active participation in consultation amongst other activities, other agents' drives such as bankers, insolvency practitioners through their respective organization contribute in the reform effort. To appreciate the efforts and level of influence of each of the agents, an elaborate discussion of each agent is undertaken below.

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[146] Terence C Halliday, ' Law Making and Institution Building in Asian Insolvency Reforms: Between the Global Norms And National Circumstances' (A Paper Presented in 5th Forum for Asian Insolvency Reform Held on 27-28 April 2006 in Beijing China)
[147] Pistor, Katharina and Xu, Chenggang, 'Incomplete Law - A Conceptual and Analytical Framework and its Application to the Evolution of Financial Market Regulation (May 2002). Columbia Law and Economics Working Paper No. 204. http://ssrn.com/abstract=310588 accessed on 3 August 2015
[148] Halliday (n 142)

5.2.6.1 Government

Law making is driven by the economic, political and social changes of capitalism itself.[149] The changes produce disturbance or trigger events that force leaders to find solutions and often their governments respond by reforming the law.[150] It is widely acknowledged that governments must provide the institutional infrastructure that makes the competitive market work and insolvency frameworks is key element of that institutional infrastructure.[151] An effective insolvency system, in terms of the overall legal and institutional framework, is known to support economic activity in a market economy.[152] One of the key roles any government plays in a market economy is to guarantee the fluidity and complete functioning of the world of business by enacting and implementing laws/policies that could guarantee the rights of those who engage in business and strengthen the institutions involved. Therefore an effective government is a significant factor in showing leadership and commitment, which are some of the basics necessary for advancement of the legislation and the institutional framework. However, the existence of such an expectation on the government does not guarantee that an existing government will actually deliver on the same. The actuality of reforms taking place or not is also dependent on resources and legislative priorities. The government's area of priority could therefore be reforms in other sectors. Besides, a government can become a hindrance. This is because politics can propel reforms only as long as such reforms promote the political legitimacy of the reigning authority. For example the Report

[149] William Chambliss, 'On Law Making' (1979) 6 British Journal of Law and Society 149-171
[150] John F Gallier and Linda Basilick, 'Utah's Liberal drug Law: Structural Foundations and Triggering Events' (1979) 26 Social Problems 284-97
[151] Douglas Webb, 'Legal and Institutional Reform Strategy and Implementation: A World Bank Perspective' (1998-1999) 30 Law & Pol'y Int'l Bus 161
[152] Sean Hagan, 'Insolvency Reform and Economic Policy' (2001-2002) 17 Conn J Int'l L 63

of the Blagden Committee on the working of the bankruptcy law and deeds of arrangement concluded that the practical experience from the law in force then was failing especially in its primary objects.[153] Despite the committee's conclusive work, no legislative initiatives were pursued in response to the recommendation of the Blagden Report, such that its many valuable proposals were never enacted.[154]

Nonetheless, the British governments have in many aspects excelled in their mandate. As a driver of reforms, the government has actively participated in forming committees to review the law. Different committees have been established from time to time in respect of one or other branch of law which influenced insolvency law and other times committees were established to consider specific aspects, such as credit and security[155] or the enforcement of judgment debts,[156] which are subjects closely inter-connected with insolvency law. Besides, there have also been commissions formed to specifically review insolvency law, such as the Cork Committee;[157] the main inspiration for the reforms made by the Insolvency Act 1985, which has already been explored in details, and which was consolidated as the Insolvency Act 1986.

In recent years, there has been a lot of positive will and commitment to insolvency law review by governments. Throughout the 1990s, the government was actively engaging in consultation, emanating from Insolvency Service, meant to give corporate rescue mechanisms a cutting edge.[158] Noteworthy is the Labour government's pledge made in 1997 where, as an

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[153] Insolvency Law and Practice, *Blagden Report* Cmnd.221, at para.55
[154] Fletcher, (n 53) pg23
[155] Insolvency Law and Practice, *Crowther Committee* (1968-1971) Cmnd 4596.
[156] Insolvency Law and Practice, *Payne Committee* (1965-1969) Cmnd 3909
[157] Insolvency Law and Practice, *Cork Report* Cmnd 8558 (1982)
[158] DTI, *CVAs and Administration Orders* (October 1993); DTI, *Revised Proposal for a New Company Voluntary Arrangement Procedure* (April 1995); DTI, *A Review of Company Rescue and Business Reconstruction Mechanisms* (September 1999)

incoming government, it proclaimed that there was a need to reassess attitudes towards business and to reshape the law in order to encourage entrepreneurs to take risks in the future.[159] This declaration proved to be a prelude to consultative exercises that resulted in the publication by the, then, Department of Trade and Industry of a series of Consultation documents as part of extensive review.[160] For instance, a review was undertaken upon an agreement between the Chancellor of the Exchequer and the Secretary of State for Trade and Industry on company rescue and business reconstruction mechanisms and a report published in 2000.[161] This review audited the development of a rescue culture in the UK and also considered how market failures are addressed in other countries. A White Paper on the general theme of promoting the competitiveness of the UK business[162] was presented to parliament in the autumn of 2000 and the issues discussed were enacted in Insolvency Act 2000, which introduced a number of reforms affecting corporate insolvency. The most significant reform was the addition of a moratorium facility to support those attempting to agree company voluntary arrangements, limited to small companies in availability. The Government's intention was to focus on enterprise and productivity as the cornerstones of its economic reforms in Parliament and this was done through the enactment of Enterprise Act 2002. Prior to the Enterprise Act 2002 was the Insolvency Act 2002 which has been documented to represent the commitment of the Labour government towards business.[163]

Another contributor to the reform debate, albeit on a more general scale, is the Justice Committee, which is one of the 19 Select Committees related to Government Departments

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[159] Fletcher (n 53) pg 23

[160] The series of DTI Consultation Documents published from 1998 onwards are available on the DTI website http://www.dti.gov.uk/cld/reviews/condocs.htm Accessed on 1 January 2014

[161] The Insolvency Service, *A review of the Company and Business Reconstruction* Mechanisms (London: TSO 1999)

[162] DTI, *Our Competitive Future: building the knowledge driven economy*, Cm.4176, (December 1998)

[163] David Milman 'Reforming Corporate Rescue Mechanisms' in John De Lacy, *The Reform of United Kingdom Company Law* (Cavendish Publishing Ltd, 2002) Pg 428

with a duty to examine the expenditure, administration and policy of the Ministry of Justice and associated public bodies amongst others things.[164] The Committee chooses its own subjects of inquiry and in the past it has engaged itself in matters of insolvency and it was recorded to have imparted a crucial momentum to the process of reform resulting in the Insolvency Act 1986.[165] The Justice report was published in 1994 and some of its recommendation was to create a permanent committee with a mandate to devise and promote a national insolvency strategy, as well as ensuring that the law is kept constantly under review so that the law keeps pace with the ever evolving social needs.[166] Such recommendations have been implemented through the creation of the Insolvency Service as an executive agency of the Department for Business, Innovation and Skills.

One scholar, Tribe, contends that the reforms that has been made and in particular the reform of CVAs can be traced back to the Conservative Party proposal in 2008.[167] In fact, in July 2008, David Cameron,[168] the (then) leader of Her Majesty's Opposition and George Osbourne[169] MP, the (then) Shadow Chancellor of the Exchequer gave speeches in which they categorically stated that corporate insolvency reforms were necessary as part of the Conservative Economic Recovery Plan. The Labour government, too, was of the similar opinion, as reflected in the 2009 budget report. In particular the government promised to ensure that the regulations and procedures for dealing with troubled companies work to facilitate company rescues whenever they are appropriate, that the maximum economic value is

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[164] The Justice Committee is established by the House of Commons under Standing Order No. 152. The details of its engagements is available in http://www.parliament.uk/business/committees/committees-a-z/commons-select/justice-committee/role/ accessed on 14th July 2014
[165] Justice, Bankruptcy (London 1975)
[166] See Justice, Insolvency Law: An Agenda for Reform (London, Justice Publication, 1994) Chs 6 and 7
[167] John Tribe, 'The Reform of UK Corporate Insolvency Law : the CVA'S, Conservatives and Chapter 11' (2009) Available at http://ssrn.com/abstract=1410693 accessed on 5th July 2013
[168] Cameron's Speech was made to the Confederation of British Industry (CBI) on Tuesday July 15 2008
[169] Osborne's Speech was made to the Centre for Policy Studies as their Annual Lecture

rescued from companies that get into difficulties, and that the knock-on effects of company insolvencies on their creditors are minimized.[170] The specific issues ear-marked for consultations were:

> 'providing for new funding lent to companies in Company Voluntary Arrangement (CVA) or administration to have absolute priority status, to allow firms in difficulties to access the funding they need to get back on track; and extending the moratorium on creditor action against small companies trying to agree a Company Voluntary Arrangement to medium and large companies, so giving them breathing space to try to reach agreement with creditors.'[171]

Significant too is the existence of the Department for Business, Innovation and Skills (BIS), formerly the Department of Trade and Industry (DTI) which is regarded, and regards itself, as having some type of custodial rights over particular areas in the legal spectrum, and key among them is insolvency law.[172] In essence, they have a standing responsibility to keep under review such laws with a view to their systematic development and reform. It is submitted therefore that the government drives insolvency law reform as a consequence of the aforementioned responsibility and in many instances reform initiatives come as a deliberate governmental decision to set in motion the requisite processes within BIS. In addition, the government has co-coordinated the various activities, as well as issuing consultation papers produced in-house then inviting both the professional and other members of the public to comment. Such engagements have borne fruit, as evidenced by the Enterprise Act 2002, which also came into being after a number of initiatives and consultations by the DTI and

[170] HM Treasury, Economic and Fiscal Strategy Report and Financial Statement and Budget Report (April 2009) Pg. 75
[171] Ibid
[172] Ian Fletcher, 'The Genesis of Modern Insolvency Law - An Odyssey of Law Reform' (1989) Journal of Business Law 365-376

the Treasury between 1999 and 2001. This initiative concluded in the publication of a White Paper, published by the Insolvency Service on July 31, 2001, entitled *Productivity and Enterprise: Insolvency—A Second Chance*. Further, because of the impact of global recession that affected business everywhere, the Department for Business, Innovation and Skills undertook a consultation on how to help businesses negotiate that hard time.[173]

Besides, the Insolvency Service has funded studies that evaluate the strengths and weaknesses of the insolvency system and the reports that were compiled are of great value in advancing reforms.[174] From the aforementioned, it is evident that the government is an influential driver of corporate insolvency reforms from its active involvement in the consultation and review processes. Notable too is that the existing insolvency framework has in many aspects actually reflected the inputs of the reports of the many reviews and consultation undertaken.

5.2.6.2 International organizations

Over recent years, insolvency laws have been given significant attention in international fora. For instance, international organizations such as the World Bank and International Monetary Fund (IMF) have been actively engaged in championing reforms to domestic insolvency systems around the world.[175] This happened especially during pre-recession times because of the view of ensuring that the legal framework facilitates restructuring so that the

[173] Available in the Insolvency Service, Encouraging Company Rescue – A Consultation http://webarchive.nationalarchives.gov.uk/+/http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/con_doc_register/compresc/compresc09.pdf accessed on 2 July 2013.

[174] Insolvency Service, Enterprise Act 2002 – Corporate Insolvency Provisions: Evaluation Report (Jan 2008), available at: http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/legislation/EA02CorporateInsolvencyReport.pdf. accessed on 8th August 2013

[175] Rebecca Parry, 'Introduction' in Katarzyna GromekBroc and Rebecca Parry (eds), *Corporate Rescue: An Overview of Recent Developments from Selected Countries* (2nd edn, Kluwer Law International, 2006) at p. 6

void between commercial life and death could be filled with workable rehabilitation processes.[176] Much as the focus of the international community is to ultimately strengthen the international financial architecture, their initiatives are designed and directed at institutions, markets and practices that governments and businesses use when they undertake economic and financial activities. In particular, the World Bank has worked together with the IMF in designing and disseminating international standards on insolvency and creditors' rights systems which are aimed at strengthening a country's domestic institutions and where necessary spurring reforms.[177] A good example is the development of Principles and Guidelines for Effective Insolvency and Creditors' Rights Systems, which was produced in 1999 by the World Bank, and which is intended to be used as an assessment tool to assist countries in their efforts to evaluate and improve core aspects of their domestic insolvency law systems.[178] The Principles cover a wide range of commercial law systems, including institutional and regulatory aspects of those systems, and elaborate fundamental principles intended to have flexible application to diverse country systems.[179] Besides, the content of the Principles is comprehensive, as it contains recommendations as to specific elements that a modern credit-based economy should have in order to facilitate broad access to credit at affordable rates, and a number of tabulated explanations.

[176] Nick Hood, 'Making Up Insolvency Law in the Recession — The World Legislates On The Hoof ' (2010) 2 Corporate Rescue and Insolvency 65

[177] Alexandra Kastrinou, 'European Corporate In solvency Law: An analysis of the Corporate Rescue Laws of France, Greece, and UK' (PhD Thesis, University of Leicester, 2009) pg. 8

[178] A consolidated document of the Principles of the World Bank and the UNCITRAL Guide has been produced, which is available at: http://siteresources.worldbank.org/GILD/ConferenceMaterial/20774191/ICR_Standard_21_Dec_2005_Eng.pdf last accessed on 27th August 2013

[179] Ibid

In addition, UNCITRAL developed a Model Law on Cross-Border Insolvency in 1997[180] whose purpose was to assist States to equip their insolvency laws with a modern legal framework to more effectively address cross-border insolvency proceedings concerning debtors experiencing severe financial distress or insolvency.[181] This Model Law focuses on authorizing and encouraging cooperation and coordination between jurisdictions, rather than attempting the unification of substantive insolvency law, and respects the differences among national procedural laws.[182] Further, in 2004 UNCITRAL developed a Legislative Guide on Insolvency Law, with a clear aim of encouraging the establishment of an effective and efficient framework for corporate insolvency, as well as providing detailed guidance and recommendations with regard to the substance of domestic insolvency laws.[183] Their main purpose, as stated in the UNCITRAL guide, is to inform and assist insolvency law reform around the world, by providing a reference tool for national authorities and legislative bodies when preparing new laws.[184] The Legislative Guide is a very detailed document that entails an exposition of the structure and the key-objectives of an effective national insolvency law system.

Besides, since the initial publication of the UNCITRAL Legislative Guide in 2004, changes have occurred through the years and produced more helpful insights and recommendations which are crucially intended to ensure the establishment of a legislative framework for insolvency that is not only effective, but also reflects modern developments and trends in the

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[180] UNCITRAL Model Law document is available in http://www.uncitral.org/pdf/english/texts/insolven/insolvency-e.pdf accessed on 30th January 2014
[181] UNCITRL Model on Cross-Border Insolvency 1997 available in http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model.html accessed on 30th January 2014
[182] Ibid
[183] Ibid
[184] UNCITRAL Legislative Guide on Insolvency Law, Parts One and Two (2004)

area of insolvency.[185] In fact, by the end of 2013, the existing UNCITRAL Legislative Guide on Insolvency Law had four parts, namely; Part one, that discusses the key objectives of an insolvency law, and structural issues, such as the relationship between insolvency law and other laws; Part two that deals with the core features of an effective insolvency law, following as closely as possible the various stages of an insolvency proceeding from their commencement to the discharge of the debtor and closure of the proceedings;[186] Part three addresses the treatment of enterprise groups in insolvency, both nationally and internationally;[187] Part four focuses on the obligations that might be imposed upon those responsible for making decisions with respect to the management of an enterprise when that enterprise faces imminent insolvency or insolvency becomes unavoidable.[188] It is evident that the provisions of the UNCITRAL Legislative Guide are wide ranging, however the same international standards do not provide a single set of model solutions. In fact, by design they are flexible guidelines addressing the key elements of an effective insolvency law system, meant to reflect the complementary nature of insolvency law with the social and legal values of the society in which it is based. Their recommendations are fundamental because they reflect modern developments and trends in the area of insolvency, and have strong persuasive nature, since they are recognized at an international level. Noteworthy too is the fact that the multilateral institutions have in recent years developed an 'appetite' for more, as evidenced by an acclaimed search for further fields of engagements in the insolvency area. In particular, UNCITRAL has gone further in giving attention to the details of such matters as the

[185] UNCITRAL Guide at p. 2
[186] Ibid
[187] UNCITRAL Legislative Guide on Insolvency Law, Part Three (2010) accessed on 9th September 2013
[188] UNCITRAL Legislative Guide on Insolvency Law, Part Four (2013) accessed on 9th September 2013

treatment of insolvency groups in insolvency, court to court communications and arbitration in insolvency law.[189]

Remarkable too is the contribution of other international bodies, such as the European Bank of Construction & Development (EBRD), INSOL International and the European Union. INSOL International works on a global scale, holding conferences, advising governments on legal reforms and training insolvency practitioners.[190] EBRD are extensively involved in project financing to promote and foster the advancement of countries to market-orientated economies and this touches upon the reform of corporate insolvency law.[191] Noteworthy too is that the global players do offer direct advice and technical assistance and condition lending on a country to country basis. International financial institutions have been involved in reform efforts and, in certain cases, have made financial assistance conditional upon insolvency law reform. For instance, the IMF and World Bank have conditionality on the respective anticipated obedience of political leadership in their engagement as they assist jurisdictions in the development of their legislation.[192] Suffice to say that an advanced economy such as the UK would not be influenced to reform through conditional lending. Even if it was, the reform would be very limited. Nonetheless, such guidelines have been documented to have created a momentum of reforms which occurs through the force of IMF and World Bank conditionality or the anticipated obedience.[193] Besides, the politics of cooperation and conflict among the global players follows an interactive process, both within the institutions

[189] Jay Westbrook, 'The Duty to Seek Cooperation in Multinational Insolvency Cases' in Henry Peter, Nicolas Jeandin & Jason J Kilborneds, The Challenges of Insolvency Reform in the 21st Century (Schulthess Buch, 2006) 361

[190] European Bank for Reconstruction and Development, 'Law in Transition Online 2007: Making an Insolvency System Work' available in http://www.ebrd.com/downloads/research/law/lit072.pdf Accessed on May 2014

[191] The European Bank for Construction & Development is one of influential financial institutions who engage in development of Insolvency Law with a focus on transition economies.

[192] The World Bank in particular is known to influence through conditional lending.

[193] Paulus (n 54)

and across institutions and it would definitely play a role.[194] These interactions follow a trajectory of promoting reforms towards a particular common goal, such as harmonization of the laws.

The work of these international players has impacted on some UK reforms. For instance, the UK in 2006 adopted the UNCITRAL Model Law, which inevitably advanced its cross border insolvency law. Generally, the existence of such international rules that are known and considered reputable in a global market rife with competition can trigger the jurisdictions of the world to re-think their laws. Also, the UK is an active participant in the international fora. In particular, the UK Government during its Presidency of the G20 was at the forefront of worldwide efforts to promote international financial regulatory reform which was considered necessary to stabilize the financial system and support economic recovery.[195] Besides, the UK government believes in international cooperation being central to strengthening the financial system for the future, and has expressed its loyalty to continue to work closely with EU and international partners to implement the G20 commitments.[196] Such platforms, as the G20 and the IMF employ peer review and benchmarking to stimulate the reform debate. In essence, change occurs through the national political leadership's wish to connect its country with the modern stream of essential legislation or simply through the persuasive power and quality of these guidelines. So far, the international players have succeeded in creating a broad movement all over the world to comply with these standards.

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[194] See www.ebrd.com/country/sector/law/st/facts/enforce/about.htm.; See also FrÉdÉrique Dahan, Elizabeth Kutenicova and J Simpson (Spring 2004), 'Enforcing secured transactions in central and eastern Europe – an empirical study' Law in transition, pp. 5-16

[195] HM Treasury, *Economic and Fiscal Strategy Report and Financial Statement and Budget Report* (March 2010) pg. 36

[196] Ibid

5.2.6.3 Interest groups

Insolvency reforms, whenever they are undertaken, impact on the rights of the different interest groups of creditors and stakeholders. Much as the groups might hold similar views as to the purposes of insolvency proceedings, diverging views emerge in any attempt to readjust the laws, as each interest group seeks to protect its own interest. Besides, interest groups, particularly those of finance professionals, may agitate for reforms and consequently achieve influence upon legislative matters, but their ability to exert influence is dependent on several factors. For instance, the resource that the professional can bring on the agenda setting and decision making is vital.[197] In addition, a well-organized group can easily mobilize on a national scale and bring influence to bear on the political process.[198] In the UK, the different interest groups in matters of insolvency are very organized and some actually have huge numbers of members, therefore giving the necessary muscle to influence reforms. In fact, the advancement of its corporate insolvency laws has benefited from, and in some instances been derailed by, lobby groups of judges, banks, lawyers and insolvency practitioners from within the UK, as well as from the EU region. A good example was witnessed, during the enactment of the Insolvency Act 1986, where the government, in its White Paper, announced its intentions to compel directors to be more vigilant about the financial situations in their companies through automatic disqualification in the event of their failure forcing the companies into bankruptcy.[199] However, the business community, with the help of

[197] Bruce G Carruthers & Terrence C Halliday, 'Professionals in a Systemic Reform of Bankruptcy Law: The 1978 US Bankruptcy Code and The English Insolvency Act 1986'(2000) 74 American Bankruptcy Law Journal 1
[198] Bruce (n 197)
[199] Bruce (n 197) pg 113

insolvency practitioners, prevailed upon the government to remove the provision of automatic disqualification and to leave it to the discretion of the court.[200]

The literature reveals that professionals have championed the reform by pressing the government forward and in other instances advising outside the parliament. In particular, during the Cork Committee consultations, the efforts of the different professional bodies were felt. Some small groups of professionals who were privileged to sit at the centre of the bankruptcy reform committees, were integrally connected to major sustained initiatives by leading their respective groups who could be lawyers, accountants or insolvency practitioners.[201] The lawyers, for instance, through their Law Society have had a committee on insolvency since the mid 1970's. Their contribution proved helpful during the Cork Committee consultations, as they focused on the technical aspects of the law and actually produced sixty briefs for the Committee on recommended reforms.[202] The accountants, using their Committee of Accountancy Bodies (CCAB), prepared an extensive set of submissions to the Cork Committee and the Department of Trade and Industry and actually actively participated through the entire process through the government White Paper and parliamentary debates.[203] It ought to be remembered that the accountants in the UK have for a long time played an integral part in insolvency issues as they covered the specialties of receivership in corporate insolvency. During the twentieth century reform, when the ideas of regulating the insolvency profession were considered, the focus was on the professionalization of insolvency, which

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[200] Bruce (n 197) pg 244-302

[201] Bruce(n 197) pg 133

[202] Bruce (n 197) pg. 96

[203] Bruce G Carruthers & Terrence C Halliday, *Rescuing Business: The Making of Corporate Insolvency Law in England and the United States* (Oxford University Press, 1998) pg. 88

gave practitioners a powerful incentive to actively participate as they attempted to ensure that they retained accesses to this work.

Another significant interest group is the insolvency professionals, who are represented by two associations' i.e the Insolvency Practitioners Association (IPA) and Association of Business Recovery Professionals (R3). The IPA was formed in 1961as a discussion group of accountants specializing in insolvency and subsequently became incorporated under its current name in 1973. During its formation, the members' interest was to register a voice in the series of reforms that were anticipated.[204] However despite this group being recognized as a body involved in insolvency there is very little documented evidence as to its engagement in pushing for corporate insolvency reforms. Besides, the little engagement has, on occasion, slowed the reform process. For instance, in the 1970s, the majority of the insolvency practitioners in the corporate insolvency field earned their fees through the staple diet of winding up and receivership. Consequently, even when the dominance of liquidation as an outcome was doing more harm than good to businesses and it was therefore very necessary to introduce rescue approaches, the attitudes among the professionals were hard to change.[205] This was however outweighed by the public climate which moved towards rescue amongst other factors.

R3, which has 97 per cent of all IPs as members, has been actively engaged in campaigning to promote business rescue and reforming the insolvency framework. For instance in March 2011 R3 launched a campaign at a roundtable event in Parliament where they called for an amendment to Section 233 of the Insolvency Act 1986 to ensure continuation of supplies in

[204] Ibid
[205] Ibid

insolvency.[206] This pursuit was successfully realized through section 129 of the Small Business, Enterprise and Employment Act 2015 which gave the Secretary of State the power to amend by order section 233 of the Insolvency Act 1986 and a consequently by publication of the Insolvency (Protection of Essential Supplies) Order 2015. Generally, the changes introduced are extension of the provisions of S233 such that list of list of supplier as well as supply is extended hence allowing a business to continue trading and therefore maximise its chances of rescue.

The group acknowledges that they campaigned long and hard for action to be taken on termination clauses, winning support from the business and creditor communities and in early 2013 the Government amended the Enterprise and Regulatory Reform Bill.[207] Besides initiating reforms, the R3 have also actively responded to the government consultations and inquiries that affect the UK insolvency industry.[208] Noteworthy too is that this organisation has expressed the view that rescue is not so much about laws and processes as the cultures prevalent within the body of creditors and the market.[209]

Another interest group that is a very significant player is that of the banks. The influence of the banking 'lobby' in the area of corporate insolvency has been described as 'phenomenal.'[210] To this group, the initial response to the Cork inspired reform was that of caution.[211] This is purely because their preference was the tried and tested tool of receivership, which

[206] R 3: Association of Business Recovery Professionals, 'Holding Rescue to Ransom - success!'(March 2011) available in http://www.r3.org.uk/what-we-do/working-in-parliament/holding-rescue-to-ransom accessed on 17 July 2014
[207] Ibid
[208] See R3 Website at http://www.r3.org.uk/what-we-do/policy-and-public-affairs/consultation-submissions for details on the many responses to the he insolvency trade body
[209] Sandra Frisby, *Report to the Insolvency Service,* (June 2006) p.64
[210] Stephen Davies, *QC Insolvency and the Enterprise Act* (Jordans, 2003)
[211] Milman (n 163) Pg 425

gave them a lot of advantage. However The British Bankers' Association, later in 1997 publicly endorsed a rescue culture and categorically stated that they had long supported it, since thousands of its customers were still in business because their banks supported them during difficult times.[212] In recent years, the British Bankers' Association, which currently has more than 250 member organizations with a worldwide presence in 180 countries[213], has actively participated in consultations concerning the insolvency framework. As an association, they acknowledge that the insolvency framework is a key element of the banks' business environment,[214] and they have participated in consultations on reforms. A good example is its involvement in the consultation exercise concerning the regulation of insolvency practitioners.[215]

Besides, EHYA, a regional trade association, which represents banks and investors involved in the European high-yield bond markets, plays a role. In fact, they actively engage in evaluating the EU member states' regulatory regimes and advise accordingly. For instance, they have evaluated the Enterprise Act 2002 and concluded that the administration procedure does not provide a rescue process that modern restructurings really require but rather addresses an out-dated set of challenges.[216] In EHYA's view, it is crucial to move to a regime of cram-down and court supervision. The arguments are based on the huge growth in the leveraged lending market, as well as the prevalence of restructurings occurring outside formal procedures. In fact, in 2007, EHYA submitted to the UK Treasury a paper outlining its views on the urgent need for insolvency reform in the UK. This was further advanced by

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[212] British Bankers Association Banks and Business Working Together (London 1997) para 3
[213] James Barty, Tommy Ricketts 'Promoting Competition in the UK banking industry' (BBA, London, 2014)
[214] Ibid
[215] The Response of the British Bankers Association in that consultation is available in http://www.insolvency.gov.uk/assets/insolvency/docs/insolvency%20profession/consultations/ipregulation/responses/5%20%20british%20bankers%20association.pdf accessed on 8th July 2014
[216] Finch (n 3)

their correspondence with the UK Insolvency Service in 2008, where they advised on the urgent need for insolvency reform in the UK.[217] Besides, EHYA together with the Institute of Bankruptcy, Restructuring and Insolvency Law**,** University College London, held an insolvency reform round table in 2009 which attracted government representatives, academics, professional bodies, company directors and investors.[218] Such an event, as expressed by Gilbey Strub, the managing director of the EHYA, provides a very important platform for formal consultation and presenting the official record to Labour MP Pat McFadden, Minister for Employment Relations and Postal Affairs at BERR is an important step toward meaningful reform.[219]

5.3 CONCLUSION

English insolvency law is diverse and has evolved over a considerable period of time. Generally, the various developmental stages reveal that there was a concerted effort to reform law. On a philosophical level this has been attributed to movements including utilitarianism, social liberalism. On a practical level, reform is a result of both a gradual increase in bankruptcies (itself due to the increasing use of credit and commercialization from industrialization) and also gradual awareness of the impact of horrors attendant upon debtors being liquidated. On a more precise view; the development reflects the influence of the numerous

[217] EHYA's Correspondence with Insolvency Service is available at www.afme.eu/workarea/downloadasset.aspx?id=5097 accessed on 5th February 2014
[218] For details on the EHYA round table held on 4th March 2009 see http://afme.eu/dynamic.aspx?id=3552 accessed on 4th Jan 2014
[219] Ibid

drivers, such as political and ideological struggles that have been part of the legislative and judicial context at various stages of its development.[220]

A historical exploration of its reform over the centuries reveals that it has been involved in a series of experiments which at times have resulted in the enactment of new legislation and many re-adjustments of existing laws to the changing conditions and sentiments of the society, and in particular the commercial community, in recent decades. In fact, Martin correctly argues that 'insolvency systems profoundly reflect the legal, historical, political, and cultural context of the countries that have developed them'.[221]

The early reforms were driven by the challenge and dilemma of dealing with bankrupt debtors. The legislation enacted during this period reflected the societal attitude of punishing the offenders. It is evident that the disgrace that accompanied being a bankrupt and the punitive laws pushed debtors to develop an increasing number of ways to avoid imprisonment. This reality drove reforms, as there was a need to develop a mechanism to assert the power and moral authority of the state through punishment. During 17th century the economic advancement, as seen by the expansion of trade, especially overseas, brought in new challenges. At that stage, reforms happened as a response of economic advancement which brought in more risk of failure and its effect on the delicate order developing in commerce. During the eighteenth century, much as there were an increased number of bankrupts, there was a gradual realization that in many cases the bankrupt might be properly an object of pity. The reforms therefore introduced the concept of a debtor's discharge. At that point, the focus of the reforms then changed from dealing primarily with the debtor's conduct with a

[220] Riz Mokal, 'Consistency of Principle in Corporate Insolvency' (December 2001). Available at SSRN: http://ssrn.com/abstract=303722 accessed on 7th July 2013

[221] Nathalie Martin, 'The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation' (2005) 28 Boston College International and Comparative Law Review1, 1–2

punitive approach and rather sought to regulate the economic situation that arises out of the debtor's financial condition.

From the nineteenth century henceforth, the institutions and legislations that developed in the UK are the result of the interplay between technological advancement, market globalization, as well their fluctuation, and political institutions and preferences. Essentially, the law has been said to be always one step behind the market, which is ever evolving, and this means that the deficiencies in the law are inevitable, hence making reform a progressive and inescapable exercise. In essence, changes in the economy have gradually rendered existing substantive rules and procedures inadequate, but reform activities are triggered by crisis. It is evident that drivers of reforms come as either agendas being pursued by government or because of the influence by interest groups of participants who play significant roles in advancing the law; action by participants prods legislatures in the direction of the development of the law. International organizations and agreements have played a very large role in driving policy change, often in response to a major crisis. Equally, the British governments have engaged in insolvency reforms often through consultation and engaging other stakeholders. It is noteworthy too that in the competition to remain an attractive investment destination, legal changes have been achieved.

CHAPTER SIX

6.0 DRIVERS OF REFORMS IN KENYA

INTRODUCTION

Insolvency frameworks have increasingly become a subject of reform activities all over the world. In fundamental nature, the importance of reforming these regulations is generally recognized but opinions differ as to what the drivers for such reforms are, or ought to be, in a country. How can Kenya's slow progress and rate of regulatory changes, or lack of them, be explained? Some scholars believe in internal factors, such as the importance of history, social norms or political factors, such as leadership, democracy and/or some form of state centralization.[1] Others identify the relevance of external factors, in particular international trade or globalization,[2] with some emphasizing the influence of reforms by neighbouring countries through regional integration.[3] In essence, the reform drivers are arguably many and bear some similarity in all jurisdictions. The drivers that have influenced UK reforms were considered in the previous chapter. However, the degree of influence of each of the drivers varies in different jurisdictions. Arguably, the policy reforms in Sub Saharan African (SSA) countries are commonly driven by the economic and political interest, especially the maintenance of close relations with key donors and advancing regional integration within the East African Community (EAC).

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[1] Jakob De Haan and Jan-Egbert Sturm, 'Does More Democracy Lead to Greater Economic Freedom? New Evidence for Developing Countries, (2003) 19 European Journal of Political Economy 3: 547–563; Daron Acemoglu, and James Robinson 'The Origins of Power, Prosperity, and Poverty, Why Nations Fail' (2012) New York: Crown Business; William Easterly, The White Man's Burden: Why the West's Efforts to Aid the Rest Have Done So Little, (Penguin Press, 2006)

[2] Daron Acemoglu, Simon Johnson and James Robinson, 'The Rise of Europe: Atlantic Trade, Institutional Change, and Economic Growth, (2005) 95 American Economic Review 3: 546-579; also see Andrei Levchenko 'International Trade and Institutional Change (2011) National Bureau of Economic Research Working Paper No. 17675, (Cambridge: NBER).

[3] Martin Gassebner, Noel Gaston and Michael Lamla 'The Inverse Domino Effect: Are Economic Reforms Contagious?' (2011) 52 International Economic Review 1: 183-200

Kenya, like most developing economies, is characterized by inadequate insolvency reforms, despite many attempts in the past to change the laws. The latest effort is the development of a Kenyan insolvency Bill 2015 which has been on the Kenyan government website since 2010. The Kenyan government, the official custodian of reforms in Kenya, has been acknowledging the need to update the law since the 1990s. It is also not lost to the many stakeholders that without effective procedures that are applied in a predictable manner, creditors may be unable to collect on their claims, which will adversely affect the future availability of credit.[4] It is therefore essential, if attempting to understand the Kenyan reform pathways, to understand the reform drivers.

One factor that must be borne in mind is that law reform may not be sufficient in itself. Laws can be dead letters if there are not sufficient means of enforcing these laws. In fact, Pistor, Raiser and Gelfer state that 'The effectiveness of legal institutions has a much stronger impact on external finance than does the law on the books.'[5] Bankruptcy laws are no exception. According to Halliday and Caruthers, effective bankruptcy law enables economic Darwinism, a means of selecting out of the market those firms which are no longer able to compete within it, something that a socialist economy conventionally does not permit.[6] This partially explains why law reforms are sometimes met with a lot of resistance by those with interests in maintaining the status quo. The analysis in this chapter generally reveals that, whenever certain drivers in particular the government have a certain interest to protect, it influences their engagement in reforms.

[4] IMF, *Orderly & Effective Insolvency Procedures: Key Issues* (IMF 1999) available in http://www.imf.org/external/pubs/ft/orderly/ accessed on 9th May 2014
[5] Katharina Pistor, Martin Raiser and Stainslaw Gelfer, 'Law and Finance in Transition Economies' (2000) 8 Economics of Transition, 2) 325-368
[6] Terence C Halliday and Bruce G Carruthers, 'The Recursivity of Law: Global Norm Making and National Lawmaking in the Globalization of Corporate Insolvency Regimes' 2007 (112) American Journal of Sociology 4

This chapter identifies and investigates the reform drivers of corporate insolvency law within the wider area of business reforms in Kenya. The first category of reform driver is the government which is a distinctive player because of the position it occupies in a jurisdiction. The second can be broadly categorized as interest groups, who are the business community and insolvency profession. The third category is broadly referred to as the regional trends. As pointed out by Stallings, international influences can impact on domestic policies through a number of ways.[7] For instance, financial support from bilateral and multilateral donors has been crucial for the implementation of insolvency reforms. Besides, multilateral donors, such as the World Bank are also known to give technical support. Further, the consequences of global trends such as, regional integration and crisis will be given due attention. The last category is the domestic forces, such as competition to attract foreign investment, poverty reduction and unemployment and the bid to promote economic growth. The endeavour to eradicate poverty and create employment becomes that driving force as the country attempts to build a better climate in which firms can invest, generate jobs and a strategy for development.

Despite the existence of a wide range of active drivers, quick assessments indicate, however, that outcomes have been far from satisfactory, as little law reform progress has been made, beckoning an inquiry as to what could be the real barrier to reforms in Kenya. Consequently, the discussion includes contrasting references to Mauritius, as a country which has recently implemented wide-ranging insolvency law reforms and to other relevant jurisdictions. This

[7] Barbara Stallings, 'International Influence on Economic Policy: Debt, Stabilization and Structural Reform' in Haggard, Stephan and Robert R Kaufman (eds.), The Politics of Economic Adjustment: International Constraints, Distributive Politics and the State, (Princeton University Press, 1992) pg. 41

is considered necessary in understanding how more less the same drivers are succeeding in one jurisdiction and almost totally failing in another.

6.1 THE GOVERNMENT

The desire to see reforms implemented in Kenya has been on-going for more than a decade now. It is largely accepted that the government is the ultimate driver of reforms. However, whether reforms take place will depend on political factors, including the level of influence of internal and external agents, in influencing the government. The intensity of external agents' agitations for reform in Kenyan business circles are typified by the U.S. Ambassador Michael Ranneberger in the following quotation,

> 'Our efforts to press for implementation of reforms are both private and public. Pri vately, we are maintaining intensive dialogue with the coalition leadership, parlia mentaryians, and actors across the political, social, and economic landscape. That dialogue is frank and constructive. Publicly, we are continuing to encourage the Ke nyan people to press peacefully for implementation of reforms. We are involved in a number of other activities aimed at promoting implementation of reforms.'[8]

The aforementioned quotation is a portion of a speech given during a Law Society of Kenya Conference in 2009. This is clear evidence that the external agents have been active in pushing for reforms. Despite such efforts to influence the government to implement reform, little has been achieved, beckoning an inquiry into the government's role in reforms.

[8] U.S. Ambassador Michael Ranneberger, 'The Reform Agenda and Kenya's Historic Opportunity' Speech to the Law Society of Kenya in October 2009 available in http://nairobi.usembassy.gov/speeches_2009/sp_10302009.html accessed on 9th June 2014

To understand how the government drives reforms, it is necessary to appreciate the political and legal aspects of any government. To start with, political factors are considered as crucial in determining the outcomes of such policies.[9] In many instances, the ability of any government to engage in reforms is largely dependent on their pre- election promises and the political games of trying to remain in power at the expiry of the 'current' term in office. A number of scholars argue that policy makers engage in reforming legislations on financial markets mainly to progress their own private gains namely: political survival and the generation of low cost financial resources.[10] In essence, political factors affect objectives of formal and the extent of influence varies across countries and time. More importantly, insolvency touches on the very fundamentals of the economic system of the country and, as such, the reform, as well as enforcement of an insolvency law, can be problematic unless powerful domestic groups are convinced that the law does not threaten them. Political influences, for example on the banking system and through the concentrated ownership of corporations forming strong vested interests, can affect the allocation of credit and state subsidies in such a way that insolvency procedures are seriously undermined.[11] Equally, the tempo of reforms will largely depend on the vested and 'protected' interest in a jurisdiction. Arguably, a government can deliberately fail to engage in particular reforms if they would interfere in any way with their vested interests.

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[9] Dani Rodrik, 'The Positive Economics of Policy Reform' (1993) 83 American Economic Review 2, pp. 356; O Morrisey, 'Politics and Economic Policy Reform: Trade Liberalization in Sub-Saharan Africa' (1995) 7 Journal of International Development 4 pp. 599-618

[10] Alberto Giovannini and Martha De Melo, 'Government Revenue from Financial Repression' (1993) 83 American Economic Review 4, pp. 953 ; Cevdet Denizer, Raj M Desai, and Nikolay Gueorguiev, 'The Political Economy of Financial Repression in Transition Economies' (1998) Bank of Korea

[11] Clas Wihlborg and Shubhashis Gangopadhyay, 'Infrastructure Requirements in the Area of Bankruptcy Law ' (Paper Presented in a conference on 'Integrating Emerging Market Countries into The Global Financial System' Washington D.C., Jan. 11-12, 2001)

As stated by Agimba, political impetus influences reform.[12] This sentiment is true majorly because the government, which is inherently political, develops overarching policy objectives, as well as the policy agenda, and is active in facilitating the reform. The scope of political influence on reform is prominent in Kenya. For instance, the 2002 elections and the installation of the National Rainbow Coalition (NARC) government with a strong reform mandate and high expectations of change provided an especially conducive environment for reforms. In fact, during the tenure of the NARC Government in Kenya, crucial government policies championing reforms were developed.[13] The government enjoyed substantial public goodwill and a remarkable boost when the Bretton Woods institutions resumed lending for budgetary support to the country, which had been previously stopped for many reasons, some of them being concerned with a lack of reforms and with corruption.[14] Generally, the former president Mwai Kibaki and his government were viewed as driving the pace of reforms.

Much as political impetus has in the past driven reforms, in equal measure political instability has been a major source of derailment of the progress of reforms. Noteworthy in Kenyan history is the 2007/2008 post-election violence and a consequential formation of the Grand Coalition Government. The occurrence of violence disrupted existing reform engagements. Besides, the Grand Coalition Government constantly engaged in wrangles debilitating legislative engagements.[15] Undoubtedly, the intentions of the leaders of the coalition faction were

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[12] Christine Agimba, 'Global Trends in the Four Doing Business Indicators-Closing a Business: Kenya's Reform Experiences' (Paper given at doing business 2011 in Africa: Sharing Reform Experiences 2011) < https://www.wbginvestmentclimate.org/loader.cfm?csModule=security/getfile&pageid=16716> accessed 24 May 2014

[13] Vision 2030 is one of the significant policies which hold the threads of reform and transformation of Kenya.

[14] See News from Africa available in http://www.newsfromafrica.org/newsfromafrica/articles/art_2655.html accessed on 20th August 2014

[15] Henry Amadi, 'Kenya Grand Coalition Government – Another Obstacle to Urgent Constitutional Reform?' (2009) 3 Africa Spectrum 149-164

to engage in necessary reforms as expressed by the Prime Minister, who stated that Kenya's bid to drive up its international competitiveness and position itself as an investor-friendly destination would be boosted once the state was done with enacting planned reforms.[16] However, little was achieved because there were a lot of high political maneuvers and in-fighting among the political partners, leaving the important legislative agenda lacking in sufficient attention. Nonetheless, post-election violence and the adoption of a new constitution during the tenure of the Grand Coalition Government were major political events that had a direct influence on the reforms. These upheavals slowed the pace of reform, but they have also helped donors to support a business environment reform within a broader framework of democracy and governance.[17] One direct outcome of these events has been the increased attention given by the government, the business community and civil society to the importance of public private dialogue, which is arguably a necessary platform for pushing for reforms.[18] Many donor and development agencies participate in these dialogues and have been stated as a valuable forum for the exchange of information and strategies.[19]

An important factor that has a bearing on how politics can frustrate rather than drive reforms in Kenya is the inability of the political class to maintain the reform momentum. Poor outcomes have been blamed on African bureaucracies that play a contradictory and conflict-ridden role, being at once part of the problem and the cure.[20] In particular, the first attempts to reforms to insolvency laws were in the 1990s when a task force was established to review the existing framework. Despite the task force's report recommending extensive changes

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[16] Macharia Kamau, 'Reforms to boost Kenya's business competitiveness' *Standard Digital*, (Nairobi, 19th October 2010)
[17] Simon White, Liz Winton and Stefan Engels, 'Review of Donor Supported Business Environment Reforms Programs and Practices in Kenya' (DECD, 2010)
[18] Ibid
[19] Ibid
[20] Steve Kayizzi-Mugerwa (eds), *Reforming Africa's Institutions: Ownership, Incentives, and Capabilities* (United Nations University Press, 2003)

being completed, nothing much was done. Another political effort came again 2009, which resulted in the Insolvency Bill 2010 being published by the government. For the whole year, its status did not change. . In 2011, when it looked like the reform momentum had died out, the finance minister proposed and introduced to table in Parliament three bills i.e. a Companies Bill, an insolvency bill and a partnership bill. In fact, during the budget statement for the Fiscal Year 2011/2012 the minister urged the Honourable Members of Parliament to prioritize debates for some critical bills which were then before the parliament.[21] To date, the insolvency bill has not been passed into law, despite several statements having been vocalized which emphasised its importance, as well as support and commitment by high profile people in government.

It is notable that during the time when little progress towards law reform was being made in Kenya, there were significant legislative developments in Mauritius, where there is a markedly different political scene. Mauritius takes pride in being a mature democracy with strong institutions and the political scene that is remarkably stable.[22] Besides, it has an open economy, with a modern legal framework, regulatory efficiency and a reliable system of state justice.[23] This is despite Mauritius being similar to many African countries in its extreme cultural diversity. In particular, its inhabitants are politically and religiously divided. Nonetheless, Mauritius is undoubtedly one of Africa's rare consolidated democracies, having held several recent national elections and witnessed changes of successive governments peace-

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[21] Republic of Kenya Budget Statement For the Fiscal Year 2011/2012 (1st July – 30th June) by Hon. Uhuru Muigai Kenyatta, E.G.H., M.P. Deputy Prime Minister and Minister for Finance 8th June 2011

[22] African Development Bank, *Mauritius 2009-2013 Country Strategy Paper-Draft (*May 2009) available in http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/Mauritius-%202009-2013%20Country%20Strategy%20Paper-Draft.pdf accessed on 3rd June 2014

[23] Anjana Chikhuri 'Business in Mauritius in Challenging Times Riding the Tide of the Current Economic Downturn for a Better Future' (2012) 51 The Magazine of Mauritius Chamber of Commerce and Industry 6-9

fully.[24] Of significance is the boldness of the political class to implement reforms. For instance, Paul, as Minister of Finance, implemented the neoliberal reform programme negotiated by the previous government with the IMF and he categorically stated that he, '….was impressed by the force of the logic inherent in the IMF recipe and adopted it despite its unpopularity'.[25] In particular, since 2005, the government embarked on a bold economic reform programme aimed at opening the economy, facilitating business, improving the investment climate, and mobilizing foreign direct investment and expertise.[26] Notable too are the government statements during the debates in Parliament over the Insolvency Bill. In particular, the Minister of Finance and Economic Empowerment was categorical that the Insolvency Bill was another example of the government's commitment to adapt to the modern environment and to comply with international norms, standards and best practices.[27] In essence, the governments have guided reforms with sufficient autonomy from a capitalist class and sufficient bureaucratic capacity, together with sufficient incentive, to promote both growth and redistribution through selective engagement with market forces.[28]

On the legal front, a government is a custodian of legal reforms. In Kenya the reform process is facilitated by a government organ namely; the Kenya Law Reform Commission (KLRC), originally established under the Law Reform Commission Act of 1982 but currently embodied in Kenya Law Reform Commission Act, 2013. The KLRC has an obliga-

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[24] Richard Sandbrook and David Romano, 'Globalization, Extremism and Violence in Poor Countries' (2004) 25 Third World Quarterly 6

[25] Ravi Gulhati & Raj Nallari, 'Successful Stabilization and Recovery in Mauritius', EDI Development Policy Case
Series No 5, Washington, DC: World Bank, (1990) pg. 40

[26] Mauritius 2013 Investment Climate Statement available in http://photos.state.gov/libraries/mauritius/196472/josephan/2013%20ICS-Final%20Report%20_Mauritius_.pdf accessed on 16 June 2014

[27] Ramakrishna Sithanen, GCSK Vice-Prime Minister, Minister Of Finance And Economic Empowerment National Assembly, Second Reading Speech of the Insolvency Bill, Tuesday 31 march 2009

[28] Richard Sandbrook and David Romano (n 24)

tion to keep under review all of the laws of Kenya and to recommend their reform to ensure that the law conforms to the letter and spirit of the Constitution. That laws must be consistent, harmonized, just, simple, accessible, modern and cost-effective in application.[29] In performing its mandate, the KLRC is supposed to work with the office of the Attorney General in formulating and implementing programmes, plans and actions for the effective reform of laws.[30] Through this Commission, the government of Kenya has been able to drive reforms in the wider legal spectrum, albeit its performance in reforming insolvency laws has not yet met expectations. It is acknowledged that the KLRC has been unable to realize its full potential in this area and has not influenced the process and pace of insolvency law reform in Kenya to a noticeable degree.

As noted, the insolvency laws have remained static for several decades in Kenya, despite the existence of the KLRC, an institution with a clear reform mandate. Arguably, insolvency law has either been subordinated in legislative priorities, or the KLRC has neglected its statutory obligation because, even where reforms have happened, they have been undertaken arbitrarily. For instance, the KLRC has a statutory role to advise departments and ministries with regard to amendments to any branch of the law relevant to them, but departments and ministries have routinely engaged consultants whenever they wish to reform the statutes relevant to them. A good example is where the Minister of Finance proposed to establish in the ministry a Business Regulatory Reform Unit (BRRU) which was subsequently set up through administrative order to ensure that new regulations, licences, fees, and charges did not create unnecessary burdens on businesses, and to liaise with regulators to ensure that all

[29] The Reform Commission Act 2013 sec 6(1) (Kenya)
[30] The Reform Commission Act 2013 sec 6(1) (Kenya)

future regulations conform to international best practices.[31] In addition the Unit was to serve as the secretariat for the task force consultative bodies that might be set as part of the 'Doing Business Indicators' providing recommendations to decision-makers and promoting good regulatory processes across government.[32]

Although ministry/department led efforts count in championing for reforms, it is arguably difficult for ministries to reform themselves, given countervailing pressures and deficient financial and human resources. Noteworthy too, contrary to the legal requirement that the Commission examine particular branches of the law and formulate draft Bills and proposals for reform, the Attorney General has commonly established task forces with a law reform mandate outside of the ambit of the Commission.[33] The proliferating of this practice was openly acknowledged by Attorney General Amos Wako on an occasion he was moving a bill in the floor of Parliament. He categorically stated that the bill was a result of the work of a task force appointed by the Attorney General in the 1990s to review the laws relating to companies, investment and insolvency.[34]

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[31] A Working Committee was formed by the Government through the Ministry of Finance Circular Ref. No. Conf.262/02/ (3) of 24 February 2005 as read with Kenya Gazette Notice No. 7521 published in the Kenya Gazette of 23rd September, 2005. The Government subsequently continued the Committee's mandate until 31 December, 2006 (subsequently extended to 28 February, 2007) The mandate of the Committee was to provide input to government decisions on the establishment of a Business Regulatory Reform Unit and A medium term regulatory reform strategy. Also see The World Bank Group, 'Regulatory Capacity Review of Kenya' (2010) available in https://www.wbginvestmentclimate.org/uploads/Kenya.pdf accessed on 9th June 2012

[32] Ibid

[33] In 1992 the Attorney General established 15 reform task forces to review and update Kenya's laws in various areas. However, in the political environment of Kenya in the 1990s, little progress could be registered. See http://www.gjlos.go.ke/default.asp for details of the programme accessed on 6th June 2014

[34] Kenya National Assembly Official Record (Hansard) Tuesday 24 May 2011 pg 24. In particular Amos Wako who is a former AG but currently Bongoma Senator gave detailed information on how the Bill he was moving was a result of a task force he himself established.

One of the explanations offered as to the reasons for KLRC ineffectiveness has been the lack of operational independence as originally crafted in the founding legislation.[35] To be specific, the office of the Attorney General has been responsible for approving the KLRC work programmes while a different body (the Ministry of Justice and Constitutional Affairs) was responsible for controlling the funding allocated from the national budget.[36] In essence, mechanisms with explicit responsibilities and authorities for managing and tracking reform inside the administration are needed to keep reform on track and on schedule, and to ensure that regulatory quality standards continue to improve.[37] Significant deficiencies inherent to the KLRC operations have been dealt with in the latest statute; the Kenya Law Reform Commission Act, 2013. Nevertheless, against the on and off impetus demonstrated by the government efforts and previous legal inadequacies, it is not in doubt that there is a consensus that the regulatory environment is primarily out-dated and therefore not in tandem with the modern challenges. Besides, there have been calls since the enactment of the Constitution of Kenya 2010 to include Regulatory Impact Assessments in the legislative process to ensure regulatory rigour and consistency across national and county government, to avoid the laws resulting in a 'Balkanization' of business regulation across 47 counties.[38] Nevertheless nothing much has changed five years later since a new constitution was enacted.

Despite all the aforementioned challenges, the government has fairly engaged in numerous attempts to drive reforms. For instance, the government has established committee/task

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[35] Patricia Kameri Mbote and Migail Akech, *Justice and the Rule of Law: A Review by AfriMAP and the Open Society Initiative for East Africa* (The open Society Initiative for East Africa, Nairobi, 2011) pg. 6
[36] Ibid
[37] The World Bank Group, 2010 'Regulatory Capacity Review of Kenya' available in https://www.wbginvestmentclimate.org/uploads/Kenya.pdf accessed on 9th June 2012
[38] African Development Bank Group, '*The State of Kenya's Private Sector: Recommendations for the Government, Development Partners and the Private Sector 2013* available in http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/The_State_of_Kenya_s_Private_Sector_-_Recommendations_for_Government-Development_Partners_and_the_Private_Sector.pdf accessed on 6th June 2014

forces which engage in extensive consultative processes with stakeholders from the public and private sectors. In fact, the task force established in 1999 by the Attorney General, which looked into insolvency laws amongst others, was composed of representatives of institutions such as the Kenya Association of Manufacturers, Federation of Kenya Employees, National Chamber of Commerce, accountants, chartered secretaries and lawyers, especially those who specialize in corporate practice.[39] Generally, formation of a task force with such a wide representation provides a good platform to capture the views of a significant portion of the stakeholders in the business arena. In fact, jurisdictions such as Mauritius who have successfully reformed their insolvency laws have used similar approaches. For instance in 2011 the government of Mauritius, in a bid to accelerate business law reform, set up a Joint Public-Private Sector Business Facilitation Task Force to identify and eliminate weaknesses encountered by businesses.[40]

A closer look into the process of enacting the Mauritian Insolvency Act of 2009 reveals very intriguing facts. The Bill was developed in close cooperation with the World Bank. In fact, it has been openly acknowledged that the Mauritius reforms were possible mainly because of access to market financing and support from development partners.[41] Besides, the reform deliberations involved the stakeholders in Mauritius. For instance, a banking committee chaired by the Governor was involved and one of the objectives of the committee is to pro-

[39] Hansard (n 34) pg. 24
[40] African Development Bank, *African Economic Outlook: Mauritius 2012* available in http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/PDF/Mauritius%20Full%20PDF%20Country%20Note.pdf accessed on 14 June 2014
[41] Koosiram Conhye, 'Implementing Aid for Trade in Latin America and the Caribbean' The National and Regional Review Meetings 2008–2009 available in http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=%202046821 accessed on 12 June 2014

vide information and views on the functioning of the wider financial sector.[42] The government therefore appointed a Steering Committee on Insolvency and Creditor Rights to work with the World Bank in the development of its report.[43] The World Bank, upon completing its work, submitted the 'Report on the Observance of Standards and Codes (ROSC) of Insolvency and Creditor Rights Systems for Mauritius' in March 2004.[44] This was a noteworthy document that shaped the reform process. In addition, a dissemination seminar was held in 2004, with the widest possible participation, including lawyers, accountants, bankers and other professionals.[45] A further consultation paper was issued in August 2007 on the policy proposals and number of policy recommendations were discussed and incorporated in the final report.[46] Most importantly, there is a conspicuous governmental political will and resilient engagement, both of which are important in achieving substantial reforms

Another noteworthy aspect in Mauritius is their Law Reform Commission, which is robust. The effectiveness and independence of this Commission is indicated in its 2013 report, which details several successful engagements that it has undertaken.[47] In fact, Section 5(2) of the Law Reform Commission Act mandates the Commission the power to initiate proposals for the review, reform or development of any aspect of the law but the Attorney General

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[42] Bank of Mauritius, *Overview of Supervisory Developments*, available in https://www.bom.mu/pdf/Research_and_Publications/BSD_Annual_Report/BSD_annrep_2004/overview.pdf accessed on 12 June 2012

[43] World Bank , *Mauritius: Insolvency and Creditor Rights Systems (World Bank 2004)* available in https://openknowledge.worldbank.org/handle/10986/14423 Licence: CC BY 3.0 accessed on 12 June 2014

[44] World Bank, *Mauritius - Report on the observance of standards and codes (ROSC): Insolvency and c=Creditor Rights Systems* (World Bank, 2004) available in http://documents.worldbank.org/curated/en/2004/03/6572694/mauritius-report-observance-standards-codes-rosc-insolvency-creditor-rights-systems accessed on 12 June 2014

[45] Amar Bheenick, 'Mauritius: Insolvency Bill' (31 March 2009) http://amarbheenick.blogspot.com/2009/03/mauritius-insolvency-bill.html accessed on 12 June 2014

[46] Ibid

[47] Law Reform Commission of Mauritius [LRC]–Brief on LRC [June2013] available in http://lrc.gov.mu/English/Reports/Documents/Brief%20on%20LRC%20June%202013.pdf accessed on 14 June2014

can also submit papers on aspects of the law to the Commission for review.[48] Fundamentally, a significant aspect is a duty of the Lord Chancellor to report annually to Parliament on the extent to which the Government has implemented the Law Commission's recommendations. In essence, the law provides a supportive environment for its Reform Commission and accountability regarding implementation for the Parliament, a system which is laudable in ensuring effectiveness and efficiency in reform.

6.2 INTEREST GROUPS

6.2.1 The Private Sector/ Business Community

The Kenyan private sector consists of a formal, large business sector which is relatively healthy, productive and influential and a massive informal small business sector that is poorly understood and supported, yet a significant player in the business industry.[49] The Kenya Private Sector Alliance is of the view that a major impetus for trade reform is Kenya's need to become globally competitive in business. A leading Kenyan lawyer expressed the following opinion

> 'the driving force for reform is being provided by Kenya's powerful clearing and for warding agents, as well as leading importers and exporters – those who most under stand the problems caused by dealing with excessive documentation, border-re lated costs, lost business opportunities, etc'.[50]

The business community has in a number of instances engaged the government of Kenya in discussions in a bid to reform insolvency laws. According to the former Attorney General, the stakeholders, who were largely members of the business community, had expressed dis-

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[48] Law Reform Commission Act, 2009 (Mauritius)
[49] Ibid
[50] BIZCLIR, 'Customs Automation and Process Reform Lesson from Kenya (2007) Available in http://egateg.usaid.gov/sites/default/files/01.128.08BP12_Kenya.pdf last accessed on 12 June 2014

satisfaction with the law relating to investment; in particular company law and the insolvency law which were stated as completely out dated hence inadequate for the modern needs of the modern Kenya.[51]

Remarkable agitation for reform started when a number of established corporations faced the threat of liquidation. The discussion on the need for reforms started in the early 2000 with a number of entrepreneurs voicing their concerns through the media. In 2006 when Uchumi supermarket, one of the few corporate entities to successfully undergo reorganization, was being listed afresh on the Nairobi Stock Exchange (NSE), the government was requested to speed up reforms on insolvency, bankruptcy regulations and the implementation of the new Companies Act.[52] It was pointed out that reforms were necessary so as to spur the growth of the private sector, and in particular make it easier for firms under receivership to emerge out of insolvency. According to Agimba, there has been a continuous pressure for reform of business laws from the business community and a proactive response to the need for reform from the highest political leadership, key government ministries and agencies.[53] In essence, the government has been working closely with private actors in respect of various structural reforms, such as public sector reforms, business and regulatory reforms, financial services sector reforms, legal and judicial reforms and land reforms to improve the investment climate.[54]

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[51] Hansard (n 34)

[52] Speech by Nairobi Stock Exchange (NSE) Chairman Mr. Eddy Njoroge During the Bell Ringing Sponsored By Uchumi Supermarkets at NSE Trading Floor, Tuesday 31st t May 2011. See Eddy Njoroge's comment on the http://www.capitalfm.co.ke/business/2011/05/uchumi-shares-return-to-the-nse/?wpmp_switcher=mobile accessed on 9th June 2014.

[53] Agimba, (n 12)

[54] Ibid

It is noteworthy that the private sector has organized itself into a Kenya Private Sector alliance (KEPSA), a forum that provides a unified voice for the private sector.[55] The main mandate of the alliance is to ensure development through advocacy, projects and partnerships, both local and international, as well as to influence public policy through policy formulation and implementation. In fact, KEPSA has in the past partnered with the government in passing various policies, strategies and Bills and increasing strategic interventions. Specifically, KEPSA has organized meetings where key government officials have been invited for discussions on reform.

In 2008, the Prime Minister began holding quarterly meetings as part of a public-private ‘National Business Agenda’ with the chairpersons of the Kenya Association of Manufacturers (KAM) the Kenya Private Sector Alliance (KEPSA), and the East Africa Business Council (EABC), and other business leaders to learn what must be done to improve the country’s business climate.[56] The discussions have been ongoing and influential, such that even in 2011, the 7th Prime Minister Round Table was organized by KEPSA as part of a continuous engagement with the government to create an enabling business environment. During that meeting, KEPSA outlined some urgent issues that needed to be addressed including a faster pace of implementation of the Bills that would promote economic growth, some of which included the Companies Bill, Partnership Bill, Insolvency Bill and Limited Liability Bill among others that are all geared towards easing the burden of doing business. Besides, one of the 2012 advocacy achievements stated by KEPSA in their website is the

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[55] To read more about KEPSA and its engagement check http://www.newlookkenya.com/index.php/newlookkenya/general-info?id=127:kenya-private-sector-alliance accessed on 11th June 2014

[56] U.S. Department of State, *2010 Investment Climate Statement – Kenya* (March 2010) available in http://m.state.gov/md138092.htm accessed on 12/6/2014

fast-tracking of the passing of stalled business-related policies and legislations which included an Insolvency Bill among others. Admittedly, the existence of the aforementioned forums organized by KEPSA ensured that the debate on reforms was kept alive and that the momentum was not lost. In fact, the Chairman of the Private Sector Alliance during the signing of the Bill to law categorically stated that they had for a long time been pushing for the Insolvency Act amongst other legislations.[57]

Members of the business community, whose role in driving reforms cannot be ignored, are Kenya's most important trade partners. This does not imply that Kenya does not trade openly within the global village but there are particular countries who, in a number of ways, trade closely and frequently with Kenya. For instance, Denmark has, since 2002, been committed to supporting development of the business sector in Kenya. Previously this has been on a basis of partnerships between Kenyan and Danish companies to facilitate knowledge transference from Denmark to Kenya and to enable those Danish companies to gain access to new markets and cheap production methods and facilities. Through such close relations, a new dimension was entered in 2005 with the launching of the Business Sector Programmes Support (BSPS).[58] This was a programme that was meant to support the business sector both on macro and micro- levels by assisting both the government and the private sector partners in creating an enabling environment for business. So far the BSPS has supported the finalization and implementation of a new Private Sector Development Strategy which includes among other things the implementation of new laws.

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[57] See http://www.president.go.ke/2015/09/11/new-dawn-for-kenya-as-president-signs-landmark-business-laws/ accessed on 22/2/2016

[58] See Ministry of Industrialization and Enterprise Development website on http://www.industrialization.go.ke/index.php/projects/128-business-sector-program-support-bsps accessed on 23 September 2014

The business community, at both regional and international levels has been championing for reforms by conducting surveys and research, on the basis of which sound recommendations have been made. For instance, in 2004, much as the government had promised that several policy reforms were underway, the Africa Private Sector Group in their analysis of the investment climate engaged in policy discussions, which were intended to preserve the momentum of on-going reforms, while also making additional suggestions to raise productivity.[59] Some of the specific recommendations they offered included the reform and modernization of the insolvency procedures contained in the Companies and Bankruptcy Acts.

Similarly in 2005, the World Bank Private Sector Unit, Africa Region highlighted the key elements of commercial legislation impacting on the overall investment climate to be the Companies Act and the Bankruptcy Act, both of which in their view, are fundamentally sound, but extremely out-dated.[60] In comparison with international best practice, they are found these Acts to be unduly technical, complex and bureaucratic. Besides, by international standards Kenya's insolvency procedures vital to any market economy – were found to be lengthy and costly, even in comparison with other countries in SSA.[61] Generally, these laws contain serious weaknesses, including a lack of a modern system for promotion of corporate rescue, limited ability of creditors to recover assets, and they therefore need a fundamental overhaul.

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[59] World Bank & IFC, *Kenya: Enhancing the Competitiveness of Kenya's Manufacturing Sector: the Role of the Investment Climate* (November 2004) available in http://s3.amazonaws.com/zanran_storage/www.gcgf.org/ContentPages/352411637.pdf10th June 2014

[60] World Bank's Regional Programme for Enterprise Development (RPED), in conjunction with KIPPRA and CSAE, Oxford Published a report available in https://openknowledge.worldbank.org/bitstream/handle/10986/8505/313870KE.txt?sequence=2 accessed on 8th June 2014

[61] Ibid

The engagement between the Kenyan businesses communities in insolvency reforms bears similarity to the approach that was used in Mauritius. Both jurisdictions have employed consultation and discussion forums. The Mauritian authorities embarked on an ambitious programme to transform the economy in partnership with the private sector.[62] However, in Kenya the discussion tended to consist more of the business community pushing for an opportunity to express their views, whereas in Mauritius, it tended to be the government inviting the views.

6.2.2 The Pursuit of Professionalism in the Insolvency Profession

A significant driver for insolvency law reforms is the apparent realization that the insolvency profession needs to tighten up its act.[63] Generally, the members of the public in Kenya have low opinions of insolvency practitioners and a perception that they act merely as 'corporate undertakers' and, exacerbating this, there have been an unfortunate number of reported cases of unethical behaviour by some receivers and liquidators.[64] For a long time, Kenya has operated without clarity as to the persons who are qualified and recognized to deal with insolvency matters within the legal framework. In fact, the many insolvency matters that have been dealt with so far are handled by lawyers and accountants with no clear regulatory body. The upshot of this is that their performance has not been satisfactory.

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[62] World Bank, *Mauritius - Financial Sector Assessment* (World Bank, 2003) available in http://documents.worldbank.org/curated/en/2003/08/2506938/mauritius-financial-sector-assessmen accessed on 15 June 2014

[63] Martin Whitehead, 'A new Insolvency Act is Coming... So Lenders, Borrowers and Insolvency Practitioners Get Ready!'(2009) Financial Focus1-8 available in http://www.pwc.com/en_KE/ke/pdf/pwc-financial-focus.pdf accessed on 13th June 2014

[64] Ibid

The challenge of appropriate regulation of insolvency practitioners is problematic in Sub-Saharan Africa, as demonstrated by a survey by Research and Innovation (R&I) which revealed that only three countries in this region: Mauritius, Rwanda and Senegal have a regulatory body that oversees insolvency practitioners and requires them to be licenced.[65] In Kenya, the Insolvency Bill, although not yet in force, captures this endeavour and proposes an Insolvency Practitioners' Board, insolvency practitioners and sets out requirements as to their qualifications.[66] There is also a clearly outlined procedure to be followed by an applicant seeking authority from the Insolvency Practitioners' Board to act as an insolvency practitioner. The regulation of insolvency practitioners is indispensable given that insolvency practitioners have a public interest role, in being officers of the court, and that they owe a broader duty to society as a whole, not just creditors.[67] In essence, an insolvency regime, no matter how robust, remains reliant on the professionals who play crucial roles in advising on business restructuring, or liquidation.

Another important aspect is the role of the court in insolvency proceedings. To start with, under section 219 of Companies Act Cap 486, if the company has by special resolution resolved that it may be wound up by the court, the court may pass a winding up order and the power of the court in such a case is discretionary. Equally the court when petitioned investigates and makes a finding before admitting a petition for winding up.[68] As far as voluntary winding up is concerned as governed by section 304, the court may order the continuation of voluntarily winding up subject to their supervision on any terms. In addition, section 222 gives the court power to hear and make determination petitions and in section 223 the Power

[65] INSOL International Africa Round Table on Insolvency Reform (30th September 2010 Abuja, Nigeria)
[66] The insolvency Bill, 2010 Part II (clauses 4 – 11) (Kenya)
[67] Africa Round Table on Insolvency Reform (n 64)
[68] Generally see the Company Act Cap 486 section 218

to stay or restrain proceedings against company. Further, the section 234 gives the court power to appoint liquidators. Generally, the court will administer cases in the course of resolving insolvency and is involved at different stages.

The court plays a role in the appointment of an official receiver (section 230) who becomes a trustee in a bankruptcy proceeding and he/she assumes the position of a liquidator is charged with the task of investigating collecting, liquidating assets and using any proceeds to pay outstanding debts on behalf of the debtor. Generally, the court has a supervisory role over the liquidators and official receivers. By itself, an insolvency process gives a considerable position of trust to insolvency professionals over the affairs of insolvent companies, since the decisions and actions of these professionals can have a significant financial impact on those affected in very difficult circumstances. There is therefore a need for expertise and efficiency in insolvency matters on the receivers or liquidators as well as specialized insolvency judges.[69]

One of the ways of improving the efficiency of the judges is to provide training to the commercial court judges who currently have jurisdiction over insolvency matters amongst many matters. Similar sentiments were echoed by the IMF which while acknowledging the substantial reduction of backlog and speedier resolution of cases since the establishment of a Commercial Court emphasized the need to enhance its capacity as well as expansion of commercial courts to other regions of the country.[70] However, equipping the relatively large number of judges as a way of enhancing efficiency will be challenging. It is therefore argued that consideration should be given to the desirability, as part of the reforms, of including

[69] Ibid

[70] International Monetary Fund, *Kenya, Uganda and the Republic of Tanzania: Selected Issues* (IMF, 2008) pg. 20

specialized insolvency judges, in order to enhance the efficiency of proceedings. There will however be a need for a feasibility study to establish its practicability. Jurisdictions such as Thailand, which have successfully established specialist Bankruptcy Courts that have jurisdiction over all insolvency proceedings and all civil cases pertaining to the same, provide a good example to learn from.[71]

6.3 THE REGIONAL TRENDS

The whole world has experienced a rapid pace of technological change, such that currencies float against one another and global exchange markets now account for sixty times the volume of trade and investment flows compared to the volume of world trade in goods.[72] Whereas business corporations have adapted to the new economic geography, and in most instances have encouraged its emergence, the national institutions have had considerable difficulty keeping up with the historic shift.[73] In essence, commercial laws are required to meet the challenges presented by the borderless global economy. Literature[74] reveals that the advanced economies simultaneously nurtured the norms and the complementary institutions needed to achieve harmonious connectivity to the global economy previously. In contrast, most of the lesser developed countries did not adjust their laws, opting to retain weak governance, limited skills, and fragile banking sectors, as a result suffered major set- backs.[75] In

[71] The Act Establishing the Bankruptcy Court and Bankruptcy Case Procedure ('the Act") 1999 Thailand; Also see Fritz Foley 'Going bust in Bangkok: Lessons from bankruptcy law reform in Thailand' (2000) Harvard Business School, mimeo

[72] Robert Picciotto*, ' Poverty Reduction and Institutional Change'* Seton Hall Journal of Diplomacy and International Relations, Winter/Spring 2000

[73] Ibid

[74] Deepak Lal, *Unintended Consequences: The Impact of Factor Endowments, Culture and Politics on Long Run Economic Performance* (Mass.: MIT Press, 1998) pg. 78 ; Francis Fukuyama, *The Great Global Disruption: Human Nature and the Reconstitution of the Social Order* (New York: Free Press, 1999) pg. 50

[75] Picciotto *(n 71)*

particular, much of Africa has tended to fall into the latter category due to civil strife, policy weaknesses, adverse terms of trade, a lack of domestic capacities, and excessive debt. However this position has recently changed as globalization has taken place; more and more countries believe that creating a viable bankruptcy system will help to fuel a market economy.[76] Besides, globalization has resulted in the emergence of international institutions that have in a number of ways played key roles in influencing reforms. The African jurisdictions have, over time, engaged in the adoption of international best practices, as well as building their own regional blocs. The East African Community, of which Kenya is a member, has formulated a development strategy in which they are open to be guided by developments in the world economy, the regional economy and in the national economies.[77] In particular, the strategic interventions which encompass legal reforms are driven by globalization, which manifests itself through intensification of competition in the global markets and the emergence of regional economic blocs. It is noteworthy too that the more the world becomes integrated, the more that a jurisdiction will become vulnerable to crisis, as will be detailed within this category of drivers.

6.3.1 Influence of International Organizations

Multilateral institutions have for a while been engaged in championing the institutionalization of the rule of law and good governance in developing countries and among the areas of focus in this regard has been the improvement of insolvency laws. In fact, the collective will of the Group of Seven (G7) international organizations to create global insolvency standards

[76] Nathalie Martin, 'The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: the Perils of Legal Transplantation' (2005) 28 Boston College International & Comparative Law Review 1
[77] EAC Development Strategy 2006-2010 available in www.mineac.gov.rw/index.php?id=106 *accessed on 5th June 2014*

paid special attention to developing economies due to their weak insolvency systems.[78] The existing international benchmarks on insolvency laws are a product of the efforts of international institutions, particularly the World Bank, UNCITRAL and the IMF. Their efforts have resulted in a unified set of insolvency benchmarks, represented by the consolidation of the World Bank's Principles for Effective Insolvency and Creditor Rights Systems and the UNCITRAL Legislative Guide on Insolvency Laws. States all over the world are encouraged to employ the World Bank Principles and guidelines on insolvency laws in modifying and updating their local insolvency laws. Such standards have been very central to reforms and it is commendable that they provide guidelines and recommendations in the form of a soft law approach, rather than legally binding treaties.[79] The advantage of having them as 'soft law' is chiefly that such an approach allows the jurisdictions of the world to implement reforms at their own discretion, which is necessary for jurisdictions previously colonized and keen on avoiding any further de facto colonization.

The international benchmarks have exerted a strong influence and have succeeded because the reforming countries rely heavily on aids and technical assistance from international institutions and the developed economies. Besides, the observance of international standards is encouraged by 'market induced discipline' and official incentives.[80] Market induced discipline is where the investors utilize information on a country's compliance with the relevant international standards in making investment decisions while official incentives arise where

[78] Nilgun Onder, 'Global Financial Governance: 'Soft' Law and Neoliberal Dominion'(Paper for the Canadian Political Science Association Congress, June 2-4 2005 London)
[79] Curzio Giannini, 'Promoting Financial Stability in Emerging Market Countries: The soft Law Approach'(2002) 44 Comp Econ Studies 125
[80] Onder, (n 77); Also see Giannini (n 78)

the use of peer pressure, naming and shaming, surveillance and financial incentives are employed by the international organizations.[81]

A key approach used by international organizations in pushing for reforms in many developing economies is through the attachment of conditions to foreign aid. Virtually every African country has received large amounts of aid aimed at stimulating policy reform, although the results have varied enormously.[82] For instance foreign aid played a positive role in Ghana and Uganda but Kenya is amongst those considered as behind in its reform agendas, despite available aid.[83] Technically, experts financed by the international institutions have been used to help with ideas in the initial phase but financial assistance grows as policies improve and increase the benefits of reform, helping to sustain local political support. In particular, the IMF and the World Bank have been known to push for the implementation of reforms as part of the preconditions for donor funding. For instance, the IMF, alongside other donor agencies, such as the World Bank in 1991 suspended the donor aid to Kenya, due to what were described as rising levels of corruption, a failure to correct macro-economic imbalances caused by fiscal indiscipline, slow reforms in the civil service, lapses in the privatization of public enterprises, and a slow pace of political reforms.[84] This forced the Kenyan government to engage in several expediency measures in an attempt to regain the lost confidence.

[81] Ibid
[82] David Dollar, Shantayanan Devarajan and Torgny Holmgren, Aid and reform in Africa (World Bank Publications, 2001)
[83] Ibid
[84] Maureen Were, Rose Ngugi and Phyllis Makau 'Understanding the Reform Process in Kenya' in Joseph Mensah (eds) Understanding Economic Reforms in Africa: A Tale of Seven Nations (Palgrave Macmillan, 2006) pg. 31

A similar incident happened in 1997 due to a failure to fulfil a donor condition of good governance. The suspension of funds exerted pressure which resulted in progress in the implementation of some economic reforms.[85] When the government finally accepted the donors' conditions and engaged in reforms, Kenya became the first Sub-Saharan African country to receive structural adjustment lending from the World Bank and later on the first to receive an Enhanced Structural Adjustment Facility (ESAF) loan from the IMF.[86] Reforms are therefore generally not prioritized willingly by the government on account of the government realizing the inadequacies in the law, or the increase of incidences of insolvency facing a jurisdiction. Rather, reforms assume a higher position in legislative priorities as a result of external pressure and primarily for the sake of the supposed economic advantage given by the donor communities for adopting a new insolvency system.

Previously, literature documented that reforms championed by outside agents have not been productive in other situations. In particular where conditional loans have been used, there have been instances where a government has agreed to measures that it does not believe in, in order to get funding and then has eventually failed to carry these measures out.[87] Burdette expressed similar sentiments that there can never be any meaningful reform without political will and proper consultation and involvements of local experts when designing new laws.[88] Admittedly, tangible and successful reforms require goodwill from the government and a political movement for change which donors cannot do very much to generate. However, the

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[85] Ibid
[86] Stephen O'Brien, and Terrence Ryan, 'Mixed Reformers: Kenya' in Shantayanan Devarajan, David Dollar, and Torgny Holmgren (eds.) Aid and Reform in Africa: Lessons from Ten Case Studies (World Bank, 2001)
[87] O'Brien and Ryan,(n 85)
[88] David Burdette, 'Corporate Insolvency Reform Experiences' (INSOL Europe Academic Forum Conference, Friday October 2011 Venice Italy)

recent trends show that the international institutions have taken deliberate efforts to involve the locals.

A significant tactic used by international organizations to push for reforms is through the use of global partnerships. The government of Kenya, in collaboration with its development partners (who are basically international financial institutions and countries which trade closely with Kenya), have developed a platform called Development Partnership Forum (DPT). At the moment, its new aid effectiveness technical group meets monthly, and a ministerial level development partnership forum co-chaired by the World Bank and the Kenyan Finance Minister convenes twice a year.[89] In particular, in 2010 using the aforementioned forum, a meeting was organized where the government was urged to take further and bolder measures to improve the business climate in Kenya, to strengthen and increase transparency in procurement and public financial management, and to improve the absorption of donor funds by dealing with key implementation challenges.[90] To make progress in these areas, the Government and its partners agreed to work together to ensure that the budget would respond to emerging priorities and that aid was aligned with the budget.[91] The government has acknowledged that since the government started participating in the exercise, substantial progress has been made in terms of administration and legal reforms have been simplified.[92]

Another approach used by international organizations such as World Bank to drive reforms is the funding and commissioning of research undertaken through both local and foreign

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[89] See Global Partnership; For Effective Development Co-operation Website available in http://www.effectivecooperation.org/news-kenya.html accessed on 12th June 2014

[90] Kenya Second Meeting of the Development Partnership Forum held in Kenya International Conference Centre, Tsavo Ballroom Nairobi, May 19, 2010

[91] Ibid

[92] Remarks by Hon. Robinson Njeru Githae, EGH. MP. Minister for Finance at the Launch of the Sub National Doing Business Reforms Report, held at the KICC, Nairobi, on 26th June 2012, 9.00 am

scholars, based on planned and prioritized activities.[93] In most developing economies, the locals hardly engage on their own initiative in research, although such studies can be very significant in understanding the limitations in the existing systems and appreciating the need for reforms. This gap has been identified and explored by the international institutions. For instance, Japan in 1991, through a Japanese agreement grant, engaged an American law firm to work in partnership with Kenyan law firms and legal professionals to assist in identifying desirable reforms to the legal regulatory framework, which included the assessment of bankruptcy laws.[94] The aforementioned engagement concluded with a report proposing a comprehensive law reforms programme in the corporate area. It was revealed in the discussions that diagnostic studies have been invaluable, if not critical, to the success of any reform. A further noteworthy research project was done in March 2009 when an 11-member team of U.S. based government representatives and consultants travelled to Kenya and conducted interviews across the public and private sectors, including with national and local officials, business owners, business associations, chambers of commerce, non-governmental organizations, the banking and lending community, university representatives, labour unions, and many others.[95] The investigation concluded in a round table presentation and discussion attended by nearly 100 local stakeholders and donors, and a worthwhile report which details recommendations and explanations of how lessons learned from previous development efforts might specifically apply in Kenya.[96]

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[93] The World Bank Websites has plenty of publication of its finding in the many undertaken researches.
[94] Paratii Ofusu Amaah, Reforming Business Related Laws to Promote Private Sector Development: The World Bank Experience in Africa (The World Bank for Reconstruction & Development, The World Bank, Washington Dc, USA, 2000) pg. 34
[95] USAID, 'Kenya Agenda For Action: Commercial Legal AND Institutional Reform; Diagnostic of Kenya's Business Environment' (USAID 2009) available in http://www.usaid.gov/kenya/fact-sheets/support-electoral-reforms-and-processes-kenya accessed on 12 June 2014
[96] Detailed information about BizCLIR, including an on-line library of BizCLIR reports, are available in www.bizclir.com. Accessed on 10th June 2014

Through such engagements, areas requiring reforms are earmarked and it is not uncommon for those areas now to include insolvency laws. Such initiatives have proved very vital in other African jurisdictions. For instance, the World Bank engaged the expertise of Professor Burdette as part of a World Bank team that evaluated the insolvency systems in Malawi and the Seychelles and produced proposals to remedy shortcomings in the existing statutes dealing with Malawian and Seychelles insolvency law.[97] This culminated in the enactment of the Seychelles Insolvency Act and the Malawian Draft Insolvency Bill, which is awaiting approval by Parliament.[98] Although the respective governments play a leading role in the reform processes, it is evident that the international organizations are better positioned to ensure that their agenda and recommendations are captured in the insolvency reform through technical and financial support.[99] It is remarkable that research funded by these institutions is arguably credible, the analytical work is technically sound and their basis of arriving at conclusions is transparent and able to withstand public scrutiny.[100] This was well articulated by Besley in his discussion of the importance of World Bank data that is publicly available and internationally recognized as a reliable source of evidence-based policymaking.[101] It is argued that a reform-minded government can use such information to motivate and sustain reform efforts.

[97] Nottingham Trent University, http://www.ntu.ac.uk/research/ref_2014/impact_case_studies/insolvency_law_practice/impact.html accessed on 3/June/2014.
[98] Ibid
[99] U Miller and S Ziegler, Making PRSP Inclusive (Project Print, Munich 2006) 4
[100] The world Bank Publications such as 'Doing Business reports' are known to be credible such that even though at the time of research and publications the country may not be directly involved in the analysis, they are able to follow up and criticize, evaluate and even implement them.
[101] Tim Besley, (A Key note speech presented in the World Bank conference at my alma mater Georgetown University) available in http://www.cipe.org/blog/tag/doing-business/ accessed on 5th June 2014

A further fundamental strategy that has also been employed by the international organizations is the organizing of conferences and round table meetings. In particular, INSOL International has been organizing round table meetings which are a platform for a high level dialogue with both private practitioners and public policy makers on insolvency reform in Africa.[102] Through such endeavours, a forum is availed for a coordinated approach by international bodies, countries and experts by sharing experience and knowledge, crucial in enhancing insolvency reform on the African policy agenda. They have held several meetings with cutting edge themes on insolvency.

A momentous Round Table meeting for Kenya was the one organized in 2012 by the World Bank Group in partnership with the International Association of Restructuring, Insolvency & Bankruptcy Professionals (INSOL International) held in Nairobi.[103] The event was documented as providing a rare opportunity for public-private dialogue in the region, where judges, regulators, policy makers, bankers, and insolvency experts discussed topics relating to non-performing loan resolution, loan workouts, restructuring and debt enforcement.[104] Besides, the event has been documented to have demonstrated a huge enthusiasm across the continent for pursuing law reform and for building the necessary capacity for successful restructurings and efficient insolvencies.[105] The current Attorney General of Kenya who attended the event, Professor Githu Muigai, was categorical on the need for African policy-

[102] See the INSOL website for details on the meeting conducted so far and those planned.
[103] The third Africa Round Table was held in Nairobi in September 2012 under the theme 'Insolvency Best Practices: A Roadmap for Reform in Africa' More than 70 participants attended this roundtable which was considered the most successful yet. .
[104] Ibid
[105] INSOL, *International Member Association Report 2012 : Annual Review* (INSOL 2012)

makers to 'learn from others and to reflect that learning in practice.' [106] He underscored the significance of best practice standards on insolvency in helping the region to continue to retain their productive value in the economy as well as stimulating entrepreneurship.[107] Inherently, such forums provide an opportunity to learn from reforms in other jurisdictions as well as stirring up reform debates which are necessary in maintaining the reform momentum.

Further, the World Bank has also been known to participate in reform processes by offering technical assistance.[108] Jurisdictions with long and established legal traditions usually seek help only in relation to specialized areas of law, and in strengthening the judiciary and establishing alternative dispute resolution mechanisms.[109] However, in states with lesser developed legal systems, the legal technical assistance that is sought may range from policy advice to assistance in drafting legislation, introducing, implementing, and enforcing new laws and regulations, devising procedures and institutions that carry out new laws, designing public information campaigns, and training.[110] In addition, support can include legislative reviews, process mappings, reviews of reform proposals, and advice for investment that would help in the implementation of the reform agenda.[111] It is evident that offering technical assistance to any jurisdiction is a complex engagement. In essence, extra resources and numerous

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[106] Word Bank Website https://www.wbginvestmentclimate.org/advisory-services/regulatory-simplification/insolvency/supporting-african-countries-in-improving-insolvency-procedures.cfm accessed on 3rd June 2014
[107] Ibid
[108] Owino Kimani, 'Cabinet Hailed for Approving Bills', Kenya Broadcasting Corporation (12 November 2010) <http://www.kbc.co.ke/news.asp?nid=67544 accessed on 13th Jan 2015
[109] World Bank, *The World Bank and Legal Technical Assistance: Initial Lessons* (World Bank, 1999) available in http://elibrary.worldbank.org/doi/book/10.1596/1813-9450-1414 accessed on 5th May 2014
[110] Ibid
[111] World Bank, *Doing Business Reform Advisory* available in https://www.wbginvestmentclimate.org/advisory-services/regulatory-simplification/doing-business-reform-advisory/ accessed on 4 June 2014

experts from a broad range of financial, legal and judicial technical areas are utilized and without these resources the objectives may not be achieved and reform momentum can be wasted.[112] Besides, technical assistance is provided to governments by World Bank Group units and sometimes in collaboration with other stakeholders. Therefore, given the wide range of stakeholders involved, there is need for considerable coordination of efforts. Consequently, the stakeholders conduct an important assessment, considering the country's laws or legal systems against the international benchmarks so as to maximize a given country's ability to meaningfully participate as a trusted partner in international trade, while at the same time ensuring that the country's laws protect its citizens and the capital invested in that country.[113] However, much as the World Bank, through such involvement, is a significant driver of reforms, experience of reforms to date has revealed that the recipient governments must demonstrate a clear commitment to legal reform and take ownership of legal reform for legal technical assistance to bring about the desired results.

The Mauritius insolvency reform is a good example of how technical support from multinational institutions is helpful. During its insolvency reforms, it is documented that the World Bank provided technical assistance and support, to help develop a pipeline of financial and private sector development policy reforms.[114] In fact, such support was recognized to have

[112] World Bank , *Kenya - Financial and Legal Sector Technical Assistance Project*, (World Bank, 2013) http://documents.worldbank.org/curated/en/2013/09/18341203/kenya-financial-legal-sector-technical-assistance-project accessed on 3 June 2014

[113] World Bank, 'UNCITRAL Legislative Guide on Insolvency Law on the Treatment of Enterprise Groups: Updating the World Banks Principles' The World Bank Insolvency and Creditors/Debtor Regimes Task Force Meetings Washington 10th January 2011 available in worldbank.org/EXTGILD/Resources/WB_TF_2011_UNCITRA_WB_Principles.pdf accessed on 5th May 2014

[114] World Bank, *Mauritius - Second Private Sector Competitiveness Development Policy Loan Project* (World Bank 2013) available in http://documents.worldbank.org/curated/en/2013/02/17279283/mauritius-mauritius-second-private-sector-competitiveness-dpl accessed on 16th June 2014

been a very useful tool, as it helped provide technical expertise and enabled global best practice on policy and institutional issues to inform policy dialogue.[115]

6.3.2 Crisis

Financial crisis has been said to be a catalyst for legal reforms in many jurisdictions.[116] This is mainly because times of crisis and uncertainty generate an energy which, if well harnessed, can help to build the foundations for a new and better order.[117] There is plenty of evidence that supports this assertion. For instance, during past financial crises, jurisdictions such as Russia, those in East Asia, and Argentina, turned their attentions to the importance of bankruptcy laws that supported the efficient resolution of financial distress.[118] The Asian financial crisis, which spread from Thailand to other countries in the region during the second half of 1997, plunged the countries affected into deep recessions that brought rising unemployment, poverty, and social dislocation and it eventually propelled massive reforms in that region.[119]

The 2008 crisis inspired some of the legislative changes made in 2009 to2011 by many EU member states, including Romania and was a good opportunity for governments and policymakers to engage in significant reform of the bankruptcy process.[120] A new insolvency

[115] Ibid
[116] Elena Cirmizi, Leora Klapper, Mahesh Uttamchandani, 'The Challenges of Bankruptcy Reform'(Policy Research Working Paper 5448,World Bank,2010)
[117] Anjana Chikhuri 'Business in Mauritius in challenging times Riding the tide of the current economic downturn for a better future' (2012) 51 The Magazine of Mauritius Chamber of Commerce and Industry 6-9
[118] Stijn Claessens, Simeon Djankov, and Leora Klapper, 'Resolution of corporate distress in East Asia' (2003) 10 Journal of Empirical Finance, 199– 216.
[119] Timothy Lane, 'The Asian Financial Crisis: What Have We Learned?' (1999) 36 A quarterly Magazine of the IMF 3
[120] Maruşa Beca, and Ileana Ashrafzadeh Nişulescu, 'The impact of the Economic Crisis on the Corporate Insolvency's Evolution in Romania' A Paper Presented in 2nd World Conference On Business, Economics And Management WCBEM 2013 held on 25-28 April 2013 in Antalya/Turkey

law was passed in Ukraine in December 2011.[121] Greece and Portugal implemented measures under the Fund-supported programs to improve the efficiency of the judicial process, while some European countries such as Moldova and Serbia enhanced their insolvency administrator regime.[122] The Slovak Republic adopted a new amendment to its bankruptcy and restructuring law that clearly defines the roles and powers of creditors, secured creditors and trustees with the aim of increasing the efficiency of the insolvency process.[123] Generally, several other European Union jurisdictions responded by reforming their laws. It is well appreciated in these western jurisdictions that crisis puts even the strongest economies into disarray and therefore structural reforms are usually undertaken as a key feature of the countries' programs to address the root causes of the crisis and its consequences, as well as to set the stage for medium-term growth.

In the past, however, crisis did not propel any reforms in emerging economies and Kenya was no exception. This was because the impact of financial crisis in these jurisdictions was limited, purely because countries in sub-Saharan Africa were barely integrated into the global financial system.[124] The banks relied on domestic deposits and lending and did not have derivatives or asset-based securities among their portfolios and this insulated them from sources of financial vulnerability that had impacts elsewhere.[125] According to Shanta Devarajan, 'African banks retain loans they originate on their balance sheets, the interbank market is small, and the market for securitized or derivative instruments was either small or

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[121] Law of Ukraine '*On Amendments to the Law of Ukraine: On Restoring Debtor's Solvency or Declaring it Bankrupt*' dated 22 December 2011
[122] Yan Liu and Christoph B. Rosenberg 'Dealing with Private Debt Distress in the Wake of the European Financial Crisis: A Review of the Economics and Legal Toolbox' (IMF Working Paper, 2013) available in https://www.imf.org/external/pubs/ft/wp/2013/wp1344.pdf assessed on 10th August 2015
[123] World Bank, *Doing Business Report 2013: Smarter Regulations for Small and Medium-Size Enterprises* (World Bank, 2013) pg.95
[124] Francis M. Mwega 'Global Financial Crisis Discussion Series Paper 17: Kenya Phase 21' 2010
[125] Ibid

non-existent.'[126] However, in recent years, globalization has led to financial systems being more integrated, hence whenever a financial crisis occurs; its impacts are felt in almost all the jurisdictions of the world. In fact, Kenya's financial market is far more open now, though the extent is still not comparable to the openness of markets in the United States, Europe, or Asia.[127] In essence, Kenya has increasingly become integrated in the global economy and the effects of turmoil in the financial systems in the United States and Europe are bound to have an effect, albeit a lagged one.[128]

Similarly the Mauritius economy has evolved and grown in sophistication in the past two decades. There is a wider variety of businesses, the economy is more globally integrated and business risk is becoming more spread and more intense. Reform commenced in the early 1980s when the government introduced a series of financial and fiscal policy measures to liberalize the economy and prepare the country for global integration.[129] Besides, given the commitment and pace at which Mauritius has opened up its economy for integration, it is more vulnerable to financial crisis. For instance in 2005, a 'triple trade shock' caused by an erosion in textile and sugar preferences, and combined with rising energy prices, shaped a very difficult outlook for Mauritius.[130] This prompted the newly-elected government in 2006 to announce an ambitious and comprehensive plan for accelerating the implementation of

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[126] Shanta Devarajanas quoted by Francis M. Mwega 'Global Financial Crisis Discussion Series Paper 17: Kenya Phase 21' Overseas Development Institute, London 2010

[127] Betty Kibaara, 'The Impact of Financial Crisis on Developing countries: Kenya' (2008) Institute of Development Studies, Brighton

[128] See Ernest Harsch 'A Growth slows, but Africa's economies are now more resilient' (Africa Renewal, 2009)

[129] Peter Larose, 'The Impact of Global Financial Integration on Mauritius and Seychelles' (2003) Summer , Bank of Valletta Review 28

[130] World Bank, *Backing Reform in Mauritius With IBRD Policy Lending* (World Bank 2010) available in http://siteresources.worldbank.org/NEWS/Resources/MauritiusBackingreform4-9-10.pdf accessed on 27 May 2014

key reforms to realize the development vision from the previous decade.[131] Further in 2008, the economic outlook for Mauritius turned dull as the world faced the worst economic conditions in decades. This reinforced the government push for reforms, which resulted in the enactment of the Insolvency Act 2009, amongst other legislations necessary to forestall the impact of crisis.[132] The quick implementation of the pre-emptive reform agenda since 2006-2008 was at the core of Mauritius's resilience during the last 2008-2009 crisis.[133]

In the Kenyan jurisdiction, it is only the recent crisis of 2008 that has stirred reform debates and prompted a rethinking regarding the country's ability to withstand the impact of crisis. In particular, the financial crisis of 2008, according to the Prime Minister, was anticipated to badly affect the Kenyan economy.[134] In reality, the magnitude of the impact is not well documented and was according to a Ministry of Finance and Central Bank official indirect and most likely small.[135] The explanation of the indirect effect were given in examples that include a slowdown of the tourism sector that relies heavily on foreign tourists, the construction industry and the stock market that benefit from remittances by Kenyans living abroad and foreign institutions e.g. hedge funds.[136]

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[131] Sunil Benimadhu, 'Global Financial Crisis and Policy Response in Mauritius: Key Lessons' (A paper presented in the North-South Institute Sheraton Hotel Ottawa, June 8-9, 2010)

[132] World Bank (n 129)

[133] Ibid

[134] Kevin Kelley, 'Africa: Raila Sees U.S. Financial Crisis Affecting Continent'(Daily Nation, Nairobi, October 2008)

[135] Hezron O Nyangito: 'Impact of the global financial crisis on the Kenyan banking system' His Keynote address as a Deputy Governor of the Central Bank of Kenya, at the Kenya Institute of Bankers, Eldoret, 16 January 2009.

[136] Capital Market Authority, 'The global Financial Crisis: Its Effects on Kenya and Possible Strategies to Mitigate the Effects'14th November 2008.

Nevertheless, the global financial crisis left both short and long terms impacts; the most immediate was the depreciation of the Kenya shilling relative to the US dollar.[137] In addition there was reduction in Tourists from KSh49.3 billion to KSh34.5 billion over the same time caused by increased fuel prices and the Global financial crisis.[138] Besides, there was the;

> 'Psychological effects e.g. lending institutions being more specific and shying away from those who cannot show ability to pay. In a case of learning from others expe rience lending institutions want to avoid any action that would bring them in the same situation that triggered the financial crisis. Firms with foreign lending had to rethink their lending terms and priorities.'[139]

The portfolio flows adversely affected the stock market, with foreign sales exceeding foreign buys in many counters, as foreign portfolio investors diversify from the market.[140] Equally the NSE-20 share index has been affected since mid-2008 and there have been reduced economic activities and capital inflows including a reversal/ reduction of portfolio capital which has aggravated the macroeconomic imbalances in the economy, amongst others.

Remarkably, there was a formation of a taskforce to inform the government on how to shield the economy from the adverse effects of the global financial crisis.[141] Some of the recommendations that were made highlighted a need to review the legal framework. Besides, a

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[137] Kibaara (n 126)

[138] Dorothy McCormick, 'The Impact of the Global Financial Crisis on Developing Countries: Impact of the Financial crisis on Kenya' in Southern Voices on the Impact of the Financial Crisis 2008 available in http://www.ids.ac.uk/go/financial-crisis-impact accessed on 5th August 2015

[139] Ibid

[140] Kibaara, (n 126)

[141] Francis Mwega, 'The Effects of the Global Financial Crisis: A Case Study of Kenya' Also see Koech, Oscar Kipyegon, and Gladys Rotich. 'The Effect of the 2008 Global Financial Crisis On The Performance Of Stock Indices At The Nairobi Securities Exchange' (2013) 2 International Journal of Innovative Research and Development 5

number of financial specialists have reiterated the need for ensuring that the financial sectors are regulated in the interest of promoting their growth while at the same time insulating them from collapse instigated by global financial crisis.[142] Such sentiments are inspired by observation of examples such as the Asian banks that are documented to have escaped, largely due to well capitalized banks, cautious regulation and huge forex reserves.[143] This is significant given the fact that the previous crisis had badly affected the Asian jurisdictions, prompting them to engage in reforms whose rewards seems to have been reaped already. From the foregoing, it may be observed that the financial crisis contributes impetus to insolvency reforms by triggering the reform debates. In fact, much as the central focus of reforms has been on the policy interventions aimed at enhancing liquidity in the market, efforts were directed towards other measures that would arguably, enhance the depth, operation and efficiency of the financial market and ultimately enhance monetary policy effectiveness.[144]

6.3.3 Regional Integration

For more than a decade now, the East African countries have engaged in deliberate efforts to establish a regional economic bloc. The 'EAC treaty' which establishes an East African Community was signed in 1999 and entered into force in 2000. According to article 5 (1) of this EAC Treaty, one of the objectives of the Community is to develop policies and programs aimed at widening and deepening cooperation among partner states in political, eco-

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[142] Nzomo Mutuku, 'The Impact of the Global Financial Crisis on the Kenyan Retirement Benefits Industry' (June 30, 2010) Available at SSRN: http://ssrn.com/abstract=1837325 or http://dx.doi.org/10.2139/ssrn.1837325 Also see Hezron O Nyangito: 'Impact of the global financial crisis on the Kenyan banking system' His Keynote address as a Deputy Governor of the Central Bank of Kenya, at the Kenya Institute of Bankers, Eldoret, 16 January 2009.

[143] Capital Market Authority, 'The global Financial Crisis: Its Effects on Kenya and Possible Strategies to Mitigate the Effects' 14th November 2008

[144] Maureen Were and Samuel Tiriongo 'Central Bank's Response to Economic Crises from a Developing African Economy Perspective: Lessons from Kenya's Experience' available in http://www.afdb.org/fileadmin/uploads/afdb/Documents/Knowledge/Central%20Bank%E2%80%99s%20Response%20to%20Economic%20Crises%20from%20a%20Developing%20African%20Economy%20Perspective%20Lessons%20from%20Kenya%E2%80%99s%20Experience.pdf accessed on 12 June 2014

nomic, social and cultural fields, research and technology, defence, security, legal and judicial affairs, for their mutual benefit. In so far as business engagements are concerned, the signing of the East African Community (EAC) Common Market Protocol (CMP) and its annexes in 2009 was momentous as it reinforced the commitment by the member states to establish a common market.

Primarily, the achievement of an integrated market necessitates the establishment of an institutional framework to develop, implement, and sustain the efficient, transparent, and market-based regulatory systems in order to achieve the economic benefits of regional integration.[145] Besides, an effective way of integrating member jurisdictions is through the harmonization of laws. In essence, laws are tools for implementing economic integration because stable, clear and uniform legislation, once commonly implemented, will encourage investment and growth of markets.[146] Therefore, national laws require review against community legislation/policy to assess whether changes in the national legal enactments are necessary to facilitate the intended objectives of the cooperation. In fact, the partner states, according to article 7(1) (b) of the EAC Treaty, committed themselves to provide an adequate and appropriate enabling environment to facilitate the integration process, including favourable policies and basic infrastructures. The adequate and appropriate enabling environment ultimately includes harmonization of all their national laws. As a member, Kenya inevitably has to engage in reforms necessary towards eliminating existing rules at domestic levels that violate the principles of the common market.

[145] World Bank, *Regulatory Capacity Review: East African Community* (World Bank 2011) available at https://www.wbginvestmentclimate.org/uploads/EAC%20Regulatory%20Capacity%20Review%20Published.pdf accessed on 5th June 2014

[146] Wilbert TK Kaahwa, 'The State of Harmonisation of Municipal Laws in the East African Community Context' in Reforming Justice in East Africa: Comparative Review of Legal Sector Processes, (Fountain Publishers, 2008) p.17, 2008

Since the inception of the East African Community, the prospects of huge economic benefits to the member states have triggered a debate on reforms. The EAC Development Strategy 2006-2010 is one of the reform engagements which stipulates that harmonization of laws is considered a key strategic intervention.[147] Besides, the EAC Secretariat commissioned a study to harmonize the commercial laws of the partner states in 2010, which recommended that the commercial laws to be harmonized should fall within nine broad clusters and one of them would be laws governing business transactions (covering legislation on bankruptcy, building societies, business organizations, capital market development, chattels transfer, the co-operative movement, export processing zones and transfer of businesses etc.).[148] In addition, the Kenyan government pledged to move with speed to amend a number of its legislative enactments and among the targeted areas are commercial laws, especially those dealing with the registration of companies and other business entities, bankruptcy and insolvency, as well as investment laws.[149]

Besides the EAC, Kenya is also a member of the World Trade Organization (WTO) and its commitments to the Common Market for East and Southern Africa (COMESA) exerts pressure on the government of Kenya to engage in a wide range of reforms in its trade processes. Pressure for change specifically in Kenya's trade processes is being felt due to Kenya's position as a founding member of the World Trade Organization. Kenya's commitment to par-

[147] EAC Development Strategy 2006-2010 is available in www.eac.int/legal/index.php?option=com...id...eac-development accessed on 5th June 2014
[148] Edward Kitonsa, 'The Status of the EAC Legal Harmonization Process in Uganda' (A paper presented at a conference on Creating a Predictable and Facilitative Legal Environment for Business in the East African Community 6th – 7th august 2012 in Arusha Tanzania)
[149] Francis Ayieko, 'Kenya fast tracks reforms to make EAC dream a reality' (The East African, 5th July 2010)

ticipate in the Preferential Trade Area (PTA) of the COMESA, the formation of the EAC Customs Union, and the private sector, form a formidable force propelling reforms necessary for this jurisdiction to become globally competitive.[150] For example, through COMESA, Kenya is among six jurisdictions that are leading the way to put into place a regional customs bond guarantee programme designed to, among other things, streamline the process of doing business in the critical trade corridor that runs from Mombasa in Kenya to Uganda and on to Kigali, Rwanda.[151] It is acknowledged that the prioritized areas of reform propelled by this grouping do not include insolvency laws but generally the wider business legal spheres meant to improve its trading across borders and to enable the grouping to become more globally competitive. However, it is argued that attracting investors and remaining globally competitive will inevitably require insolvency reforms, given the pivotal role that insolvency law plays in directing the flow of credit.

6.4 INTERNAL FORCES /REALITIES

Most Sub-Saharan countries struggle with poverty, unemployment, and minimal economic growth etc. For a long time, laws in these emerging economies have been known to be unresponsive to development needs. However, trends have recently changed as law reforms in areas such as business laws and in relation to commercial transactions have been documented to stimulate economic growth. In essence, the attempts to tackle the challenges have forced the jurisdictions to engage in legal reforms. Of particular interest is how foreign direct investment, poverty reduction and economic growth have propelled insolvency reforms.

[150] BIZCLIR, 2007 'Customs Automation and Process Reform Lesson from Kenya Available in http://egateg.usaid.gov/sites/default/files/01.128.08BP12_Kenya.pdf Access on 12 June 2014
[151] Ibid

6.4.1 Foreign Direct Investment (FDI)

Foreign direct investment is generally understood as a direct investment into production or business in a country by an individual or company of another country. It includes equity capital, re-invested earnings and intra-company loans, with the first two dominating net FDI to Kenya.[152] FDI is particularly important because it brings investable financial resources to host countries, provides new technologies and may enhance the efficiency of existing technologies.[153] In addition, FDI may facilitate access into export markets, thereby playing an important role in strengthening the export capabilities of domestic economies; may enhance skills and management techniques; and may provide cleaner technologies and modern environment management systems.[154] Undoubtedly, FDI contributes to the growth and development of a country by complementing its domestic investment, facilitating trade, and transfer of knowledge and technology.[155]

However, foreign investors face considerable levels of risk where legal systems lack transparency, predictability, and security, and as a result such investors will often avoid high-risk environments. In essence, foreign investors are attracted to legal systems which are predictable and efficient; and second, investors have the ability to easily identify a uniform set of characteristics which render any legal system predictable and efficient.[156] An inefficient legal system raises transaction costs by failing to provide affordable mechanisms for enforcing

[152] Mwega (n 123)
[153] Ibid
[154] Ibid
[155] Read more on the benefits of FDI in Judith Kemunto Mainye 'The Main Impediments to the Growth of Foreign Direct Investment Inflows in Kenya' (Maters Thesis, University of Nairobi, 2013) pg. 6
[156] Amanda Perry, 'An Ideal Legal System for Attracting Foreign Direct Investment? Some Theory and Reality' (2000) 15 American University International Law Review 6

legal rights and obligations.[157] Low transaction costs are guaranteed where a host state's laws are of good quality i.e. modern and its courts and bureaucracies are provided with adequate infrastructure, and with trained and properly compensated staff.[158] Fundamentally, the availability of business opportunities alone is not sufficient but investment climate features such as strong institutions and investor-friendly regulations also matter and may even boost the development impact of the investment. The international community underscored the importance of an enabling business climate for private investment and job creation during the Group of 20 (G20) summit in Mexico.[159]

Conversely, the business climates of many emerging economies are dominated by a few players and entry to such emerging markets is difficult and costly; laws and regulations distort market competition, ineffective enforcement of rules makes emerging economies less likely to compete globally.[160] In particular, operating and regulatory environments in developing economies have been documented as challenging, as they remain relatively inefficient, uncompetitive and dominated by their informal economies.[161] Nonetheless, given the significance of foreign investment, developing countries are now giving new interest to the creation of the right environment for a country to attract foreign investment. In particular, it is widely acknowledged that business regulation reforms help a country to create an invest-

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[157] World Bank , *The Role of the State in a Changing World* (World Bank, 1997) at page 43 available in http://econ.worldbank.org/external/default/main?pagePK=64165259&theSitePK=469382&piPK=64165421&menuPK=64166093&entityID=000020953_20070620145917 accessed on 5th May 2014
[158] Perry, (n 155)
[159] IFC Jobs Study: 'Assessing Private Sector Contributions to Job Creation and Poverty Reduction', January 2013
[160] Martha M Licetti, 'Competition Policy, Trade and Competitiveness'(A Paper Presented in Pre-ICN Forum held at Palmeraie Golf Hotel, Marrakech on 22nd April 2014)
[161] World Development, *A Better Investment Climate for Everyone* (World Bank and Oxford University Press, 2005) available in http://web.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTRESEARCH/EXTWDRS/0,,contentMDK:23062314~pagePK:478093~piPK:477627~theSitePK:477624,00.html accessed on 18 June 2014

ment climate that is conducive to starting and running a business, where complying with regulations brings more benefits than costs. The countries' governments are therefore formulating and implementing laws that will ensure that the country attracts foreign investors and ensure that they operate in a competitive environment.[162] In particular, among the laws given attention are corporate insolvency laws, since well-functioning corporate governance and bankruptcy laws are generally believed to be critical to investment and growth. They are particularly important in emerging market economies where corporations often are hugely influential in the economy-at-large and in politics.[163]

FDI has played an increasingly important role in the Kenyan economy, such that when there was a decline in the net FDI flows in the early 1980s and 1990s, economic reforms were undertaken in an attempt to improve the business environment.[164] However, since the 2000s FDI flows to Kenya have not only been highly volatile, they have generally declined.[165] Besides, there is evidence that investors are moving their interests to Kenya's neighbours in the EAC (Uganda and Tanzania) due to low investor confidence, resulting from factors in Kenya like insecurity, poor infrastructure, high interest rates, and high operational costs, an unsupportive judicial system and insufficient legislation. In fact by 2004, there was a growing concern within the Kenyan Government as to the decline of Kenya's competitiveness,

[162] Benson Durham, 'Absorptive Capacity and the Effects of Foreign Direct Investment and Equity Foreign Portfolio Investment on Economic Growth' (2004) 48 European Economic Review, No. 2, pp. 285-306
[163] Erik Berglof, Patrick Bolton, Sergei Guriev, & Ekatherina Zhuravskaya, 'Government and Market Failures in Emerging Market Economies: Implications for Corporate Governance and Bankruptcy available in http://siteresources.worldbank.org/DEC/Resources/84797-1251813753820/6415739-1257192350745/ErikBerglof.PDF accessed on 18th June 2014
[164] Francis M Mwega, and Rose Wanjiru Ngugi, 'Foreign Direct Investment in Kenya'. Paper presented at the AERC Special Workshop on FDI in Sub-Saharan Africa, February 2005.
[165] Ibid

not only in the global economy but also in the region.[166] Equally, there was a growing consensus within the government as to the need for bolder and more aggressive reforms to create a competitive and an enabling environment for enhanced private sector investments.[167] A notable reforming effort resulted include the establishment of the Business Regulatory Reform Unit (BRRU) in the Ministry of Finance. This was a culmination of the Business Licensing Reform Project, a crucial move in reforming business laws generally.

The limited reforms in the business laws have done little to improve Kenya's competitiveness since, according to the World Bank Doing Business Report, Kenya was ranked 106 in 2011, 109 in 2012 and further dropped to position 121 in the world's global list of economic competitiveness in the year 2013.[168] This is disturbing, given that Kenya compares so unfavourably in relation to its neighbours Uganda and Rwanda which were ranked at 52 and 120 respectively in the same index.[169] These reports highlight a number of issues touching upon a country's business environment, namely: ease of starting business, dealing with construction permits, getting electricity, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts and resolving insolvency. Given the variety of issues that they address, these reports are very informative and arguably contribute in influencing the investors' choice of investment destination.

The desire to improve Kenya's competitiveness to attract FDI has driven a number of reforms; insolvency reforms being one of them. The pressures of globalization of capital movement and the threat that companies will relocate to countries with more favourable

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[166] The Ministry Of Finance, 'Establishment of the Business Regulatory Reform Unit (BRRU)' available in http://www.businessadvocacy.org/dloads/briefBBRU0808.pdf accessed on 21 August 2014
[167] Ibid
[168] World Bank, *Doing Business Reports 2013* available in http://www.doingbusiness.org/rankings accessed on 29th May 2014
[169] Ibid

business environments have pushed the Kenyan government to respond.[170] In fact the former president of Kenya, Hon. Mwai Kibaki is on record as having said that the Insolvency Bill 2010 was one amongst many government engagements that are pursuing an enabling environment that will make Kenya more competitive in terms of business and investment.[171] The efforts have been on-going for almost two decades with the aim to review, modernize and generally simplify the laws.[172] A notable impetus was in 2003-2007 when a policy strategy was adopted that was anchored on the new government overarching policy objectives of its Economic Recovery Strategy for Wealth and Employment Creation.[173] Much as this particular policy did not directly discuss insolvency reforms, it is one of the significant engagements by the government in the reform of business laws. A further impetus came in 2008 with the launching of Kenya's 'Vision2030', a government driven agenda which seeks to transform Kenya into a competitive and prosperous middle income economy.[174] It is noteworthy that the reform initiative is carried out within the wider context of facilitating growth of trade and investment and foreign direct investment, all aimed at reducing poverty.[175]

6.4.2 Economic Growth and Poverty Reduction

There is also a general consensus that entrepreneurship is very important for supporting the dynamism of the modern market economy, and that a greater entry rate of new businesses

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[170] Catherine K Gachenge and Karanja Ngugi, 'Challenges Facing Licencing Process of Foreign Direct Investments: A Case of Kenya Investment Authority' (2013) 1 International Journal of Social Sciences and Entrepreneurship 2

[171] HE Hon President M Kibaki, 'Speech During the Official Opening of Parliament' (the Fourth Session of the Tenth Kenyan Parliament 23rd February 2010)

[172] Agimba (n 12)

[173] Kenya, 'Investment Programme for the Economic Recovery Strategy for Wealth and Employment Creation 2003-2007' (Poverty Reduction Papers IMF Country Report No. 05/11, 2005) < http://www.imf.org/external/pubs/ft/scr/2005/cr0511.pdf > accessed on 29th May 2013

[174] Benhajj S Masoud, 'The Kenyan Insolvency Bill 2010: A Cross-Border Insolvency Analysis' (2013) 4 Open University Law Journal 1:195-207

[175] Whitehead (n 62)

can encourage competition and economic growth.[176] This reality has pushed jurisdictions all over the world to engage in legal reforms necessary for encouraging such entrepreneurial activities. In particular, jurisdictions are reforming their laws to make it possible for firms to enter into the market and secondly to ensure that business exit process are quick and efficient, to allow creditors to recover their assets and entrepreneurs to pursue new opportunities.[177] Growing the economy inevitably reduces poverty.

Besides, many books and influential reports have outlined the role of business activities in helping to reduce poverty and unemployment. This, coupled with the underlying proposition that efficient regulatory frameworks are vital preconditions for a greater role for the private sector in development, drives reform. Besides, poverty reduction is the overarching global policy challenge today.[178] This is primarily because poverty breeds despair, social unrest, aggravated ethnic tensions and engenders political instability.[179] In addressing this challenge, development assistance is moving away from the fulfilment of resource transfer targets toward the nurturing of new policy ideas, the sharing of development knowledge across countries, and the promotion of domestic capacity.[180] In essence, greater selectivity is being practiced to ensure that assistance flows are directed to countries committed to policy reform and poverty reduction. In fact, the international players who have partnered for a while with poorer countries in fighting poverty acknowledge that facilitation of commercial activities is important. A general observation of the World Bank Doing Business cross-country surveys suggests that poorer countries tend to have faulty commercial law systems.

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[176] Leora Klapper, Luc Laeven, Raghuram Rajan 'Entry Regulation as a Barrier to Entrepreneurship' (2006) 823 Journal of Financial Economics 591– 629; Simeon Djankov, Rafael La Porta, Florencio Lopez- de-Silanes, and Andrei Shleifer 'The regulation of entry' (2012) 117 Quarterly Journal of Economics (1): 1– 35
[177] Ron Duncan and Doan Quang 'Trade Liberalisation, Economic Growth and Poverty Reduction Strategies' (2002) available in http://aid.dfat.gov.au/Pages/Publications-and-Research.aspx accessed on 16 June 2014
[178] Picciotto (n 74)
[179] Ibid
[180] Ibid

In Kenya, a serious challenge facing the country today is to create employment opportunities for its continuously growing labour force, notably the youth, and another key challenge is poverty reduction.[181] As a result, reform has been undertaken in the wider legal spectrum as part of Kenya's strategies towards overcoming the challenges. Such engagements are considered worthwhile since there is a growing body of evidence that demonstrates that entrepreneurial activity plays a direct and important role in poverty reduction.[182] In fact, studies in a number of countries show that entrepreneurial activity is a primary determinant of upward income mobility of poor people.[183] Generally, entrepreneurship is, or can be, the central creative economic force in all countries. Arguably, the realization that one of the ways of dealing with poverty challenges is by encouraging entrepreneurship is a force that drives policy change that creates conditions where entrepreneurship is constructive and dynamic.

Generally, one of the objectives of an insolvency law is to protect and maximize value for the benefit of all interested parties and the economy in general.[184] This is an objective that is most obviously pursued during rehabilitation, where value is maximized by continuing a viable enterprise. In particular, rescue mechanisms can be viewed as economically beneficial in the long run, since they encourage debtors to restructure before their financial difficulties become too severe. Moreover, rescuing a viable enterprise serves a broader societal interest, by giving debtors a second chance; hence it encourages the growth of the private sector and

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[181] African Development Bank Group, *Kenya2014 Country Strategy Paper 2014-2018* (February 2014) available in http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2014-2018_-_Kenya_Country_Strategy_Paper.pdf accessed on 4th May 2014

[182] Nicholas Stern, 'Investment Climate: Lessons and Challenges' The British Academy, Distinguished Lecture Series 19 November 2002

[183] Ibid

[184] IMF, *Orderly and Effective Insolvency Procedures: Key Issues* (IMF 1999) available in http://www.imf.org/external/pubs/ft/orderly/ accessed on 18 August 2015

an entrepreneurial class. In fact, one of the primary drivers of corporate insolvency law has been the recognition that Kenya should move to embrace the so-called 'rescue culture'.[185] An embedded and intrinsic objective of the on-going insolvency reforms is therefore to strengthen poverty reduction strategies through rehabilitation and the use of rescue procedures whose effective implementation would save jobs and revenue in the long term.[186]

There is a close relationship between the establishment of a strong investment climate and poverty reduction in the sense that an enabling investment climate facilitates investments and exports and it improves productivity which, in turn, spurs economic growth, which positively affects poor people through improvements to their income.[187] It is not in doubt that sustained economic growth is the most critical factor in alleviating poverty.[188] Consequently, economic growth requires an enabling investment climate and one of the ways of achieving this is by establishing efficient legal frameworks.

6.5 CONCLUSION

The analysis in this chapter has revealed that a number of drivers are involved in prompting insolvency reforms. Similar drivers exist in both Mauritius and Kenya but the influence of the drivers has differed in impact because of various reasons. Each of the drivers has influenced reforms to varying degrees and some drivers are complementary. For instance much as reforms are driven by changes in market dynamics, an effective government is a critical complement. The markets need government and government needs markets because gov-

[185] Whitehead, (n 62)
[186] Kenya, (n 172)
[187] IFC's poverty webpage: http://ifcnet.ifc.org/ifcint/deveffectiveness.nsf/Content/home accessed on 28/May 2014
[188] Raj Nallari & Breda Griffith 'Understanding Growth and Poverty Theory, Policy, and Empirics' (World Bank 2011)

ernment action is crucial to the ability of people to participate effectively in economic opportunity.[189] In essence, an active government that fosters an environment where markets can function, contracts are enforced, and the basic infrastructure works will always prioritise a reform agenda. Policy formation is primarily driven by domestic political economy. Accordingly, it is prudent to appreciate that the government's political and legal responsibilities are complimentary in their effectiveness to propel reforms. On the legal front, the Kenyan government has not influenced the process and pace of insolvency reforms to a noticeable degree. In contrast, the Mauritian reforms are by and large a result of an efficient government initiative.

From 1990 to date, the business community in Kenya has constantly maintained its call to prioritize the reforming of some vital business legislation e.g. through the Companies Bill, Insolvency Bill and Partnerships Bill that seeks to coordinate and reduce the cost of doing business, which is necessary to improve the investment climate in Kenya. As noted, KEPSA has partnered with the government in passing various policies and Bills and increasing strategic interventions. The meetings that KEPSA has organized with key government officials have been significant in maintaining the momentum of reforms.

Multilateral institutions such as the World Bank play the role of repositories of credible, accessible, and up-to-date information that serves as an international benchmark for progress. Access to information is the basis for evidence-based policymaking and can serve as a catalyst for necessary reforms. Besides, the multilateral institutions drive reforms through organization of Round Table Meetings which are platforms for peer reviewing amongst juris-

[189] Nicholas Stern, 'Investment Climate: Lessons and Challenges' Distinguished Lecture Series 19

dictions. In addition, the use of conditional funds and aids are employed to ensure that governments implement reforms.

Internal challenges such as poverty, unemployment and the competition to attract investment have contributed to the driving of reforms. In Kenya in particular, law reforms in the wider spectrum of business laws have so far been documented to stimulate economic growth. In essence, the attempts to tackle the challenges have forced the jurisdictions to engage in legal reforms. As regards global trends, integration, both at regional and international levels has necessitated the harmonization of laws. Besides, it is notable that major reforms have often been preceded by economic and political crises.[190]

The biggest answer to what drives reforms was captured in a nutshell by the following quotation:

> 'When are reforms likely to be successfully implemented? They tend to be successful when certain conditions, or combinations of them, are present. These include, demand from strong lobbyists in the private sector, the World Bank and other donor agencies, the media or the existence of specific crisis situations. These trigger response from the highest level of government…….which then force through the demanded changes'[191]

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[190] David Dollar, Shantayanan Devarajan and Torgny Holmgren, *Aid and reform in Africa* (World Bank Publications, 2001)

[191] Hemant B Chittoo, Needesh Ramphul, and Bhissum Nowbutsing, 'Globalization and Public Sector Reforms in a Developing Country' (2009) 8 Culture Mandala: Bulletin of the Centre for East-West Cultural & Economic Studies 2

In essence, reforming the legal framework is a long process which requires stimulus from the drivers considered in this Chapter, leading to a commitment from the government and a continuous sustained effort over time.

CHAPTER SEVEN

7.1 CONCLUSION AND RECOMMENDATION

INTRODUCTION

In the previous chapters we have considered the drivers for insolvency law reform and seen how their influence differs significantly in particular countries. We have also explored the historical evolution of corporate insolvency laws in specific jurisdictions with an aim of establishing whether Kenya can benefit from their experiences in its reform engagements. The exploration of the wellspring of legal traditions and fundamental principles that underpin corporate insolvency laws is vital in appreciating the need for reform. The momentous developments provide great insights in understanding how reforms are realized. Besides, it was considered prudent to appreciate how insolvency laws impact upon investment decisions, as well as the relevance of business turnaround in the currently volatile economic climate, where businesses are struggling for credit and in many cases simply struggling to survive.

This last chapter is divided into four main parts. It starts with a summary of the main insights that have emerged in the study. The second part deals with the contribution to knowledge by this study. The third part focuses on the legal and policy implications of the contribution made. It then expounds on the limitations of the study as well as pointing out the possible direction of further research.

The aims, as stated in Chapter One, shaped a platform, setting out the boundaries of the research and how this was to develop throughout the thesis. One of the aims was to evaluate whether Kenyan insolvency laws supports modern businesses and to consider what, if any,

legal reforms might be desirable to better achieve this end. This was important given the slow pace of reforms to the Kenyan corporate insolvency laws. The study also undertook a comparative analysis between Kenya, the U.K and Mauritius with an aim of reflecting upon the experiences and lessons in each jurisdiction. This necessitated an in-depth investigation of how the reforms have been carried out in the respective jurisdiction and the drivers of reform in each case.

7.2 MAIN INSIGHTS

The context of the study was elaborated in Chapter One with a justification as to why it is prudent to undertake a research of this nature. The fundamental concepts in insolvency law were explored and it was demonstrated that company failures do happen and can be triggered by internal deficiencies, such as poor management, or external, such as a natural disaster.[1] Where these deficiencies trigger company failure, there is a need for an efficient insolvency framework.[2] It was also argued and subsequently proved, mainly in Chapter Three that Kenyan insolvency law has lagged behind, despite an overwhelming recognition that an effective and efficient insolvency framework is necessary for the health of an economy, not least because it specifically influences investment decisions.[3] Besides, insolvency laws of many jurisdictions all over the world have undergone reforms, especially in recent years, as the impact of financial meltdown has left daunting negative effects. For instance, in Europe, crisis in the credit market triggered a large number of corporate failures, and consequently

[1] Roy Goode, *The Principles of Corporate Insolvency Law*, (2nd edn, Sweet & Maxwell,1997) pg.9
[2] Ibid
[3] Christine Agimba, 'Global Trends in the Four Doing Business Indicators-Closing a Business: Kenya's Reform Experiences' (Paper given at doing business 2011 in Africa: Sharing Reform Experiences 2011) <https://www.wbginvestmentclimate.org/loader.cfm?csModule=security/getfile&pageid=16716> accessed 24 May 2014; Also see World Bank, Doing Business Report 2004 (Washington, 2004)

dramatic losses of jobs.[4] Such realities underscore the importance of an effective insolvency framework whose main aim is to provide mechanisms to keep viable businesses operating, rather than entering a premature liquidation.[5] Besides, it was argued that a legal framework should also discourage lenders from issuing high-risk loans and the managers from making other reckless financial decisions.[6] The preoccupation of this thesis was therefore to understand the extent of the inadequacies of the insolvency framework in Kenya, to understand how other jurisdictions have been able to reform their laws and possibly to make helpful suggestions as to the way forward.

Chapter Two of this study explored the theories that have been developed in an attempt to understand the justification for the existence and roles of insolvency law. It was established that the normative debates on insolvency philosophy and policy have been dominated by two groups, originally named the social and economic but characterized in literature as 'Proceduralists' and 'Traditionalists'.[7] The former group comprises of those whose main focus in an insolvency process is the creditors' interest.[8] The latter are theorists and policy makers who hold the view that insolvency law should do more than to facilitate the protection of creditors but should as well seek to protect other stakeholders and wider community interests.[9] It became evident that different theories that explain the usage of insolvency law exist at different levels of generality and have varying applications and uses as explanatory tools. Besides, the debates and theories that ensued have almost exclusively been developed from the viewpoint of developed economies and hence they cannot adequately reflect the reality

[4] Anousha Sakoui 'Bankrupt Europeans are flocking to London' 20th August 2010, Financial Times, available at: http://www.ft.com/cms/s/0/6f9338e6-ac7d-11df-8582-00144feabdc0.html, accessed on 10 August2014
[5] IMF (1999), '2 - General Objectives and Features of Insolvency Procedures' pg.3
[6] World Bank, *Doing Business Report 2012 'Resolving Insolvency'* (Washington, 2012)
[7] For an elaborate discussion on insolvency theories, see Riz Mokal, 'Corporate Insolvency Law - Theory and Application ' available at SSRN: http://ssrn.com/abstract=701402 accessed on 3rd September 2014
[8] Thomas H Jackson, *The Logic and Limits of Bankruptcy Law* (Harvard University Press, 1986)
[9] Elizabeth Warren, 'Bankruptcy Policy' (1987) 54 University of Chicago Law Review 775

of an emerging economy. In addition, the pressure towards globalization through the usage of international benchmarks arguably developed with a skewed focus that was based on the experiences of developed systems without giving due attention to the circumstances of developing economies, a focus which can arguably result in unsuitable legislative reforms in those jurisdictions. However, the theoretical debate served to reveal the extent of the conflicting interests that insolvency laws deal with as it balances the many and sometimes incompatible goals. Nonetheless, it became apparent in the study that if an efficient insolvency framework is in place in particular with business rescue carefully pursued, it can help in addressing some of the challenges faced in developing nations such as job preservation for employees and the promotion of economic growth. It was argued that in Kenya, as it reforms its insolvency laws, attempts must be made to develop a realistic law which will inevitably require a lot of trade-offs in the many interests to be balanced. In essence, it is essential that the legislation must not be a hindrance to credit flow for investment and so it should be entrepreneur-friendly yet at the same time it is important that it should preserve financial stability and jobs.

Chapter Three addresses the first aim of assessing current Kenyan insolvency law from the standpoint of encouragement of external and internal investment. It analyses and evaluates the Kenyan legislative insolvency framework using international benchmarks. Specifically, the UNCITRAL Legislative Guide on Insolvency[10] was extensively used to establish how Kenya's current framework compares to international benchmarks. It was argued that a number of reasons influenced the choice of using the international benchmarks as an evaluative tool. One, the global insolvency norms which emanate from the efforts of multilateral

[10] UNCITRAL 2004 available in http://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf accessed on 6th September 2014

institutions, particularly, UNCITRAL, the World Bank and the IMF are reputable and widely accepted, given the number of jurisdictions that have in the recent past considered them in their reforms.[11] Second, the benchmarks are meant to assist the national authorities in their efforts to strengthen domestic economic and financial sector policy frameworks.[12] Besides, the World Bank considers countries' investment climates and ranks them according to their performances and their reports influence investors' confidence and improve capital access.[13]

In addition, the character of the global scripts may be regarded as very favourable, since they embody high order objectives and many substantive & procedural recommendations yet still permit considerable discretion to the national policy makers to indigenize the global norms because they are 'soft law'.[14] The investigation revealed that the Kenyan legislative framework is ill-equipped to support modern businesses, or even encourage external and internal investment. The first weakness is that the law is archaic, dating back to the colonial period. The insolvency provisions are contained in Kenya's Companies Act (1962). The lack of a statute singularly dedicated to insolvency makes the legislation embodying it bulky, complicated and cumbersome to access. It is also notable that relevant sections are not chronologically arranged. The law's application, too, has been unsatisfactory with virtually every business that faces financial distress having been liquidated.

The UNCITRAL Legislative Guide on Insolvency sets out nine key objectives and each of the objectives was applied to the Kenyan insolvency framework in order to establish how

[11] Generally most jurisdictions of the world that have engaged in insolvency reforms have paid attention to the international benchmarks. For instance, the UK, China, Mauritius, France, South Africa etc.
[12] Curzio Gianini, ' Promoting Financial Stability in Emerging Market Countries: The Soft Law Approach and beyond' (2002) 44 Comp Econ Studies 125
[13] Robert K Rasmussen, 'The Ex Ante Effects of Insolvency Reform on Investment Incentives' (1994) 72 Wash U L Q 1159
[14] Gianini (n 12)

the Kenyan laws measure up against the international benchmarks. It was argued that, much as the Kenyan insolvency laws are predisposed towards liquidation, they have the advantage of certainty. In particular, the provisions in respect of the winding-up of companies have been applied consistently over a long period of time, making the system recognizable and potentially functional for all the stakeholders. However, not all businesses that face financial distress are worthy or liquidation. In fact, the expectation of an efficient insolvency system is to strike a balance between liquidation and reorganization,[15] the latter of which is visibly lacking in the Kenyan insolvency law. In addition, although the laws permit an automatic stay, a critical feature for the maximization of the value for assets, this is negated by the length of time that insolvency disputes take to be resolved, given that the laws do not stipulate the expected time frame. A World Bank report documented that in 2009 a formal insolvency process in Kenya took an average of 4.5 years to resolve.[16] This was however a conclusion arrived at from observing the cases that had so far been dealt with but no details was offered as to whether this referred to winding up or receivership.

The Kenyan law also lacks clear mechanisms or incentives for managers to initiate the insolvency process at a sufficiently early stage. For instance, good contrasting examples can be drawn from the US, where filing early is encouraged by the 'carrot' of being a debtor in possession.[17] Generally, the evaluation revealed a lot of inadequacies but it was argued that the existing reform efforts of the Insolvency Bill 2010 would hopefully address them. However, given that this Bill still has to go through debates in Parliament and it may be the subject of amendments, the extent to which this Bill will lead to changes is undoubtedly unde-

[15] UNCITRAL Legislative Guide on Insolvency Law, Objective no.3
[16] World Bank, (2010) *Doing Business Report*, available in http://www.doingbusiness.org/reports/doingbusiness/doingbusiness 2011 accessed on 12th September 2011
[17] Gabriel Moss, 'Chapter 11-an English Lawyers Critique' 1998 (11) Insolvency International 3, 17-20

terminable at present. It was also underscored that, since the legislation in respect of insolvency procedures in Kenya is heavily reliant on the courts for supervision, the reputation of the Kenyan court system of being inefficient and hampered by corruption is a cause for concern. Nonetheless, the on-going reforms to the judiciary are commendable, however it remains to be seen whether the reforms will improve the reputation of, and confidence in, the laws and whether the law actually becomes efficient and dependable.

Chapter Four addresses the third objective of the study, which is establishing whether there are any informal approaches to corporate rescue in Kenya that may enable present weaknesses in the formal laws to be overcome. It was established that informal restructuring efforts come in a variety of forms and different modes of actions which may entail firms raising new capital such as through assets sales; negotiating terms with creditors; merging with another company; workouts, including pre-packaged reconstructions, amongst others. Although a variety of informal mechanisms are employed in Kenya, they are relatively underdeveloped. Mechanisms such as debt for equity swaps, managerial techniques and cost cutting measures, such as downsizing the workforce, are constantly used, although there is a glaring lack of any documented evidence on how they are undertaken. However more appropriate mechanisms for corporate restructuring that are popular in developed economies, such as workouts and pre-packs have not been developed. It was argued that, since the Kenyan judiciary suffers from a lack of public confidence, as well as having a significant backlog of cases and shortage of Judges with expertise on insolvency matters, out of court restructuring can be a good alternative. It was submitted that an opportune time to nurture the informal mechanisms is now since there is a general recognition in Kenya that taking every dispute to court burdens the judicial system and even strains beneficial relations.

It was noted that informal mechanisms are difficult to implement without an effective formal framework. Literature documents that informal procedure workouts are negotiated in the 'shadow of the law' and therefore depend on the enabling legal environment that has clear laws and procedures to facilitate disclosure or access to timely and accurate financial information regarding the distressed enterprise.[18] Therefore, Kenya's insolvency framework will need to nurture recognizable informal mechanisms while, at the same time, improving the efficiency of the judicial systems. It was established clearly that a legal system influences informal procedures and to a certain extent determines the possibilities for out of court debt restructuring in any given jurisdiction. In essence, effective formal insolvency procedures serve as a warning to those who would not otherwise easily participate in out of court arrangements.[19] The workouts and pre-packaged models offered by the international benchmarks form a good start when considering what sort of mechanisms to nurture. It was argued that developing a functional equivalent is a realistic approach as this allows for a possibility of having mechanisms hinged on the realities of a developing economy, such as macroeconomic conditions, the composition of debt and the legal/institutional framework.

Chapter Five addresses the fourth objective by investigating how other jurisdictions have successfully reformed their laws. This was done in order to inform the discussion of Kenya's prospects for reform. The chapter explored the historical evolution of the UK corporate insolvency laws. This study revealed that the evolutions of the UK insolvency system span over several decades and were significantly shaped by the Cork Report,[20] which above all aimed to define the characteristics of what made a good modern insolvency system. The

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[18] World Bank (2001) *Principles and Guidelines for Effective Insolvency and Creditor Rights Systems* pg.5 Available in <http://www.worldbank.org/ifa/ipg_eng.pdf> accessed on 9th Nov 2012

[19] Jose M Garrido, ` Out of Court Debt Restructuring' (Washington, World Bank, 2012)

[20] Insolvency Law and Practice: Report of the Review Committee (Cmnd 8558, HMSO 1982), "The Cork Report"

report was so influential that it remains a valuable resource for anyone wishing to gain a full understanding of the UK's insolvency regime and, in particular, its historical reform drivers. In addition, an identification and examination of corporate insolvency drivers in the UK was undertaken in the context of the quest to understand how insolvency reforms in this jurisdiction have been successfully championed. A number of drivers emerged which influences the will of the government to engage in reforms hence the government can best be described as the ultimate driver of reforms. Many market regulations take place within the confines of the national state and accordingly a government is very influential in its structure and reforms. A government's vital role in a market economy is to guarantee the fluidity and complete functioning of the world of business by enacting and implementing laws/policies that could guarantee the rights of those who engage in business and strengthen the institutions involved.[21] It was argued that the existence of such an expectation on the government does not guarantee that an existing government will actually deliver on the same. In fact a government can become a hindrance. However, the British governments have been effective in driving reforms through as they have actively participated in forming the committees to review the law and the government department (known now as) the Department for Business, Innovation and Skills (BIS) has pursued an agenda of regular review and reform, and governments have also engaged in mature constructive politics, evidenced through parliamentary debates.

Valuable lessons were drawn from the UK reform process, key among which was the importance of government commitment and consistency. It was argued that other reform drivers can easily be negated unless the government, using its legal mandate, translates the energy

[21] Douglas Webb, 'Legal and Institutional Reform Strategy and Implementation: A World Bank Perspective' (1998-1999) 30 Law & Pol'y Int'l Bus 161

and ideas into legislation. In addition, the existence of efficient institutions, in particular the Department for Business, Innovation and Skills (BIS) is very fundamental. Besides, the adverse effect of the financial crisis, coupled with globalization, which increased the vulnerability of all jurisdictions of the world, has underscored the need to nurture a rescue culture.

International organizations, such as the World Bank and International Monetary Fund have successfully championed reforms through designing and disseminating international standards on insolvency and creditors' rights systems which are aimed at strengthening a country's domestic institutions and where necessary spurring reforms.[22] Besides, the contributions of international bodies, such as the European Bank of Construction & Development (EBRD) and INSOL International have also been significant. INSOL International works on a global scale, holding conferences, advising governments on legal reforms and training insolvency practitioners.[23] It was argued that the existences of such international rules that are known and considered reputable in a global market rife with competition, prompt the jurisdictions of the world to re-think their laws. Also, the UK is an active participant in the international forums. Such platforms enhance peer review and benchmarking and stimulate reform debates.

Interest groups such as R3 (a UK insolvency trade body) actively engage in campaigning to promote business rescue and reforming the insolvency framework. In fact, the role of professionals in setting the agenda and decision was found out to be very vital.[24] However, the

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[22] International Monetary Fund Legal Department, *Orderly and Effective Insolvency Procedures Key Issues*, (IMF: 1999); World Bank, *Principles and Guidelines for Effective Insolvency and Creditor Rights Systems*, (World Bank: 2001)

[23] European Bank of Construction, 'Making of an Insolvency System Work' available in http://www.ebrd.com/downloads/research/law/lit072.pdf accessed on 4th September 2014

[24] Bruce G Carruthers & Terence C Halliday, 'Professionals in a Systemic Reform of Bankruptcy Law: The 1978 US Bankruptcy Code and The English Insolvency Act 1986'(2000) 74 American Bankruptcy Law Journal 1

ability of the interest groups to have influence on reforms depends on its ability to be organized and its resources.[25] Financial crisis was elaborated as propelling reforms and specifically, insolvency law inevitably obtains a much more prominent place in the social consciousness than usual during such times.[26] It was observed that major reforms in the UK were always preceded by major crisis.

Another unique driver that was ascertained was the pursuit of the rescue culture, an endeavour pursued within the British jurisdiction since the time of the publication of the Cork Report in 1982. Further globalization has driven reforms in the UK as the momentum of reform; the content of reform, and the trajectory of reform has proceeded from, or responded to, the transnational and global context. This has further been enhanced by the integration of the British economy into the EU as this has necessitated the development of common and harmonized laws.

The sixth chapter identified and explored the reform drivers in Kenya and made comparisons to how specific similar drivers in Mauritius operate. It was established that the two jurisdictions are very similar in many aspects. Besides the same drivers, in particular the governments, international institutions, business groups and the challenges of growing the economy through attracting investments are active in driving reforms. It is evident that the two jurisdictions acknowledge that effective insolvency laws play a significant role in the strength of an economy, and predominantly upon the framework that influences investment decisions. However, significant differences exist in the reforms, primarily because Mauritius has deliberately turned the challenges into great reform opportunities. Besides, this jurisdic-

[25] Ibid

[26] Fredrick Dahan and Elizabeth Kirk, 'Debt enforcement in Insolvency: What We Know and What We Do Not (yet) Know' available in http://www.ebrd.com/pages/sector/legal/insolvency.shtml accessed on 9th July 2013

tion has willingly cooperated with the international players and utilized donor aid and technical support. It was argued that the greatest impediments to the reforms in Kenya were disruptive politics and a lack of consistency on reform engagements by the government. It was considered that the fundamental lessons that the Kenyan jurisdiction can learn from Mauritius were that it is vital that there should be an effective government with a strong political will to implement reforms. In addition, it was noted that independent and efficient institutions, particularly the reform commission whenever it is robust, enhance realization of reform. It was also argued that a duty created on the Lord Chancellor to report annually to Parliament on the extent to which the Government has implemented Law Commission recommendations is a brilliant approach for accountability purposes. In essence, the law should provide a supportive environment for its reform commission and accountability regarding the implementation should be imposed on the parliament, a structure which is laudable in ensuring effectiveness and efficiency in reforms.

7.3 CONTRIBUTION TO KNOWLEDGE BY THIS STUDY

This study contributes to the limited scholarship in insolvency law and legal reforms in Kenya and the entire Sub-Saharan African region. First, it contributes to the literature in insolvency law by pioneering an insolvency law study in Kenya. As pointed out in chapter one, Kenya as a jurisdiction lacks documented information on how insolvency issues are dealt with. For instance, insolvency cases and informal restructuring have been reported in the newspapers as having taken place but there has been a glaring lack of scholarly evidence of the same. One possible reason could be the fact that this particular area of law has hitherto been neglected in Kenya but globalization and its impact necessitates awakening.

Secondly, the study contributes to knowledge by generating in-depth theoretical insights and understanding of the challenges that Kenya as a country faces in the endeavour to reform the insolvency laws that will be appropriate to this jurisdiction. The experiences of the other jurisdictions considered in the thesis were very informative in understanding what the real hurdles to reform are, given that the drivers exist and are evidently active but with limited results.

This study also contributes to knowledge by generating an original doctrinal legal scholarship on insolvency law in Kenya. First is the exploration of the existing theories on insolvency law, then an evaluative exploration of the existing legal framework. An elaboration of the English jurisdiction's reforms and its drivers serves to prove how the existing legal framework left to Kenya as a colonial legacy is out of touch with the expectations of modern businesses. Given that the English jurisdiction which developed the law upon which Kenyan law is based has changed its own beyond recognition there is a compelling need for reforms in Kenya.

The study has also contributed to knowledge by providing an insight into how the international insolvency benchmarks and the international institutions, as drivers of reforms, can be very helpful to Kenya as a jurisdiction, as they have been in Mauritius, an equally emerging economy. Besides, the study provides a framework for determining the local policy context that might be useful in understanding why the reform processes have been too slow. Considering that there is no evidence that even a single study has previously been done to identify the challenges and to compare them with experiences in other jurisdictions, as well as compliance with international benchmarks, this study is very informative.

7.4 RECOMMENDATIONS AND IMPLICATIONS FOR POLICIES AND LEGISLATION

The insights from the findings of this research have important implications for policy and legislation in Kenya. In particular, the study underscores that meaningful reform not only needs legislative changes but also effective institutions, resulting from a conjunction of pragmatic concerns in the minds of practitioners, policy makers and extensive evidence-based researches which open up explanations of legal change, markets and globalization. In addition, for Kenya to realize an effective insolvency framework, political will and commitment by the government is fundamental. Besides, the increasing integration of the Kenyan economy into the global economy makes Kenya more vulnerable to the effects of a global financial crisis and therefore reforming the existing framework is necessary as part of preventive measures. However, careful considerations are necessary in order to make reforms which take account of both the local realities as well international insolvency benchmarks. This is mandatory in ensuring that Kenya does not just enact unsuitable insolvency laws. Another crucial focus of the reforms should be on their implementation. As already demonstrated Kenya has for a long time acknowledged the need for reforms and engaged in drafting insolvency bills which have failed to come into force. Besides, commitments at the highest levels of government have been made on several occasions, such that many other reform participants have come to see such efforts as ‘mere talk’. In essence, opportunities for reform are widely understood in Kenya, and many have been underway for some time, even in other legal spectrums. However, removing obstacles to their implementation should be a key priority. This study has clearly demonstrated that the biggest problem is political sabotaging. It was observed that developing countries that are still struggling with judicial corruption, political instability and inadequate rule of law generally fail to realize meaning-

ful reforms and are likely to be disadvantaged in competing to attracting investment. However, once effective and efficient insolvency law is in place, it inspires confidence from investors both local and foreign, which boost the economy as well as help address some challenges such as unemployment and fighting poverty. To the Kenyan jurisdiction, the Mauritian approach of having the parliament held accountable for its legislative engagement is highly recommended as a reform model. This will not only increase the chances that Bills are actually passed into law but also improve the existing pace of reform initiatives which are too slow.

7.5 LIMITATIONS AND AREAS OF FURTHER RESEARCH

There are several limitations in this study. The main one was the limited relevant materials on the jurisdictions of Kenya and Mauritius. There is a notable lack of scholarly work in this area. Besides, the primary sources that are the foundation of any study of this nature were not readily available and accessible. The case law reporting in Kenya is inadequate and in some instances non-existent, despite the local newspapers constantly carrying relevant headlines, and there were hardly any details available as to cases that could be very helpful in developing scholarship in the area of insolvency. The analysis of the reports by the World Bank, IMF, and EBRD was conducted on the basis of only the very few such reports that were relevant to the jurisdictions under study. Such reports were however very insightful. Further reliance had to be made on secondary sources which included textbooks, journals articles, and newspapers.

A second limitation is the extent to which insolvency theories could be applied in this study. As was explained, the existing theories originate from western and developed jurisdictions

which are characterized by advanced technology, multinational corporations and sophisticated legal and financial systems. Much as the theories can be adapted and refined, such an adaptation is challenging. In essence, what sort of objectives should an insolvency framework for a developing economy prioritize, what sort of procedures should the law embody? What sort of practical implementation provisions should the law personify? Therefore, it is recommended that a theory should be developed that is cognizant to the challenges and circumstances of an emerging economy. It is appreciated that it is difficult to have a perfect system hence no perfect theory; an ideal theory should balance the interest of creditors as well as those of other stakeholders. The theory should modify the Traditionalist views. It should be a theory that sees insolvency as collective loss sharing device which should allow for revision of original contractual entitlements of the parties in light of current facts whenever necessary. Such a theory should also visualize an insolvency law not excessively reliant on the courts. Besides, it should have regard to the existing international benchmarks on insolvency. This is because the insolvency benchmarks have the capacity of being tailored in a manner to reflect the existing realities in emerging economies.

A third limitation was a consequence of the scope of the study, which meant that all relevant and topical contextual issues could not be pursued in detail. In particular, it was established that efficient reforms need to go beyond legislative reform and be extended to implementation. Legal scholars have acknowledged that the difficulties in implementation are majorly caused by the lack of political will of the government,[27] which was partly explored in this study. A crucial area recommended for further research is the Kenyan judicial system and in particular the commercial courts and their role in ensuring efficiency in insolvency matters.

[27] OCED, Asian Insolvency Systems : Closing the Implementation Gap (2007, USA) available in http://www.oecd.org/about/publishing/corrigenda.htm accessed on 17th June 2014

It is submitted that it is crucial to establish the courts' capabilities and inadequacies as they are very vital in achieving the desired enabling environment, in so far as insolvency disputes are concerned. Much as the study proposed the establishment of a bankruptcy court as a potential aspect to consider as part of reform, the study did not explore the practicalities of this. Therefore, a recommended area of further research is to investigate the possibilities of creating a bankruptcy court in Kenya. A study of how other jurisdictions, such as Thailand, have done this will be very insightful.

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