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Flattening the insolvency curve: the adaptability and responsiveness of Kenya's corporate insolvency law in tackling pandemic and economic depression insolvencies.

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DECLARATION

I declare that this work has not been previously submitted and approved for the award of a degree by this or any other University. To the best of my knowledge and belief, the thesis contains no material previously published or written by another person except where due reference is made in the thesis itself.

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ABSTRACT

The covid-19 viral pandemic has negatively affected global economic growth prompting governments across the world to set up fiscal and monetary policy interventions to mitigate the adverse effects of the pandemic on their economies. Kenya, as a consequence, similarly set up economic and financial support measures to forestall economic depression. Unlike some major economies such as the U.K. which modified their insolvency regimes to forestall pandemic insolvencies, there were no such amendments made to the Kenya's Insolvency Act. This is despite the unpredictability presented with new more deadly covid-19 variants coming up, which has further dampened the pace of economic recovery.

Utilising doctrinal and comparative research methods, this thesis has examined whether Kenya's corporate insolvency law is adaptive and responsive in the event of an emergency and whether the objectives of the Insolvency Act, (Act No.18 of 2015) have been achieved following the ongoing pandemic. It has evaluated the adaptability and responsiveness of Kenya's insolvency law to support companies during an economic depression; the kind brought about by the current pandemic.

By referring to the vital elements of an efficient and effective insolvency framework outlined in the UNCITRAL Legislative Guide on Insolvency Law, it has been confirmed that Kenya's current insolvency law is inadaptable and unresponsive to the unprecedented challenges of the pandemic or other emergency, such as an economic depression. Therefore, by examining how the United Kingdom has responded to the emergency, it has been established that Kenya can borrow critical lessons. The thesis has laid out recommendations on emergency policy and legislative reforms that could make the Kenyan insolvency framework better suited to supporting businesses during emergencies.

There is limited research on insolvency law and legal reforms in Kenya touching on the pandemic and the thesis contributes to this literature on Kenyan corporate insolvency law by outlining the legal framework as it currently is and its limitations. The study contributes knowledge by analysing the theoretical framework underpinning insolvency law. It also outlines the international insolvency benchmarks by the IMF, World Bank and UNCITRAL and how these can influence Kenya. This literature on Kenyan corporate insolvency law is limited, and on this, the thesis is enlightening.

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LIST OF ABBREVIATIONS

CIGA	Corporate Insolvency and Governance Act
COMI	Centre of Main Interests
CVA	Company Voluntary Arrangement
CVL	Creditors' Voluntary Liquidation
Covid-19/Pandemic	Coronavirus Disease 2019
DIP	Debtor in Possession
FCA	Financial Conduct Authority
FSMA	Financial Services and Markets Act, 2000
IMF	International Monetary Fund
MVL	Members' Voluntary Liquidation
PIP	Practitioner in Possession
PRA	Prudential Regulatory Authority
WHO	World Health Organisation
UNCITRAL	United Nations Commission on International Trade Law

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The Public Order Act, Cap. 56 (Legal Notice No. 36:The Public Order (State Curfew) Order, 2020)

United Kingdom

Companies Act 2006, Chapter 46

Corporate Insolvency and Governance Act, 2020, Chapter 12

Deregulation Act, 2015

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International Instruments

UNCITRAL Legislative Guide on Insolvency Law

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CHAPTER ONE

1. CONTEXTUAL FRAMEWORK OF THE STUDY

1.1 INTRODUCTION

Corporate insolvency law addresses legal problems that arise when a corporation finds itself in insolvency due to financial distress.[1] Insolvency occurs when a company is unable to pay its debts as they fall due.[2] Insolvency law relieves such a debtor lacking the means to pay its creditors.[3] In Kenya, corporate insolvency is governed by the Companies Act, the Insolvency Act and the rules and regulations thereunder. Under the Companies Act[4] and the Insolvency Act,[5] a company is said to be insolvent if it is placed in liquidation when its assets are insufficient to pay for its debts, liabilities and the expenses of the liquidation; or if the company is under administration whereby an insolvency practitioner manages the affairs of the insolvent company.[6] Although Kenya's insolvency system has traditionally favoured creditors' interests[7] as opposed to the preservation of the corporation, it is argued that with the enactment of the Insolvency Act (Act No.18 of 2015), a rescue culture is now embedded in Kenya's framework which closely resembles the United Kingdom's Insolvency Act, 1986. The 1986 Act has been heralded as epitomising corporate rescue culture, which seeks to preserve viable businesses undergoing financial distress.[8]

Utilising the elements of an efficient and effective insolvency framework outlined in the UNCITRAL Legislative Guide on Insolvency Law, this thesis has examined whether Kenya's corporate insolvency law is adaptive and responsive in the event of an emergency and whether the objectives of the Insolvency Act, have been achieved following the ongoing pandemic. It has evaluated the adequacy of Kenya's insolvency law to support companies during economic depressions, the kind brought about by the current pandemic.

With a view to drawing lessons, the thesis has also examined how the United Kingdom has responded to the emergency to establish whether Kenya can borrow critical lessons. Such a comparative perspective enlarges the solution set for legal problems and also helps evaluate the domestic approach, Kenya's in this instance, against an international benchmark or best

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[1] Eidenmüller H, 'Comparative Corporate Insolvency Law' in J N. Gordon and W Ringe (Eds) *The Oxford Handbook of Corporate Law and Governance,* Oxford University Press, May 2018, 1237.
[2] Black's Law Dictionary, 9th Edition, 867.
[3] Black's Law Dictionary, 9th Edition, 867.
[4] Section 218 (3), *Companies Act*, (Act No. 17 of 2015).
[5] Section 384, *Insolvency Act,* (Act No.18 of 2015).
[6] Section 520, *Insolvency Act,* (Act No.18 of 2015).
[7] Too F C, 'A Comparative Analysis of Corporate Insolvency Laws: Which is the best option for Kenya?' Published PhD Thesis, Nottingham Trent University, Nottingham, 2015, 63. http://irep.ntu.ac.uk/id/eprint/27951/1/Thesis%20post%20viva%20FINAL.pdf on 14th April 2021.
[8] *Powdrill v. Watson* (1995), 2 AC 394, The United Kingdom House of Lords.

practice.[9] This thesis has focussed on the United Kingdom (U.K.). The U.K. is classified as leading the search for optimal insolvency and restructuring regimes for corporate entities in financial distress.[10] In fact, after the 2007-2008 economic crisis, the U.K. was the first major country to enact a modern bank resolution and recovery regime, the Banking Act of 2009.[11] Furthermore, the Kenyan Insolvency Act (Act No.18 of 2015) is modelled after the U.K.'s Insolvency Act, 1986, and both Kenya and the U.K. are common law jurisdictions.

Lastly, the thesis has outlined recommendations on emergency policy and legislative reforms that may make the Kenyan insolvency framework better suited to supporting businesses during economic depressions, such as those brought on by pandemics and financial crises.

1.2 BACKGROUND OF THE PROBLEM

The covid-19 pandemic has been described as the worst economic downturn since the great depression and much worse than the Global Financial Crisis.[12] The Global Financial Crisis was caused by a fraudulent mis-selling of domestic mortgages in the USA to risky borrowers who could not repay them. Once the borrowers began to default, a market liquidity crisis hit, and banks refused to lend to one another.[13] As such, it was a problem that developed within the economy and, therefore, endogenous, unlike the pandemic, which is driven by a health crisis and attributed to exogenous factors that directly influence the global economy.[14] A pandemic is a widespread outbreak of disease[15] or an epidemic that has spread over several countries or continents and affects many people.[16]

Whereas human loss following the pandemic has been incredibly high, the economic loss brought about by the pandemic has been equally severe. In Kenya, the first covid-19 case was confirmed on 12th March 2020.[17] There have been 323,183 cases and 5,545 dead at the time of

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[9] Eidenmüller H, 'Comparative Corporate Insolvency Law', 1238.
[10] Eidenmüller H, 'Comparative Corporate Insolvency Law', 1238.
[11] Brierley P, *The UK Special Resolution Regime for Failing Banks in an International Context*, Bank of England Financial Stability Paper No. 5, July 2009 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1447913 on 21st August 2021.
[12] Gopinath G, *The Great Lockdown: Worst Economic Downturn Since the Great Depression*, IMF Blog, 14 April 2020 https://blogs.imf.org/2020/04/14/the-great-lockdown-worst-economic-downturn-since-the-great-depression/ on 13th February 2021.
[13] Hudson A., *The Law of Finance*, 2nd ed, Sweet and Maxwell, 2013, 1313.
[14] Arif M, Naeem M, Hasan M, Alawi S and Hesary F, 'Pandemic crisis versus global financial crisis: Are Islamic stocks a safe-haven for G7 markets?', *Economic Research-Ekonomska Istraživanja*, 2021, 3 https://www.tandfonline.com/doi/full/10.1080/1331677X.2021.1910532 on 7th March 2022.
[15] Merriam-Webster's Dictionary and Thesaurus, 2007, 583.
[16] CDC Web Archive, https://www.cdc.gov/csels/dsepd/ss1978/lesson1/section11.html On 4th March 2022.
[17] - https://www.health.go.ke/first-case-of-coronavirus-disease-confirmed-in-kenya/ on 13th June 2021

writing this Thesis.[18] Worldwide, as of 14th March 2022, 456,797,217 confirmed cases of COVID-19, including 6,043,094 deaths, were reported to the WHO.[19]

According to World Bank forecasts, the global economy was expected to shrink by 5.2% in 2020, representing the deepest recession since World War II. Sub-Saharan African economic activity was expected to contract by 2.8%, the deepest contraction on record.[20] In Kenya, as with other jurisdictions, covid-19 led to the introduction of governmental measures[21] to slow the rate of infections by limiting the movement of people and goods through curfews[22] and lockdowns and the mandatory closure of non-essential businesses.[23] This reduced employment by 11.8% between April and June 2020, and real income decreased by 7.9% and 6.8% for rural and urban households, respectively. It also led to drops in tourism and domestic investment and an increased government deficit of Kshs. 25.1 billion.[24]

Kenyan businesses have been affected by the pandemic. In 2020 and 2021, the Financial Sector Deepening Trust (FSD) Kenya, together with the Kenya National Bureau of Statistics (KNBS) and the Central Bank of Kenya (CBK), conducted two surveys to better understand the impact of the COVID-19 pandemic on Micro and Small Enterprises (MSEs).[25] 20% of MSEs closed during the pandemic. MSEs account for 98% of Kenyan businesses. The sector experienced a 41% drop in employment levels.

The World Bank also analysed the impact of the pandemic on a wide range of Kenyan businesses.[26] The results indicated that 93% of establishments experienced sales decline compared to the same period over the previous year, and that close to 65% of businesses experienced a decrease in demand, cash flow, and available finance, which mirrored the findings in the CBK survey. The World Bank highlighted that this reduction in business and decline in profitability could continue, leading to further business failure and financial distress.

[18] - https://www.health.go.ke/ on 14th March 2022

[19] - https://covid19.who.int/ on 14th March 2022

[20] World Bank, *COVID-19 to Plunge Global Economy into Worst Recession since World War 2*, Press Release No: 2020/209/EFI, - https://www.worldbank.org/en/news/press-release/2020/06/08/covid-19-to-plunge-global-economy-into-worst-recession-since-world-war-ii on 12th April 2021

[21] *The Public Health* (COVID-19 Restriction of Movement of Persons and Related Measures) *Rules, 2020*, (Legal Notice Number 50 of 2020)

[22] *The Public Order Act, Cap. 56* (Legal Notice No. 36:The Public Order (State Curfew) Order, 2020)

[23] International Monetary Fund, *Tracker on Policy Responses to Covid-19, Kenya*, 2021, - https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19 on 3rd August 2021.

[24] Nechifor V, Ferrari E, Kihiu E, Laichena J, Omanyo D, Musamali R and Kiriga B, 'COVID-19 impacts and short-term economic recovery in Kenya', Joint Research Centre, Publications Office of the European Union, 2020, 2, - https://www.researchgate.net/publication/343254871_COVID-19_impacts_and_short-term_economic_recovery_in_Kenya , on 3rd August 2021.

[25] Central Bank of Kenya, *FinAccess MSE COVID-19 Tracker Survey Report*, 2021 https://www.centralbank.go.ke/wp-content/uploads/2021/06/MSEsCOVID-19Tracker.pdf on 18th August 2021.

[26] World Bank, *Socioeconomic Impacts of COVID-19 in Kenya on Firms : Rapid Response Phone Survey, Round 1*, 2021, https://openknowledge.worldbank.org/handle/10986/35172 on 18th August 2021

Corporate insolvency laws impact entrepreneurship and economic growth,[27] and it has been argued that improving the efficiency of insolvency procedures will be crucial for the speedy and effective recovery of businesses affected by the pandemic.[28] An efficient framework ought to have the capacity to address the menaces brought about by not only a pandemic but also economic downturns. This is to safeguard and adequately preserve viable businesses as they overcome temporary financial difficulties that may lead to insolvency or liquidation.

It is crucial to understand the nature and causes of corporate failure so that insolvency law can be designed in a manner that, so far as possible, does not contribute to undesirable failures or prove deficient in processing failed companies.[29] In this regard, an efficient corporate insolvency framework should provide for companies' efficient and equitable administration and maintain a fair balance between the interests of the insolvent debtor and its creditors.[30] It ought to minimise the destruction of value generated when insolvency proceedings are initiated and provide for the efficient allocation of a company's assets. [31] If the insolvent debtor's financial position is redeemable, the framework ought to enable it to operate as a going concern and ultimately meet its financial obligations to the creditors.[32]

The Cork Committee, 1982, identified the aims of an excellent modern insolvency framework to include being able to identify and treat imminent insolvency at an early rather than a late stage.[33] The framework ought to provide a means for preserving viable commercial enterprises.[34] This preservation aims to facilitate reorganisation to maximise the eventual return to creditors, thereby providing a better return than if the debtor was liquidated, and it preserves jobs for employees and trade for suppliers.[35]

From the onset, it should be noted that Kenya's framework does not have a provision for an automatic moratorium unless the company in distress resorts to formal insolvency procedures. The Insolvency Act provides for moratoria upon application for administration,[36] during the administration process[37] or when directors of a company apply for a moratorium under the supervision of an authorised insolvency practitioner.[38] The moratorium subsists for thirty days,

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[27] Eidenmüller H, 'Comparative Corporate Insolvency Law', 1238

[28] Grégory C, Zsolt D, Maria D and Guntram W, 'The Great COVID-19 Divergence: Managing a Sustainable and Equitable Recovery in the European Union', Bruegel (Issue 11/21), 2021 1, https://www.jstor.org/stable/resrep32249 on 24th August 2021.

[29] Finch V, *Corporate Insolvency Law; Principles and Perspectives*, 3rd ed, Cambridge University Press, 2018, 117

[30] Section 3 (1)(a), *Insolvency Act*, (Act No.18 of 2015).

[31] Section 3(1)(d), *Insolvency Act*, (Act No.18 of 2015).

[32] Section 3(1)(c), *Insolvency Act*, (Act No.18 of 2015).

[33] Tolmie F, *Corporate and Personal Insolvency Law*, 2nd ed, Cavendish Publishing Limited, London, United Kingdom, 2003, 4

[34] Tolmie F, *Corporate and Personal Insolvency Law*, 5

[35] Part 1B (Paragraph 4) and Part 2 IV (Paragraph 3), *United Nations Commission on International Trade Law Legislative Guide on Insolvency Law*, 2005, 10 and 209

[36] Section 559, *Insolvency Act*, (Act No.18 of 2015).

[37] Section 561, *Insolvency Act*, (Act No.18 of 2015).

[38] Section 643 and 644, *Insolvency Act*, (Act No.18 of 2015).

with room for an extension of thirty more days upon application to court.[39] Initially, such moratoria were available to directors proposing a voluntary arrangement but now apply to companies under financial distress.[40]

Financial distress is a circumstance in which a corporation cannot fulfil its debt obligations to its creditors, which may lead to either restructuring or liquidation.[41] Distressed companies are those that either encounter financial crises that cannot be resolved without recasting the company's operations or structures[42] or those that are revealed to be in a state of cash flow that is insufficient to cover current obligations such that drastic action is required.[43]

The Covid-19 pandemic is associated with two contagions, one related to the virus and its effect on the population, and the other its impact on the economy. This Thesis has dealt with the economic slowdown that the pandemic has triggered. Arguably, the judicial system may become overwhelmed and be unable to manage an increase in insolvency cases. This will limit the effective application of insolvency laws to help viable companies facing financial difficulties owing to the pandemic.[44] Some authors have even estimated the precise number of judges needed to handle the wave of insolvency cases in some countries, such as the United States.[45] Should the insolvency curve arising as a consequence of the pandemic fail to be flattened, the judiciary may be overwhelmed by an influx of insolvency petitions, thereby limiting the efficacy of our corporate insolvency laws.

Is Kenya's current corporate insolvency legal framework adequate, or as we look for vaccines for covid-19, do we also need to find a vaccine for our corporate insolvency laws? Are there lessons to be learned from the U.K., which has successfully managed and limited occurrences of corporate insolvency?

1.3 STATEMENT OF THE PROBLEM

An effective corporate insolvency framework is fundamental in dealing with business failures which inevitably occur in any economy. This is because such a law should amongst other things

[39] Section 669, *Insolvency Act*, (Act No.18 of 2015).

[40] Section 643 (1) *Insolvency Act*, (Act No.18 of 2015).which was deleted by Section 18, *Business Laws (Amendment) (No. 2) Act*, (Act No. 1 of 2021).

[41] Isayas Y, 'Financial distress and its determinants: Evidence from insurance companies in Ethiopia', *Cogent Business and Management*, 2021, 2 https://doi.org/10.1080/23311975.2021.1951110 on 3rd August 2021

[42] Finch V, *Corporate Insolvency Law; Principles and Perspectives*, 118

[43] Finch V, *Corporate Insolvency Law; Principles and Perspectives*, 119

[44] Organisation for Economic Co-operation and Development, *Insolvency and debt overhang following the COVID-19 outbreak: assessment of risks and policy responses*, 2020 - https://www.oecd.org/coronavirus/policy-responses/insolvency-and-debt-overhang-following-the-covid-19-outbreak-assessment-of-risks-and-policy-responses-7806f078/#section-d1e35 on 18th August 2021

[45] Iverson B, Ellias J. A., Roe M. J., 'Estimating the Need for Additional Bankruptcy Judges in Light of the COVID-19 Pandemic' *Harvard Business Law Review, Vol. 11, 2020* www.ssrn.com/abstract=3624529 on 12th April 2021

provide for companies' efficient and equitable administration and maintain a fair balance between the interests of the insolvent debtor and its creditors.[46] In the event that the insolvent debtor's financial position is redeemable, the framework should enable these businesses to run as going concerns so they may eventually meet their financial obligations to the creditors.[47]

The framework ought to provide a means for preserving viable commercial enterprises.[48] This preservation aims to facilitate reorganisation to maximise the eventual return to creditors, thereby providing a better return than if the debtor was liquidated, and preserves jobs for employees and trade for suppliers.[49] The impact of the insolvency of a company is felt beyond the company[50] as it can affect the interests of creditors, suppliers, customers, the government and employees.[51] An efficient insolvency framework should be responsive to such realities. In fact, experience has exhibited the extent to which the absence of orderly and effective insolvency procedures can worsen economic and financial crises[52]. This reality has made Insolvency frameworks to become a subject of reform activities around the world.

The advent of the Covid 19 pandemic triggered several jurisdictions to swiftly enact legislation and policy decisions to mitigate the pandemic's impact on their economies, particularly, rescue packages for SMEs. Little was done in Kenya. Kenya’s current insolvency law has proved inadequate in responding to the unprecedented challenges of the covid-19 pandemic.[53]

This study evaluates the responsiveness of Kenya’s corporate insolvency framework and draws lessons from the UK toward a more adaptable and responsive framework in the face of future economic shocks. The central argument is that our current legislative framework is inefficient and inadaptable in supporting businesses during an economic depression, the kind brought about by a pandemic or recession. The study investigates the problem with a view to suggest recommendations on emergency policy and legislative reforms that may make the Kenyan insolvency framework better suited to supporting businesses during economic depressions,

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[46] Section 3 (1)(a), *Insolvency Act*, (Act No.18 of 2015).
[47] Section 3(1)(c), *Insolvency Act*, (Act No.18 of 2015).
[48] Tolmie F, *Corporate and Personal Insolvency Law*, 5.
[49] Part 1 (paragraph 4) and Part IV (paragraph 3) *United Nations Commission on International Trade Law Legislative Guide on Insolvency Law*, 10 and 209
[50] Aghion P, Hart O, and Moore J, ‘The Economics of Bankruptcy Reform’, *Journal of Law, Economics and Organization*, Vol. 8, No. 3, 1992, Oxford University Press, 523-546. https://www.jstor.org/stable/764866 on 25th August 2021
[51] Azmi, R and Razak, ‘The Theories Underpinning Corporate Insolvency Law: An Analysis’, in *Business Practices In Malaysia*, McGraw-Hill, Kuala Lumpur, Malaysia, 2012, 5 https://www.researchgate.net/publication/312091906_THE_THEORIES_UNDERPINNING_CORPORATE_INSOLVENCY_LAW_AN_ANALYSIS on 18th July 2022
[52] IMF 1999, *Orderly & Effective Insolvency Procedures*, https://www.imf.org/external/pubs/ft/orderly/ on 26th July 2022
[53] Routledge J, ‘Rethinking insolvency law amid the COVID-19 pandemic’, *Pacific Accounting Review*, 2021, 1, - https://www.emerald.com/insight/0114-0582.htm on 12th April 2021

considering that the pandemic is likely to subsist[54] and, further, there is a likelihood of future pandemics[55] and economic depressions.

1.4 RESEARCH OBJECTIVES

The overarching objective of this research is to assess the effectiveness of Kenya's existing corporate insolvency law. The specific objectives are as follows:

i) To evaluate Kenya's corporate insolvency law based on the elements of an efficient insolvency framework identified in the UNCITRAL Legislative Guide in order to determine the adaptability and responsiveness of Kenya's law and whether the objects of the laws can be met in the event of a pandemic or economic depression.
ii) To analyse legislative and policy measures undertaken by the U.K. to curb corporate insolvency risks associated with the pandemic and determine whether there are lessons Kenya can learn from this jurisdiction.
iii) To make recommendations to help make the Kenyan insolvency framework better suited to supporting businesses during a pandemic or economic recession.

1.5 RESEARCH QUESTIONS

With the covid-19 pandemic in mind, it has been argued[56] that existing corporate insolvency framework may be inadequate to deal with companies facing financial distress due to pandemics and economic recesses. The questions that this Thesis has addressed are:

i) Based on the elements of an efficient insolvency framework identified in the UNCITRAL Legislative Guide, what shortcomings can be identified in Kenya's corporate insolvency legal framework in adapting to and responding to a pandemic or economic recession?
ii) Are there lessons to be learned from the U.K., which has implemented insolvency policy and legislation to curb the risk of exposure driven by the covid-19 pandemic?
iii) What measures can be undertaken or adopted to help make the Kenyan insolvency framework better suited to supporting viable businesses during a pandemic or economic recession?

[54] Congressional Research Service, *Global Economic Effects of COVID-19*, July 9, 2021, 6 - https://crsreports.congress.gov/product/pdf/R/R46270/75 on 1st August 2021
[55] Hongpeng J and Min W, 'Sustained research fund and dedicated research center to prepare for the next pandemic', *Precision Clinical Medicine*, Volume 3, Issue 2, Oxford University Press, 2020, 96, https://doi.org/10.1093/pcmedi/pbaa012 On 3rd August 2021
[56] Routledge J, 'Rethinking insolvency law amid the COVID-19 Pandemic', 1

1.6 HYPOTHESIS

Kenya's existing corporate insolvency framework cannot adapt and adequately respond to assist viable businesses facing financial distress due to pandemics and economic recesses.

1.7 RATIONALE AND JUSTIFICATION FOR THE STUDY PROBLEM

The Covid 19 pandemic has made it imperative to reconsider the adaptability and responsiveness of corporate insolvency law in light of the increase in companies facing financial distress. This is partly because the existing insolvency law was not designed in the context of the unprecedented challenges of the covid-19 pandemic.[57] This raises concerns about its suitability to assist in rehabilitating distressed companies, which is crucial for economic recovery. According to scientific research on the socio-economic impact of the Covid 19 pandemic, many nations are still grappling with finding innovative ways to mitigate the pandemic's effects and revive their economies.[58] This research is non-existent in the Kenyan jurisdiction, a gap that this research seeks to fill, albeit in a small way.

The contribution of this research is of great public interest. First, it is instrumental to policymakers as they draft and formulate Kenyan laws to ensure that Kenya is not left behind as the rest of the world manages the economic fallout due to the pandemic and future economic stresses leading to insolvency. Secondly, it is helpful for viable corporations considering the best approaches to deal with corporate insolvency due to financial distress. For investors, the study will strive to develop an optimal debtor and creditor insolvency regime in light of global best practices.

Insolvency laws were not designed with the pandemic in mind and that there is limited research on insolvency law and legal reforms in Kenya touching on the pandemic. As such, the thesis contributes to this literature on Kenyan corporate insolvency law by outlining the legal framework as it currently is and its limitations. The study contributes to this knowledge by analysing the theoretical framework underpinning insolvency law and its limitations. It also outlines the international insolvency benchmarks by the IMF, World Bank and UNCITRAL and how these can influence Kenya. This literature on Kenyan corporate insolvency law is limited, and on this, the thesis is enlightening. To learn lessons, the thesis also outlines the UK insolvency framework, the changes that were made immediately after the onset of the pandemic and how these were brought about.

[57] Routledge J, 'Rethinking insolvency law amid the COVID-19 Pandemic', 5
[58] Almeida F, 'Innovative response initiatives in the European Union to mitigate the effects of COVID-19', *Journal of Enabling Technologies*, Emerald Publishing Limited, 2020, 2 - https://doi.org/10.1108/JET-09-2020-0039 on 13th April 2021

1.8 THEORETICAL FRAMEWORK

There are broadly two schools of thought that try to explain the aim of insolvency law. These are proceduralists who focus on creditors' interests during corporate insolvency,[59] and the traditionalists who focus on not only creditors' interests but also other stakeholders' interests.[60] Proceduralists advocate for the maximisation of the economic value of the debtor for the creditors' economic recovery, whilst traditionalists view insolvency as a procedure to address the social problems caused by business failure leading to insolvency.[61]

Jackson and Baird, who propounded the proceduralist theories of creditor wealth maximisation and creditor's bargain, posit that the main objective of insolvency law is to maximise the creditors' collective return through collective proceedings in cases where the rights to the debtor's assets are spread among more than one creditor.[62] The theories do not recognize reorganization of a financially distressed company as a legitimate objective of insolvency law unless to the extent that it is intended to maximize returns to the creditors.[63]

According to proceduralists, insolvency exists for purposes of debt collection and is directed toward reducing the costs associated with diverse ownership interests of the creditors; creditors agree to a collective procedure to enforce their claims rather than by individual action.[64] Depending on the type of creditors intending to agree, this may involve them deciding that they would all receive an equal share in any subsequent liquidation process, or it may include some bargaining that would allow pre-existing proprietary rights to be respected. This bargaining activity establishes creditor interests as being paramount.

However, the impact of a company's insolvency is felt beyond the company as it can affect the interests of creditors, suppliers, customers, employees, the government and the community and environment in which the business is situated.

Unlike proceduralist theorists, traditionalists posit that upon insolvency, those with high-priority claims could give way to others, such as the community, in sharing the value of the insolvent debtor.[65] Singer contends that property rights are often shared and not vested in an

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[59] Jackson T. H., 'Bankruptcy, Non-Bankruptcy Entitlements and Creditors' Bargain', *Yale Law Journal*, 1982, 857 https://heinonline.org/HOL/P?h=hein.journals/ylr91&i=879 on 18th July 2022

[60] Azmi, R and Razak, 'The Theories Underpinning Corporate Insolvency Law: An Analysis', 8

[61] Tribe J, 'Deploying Communitarianism Bankruptcy Theory to Rescue Insolvent Charities and maintain Charitable Purposes', in J Picton & J Sigafoos (eds), Debates in Charity Law pp 81-102 https://livrepository.liverpool.ac.uk/3115302/ on 18th July 2022

[62] Baird, D. G., & Jackson, T. H. 'Corporate Reorganizations and the Treatment of Diverse Ownership Interests: Comment on Adequate Protection of Secured Creditors in Bankruptcy', *University of Chicago Law Review*, 1984, 105. https://heinonline.org/HOL/P?h=hein.journals/uclr51&i=111 on 19th July 2022

[63] Azmi, R and Razak, 'The Theories Underpinning Corporate Insolvency Law: An Analysis', 7

[64] Jackson T. H., 'Bankruptcy, Non-Bankruptcy Entitlements and Creditors' Bargain', 867

[65] Finch V, *Corporate Insolvency Law; Principles and Perspectives*, 36.

individual, especially since there is a mutual dependence between companies and the communities in which they are situated.[66] this community includes management, shareholders, workers and their families, suppliers, and the government.[67] Singer argues that this is because property law has limits on an owner's rights to do as they wish with their property with a view of protecting the legitimate interests of these other parties.[68] As such, traditionalists give prominence to the view of bankruptcy as a procedure meant to address an array of social problems caused by business failure.[69]

Consequently, the theoretical underpinning of this thesis is based on two theories, the communitarian theory and the explicit values approach, which are traditionalist theories. The thesis utilises these theories intending to highlight the rights of parties affected by insolvency to assist the rehabilitation of viable distressed companies to promote their economic recovery during pandemics and economic recesses for the benefit of debtors, creditors and other stakeholders.

1.8.1 Communitarian Theory

The Communitarian theory offers an alternative to the creditors' bargain model which limits choices to economic outcomes only by embracing interests that go well beyond simple wealth maximisation.[70] Gross, who promoted this theory, posits that insolvency law should consider the interests of not only creditors but also debtors, employees, the environment, suppliers, and the local community. According to her, these community interests must be taken into account when designing corporate and personal bankruptcy systems.[71] Where an insolvency law contains provisions for the rescue of an insolvent company, its creditors can still maximise their returns even when the law takes on board the interest of other parties, such as the employees and the public.[72] Gross is emphatic that, as such, creditor and shareholder interests must still be considered in the insolvency process since the community interests do not trump other interests.[73] This more expansive economic model is all-inclusive since multiple stakeholders are considered when framing an insolvency law.

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66 Singer, J, 'The Reliance Interest in Property', *Stanford Law Review*, 1988, 622, https://www.jstor.org/stable/1228814 on 10th August 2022.

67 Singer, J, 'The Reliance Interest in Property', *Stanford Law Review*, 640

68 Singer, J, 'The Reliance Interest in Property', *Stanford Law Review*, 642 and 664

69 Too F C, 'A Comparative Analysis of Corporate Insolvency Laws: Which is the best option for Kenya?' 38

70 Judicial Co-Operation supporting Economic Recovery in Europe (JCOERE) Consortium. (2019) Report 1, *Identifying substantive and procedural rules in preventive restructuring frameworks including the Preventive Restructuring Directive which may be incompatible with judicial co-operation obligations*, JCOERE Project, University College Cork, 2019, 45 https://www.ucc.ie/en/jcoere/research/report1 on 26th July 2022.

71 Gross K, 'Taking Community Interests into Account in Bankruptcy', *Washington University Law Review*, 1994, 1031, https://openscholarship.wustl.edu/law_lawreview/vol72/iss3/20 on 18th August 2021.

72 Azmi, R and Razak, 'The Theories Underpinning Corporate Insolvency Law: An Analysis', 12

73 Gross K, 'Taking Community Interests into Account in Bankruptcy', 1033.

Accordingly, the Communitarian theory advocates for consideration of the interests of not only creditors and the debtor but also those affected by the insolvency. Unlike proceduralist theories, which solely focus on maximising the collective return to creditors,[74] the communitarian theory considers not only the interests of creditors and shareholders but also the welfare of the community where the debtor is situated.[75]

Criticizing the communitarian theory, Finch argues that the problem is not only that community interests are hard to identify but also because there are so many interests worthy of protection in insolvency and that the selection of interests worthy of legal safeguard will likely give rise to a potential dispute.[76] The theory has been criticised because of the difficulty in quantifying community interests, and it has been argued that community welfare is not an appropriate concern for insolvency. Proceduralist theorists believe that insolvency policy should not concern itself with solving social ills since fashioning remedies for all the damage brought by a business' collapse is arduous, beyond the competence of a bankruptcy court, and it is challenging to measure the wide-ranging effects of corporate failure.[77] Finch opposes the theory since it clouds insolvency law by departing from creditor rights enforcement and taking on issues dealt with better by allocating pre-insolvency rights.[78] For instance, to protect employees' rights on employment security, fair dismissal and compensation for redundancy should not be the purview of insolvency law but employment law.

Insolvency should, nonetheless, be treated as a problem of business failure. Appropriate value should therefore be placed on assisting viable firms to stay in business for the benefit of not only creditors but also of directors, shareholders, employees, suppliers and the stakeholders of the debtor, whose livelihoods depend on the business and the community.[79]

The theory is ascribed to because it favours the debtor's survival if it is viable, as well as systematic winding up in the event reorganisation is not feasible.[80] Accordingly, in an emergency situation such as a pandemic or recession, the interests of the different stakeholders need to be considered when formulating a restructuring plan in order to preserve a financially distressed company. This is in line with the Cork Committee Report’s statement of aims, which stressed that insolvency affects society and that insolvency frameworks should provide a means of preserving viable debtors capable of contributing to the economic life of a country.[81]

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[74] Finch V, ‘The Measures of Insolvency Law’, *Oxford Journal of Legal Studies* , 1997, 231, https://www.jstor.org/stable/764590 on 25th July 2021
[75] Gross K, ‘Taking Community Interests into Account in Bankruptcy’, 1042.
[76] Finch V, *Corporate Insolvency Law; Principles and Perspectives*, 37.
[77] Azmi, R and Razak, ‘The Theories Underpinning Corporate Insolvency Law: An Analysis’, 7
[78] Finch V, *Corporate Insolvency Law; Principles and Perspectives*, 36
[79] Finch V, ‘The Measures of Insolvency Law’, 229
[80] Finch V, *Corporate Insolvency Law; Principles and Perspectives*, 36
[81] Finch V, *Corporate Insolvency Law; Principles and Perspectives*, 36

1.8.2 Explicit values theory

This approach toward insolvency is promoted by Finch, who argues that existing insolvency theories fail to provide a complete view of the appropriate measures of insolvency law.[82] When propounding this theory, Finch asserted that one needs to look at where the power requiring legitimation of corporate managerial power is, and secondly, the basis of requiring legitimation.[83] She posits that this power is usually taken out of the hands of management during insolvency processes and placed in the hands of other parties such as creditors, insolvency practitioners and courts. These processes affect public interests since insolvency decisions concern the deaths of corporations, and in turn, these decisions affect livelihoods and communities. Such processes also affect private interests when pre-insolvency property rights and securities are frozen, and creditors are restrained from enforcing their legal rights.

Finch argues that the insolvency process is broad, based on communitarian approaches and also concerned with protecting creditors' interests.[84] Her values argument is based on the premise that certain values are broadly accepted, and insolvency laws ought to be designed to serve those values. Finch postulates that the legitimacy of the principles and procedures of corporate insolvency law can be verified by referring to four values: efficiency, expertise, accountability and fairness. Firstly, efficiency looks to the securing of mandated ends at the lowest cost; secondly, expertise refers to the proper exercise of judgment by specialists; accountability, on the other hand, looks to the control of insolvency participants by democratic bodies or courts or through the openness of processes and their amenability to representations; and lastly, fairness considers issues of substantive justice and distribution.[85]

In his critique of 'Corporate Insolvency Law-Principles and Perspectives' by Vanessa Finch, Mokal argues that even though Finch stated that the efficiency yardstick considers varied notions of efficiency, she does not explain why she picks only one of them and rejects the rest.[86] He notes that Finch also failed to outline precisely the desired costs to be avoided when she stated that technical efficiency deals with "achieving the objectives being pursued by Parliament" with the least use of resources and costs and with little waste of effort. It was also not explained how this effort may be wasted.[87] Consequently, Mokal argued that if such concerns were ignored, the explicit values approach would not only be incomplete, but also internally inconsistent.

[82] Finch V, 'The Measures of Insolvency Law', 242
[83] Finch V, *Corporate Insolvency Law; Principles and Perspectives*, 42
[84] Finch V, *Corporate Insolvency Law; Principles and Perspectives*, 43
[85] Finch V, 'The Measures of Insolvency Law', 227-251.
[86] Mokal R, 'On Fairness and Efficiency', *The Modern Law Review*, 2003, 454, https://www.jstor.org/stable/1097567 on 26th August 2021
[87] Mokal R, 'On Fairness and Efficiency', 458

Despite these shortcomings, this theory highlights an inclusive approach to insolvency and helps highlight the considerations necessary to transform a framework when the pandemic brings about economic distress.

The traditionalist theories are most suited for purposes of evaluating the responsiveness and adaptability of Kenya's corporate insolvency framework because in the event of insolvency, the law considers not only the interests of creditors, but also the debtor's and those of the debtor's members. This is highlighted in Chapter two of the thesis. Furthermore, the UNCITRAL Legislative Guide on Insolvency Law, which provides an outline of the diverse key elements that guide lawmakers and policymakers when designing an insolvency law, has been employed to determine whether Kenya's law is responsive and capable of adapting in the event of an emergency. The Guide shows how the different stakeholders to the debtor are involved when formulating and implementing a restructuring plan in order to preserve a financially distressed company. This is also highlighted in Chapter two.

1.9 RESEARCH METHODOLOGY

The thesis has principally employed doctrinal research methodology, which makes it possible to identify the principles, standards and procedures of law. It entails a critical analysis of primary and secondary sources of law. The primary sources of law that will be considered are legislation, case law, policy and governmental reports, which will save time by eliminating the need for data collection and analysis and utilising funds for these purposes. Incorporating case law as a way of identifying legal principles based on previous judicial decisions serves the dual function of determining legal outcomes with greater consistency and clarifying the law's position on certain issues.[88]

The secondary sources, on the other hand, will include textbooks, journal articles and institutional reports from the Central Bank of Kenya, the International Monetary Fund and the World Bank, which provide a wealth of knowledge not only from Kenya but from other jurisdictions which also provides a benchmark on which to evaluate our insolvency law. The doctrinal approach is preferred because the information needed is readily available as both primary and secondary sources of law.

It would have been enlightening to interview proprietors of SMEs who were affected in diverse ways by the pandemic, but due to time constraints, it was impossible to do so for the purposes of the thesis. Luckily, however, there is ample writing on the empirical situation, which has been highlighted in this chapter. Furthermore, the thesis relates to an analysis of Kenya's corporate insolvency legal framework to offer suggestions on how the framework might be made more adaptable and responsive in a pandemic or economic recession.

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[88] Fox-Williams J, 'Doctrinal Legal Research: What does it entail and is it relevant to current law?' *SSRN Electronic Journal*, 2016, 2 http://dx.doi.org/10.2139/ssrn.3309266 on 18th July 2022

Nonetheless, these sources will also help in analysing in detail and seeing the different views taken on the matter and how the United Kingdom, from which our insolvency law is borrowed, has responded to the emergency to establish whether Kenya can borrow critical lessons. Specifically, the thesis has highlighted the communitarian and explicit values theories and compare the objectives of insolvency laws in Kenya and the United Kingdom and outlines how the pandemic has affected the changes in policy in the UK.

1.10 LITERATURE REVIEW

Whereas there is plentiful literature on Kenya's corporate insolvency regime, there is a lack of literature on the impact of the pandemic on corporate insolvency in Kenya and Africa generally. Internationally, these works are plentiful, focusing on the effects of the pandemic and the several changes made to insolvency regimes in various jurisdictions.

The UK's insolvency framework has been modified severally in response to shocks prompted by the July 1990 to March 1991 economic recession, the 2007-2008 global financial crisis and the covid-19 pandemic. However, the pandemic is the first regulation responsiveness test that the Kenyan insolvency regime is undergoing.

Routledge J argues that due to the COVID-19 pandemic, it is imperative to consider the efficiency of insolvency law due to the increase in companies facing financial distress. [89] He hypothesises that existing corporate insolvency law was not designed in the context of the unprecedented challenges of the covid-19 pandemic and may not provide the framework needed to assist the rehabilitation of distressed companies for economic recovery. He advocates for the rescue and rehabilitation of insolvent debtors through a pandemic insolvency policy that is both value-based and debtor-friendly. In this context, insolvency law should refocus on debtors and their rehabilitation instead of excessively focusing on the creditor's interests.

Similarly, Didea and Ilie emphasise that insolvency will develop into a "real fact" in everyday life, whereby legal reform enabling a second chance for affected businesses will be a vital necessity of the economic and social revitalisation and are of the view that there ought to be reform of insolvency law to facilitate a "rescue culture" or as a minimum the temporary modification of specific rules, by measures of "relaxation" and a suspension of specific requirements incumbent on the debtor experiencing financial difficulty.[90]

There was a decline in business insolvency filings in economies that introduced emergency measures designed to make it challenging to push a debtor into insolvency due to the pandemic. However, the likelihood of a rise in insolvency filings due to the evidence of previous crises

[89] Routledge J, 'Rethinking insolvency law amid the COVID-19 Pandemic', 1

[90] Didea I, and Ilie D, 'The State of Emergency and the Economic Repercussions. A New "Avalanche" of Insolvencies', *Journal of Law and Administrative Sciences* No.13/2020 http://jolas.ro/wp-content/uploads/2014/09/jolas-no.13.pdf on 16th April 2021

together with underlying factors such as lower sales, higher unemployment, firm liquidity challenges, and heightened corporate vulnerabilities, exemplifies the need to strengthen insolvency frameworks.[91]

Casey[92] explores why corporate insolvency law exists and why there are special rules that apply only in financial distress and posits that the Creditors' Bargain Theory identifies two core purposes of insolvency law: recreating a hypothetical ex-ante bargain and respecting creditors' non-insolvency entitlements and argues that the sole purpose of corporate insolvency law is to solve the incomplete contracting problem that accompanies financial distress.

From the foregoing, it is arguably essential to assess the adaptability and responsiveness of Kenya's corporate insolvency framework vis-à-vis the pandemic, to determine whether the objectives of the Act can be met.

In the introduction to her book, Finch contends that it is not possible to evaluate any area of law, propose reforms or even improve the law unless there is clarity concerning the values and objectives sought to be furthered, the feasibility of operating certain procedures and the efficiency with which given rules or processes can be applied on the ground.[93]

In order to make an assessment, the insolvency procedures available to debtors in financial distress would need to be illuminated. These include filing petitions to court by either a creditor or debtor's directors, voluntary liquidation, company voluntary arrangements by directors and administration initiated by a holder of a qualifying floating charge.

The UNCITRAL Legislative Guide on Insolvency Law[94] outlines vital elements of an efficient and effective insolvency framework which addresses the financial difficulties experienced by debtors. It provides a good outline of the diverse key elements that guide lawmakers and policymakers when designing an insolvency law. Amongst others, these key elements include the commencement of insolvency proceedings, decision-making, retention of control of the business, reorganisation plan and reorganisation finance, identification of debtors, treatment of ongoing contracts, accountability of directors, protection of the insolvency estate, costs and expenses of the insolvency proceedings.

Notably, there was no major change in Kenyan insolvency law to mitigate the effects of the pandemic on business activity, health services, and people's lives. However, the CBK's Monetary policy which was conducted in the context of the global coronavirus (COVID-19)

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[91] Muro, Sergio, *The Calm Before the Storm : Early Evidence on Business Insolvency Filings After the Onset of COVID-19*, COVID-19 Notes; World Bank, 2021 https://openknowledge.worldbank.org/handle/10986/35261 on 12th April 2021

[92] Casey A. 'Chapter 11's Renegotiation Framework and the Purpose of Corporate Bankruptcy', *Columbia Law Review*, 2020, 1709-1770 https://www.jstor.org/stable/10.2307/26958731 on 14th April 2021

[93] Finch V, *Corporate Insolvency Law; Principles and Perspectives*, 4.

[94] UNCITRAL Legislative Guide on Insolvency Law, 2005 https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/05-80722_ebook.pdf on 30th May 2022

pandemic outlined the pandemic's impact in Kenya and the policies implemented by the government to mitigate this impact on health, social, economic and financial sectors.[95] Furthermore, other countries' private sector, government agencies and civil society are working together to propose innovative initiatives to mitigate the effects of COVID-19.[96]

As in Kenya, numerous countries introduced containment measures to slow the spread of COVID-19, which led to a severe recession. As lockdown measures continue and the recession gets more profound, a more comprehensive strategy for the future needs to be designed.[97] The Executive of Conference of European Restructuring and Insolvency Law (CERIL) were of the opinion that existing insolvency legislation is incapable of providing adequate responses to the tremendously difficult circumstances in which many companies are in due to the pandemic and called upon the E.U. and European domestic lawmakers to take quick action and adapt insolvency legislations where necessary due to the extraordinary economic situation they faced and to prevent unnecessary bankruptcies.[98]

The Insolvency Act's enactment was aimed at regaining the World Bank's and the International Monetary Fund's lost confidence in the country.[99] Enactment of the legislation is principally on account of political and governmental pressure and pressure from Kenya's private sector and business community. Indeed, a study by the IMF[100] found weaknesses in Kenya's credit reference data, companies and land registries, the commercial courts and the corporate insolvency framework.

Conversely, before enacting the UK's 1986 Act, a Review Committee on Insolvency Law and Practice was appointed in January 1977, tasked with the mandate to review, examine and make recommendations on the law and practice relating to insolvency, bankruptcy, liquidation and receiverships.[101] Political pressure to change insolvency laws restarted in 1997 to ensure that the law embraced a genuine rescue culture and offered user-friendly procedures for reorganizing financially troubled companies.[102] This culminated in the Insolvency Act 2000 reforms to the CVA procedure, and the introduction of a moratorium, among other changes. In

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[95] Central Bank of Kenya *Monetary Policy Committee Report, October 2020,* https://www.centralbank.go.ke/uploads/monetary_policy_reports/65271118_25th%20Monetary%20Policy%20Committee%20Report,%20October%202020.pdf on 14th April 2020

[96] Almeida F., 'Innovative response initiatives in the European Union to mitigate the effects of COVID-19', 1

[97] Anderson J, Tagliapietra S and Wolff G, 'Rebooting Europe: A Framework for A Post Covid-19 Economic Recovery' Bruegel, 2020 https://www.jstor.org/stable/resrep28618 on 25th February 2021

[98] Madaus S. and Wessels B, CERIL (Conference on European Restructuring and Insolvency Law) Executive Statement 2020-1 on Covid-19 And Insolvency Legislation, 2020 https://ceril.congressus.nl/_media/1296809/2ce93811f1f14745a9f94a9161b53766/view on 17th April 2021

[99] Too F C, 'A Comparative Analysis of Corporate Insolvency Laws: Which is the best option for Kenya?', 275-281

[100] IMF Country Report No. 08/353, *Kenya, Uganda, and United Republic of Tanzania: Selected Issues*, 2008, 41 http://www.imf.org/external/pubs/ft/scr/2008/cr08353.pdf on 10th April 2022

[101] Finch V, *Corporate Insolvency Law; Principles and Perspectives*, 13.

[102] Fletcher, I. F., 'UK Corporate Rescue: Recent Developments - Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements - the Insolvency Act 2000, the White Paper 2001, and the Enterprise Act 2002', 128

July 2001, a white paper[103] was published intending to recast administrative receivership by reforming administration to make it a fast-acting, effective, and accessible vehicle for corporate rescue.[104] It was planned to scrap administrative receivership and the change was enacted as part 10 of the Enterprise Act 2002. Further, in 2016, the UK government consulted and proposed four mechanisms to enhance their corporate insolvency regime and enable the rescue of viable businesses.[105]

In March 2018, the UK Government consulted on the jurisdiction's insolvency and corporate governance framework,[106] focusing on reducing the risk of major company failure due to poor governance to improve their insolvency framework. It came up with proposed steps, including an insolvency regime supporting effective intervention by the shareholders and, where required, the regulators at the earliest signs of trouble.[107] This is a clear indication that changes in laws are influenced by prevailing economic hardship, financial crisis, lobbying by political and private bodies and demands from financial bodies such as the UNCITRAL, World Bank and the IMF.

The IMF argues that as the economy starts to recover, solvency problems will become more prominent, calling for a policy focus on facilitating the reallocation of resources, for example, by setting up effective insolvency frameworks. They hold that targeted liquidity support will be critical to assisting the restructuring of hard-hit industries.[108] In this regard, Aurelio Gurrea-Martinez considers the role and limits of insolvency law in the current pandemic and provides possible responses countries can take to flatten the insolvency curve while keeping businesses alive.[109]

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[103] 'Insolvency - A Second Chance', the UK Department of Trade and Industry, (Cm. 5234) (H.M.S.O. 2001), https://webarchive.nationalarchives.gov.uk/ukgwa/20130814153556/http://www.archive.official-documents.co.uk/document/cm52/5234/523403.htm on 21st July 2022

[104] Fletcher, I. F., 'UK Corporate Rescue: Recent Developments - Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements - the Insolvency Act 2000, the White Paper 2001, and the Enterprise Act 2002', 129

[105] 'A Review of the Corporate Insolvency Framework: A consultation on options for reform', The Insolvency Service, 2016, 10, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/525523/A_Review_of_the_Corporate_Insolvency_Framework.pdf on 2nd April 2022

[106] Insolvency and Corporate Governance, Government response, 2018 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/736207/ICG_-_Government_response_doc_-_24_Aug_clean_version__with_Minister_s_photo_and_signature__AC_final.pdf on 23rd May 2022

[107] Insolvency and Corporate Governance, Government response, 2018, 6

[108] IMF Asia and Pacific Department, *Policy Advice to Asia in the COVID-19 Era*, https://www.imf.org/en/Publications/Departmental-Papers-Policy-Papers/Issues/2021/03/01/Policy-Advice-to-Asia-in-the-COVID-19-Era-50009 on 16th April 2021

[109] Gurrea-Martínez A, Findlay M, Yihan G, 'The value of insolvency law in the COVID-19 crisis, Aurelio Gurrea-Martinez' *Singapore Management University School of Law*, 2020 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3686357# on 15th April 2021

Kenya's Senate introduced a law[110] that proposes a loans and mortgages moratorium preventing lenders from imposing penalties or credit reference bureau listing for borrowers unable to meet their monthly payment obligations and a directive for landlords to enter into tenancy agreements with tenants unable to meet their rent obligations until after the pandemic. The principal object of the Bill is to provide a framework for the management of the covid-19 pandemic and future pandemics.

Conversely, the pandemic encouraged the UK to amend its insolvency laws by introducing temporary measures for use in the early phase of the pandemic and more permanent changes in its insolvency legislation to make their insolvent frameworks more robust. This is because, despite its stout insolvency regime, it was noted that the UK framework lacked a cramdown procedure and provisions on post-commencement financing which are necessary for effective corporate rescue culture.[111] A cramdown is the ability of a majority of creditors to bind one or more dissenting creditors.[112] The accelerated recommended emergency insolvency reforms had been under consideration years before the pandemic. The Corporate Insolvency and Governance Act, 2020 received Royal Assent and became law in the United Kingdom on 25th June 2020. In response to the Covid-19 pandemic, this new legislation was put forward by the U.K. government to assist companies to trade through the unconducive economic climate brought about by the pandemic and to introduce permanent changes to the U.K. insolvency framework.[113] Through CIGA, the UK ensured the existence of a moratorium while the restructuring was negotiated, the possibility of early intervention when a company was financially distressed and introduced an effective mechanism for cramdown through a new restructuring plan. These changes are in line with the recommendations of the UNCITRAL Legislative Guide on Insolvency Law. These changes have made the UK's law a more robust and effective insolvency regime from which lessons can be learned.

The previous insolvency regime and the drivers of insolvency reform in Kenya before the 2015 Insolvency Act are highlighted by F.C. Too.[114] She reviews the insolvency frameworks in Kenya and compares them with the insolvency frameworks of the U.K. and Mauritius. She gives a conceptual approach to Kenya's insolvency law and then justifies the existence of insolvency law from a theoretical perspective. She explores the insolvency framework in

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[110] The Pandemic Response and Management Bill, 2020 http://www.parliament.go.ke/node/12231 On 14th April 2021

[111] Muhammad R, Kashif J. and, Farqaleet K, 'Corporate Rescue Culture Realities and Limitations of the Existing Laws of the United Kingdom', 587

[112] Harris, J, 'Class Warfare in Debt Restructuring: Does Australia Need Cross-Class Cram down for Creditors' Schemes of Arrangement?', The University of Queensland Law Journal, 2017, 1 https://ssrn.com/abstract=3306928 on 22nd July 2022

[113] Garvin J, and Charlton, D., 'The United Kingdom Protection for Businesses in Debt during the COVID-19 Pandemic and beyond.' *Commercial Law World*, 2020, 20-21. HeinOnline. https://heinonline.org/HOL/Page?handle=hein.journals/colaworl34&collection=journals&id=46&startid=&endid=47 on 13th April 2021

[114] Too F C, 'A Comparative Analysis of Corporate Insolvency Laws: Which is the best option for Kenya?' Published PhD Thesis, Nottingham Trent University, Nottingham, 2015, 63, http://irep.ntu.ac.uk/id/eprint/27951/1/Thesis%20post%20viva%20FINAL.pdf on 14th April 2021

Kenya, revealing weaknesses and analysing mechanisms that may aid the insolvency structure. After that, she deduces whether Kenya can gain from the experiences the insolvency frameworks reviewed.

Similarly, E.A. Otieno[115] writes on the effectiveness of the Kenyan corporate insolvency regime. The writer begins by highlighting the essentials of an efficient insolvency system. She discusses the four main essentials of an efficient insolvency regime derived from the philosophical foundations: the prevention function, the rehabilitative function, the distributive function, and the punitive function. Although these are similar to the objects of the Insolvency Act, the thesis was published ten years prior to the Act.

Iheme contends that the Insolvency Act, 2015 is still foreign to Kenyan debtors and creditors,[116] and that the formal insolvency processes and courts are not utilised since they considered generally time-consuming and financially draining.[117]

Furthermore, K.I. Laibuta[118] who outlines Kenya's corporate insolvency law by analysing the provisions of the Act and presenting the various insolvency frameworks available for a company in financial distress, does not consider the effectiveness or adaptability of Kenya's law. In fact, in her thesis on the effectiveness of the remedies of wrongful and fraudulent trading in Kenya, Nzula notes that not only is there no literature regionally on the effectiveness of an insolvency regime, but there is also a lack of substantial debate on the effectiveness of the Kenyan insolvency regime,[119] a gap this thesis tries to fill.

From the foregoing literature, it is evident that our insolvency law was not devised with the outlook of a pandemic in mind, and some gaps exist as regards the procedures available to debtors facing financial difficulties. These gaps are unexplored in Kenyan literature. They include the unavailability of the existence of a moratorium whilst a reorganisation plan is negotiated, the possibility of early intervention by providing a hybrid of a debtor in possession and practitioner in possession model, availability of restructuring finance, and an effective mechanism for cramdown. In that regard, this research aims to fill in that gap in the literature and explore means by which the same can be entrenched in the Kenyan corporate insolvency legal framework. The research will also seek to make recommendations on emergency policy

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[115] Otieno-Arwa Eunice, 'Corporate Insolvency Systems in Kenya: A case for reform', Published LL.M Thesis, University of Nairobi, 2005 http://erepository.uonbi.ac.ke:8080/xmlui/handle/123456789/11733 on 14th April 2021.

[116] Iheme C, 'A Doctrinal Assessment of the Insolvency Frameworks of African Countries in Coping with the Pandemic-Triggered Economic Crisis', *Stellenbosch Law Review*, Vol. 2, 2021, 309 https://doi.org/10.47348/SLR/2021/i2a7 on 9th September 2021

[117] Iheme C, 'A Doctrinal Assessment of the Insolvency Frameworks of African Countries in Coping with the Pandemic-Triggered Economic Crisis', 311

[118] Laibuta K.I., *A Handbook of Company Law*, Revised Edition, 2019, LawAfrica Publishing Kenya Ltd. Nairobi, Kenya, 477

[119] Nzula M. 'A Critical Analysis of the Efficacy of the Civil Remedies for Fraudulent and Wrongful Trading under the Insolvency Act', Published LL.M Thesis, University of Nairobi, 2015, 20. http://erepository.uonbi.ac.ke/handle/11295/105771 on 24th August 2022

and legislative reforms that may make the Kenyan insolvency framework better suited to supporting businesses during economic depressions.

1.11 CHAPTER BREAKDOWN

The thesis comprises four chapters.

The first chapter outlines the agenda of the thesis. This entails the introduction and background of the study, followed by a statement of the problem which articulates the specific legal problem under study. In addition, the chapter outlines the objectives of the study, rationale, questions raised, hypothesis and the study's justification, and the basic assumptions upon which the study rests. The chapter also entails the theoretical framework underpinning the study and the methodology adopted. It concludes with a discussion on the literature review and demonstrates the gap in the literature.

The second chapter is intended to feature the conceptual framework of corporate insolvency in Kenya. It offers elaborate definitions and descriptions of the insolvency procedures and processes available to creditors, directors and other stakeholders of companies undergoing insolvency. It further analyses the underlying assumptions and rationale of the approaches available to these stakeholders.

The third chapter considers the approaches available to the United Kingdom and whether the UK has adopted measures to combat insolvency brought about by economic distress due to the pandemic. It seeks to uncover the trend which has been demonstrated by the developments in this area of law and the objectives behind the amendments and legislative developments which may inform the approach Kenya may take. It also investigates the effect of the covid 19 pandemic on corporate insolvency and the possible approaches available to creditors and stakeholders. In addition, it analyses the approaches available in the United Kingdom to determine if there are any lessons Kenya could borrow.

The final chapter contains a summary of the study's findings and the conclusion taken from the Study. Alongside this, it will recommend the necessary amendments to the Kenyan Insolvency Act (Act No.18 of 2015) 2015.

CHAPTER TWO

2. THE INSOLVENCY FRAMEWORK IN KENYA

2.1 INTRODUCTION

In Kenya, as has been the case historically,[120] the Insolvency Act's enactment was aimed at regaining the World Bank's and the International Monetary Fund's lost confidence in the country.[121] The legislation was enacted principally due to political and governmental pressure and pressure from Kenya's private sector and business community. Indeed, a 2008 study by the IMF[122] found weaknesses in Kenya's credit reference data, company and land registries, the commercial courts and the corporate insolvency framework. It was suggested that Kenya ought to modernise its insolvency procedures, strengthen its specialised commercial courts and give its judges more training.[123] As such, Kenya had warning 12 years before the pandemic that its insolvency framework was inadequate and in need of reform. Arguably if this warning had been heeded in a timely manner, the pandemic might have found us better prepared. We still do not have a specialised insolvency court or judges specifically appointed and trained to handle insolvency proceedings. This, despite the World Bank Principles noting the importance of a specialised independent court and judges specialised in insolvency proceedings.[124]

In contrast, before enacting the UK's 1986 Act, a Review Committee on Insolvency Law and Practice was appointed in January 1977, tasked with the mandate to review, examine and make recommendations on the law and practice relating to insolvency, bankruptcy, liquidation and receiverships.[125] The committee, in its final report, made recommendations, including designing a single insolvency law to replace the various statutes in place at the time; the creation of a single system of insolvency courts; introduction of alternative processes to outright winding-up and bankruptcy; professional regulation of private insolvency practitioners; new penalties against errant directors be put in place; and lastly, that creditors be given more significant participation in the insolvency process and a voice in the choice of liquidator.[126]

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[120] Were M., Ngugi R., Makau P., Wambua J and Oyugi L., 'Kenya's Reform Experience: What Have We Learnt?', Macroeconomics Division Kenya Institute for Public Policy Research and Analysis (KIPPRA), Working Paper No. 12 December 2005, 9, 20, https://repository.kippra.or.ke/bitstream/handle/123456789/2847/wp%2012.pdf?sequence=1&isAllowed=y on 10th April 2022

[121] Too F C, 'A Comparative Analysis of Corporate Insolvency Laws: Which is the best option for Kenya?', 275-281

[122] IMF Country Report No. 08/353, *Kenya, Uganda, and United Republic of Tanzania: Selected Issues*, 2008, 41 http://www.imf.org/external/pubs/ft/scr/2008/cr08353.pdf on 10th April 2022

[123] IMF Country Report No. 08/353, *Kenya, Uganda, and United Republic of Tanzania: Selected Issues*, 2008, 43

[124] The World Bank, *The World Bank Principles for Effective Insolvency and Creditor/ Debtor Regimes*, 2016, 19 https://documents1.worldbank.org/curated/en/518861467086038847/pdf/106399-WP-REVISED-PUBLIC-ICR-Principle-Final-Hyperlinks-revised-Latest.pdf on 20th June 2022

[125] Finch V, *Corporate Insolvency Law; Principles and Perspectives*, 13.

[126] Finch V, *Corporate Insolvency Law; Principles and Perspectives*, 13.

Kenya lacks the social infrastructure and financial and human resources needed for its judicial and economic systems to properly enforce the Insolvency Act 2015 compared to the UK, whose insolvency regime's provisions were largely incorporated into Kenya's law.[127] Iheme argues that the 2015 Insolvency Act is still foreign to Kenyan debtors and creditors,[128] with many citizens considering the formal insolvency processes and courts generally time-consuming and financially draining.[129]

The UK's Insolvency Act has been amended severally in response to shocks triggered by the 1990's economic recession, the 2008 global financial crisis and the covid-19 pandemic. The pandemic is the first regulation responsiveness test that the Kenyan insolvency framework is undergoing.

This Chapter discusses some key elements of restructuring frameworks, including commencement, control, decision-making, reorganisation plan and reorganisation finance which are discussed in detail in the UNCITRAL Legislative Guide on Insolvency Law.[130] It highlights how these key objectives and principles influence a state's choice in designing an insolvency law.

The Chapter features the conceptual framework of Kenya's corporate insolvency. It offers elaborate descriptions of the approaches available to distressed corporations in the jurisdiction. The insolvency procedures discussed in this Chapter include administration, company voluntary arrangements, and the various forms liquidation takes. The Chapter covers the remedy of wrongful trading.

The Chapter also outlines the deficiencies and shortcomings of these processes in the event of an emergency precipitated by an economic recession or a pandemic, and whether Kenya's law is responsive or adaptable in such situations.

2.2 THE KEY ELEMENTS OF CORPORATE INSOLVENCY LAW

This part of the thesis evaluates the adaptability and responsiveness of the Kenyan corporate insolvency framework by reference to the UNCITRAL Insolvency Legislative Guide. The Guide provides an evaluative framework which is widely accepted, commonly used and reputable, considering the large number of jurisdictions that have utilized them in their

[127] Iheme C, 'A Doctrinal Assessment of the Insolvency Frameworks of African Countries in Coping with the Pandemic-Triggered Economic Crisis', 308

[128] Iheme C, 'A Doctrinal Assessment of the Insolvency Frameworks of African Countries in Coping with the Pandemic-Triggered Economic Crisis', 309

[129] Iheme C, 'A Doctrinal Assessment of the Insolvency Frameworks of African Countries in Coping with the Pandemic-Triggered Economic Crisis', 311

[130] UNCITRAL Legislative Guide on Insolvency Law, 2005 https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/05-80722_ebook.pdf on 30th May 2022

reforms.[131] The UNCITRAL Legislative Guide outlines vital elements of an efficient and effective insolvency framework which addresses the financial difficulties experienced by debtors. Amongst others, these key elements include the commencement of insolvency proceedings, decision-making, retention of control of the business, reorganisation plan and reorganisation finance, identification of debtors, treatment of ongoing contracts, accountability of directors, protection of the insolvency estate, costs and expenses of the insolvency proceedings.[132] Although all these are relevant considerations for establishing an insolvency framework, this part will only cover some of the key elements in detail owing to time constraints and some of these elements overlapping.

2.2.1. Commencement of proceedings

Commencement[133] covers the persons who can initiate an insolvency procedure: whether the debtors, creditors, the company, its directors and other parties. It also deals with the issue of when these individuals can commence insolvency proceedings. Whereas the general principle is that it is desirable to facilitate access to insolvency proceedings conveniently, cost-effectively and quickly,[134] the parties commencing restructuring proceedings have different incentives guiding their decisions.

For instance, self-interested secured creditors have no incentive to choose value-maximising insolvency proceedings. They may be unconcerned and choose an inefficient procedure since they are the most overtly protected parties in insolvency.[135] In the same vein, even where the commencement is left to creditors, debtors may be able to delay the insolvency process by strategically avoiding defaults through making scheduled payments on debts.[136] Conversely, directors might prefer a procedure that will allow them to stay in control of the business as long as possible and, as such, would choose a process that prolongs the company's life even if it is inefficient.[137]

There is, therefore, difficulty in ascertaining who the best party to initiate the most efficient and effective insolvency proceedings is. As seen in the preceding analysis, Kenyan insolvency law solves this problem by allowing the debtor and its creditors to be involved in or even initiate insolvency proceedings. For instance, Administrators may be appointed by the creditors with a qualifying floating charge on a company's property[138] or by the company, its directors[139] or

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[131] Too F C, 'A Comparative Analysis of Corporate Insolvency Laws: Which is the best option for Kenya?', 307
[132] Part One, paragraph 20, UNCITRAL Legislative Guide on Insolvency Law, 2005, 16
[133] Part Two, paragraph 20, UNCITRAL Legislative Guide on Insolvency Law, 2005, 45
[134] Part Two, paragraph 21, UNCITRAL Legislative Guide on Insolvency Law, 2005, 45
[135] Warren, E., *'Bankruptcy Policymaking in an Imperfect World'*, *Michigan* Law Review, VOL 92, (1993), 359. https://repository.law.umich.edu/mlr/vol92/iss2/4/ on 25th June 2022
[136] Hahn, D. 'Concentrated ownership and control of corporate reorganisations', Journal of Corporate Law Studies, 4(Part 1), 2004, 143. https://heinonline.org/HOL/P?h=hein.journals/corplstd4&i=119 on 25th June 2022
[137] Part Two, paragraph 21, UNCITRAL Legislative Guide on Insolvency Law, 2005, 45
[138] Section 534, *Insolvency Act*, (Act No.18 of 2015) and Section 886, *Companies Act*, (Act No. 17 of 2015).
[139] Section 541, *Insolvency Act*, (Act No.18 of 2015).

the court upon application.[140] In company voluntary arrangements, the company's directors propose to the company and its creditors for their approval of a voluntary arrangement before it is effected.[141] Similarly, in a compromise or scheme of arrangement, the company agrees with its creditors or any class of them, or its members or any class of them to restructure the company or businesses.[142]

By involving these different actors in the commencement of corporate insolvency processes, the Kenyan framework weighs the interests of a broad range of diverse constituents which is in line with the UNCITRAL Guide recommendations. This is a traditionalist view as framework does not solely focus on maximizing the debtor’s economic value for creditor’s interests or for the creditor’s economic recovery.

Regarding the commencement of insolvency proceedings, the UNCITRAL Legislative Guide proposes early intervention when the debtor is financially distressed and has ceased to make payments or does not have sufficient cash flow to service its existing responsibilities as they fall due during the ordinary course of its business.[143] This liquidity, cash flow or general cessation of payments test, puts the defining factors within the creditors' reach. This is because the creditors would be best placed to note when payments for rent, taxes, salaries or goods and services are not made. Another test that may be used is the balance sheet test which is based on an excess of liabilities over assets as an indicator of financial distress.[144] However, this test might delay liquidation and diminish recoveries since it relies on information controlled by the debtor. Other parties might consequently find it difficult to ascertain the actual state of the debtor's financial status until it is too late.[145]

Furthermore, an expert will usually be required to review the debtor's books and records to determine the business's fair market value. If such records are kept inappropriately or are not readily available, this may contribute to the delay.[146] For instance, the Court in Bankruptcy Cause 28 of 1963, *Charan Singh S/O Kesar Singh-Debtor*[147] noted that there was a delay in finalising the debtor's statement of affairs owing not only to the debtor’s unwillingness to cooperate with the official receiver but also its books of account were improperly written up and did not disclose the debtor’s full state of affairs.

In order to ensure the debtor’s survival, a vital tool of an insolvency procedure is the availability of a moratorium on or after commencement, suspending or staying creditor action to avoid the depletion of the insolvency estate.[148]

[140] Section 523, *Insolvency Act*, (Act No.18 of 2015).
[141] Section 625, *Insolvency Act*, (Act No.18 of 2015).
[142] Section 922(1), *Companies Act*, (Act No. 17 of 2015).
[143] Part Two, paragraph 23, UNCITRAL Legislative Guide on Insolvency Law, 2005, 45
[144] Part Two, paragraph 23, UNCITRAL Legislative Guide on Insolvency Law, 2005, 46
[145] Part Two, paragraph 25, UNCITRAL Legislative Guide on Insolvency Law, 2005, 45
[146] Part Two, paragraph 26, UNCITRAL Legislative Guide on Insolvency Law, 2005, 47
[147] *In Re Charan Sighh s/o Kesar Sighh* [1972] eKLR, http://kenyalaw.org/caselaw/cases/view/28034/
[148] Part II, paragraph 26, UNCITRAL Legislative Guide on Insolvency Law, 2005, 83

From the foregoing, in the event of an emergency such as the pandemic, early intervention coupled with access to a moratorium by a debtor is crucial to ensure successful turnaround of a financially distressed company.

2.2.2. Control

Upon commencement of proceedings, an insolvency procedure can allow either a debtor to retain control of the business or give this control to an independent party, such as an insolvency practitioner appointed to supervise and manage the debtor.[149] Where the debtor retains control, they are referred to as 'a debtor in possession' (DIP), most notably in the United States' Chapter 11. Where the practitioner is appointed, they are referred to as 'a practitioner in possession' (PIP), which is evident in the UK's and Kenya's insolvency regimes.

A DIP system might encourage early intervention since the directors may not be apprehensive of losing their positions in the company, and these directors, unlike the insolvency practitioners, have the requisite knowledge and skills to manage the debtor and information regarding the debtor which might be unavailable to the practitioners.[150] Conversely, allowing the debtor who is not in a good financial situation and is unable to pay back its debt to be a part of a business or company could challenge and destabilise the business trust and weaken the public's confidence.[151]

In Kenya's PIP system, authorised insolvency practitioners mainly control the liquidation[152] and administration[153] processes. These practitioners also supervise company voluntary arrangements,[154] member's voluntary arrangements,[155] and the creditor's voluntary liquidation.[156] When considering an application for an administration order to enable proposed administrators to effect the sale of an insolvent business, the English court commented that it placed great reliance on the expertise, experience and impartiality of insolvency practitioners and, if the proposed administrator said that the purpose could be achieved, it would require unequivocal evidence to the contrary to overturn that view.[157]

In these formal insolvency procedures, the participation of an insolvency practitioner is therefore required by statute in some capacity and is key to the insolvency processes. In the PIP system, however, directors are required to give up control to the insolvency practitioner, who may not be precisely knowledgeable, compared to the ousted management, about the

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[149] Part One, paragraph 20(d), UNCITRAL Legislative Guide on Insolvency Law, 2005, 16
[150] Hahn, D. "Concentrated ownership and control of corporate reorganisations", 146.
[151] Kasuri, M.R, Javed K and Khokhar F, 'Corporate Rescue Culture Realities and Limitations of the Existing Laws of the United Kingdom', Journal of Contemporary Issues in Business and Government, 2022, 586 http://dx.doi.org/10.2139/ssrn.4144207 on 19th July 2022
[152] Section 416(3), *Insolvency Act*, (Act No.18 of 2015).
[153] Section526, *Insolvency Act*, (Act No.18 of 2015).
[154] Section 625(3), *Insolvency Act*, (Act No.18 of 2015).
[155] Section 399 (3), *Insolvency Act*, (Act No.18 of 2015).
[156] Section 408(1), *Insolvency Act*, (Act No.18 of 2015).
[157] *DKLL Solicitors v HM Revenue and Customs* [2007] England and Wales High Court, 2007 (Ch.)

debtor's business but who are allegedly more morally upright than the ousted directors.[158] As an outsider, the practitioner would require time to acquaint himself with the operations of the company first before taking any meaningful action. Directors may also be disincentivised from seeking early help where the company is insolvent or near insolvency and will likely take unjustifiably significant business risks to rescue the company or cling to power.[159]

It has been suggested that the effort of rescuing the corporation will be more efficient if the existing management, who have considerable experience, understanding and information concerning the business, is integrated and incorporated into the rescue, but without them retaining or holding their managerial powers.[160] Consequently, a hybrid system might be more effective in an emergency situation.

2.2.3. The Reorganisation Plan

Reorganisation is the process by which a debtor's financial well-being and the viability of its business can be restored to enable the company to continue operating. Reorganisation can be through several techniques, which include debt forgiveness, debt-equity conversions, debt rescheduling and sale of the business, or parts of it, as a going concern.[161] A reorganisation plan is a strategy through which the financial well-being and viability of the debtor's business can be restored.[162]

The issues to be considered include form of the plan or its nature, its content, the person preparing it, when it is prepared, in what way it will be approved by creditors, if court confirmation will be required and the effect and implementation of the proposed plan.[163] The UNCITRAL Legislative Guide on Insolvency Law proposes a plan that is not too constrictive or intrusive. For instance, one which is not designed only to rehabilitate the debtor fully, which prohibits debt from being written off, or restricts the amount that must eventually be paid to creditors by specifying a minimum proportion or prohibits the exchange of debt for equity. The approach adopted may depend not only on the purpose and objectives of the proposed plan but also on the parties permitted to propose the plan, whether debtor, creditors or insolvency practitioner.[164]

In Kenya, reorganisations can be through a voluntary arrangement[165] where the company intends to facilitate the orderly discharge by the company of its financial obligations and enable

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[158] Iheme C, 'A Doctrinal Assessment of the Insolvency Frameworks of African Countries in Coping with the Pandemic-Triggered Economic Crisis', 318

[159] Finch V, *Corporate Insolvency Law; Principles and Perspectives*, 330

[160] Muhammad R, Kashif J. and, Farqaleet K, 'Corporate Rescue Culture Realities and Limitations of the Existing Laws of the United Kingdom', *Journal of Contemporary Issues in Business and Government*, Vol. 28, No. 03, 2022, 586 http://dx.doi.org/10.2139/ssrn.4144207 on 21st July 2022

[161] Part One (B), paragraph 12(kk), UNCITRAL Legislative Guide on Insolvency Law, 2005, 7

[162] Part One (B), paragraph 12(ll), UNCITRAL Legislative Guide on Insolvency Law, 2005, 7

[163] Part IV, paragraph 1, UNCITRAL Legislative Guide on Insolvency Law, 2005, 209

[164] Part IV, UNCITRAL Legislative Guide on Insolvency Law, 2005, 209-233.

[165] Section 625, *Insolvency Act*, (Act No.18 of 2015).

it to carry on business as a going concern and avoid liquidation.[166] It may also be through a scheme of arrangement for restructuring the company or businesses[167] to amend existing debt arrangements, extend maturities, or implement debt restructurings through debt for equity and debt for debt swaps.[168] The company can modify its share capital structure using four approaches. Firstly, the company can increase its share capital through issuance of new shares.[169] A company can decrease its share capital by reduction of its shares or reducing the nominal value of its shares.[170] Thirdly, the company may divide its shares into two or more shares of a slightly lower nominal amount than its existing shares.[171] Lastly, the company can consolidate its existing shares into shares of a more considerable nominal amount than that of the existing shares.[172]

An advantage of the scheme is that it becomes binding upon all the shareholders once the special resolution is passed (if approved by three-quarters of the shares).

There are shortcomings to both schemes and CVA’s which make it deficient in the event of an emergency. The company must deal with individual creditors to obtain their approval in CVA's since the procedure does not provide a cross-class cramdown. There is also a lack of a cramdown mechanism between classes of creditors within a scheme.[173] Such a cross-class cramdown is the ability of a majority of creditor classes to bind one or more dissenting classes.[174] Both schemes and CVA's lack a moratorium, and as has been argued herein, these are necessary in an emergency to ensure a debtor is successfully rescued.

2.2.4. Decision-making

In designing an insolvency law, it is crucial to determine how roles will be allocated to the participants involved in decision-making. The participants have statutory responsibilities to make critical decisions on supervision and oversight of the debtor and the insolvency processes.[175] These decision-makers will often have competing interests. For instance, determining the functions that should be given to creditors could involve a consideration of the

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[166] *In Matter of T&N Limited and Others [2005]* EWHC 2870 (Ch), https://www.bailii.org/ew/cases/EWHC/Ch/2005/2870.html on 24th February 2022

[167] Section 922(1), *Companies Act*, (Act No. 17 of 2015).

[168] Paterson, S, ‘Reflections on English Law Schemes of Arrangement in Distress and Proposals for Reform’, European Company and Financial Law Review, 2018, 475, https://core.ac.uk/reader/161930130 on 25th June 2022.

[169] Section 404(1)(a), *Companies Act*, (Act No. 17 of 2015).

[170] Section 404(1)(b), *Companies Act*, (Act No. 17 of 2015).

[171] Section 405(1)(a), *Companies Act*, (Act No. 17 of 2015).

[172] Section 405(1)(b), *Companies Act*, (Act No. 17 of 2015).

[173] Paterson, S, ‘Reflections on English Law Schemes of Arrangement in Distress and Proposals for Reform’, 476.

[174] Harris, J, ‘Class Warfare in Debt Restructuring: Does Australia Need Cross-Class Cram down for Creditors’ Schemes of Arrangement?’, The University of Queensland Law Journal, 2017, 1 https://ssrn.com/abstract=3306928 on 22nd July 2022

[175] Part One, Paragraph 27, UNCITRAL Legislative Guide on Insolvency Law, 2005, 27.

entire insolvency law and the balance to be achieved between the insolvency practitioner, the court, the debtor and its creditors.[176]

Creditors prefer not to play an active role in insolvency proceedings, especially in instances where the return to them is unlikely to be substantial and where their involvement could require resources. It is crucial to overcome such creditor apathy and encourage participation.[177] A creditor may also be incentivised to take advantage of individual collection remedies before other creditors act, which Jackson identifies as a 'prisoner's dilemma'. He explains it as rational individual behaviour that, without cooperation of other individuals, leads to a substandard decision when viewed collectively and argues that this occurs when certain rules are in the interest of an entire class of persons but, because of an inability to reach a collective solution, each class member acts out of immediate self-interest in such a way that a less efficient solution results.[178] Another issue for consideration is how the law will treat secured creditors when voting. One approach can allow the creditors more significant participation in the proceedings to determine a plan or even a low level of involvement where an insolvency practitioner makes all critical decisions on uncontested general administration matters[179]

As regards the debtor, if the business is to be continued, a greater need arises to have the debtor involved in management, assisting the insolvency practitioner and also providing information to the court.[180]

The insolvency law may offer mechanisms to strengthen decision-making to enhance reorganisation prospects. This may include provisions establishing classes and majorities of creditors who can make decisions based on their varying economic interests.[181] It may also provide for binding dissenting creditors if there is approval by a requisite majority of creditors (a cramdown provision),[182] provisions on the protection of the interests of these dissenting creditors and provisions on court confirmation of the plan or other rules of the courts in the decision-making process.[183]

In Kenya, administrators may be appointed by the creditors with a qualifying floating charge on a company's property[184] or by the company, its directors[185] or the court upon application.[186] In company voluntary arrangements, the company's directors propose to the company and its creditors for their approval of a voluntary arrangement.[187] Similarly, in a compromise or

[176] Part Two III, Paragraph 77, UNCITRAL Legislative Guide on Insolvency Law, 2005, 190.
[177] Part Two III, Paragraph 85, UNCITRAL Legislative Guide on Insolvency Law, 2005, 193.
[178] Jackson T. H., 'Bankruptcy, Non-Bankruptcy Entitlements and Creditors' Bargain', 862
[179] Part Two III, Paragraph 87, UNCITRAL Legislative Guide on Insolvency Law, 2005, 193.
[180] Part Two III, Paragraph 1, UNCITRAL Legislative Guide on Insolvency Law, 2005, 161.
[181] Part Two IV, Paragraph 42, UNCITRAL Legislative Guide on Insolvency Law, 2005, 222.
[182] Part Two IV, Paragraph 54-56, UNCITRAL Legislative Guide on Insolvency Law, 2005, 226.
[183] Part Two IV, Paragraph 56, UNCITRAL Legislative Guide on Insolvency Law, 2005, 226.
[184] Section 534, *Insolvency Act*, (Act No.18 of 2015) and Section 886, *Companies Act*, (Act No. 17 of 2015).
[185] Section 541, *Insolvency Act*, (Act No.18 of 2015).
[186] Section 523, *Insolvency Act*, (Act No.18 of 2015).
[187] Section 625, *Insolvency Act*, (Act No.18 of 2015).

scheme of arrangement, the company agrees with its creditors or any class of them, or its members or any class of them to restructure the company or businesses.[188] Consequently, all the key stakeholders are involved in these insolvency processes and is in line with the UNCITRAL Legislative Guide recommendations, a positive score. Kenya's framework is therefore more aligned with the traditionalist theories as they not only involve these different stakeholders, but also focus on rehabilitation of the debtor and not solely on maximizing the debtor's economic value for creditor's interests.

2.2.5. Reorganisation Finance

To ensure the continued operation of the debtor's business and to maintain business activities, the debtor requires access to funds to cover labour costs, the purchase of goods and services, contracts maintenance, insurance, rent, and other operating expenses.[189]

This can be through pre-commencement or post-commencement financing which is meant to facilitate their rehabilitation of a financially distressed company. South Africa's Companies Act defines pre-commencement financing as financing obtained before the commencement of the rescue proceedings whereas post-commencement financing is financing obtained by a company during the business rescue proceedings.[190] Such financing may be secured to the lender by utilising any asset of the company that is not otherwise encumbered and will be given preference. The rights of the lenders secured creditors will not be adversely affected unless the worth of the collateralized assets begins to dwindle, and as such, they will retain their pre-commencement priority in the collateralized asset, unless they consent otherwise.[191]

Unlike in South Africa's law, our second schedule to the Companies Act, which sets out the order of payments to preferential creditors, does not explicitly recognize such financing.

Reorganisation funding may be value enhancing for a distressed company and could also improve returns to its creditors or, at the very least, not worsen their position.[192] Unfortunately, a company involved in a formal insolvency process encounters difficulty in obtaining financing since creditors will be averse to lending to the company on an unsecured or under-secured basis due to the risks involved and the fact that repayment will depend on the successful turnaround of the company.[193]

The need for finance will have to be determined at an early stage, sometimes even before the commencement of the insolvency proceedings.[194] Financing may be through trade credit

[188] Section 922(1), *Companies Act*, (Act No. 17 of 2015).
[189] Part Two II, Paragraph 94, UNCITRAL Legislative Guide on Insolvency Law, 2005, 113.
[190] Section 135(2) of the South African Companies Act
[191] Part Two II, Paragraph 103, UNCITRAL Legislative Guide on Insolvency Law, 2005, 116.
[192] Finch V, *Corporate Insolvency Law; Principles and Perspectives*, 335.
[193] Finch V, *Corporate Insolvency Law; Principles and Perspectives*, 333.
[194] Part Two II, Paragraph 95, UNCITRAL Legislative Guide on Insolvency Law, 2005, 114.

extended to the debtor by vendors of the goods and services required to run the business, loans, or other forms of finance.[195]

Such post-commencement lending can come from pre-insolvency lenders who have an already existing relationship with the debtor and seek to enhance the likelihood of recovering existing claims or from lenders with no pre-insolvency relationship with the debtor. New financing is financial assistance provided by an existing or a new creditor in order to implement a restructuring plan.[196] Interim financing is financial assistance, provided by an existing or a new creditor, that includes, as a minimum, financial assistance during the stay of individual enforcement actions, and that is sensible and immediately essential for the debtor to continue operating, or to maintain or improve the value of its business[197]

These lenders usually seek a higher return from the company.[198] The pre-insolvency lenders agree to lend to these distressed businesses to maintain the existing relationship with the debtor and to avoid a situation where their priority may be displaced by a lender who provides the financing needed. Notably, both types of lenders are accorded special treatment on account of this post-commencement financing[199] which includes a priority that ranks before the debtor's ordinary unsecured creditors and any statutory priorities such as taxes or social security claims.[200]

As has been seen, there are diverse choices that lawmakers and policymakers will make when designing an insolvency law. The UNCITRAL, the World Bank, the IMF and other global financial institutions emphasise the need for good insolvency laws that meet the standards highlighted herein.

In determining the responsiveness and adaptability of Kenya's corporate insolvency framework in an emergency situation, we will look at these vital elements in the insolvency procedures available for Kenyan companies.

2.3 INSOLVENCY PROCESSES

The insolvency framework is contained in the Insolvency Act and the Companies Act, which provide the procedures invoked in the corporate insolvency process for certain companies. The Insolvency Regulations, 2016 give effect to the Insolvency Act. The Companies Act provides for restructuring of corporations through the consolidation and alteration of a company's share

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[195] Part Two II, Paragraph 94, UNCITRAL Legislative Guide on Insolvency Law, 2005, 114.
[196] Title I, article 2 (1)(7), Directive (Eu) 2019/1023 of the European Parliament and of the Council, Official Journal of the European Union, 20th June 2019, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019L1023&from=en on 20th July 2022
[197] Title I, article 2 (1)(8) Directive (Eu) 2019/1023 of the European Parliament and of the Council, n
[198] Part Two II, Paragraph 99, UNCITRAL Legislative Guide on Insolvency Law, 2005, 115.
[199] Part Two II, Paragraph 99, UNCITRAL Legislative Guide on Insolvency Law, 2005, 115.
[200] Part Two II, Paragraph 101, UNCITRAL Legislative Guide on Insolvency Law, 2005, 116.

capital, arrangements, compromises, amalgamations and reconstructions. It also regulates the merger and division of public companies. Banks[201] and insurance companies[202] are subject to special insolvency regimes under the specific statutes which regulate these institutions. The Insolvency Act prohibits the appointment of administrators for banks, insurance and finance institutions,[203] and such institutions are ineligible to obtain moratoriums.[204] Furthermore, an insurer that carries on a long-term business cannot be voluntarily liquidated.[205]

Insolvency arises due to financial or economic distress, which leads to business failure or default by the debtor. A company experiencing a shortfall in cash flow required to meet its debt obligations is said to be in financial distress. However, a company in economic distress has an unsustainable business model and is consequently not viable without asset restructuring.[206] Insolvency may therefore be a symptom of a cash flow or liquidity shortfall, which may be viewed as a temporary rather than a chronic condition.[207] It may also come about as balance sheet insolvency, which is especially critical and is a situation where the debtor's total liabilities exceed a fair valuation of its total assets.[208]

Business failure is defined to include businesses that cease operations following assignment or insolvency; cease with loss to creditors after such actions as execution, foreclosure, or attachment; voluntarily withdraw, leaving unpaid obligations; are involved in court actions such as receivership, reorganisation, or arrangement; or willingly compromise with creditors.[209] Therefore, when a company encounters financial distress, it can utilise two approaches that may enable them to regain health or undergo liquidation.[210] Firstly, it may employ a formal insolvency procedure, which usually involves a court, and this approach allows the debtor to deal with creditors collectively. On the other hand, it can engage in an out-of-court restructuring, informal strategies whereby the insolvent debtor negotiates with individual creditors.[211]

Before the enactment of the current Insolvency Act, the most common outcome of an over-indebted company was receivership initiated by the secured creditor seeking to realise its

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[201] Section 35, *Banking Act*, Cap 488 - the Deposit Protection Fund Board undertakes liquidation of financial institutions

[202] Section 121 and 123, *Insurance Act*, Cap 487

[203] Section 529, *Insolvency Act*, (Act No.18 of 2015).

[204] Section 639, *Insolvency Act*, (Act No.18 of 2015).

[205] Section 120, *Insurance Act*, Cap 487

[206] Altman W, Hotchkiss E and Wang W, *Corporate Financial Distress, Restructuring, and Bankruptcy: Analyze Leveraged Finance, Distressed Debt, and Bankruptcy*, 4th ed. John Wiley & Sons, Inc. New Jersey, 2019, 8

[207] Altman W, Hotchkiss E and Wang W, *Corporate Financial Distress, Restructuring, and Bankruptcy: Analyze Leveraged Finance, Distressed Debt, and Bankruptcy*, 7

[208] Altman W, Hotchkiss E and Wang W *Corporate Financial Distress, Restructuring, and Bankruptcy: Analyze Leveraged Finance, Distressed Debt, and Bankruptcy*, 7

[209] Beckman T, 'A Brief History of the Gasoline Service Station', *Journal of Historical Research in Marketing*, vol. 3 no. 2 https://doi.org/10.1108/17557501111132127 on 22nd August 2021

[210] Finch V, *Corporate Insolvency Law; Principles and Perspectives*, 118

[211] Too F, 'Corporate Restructuring: Towards More Informal and Flexible Models', *African Journal of Commercial Law 1 (2019/2020)*, 24

collateral. This was followed by liquidation since the law made it challenging for companies under receivership to return to profitability since the managers appointed to facilitate any possible turnaround acted more like undertakers rather than managers intending to revive the distressed companies.[212] Consequently, Justice Ringera held that, "*Receivership would most probably result in the complete destruction of the business and goodwill of the company ... and I think it is notorious fact of which judicial notice may be taken that receiverships in this country have tended to give the kiss of death to many a business*."[213]

However, since the enactment of the Insolvency Act, 2015, corporate insolvency law has been centred on company rescue. The law has not undergone a responsiveness test since its promulgation, and the covid-19 pandemic is the first regulation responsiveness test that the Kenyan insolvency regime is undergoing. Furthermore, as explained in Chapter one, the Insolvency Act was only amended in section 643(1)[214] to enable companies under financial distress to obtain moratoriums since initially these moratoria were available to directors proposing a voluntary arrangement. No other amendments have been done following the pandemic, thus necessitating an analysis of whether the framework is responsive and adaptive in the event of an emergency due to an economic recession or pandemic.

2.3.1. Administration

This is the management or performance of the executive duties of an institution or business.[215] The objects of administration are to maintain the company as a going concern, the achievement of a better outcome for the company's creditors as a whole than would likely be the case if the company were liquidated without first being in administration or the realisation of the company's property for purposes of distribution to its secured or preferential creditors.[216] Administration involves taking control by the administrator of either the entire or substantially the entirety of the company's business and its assets[217] to achieve these objectives. The administrator's primary goal, however, is to rescue the company while acting in the interests of all the creditors.[218]

In *Midland Energy Ltd. vs George Muiruri Trading as Leakey's Auctioneers and another*[219] Tuiyott J. noted that the case before him exhibited the tensions that can arise between creditors and a company under administration. The judge was emphatic that Kenya's insolvency law was designed to give a second chance to economically distressed companies, which was unlike the past whereby an ailing company's fate would customarily be a winding up or liquidation order.

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[212] Too F C, 'A Comparative Analysis of Corporate Insolvency Laws: Which is the best option for Kenya?', 129
[213] *Jambo Biscuit (K) Ltd v Barclays Bank of Kenya Ltd., Andrew Douglas Gregory and Abdul Zahir Sheikh* [2003], 2 EA 434
[214] Section 18, *Business Laws (Amendment) (No. 2) Act*, (Act No. 1 of 2021).
[215] Black's Law Dictionary, 9th Edition at 49
[216] Section 522(1), *Insolvency Act*, (Act No.18 of 2015).
[217] Laibuta K.I., *A Handbook of Company Law*, 477
[218] Section 522(3), *Insolvency Act*, (Act No.18 of 2015).
[219] *Midland Energy Limited v George Muiruri t/a Leakey's Auctioneers & another* [2019] eKLR, http://kenyalaw.org/caselaw/cases/view/170016/ on 24th February 2022

He noted that the insolvent company must be protected from aggressive creditors who could cause a run on the assets of the distressed company.

Insulation of an insolvent company under administration is provided by a moratorium[220] on enforcing debts and securities over the company's property. The moratorium also suspends the initiation or continuation of legal proceedings or execution against the company.[221] The business will be saved by maintaining the company as a going concern. This protection would ensure that the company is not distracted by precipitate action so that the administrator can undertake his mandate in the interest of all creditors of the company. The administrator will realise a better outcome for the creditors than in liquidation and realise the company's property to distribute to one or more secured or preferential creditors.[222] As such, through the guardianship of an insolvency practitioner, administration allows for the ongoing operation of a company while it is still under the protection of a moratorium which is a valuable feature of debt restructuring.

Further, in *In re Nakumat Holdings Limited*,[223] Onguto J. held that administration is an instrument designed to offer breathing space for companies that are insolvent whilst additionally putting superior returns and packages for creditors, not typically available in liquidation since it is a cheaper process for the company. He noted that the Insolvency Act acknowledged the business value of a company as a going concern and specifically that the distressed company was better placed by escaping the liquidation process for the sake of stakeholders of the company. In the judge's eyes, this was an apparent attempt to safeguard and balance the conflicting interests of the company's employees, creditors, suppliers, and shareholders since the company would be maintained, and at the same time creditors would be happier with the hope of complete recovery.

Administrators are appointed by the holders of any debentures secured by a qualifying floating charge on a company's property once they obtain an order of the court or under the powers contained in an agreement to enforce security in the event of default under a floating charge.[224] An administrator can also be appointed by the company, its directors[225] or the court upon application.[226] Upon appointment by way of an administration order,[227] an administrator is deemed an officer of the court, even if such an appointment is not by the court.[228] Notably, one may not appoint an administrator under section 534 of the Act unless the person has given at

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[220] Section 559 and Section 560, *Insolvency Act*, (Act No.18 of 2015).
[221] *Freakley and others v. Centre Reinsurance International Company and others* [2006] UKHL 45, https://www.bailii.org/uk/cases/UKHL/2006/45.html on 24th February 2022
[222] Section 522 (1), *Insolvency Act*, (Act No.18 of 2015).
[223] *In re Nakumat Holdings Limited* [2017] eKLR, http://kenyalaw.org/caselaw/cases/view/143828/ on 24th February 2022
[224] Section 534, *Insolvency Act*, (Act No.18 of 2015) and Section 886, *Companies Act*, (Act No. 17 of 2015).
[225] Section 541, *Insolvency Act*, (Act No.18 of 2015).
[226] Section 523, *Insolvency Act*, (Act No.18 of 2015).
[227] Section 530, *Insolvency Act*, (Act No.18 of 2015).
[228] Section 525, *Insolvency Act*, (Act No.18 of 2015).

least three days' notice to a holder of any preceding qualifying floating charge, enabling the prior qualified floating charge holder to consider appointing an administrator itself.[229]

Administration inevitably ends after twelve months from the date of appointment of an administrator.[230] It can be terminated by order of the court for reasonable cause,[231] upon application by the administrator[232] or a creditor,[233] or upon realisation of the objectives of the administration.[234] The Court may order an extension to the administrator's term in office for a specified period upon an administrator's application, and the term may also be prolonged by consent for a specified period of not more than six months.[235]

Several shortcomings of this process are identifiable in an emergency such as a recession or pandemic. Primarily, those in charge of running the day-to-day operations of the company are required to relinquish this control to an insolvency practitioner. This, despite the practitioner possibly not being knowledgeable about the debtor's business like the ousted management.[236]

This makes it particularly risky in a pandemic situation because, as earlier explained, the debtor's management is likely to be disincentivised from seeking early help when the company becomes insolvent and will likely take excessive business risks to rescue the debtor or ensure they remain in power.[237]

Furthermore, a pandemic situation creates the need for urgent insolvency interventions due to the emergency, and the debtor's directors could as a consequence drive it into insolvency by clinging to power to avoid personal liabilities.[238] Consequently, the going concern value of the debtor's assets will dissipate and this in turn prejudices any rescue operations and diminishes the value of the assets available for distribution to creditors.

Secondly, the process is pegged towards creditor protection as opposed to debtor relief characteristic of Chapter 11 of the United States Bankruptcy Code, which is strongly oriented towards avoiding social costs associated with liquidation and preserving the business as a going concern.[239] This is because the debtor need not be insolvent or near insolvent to apply for chapter 11 relief, unlike in administration. Furthermore, Chapter 11 relief provides for a cramdown whereby a plan the court confirms may be imposed on a class of objecting creditors

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[229] Section 535(1), *Insolvency Act*, (Act No.18 of 2015).
[230] Section 593, *Insolvency Act*, (Act No.18 of 2015).
[231] Section 598, *Insolvency Act, (Act No.18 of 2015).*
[232] Section 595, Insolvency Act, (Act No.18 of 2015).
[233] Section 597, *Insolvency Act, (Act No.18 of 2015).*
[234] Section 596, *Insolvency Act*, (Act No.18 of 2015).
[235] Section 594(1), *Insolvency Act*, (Act No.18 of 2015).
[236] Iheme C, 'A Doctrinal Assessment of the Insolvency Frameworks of African Countries in Coping with the Pandemic-Triggered Economic Crisis', 318
[237] Finch V, *Corporate Insolvency Law; Principles and Perspectives*, 330
[238] The World Bank Group, *COVID-19 Outbreak: Implications on Corporate and Individual Insolvency*, 2020, 2 https://pubdocs.worldbank.org/en/912121588018942884/COVID-19-Outbreak-Implications-on-Corporate-and-Individual-Insolvency.pdf on 13th August 2022
[239] Finch V, *Corporate Insolvency Law; Principles and Perspectives*, 230

subject to a 'best interest' test. This is a test whereby the court must be satisfied that the objecting creditor will receive as much as they would in liquidation.[240] We do have the concept of a cramdown and a division of creditors into classes for purposes of corporate insolvency in Kenyan insolvency law, but these apply in voluntary arrangements[241] and not in administration.

Thirdly, a company in distress may find it challenging to obtain financing as the Act does not have a provision for super-priority funding, which it requires in the event of an emergency. A super-priority regime ensures that the providers of funds during a moratorium are prioritised over all existing creditors.[242] As such, creditors will consider it risky to lend to a distressed company on an unsecured or under-secured basis since repayment will depend on the success of the proposed rescue. Several countries provide for post-petition financing, including Germany, France, Australia, Sweden, New Zealand, the United States and most recently, the United Kingdom. CIGA inserted section 174A[243] and section A53(2),[244] providing super-priority post-moratorium and moratorium debt, respectively. Where a loan is advanced to the distressed company during the moratorium and remains unpaid at the end of the moratorium, it will have super-priority and be paid out of realisations ahead of lenders holding existing floating charges. Kenya's insolvency regime may benefit from the introduction of such lending.

Lastly, as it stands, nothing stops creditors whose contracts empower them to privately enforce their rights from doing so at the pre-commencement stage, and distressed companies stand a risk of being subjected to an insolvency application. Notably, some countries, including the UK, have introduced a free-standing moratorium aimed at providing companies facing financial distress with an opportunity to consider the best tactic to rescue viable businesses without risking enforcement and legal action by its creditors.

As highlighted in chapter three of the thesis, through CIGA,[245] the UK introduced an amendment to sections 233 and 233A of its Insolvency Act, which prohibits the operation of termination clauses that take effect upon insolvency or are based on past breaches of contract. The amendments effectively ensure that contracted suppliers will have to continue to supply, even where there are pre-insolvency arrears.

Initially, the sections invalidated termination clauses in particular company insolvency and rescue procedures relating to supplies such as gas, electricity, communication and certain electronic services. Currently, the new section prevents suppliers of a much more comprehensive range of supplies from relying on termination clauses or doing 'any other thing' due to a company entering a qualifying restructuring or insolvency procedure. Under Kenyan

[240] Finch V, *Corporate Insolvency Law; Principles and Perspectives*, 231
[241] Section 629(8), *Insolvency Act*, (Act No.18 of 2015).
[242] Finch V, *Corporate Insolvency Law; Principles and Perspectives*, 334
[243] Section 174A, Insolvency Act, UK, https://www.legislation.gov.uk/ukpga/1986/45/section/174A
[244] Section A53(2), Insolvency Act, UK, https://www.legislation.gov.uk/ukpga/1986/45/section/A53
[245] Section 233B, Insolvency Act, UK, https://www.legislation.gov.uk/ukpga/1986/45/section/233B

law, the services are related to specific supplies such as gas, electricity, water and communication services.[246]

In Kenya, there was a tremendous increase of companies undergoing administration from July 2021 to March 2022: there were fourteen,[247] compared to the previous periods; 2020-2021,[248] 2019-2020[249] and 2018-2019,[250] where there were, in total, seventeen registered companies in administration. The increase could be attributed to the creditors being assured a better deal than in liquidation and the procedure allowing the company to have a chance at being restructured.

2.3.2. Company Voluntary Arrangements (CVA's)

The directors of a company may issue a proposal to the company and its creditors for their approval of a CVA whereby the company enters into an arrangement to satisfy its debts on terms to be agreed on with its creditors or a scheme for arranging its financial affairs under the supervision of an insolvency practitioner.[251] The voluntary arrangement cannot alter or affect the rights of the debtor's secured creditors to enforce their securities unless the creditor agrees to such a modification. The CVA intends to facilitate the orderly discharge by the company of its financial obligations and enable it to carry on business as a going concern and avoid liquidation.[252] Notably, a distressed company need not necessarily have taken any active steps to obtain the court's or a formal or unconditional creditor consent provided that it can show that a scheme of arrangement has been agreed on or is being negotiated by the main body of creditors and that it has a reasonable prospect of succeeding.[253]

A shortcoming to CVA's is that the Act does not provide a moratorium and a period of protection during which the company can consider an arrangement in an emergency. The company's directors proposing the voluntary arrangement or composition may recommend that the company obtains a moratorium,[254] and this heightens the rescue culture presented in the Insolvency Act. A moratorium can also be achieved by combining the CVA proposal with an application to the court for the appointment of an administrator.[255] Such a move, however, has

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[246] Section 625, *Insolvency Act*, (Act No.18 of 2015).
[247]BRS Statistics (Office of the Official Receiver) - 2021/2022 https://brs.go.ke/or-statistics-2022.php on 2nd May 2022
[248]BRS Statistics (Office of the Official Receiver) - 2020/2021 https://brs.go.ke/or-statistics-2021.php on 2nd May 2022
[249] BRS Statistics (Office of the Official Receiver) - 2019/2020 https://brs.go.ke/or-statistics-2020.php on 2nd May 2022
[250]BRS Statistics (Office of the Official Receiver) - 2018/2019 https://brs.go.ke/or-statistics-2019.php on 2nd May 2022
[251] Section 625, *Insolvency Act*, (Act No.18 of 2015).
[252] *In Matter of T&N Limited and Others* [2005] EWHC 2870 (Ch), https://www.bailii.org/ew/cases/EWHC/Ch/2005/2870.html on 24th February 2022
[253] *Roberts Petroleum Limited v Bernard Kenny Limited (In liquidation),* 1981 The United Kingdom Court of Appeal, https://www.bailii.org/ew/cases/EWCA/Civ/1981/10.html
[254] Section 626(1), *Insolvency Act*, (Act No.18 of 2015).
[255] Finch V, *Corporate Insolvency Law; Principles and Perspectives*, 419

its drawbacks since it not only means additional expense for the company but also leaves control of the business in the hands of the administrator and not the directors.

A clear demonstration that a company in distress can benefit significantly from a moratorium was in a matter where Justice Blair[256] held that the court had jurisdiction to order a stay of proceedings brought by two creditors to enforce their holdings of the debt against a debtor, pending the implementation of a scheme of arrangement between the debtor and its creditors. The debtor argued that continuing the proceedings would disrupt the scheme and destabilise the restructuring process. In his finding, the judge noted that the discretion to grant a stay pending the implementation of a scheme was to be exercised in 'special circumstances'. For instance, the special circumstances of the matter before him were that there was a reasonable prospect of the scheme of arrangement being successfully implemented by the debtor, the negotiations having gone on for two-and-a-half years and including the debtor, the lenders, the Government of Vietnam, and their respective advisers. Lastly, the debtor had also secured the necessary lender support to qualify for a scheme of arrangement.

Another shortcoming of CVA's is the need to deal with the creditors to obtain their approval since the CVA procedure does not provide a cross-class cramdown which may delay insolvency proceedings. The ability of a majority of creditor classes to bind one or more dissenting classes is referred to as a cross-class cramdown.[257] Concentrated creditor theory holds that a multiplicity of creditors increases negotiating frictions, and enfranchising parties other than the floating charge holder increases negotiation costs relative to receiverships, thereby reducing the chances of rapid and effective responses to corporate troubles.[258]

As such, the CVA may prove inefficient and ineffective if there is an emergency. Specifically, a creditor can block a proposed arrangement even where it is in the company's and the rest of the creditors' best interests. Furthermore, secured creditors can choose not to join the CVA, which would require the distressed company to negotiate with each secured creditor, undermining achieving an optimal rescue solution and increasing costs.

For instance, in the Uchumi Supermarket Limited[259] restructure, this was experienced where the company's secured creditors rejected the CVA. The court held that it could only approve a company's proposal, or its modification, if a majority of the company's secured creditors sanctioned the proposal or if the proposal or its modification did not exploit the dissenting members. Following the pandemic, the UK introduced a cramdown mechanism whereby

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[256] *Bluecrest Mercantile BV v Vietnam Shipbuilding Industry Group and Others* (2013) EWHC 1146, The United Kingdom High Court

[257] Harris, J, 'Class Warfare in Debt Restructuring: Does Australia Need Cross-Class Cram down for Creditors' Schemes of Arrangement?', The University of Queensland Law Journal, 2017, 1 https://ssrn.com/abstract=3306928 on 22nd July 2022

[258] Finch V, *Corporate Insolvency Law; Principles and Perspectives*, 327

[259] *In re of Uchumi Supermarkets Plc* [2019] eKLR http://kenyalaw.org/caselaw/cases/view/181157 on 30th May 2022

secured and unsecured creditors would be bound to a rescue plan since dissenting creditors could block a restructuring proposal.[260]

It is an established fact that successful restructuring depends on the insolvent business being capable of obtaining financing to enable it to operate as a going concern.[261] Temporary funding of the business as a going concern could also be crucial to maximise recoveries in a liquidation.[262] Unfortunately, a lack of financing for distressed companies in their operations during the CVA is arguably a barrier to this being an effective rescue mechanism[263] since creditors are unlikely to agree to the company's proposal without the prospect of secure funding.[264]

Iheme[265] argues that neither the receivership nor the administration system is suitable for Kenya, and that based on Kenya's economy and the financial status of its corporate businesses, only a debtor-in-possession ("DIP") model, such as the company voluntary arrangement ("CVA") should be retained as a debt restructuring (insolvency) procedure. It does not seem to be a popular procedure, as there were only two companies in CVA between 2016 and 2019, despite the CVA being touted as the best insolvency procedure for Kenya. Notably, there were no companies under CVA between June 2021 to March 2022,[266] one in July 2020 to June 2021[267] and none in 2019-2020.

2.3.3. Liquidation

Liquidation is a prelude to the ultimate demise of a company.[268] It is the key insolvency proceeding whereby the affairs of the insolvent company are managed by a liquidator before the company's dissolution when it is removed from the Companies Register. It is the process of settling accounts and liquidating the insolvent's assets in anticipation of dissolution.[269] A debtor's liabilities are ascertained, and their non-exempt property is collected, converted into cash and distributed to the various creditors. Such liquidation can either be voluntary or under

[260] Schedule 9, *Corporate Insolvency and Governance Act*, Chapter 12, https://www.legislation.gov.uk/ukpga/2020/12/schedule/9/enacted

[261] Halász C and Vogelmann A, 'Post-petition financing in Germany', The Restructuring and Insolvency Multi-Jurisdictional Guide 2014/15, 2014 https://www.morganlewis.com/-/media/files/docs/2014/plc---post-petition-financing-in-germany.pdf on 20th July 2022

[262] Halász C and Vogelmann A, 'Post-petition financing in Germany', The Restructuring and Insolvency Multi-Jurisdictional Guide 2014/15, 2014

[263] Finch V, *Corporate Insolvency Law; Principles and Perspectives*, 425

[264] Finch V, *Corporate Insolvency Law; Principles and Perspectives*, 429

[265] Iheme C, 'A Doctrinal Assessment of the Insolvency Frameworks of African Countries in Coping with the Pandemic-Triggered Economic Crisis', 317

[266] BRS Statistics (Office of the Official Receiver) - 2021/2022 https://brs.go.ke/or-statistics-2022.php on 2nd May 2022

[267] BRS Statistics (Office of the Official Receiver) - 2020/2021 https://brs.go.ke/or-statistics-2021.php on 2nd May 2022

[268] Goode R, *Principles of Insolvency Law*, 4th ed., Sweet & Maxwell, 2011, 149

[269] Black's Law Dictionary, 9th Edition, 1738

an order of the court[270] and is also referred to as winding-up. Generally, the two principal forms of winding-up are the creditor's voluntary liquidation or a compulsory liquidation by the court. Whether the liquidation is a form of exit from administration or lodged in a usual manner, these two principal forms of liquidation are broken into four sub-groups. These are the creditors' voluntary liquidation through a member's resolution, a compulsory liquidation by court order upon lodging a petition, the compulsory liquidation as an exit from liquidation by court order and lastly, a creditors' voluntary liquidation as an exit from administration.

2.3.3.1. Liquidation as an exit from administration

Liquidation may firstly be commenced upon registration and lodgement of a notice by an administrator, with the Registrar[271] and the court[272] indicating that the total sum that the company's secured creditors are likely to receive has been paid to or has been set aside for the creditor, and that a distribution will be made to the companies unsecured creditors, if any. This notice will be sent to each creditor whose claim the administrator is aware of.[273] Once the notice is registered, the administrator's appointment ends, and the company will be liquidated as though a special resolution for voluntary liquidation under section 393 of the Act had been passed on the day the notice was registered.[274] The registration causes the administrator's appointment to terminate and the company will be wound up as if a resolution for winding up had been passed on the day the notice is registered.[275] The company's creditors may nominate a qualified person to act as liquidator, failing which the administrator will act as liquidator.[276]

2.3.3.2. Compulsory Liquidation by Court Order

A company under administration may be dissolved by order of the court where it is evinced to the court's satisfaction that the company does not have enough property available for distribution to its creditors.[277] In this instance, the administrator lodges a notice to that effect with the Registrar[278] and, after that, with the court. This notice is also shared with the creditors whose claim and address the administrator is aware of.[279] At this point, the administrator's appointment ceases, and the company stands dissolved at the end of three months.[280]

Liquidation can also be by way of compulsory liquidation under the High Court's supervision on the application of either the company, its directors, a creditor or group of creditors, a

[270] Section 381 (2), *Insolvency Act*, (Act No.18 of 2015).
[271] Section 599(2), *Insolvency Act*, (Act No.18 of 2015).
[272] Section 599(4)(a), *Insolvency Act*, (Act No.18 of 2015).
[273] Section 599(4)(b), *Insolvency Act*, (Act No.18 of 2015).
[274] Section 599(5)(b), *Insolvency Act*, (Act No.18 of 2015).
[275] *Nygate & Anor v E Squared Ltd.* [2006] EWHC 532 (Ch) (16 March 2006) https://www.bailii.org/ew/cases/EWHC/Ch/2006/532.html on 24th February 2022
[276] Section 599(6), *Insolvency Act*, (Act No.18 of 2015).
[277] Section 600(5)(a), *Insolvency Act*, (Act No.18 of 2015).
[278] Section 600(1), *Insolvency Act*, (Act No.18 of 2015).
[279] Section 600(5)(b), *Insolvency Act*, (Act No.18 of 2015).
[280] Section 600(6), *Insolvency Act*, (Act No.18 of 2015).

contributory or group of contributories, a provisional liquidator or administrator, the Attorney General or a liquidator if the company is under voluntary liquidation.[281] The application for liquidation is presented to the court, and liquidation commences upon such an application being lodged.[282]

2.3.3.3. Voluntary Liquidation

A company may be dissolved by voluntary liquidation, either member's or creditors' voluntary liquidation. A company's voluntary liquidation is commenced and continued on the presumption that the company has sufficient assets capable of satisfying all its creditors.[283] In a member's voluntary liquidation, the company's directors make a statutory declaration of solvency. This is a declaration that the directors have made a complete inquiry of the company's affairs and have formed an opinion that the company will be capable of paying its debts in full, with interest, within a period not exceeding twelve months from the liquidation's commencement.[284] This declaration is lodged with the Registrar within fourteen days of passing the resolution for liquidation. An insolvency practitioner is appointed as a liquidator by the company in a general meeting to liquidate its affairs and distribute its assets.[285]

Creditors' voluntary liquidation is either one where creditors resolve to liquidate the company, or one where the liquidation started as a members' voluntary liquidation but is converted into a creditors' liquidation on account of the directors' inability to validly declare the company's solvency – which is a requirement in a members' voluntary liquidation. In this instance, the company in liquidation must convene a meeting of its creditors within fourteen days of the company's general meeting to deal with a proposed resolution for voluntary liquidation.[286] During this meeting, the creditors will examine the company's statement of affairs prepared by the directors,[287] and the company and the creditors will appoint an authorised insolvency practitioner who shall liquidate the company and distribute its assets.[288] In a voluntary liquidation, the liquidation commences upon passing the resolution for liquidation.[289] The company stands dissolved at the end of three months after registering the liquidator's final account and return with the Registrar.[290]

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[281] Section 423-426, *Insolvency Act*, (Act No.18 of 2015).
[282] Section 431(3), *Insolvency Act*, (Act No.18 of 2015).
[283] Laibuta K.I., *A Handbook of Company Law*, 496
[284] Section 398(1), *Insolvency Act*, (Act No.18 of 2015).
[285] Section 399(1), *Insolvency Act*, (Act No.18 of 2015).
[286] Section 406(1), *Insolvency Act*, (Act No.18 of 2015).
[287] Section 407(1), *Insolvency Act*, (Act No.18 of 2015).
[288] Section 408(1), *Insolvency Act*, (Act No.18 of 2015).
[289] Section 431(1)(a), *Insolvency Act*, (Act No.18 of 2015).
[290] Section 494(3), *Insolvency Act*, (Act No.18 of 2015).

2.3.3.4. Effects and Legal Consequences of Liquidation

Once a liquidator is appointed, all directors' powers terminate, except in so far as the company in general meeting, or the liquidator, sanctions their extension.[291] Once the company is liquidated, its liquidator must prepare an account of the liquidation process and the manner in which the company's property has been disposed of.[292] The liquidator is required to summon a general meeting of the creditors and the company to present this account. The account is lodged with the Registrar and accompanied by details of the meetings.[293]

Upon commencement of the liquidation, a Court order must be sought before the company's property is disposed of, before the transfer of shares or any alteration in the status of the members of the company; otherwise, such acts are void.[294] The attachment, sequestration, distress or execution against the company's assets after the commencement of the liquidation is also invalid.[295] Lastly, legal proceedings cannot be initiated against the company once liquidation commences unless leave of court is sought.[296] As such, companies in liquidation also benefit from moratoria. The court in *Cook v Mortgage Debenture Ltd* [2016] EWCA Civ 103[297] outlined the purpose and effect of the liquidation moratorium as follows. Firstly, since the company's property stands to be realised and distributed, subject to any existing interests, among the creditors on a *pari passu* basis, the moratorium prevents any creditor from obtaining priority and thereby undermining the *pari passu* basis of distribution. Secondly, since liquidation contains provisions for adjudicating claims by persons claiming to be creditors, the moratorium protects those procedures and prevents unnecessary and potentially expensive litigation.

Liquidation ought to be completed within twelve months after its commencement, failure to which the liquidator must lodge with the Registrar a statement outlining particulars of the liquidation proceedings until the liquidation is completed.[298]

To achieve the maximization of value of the debtor, there ought to be a balance between reorganization and liquidation. An effective insolvency framework ought to balance the advantages of short-term debt collection through liquidation against preservation of the debtor's business value through reorganization.[299] In this regard, the objectives of corporate insolvency law in the context of liquidation are firstly to transfer the management of the company to a duly authorized insolvency practitioner. Secondly, to provide for the orderly

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[291] *George W M Omondi & another v National Bank of Kenya Ltd & 2 others* [2001] eKLR http://kenyalaw.org/caselaw/cases/view/3485 on 24th February 2022
[292] Section 414(1), *Insolvency Act*, (Act No.18 of 2015).
[293] Section 414(4), *Insolvency Act*, (Act No.18 of 2015).
[294] Section 429(1), *Insolvency Act*, (Act No.18 of 2015).
[295] Section 430, *Insolvency Act*, (Act No.18 of 2015).
[296] Section 432(2), *Insolvency Act*, (Act No.18 of 2015).
[297] *Cook v Mortgage Debenture Ltd* [2016] EWCA Civ 103, The UK Court of Appeal (Civil Division) https://www.bailii.org/ew/cases/EWCA/Civ/2016/103.html
[298] Section 489(1), *Insolvency Act*, (Act No.18 of 2015).
[299] Part One I, Paragraph 6, UNCITRAL Legislative Guide on Insolvency Law, 2005, 11.

realization of assets and meeting of claims and prevent individual creditors from pursuing their claims. The third objective is to prescribe an equitable ranking of claims among different classes of creditors, and distribution of the proceeds of realizations among the creditors. Fourthly, it enables the setting aside of prejudicial transactions made by the company before the commencement of the liquidation. Lastly, liquidation enables an investigation into the causes of failure and the conduct of directors to be done with a view of instituting criminal or civil proceedings, including their disqualification.[300]

Liquidation unnecessarily destroys a large amount of a company's value as a going concern. Therefore, rehabilitative restructurings are almost always preferable for not only these financially distressed companies but also their creditors and the society at large, where the company is cash-flow insolvent but economically viable.[301] The same cannot be said for an economically distressed company. Despite this shortcoming, liquidation ensures that a company that is unable to pay its debts as they become due, or whose debts exceed its assets, is removed from the companies' registry, enables inter-creditor problems to be addressed efficiently to avoid the loss of value for all creditors, and enables a sustainable debtor-creditor relationship.[302]

The preceding discussion on the liquidation process serves to demonstrate that considering the lengthy procedures and the statutory requirements of liquidation, it would be ill-suited as a response to emergencies such as the pandemic.

In terms of statistics, eight registered companies were under voluntary liquidation between July 2021 and March 2022,[303] five from July 2020 to June 2021[304] and nine from July 2019 to June 2020.[305] Although there were sixty three liquidation petitions filed in court between January 2016[306] to June 2018,[307] there was a high increase in these petitions from July 2018 to June 2019, which saw forty four [308] petitions filed and a similar number between July 2019 to June 2020.[309] Forty petitions were filed between July 2020 and June 2021,[310] and thirty two[311]

[300] Sir Goode R, and McKendrick E, *Goode and McKendrick on Commercial Law*, 6th ed., LexisNexis UK, 2020, 939

[301] Payne J, 'Debt Restructuring in English Law: Lessons from the US and the Need for Reform' Oxford Legal Studies Research Paper Number 89, 2013, 4, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2321615 on 14th April 2022

[302] Part One II, Paragraph 35, UNCITRAL Legislative Guide on Insolvency Law, 2005, 31.

[303] BRS Statistics (Office of the Official Receiver) - 2021/2022 https://brs.go.ke/or-statistics-2022.php on 2nd May 2022

[304] BRS Statistics (Office of the Official Receiver) - 2020/2021 https://brs.go.ke/or-statistics-2021.php on 2nd May 2022

[305] BRS Statistics (Office of the Official Receiver) - 2019/2020 https://brs.go.ke/or-statistics-2020.php on 2nd May 2022

[306] https://brs.go.ke/or-statistics-2016.php

[307] https://brs.go.ke/or-statistics-2018.php

[308] https://brs.go.ke/or-statistics-2019.php

[309] https://brs.go.ke/or-statistics-2020.php

[310] https://brs.go.ke/or-statistics-2021.php

[311] https://brs.go.ke/or-statistics-2022.php

petitions have been filed over the past year (July 2021 to March 2022). There was no considerable increase in the petitions filed in court for liquidation over the pandemic. This may be attributed to the policy and fiscal measures introduced by the government and the private sector, and it is suggested that we have merely postponed the insolvency petitions.[312]

In any event, liquidation is a popular procedure, which is at odds with the rescue culture advocated by the Insolvency Act, especially in administration. This could be because administration necessitates waiting for an administrator to put in place a reorganization plan and requires to be put to a vote before being implemented.[313] Another reason could be directors being disincentivized from seeking help or even assisting the administration due to their managerial powers being displaced during the administration, and the fact that that administrator is empowered to remove or appoint new directors.[314]

2.3.4. Schemes of Arrangement

A compromise or scheme of arrangement is an agreement between a company and its creditors or any class of them, or its members or any class of them, to restructure the company or businesses to meet its debt obligations.[315] Schemes are fundamentally contractual in nature and are grounded in the scheme document, which is essentially a contract between the company and its creditors, and there is no need to involve an insolvency practitioner.[316] A scheme is, therefore, principally a debtor-in-possession process, since the company's existing management is not displaced in favour of an insolvency practitioner. The scheme, however, differs from a contract since it can, in certain circumstances, bind dissenting creditors.[317] They are used to implement a moratorium whilst a restructuring is being agreed upon, to amend existing debt arrangements, to extend maturities or to implement debt restructurings through debt for equity and debt for debt swaps.[318]

Under the Act, an arrangement includes the reorganisation of the company's share capital through consolidating its shares of different classes or by division of its shares into shares of different classes.[319] It may also be an arrangement or compromise between the company and its creditors that results in a variation of the creditors' rights which allows a financially

[312] Uttamchandani M, Muro S and Bertens E., *The calm before the storm: Early evidence on business insolvency amid COVID-19*, The World Bank Blogs, 2021 https://blogs.worldbank.org/psd/calm-storm-early-evidence-business-insolvency-amid-covid-19 on 14th August 2022

[313] Fletcher, I. F., 'UK Corporate Rescue: Recent Developments - Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements - the Insolvency Act 2000, the White Paper 2001, and the Enterprise Act 2002', 124

[314] Fletcher, I. F., 'UK Corporate Rescue: Recent Developments - Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements - the Insolvency Act 2000, the White Paper 2001, and the Enterprise Act 2002', 126

[315] Section 922(1), *Companies Act*, (Act No. 17 of 2015).

[316] Finch V, *Corporate Insolvency Law; Principles and Perspectives*, 412.

[317] Section 926 (3), *Companies Act*, (Act No. 17 of 2015).

[318] Paterson, S, 'Reflections on English Law Schemes of Arrangement in Distress and Proposals for Reform', 475,

[319] Section 922(3), *Companies Act*, (Act No. 17 of 2015).

distressed company to avoid formal insolvency proceedings. It may be initiated by the company's directors or members, its creditors, a liquidator, or an administrator if the company is in liquidation or under administration.[320] The compromise or arrangement must be sanctioned by the High Court to bind the creditors or members[321] and is only effective once the court order is lodged with the Registrar of Companies for registration.[322]

In considering an applicant's petition for approval of the scheme, the court will first establish whether the statutory majority passed the necessary resolutions. Secondly, it reviews the decisions taken at the meetings to establish whether the class was represented fairly by those attending the meeting, that the majority acted bona fide and did not promote interests adverse to those of the class concerned, that a member of the class concerned might reasonably approve the scheme and that there was no technical or legal defect in the scheme.[323] The court will focus on the rights to be released or varied under the scheme and the new rights to be granted rather than the creditor's interests. It must be satisfied that the scheme is such that a reasonable businessman acting in respect of his interest might reasonably approve. It must be shown that the statutory majority has acted bona fide, has consulted the various classes of creditors, has not unduly coerced the minority and has complied with statutory requirements. This is because where the creditors are acting on sufficient information and with time to consider what they are about, and have acted honestly; they are much better judges of what is to their commercial advantage than the court can be.[324] Even where there is a deliberate omission of information concerning the value of assets and liabilities exempted by statute, the court will not exercise its discretion to interfere with the arrangement so long as there is evidence that the scheme and compensation to the creditors is fair.[325] The court's supervision therefore averts abuse of the process.

An advantage of the scheme is that it becomes binding upon all the shareholders once the special resolution is passed (if approved by three-quatres of the shares). Furthermore, the shareholders have the protection of prior court approval of the scheme as will be discussed shortly.

There are several shortcomings of schemes which may limit its use in an emergency, namely the lack of a moratorium and the lack of a cramdown mechanism between classes of creditors within a scheme.[326] As has been argued herein, these are necessary in a pandemic or economic recession situation to ensure a debtor is successfully rescued if this is the scheme's objective. For instance, the Kenya Airways scheme of arrangement experienced difficulty as the airline

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[320] Section 923(2), *Companies Act*, (Act No. 17 of 2015).
[321] Section 926(3), *Companies Act*, (Act No. 17 of 2015).
[322] Section 926(4), *Companies Act*, (Act No. 17 of 2015).
[323] Gower, *Principles of Modern Company Law*, 11th ed., Sweet and Maxwell, 2021, 1077.
[324] *Re English, Scottish and Australian Chartered Bank* (1891-4) All E.R., 775
[325] *Re National Bank Limited* (1966) 1 All E.R. 1006
[326] Paterson, S, 'Reflections on English Law Schemes of Arrangement in Distress and Proposals for Reform', 476.

was securing additional capital to continue trading as a going concern. There were numerous applications by creditors who disputed that the scheme applied to them.[327]

Unfortunately, there are no statistics from the office of the official receiver on the companies in schemes,[328] but it is important to consider them and determine if they are adaptive and responsive and suited in an emergency situation. The schemes discussed are mergers of companies, division of companies and reorganisation of a company's share capital.

2.3.4.1. Merger of Companies

Per the Companies Act, a scheme is a merger if the undertaking, property and liabilities of one or more public companies are to be transferred under the scheme to another existing public company or a new company,[329] one explicitly formed for the merger. Under the Competition Act, a merger ensues when a company either procures or gains control over the whole or part of the business of another company, which may be by exchange of shares resulting in a substantial change in ownership of the acquired undertaking.[330]

The directors of the merging entities must prepare and adopt draft proposed merger terms[331] as provided under the Act. The proposal must thereafter be lodged for registration[332] and gazettement[333] with notice being given to the Competition Authority of Kenya. The directors of the merging entities must appoint an expert to prepare a written report on the terms for presentation to the members of each of the companies.[334] The directors must also prepare and adopt explanatory reports of the proposed merger.[335] Both parties must then pass a special resolution to commence the process.[336] For publicly listed companies, the Capital Markets Act,[337] and the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations, 2002,[338] require the Boards of Directors to announce the merger. Each merging entity must also notify the Competition Authority of Kenya regarding the proposed merger in

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[327] *Equity Bank Kenya Limited v Kenya Airways PLC & 11 others* [2017] eKLR http://kenyalaw.org/caselaw/cases/view/140386 on 5th June 2022
[328] BRS Statistics (Office of the Official Receiver) - 2021/2022 https://brs.go.ke/or-statistics-2022.php on 2nd May 2022
[329] Section 933(1), *Companies Act*, (Act No. 17 of 2015).
[330] Section 41(2)(g), *Competition Act*, (Act No. 12 of 2010)
[331] Section 934(1), *Companies Act*, (Act No. 17 of 2015).
[332] Section 935(1), *Companies Act*, (Act No. 17 of 2015).
[333] Section 935(2), *Companies Act*, (Act No. 17 of 2015).
[334] Section 938, *Companies Act*, (Act No. 17 of 2015).
[335] Section 937, *Companies Act*, (Act No. 17 of 2015).
[336] Section 936, *Companies Act*, (Act No. 17 of 2015).
[337] Section 30F, *Capital Markets Act*, Cap 485A.
[338] Regulation 19, *Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations*, 2002.

writing.[339] Its decision on the merger ought to be delivered within 60 days of receipt of the merger notification or within 30 days after a hearing conference is convened.[340]

Liquidation and mergers, two ways in which corporations cease to exist, have several similarities. They transfer control of corporate resources to new owners.[341] As we have seen, one of the objectives of liquidation is the maximization of value to creditors, and similarly, through mergers, the companies affected may receive value created by corporate combinations.[342] Through mergers, as in liquidations, a company's assets can be transferred to more productive uses to improve the control and management of assets.[343]

2.3.4.2. Division of companies

In a division, the company is split, without going into liquidation, into business units, sections, or departments, which can either be transferred to existing corporations or become independent legal entities. Where there is a complete division of the company, it ceases existing once it has transferred all its liabilities and assets to another company. A partial division can also take place and in this instance, the company which is being divided does not transfer all its liabilities and assets and, therefore, continues existing.[344] In a division, the company being divided is transferred to several other receiving companies, however in a merger, the transfer is from one or more companies to another single company.[345]

A scheme involves a division if the undertaking, liabilities and assets of a company are to be divided among and transferred to two or more companies, under the scheme.[346] The company's division is initiated by its directors who prepare a draft proposal of the terms for the scheme.[347] A special resolution of the members then approves the proposal,[348] and the draft terms are lodged with the Registrar of Companies for registration[349] and gazettement.[350] Similarly to mergers, the directors of the transferor and transferee entities are required to appoint an expert to review the company's documents and the intended division to prepare a written report on the

339 Section 43, *Competition Act*, (Act No. 12 of 2010).
340 Section 44, *Competition Act*, (Act No. 12 of 2010).
341 Jarrell G.A, Brickley J.A and Netter J.M, 'The Market for Corporate Control: The Empirical Evidence Since 1980', The Journal of Economic Perspectives, 1988, 51 https://www.jstor.org/stable/1942739 on 20th July 2022.
342 Jarrell G.A, Brickley J.A and Netter J.M, 'The Market for Corporate Control: The Empirical Evidence Since 1980', 53
343 Jarrell G.A, Brickley J.A and Netter J.M, 'The Market for Corporate Control: The Empirical Evidence Since 1980', 54
344 Fomcenco A, 'Mergers & Acquisitions Counseling and Choice of Method', Published PhD Thesis, Aalborg University Press, Denmark, 2015, 10 https://vbn.aau.dk/ws/portalfiles/portal/316449697/Alex_Fomcenco_E_pdf.pdf on 20th July 2022.
345 Fomcenco A, 'Mergers & Acquisitions Counseling and Choice of Method', 45
346 Section 948, *Companies Act*, (Act No. 17 of 2015).
347 Section 949(1), *Companies Act*, (Act No. 17 of 2015).
348 Section 951(1), *Companies Act*, (Act No. 17 of 2015).
349 Section 950(1), *Companies Act*, (Act No. 17 of 2015).
350 Section 950(2), *Companies Act*, (Act No. 17 of 2015).

terms for presentation to the members of each of the companies.[351] To protect the holders of securities on the company's assets, the directors must also prepare and adopt explanatory reports of the proposed division scheme.[352] This ensures that their interests are protected under the scheme. If the division will cause any material changes to the company's assets, the company directors are required to report this.[353] If needed, one may apply to the court for an order to convene a meeting of the shareholders or creditors of an existing transferee company.[354] Such an application is made by a director, shareholder, creditor or administrator if the company is under administration.[355] In any event, the High Court must sanction the division scheme.[356]

Division of companies can possibly lead to the liquidation of a group through the division of group-related companies that are desired to be liquidated or sold and merging them into a single company formed or set aside for this purpose.[357]

As we have seen, the UNCITRAL Legislative Guide proposes early intervention when a company is insolvent or on the verge of insolvency. As such, if a debtor was to consider a merger or division, the timelines and statutory requirements would prevent them from taking prompt action which is needed in an emergency such as a pandemic. This shortcoming is compounded by the unavailability of a moratorium suspending or staying creditor action for both mergers and division of companies. Furthermore, none of the two procedures have a cramdown mechanism, which is desirable in an emergency situation.

2.3.4.3. Reorganisation of a company's share capital

A limited company with a share capital can adjust its share capital structure for strategic reasons, for instance raising funds or to obtain financing for a project. The Companies Act provides four ways for a company to reorganise its share capital. Firstly, a company may increase its share capital by issuing new shares.[358] The company can decrease its share capital through reduction of the nominal value of its shares or the number of shares.[359] Thirdly, it may subdivide its existing shares into shares of a smaller nominal amount than its already existing shares.[360] Lastly, the company can consolidate its existing shares into shares of a more considerable nominal amount than that of the existing shares.[361] A special resolution of the members is required to reduce share capital.[362] However, the other share capital reorganisations

[351] Section 952, *Companies Act*, (Act No. 17 of 2015).
[352] Section 953, *Companies Act*, (Act No. 17 of 2015).
[353] Section 956, *Companies Act*, (Act No. 17 of 2015).
[354] Section 966(1), *Companies Act*, (Act No. 17 of 2015).
[355] Section 966(2), *Companies Act*, (Act No. 17 of 2015).
[356] Section 967, *Companies Act*, (Act No. 17 of 2015).
[357] Fomcenco A, 'Mergers & Acquisitions Counseling and Choice of Method', 102
[358] Section 404(1)(a), *Companies Act*, (Act No. 17 of 2015).
[359] Section 404(1)(b), *Companies Act*, (Act No. 17 of 2015).
[360] Section 405(1)(a), *Companies Act*, (Act No. 17 of 2015).
[361] Section 405(1)(b), *Companies Act*, (Act No. 17 of 2015).
[362] Section 407, *Companies Act*, (Act No. 17 of 2015).

are authorised through an ordinary resolution by the company's members[363] save for where the company's articles provide for a higher limit.[364] Upon being passed, the company must lodge the resolution with the Registrar of Companies within a month of subdividing, consolidating or dividing the shares.[365] Once the company has passed a resolution to reduce its share capital, it is required to apply to court to confirm the proposed reduction.[366] In the event that the proposed share capital reduction involves either a decrease of liability in respect of unpaid share capital or the payment of any paid-up share capital to a shareholder, then the creditors are entitled to object to such reduction.[367]

Nonetheless, before the court makes an order, it will seek confirmation that the creditors of the company have approved the reduction or that their debt or claim with the debtor has been settled or discharged.[368] The company will consequently be required to file the court order and the statement of share capital approved by the court with the Registrar of Companies for registration.[369] The Registrar will then certify the registration of the order and the company's capital statement, authenticate the certificate with the Registrar's official seal and thereby complete the process.[370]

A Private company can also choose to reduce its share capital without the requirement of moving the court by all its directors making a statement confirming the company's solvency within fourteen days prior to passing the resolution on reduction.[371] Each of the directors of the company must declare that they are of the opinion that there exist no grounds on which the company could subsequently be found to be unable to pay or otherwise discharge its debts and that the company will be capable of paying its debts as they fall due, for up to a year.[372] The company must, within fourteen days of passing the resolution, lodge with the Companies Registrar a copy of the resolution, a statement of capital and a statement of its directors confirming that the solvency statement was made within the statutory timeframe.[373] The resolution is effective once these documents are registered by the Companies Registrar.[374]

Arguably, this procedure may not be suitable to deal with insolvency challenges since it is used in scenarios where the company can justifiably prove that it is not cash flow insolvent.

[363] Section 405(3), *Companies Act*, (Act No. 17 of 2015).
[364] Section 405(5), *Companies Act*, (Act No. 17 of 2015).
[365] Section 406, *Companies Act*, (Act No. 17 of 2015).
[366] Section 408(1), *Companies Act*, (Act No. 17 of 2015).
[367] Section 408(2), *Companies Act*, (Act No. 17 of 2015).
[368] Section 410(2), *Companies Act*, (Act No. 17 of 2015).
[369] Section 411(1), *Companies Act*, (Act No. 17 of 2015).
[370] Section 411(5), *Companies Act*, (Act No. 17 of 2015).
[371] Section 419(1), *Companies Act*, (Act No. 17 of 2015).
[372] Section 420(1), *Companies Act*, (Act No. 17 of 2015).
[373] Section 421(1), 421(2) and 421(3), *Companies Act*, (Act No. 17 of 2015).
[374] Section 421(5), *Companies Act*, (Act No. 17 of 2015).

2.3.5. Wrongful Trading

At the onset of the pandemic, several regimes temporarily suspended the operation of wrongful trading liability. This assured company directors that they would not be held personally liable for using their best efforts to continue to trade the company during the pandemic if the company were to ultimately fail. It was also meant to ensure viable companies continued to trade despite the uncertainty caused by the pandemic to avoid a wave of unnecessary insolvencies.[375] It would therefore be appropriate to discuss wrongful trading in detail.

The Insolvency Act does not explicitly define wrongful trading but describes when a company's official has engaged in wrongful trading. A wrongful act is defined as one characterised by unfairness or injustice or contrary to law or unlawful.[376] Wrongful conduct, on the other hand, is an action taken in violation of a legal duty or an act that unjustly infringes on another's rights.[377] Wrongful trading is a situation where the officers of a company allow it to continue its business after it has occurred to them that the company's insolvency is inevitable.[378]

A company's directors owe fiduciary duties (of good faith,[379] loyalty[380] and honesty) and good care, skill and diligence,[381] which are based on the principles of common law and equitable principles. These duties are owed solely to the company and not to its individual members.[382] However, under common law, when the directors know or ought to have known that the company is insolvent or likely to become insolvent, their duties are extended to cover the creditors and their interests.[383] Where directors make a payment out of the company's capital for the redemption or acquisition by a company of its shares, and the company undergoes liquidation within 12 months of such payment, the directors involved will be personally liable to contribute to the company's assets to the extent necessary to satisfy the company's insufficiency to pay its debts.[384] Should it appear to a liquidator that an officer of the company was aware that there was no reasonable possibility that the company would avoid being placed in insolvent liquidation, the liquidator may apply to the court for an order[385] declaring such an officer liable to contribute to the company's assets[386] if the officer took no steps to avoid a potential loss to the company's creditors,[387] using the skill, experience and knowledge that might be reasonably be expected of a person carrying out similar functions as those carried out

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[375] Paragraph 82, 'Corporate Insolvency and Governance Bill Explanatory Notes', 16, 2020.
[376] Black's Law Dictionary, 9th Edition, 1751
[377] Black's Law Dictionary, 9th Edition, 337
[378] Collins English Dictionary https://www.collinsdictionary.com/dictionary/english/wrongful-trading on 1st March 2022
[379] Section 143 (1), *Companies Act*, (Act No. 17 of 2015).
[380] Section 146, *Companies Act*, (Act No. 17 of 2015).
[381] Section 145, *Companies Act*, (Act No. 17 of 2015).
[382] Section 140 (1), *Companies Act*, (Act No. 17 of 2015).
[383] Section 1002, *Companies Act*, (Act No. 17 of 2015).
[384] Section 386(3), *Insolvency Act*, (Act No.18 of 2015).
[385] Section 506(3), *Insolvency Act*, (Act No.18 of 2015).
[386] Section 506(5), *Insolvency Act*, (Act No.18 of 2015).
[387] Section 506(6), *Insolvency Act*, (Act No.18 of 2015).

by the officer responsible to the company.[388] The director may also be disqualified from being or acting as a director, liquidator, administrator, supervisor of a voluntary arrangement or being involved in the promotion, formation or management of the company or any other company for a period not exceeding fifteen years.[389] These provisions on wrongful trading are identical to the UK's provisions.[390]

Whereas the UK temporarily suspended the remedy of wrongful trading during the pandemic, no such measure was introduced in Kenya.

2.4 CONCLUSION

This Chapter discusses the key attributes of insolvency law, the choices the lawmakers make, and their considerations when designing such a law. It has outlined the processes available for Kenyan companies facing financial distress due to insolvency.

When used as stand-alone devices, none of the mechanisms discussed provides all the necessary features for an adaptable and responsive restructuring mechanism. As such, it is incumbent upon the users, namely the director, creditors and members to choose which specific procedure best addresses their needs. Besides, at times a combination of more than one procedure is necessary. For instance, a company could start off in an administration proceeding and end up in liquidation.

Undoubtedly though, the need for a moratorium in an insolvency proceeding cannot be gainsaid. This is because without it, creditors to an insolvent debtor can take steps to enforce security or commence insolvency proceedings against the debtor where there is default and thereby thwart any prospect of rescue. Arguably, a moratorium's usefulness in the insolvency processes cannot be underplayed.

From the analysis, the court is also involved in liquidation, administration, sanctioning a scheme of arrangement, and confirming a proposed reduction where a company is reorganising its share capital. Kenyan insolvency processes are heavily court reliant, and therefore vulnerable to negative impact in a pandemic due to government-imposed lockdowns and social distancing measures. During the covid-induced lockdown, no physical court presence or access was allowed, and court proceedings were conducted online, with directions that the pleadings and other documents be lodged and served electronically in the Court of Appeal,[391] the

[388] *Re Produce Marketing Consortium Limited* (1989) 3 All ER, 1
[389] Section 505(8), *Insolvency Act*, (Act No.18 of 2015).
[390] Section 214, UK *Insolvency Act*, https://www.legislation.gov.uk/ukpga/1986/45/section/214 on 1st March 2022
[391] Justice William Ouko (President, Court of Appeal), *Practice Notes for The Conduct of Court Business During the Global Coronavirus Pandemic*, 2020, http://kenyalaw.org/kl/index.php?id=10327 on 19th September 2021

Supreme Court,[392] and other courts.[393] Similarly, judgments, rulings and orders were to be transmitted to parties by email with the notice on delivery of these decisions to be done by email. As a consequence, the court process suffered.

Although the technology was embraced urgently to deal with court matters due to the emergency at the time, the effort was not sufficient which consequently put companies at a perpetual position of risk. Specifically, the number of cases resolved in all courts reduced from 469,359 in the financial year 2018/19 to 289,728 cases in 2019/20 when COVID-19 disease was first reported in Kenya.[394] The situation has, however, since improved. As of 20th July 2022, court proceedings are still conducted online in most stations across the country and documents are filed and served electronically. In her memo of 12th July 2022 to all judicial officers, the Honourable Chief Justice of Kenya directed that court processes continue to be done online. The Chief Justice noted that the use of technology improved productivity and enhanced access to justice.

As we have seen, the UNCITRAL Legislative Guide proposes early intervention when a company is insolvent or on the verge of insolvency. The guide also provides recommendations on what ought to be considered in designing an ideal insolvency framework. In summary, the framework should have provision for a moratorium, a cramdown mechanism, and pre-commencement and post-commencement reorganization financing.

Iheme's argument that the 2015 Insolvency Act is still foreign to Kenyan debtors and creditors,[395] and that the formal insolvency processes and courts generally are considered time-consuming and financially draining[396] holds water. The formal insolvency procedures are not utilised to their full extent and proposals need to be considered to promote their use.

From the analysis, there are several shortcomings of the insolvency procedures available in the Kenyan insolvency framework which make it unresponsive and inadaptable in an emergency situation. Firstly, other than voluntary arrangements, none of the other insolvency processes provide a cross-class cramdown which is invaluable in an emergency.

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392 Gazette Notice No. 9586, *the Supreme Court (General) Practice Directions*, 2020, http://kenyalaw.org/kl/index.php?id=11080

393 Gazette Notice No. 2357, *Practice Directions on Electronic Case Management*, 2020 http://kenyalaw.org/kl/index.php?id=10211 on 19th September 2021

394 Marang'a M. W, Kimalu P. K, and Ochieng M. A, 'Effect of COVID-19 pandemic on resolution of cases in courts: The Kenyan Judiciary', Research Paper No. 1 of 2021, 1 https://www.judiciary.go.ke/download/effects-of-covid-19-pandemic-on-resolution-of-cases-in-courts-the-kenyan-judiciary/ on 20th June 2022

395 Iheme C, 'A Doctrinal Assessment of the Insolvency Frameworks of African Countries in Coping with the Pandemic-Triggered Economic Crisis', 309

396 Iheme C, 'A Doctrinal Assessment of the Insolvency Frameworks of African Countries in Coping with the Pandemic-Triggered Economic Crisis', 311

Secondly, there is no stand-alone moratorium which is necessary in an emergency to ensure a debtor is successfully rescued since the formal insolvency processes have to be invoked in order for a distressed company to enjoy the moratorium.

Thirdly, directors might be required to give up control to an insolvency practitioner which might disincentivise them from seeking early help when the company is insolvent or near insolvency.

Fourthly, a company in distress may find it difficult to obtain financing as the Insolvency Act does not have a provision for super-priority funding, which is vital in the event of an emergency.

Lastly, the length of the informal processes and the statutory could prevent them from taking prompt action which is needed in an emergency such as a pandemic.

CHAPTER THREE

3. THE UNITED KINGDOM'S INSOLVENCY LAW, POLICY AND PROCEDURES

3.1 INTRODUCTION

The United Kingdom's corporate insolvency legislative framework is provided in the Insolvency Act, 1986[397] and the Insolvency Rules, 2016.[398]

The thesis has centred on the UK since Kenya's Insolvency Act is modelled on the UK's insolvency law. Secondly, the UK is classified as leading the search for optimal insolvency and restructuring regimes for corporate entities in financial distress,[399] and lastly both countries are common law jurisdictions.

Similar to Kenya, the UK's Insolvency Act and Rules thereunder apply to both individuals and to companies with certain limitations as they do not cover credit institutions or insurance companies. The Financial Services and Markets Act, 2000,[400] regulates these institutions. The Act sets out the United Kingdom's financial services regulatory regime, generally through regulation by the Financial Conduct Authority (FCA) and the Prudential Regulatory Authority (PRA). The Insolvency Act and its rules are supplemented by Company Disqualification Act, 1986[401] and the Companies Act, 2006[402] which provides for schemes of arrangement utilised in restructurings.

Several changes have been effected to the UK's insolvency regime, notably by the Enterprise Act, 2002,[403] which streamlined the circumstances in which the holder of a qualifying floating charge could appoint an administrative receiver to enable it to realise its security. Other changes to the law were through the Insolvency (Protection of Essential Supplies) Order, 2015[404] and the Corporate Insolvency and Governance Act, 2020 (CIGA),[405] discussed below.

This Chapter discusses the UK insolvency framework, and some of the changes it has undergone and the reasons behind these changes. It offers an elaborate analysis of the proposals that culminated in the enactment of CIGA which was promulgated as a consequence of the covid-19 pandemic.

397 https://www.legislation.gov.uk/ukpga/1986/45 on 1st May 2022
398 https://www.legislation.gov.uk/uksi/2016/1024/contents/made on 1st May 2022
399 Eidenmüller H, 'Comparative Corporate Insolvency Law', 1238.
400 https://www.legislation.gov.uk/ukpga/2000/8/contents on 1st May 2022
401 https://www.legislation.gov.uk/ukpga/1986/46/pdfs/ukpga_19860046_en.pdf
402 https://www.legislation.gov.uk/ukpga/2006/46/pdfs/ukpga_20060046_en.pdf on 1st May 2022
403 https://www.legislation.gov.uk/ukpga/2002/40/pdfs/ukpga_20020040_en.pdf
404 https://www.legislation.gov.uk/uksi/2015/989/made
405 https://www.legislation.gov.uk/ukpga/2020/12/pdfs/ukpga_20200012_en.pdf

The insolvency procedures discussed in this chapter include administration, company voluntary arrangements, and the various forms liquidation takes.

3.2 INSOLVENCY PROCEDURES

Various procedures can wind up or rescue a company in distress in the UK or if the company has sufficient connections with the UK.[406] In the UK, four possible mechanisms are available to a company considering debt restructuring: a workout, a company voluntary arrangement, a scheme of arrangement and administration. In practice, however, companies and their advisers have combined the latter two options to add a fifth possibility, namely a scheme twinned with administration.[407] Other procedures include voluntary or compulsory liquidation and receivership.

3.2.1 Administration

Administration[408] is available for companies in distress and was proposed by the Cork Committee. The Committee held a belief that company rescue could benefit from allowing an independent expert to take over management of a distressed company to reorganise the debtor and restore profitability, maintain employment, develop proposals for realising assets for creditors and shareholders and carry on business where it is unlikely that existing management can do so.[409]

The Committee believed that corporate rescue opportunities ought to be taken early for them to stand a chance of success[410] and that the debtor should be given breathing space from the pressures attendant to claims.[411]

Administration was conceived as a hybrid procedure combining the powers of the floating charge receivership with improved objectives, a rescue-oriented mission and a "collectivity" approach.[412] Collectivity is a component of an insolvency framework that inhibits individual debt enforcement amongst creditors which is usually achieved by the imposition of a mandatory moratorium.[413] Collectivity prevents the rush to collect between creditors which

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[406] Part 1(Paragraph 4); and Section 265, *Insolvency Act*, 1986
[407] Payne J, 'Debt Restructuring in English Law: Lessons from the US and the Need for Reform' Oxford Legal Studies Research Paper Number 89, 2013, 1 - https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2321615 on 14th April 2022
[408] Schedule B1, Insolvency Act, 1986
[409] Finch V, *Corporate Insolvency Law; Principles and Perspectives*, 302.
[410] Schedule B1(Paragraph 2), *Insolvency Act*, 1986
[411] Finch V, *Corporate Insolvency Law; Principles and Perspectives*, 302.
[412] Fletcher, I. F., 'UK Corporate Rescue: Recent Developments - Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements - the Insolvency Act 2000, the White Paper 2001, and the Enterprise Act 2002', *European Business Organization Law Review (EBOR), Vol. 5, No. 1*, 2004, 125 https://ssrn.com/abstract=597663 on 21st July 2022
[413] Frisby S., 'In Search of a Rescue Regime: The Enterprise Act 2002', *The Modern Law Review*, (2004). 249. http://www.jstor.org/stable/3699143 on 23rd August 2022

normally leads to a piecemeal dismantling of a financially distressed debtor's assets. Such a rush diminishes critter value and impedes rescue attempts.

Administration was not user-friendly and had barriers to entry due to its being initiated through a court order, bore a severe and costly burden of proof and required money with no assurance that an administration order would be issued. Directors were also disincentivized from seeking help or even assisting the administration due to their managerial powers being displaced during administration, and the fact that the administrator was empowered to remove or appoint new directors.[414] There were loopholes in the law which allowed some creditors to escape from the effects of the moratorium stay and there was no clear exit strategy out of the administration procedure.[415]

In July 2001, a white paper[416] was published intending to recast administrative receivership by reforming administration to make it a fast-acting, effective, and accessible vehicle for corporate rescue.[417] It was planned to scrap administrative receivership and the change was enacted as part 10 of the Enterprise Act 2002.

The Enterprise Act introduced the 'qualified floating charge holder' whereby a creditor is entitled to appoint an out-of-court administrator, instead of a receiver, to enforce security in the event of default under a floating charge.[418] Before the 2002 changes, the insolvency procedures suffered from serious flaws which limited their practical utility. This was because the administration and the company voluntary arrangement procedures introduced in 1986 to enable corporate rescue, played a negligible role since there nonetheless were high levels of liquidation and administrative receiverships.[419] Administrative receivership was preferred by creditors since it was a rapid and more commercially expedient procedure than administration

[414] Fletcher, I. F., 'UK Corporate Rescue: Recent Developments - Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements - the Insolvency Act 2000, the White Paper 2001, and the Enterprise Act 2002', 126

[415] Fletcher, I. F., 'UK Corporate Rescue: Recent Developments - Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements - the Insolvency Act 2000, the White Paper 2001, and the Enterprise Act 2002', 126

[416] 'Insolvency - A Second Chance', the UK Department of Trade and Industry, (Cm. 5234) (H.M.S.O. 2001), https://webarchive.nationalarchives.gov.uk/ukgwa/20130814153556/http://www.archive.official-documents.co.uk/document/cm52/5234/523403.htm on 21st July 2022

[417] Fletcher, I. F., 'UK Corporate Rescue: Recent Developments - Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements - the Insolvency Act 2000, the White Paper 2001, and the Enterprise Act 2002', 129

[418] Schedule B1 Paragraphs 14 and 16, *Insolvency Act*, 1986

[419] Fletcher, I. F., 'UK Corporate Rescue: Recent Developments - Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements - the Insolvency Act 2000, the White Paper 2001, and the Enterprise Act 2002', 121

which required waiting for an administrator to put in place a reorganization plan which also required a vote before being implemented.[420]

In receivership, the creditors with the most superior claim could enforce their prior security and thus defeat the enforcement rights of other stakeholders. The receiver owed his primary obligations to their chargee[421]and not to other creditors, the debtor or other parties who could be affected by their receivership.[422] As such, receiverships were the preferred mode of execution against distressed companies by creditors holding charges over substantially the entirety of the debtor's assets and this was seen as detrimental to not only the unsecured creditors but also to the debtor.[423]

Currently however, a floating charge qualifies if its provisions enable the holder to appoint an administrator, and the charge relates to the entire or substantially the entirety of the company's property. They cannot appoint a receiver.

An administrator is appointed by lodging an application for a court-based appointment or by making a filing in court to document an out-of-court appointment by the company, its directors or by a holder of a qualifying floating charge. This was a more debtor-friendly procedure since, like in Kenyan law, the administrator's primary objective is to rescue the company while acting in the interests of all creditors.[424] Furthermore, before the Deregulation Act 2015,[425] directors could not initiate the appointment of an administrator upon a winding-up petition being presented; however, this is no longer the case, and creditors cannot use the winding-up procedure to stop a proposed administration.

The holder of the qualifying floating charge will have informed the administrator about the company, its businesses, prospects and risks, which information will guide the administrator in making an informed opinion on whether the purpose of the administration is reasonably likely to be achieved.[426]

The court makes the order for administration if it is satisfied that the company is likely to become or is unable to pay its debts and that the administration order is reasonably anticipated

420 Fletcher, I. F., 'UK Corporate Rescue: Recent Developments - Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements - the Insolvency Act 2000, the White Paper 2001, and the Enterprise Act 2002', 124

421 Alam, S, 'The Enterprise Act 2002: Past, Present & Future', SSRN Electronic Journal, 2012, 4 http://dx.doi.org/10.2139/ssrn.2458327

422 Finch, V. 'The Recasting of Insolvency Law', The Modern Law Review, Vol. 68, No. 5, 2005), 716, https://www.jstor.org/stable/3699055

423 Finch, V. 'The Recasting of Insolvency Law', 716,

424 , Schedule B1 Paragraph 3, *Insolvency Act*, 1986

425 Schedule 6(paragraph 5), *Deregulation Act*, 2015, https://www.legislation.gov.uk/ukpga/2015/20/schedule/6 on 30th May 2022

426 Finch, V. 'The Recasting of Insolvency Law', 715

to achieve the administration's purpose. However, this is not a requirement if the application is by a holder of a qualifying floating charge.[427]

In issuing an administration order, the court effectively hands over the responsibility of running the debtor to an insolvency practitioner who becomes the administrator.[428] The existing management is dislodged from its executive responsibilities and as such administration is a PIP mechanism. McCormack, in his analysis of the law in the UK, noted that in Germany the debtor can apply to the court, where the creditors' consent, for an order that the company be administered by existing management under the supervision of an insolvency practitioner.[429] The court will only issue such an order if the creditors would not be unduly prejudiced. Arguably, Kenya can benefit from such a hybrid system which was recommended by the UNCITRAL Legislative Guide in chapter two.

The purpose of administration, and the objectives of the administrator, are to rescue the distressed company as a going concern, achieving a better result for all the creditors of the company than would be probable if the company were wound up without it being firstly in administration, or if the other objectives fail, realising property to make a distribution to the company's secured or preferential creditors.[430] As such, unless it is not reasonably practicable, the administrator should prioritise saving the business if that will give a better result for the creditors. An administrator is enabled to do all that is necessary for the management of the debtor and is responsible for formulating proposals in order to achieve the purposes of administration.[431]

It has been contended that the imprecise and subjective terms 'believes', 'reasonably practicable' and 'a better result' are likely to lead to cases seeking to challenge the administrator's exercise of judgment.[432] This framing also ignores the interests of other stakeholders including employees and shareholders of the debtor and elevates the creditors' interests above other possible benefits of corporate rescue including employment and continuation and preservation of shareholder value.[433] This proceduralist view of insolvency is a departure from the Cork Committee's expectation that the livelihood and well-being of those

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[427] Schedule B1(Paragraph 35(2)), *Insolvency Act*, 1986

[428] McCormack G., 'Control and Corporate Rescue: An Anglo-American Evaluation', *The International and Comparative Law Quarterly*, 2007, 518. http://www.jstor.org/stable/4498088 on 24th August 2022

[429] McCormack, G., 'Control and Corporate Rescue: An Anglo-American Evaluation', 523.

[430] Schedule B1(Paragraph 3(1)), *Insolvency Act*, 1986

[431] McCormack, G., 'Control and Corporate Rescue: An Anglo-American Evaluation', 519.

[432] Fletcher, I. F., 'UK Corporate Rescue: Recent Developments - Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements - the Insolvency Act 2000, the White Paper 2001, and the Enterprise Act 2002', 136

[433] Fletcher, I. F., 'UK Corporate Rescue: Recent Developments - Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements - the Insolvency Act 2000, the White Paper 2001, and the Enterprise Act 2002', 137

dependent on an enterprise, such as employees, would be a legitimate consideration that a modern insolvency law must have regard for.[434]

From the foregoing, administration leads to different exits for the company,[435] including liquidation, the restoration of the business to a position where it can either be sold as a going concern, or the assets can be sold more advantageously than in liquidation.

The administrator's powers include appointing or removing a director,[436] calling a meeting of the company's members,[437] and dealing with property that is subject to a floating charge as if it were not subject to the charge.[438] Upon an application to the court for an order, they can deal with property subject to a security, other than one subject to a floating charge, as if it were not subject to the security.[439] Upon application to the court, the administrator can also dispose of the company's goods possessed under a hire-purchase agreement as if all the rights of the owner under the contract were bestowed upon the company.[440]

An advantage of administration over the other restructuring procedures is the existence of a statutory stay. Where the court-based approach is used, an interim moratorium on creditor action arises from when the application for administration is lodged until the appointment order takes effect or until the application is granted or dismissed.[441] The moratorium stops the enforcement of claims against the company, whether secured or unsecured.[442] The full moratorium takes effect upon the appointment of the administrator.[443]

Similar to Kenya, there are disadvantages to company administration in the UK framework which limit its adaptability and responsiveness in an emergency. Firstly, since it is an insolvency procedure, a debtor can only use administration to restructure its debts upon its insolvency, and the potential for early intervention is therefore diminished. Secondly, administration is not a debtor-in-possession proceeding. Thirdly, it is limited as a cramdown mechanism.[444] Furthermore, it might be possible to enter into administration without a court order whereby forms are completed and merely lodged in court, and this is susceptible to abuse where a business can lose its reputation and the public's confidence due to mere speculation that it may be insolvent when it is not.[445]

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434 Muhammad R, Kashif J. and, Farqaleet K, 'Corporate Rescue Culture Realities and Limitations of the Existing Laws of the United Kingdom', 583

435 Schedule B1 paragraph 3(1), *Insolvency Act*, 1986.

436 Schedule B1(Paragraph 61), *Insolvency Act*, 1986

437 Schedule B1(Paragraph 62(a)), *Insolvency Act*, 1986

438 Schedule B1(Paragraph 70(1)), *Insolvency Act*, 1986

439 Schedule B1(Paragraph 71(1)), *Insolvency Act*, 1986

440 Schedule B1(Paragraph 72(1)), *Insolvency Act*, 1986

441 Schedule B1(Paragraph 44(1)), *Insolvency Act*, 1986

442 McCormack, G., 'Control and Corporate Rescue: An Anglo-American Evaluation', 519.

443 Schedule B1(Paragraph 43), *Insolvency Act*, 1986

444 Payne J, 'Debt Restructuring in English Law: Lessons from the US and the Need for Reform', 15

445 Muhammad R, Kashif J., and Farqaleet K, 'Corporate Rescue Culture Realities and Limitations of the Existing Laws of the United Kingdom', 585.

As will be discussed shortly, some of these deficiencies were done away with upon the onset of the pandemic with the introduction of a free-standing moratorium which does not require a financially distressed debtor to apply for an administration order to obtain a moratorium. Secondly, a new cross-class cramdown mechanism for court-approved restructuring plans was introduced for companies that were unable to carry on business as going concerns during the pandemic. Kenya may learn from these changes.

3.2.2 Liquidation

Liquidation involves winding up the company and gathering the company's assets for subsequent distribution to creditors in the priority prescribed under the Insolvency Act. After that, the company is dissolved and removed from the register of companies. Notably, if the liquidator believes they can achieve a better result for the creditors if the company were placed in administration, they may apply to the court to be appointed administrator.[446]

There are two types of winding up; compulsory winding up by court order and voluntary winding up, initiated by the company's members. Voluntary winding up then splits into two types; the members' voluntary winding up[447] and the creditors' voluntary winding up. The members' voluntary winding up is predominantly under the control of the members, where the directors swear a statutory declaration of solvency. On the other hand, the creditors' voluntary winding up is mainly under the control of the creditors, as the directors have seen fit not to swear a statutory declaration of solvency.

3.2.1.1 Voluntary Liquidation

For voluntary liquidation (CVL and MVL), the company, in a general meeting, passes a special resolution in favour of the liquidation.[448] The voluntary winding up is deemed to have commenced when the resolution is passed.[449] A liquidator may be nominated at the meeting where the resolution is passed,[450] but if the members and creditors disagree on the appointee, the creditor's nominee will be appointed.[451] In any case, a challenge can be mounted in court against a liquidator's appointment within seven days.[452] The liquidator must be an insolvency practitioner[453] , and their appointment must be gazetted within 14 days and notification lodged with the Companies Registrar.[454] Notice of the resolution for voluntary winding up is also by way of advertisement in the Gazette within fourteen days of it being passed.[455] In a CVL, the

[446] Schedule B1 (Paragraph 11), *Insolvency Act*, 1986.
[447] Section 90, *Insolvency Act*, 1986.
[448] Section 84(1), *Insolvency Act*, 1986
[449] Section 86, *Insolvency Act*, 1986
[450] Section 100(1), *Insolvency Act*, 1986
[451] Section 100(2), *Insolvency Act*, 1986
[452] Section 100(3), *Insolvency Act*, 1986
[453] Section 389(1), *Insolvency Act*, 1986
[454] Section 109(1), *Insolvency Act*, 1986
[455] Section 85(1), *Insolvency Act*, 1986

company's directors must place before the creditors meeting a statement of affairs within seven days of the resolution for voluntary winding up.[456]

Upon commencement of the liquidation process, a moratorium will take effect.[457] The company's directors will relinquish their powers during the liquidation, and directorial powers can only be exercised with the liquidation committee or creditor's approval[458] or if the court sanctions it.[459] The creditors have an array of powers: they can appoint or remove any member from the liquidation committee,[460] apply to the court for a company's voluntary winding up, and remove a liquidator from office.[461]

The liquidator may be removed from their office by a court order or, in the event of a member's voluntary winding up, by a general company meeting summoned specially for that purpose.[462] Furthermore, a liquidator vacates office when they cease to be qualified to act as insolvency practitioners. They can also resign by giving notice of their resignation to the Registrar of companies.[463] Lastly, a liquidator vacates the office upon the available company assets being realised and distributed to the creditors in order of priority, and the liquidator has produced a final account of the winding up.[464]

Before dissolution, the liquidator must call a meeting of the members and creditors where the accounts of realisations and distributions are submitted.[465] Together with any statement of the company's creditors objecting to the liquidator's release, these accounts are filed with the Registrar of Companies within a week of the meeting.[466] The Registrar will, after that, record the liquidator's account and return, and the company will be deemed dissolved three months later.[467]

3.2.1.2 Compulsory liquidation

Unlike the members and creditors liquidation, the compulsory liquidation process involves actions initiated against the company's wishes whereby a petition is lodged in court by a creditor, the company, its directors, a contributory, or a magistrate's court clerk in the

[456] Section 99(1), *Insolvency Act*, 1986
[457] Section 126-128, *Insolvency Act*, 1986
[458] Section 103, *Insolvency Act*, 1986
[459] Section 114, *Insolvency Act*, 1986
[460] Section 101, *Insolvency Act*, 1986
[461] Section 171(2)(b), *Insolvency Act*, 1986
[462] Section 171(2)(a), *Insolvency Act*, 1986
[463] Section 171(5), *Insolvency Act*, 1986
[464] Section 171(6-7), *Insolvency Act*, 1986
[465] Section 106(1), *Insolvency Act*, 1986
[466] Section 106(3-4), *Insolvency Act*, 1986
[467] Section 201(2), *Insolvency Act*, 1986

enforcement of a fine.[468] Receivers can also lodge the petition to aid the realisation of the company's assets.[469] Administrators may file petitions after distribution.

This petition will be on the basis that the company cannot pay its debts[470] where a creditor who is owed over £750 has served a written demand for payment upon the debtor and the debtor has failed to pay the sum owed for three weeks[471] or secondly, if pursuant to court mandated execution or other process issued on a decree, judgement or court order in favour of a creditor is returned unsatisfied[472] or, if the court is satisfied that the debtor cannot pay its debts as they fall due[473] and lastly, if it is proved that the value of the assets of the debtor is less than the total of its prospective and contingent liabilities.[474]

This petition should not only be served upon the debtor and other parties but also advertised in the Gazette within seven days of service and at least seven days before the petition's hearing.[475] The company may apply to the court for the appointment of an interim liquidator to oversee the debtor's assets until the hearing and determination of the petition.[476] The debtor will therefore be able to avoid dissipation of its assets or prejudice of its claims. Another way of protecting the debtor's assets is through an application by the petitioner for a stay of legal proceedings against it.[477] The winding-up is deemed to commence on the date the petition is lodged in court. Therefore, any transfer or other disposition of the debtor's property, transfer of its shares or alteration of the status of its members in the intervening period is void.[478] Furthermore, any attachment, distress, sequestration or execution against the distressed company after the winding-up has commencement is also void.[479]

The existence of a debt of the statutory amount is not sufficient on its own to force a winding-up petition, and since the court has discretion, it will consider the views of other creditors. In *Re ABC Coupler and Engineering Co Ltd* [1961] 1 All ER 354, a judgment creditor with a debt exceeding the statutory amount petitioned for an order that the company be compulsorily wound up; however, the petition was not supported by any other creditor and was opposed by some of them, and the company had goodwill and a substantial excess of assets over liabilities. The petition was disallowed.

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[468] Section 124(1), *Insolvency Act*, 1986
[469] Schedule B1(Paragraphs 65-66 and 83-84), *Insolvency Act*, 1986
[470] Section 122(1)(f), *Insolvency Act*, 1986
[471] Section 123(1)(a), *Insolvency Act*, 1986
[472] Section 123(1)(b), *Insolvency Act*, 1986
[473] Section 123(1)(e), *Insolvency Act*, 1986
[474] Section 123(2), *Insolvency Act*, 1986
[475] Rule 7.10, *Insolvency (England and Wales) Rules*, 2016
[476] Section 135, *Insolvency Act*, 1986
[477] Section 126, *Insolvency Act*, 1986
[478] Section 127(1), *Insolvency Act*, 1986
[479] Section 128(1), *Insolvency Act*, 1986

There was no amendment to the UK liquidation procedure following the pandemic despite the process suffering from similar deficiencies to the Kenyan framework when dealing with pandemic insolvencies.

The liquidation processes are not only lengthy, but they also have numerous statutory requirements which make it ill-equipped to respond to emergencies.

3.2.3 Company Arrangements

The procedures available are schemes of arrangement[480] and company voluntary arrangements.[481]

3.2.3.1 Scheme of arrangement

Schemes are provided in the Companies Act as it is not strictly an insolvency process. The scheme allows a company to avoid filing for insolvency and meet with its creditors to discuss a plan.[482] It is a court-approved compromise or arrangement that allows the company, its members and creditors, or any class of either of them,[483] to reorganise the share capital of the company's by the division of shares into other classes or the consolidation of shares of different classes.[484] The scheme can be used to effect compromises with creditors to restructure debts, vary the rights of a class or implement debt for equity swaps.

The procedure for the scheme involves an application to the court for an order calling for a meeting of the creditors or their classes of the creditors or of the members or a class of the company's members.[485] The application is made by a creditor, the company, a member, liquidator or administrator of the company.[486] During the meeting, a majority representing 75% of the members or creditors, or a class of either of them, who are present and voting, need to agree to the arrangement for an application to be made to the court to sanction it.[487] If approved, the agreement is binding upon the company, a liquidator, contributories and all creditors or members, or a class of either one as the case may be.[488]

The scheme does not benefit from a moratorium on creditor actions unless it is combined with formal insolvency proceedings of administration and liquidation, which have statutory moratoriums.

[480] Section 895, *Companies Act*, 2006
[481] Schedule 1, *Insolvency Act*, 1986
[482] Stevenson D, 'Grab the Fire Extinguisher: Comparing UK Schemes of Arrangement to U.S. Corporate Bankruptcy After Jevic', SSRN Electronic Journal, 2019, 1 http://dx.doi.org/10.2139/ssrn.3378826
[483] Section 895(1), *Companies Act*, 2006
[484] Section 895(2), *Companies Act*, 2006
[485] Section 896(1), *Companies Act*, 2006
[486] Section 896(2), *Companies Act*, 2006
[487] Section 899(1), *Companies Act*, 2006
[488] Section 899(3), *Companies Act*, 2006

Since the UK scheme and CVA did not have a statutory stay, the UK's Insolvency Lawyer's Association, in a consultation paper, proposed a short court-sanctioned moratorium of 28 days. The moratorium was to cover all forms of restructuring, would be available from an early stage, and would remove the risk of liability for trading for directors throughout the moratorium, providing the conditions of the moratorium are met and would involve the oversight of an insolvency supervisor.[489] This moratorium was finally actualised in the UK Corporate Insolvency and Governance Act 2020, where it was introduced as a free-standing tool, not linked to any insolvency procedure, to avoid the need to resort to the formal processes.[490]

The scheme can be an expensive and cumbersome process owing to the extensive court supervision and meetings of creditors and shareholders which are involved.[491] Consequently, the scheme of arrangement is not suited in the event of an emergency due to this and also because it lacks a moratorium.

3.2.3.2 Company voluntary arrangements (CVA's)

Like administration, the CVA was introduced by the Insolvency Act 1986 on recommendations of the Cork Committee and is similarly directed at company rehabilitation to restore them to profitable trading and avoid liquidation.[492]

Political pressure to change insolvency laws started in 1997 to ensure that the law embraced a genuine rescue culture and offered user-friendly procedures for reorganizing financially troubled companies.[493] This culminated in the Insolvency Act 2000 reforms to the CVA procedure, and the introduction of a moratorium, among other changes. The CVA previously lacked a moratorium when a company most needed one, i.e., the period between the company embarking on the process of seeking to conclude the arrangement with its creditors and the conclusion and adoption of the proposal.[494] The company would therefore be at risk of the creditors and enforcing their rights to the debtor's detriment. These changes pushed the

[489] 'Encouraging Company Rescue – A Consultation (June 2009) Response of Insolvency Lawyers' Association', Insolvency Lawyer's Association UK, 2009,5 https://www.ilauk.com/docs/ila_response_to_consultation_sep_09.pdf on 30th March 2022

[490] Section 1 (Part A1), *Corporate Insolvency and Governance Act*, Chapter 12, https://www.legislation.gov.uk/ukpga/2020/12/section/1/enacted

[491] Stevenson D, 'Grab the Fire Extinguisher: Comparing UK Schemes of Arrangement to U.S. Corporate Bankruptcy After Jevic', 25

[492] Frisby S. 'Of rights and rescue: a curious confluence?', *Journal of Corporate Law Studies*, 2019, https://doi.org/10.1080/14735970.2019.1615165 on 25th June 2022

[493] Fletcher, I. F., 'UK Corporate Rescue: Recent Developments - Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements - the Insolvency Act 2000, the White Paper 2001, and the Enterprise Act 2002', 128

[494] Fletcher, I. F., 'UK Corporate Rescue: Recent Developments - Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements - the Insolvency Act 2000, the White Paper 2001, and the Enterprise Act 2002', 127

voluntary arrangement closer to the US Chapter 11 debtor in possession model of corporate reorganization.[495]

The CVA is an informal agreement between a company and its unsecured creditors to compromise its debts for a company in financial distress to avoid liquidation.[496] The voluntary arrangement cannot affect a secured creditor's rights[497] or a preferential creditor of the company to enforce his security without the creditors' agreement. [498] Arguably, the voluntary arrangement may not benefit companies with a large amount of secured debt.

The company does not need to be insolvent or unable to pay its debts to benefit from a CVA since the voluntary arrangement proposal may be made by a company's directors. A liquidator or administrator may also make it if the company is in either liquidation or administration.[499] The directors are required to nominate an insolvency practitioner to act concerning the voluntary arrangement as either a trustee or supervisor of the CVA's implementation, and the nominee must, within 28 days of the nominee receiving notice of the CVA, submit a report to court declaring whether the meetings of the creditors and the company ought to be summoned to consider the proposal.[500] The proposal must not only be approved by 50%[501] in value of the members present at the member's meeting but also 75% of the creditors voting by proxy or in person by reference to the value of what they are owed.[502]

Once approved, the voluntary arrangement is operative and binding upon the company and all its creditors that are entitled to vote at the meeting or would have been so entitled should they have had notice of the meeting.[503] A cramdown is possible under the CVA, although it cannot bind secured or preferential creditors without their consent.[504]

There is a moratorium under voluntary arrangements, but only for small companies.[505] However, the moratorium may be obtained by combining the voluntary arrangement proposal with an application to the court for the appointment of an administrator.[506] A company qualifies as a small company if, in the preceding financial year, it has satisfied at least two requirements; have an annual turnover of not more than £5.6 million, a balance sheet total not exceeding £2.8 million and not more than 50 employees.[507] A company will not apply for a moratorium if an

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495 Fletcher, I. F., 'UK Corporate Rescue: Recent Developments - Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements - the Insolvency Act 2000, the White Paper 2001, and the Enterprise Act 2002', 127
496 Section 1(1), *Insolvency Act*, 1986
497 Section 4(3), *Insolvency Act*, 1986
498 Section 4(4), *Insolvency Act*, 1986
499 Section 1, *Insolvency Act*, 1986
500 Section 2(2), *Insolvency Act*, 1986
501 Rule 2.36, *Insolvency (England and Wales) Rules*, 2016
502 Finch V, *Corporate Insolvency Law; Principles and Perspectives*, 418.
503 Section 5(2), *Insolvency Act*, 1986
504 Section 4(3), *Insolvency Act*, 1986
505 Section 1A (1), *Insolvency Act*, 1986
506 Schedule B1, *Insolvency Act*, 1986
507 Section 382(3), *Companies Act*, 2006

administration order is in force, if it is in liquidation, if an administrative receiver has been appointed, if in the preceding year a moratorium has been in force or if a voluntary arrangement has ended prematurely.[508]

Since the CVA is not an insolvency procedure, it can be utilised before insolvency to restructure a company's debts and rescue them early in the company's financial difficulties. Another advantage is that it is a debtor-in-possession procedure as the company's management remains in control throughout the recommendation and implementation of the CVA unless the company is already in administration or liquidation.[509]

The CVA has been criticized for its imprecise drafting of the rules governing creditors' eligibility to vote and the fact that creditors could escape from being bound by the CVA.[510] Furthermore the lack of a moratorium, other than for small businesses, coupled by a lack of cross-class cramdown mechanism make the CVA ill-suited to deal with a pandemic or economic recession. As will be seen shortly, through CIGA the UK introduced a cramdown mechanism whereby secured and unsecured creditors would be bound to a rescue plan.[511]

3.3 CHANGES PROPOSED

Despite having a robust insolvency regime, it was noted that the UK framework lacked a cramdown procedure, and provisions on post-commencement financing which are necessary for effective corporate rescue culture.[512]

In 2016, the UK government consulted and proposed four mechanisms to enhance their corporate insolvency regime and enable the rescue of viable businesses. Firstly, they recommended the creation of a novel moratorium that was intended to provide companies with the opportunity to consider the best means of rescuing viable businesses. This moratorium would remove the need for the company to enter administration to enjoy a statutory moratorium and prevent suppliers from terminating essential contracts. It ensured that these companies were free from creditor enforcement and legal action, providing them with space to breathe through a stay on possible enforcement actions whilst they restructure their debts.[513]

[508] Schedule A1(Paragraph 4), *Insolvency Act,* 1986

[509] Payne J, 'Debt Restructuring in English Law: Lessons from the US and the Need for Reform', 7

[510] Fletcher, I. F., 'UK Corporate Rescue: Recent Developments - Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements - the Insolvency Act 2000, the White Paper 2001, and the Enterprise Act 2002', 127

[511] Schedule 9, *Corporate Insolvency and Governance Act*, Chapter 12, https://www.legislation.gov.uk/ukpga/2020/12/schedule/9/enacted

[512] Muhammad R, Kashif J. and, Farqaleet K, 'Corporate Rescue Culture Realities and Limitations of the Existing Laws of the United Kingdom', 587

[513] 'A Review of the Corporate Insolvency Framework: A consultation on options for reform', The Insolvency Service, 2016, 10, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/525523/A_Review_of_the_Corporate_Insolvency_Framework.pdf on 2nd April 2022

Secondly, it was proposed that distressed companies be assisted to trade during the restructuring process to make it easier for them to maintain ongoing contracts, which are crucial for the continuation of the business.[514] At the time, a business going into an insolvency procedure would trigger the use of a contractual termination clause by a supplier even if the company in distress was paying its dues timely.

The proposal aimed to ensure a fair and successful solution for all creditors by avoiding a situation where the company in distress is taken advantage of by key suppliers seeking to profit from this distress, which hindered any chances of the business's rescue. Companies must designate which supplies contracts were essential before the insolvency procedure. This included the provision of gas, water, electricity, information technology and supplies of other services and goods that could also be essential to the business' survival depending on the nature of the business undertaken. For instance, a paper supplier to a distressed printing company would be considered essential to the company's survival, especially where they were the sole supplier of a paper used by the company in distress.[515]

This proposal was effected when Insolvency Act 1986 was amended on 1st October 2015 to ensure the continuity of the supply of utilities and information technology goods and services to insolvent businesses.[516] It is almost identical to section 689 of Kenya's Insolvency Act. While a contractual party may choose to stop performance on account of the insolvency of the financially distressed debtor, they are nevertheless required to continue to supply essential goods and services to the insolvent company irrespective of a clause to the contrary in the governing contract. Unless the insolvent debtor agrees to the termination of the supply contract, the supplier can apply to the court for an order to terminate the contract where the continuation of the contract would cause the supplier hardship.[517]

The third proposal was to develop a flexible restructuring plan enabling a rescue plan to bind secured and unsecured creditors by introducing a 'cramdown' mechanism.[518] At the time of the proposal, dissenting creditors could, depending on the procedure, block a restructuring plan. The CVA was especially criticised for being limited as a mechanism for a distressed company's rescue, particularly as it could not bind the company's secured creditors to a plan.[519]

Most of these secured creditors could voluntarily join in a restructuring but chose not to, forcing distressed companies to negotiate separate deals with these creditors. Parties were consequently

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[514] 'A Review of the Corporate Insolvency Framework: A consultation on options for reform', The Insolvency Service, 19

[515] 'A Review of the Corporate Insolvency Framework: A consultation on options for reform', The Insolvency Service, 20

[516] *The Insolvency (Protection of Essential Supplies) Order No. 989 of 2015* https://www.legislation.gov.uk/uksi/2015/989/made

[517] Section 372(A)(4) and 233(A), *The Insolvency (Protection of Essential Supplies) Order No. 989 of 2015*.

[518] 'A Review of the Corporate Insolvency Framework: A consultation on options for reform', The Insolvency Service, 22

[519] 'A Review of the Corporate Insolvency Framework: A consultation on options for reform', The Insolvency Service, 6

prevented from reaching an optimal rescue solution, therefore delaying the process, increasing the costs of rescue and putting the company at an even higher risk of failure.[520] It would have been beneficial in cases where dissenting creditors are obstructing a reorganisation plan to have a tool or mechanism to gain consent if the proposed plan is in the majority's best interests.

The cramdown mechanism ensures that dissenting classes of minority creditors or members no longer have the ability to block viable restructuring proposals if the plan would not leave them any worse off than the likely alternative if the plan was not passed. If such a mechanism was adopted in Kenya, it would shorten the process of reaching a restructuring plan thereby reducing costs of a debtor's rescue.

Lastly, it was proposed to explore the options for rescue financing. This is because the non-existence of such financing provisions insolvency framework disparages an effective and active corporate rescue culture.[521] At the time of the proposal, rescue financing was only permitted as an expense in the administration procedure.

It was noted that new administration funding was typically provided by the existing floating charge holder, who did not have to vary their existing security. Additionally, the assets that were not covered under the floating charge were by then subject to fixed charges, and the distressed company's ability to borrow was limited in some cases due to existing negative pledge clauses.

The UK government thus sought to further develop their rescue finance by introducing provisions allowing companies, during their administration or debtor in possession rescue, to give security, over the company's property that was already subject to fixed charges, to new lenders. These would rank similar to a first charge or an additional but subordinate charge on the property and give provisions on safeguards for the existing charge holders.[522] The idea behind the move was a view that more accessibility to rescue finance would reduce the number of companies that failed despite having viable futures. Also, the increased competition between the lenders would reduce the cost of obtaining the financing, which would in turn contribute to the economic rehabilitation of companies in distress.

In March 2018, the UK Government consulted on the jurisdiction's insolvency and corporate governance framework,[523] focusing on reducing the risk of major company failure due to poor governance to improve their insolvency framework. It came up with proposed steps, including

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[520] 'A Review of the Corporate Insolvency Framework: A consultation on options for reform', The Insolvency Service, 23

[521] Muhammad R, Kashif J. and, Farqaleet K, 'Corporate Rescue Culture Realities and Limitations of the Existing Laws of the United Kingdom', 587

[522] 'A Review of the Corporate Insolvency Framework: A consultation on options for reform', The Insolvency Service, 28

[523] Insolvency and Corporate Governance, Government response, 2018 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/736207/ICG_-_Government_response_doc_-_24_Aug_clean_version__with_Minister_s_photo_and_signature__AC_final.pdf on 23rd May 2022

an insolvency framework that supported the intervention of the company's shareholders and that of regulators in the beginning of signs of trouble.[524] It was further suggested that the government does ensure greater accountability of directors in group companies when they sold subsidiaries that experienced distress. It was noted that nonetheless, the new measures ought not to disincentivise rescues or needlessly hold directors liable for the conduct of other persons over which they did not have any control.[525]

The 2018 report recognised other reforms from the 2016 report that were aimed at increasing creditors' protection and providing a just balance of the rights of the company that sought rescue as well as the rights of its creditors who sought payment from the company. They included introduction of the novel moratorium aimed at ensuring that viable financially distressed companies had a period to consider rescue, when creditors, could not act against the distressed company. This would allow it to prepare to restructure or seek new investment.

Secondly, suppliers were prohibited from enforcing termination clauses in contracts for the supply of services and goods due to a distressed company entering into either a formal insolvency procedure, the novel moratorium, or the newly introduced restructuring plan. Lastly, it was suggested to create a new restructuring plan that had the ability to bind any dissenting classes of creditors.[526] Some of these reforms were enacted in the Corporate Insolvency and Governance Act, 2020.[527]

3.4 CIGA

The covid-19 pandemic accelerated reforms in the UK's legislation leading to the Corporate Insolvency and Governance Act, 2020 (CIGA). [528] The law was not a rushed response to the pandemic. Rather, the Act is the culmination of the policy work undertaken since the publication of "A Review of the Corporate Insolvency Framework" in May 2016[529] and a government response published in 2018. The Explanatory Notes to the Act state that the policy objective behind the Act was to provide businesses with the flexibility and breathing space they need to continue trading and avoid insolvency owing to the effects of the pandemic.[530]

CIGA brought about measures to achieve its objective; long-term measures to protect companies at risk of insolvency and short-term measures designed to mitigate immediate challenges of the pandemic. The permanent measures included introducing a free-standing

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524 Insolvency and Corporate Governance, Government response, 2018, 6
525 Insolvency and Corporate Governance, Government response, 2018, 8
526 Insolvency and Corporate Governance, Government response, 2018, 9
527 Paragraph 87, 'Corporate Insolvency and Governance Bill Explanatory Notes', 4, 2020, https://publications.parliament.uk/pa/bills/cbill/58-01/0128/en/20128en.pdf on 23rd May 2022
528 Paragraph 1, 'Corporate Insolvency and Governance Bill Explanatory Notes', 4, 2020, https://publications.parliament.uk/pa/bills/cbill/58-01/0128/en/20128en.pdf on 23rd May 2022
529 A Review of The Corporate Insolvency Framework: A Consultation on Options for Reform, 2016 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/525523/A_Review_of_the_Corporate_Insolvency_Framework.pdf
530 Insolvency and Corporate Governance, Government response, 2018.

moratorium for distressed debtors, extending provisions dealing with contract termination clauses, and a new cross-class cramdown mechanism for court-approved restructuring plans. These measures were generally designed to introduce greater flexibility into the insolvency regime, allowing companies breathing space to explore options for rescue whilst supplies are protected. This would ensure these companies could have the maximum chance of survival, temporarily suspend parts of insolvency law to support directors to continue trading through the pandemic without the threat of personal liability and protect companies from aggressive creditor action and provide companies and other bodies with temporary easements on company filing requirements and requirements relating to meetings including annual general meetings.[531]

3.4.1 Moratorium

CIGA introduced a free-standing moratorium[532] for companies that could not pay their debts or were likely to be unable to do so[533] and required protection from creditor action as long as the moratorium would result in the company's rescue. The moratorium would give the debtor breathing space to explore its rescue and restructuring options free from creditor action. The moratorium runs for 20 business days[534] which can be extended for a further period of 20 days by the directors alone,[535] for up to a year with the creditor's consent,[536] or indefinitely by the court upon application by the directors.

The company is overseen by an insolvency practitioner (IP) acting as a monitor. However, the directors remain in charge of running the business daily. The directors may obtain the moratorium[537] upon an application exhibiting a statement from a qualified insolvency practitioner who will act as the monitor indicating that they consent to the proposed moratorium and that the company is eligible to obtain it.[538] Arguably, the moratorium is a debtor-in-possession mechanism since the directors retain control of the company's day-to-day operation while the insolvency practitioner supervises them to ensure the company's rescue is achieved.[539]

The moratorium restricts insolvency proceedings, specifically a petition for winding up the company, resolution for voluntary winding up, an administration application and the appointment of an administrative receiver cannot be made.[540] The moratorium also restricts enforcement and legal proceedings against the company.[541] Floating charges cannot crystallise

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531 Paragraph 2, 'Corporate Insolvency and Governance Bill Explanatory Notes', 4
532 Schedule A1, *Insolvency Act*, 1986
533 Paragraph A6(1) (d-e), *Corporate Insolvency and Governance Act*, 2020
534 Paragraph A9(2), *Corporate Insolvency and Governance Act*, 2020
535 Paragraph A10, *Corporate Insolvency and Governance Act*, 2020
536 Paragraph A11, *Corporate Insolvency and Governance Act*, 2020
537 Paragraph A3(1) (a), *Corporate Insolvency and Governance Act*, 2020
538 Paragraph A6(1) (c), *Corporate Insolvency and Governance Act*, 2020
539 Paragraph A13, *Corporate Insolvency and Governance Act*, 2020
540 Paragraph A20(1), *Corporate Insolvency and Governance Act*, 2020
541 Paragraph A21, *Corporate Insolvency and Governance Act*, 2020

during the moratorium.[542] Notably, however, the debtor can obtain credit during the moratorium if the lender or creditor has been notified of the subsistence of the moratorium.[543]

3.4.2 Extension of statutory controls for termination clauses in supply contracts.

Most commercial contracts contain provisions for the automatic termination of the contract should a debtor enter into an insolvency process. These clauses declare that a loan or contract is either terminated or accelerated automatically upon filing a petition in bankruptcy or that bankruptcy constitutes an event of default, entitling the lender or contract-holder to terminate or accelerate the terms of the contract or lease.[544]

CIGA defines an 'acceleration or early termination clause' as a provision of a financial contract or other instrument pursuant to which, on the happening of an event, a liability falls due earlier than it otherwise would, or one that bestows a right which would result in a liability falling due earlier than it otherwise would, or a liability being extinguished and replaced by another liability.[545]

The measure prohibits suppliers from terminating a contract due to a debtor entering a formal restructuring or insolvency procedure or based on past breaches of their contract. Contracted suppliers will have to continue to supply, even with pre-insolvency arrears. CIGA expanded the scope of the supplier restriction to invoke these termination clauses by introducing section 233B[546] to the Insolvency Act, which protects the suppliers of goods and services. Initially, the provisions applied to contracts for the supply of gas, electricity, water, communication, and IT services; however, the scope has now been expanded.[547]

Once the debtor becomes subject to an insolvency procedure, the supplier is unable to explicitly indicate or do anything which has the effect of making it a condition of the supply of goods and services that any outstanding charges in respect of a supply made to the company before that time are paid.[548] As such, the creditor cannot make it a requirement for the directors or company officials to provide a personal guarantee to obtain the goods or services. The policy intention of this measure was to assist distressed companies to trade through a restructuring or insolvency procedure in order to maximise the opportunities for the company's rescue or selling its business as a going concern.[549]

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[542] Paragraph A22, *Corporate Insolvency and Governance Act*, 2020

[543] Paragraph A25, *Corporate Insolvency and Governance Act*, 2020

[544] Jackson T. H., 'Bankruptcy, Non-Bankruptcy Entitlements and Creditors' Bargain', 887

[545] Paragraph 148A (11), *Corporate Insolvency and Governance Act*, 2020

[546] Paragraph 14, *Corporate Insolvency and Governance Act*, 2020.

[547] Section 233B (3), *Insolvency Act*, 1986.

[548] Section 233B (7), *Insolvency Act*, 1986.

[549] Paragraph 32, 'Corporate Insolvency and Governance Bill Explanatory Notes', 8, 2020.

3.4.3 Introduction of a new cross-class cramdown mechanism

A new restructuring plan was introduced by CIGA into the Companies Act 2006 as Part 26A (Arrangements and Reconstructions for Companies in Financial Difficulties),[550] which sets out the procedure for a company to enter into the new cross-class cramdown mechanism. The company needs to show that it is likely to or has encountered difficulties which affect its capability to carry on its business as a going concern[551] and that there is an arrangement or compromise that has been proposed between the company and its members or the creditors or any class of either of them.[552]

The purpose of the arrangement or compromise is to eliminate, prevent, reduce or mitigate the effects of the financial difficulties that the company is undergoing.[553] It needs to be sanctioned by the court,[554] and similarly to the scheme of arrangement, the court will convene class meetings of the creditors and members to enable them to vote on the compromise or arrangement.[555] To be sanctioned by the court, the compromise requires approval by 75% in value of the creditors or members or a class or present and voting in person or by proxy at the meeting.[556] Unlike in the schemes of arrangement, there is no requirement of approval by 50% in number of each class of creditors. Furthermore, the court can still sanction the compromise or arrangement even where not all classes have voted in agreement to it.[557] This would effectively impose the compromise or arrangement on any dissenting classes of creditors.

For the cramdown to apply, the court must be satisfied that none of the dissenting class of creditors or members would be worse off under the compromise or arrangement than under the 'relevant alternative'.[558] The compromise or arrangement must be approved by at least one class of creditors or members of the company who would receive a payment or have a 'genuine economic interest in the company' if the 'relevant alternative' were to occur.[559] The relative alternative is whatever the court considers most likely to occur if the compromise or arrangement were not sanctioned.[560] The court has the discretion to approve a restructuring plan and may decline to approve it on the grounds that it would be unjust and inequitable to do so, even if the conditions in section 901G have been met.[561]

Despite its advantages, the cramdown power has been criticized since it increases the risks associated with selective restructuring since the guardrail of class approvals is no longer there,

[550] Schedule 9, *Corporate Insolvency and Governance Act*, 2020.
[551] Section 901A (2), *Companies Act*, 2006.
[552] Section 901A (3)(a), *Companies Act*, 2006.
[553] Section 901A (3)(b), *Companies Act*, 2006.
[554] Section 901C, *Companies Act*, 2006.
[555] Section 901C (1), *Companies Act*, 2006.
[556] Section 901F, *Companies Act*, 2006.
[557] Section 901F (5), *Companies Act*, 2006.
[558] Section 901G (3), *Companies Act*, 2006.
[559] Section 901G (5), *Companies Act*, 2006.
[560] Section 901G (4), *Companies Act*, 2006.
[561] Paragraph 204, 'Corporate Insolvency and Governance Bill Explanatory Notes', 36, 2020.

and as such, companies may be tempted to use the cramdown feature to write off debts in a manner that generates unfair value for the other stakeholders.[562]

3.4.4 Restriction on winding-up petitions

Schedule 10 of CIGA, 'Winding-Up Petitions: Great Britain', prevents certain statutory demands by creditors from being effective by temporarily prohibiting a winding-up petition from being lodged against a company on the grounds that it is unable to pay its debts or a winding-up order from being made on this ground if the debtor's inability to pay is due to the pandemic.

A creditor could not issue a statutory demand to bring a winding-up petition against a debtor between 1st March 2020 and 30th September 2020.[563] Therefore these demands could not form the basis of a winding-up petition presented at any point after 27th April 2020. A creditor could, however, lodge a petition against a registered or unregistered company on the grounds that it was unable to pay its debts if, upon reasonable grounds, it believed that the inability to pay was not the result of the pandemic.[564] If a petition was presented and this condition was not met, the court could order the company's position to be restored to what it would have been if the petition had not been made.[565] The company would avoid the adverse effects of winding up petitions brought under the pre-existing law, and the court could even order the petitioner to be liable for costs.[566]

3.4.5 Suspension of liability for wrongful trading

Under paragraph 12 of CIGA, the liability of directors for wrongful trading was suspended between 1st March 2020 and 30th September 2020,[567] and a court could not hold a director responsible for worsening the company's financial position or that of its creditors during this period.[568] Notably, the directors had no requirement to show that the company's worsening financial position was due to the pandemic. Certain companies regulated under the Financial Services and Markets Act, 2000 were excluded, including insurance companies, banks, electronic money institutions, investment banks and firms, payment institutions and other financial institutions,[569] building societies, friendly societies or credit unions.[570] The wrongful trading provisions are contained in sections 214 and 246ZB of the Insolvency Act 1986 for

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562 Paterson, S and Walters, A, 'Selective Corporate Restructuring Strategy', *SSRN Electronic Journal*, 2021, 9 http://dx.doi.org/10.2139/ssrn.3924225 on 20th July 2022.
563 Paragraph 1(3), Schedule 10, *Corporate Insolvency and Governance Act*, 2020.
564 Paragraphs 2-3, Schedule 10, *Corporate Insolvency and Governance Act*, 2020.
565 Paragraph 4, Schedule 10, *Corporate Insolvency and Governance Act*, 2020.
566 Paragraph 214, 'Corporate Insolvency and Governance Bill Explanatory Notes', 37, 2020.
567 Paragraph 12(2), *Corporate Insolvency and Governance Act*, 2020.
568 Paragraph 12(1), *Corporate Insolvency and Governance Act*, 2020.
569 Paragraph 12(3-5), *Corporate Insolvency and Governance Act*, 2020.
570 Paragraph 12(8), *Corporate Insolvency and Governance Act*, 2020.

liquidation and administration, respectively, in Great Britain[571] and Article 178 of the Insolvency (Northern Ireland) Order 1989 for liquidation in Northern Ireland.[572]

The policy objective behind this temporary suspension of wrongful trading liability was to assure company directors that they would not be held personally liable for using their best efforts to continue to trade the company during the pandemic if the company ultimately failed. It was also aimed at ensuring viable companies continued to trade despite the uncertainty caused by the pandemic to avoid a wave of unnecessary insolvencies.[573]

3.5 CONCLUSION

There is no perfect insolvency procedure, and insolvency law reforms are ever-changing. These changes are influenced by prevailing economic hardship, financial crisis, lobbying by political and private bodies and demands from financial bodies such as the UNCITRAL, World Bank and the IMF.

The pandemic encouraged the UK to amend its insolvency laws by introducing temporary measures for use in the early phase of the pandemic and more permanent changes in its insolvency legislation. The accelerated recommended emergency insolvency reforms had been under consideration years before the pandemic. Through CIGA, the UK ensured the existence of a moratorium while the restructuring was negotiated, the possibility of early intervention when a company was financially distressed and introduced an effective mechanism for cramdown through a new restructuring plan. These changes are in line with the recommendations of the UNCITRAL Legislative Guide on Insolvency Law, 2005, which have been discussed in Chapter 2. These changes have made the UK's law more robust and effective insolvency regime from which lessons can be learned.

[571] Paragraph 12(7), *Corporate Insolvency and Governance Act*, 2020.
[572] Paragraph 12(13), *Corporate Insolvency and Governance Act*, 2020.
[573] Paragraph 82, 'Corporate Insolvency and Governance Bill Explanatory Notes', 16, 2020.

CHAPTER FOUR

4. LESSONS FOR KENYA AND RECOMMENDATIONS FOR THE WAY FORWARD

4.1 MAIN INSIGHTS

The overarching objective of this research was to assess the effectiveness of Kenya's existing corporate insolvency law. The specific objectives were first, to evaluate Kenya's corporate insolvency law based on the UNCITRAL Legislative Guide to determine the adaptability and responsiveness of Kenya’s law and whether the objects of the laws could be met in the event of a pandemic or economic depression. Secondly, it was intended to analyse legislative and policy measures undertaken by the U.K. to curb corporate insolvency risks associated with the pandemic and to determine whether there were lessons Kenya could learn from this jurisdiction. Lastly, it was intended to make recommendations to help make the Kenyan insolvency framework better suited to supporting businesses during a pandemic or economic recession.

To achieve these objectives, it was necessary to assess Kenya's current corporate insolvency regime against the principles reflected in the UNCITRAL Legislative Guide as well as the essential features of the UK insolvency regime and reforms undertaken in the UK due to the pandemic. Upon achieving this, it was possible to ascertain the lessons Kenya can derive from the UK, and this Chapter provides these lessons and recommendations for the way forward.

The study utilised doctrinal and comparative research methods to conduct a thorough desk review of laws and policies and investigate lessons from the UK based on its experiences. The study hypothesised that Kenya's existing corporate insolvency framework is inadequate to assist viable businesses facing financial distress due to pandemics and economic recesses. The research confirmed the study's hypothesis and highlighted the inefficiencies of the insolvency processes available in Kenyan law.

In Chapter One, the thesis has demonstrated that the pandemic and the 2008 global financial crisis increased the risk of insolvency for corporations worldwide which led to quick responses by policymakers to reform insolvency laws. Chapters one and two of the study address the first objective, an evaluation of Kenya's corporate insolvency law to determine its efficacy and whether the objects of the laws can be met in the event of a pandemic or economic depression. The study demonstrated that the Kenyan government took policy measures to prevent firms from getting distressed but that the corporate insolvency regime has been largely untouched. The study has shown that despite the various restructuring procedures on offer, they are under-utilised by firms in distress. The insolvency processes utilised favour liquidation of the companies rather than their rescue despite this being one of the objectives of the Insolvency Act highlighted in chapters one and two. It was explained in chapter two and three why distressed companies preferred liquidation to the restructuring processes.

Chapter two highlighted the critical elements of designing an insolvency framework which served as a background for discussing Kenyan corporate insolvency law. The Chapter demonstrated that it is arguably difficult to make the most use of the procedures available to distressed companies. It is difficult not only because of negative connotations attending to the procedures but also due to design challenges that make it difficult to use them in restructuring and rescuing distressed companies. It was highlighted how the Kenya Airways scheme of arrangement experienced difficulty due to numerous applications by creditors who disputed that the scheme applied to them.

An effective debt restructuring mechanism is essential to a regime's ability to deal with corporate financial distress. Yet, each debt restructuring mechanism available to companies under Kenya law is not perfect. As seen in Chapter two, none of the insolvency procedures provide all the critical components for a restructuring regime identified from the UNCITRAL Legislative Guide on Insolvency Law, namely the existence of a moratorium whilst the reorganisation plan is negotiated, the possibility of early intervention, availability of restructuring finance, and an effective mechanism for cramdown.

The second objective, an analysis of the legislative and policy measures undertaken by the UK to curb corporate insolvency risks associated with the pandemic, is addressed in Chapter Three. The Chapter considered the UK's insolvency regime to determine whether there were lessons that Kenya could learn from their approach to the emergency. The thesis focussed on the UK since Kenya modelled its insolvency law on the UK's. Furthermore, the UK is classified as leading the search for optimal insolvency and restructuring regimes for corporate entities in financial distress, and both countries are common law jurisdictions. The Chapter analysed the UK corporate insolvency regime, some proposed changes, and the reforms made through CIGA.

The study derived valuable lessons from the UK reform process. Firstly, stakeholders should undertake a regular insolvency law review to assess its efficacy and efficiency. Secondly, that stakeholder and governmental institutions' involvement is vital for successful reform. Thirdly, international financial institutions have succeeded immensely in making recommendations for designing an efficient insolvency framework, and lawmakers cannot disregard these recommendations when creating or reforming the law. Fourthly, crises such as the international financial crisis and the pandemic accelerate reforms to insolvency law to ensure it could effectively assist in rehabilitating distressed companies, which is crucial for economic recovery during and after the crisis.

4.2 RECOMMENDATIONS

4.2.1 A hybrid debtor-in-possession rescue procedure

In chapter two it was established that once insolvency proceedings are commenced, the debtor could either retain control of the business or relinquish it to a practitioner appointed to supervise and manage the debtor. It was consequently determined that Kenya’s insolvency framework provides for a practitioner-in-possession who controls and supervises the various insolvency processes. The debtor’s management are ousted in this system.

We saw that the UNCITRAL Legislative Guide on Insolvency Law suggests that efficient rescue could occur where existing management is integrated into the rescue, but without them being allowed to retain their managerial powers. This was implemented by the UK through CIGA which introduced a moratorium whereby, in the event of an emergency, a distressed company’s management would retain control under the supervision of an insolvency practitioner.

As such, a way forward for Kenya could be the provision of a business rescue procedure that allows the debtor to remain in control during an emergency such as the pandemic or a recession, under the oversight of an insolvency practitioner, in order to maintain checks and balances.

This procedure would avoid imposing a practitioner and new management on the debtor, who might be unqualified to manage the debtor's day-to-day operations and prevent potential hostility between the practitioner and the management.

Such a hybrid system could be more adaptive and responsive in an emergency as it could encourage early intervention. This is because the directors will not be apprehensive of losing their positions in the company were the company to enter into a formal insolvency procedure. Secondly, the directors have the requisite knowledge and skills to manage the Company. Lastly, any reputational damage the Company may encounter is minimised.

However, this system is not without its risks, which might need to be mitigated, primarily where the financial problems the Company's distress is facing are occasioned by bad management. As such, corporate governance mechanisms must therefore be in place to hold directors accountable.

4.2.2 Assessment of court involvement

It was noted that during financial crises, many jurisdictions introduce new insolvency mechanisms to reduce reorganisation costs by introducing an out-of-court system to bypass the judicial court process and its attendant costs and delays.[574] The Court's involvement or

[574] The World Bank, *The World Bank Principles for Effective Insolvency and Creditor/ Debtor Regimes*, 7

intervention in the rescue procedures, especially where a moratorium is required, urgently needs to be assessed.

Our courts which ordinarily deal with insolvency applications are burdened with commercial cases since they hear insolvency applications and petitions in tandem with other matters before the court. We do not have specialised courts or judges to deal with insolvency or bankruptcy cases. The World Bank Principles note the importance of a specialised independent court and Judges specialised in insolvency proceedings.[575]

A rescue solution with limited court control would be ideal in an emergency such as a recession or pandemic situation, where the Company needs a moratorium urgently. By-passing the court would save time to obtain the moratorium and avoid the prolonged delays in hearing and determination of these court applications. For instance, an insolvency application to the Commercial Court can also be challenged in the Court of Appeal, as seen in the Kenya Airways scheme, which would prolong the delay and render any action that an applicant wishes to forestall nugatory or the application purely academic.

4.2.3 Moratorium

The analysis of Kenya's corporate insolvency regime revealed that although there is provision for moratoria, the same can only be obtained through formal insolvency procedures, by way of application to court. For instance, in chapters two and three we saw that schemes and CVA's must be coupled with administration in order to benefit from moratoriums.

Considering Kenya's court system, it was determined that the length of time and consequential delay in hearing and determining applications in order to obtain court orders may act against a debtor in an emergency. It was highlighted how this could delay the successful turnaround or restructuring of a financially distressed company. It was noted that the UNCITRAL Legislative Guide suggests that an effective insolvency framework provides for moratoria and that obtaining moratoriums swiftly was crucial post-commencement if the company's turnaround were to succeed. To this end, we established that the U.K. made provision for a stand-alone moratorium at the onset of the pandemic.

Kenya's insolvency law can benefit by providing temporary limitations, in an emergency situation, such as suspension of statutory demands leading to insolvency; and suspension of filing insolvency petitions, preventing suppliers of goods and services from terminating their contracts with the company on the grounds of insolvency alone. This would deter suppliers from exercising contractual termination rights and enable viable companies to consider rescue plans without insolvency hanging over their heads.

There ought to be safeguards protecting creditors, such as seeking their consent, or even a court order if the duration of the moratorium is to be extended. Another safeguard could be a limitation of the applicability of such a moratorium, such that it would only apply in an

[575] The World Bank, *The World Bank Principles for Effective Insolvency and Creditor/ Debtor Regimes*, 19

emergency situation with a rider that any abuse of the mechanism would lead to personal liability against the directors if the creditor's interests were impaired.

4.2.4 Suspension of wrongful trading

Directors of viable companies faced difficult decisions during the pandemic, whether to continue trading by taking new obligations and consequently incurring a duty to take every step which a reasonably diligent person would take to minimise potential loss to the company's creditors. Several regimes suspended the duty to avoid wrongful trading to give directors more confidence to trade if their companies were viable. As such, a director could avoid liability when trading whilst insolvent.

It is proposed that where illiquidity or over-indebtedness is caused due to intervening circumstances such as a pandemic, recession, or financial crisis, a company's directors not be held liable for wrongful trading if they trade in the best interests of the company. Although the directors will still owe fiduciary duties and provisions on fraudulent trading will still be in force, this measure ought to be temporary to prevent possible abuse.

4.2.5 Cross-class Cramdown procedure

In chapter two we confirmed that the Kenyan corporate insolvency framework does not provide for a cross-class cramdown which, as explained in the thesis is the ability of a majority of creditor classes to bind minority creditors within a specific class of creditors or members. For instance, as explained in chapter two, where a creditors' scheme of arrangement is proposed between a company and one or more classes of creditors and one class of creditors dissents, then the scheme fails. As such, the procedures available make the law inadaptable and unresponsive in an emergency situation. We also noted that the UNCITRAL Legislative Guide suggests that a cross-class cramdown is required if an insolvency law is to be considered effective.

It is proposed to adopt a cross-class cramdown procedure in schemes that will allow for a court order to be obtained which would bind dissenting classes of creditors to a restructuring plan and ensure the majority view of creditors is upheld. In order to protect the dissenting class of creditors, it is proposed that they be paid an amount similar to at least what they would receive if the debtor was to be liquidated. Further, it is proposed that the cross-class cramdown be available upon application to court where the classes of creditors seeking the cramdown represent a majority of at least 75% of the value of the debts owed. Lastly, it is proposed that such a mechanism does allow the minority classes an opportunity to oppose the scheme when the application is being heard and determined.

Implementing a cross-class cramdown for purposes of restructuring will provide an adaptive restructuring procedure in an emergency bringing Kenya's corporate insolvency law in line with other jurisdictions and international best practices.

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Appendices

Appendix A: Similarity Report

Ouriginal
by Turnitin

Document Information

Analyzed document	LL.M Thesis - Ndolo Final Draft.docx (D144347950)
Submitted	2022-09-19 11:35:00
Submitted by	
Submitter email	denis.ndolo@strathmore.edu
Similarity	15%
Analysis address	library.strath@analysis.urkund.com

Sources included in the report

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W	URL: https://blogs.imf.org/2020/04/14/the-great-lockdown-worst-economic-downturn-since-the-great-depression/ Fetched: 2022-09-19 11:36:00
W	URL: https://www.centralbank.go.ke/wp-content/uploads/2021/06/MSEsCOVID-19Tracker.pdf Fetched: 2022-09-19 11:37:00
W	URL: https://openknowledge.worldbank.org/handle/10986/35172 Fetched: 2022-09-19 11:38:00
SA	**16B097_Neeti Amin- Seminar Paper.docx** Document 16B097_Neeti Amin- Seminar Paper.docx (D110091996)
W	URL: https://www.imf.org/external/pubs/ft/orderly/ Fetched: 2022-09-19 11:38:00

Appendix B: Ethical Clearance Confirmation

Strathmore UNIVERSITY

9th September 2022

Denis Ndolo Kieti
051497
denis.ndolo@strathmore.edu

Dear Denis,

RE: Flattening the Insolvency Curve: The Adaptability and Responsiveness of Kenya's Corporate Insolvency Law in Tackling Pandemic and Economic Depression Insolvencies

This is to inform you that the Office of Graduate Studies on 9th September 2022 received your acknowledgement of breach in ethical processes given that you have already collected data and written the Thesis prior to obtaining Ethical clearance. The ethics approval process is ONLY done before any collection of primary or secondary data.

This is a letter for you to proceed with the next steps of your academic requirements.

Please be advised, that in future, all research proposals should be submitted to the SU-IERC through the RHInnO Ethics platform: https://strathmoreuniversity.rhinno.net/login

Disclaimer: This is not in any way an ethical approval letter.

Yours sincerely,

Dr. Bernard Shibwabo
Director of Graduate Studies