

Insolvency & Restructuring - International

Best practice and tailored reforms in African insolvency: lessons from INSOL

Contributed by **Punuka Attorneys & Solicitors**

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The success of the third INSOL Africa Roundtable has proved that African governments, financial institutions, policy makers and the private sector are now more actively engaged in modernising the insolvency framework on the continent. Reform of Africa's insolvency regimes is vital for economic growth and investments in this emerging market.

The roundtable, held in Nairobi, Kenya on September 7 and 8 2012, focused on best practices in insolvency reform. It was attended by delegates from more than 20 African countries, with a strong representation of key government executives, policy makers⁽¹⁾ and senior executives from financial institutions. The roundtable was opened by the attorney general of Kenya, Professor Githu Muigai.

Kenya is itself in the midst of a complete overhaul of its commercial and investment laws, with the introduction of two critical new bills: the Companies Bill and the Insolvency Bill. According to the deputy solicitor general, were the product of comparative analysis of several common law insolvency jurisdictions,⁽²⁾ with a particular bias for business rescue⁽³⁾ and regulation of the insolvency profession.

The Africa Roundtable is a platform for policy makers and stakeholders to share knowledge on best practices and proffer ideas on how to adapt to suit the local particularities of African insolvency systems. Its key proponents - INSOL, the World Bank and the International Finance Corporation (IFC) - believe that such interaction would enhance the modernisation of insolvency laws and, by extension, grow and sustain local entrepreneurial spirit, financial intermediation, local investments and foreign direct investments, which are crucial for sustainable economic development in emerging African markets. The roundtable also seeks to examine diverse African experiences whenever possible, to discover what works. The goal of these exchanges is to achieve converging best practices in individual country reforms at various stages of advancement or implementation.

Harmonising policy approaches

The policy makers and stakeholders agreed that harmonisation of laws at a regional level is needed (eg, the Organisation for the Harmonisation of Commercial Law in Africa, the Economic Commission for Africa and, the Economic Community for West African States).

It has become imperative for each country to engage in holistic law reform⁽⁴⁾ (many of the policy makers and government representatives affirmed that their governments are now working towards this end), which includes not only insolvency reform but also credit, securities law and company law reform. At the roundtable, emphasis was also placed on the need for each country to engage in diagnostic analysis, data gathering, expert consultation and stakeholders consultations before any reform law is drafted. The law must aim to solve identified problems. The one-size-fits-all approach of a slavish use of legislative guide and model law, while seemingly appealing for the sake of uniformity, would not solve the problems, peculiarities and cultural context of African insolvency systems.

Governments of the different African countries were advised that insolvency reform must be a joint effort between the private sector and government. The bankers present at the roundtable indicated a preference for non-formal workouts and avoidance of formal insolvency proceedings because these are cumbersome and protracted. The bankers

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advocated, and it was agreed that any reform must include, a fast-track insolvency procedure. However, some of the speakers sought to demonstrate the correlation between an effective formal insolvency system and the recovery of real money or value, because most of their informal workouts are self-financed and as such may not typically bring in real money, leading to the eventual collapse of the banks and a rush for bailouts.

An effective insolvency system in the context of most African countries was described as one that is flexible enough to allow for debtor in possession schemes (which seems in line with the possessive attitude of African debtors) and relevant moratoria (business rescue oriented) without sacrificing the rights and interests of creditors.

In dealing with policy issues in insolvency reform, it was agreed that micro, small and medium-sized enterprises (MSMEs) must be considered. Because national economic development and growth lies in the ability of governments to support MSMEs, access to finance for MSMEs is an unavoidable issue which must be reckoned with early when formulating an effective insolvency system that can be properly integrated with the larger economic system. The policy makers in their development roles must understand why formal lenders do not have an appetite for lending to MSMEs. Is it because there is too a high risk (a fear of non-payment⁽⁵⁾ or a lack of corporate governance)? Why is the business restructuring and insolvency process not flexible enough to allow for recovery against MSMEs? Why are systems too lax to encourage necessary liquidation of MSMEs where required? In that regard, it was suggested that governments consider establishing a fast-track procedure⁽⁶⁾ for MSME disputes, as well as business rescue options such as standby negotiations or arbitration with a moratorium - as has been the case in India. Some of these suggestions tap into the much broader topic on the need to consider adequate and workable alternatives to formal insolvency processes in line with the key characteristic of flexibility of an effective insolvency system.

Less formal workout systems

The roundtable discussed the deployment of alternative dispute resolution (ADR) procedures and recognition of informal workouts in existing insolvency systems. Some participants felt that, as informal systems, these should not be part of formal insolvency legislation, while others felt they could be part of a multi-door court system. The Kenyan delegation mentioned that their pending Companies and Insolvency Bills provide for informal workouts and contain a flexible and less formal⁽⁷⁾ business rescue chapter, including company voluntary arrangement and administration procedures.

The session on ADR and insolvency⁽⁸⁾ focused mainly on informal workouts (ie, out-of-court arrangements which are purely contractual and a sort of composition).

The advantage of the informal approach to insolvency and business restructuring was said to lie in the speed of the process and alleged lower costs and higher recovery.⁽⁹⁾ Informal workouts, according to Professor Fidelis Oditah QC SAN, were originally derived from the London approach⁽¹⁰⁾ by which creditors met and agreed on a common approach to the insolvency. The fundamental question that arose was whether ADR was compatible with insolvency, and particularly collective arrangements. Put another way, should an informal arrangement be subjected to a formal arrangement? For Oditah, the ADR process can be incorporated in informal workouts and would be subject only to the "imagination and expertise of the participants". However, acceptance of workout would depend on the confidence of creditors in the skill and experience of the insolvency practitioner in analysing the insolvency and proffering a solution. Moreover, the main challenge to workability of ADR in informal workouts seems to be the issue of mistrust between the parties.

Japan's business revitalisation ADR procedure and Uganda's new Insolvency Law were used as points of discussion. In Uganda, there is provision for voluntary liquidation, and if there is disagreement on value, among other things, there is provision for arbitration (ie, ADR - and the outcome then has the effect of a judgment of the court). The head of the Ugandan Commercial Court stated that in all commercial disputes court-directed ADR is available - which can be used at pre-hearing conferences - and ADR rules are annexed to the court rules.

The solicitor general of Zambia informed the roundtable participants that in Zambia, it is part of the Code of Professional Ethics that lawyers must attempt ADR before filing any case. There can also be party-instigated arbitration. The court can also direct formal court appointed mediation. The outcome is then entered as a judgment. Part 11 of the Zambian Companies Act allows for an arrangement with creditors, but it must be followed with a formal court process to secure it because of mistrust.⁽¹¹⁾ Success of the process hinges on the honest business intention and credibility of insolvency practitioners.

However, the cost of arbitration is seen to be exorbitant and discouraging deterrent to informal workouts and dispute resolution. There was also a challenge at the roundtable on what exactly is arbitrable. For instance, a recent decision from Nigeria held that tax disputes cannot be the subject of arbitration and an award on investment tax credits

was set aside.

Implementing law reform

It was noted that many African countries are taking steps to enact new legislation on insolvency and business recovery. However, no matter how good the laws are if they cannot be implemented and sustained, then they are doomed to fail. Some of the challenges of implementation include a lack of understanding of the principles behind the reform and of its compliance obligation. Successful implementation therefore would involve education and public enlightenment, retraining and capacity building. At times, new institutions may have to be created from scratch.

Instead of creating new institutions, some expert speakers advised that governments and the courts should use existing institutions to drive the new system. For instance, Mauritius is using its registrar of companies, an existing institution, to drive implementation of its new insolvency law.

With large areas to govern and the need to build capacity, Mauritius is using information and communication technology to tackle such challenges while developing its human capacity. Prabha Chinien said that Mauritius has used existing staff with little training to set up the new Directorate of Insolvency. It also has a technology database to which all departments have access, and which is connected to the High Court, so that when orders are made, they are fed into the database. The public and creditors have immediate access to this database. Mauritius also has an e-court process, whereby cases are filed electronically and automatically allocated to a judge, who then follows up the case electronically. Insolvency practitioners in Mauritius require registration with the registrar of companies, rather than a licence. There is a Code of Conduct for insolvency practitioners, which seeks to formally recognise the importance of establishing a framework for out-of-court workout procedures. A draft is undergoing consultation and awaiting comments - particularly from banks - and is due to be adopted soon.

The chief master of South Africa spoke of the South African experience. He said that South Africa has considered the possible introduction of a central securities register. Although it has not yet succeeded, this project should still be pursued. The chief master mentioned that the work of the existing master's office involves more than insolvency. It maintains a register of deceased estates and securities, including the status of every company (eg, whether in winding up). Court orders are granted manually and then find their way to the master's office to be entered the register, which can take up to three months.

An electronic central securities register is being pursued because online availability of properties under charge, or for realisation, would eliminate corruption by insolvency practitioners.⁽¹²⁾

Regulation of insolvency practitioners

Regulation of insolvency practitioners is perhaps one of the most important areas that requires reform. However, it seems that contrary to best practice, until recently this area has been completely ignored by many African jurisdictions.⁽¹³⁾ The interactive session on this topic centred on the fact that good insolvency laws would be useless if 'good'⁽¹⁴⁾ people were not available to implement them. In implementation, the insolvency practitioner plays two roles. The first is to realise the assets and manage or distribute them. The second, a regulatory role, is to report to the government on the performance of the company and its directors. This is the basis under which directors are blacklisted and the system cleaned up. Best practice, as agreed in the African systems, requires insolvency practitioners who have knowledge and experience as well as integrity (ie, independence, impartiality and credibility).

Oditah led a discussion on whether and if so how insolvency practitioners in African jurisdictions should be regulated.

While the consensus was that regulation is required, deciding on but the manner of regulation requires a deeper understanding of the societal and cultural values of each country and what is likely to work most efficiently in each jurisdiction. Generally, there are different levels of regulation: self-regulation, statutory regulation and something in the middle, which is minimum regulation by government allowing for self-regulation by voluntary bodies.

Whichever method is selected, best practice requires that criteria be objective and verifiable. Also, having regard to the attributes of competence, professionalism and integrity, the issue of remuneration must be clearly regulated, including issues such as fees (fixed, ⁽¹⁵⁾ flat or hourly rate), priority of such remuneration in relation to other costs and caps on fees for some or all insolvency work.

With self-regulation, one way to strengthen a profession is to bring it together under an umbrella organisation. This results in convergent practices. Only three countries in Africa have such associations. The danger with self-regulation alone, from the

perspective of best practices, is the concern of regulatory capture and the risk of defalcation and fraud if insolvency practitioners maximise their fees and leave only a husk of a company after discharging their stewardship.

Thus, even though it was suggested, for the purpose of legislative activism, capacity building and continuous legal training, that all countries should have local associations to pursue and support insolvency reform, the optimum regulatory model is arguably minimum regulation, which basically positions the insolvency practitioner between market forces and regulatory forces.

Another important issue in effective regulation is ethics, but this must begin from an early stage. Quality control should be part of the process.

When discussing regulation in certain jurisdictions, such as Mauritius and Zambia, it was said that registration is the easy part. Registration ensures barriers to entry and requires minimum training and minimum standards of knowledge. In Zambia, lawyers and accountants are registered by the registrar of companies. Insolvency practitioners are also registered in Mauritius, although there is no licensing requirement.

Ordinarily, even with self-regulation, apart from an obligation to engage in training and being bound by a strict code of conduct, professionals should have a professional indemnity. An effective regulation should also envisage some form of reporting and supervision by a regulatory institution.

In South Africa, an insolvency practitioner must by law put up security to the value of the property that he or she is administering. He or she can be removed for transgression and is under the supervision of the master. However, there is no power to impose fines, suspension or lower penalties.

Comment

The 2012 Nairobi INSOL Africa Roundtable, which focused on best practices in legislative reform, confirmed that legislative reform is not an agenda for the government or private sector alone. It must rather involve a cooperative effort by both private and public sectors in each country, as well as a multilateral effort in sharing best practices across borders. Insolvency practitioners in African countries were encouraged to set up associations as a platform for self-regulation and to engage with the governments of their various countries in insolvency reform. Any such reform should address substantive insolvency laws, cross-border insolvency, regulation of insolvency practice, fast-track procedures and informal workouts, as well as special consideration for MSMEs. To succeed, the reform process must be collaborative and involve all stakeholders, particularly creditors and lenders. Multilateral agencies such as the World Bank and the IFC have indicated their commitment to support insolvency reform in Africa.

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Endnotes

(1) Attorney generals, solicitor generals, registrar generals, key regulators and internationally acclaimed expert insolvency practitioners.

(2) Such as the United Kingdom, Australia, New Zealand and Canada.

(3) Introduction of business rescue chapters in these bills, including but not limited to, company voluntary arrangements and administration procedures.

(4) The Kenyan example was highlighted as a case in point as to how seriously the government is engaging in tackling the issues. This advice dates back to 2007 when the World Bank's Report on Observance of Standards and Codes was released.

(5) Seychelles banks do not lend to MSMEs because of the risk of non-recovery and lack of trust in the court system. The courts have set up a fast-track court system and work to reform the insolvency system is ongoing.

(6) Generally, it was said that the courts must be re-equipped and trained in specialised areas. The Kenyan experience has shown that since the establishment of a Commercial Court, there has been substantial reduction of backlog and speedier resolution of cases. Deputy Solicitor General Christine Agimba suggested that the Africa Round Table should invite law schools and training institutions as judges.

(7) By formal, it is meant involving substantial, active and regular participation of the court and the judicial process.

(8) Moderated by Fidelis Oditah, QC, SAN.

(9) In practice, in Nigeria it would appear that real money is not always realised by the

banks or the archaic and inefficient formal process which the banks have failed or neglected to reform.

(10) Where essentially banks come together and agree their own moratorium and workout.

(11) In Lesotho they have small claims courts to help.

(12) Sweden was mentioned as a country where the database system is working so well that it helps insolvency practitioners and tracks cases and remuneration. Russia has an online auction used in insolvency.

(13) Note that South African Chapter 6 regulating Business Rescue Practitioners came into force in 2011. The Ugandan Insolvency Act, particularly Section 206 establishing the regulation of insolvency practitioners, was also enacted late 2011.

(14) Responsible and competent, fit and proper professionals.

(15) In Mauritius maximum remuneration is 15% if no interest.

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