

Insolvency & Restructuring - Nigeria

Driving business recovery: the role of the courts

Contributed by [Punuka Attorneys & Solicitors](#)

November 18 2011

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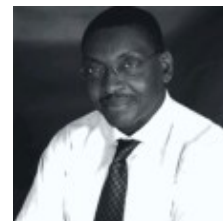
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Introduction

The principal focus of modern insolvency legislation is no longer the liquidation and elimination of insolvent entities, but rather the remodelling of the financial and organisational structure of enterprises in financial distress to enable the rehabilitation and continuation of their business. As a result, various jurisdictions have developed collective proceedings with a business rescue bias.⁽¹⁾ The Nigerian general insolvency regime⁽²⁾ is somewhat deficient in this regard,⁽³⁾ with the exception of the area of bank insolvency, where legislative intervention via the enactment of the Asset Management Corporation of Nigeria Act in June 2010 has created a more business rescue-friendly environment.⁽⁴⁾ Against these limitations, and pending further modernisation of the Nigerian general insolvency regime, this update proposes that the courts can proactively encourage business recovery in suitable circumstances using some well-established techniques.

Courts' role in driving business recovery

The Companies and Allied Matters Act, which was enacted in the 1990s, does not appear to provide an adequate definition of 'insolvency' within the context of either non-collective⁽⁵⁾ or collective⁽⁶⁾ proceedings. Indeed, the formal definitions of corporate insolvency and personal bankruptcy in Nigeria are not only inadequate, but also inefficient in that they both essentially require existence of a judgment debt.⁽⁷⁾

There is a difference between 'cash-flow insolvency' and 'balance-sheet insolvency'. While the former relates to temporary liquidity or a cash-flow crisis, the latter relates to the insufficient asset base of the company. Cash-flow insolvency usually connotes a proper case for business rescue consideration, while balance-sheet insolvency establishes a typical case for liquidation. Unfortunately, the statutory approach under Section 409(a) of the act offers judges a lazy alternative by providing an inaccurate insolvency test. It provides that there is a presumption that a company is insolvent and should be wound up if it is established that it is unable to pay N2,000 (less than \$15) after the expiration of a 21-day statutory demand notice. Liquidating a company which is not balance-sheet insolvent on this basis could cause unnecessary and avoidable social upheaval and defeat the purpose of the law.

Judicial activism and creativity in dealing with the challenges posed by the insolvency law have been advocated to help to prevent abusive use of the insolvency process to eviscerate otherwise viable companies. However, under Nigerian law, the judge must remain impartial and should administer the law, rather than creating it. It is therefore difficult to promote judicial activism and creativity. How can a judge favour a business rescue-oriented proceeding without making the law? How will a judge know which case is appropriate for business recovery rather than asset realisation by an insolvency practitioner (which may affect the company's long-term balance-sheet insolvency)?

While there is no doubt that the court's function is to interpret the law "as it is" and not "as it ought to be", under the laws of Nigeria and other common law jurisdictions⁽⁸⁾ the courts should interpret and apply the law by reference to the intent of the legislature. Therefore, the courts may sometimes need to go beyond the literal meaning of the statutory provisions in order to avoid absurdity. In so doing, they must exercise discretion to allow the law to deal with new and perhaps unanticipated situations without the need for new legislation.

It seems absurd to trigger a creditor's winding up on the basis of the company's inability

to pay \$15; even though a company may be cash flow insolvent (ie, have a temporary and remediable cash-flow downturn), it may still be balance-sheet solvent. Section 409 of the Companies and Allied Matters Act, which presumes insolvency if the company cannot pay \$15, also provides an alternative that a judge should be satisfied that the company cannot pay its debt before triggering winding up. Thus, where the literal interpretation will invariably lead to absurdity, the court may step in to give a more sensible interpretation.(9)

Moreover, in Nigeria, judges should exercise their discretion based on the evidence presented to them. If they are not satisfied with the evidence, judges may refuse to grant an injunctive or winding-up order, and may instead consider an option that would save the business and protect many other tied interests.

Further, unlike in the United Kingdom where the courts have no rulemaking powers, in Nigeria the chief judge of the Federal High Court (which deals with insolvency matters) has constitutional subsidiary rulemaking and practice direction powers under the 1999 Constitution (as amended) and its enabling act.(10) This puts the courts in a much better position to trigger legal reform.

Receivership and winding-up proceedings

In Nigeria, a receiver or manager may be appointed by the court or privately.(11) The court can appoint a receiver on the application of a trustee for a debenture holder,(12) a debenture holder(13) or an interested person.(14)

Even in cases of private appointment, where the court ideally plays no role, the court is invariably involved either by the creditor or receiver seeking a protective order or by the debtor seeking a restraining order against the creditor or receiver. Further, a receiver or manager appointed privately can apply to the court for direction and usually goes to court to obtain a preservative order against the company in receivership (Section 391 of the Companies and Allied Matters Act).

In all these proceedings there is no requirement that the insolvency practitioner be regulated or properly qualified. Insofar as he or she has not been judged to be of unsound mind or fraudulent character, anyone can be appointed as an insolvency practitioner.(15)

The power of the court to give direction on a private receivership or to appoint a receiver directly affords it the opportunity to influence a rescue culture and to improve professionalism in insolvency proceedings. For example, the court can, by way of appointment order, decide to approve the appointment of professionals with proven track records or to direct that an association such as the Business Recovery and Insolvency Practitioners Association of Nigeria provide reputable professionals or give referrals for appointment. In such case the court may be able to commandeer the requisite expertise necessary to handle the insolvency situation, whereby it may direct the insolvency practitioner – particularly in circumstances where he or she is appointed as both receiver and manager – to consider a possible rescue plan for creditors and to revert to the court for consideration of such plan. Clearly, under the law such an insolvency practitioner is enjoined to act and take decisions in the best interest of the ailing company as a whole and not just for the benefit of the appointor.(16)

Further, to the extent that the judge is asked to exercise discretion on the basis of an application for an injunction in respect of a receivership, whether restraining (debtor) or preservative (creditor), he or she has the opportunity to consider objectively whether a deserving case of business rescue can be considered without descending into the arena of conflict by reference to evidence:

- supplied by the parties regarding the cash-flow and balance-sheet statements of the debtor company; and
- pertaining to the competence of the insolvency professional sought to be appointed and his or her expert opinion as to the viability of business or otherwise.

The objectivity of this process can be strengthened where the evidence supplied affords both parties the opportunity to submit different plans for the business, with the experts having the opportunity to revert on areas of agreement and disagreement.

In addition to appointing and instructing the insolvency practitioner, the court can remove an insolvency practitioner or revoke injunctive orders if the requirements of such orders are not being fulfilled. In essence, the court can supervise administration of the receivership.(17)

These points also generally apply in the context of the collective proceedings existing under the Nigerian framework:

- liquidation or winding up (Part XV of the Companies and Allied Matters Act);(18) and
- judicial reorganisations (described as "arrangement and compromises" under Part XVI of the act).(19)

These two procedures are not business rescue friendly.

Unlike other African jurisdictions (eg, South Africa and Uganda), which have created collective procedures aimed at saving a business by giving it the necessary respite to achieve a turnaround through a proposed plan,⁽²⁰⁾ the Nigerian system takes an outdated approach to corporate insolvency matters.

The courts should rise to the challenges posed by the framework by using their discretionary powers to establish a proper case for winding up by reference to evidence supplied by the parties aimed at establishing 'real' (ie, balance-sheet) insolvency in order to filter proper cases for collective insolvency proceedings. For example, in determining insolvency, the court has room under Section 409 of the Companies and Allied Matters Act to avoid the lazy 'demand notice' approach and instead to require a plan prepared by an insolvency professional as to balance sheet or cash-flow insolvency. After all, the court has the power to apply the law, and in this regard has wide discretion depending on the facts supplied in each case. By demanding to be satisfied that real insolvency exists before liquidation, and by preferring business rescue in other instances, the court is merely applying the law.

With regard to the chief judge's rulemaking powers, a practice direction should be issued requiring that every application for relief against exercise of a security right or for directions under Section 391 of the Companies and Allied Matters Act be supported by a rescue plan prepared by a member of an authorised insolvency association or a professional licensed by the official receiver of the court.⁽²¹⁾

Comment

Notwithstanding the limitations of the existing general insolvency framework, which is in urgent need of reform, the courts are constitutionally and legally empowered to influence positively the practice of business rescue and insolvency for the benefit of society and to ensure the more efficient administration of justice. They have a fundamental role to play in dispensing justice and balancing the interests of various stakeholders in commercial insolvency-based disputes. In this regard, the courts can subtly achieve a paradigm shift in the insolvency framework towards business recovery using their powers to interpret and apply the law and to make rules.

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Endnotes

(1) Examples are:

- the US debtor in possession, also known as the Chapter 11 bankruptcy procedure;
- the UK administration procedure under the UK Insolvency Act 1986; and
- the South African Chapter 6 procedure under the Companies Act 2008.

(2) The Companies and Allied Matters Act C20 LFN 2004.

(3) For further details please see "[Restructuring and new capital: the role of government and insolvency practitioners](#)".

(4) For further details please see "[Dealing with bank insolvency: Asset Management Corporation of Nigeria Act](#)".

(5) Non-collective proceedings involve only specific creditors of the company and envisage proceedings such as informal reorganisations, different categories of receivership, self-managed proceedings and private arrangements. In Nigeria, receivership is the formally recognised non-collective proceeding.

(6) The term 'collective proceedings' means formal winding up, liquidations and, as the case may be, reorganisations of companies through arrangement and compromises under the Companies and Allied Matters Act. Such proceedings typically involve a process that is open to all creditors and stakeholders in the company.

(7) See Section 567 of the Companies and Allied Matters Act and Section 1 of the Bankruptcy Act.

(8) Otherwise, it might be acting outside its constitutional adjudicatory powers and such action will be said to be null and void. See *AG Abia State v AG Federation* (2006) 16 NWLR (Pt. 1005) 265.

(9) *Opeola v Opadiran, supra*.

(10) Section 254 of the 1999 Constitution (as amended) and Sections 9 and 44 of the Federal High Court Act.

(11) Based on a provision in the security instrument held by a creditor authorising it to make such appointment.

(12) Section 209(d) of the Companies and Allied Matters Act. By Section 209(3) of the act, all receivers or managers appointed under that section shall exercise their vast powers subject to any order made by the courts.

(13) In this case, under Section 388 of the Companies and Allied Matters Act the court has the power to appoint an official receiver.

(14) Section 389 of the Companies and Allied Matters Act; in this case the court may additionally appoint the receiver as a manager.

(15) Section 387 of the Companies and Allied Matters Act.

(16) Section 390(2) of the Companies and Allied Matters Act. See also Hubert Picarda, *The Law Relating to Receivers, Managers and Administrators*, third edition, p131, which shows that a decision not to continue in trade in deserving circumstances by the insolvency practitioner amounts to a breach of the duty of care.

(17) In deserving circumstances involving fraud, the court may also refer such matter to the Office of the Attorney General of the Federation for criminal prosecution.

(18) The Companies and Allied Matters Act puts winding up into three categories:

- court instigated (compulsory);
- voluntary; or
- subject to court supervision, for registered companies.

(19) See Sections 538, 539 and 540 of the Companies and Allied Matters Act.

(20) For a deeper reading and comparative jurisdictional analysis on these issues, please see the author's paper "Insolvency regime in Nigeria: challenges for reform and lessons from other jurisdictions", delivered on October 20 2011 at the Regional Workshop on Building Effective Insolvency and Secured Transaction Systems in Eastern and Southern Africa, Entebbe, Uganda.

(21) In South Africa, liquidators are supervised and sanctioned by the master. Clearly, such an arrangement is possible in Nigeria through the court's subsidiary rulemaking powers.

A presentation based on this update was given at the 2011 Federal High Court Judges Conference held at the Shakuru Conference Hotel, Sokoto on October 11 2011.

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