The University of Zambia
School of Law

TITLE: “PITFALLS OF INSOLVENCY PROVISIONS UNDER THE ZAMBIAN COMPANIES’ ACT”.

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A dissertation submitted to the University of Zambia in partial fulfillment of the requirements for the award of Master of Laws (LLM) Degree.

November, 2015

DECLARATION

I, BWEMBYA ANTHONY DO HEREBY DECLARE THAT this dissertation is my original work and has not been presented for a degree to the University of Zambia or any other University. All other sources of information cited herein have been duly acknowledged.

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CERTIFICATE OF APPROVAL

This dissertation authored by Anthony Bwembya (Computer Number: 53100) and entitled *Pitfalls of Insolvency Provisions under the Zambian Companies' Act* has been approved as fulfilling the requirements for the award of the Degree of Master of Laws by the University of Zambia.

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ABSTRACT

The purpose of this study was to establish whether the provisions of the Zambian Companies' Act in relation to insolvent companies do provide an effective mechanism for protecting the wider interests of different stakeholders who include shareholders, employees, tax authorities, suppliers and customers. The insolvency provisions in the Zambian Companies Act, like those in many other commonwealth countries are premised on English law. Many jurisdictions including England have undertaken insolvency law reform to introduce modern and workable concepts such as those aimed at facilitating corporate rescue, enhancing director's responsibility, providing for expeditious and non-court based procedures, among others. In Zambia however, the Companies Act is still premised on the repealed English Companies Act of 1948. The problem is that it is not known whether the current insolvency provisions are capable of providing safeguards to guarantee equitable and fair outcomes for all stakeholders in situations where debtor companies undergo financial distress. This approach adopted was a desk research method encompassing mainly collection of primary data in the form of local and foreign legislation, law reports and secondary data from text books, newspaper articles, journals, internet and dissertations and obligatory essays. The major research findings were that, insolvency provisions in the current Zambian Companies' Act fall short of international best practice in that they lack any effective mechanism for corporate rescue and cross border insolvency. The said provisions are also incapable of fostering accountability, transparency and fairness among liquidators and receivers. The conclusion from the study was that insolvency provisions in their current form are incapable of safeguarding the interests of any of the stakeholders when a company has become insolvent. The major recommendations arising out of this research include the need to; strengthen provisions of the Zambian Companies' Act relating to director's duties and responsibilities; introduce provisions aimed at corporate rescue; introduce provisions aimed at improving accountability, expertise and fairness among Receivers and Liquidators in their practice; introduce provisions to cater for cross border insolvency and reform the judiciary in order to make it effective in dealing with cases of insolvency.

ACKNOWLEDGMENTS

This dissertation bears an imprint of a number of people to whom I am most grateful. My profound gratitude goes to Mr. Fredrick Mudenda who made himself available to supervise this work. I am indebted to him for his professional guidance and comments without which it would not have been possible to complete this work successfully.

Many thanks to my colleagues at the Patents & Companies Registration Agency (PACRA) for their comments during the preparation of this work.

Last but not the least, special thanks to my dear wife Deborah for her encouragement and for being there for me during my course work and preparation of this work.

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CHAPTER 1

INTRODUCTION

1.1 Background

In a society that facilitates the use of credit by companies, there is always a degree of risk that those who are owed money by the company will suffer because the company has become unable to pay its debts as they fall due. In a situation where there are a number of creditors who are owed money by the company and they all pursue the rights and remedies available to them, a chaotic race to protect interests would take place and this might produce inefficiencies and unfairness. Huge costs would be incurred in pursuing individual creditors' claims competitively and those creditors who enforced their claim with most vigour and expertise would be paid but naïve late comers would not. Therefore the main aim of insolvency law is to replace this free-for-all eventuality with a legal regime in which creditors' rights and remedies are suspended and the process established for the orderly collection and realisation of the debtors assets and the fair distribution of these according to creditors' claims[1].

Black's Law Dictionary defines insolvency as the condition of being unable to pay debts as they fall due or in the usual course of business[2]. Many countries whose laws were based on English company law statutes and allied legislation have undergone reform to more modern models embracing workable concepts of company re-organisation, director responsibility for wrongful trading, expedited procedures and other features. The same does not seem to be the case with Zambia.

This research therefore, aims at critically evaluating the current provisions relating to insolvency in the Zambian Companies Act[3]. An evaluation of the provisions aforesaid can only be effectively undertaken if we begin by discussing some theories that seek to explain the proper purpose of insolvency law. An exposition of the arguments put across by some scholars

[1] Finch V., *Corporate Insolvency Law: perspectives and principles*,(Cambridge: Cambridge University Press, 2009) P 9
[2] Garner B , *Black's Law dictionary*, (Dallas: West Group Publishing 1999) p799
[3] The Companies' Act of 1994, Chapter 388 of the Laws of Zambia.

as to the objectives that every ideal insolvency law regime should seek creates a spring board for a critical examination of the provisions relevant to this study. This chapter, therefore, begins by discussing theories of insolvency law.

1.1.1 Theories of Insolvency Law

A number of commentators inspired by law and economics paradigm have attempted to define the proper function of insolvency law. Theories have thus been developed in pursuit of establishing the proper role of insolvency law. Of the different theories, two appear to be the most variant with each other namely; the *creditor wealth maximization theory* and the *multiple values theory.* The two theories are discussed in the paragraphs that follow. An exposition of the two theories is extremely important in this study as it forms the stepping stone towards a critical evaluation of insolvency law in Zambia given the purpose(s) of an ideal insolvency legal regime as have been propounded by different theorists.

1.1.2 Creditors' wealth maximization theory

The proponents of this view have argued that the proper function of insolvency law is to maximize the collective returns to creditors.[4]Thus in the creditor maximization approach, all policies and rules will be designed to ensure that the return to creditors as a group is maximized. In this regard, insolvency law will primarily be concerned with maximizing the value of a given pool of assets, not with how the law should allocate entitlements to the pool. This position has been a source of strong criticism especially by those who assert that insolvency law should not just be concerned about creditors but also about the effects that the collapse of the company will have upon those without formal legal rights. For instance, Finch observes that creditors may suffer in insolvency but those without formal legal rights may also be prejudiced: employees will lose jobs and suppliers will lose customers, but also tax authorities whose prospective entitlements may be diminished and neighbouring traders whose business environments maybe devalued.[5]

[4] Baird D.G, *"The uneasy case for corporate reorganizations,"* Journal of legal studies, 15 (1986):127
[5] Finch V, *corporate Insolvency Law: Perspectives and principles*, 37

1.1.3 Multiple values theory

In contrast to approaches that tend to assert that insolvency law can pursue a single economic rationale, the multiple values approach sees insolvency law as a branch of law consisting of multi-dimensional objectives. Thus, the proponents of this theory view insolvency processes as attempting to achieve such ends as distributing the consequences of financial failure among a wide range of actors; establishing priorities between creditors; protecting the interests of future claimants; offering opportunities for continuation, reorganization, rehabilitation; serving the interests of those who are not technically creditors but who have an interest in continuation of the business e.g. employees. [6] One finds the multiple values approach more credible in that it forms a basis upon which an insolvency law regime can be evaluated in terms of how such a system answers to the needs of different constituents. It seems the United Kingdom insolvency law reforms adopted the multiple values theory. The Committee adopted to review, examine and make recommendations on the law and practice prior to the 1986 reforms expressed the aims of insolvency law as consisting mainly of:[7]

a) To preserve viable commercial enterprises capable of contributing usefully to national economic life; and
b) To recognize and safeguard the interests of not only of insolvents and their creditors but of society and other groups in society who are affected by the insolvency for instance not only the interests of directors, shareholders and employers but also of suppliers, those whose livelihoods depend on the enterprise.

This discussion will proceed as an evaluation of insolvency provisions in the Companies Act on the basis of ability to provide, among other things, a mechanism for re-organisation of financially troubled enterprises and not just ability to maximize returns to creditors. The corporate rescue approach whereby the law provides deliberate mechanisms aimed at saving financially troubled but viable companies from collapse has been endorsed even by the

[6] Baird D.G, *"The uneasy case for corporate reorganizations,"* Journal of legal studies,46
[7] Report of the Review committee on Insolvency Law and practice (cmnd.8558, 1982) 198(i) and (ii)

World Bank. Based on lessons and experiences obtained through assessments of various insolvency regimes, the World Bank has developed principles for effective insolvency and creditor rights systems.[8] The principles assert that the main thrust of the law should be to rehabilitate financially troubled enterprises because assets are more valuable if retained in a rehabilitated business than when sold in liquidation. To support corporate rehabilitation, the World Bank principles also recognize that the rescue of a business preserves jobs, provides creditors with a greater return based on higher going concern values of the enterprise, potentially produces a return for owners and obtains for the country the fruits of the rehabilitated enterprise. This argument is also supported by the United Nations Commission on International Trade Law (UNICITRAL) Guide on Insolvency Law.[9] The guide provides a comprehensive statement of the key objectives and principles that should be reflected in a state's insolvency laws. One of the core features in the guide is the recommendation for provisions for expedited re-organisation of troubled enterprises. The World Bank principles together with the UNICITRAL guide will form part of the critical benchmarks for evaluating Zambia's insolvency law in this research.

1.2 Statement of the problem

There are a number of stakeholders with different interests in a company. These stakeholders who include shareholders, employees, creditors, tax authorities and customers, among others, are definitely interested in seeing the enterprise carry on as a going concern. It follows therefore, that the law should be designed in such a way that it is supportive of an environment in which Companies are able to carry on as going concerns even though they may occasionally experience financial distress. Even where it is not possible to rescue a financially troubled enterprise and liquidation proceeds, the law should provide effective mechanisms to guarantee that the outcome of the process serves the interests of not just one or some but all of the stakeholders aforementioned.

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[8] Available on: htpp:www.worldbank.org (accessed on April 24th, 2014)
[9] Available on http//www.unicitral.org (accessed on April 24th, 2014)

The problem is that it is not known whether the mechanisms provided for in the Companies Act are capable of providing safeguards that can guarantee equitable and fair outcomes for all stakeholders in situations where debtor companies experience financial distress.

1.3 Objectives of the study

The objectives of this study are:

(i) to establish whether the Zambian Companies Act[10] provides sufficient mechanisms to deal with insolvent companies;

(ii) to examine the extent to which the insolvency provisions in the Zambian Companies Act[11] are capable of being an effective mechanism for protecting the interests of all stakeholders when a company is insolvent; and

(iii) to draw lessons from other jurisdictions that have reformed their insolvency legal regimes.

1.4 Research Questions

This research shall endeavour to answer the following questions:

i) Does the current Zambian Companies Act[12] provide for effective and adequate mechanisms for the rescue of financially distressed companies?

ii) Are the provisions under the Zambian Companies Act[13] capable of engendering accountability, fairness and expertise among Liquidators and Receivers?

iii) Does the Zambian Companies Act[14] provide sufficient protection for the interests of creditors?

iv) Is the Zambian Judiciary capable of playing an effective role in the administration and dispensation of justice in respect of insolvency matters?

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[10] Chapter 388 of the Laws of Zambia
[11] Chapter 388 of the Laws of Zambia
[12] Chapter 388 of the Laws of Zambia
[13] Chapter 388 of the Laws of Zambia
[14] Chapter 388 of the Laws of Zambia

v) What mechanisms must be put in place to make the Judiciary a more effective and efficient umpire in dealing with insolvency matters?

1.5 Significance of the study

From the research and literature review that follows, it has become clear that very little work has been carried out before to evaluate insolvency provisions in the current Zambian Companies Act[15]. The importance of this study is that it will identify gaps in insolvency provisions in the Companies Act and suggest practical reforms that would enable corporate insolvency law conform to international best practice. This study will be particularly useful to policy and law makers as it can inform policy and legal reform.

1.6 Literature review

Kenneth Mwenda has advocated for the reform of corporate insolvency laws in many of the African countries that follow the English common law, including Zambia[16]. He identifies nine areas that need change: one of these is the need for African countries to enact legislation that provides for the rehabilitation of insolvent companies.[17] He states that it should not always be the case that a company that is insolvent should end up in liquidation. He asserts that the legal regime should strike a balance between the creditors and the debtor company itself as well as other stakeholders such as unsecured creditors as and statutorily mandated preferential creditors in order that secured creditors would not have an upper hand and look after their own interest.

At a national level, most national law development commissions have also conducted many studies into the reform of their corporate insolvency laws to address some of the shortcomings noted by Mwenda.[18]

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[15] Chapter 388 of the Laws of Zambia

[16] Mwenda K, '*The future of corporate insolvency law and secured transactions in commonwealth Africa; Africa Growth South Africa Agenda* South Africa July-September 2007, 43

[17] Mwenda K, *'The future of corporate insolvency law and secured transactions in commonwealth Africa*; Africa Growth South Africa Agenda South Africa July-September 2007, 43

[18] Mwenda K, *'The future of corporate insolvency law and secured transactions in commonwealth Africa*; Africa Growth South Africa Agenda South Africa July-September 2007, 43

Kaulung'ombe[19] examined the need for Zambia to enact adequate business rescue legislation. She approached the study by making a comparative analysis of the business rescue procedures in Australia, South Africa and the United Kingdom and made recommendation regarding the model that Zambia may adopt. Kaulung'ombe suggests that the best rescue procedures should be based on the Australian model. She however recommends that the model to be adopted should be simple and inexpensive to cater for the micro-small and medium enterprises which form the majority of companies in Zambia. Although the present research has also highlighted the need for an effective business rescue mechanism, its scope is wider as it has been extended to evaluation of the provisions in respect of ability to promote the rights of all the creditors, ability of the law to engender accountability and efficiency of insolvency practitioners as well as enable the Judiciary to play an effective role in insolvency matters. The present research draws examples from the United States of America, New Zealand and England.

Finch[20] highlights a host of changes that have reshaped insolvency law and practice notably the consolidation of the rescue culture in the UK, the rise of pre-packaged administration and the substantial replacement of administrative receivership with administration. The book also considers the implications of recent and dramatic changes in the provision of credit, the movement of an increasing amount of insolvency work to non-formal procedures and the arrival on the scene of a new cadre of specialists in corporate turnaround. Finch argues that changes in approach are needed if the insolvency law is to develop the coherence and purpose and offers a framework for such an approach.

Massoud[21] in his article sets out the context within which sub-Saharan Africa may undertake legislative reform in respect of cross border insolvency. The article raised issues that are likely to arise during the reform process and challenges that may be faced. The article provides useful insights especially

[19] Kaulungómbe K.G, *'Business Rescue for Zambia, suggestions for legislative Reforms'*: An obligatory essay submitted to the faculty of Law at University of Cape Town in partial fulfilment for the award of the Master of Laws Degree, February 2012

[20] Finch V, *Corporate Insolvency Law: perspectives and principles*, P 9

[21] Massoud B, "*The context for the cross border insolvency Law reform in Sub- Saharan Africa*". International Insolvency Review, volume 23, issue 3

that one of the recommendations in the current work is the introduction of cross border insolvency provisions in the law.

Azmi[22] in her Doctoral Thesis compared insolvency law in the UK to Malaysia and highlighted numerous areas of strength and weakness in either regime. The thesis provides useful analysis that have informed some of the recommendations in the present research.

Hussain and Wihlborg assert that the overall objectives of insolvency laws are[23]:-

a) *The allocation of risk among participants in a market economy in a predictable equitable, and transparent manner; and*
b) *To protect and maximize value for the benefit of all interested parties and the economy in general without effective procedures that are applied in a predictable manner; creditors may be unable to collect on their claims, which will adversely affect future availability of credit. The law should recognize the interest of secured creditors over those that may be unsecured such as employees. Similarly the rights of debtor companies (and their employees) may not be adequately protected and different creditors may not be treated equitably. The capitalist run economy will thus not foster growth and competition and will result in increased risk. As a consequence, this may lead to economic failure and financial crisis as the world has experienced.*

   Insolvency laws in many jurisdictions are evolving with a large number of the reforms focusing on reorganising or rescue of the ailing entity rather than its liquidation.[24]

The arguments put across in this dissertation will be against the background that insolvency law, like any other branch of law, is intended to serve a particular purpose(s). The author in all the arguments has been influenced by the *"multiple values theory"* of insolvency law as opposed to the *"creditor wealth maximization theory".*

[22] Azmi R, *A comparative study of corporate Rescue in the UK and Malaysia*; A dissertation submitted in partial fulfilment for the award of Doctoral Degree – University of Aberdeen, 2008. Available on: http://digitool.abdn.ac.uk Accessed on 22.9.2015

[23] Hussain Q and Wihlbor C, "*Corporate Insolvency procedures and Bank Behavior : A study of selected Asian economies*" A working paper of the international Monetary Fund(WP/99/135), p7-8

[24] The Government enacted the Citizen Economic Empowerment (CEE) Act in 2006, based on a belief that a countries long term economy as well as political growth should be driven by its citizenry who need to be economically empowered.

1.7 Methodology

This research is a qualitative one. Consequently, it was conducted through the collection of data in the form of local and foreign legislation, law reports of both local and foreign jurisprudence, text books, newspaper articles, journals, internet and dissertations.

1.8 Layout of chapters

Chapter One has introduced the study and has covered the background to the study, the statement of the problem, objectives of the study, research questions as well as the literature review.

Chapter Two provides an evaluation of the insolvency provisions in the Zambian Companies Act in terms of capacity to provide effective mechanisms for corporate rescue. This chapter critically examines the Zambian Companies' Act against the benchmarks of international instruments such as the United Nations Commission on International Trade Law (UNICITRAL) guide on insolvency legislation as well as the World Bank recommendation on creating an effective insolvency and creditor rights system.

Chapter Three examines insolvency law in England, New Zealand and the United States of America. The chapter highlights key areas from which Zambia can learn lessons from the three jurisdictions.

Chapter Four evaluates the mechanisms for protection of creditor interests by a critical examination of provisions of the Zambian Companies Act relating to receivers and liquidators and determining the potential of the said provisions to encourage accountability, fairness and expertise by liquidators and receivers. The chapter further examines provisions relating to floating charges with the aim of assessing the potential of the provisions to adequately safeguard creditor interests.

Chapter Five considers and evaluates the effectiveness of the Zambian Judiciary in insolvency matters. The chapter evaluates the role of the judiciary in the insolvency legal regime by examining its capability to contribute to the efficacy of Insolvency Law.

Chapter Six, being the final chapter gives the findings, conclusions and recommendations of the study.

CHAPTER 2

EVALUATION OF CORPORATE RESCUE MECHANISMS UNDER THE ZAMBIAN COMPANIES ACT

2.1 Introduction

This chapter critically evaluates the effectiveness of insolvency provisions in the Zambian Companies Act[1] (herein after referred to as the Act), as a means by which financially troubled companies may be saved from collapse. As a way of setting the stage, in Chapter 1 the research began by identifying some theories that seek to explain the features of an ideal corporate insolvency regime. An exposition of those theories suggested that an ideal corporate insolvency law is one that embraces principles, practices and procedures capable of influencing the restoration of debtor companies to profitable positions where practicable. This chapter therefore seeks to examine the procedures to which an insolvent company may be amenable and determine whether such procedures are capable of providing the means for the rescue of a company in financial distress. Corporate rescue may be defined as a major intervention necessary to avert eventual financial failure of the company[2]. The chapter begins by highlighting the three procedures available to an insolvent company in the Act namely; schemes of arrangement[3], receivership[4] and liquidation[5]. Each of these procedures is then examined in terms of its suitability as a corporate rescue mechanism.

2.2 Insolvency procedures under the Zambian Companies Act

Insolvency provisions in the Act are in three parts, first, provisions relating to the appointment and functions of receivers are contained in part V division 5.3 entitled "*Receivers".* Secondly, provisions relating to liquidations are in part XIII entitled "*Winding-Up*" and third, schemes of arrangements are

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[1] Chapter 388 of the Laws of Zambia
[2] Belcher A, Corporate Rescue (Sweet & Maxwell, London, 1997) p 12
[3] Section 234 of the Companies Act Chapter 388 of the Laws of Zambia
[4] Section 107 of the Companies Act Chapter 388 of the Laws of Zambia
[5] Section 282 of the Companies Act Chapter 388 of the Laws of Zambia

in part XI of the Act[6] entitled "*Schemes of arrangement, take-overs and the protection of minorities"*. Thus, there is no other procedure to which an insolvent debtor is amenable apart from receivership, liquidation or a scheme of arrangement.

2.2.1 Schemes of arrangement

A scheme of arrangement has been described in the Act as;

> *where a compromise or arrangement is proposed between a company and its creditors or any class of its creditors , the Court may, on the application of the company or any creditor or any member of the company, or, in the case of a company being wound up, of the liquidator, order a meeting of the creditors, the class of creditors, the members or the class of members, as the case may be, to be convened , held and conducted in such manner as it thinks fit to consider the compromise or arrangement*[7]

Charlesworth's Company law states that the word "arrangement" has a very wide meaning which is wider than the word "compromise". Further that arrangement may involve for example, debenture holders giving an extension of time for payment, accepting a cash payment less than the face value of their debentures, giving up their security in whole or in part and indeed exchanging their debentures for shares in the company.[8]To initiate the process of compromise or arrangement, the company itself, a creditor, a member of the company or liquidator must apply to court for an order that a meeting of the company and relevant category of stakeholders be held to consider the compromise or arrangement.[9] In a compromise or arrangement, a creditor will vote in proportion to the amount of money owed to that creditor unless the Court orders otherwise.[10]

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[7] Companies' Act Section 234
[8] Morse G, *Charlesworth's Company law* (London: Sweet & Maxwell, 2007)), 662
[9] Companies 'Act Section 234(2)
[10] Companies' Act Section 234(5)

2.2.1.1 Shortcomings of schemes of arrangement as a corporate rescue mechanism

The major weakness with an arrangement is that it is not easy in practice to provide comfort to all creditors that their interests will be protected. A compromise requires that all parties with contractual rights consent to waive or defer or alter priorities. Dissenting creditors have a right to trigger receivership or even liquidation[11]. This renders creditors' arrangement a very fragile device that is dependent on a high degree of co-operation from a range of parties. In practice therefore, even if an attempt was made to enter into arrangements with creditors, more likely than not, the end result would be either a receivership or liquidation. Additionally, the fact that the arrangement requires Court approval[12] renders the procedure highly dependent upon the Courts and therefore an undesirable insolvency procedure.

One of the possible conditions that the court would attach to an order approving a compromise or arrangement would be for the company to allow the affected member to exercise his appraisal right.[13] The challenge with this mechanism is that it is likely to impose unnecessary expense on an already financially troubled enterprise especially that, the Act does not expressly provide limits or exceptions as to the shareholders exercise of the appraisal right. It would have been helpful if a Proviso had been included in the Act that the court could only order a company to buy back any shares if it would not further compromise the company's solvency or liquidity. It is only logical to assume that for any company to contemplate a compromise with creditors, that company would already be insolvent or at the very least on the verge of becoming insolvent. The company would in those circumstances be experiencing serious cash flow problems and would have very little or no cash at its disposal.

[11] Companies Act Sections 108 and 314
[12] Companies Act Section 234
[13] Farouk HI Cassim et al *Contemporary Company Law* (Cape Town: Juta & Co. ltd, 2011) 719, defines an appraisal as a right of a dissenting shareholder who does not approve of certain trigger events to have their shares bought out by the company in cash, at a price reflecting the fair value of shares and which value may in certain cases be judicially determined.

Further, allowing a shareholder to exercise an appraisal right technically means that the shareholder's interest take precedence over those of the creditors, which ordinarily should not be the case.

The numerous court applications throughout the process make the whole procedure of schemes of arrangements very expensive and therefore unattractive.

The practical challenge with the scheme of arrangement especially if it involves conversion of a debt into equity is that it literally renders the creditor unsecured once he has become a shareholder. A recent case in Zambia[14] illustrates the difficulties that maybe encountered when a creditor converts his debt and thereafter seeks to exercise his right of appraisal. In this case, the plaintiff acting in consortium with other banks provided a loan facility to a company and secured it by fixed charges over the assets of the company. Following default by the company in the repayment of the loan, the plaintiff agreed to participate in the restructuring of the capital of the company. The effect of the restructuring was that the plaintiff's debt to the company would be converted into equity, effectively making the plaintiff a shareholder in the company. This was in consideration of three shareholders executing an equity buy-back guarantee in favour of the plaintiff by which they would undertake to buy- back the plaintiff's equity, in the event of occurrence of any default event. A few months after execution of the said conversion, the plaintiff and other lenders were informed by the debtor company's directors that their board had resolved to suspend operations of the company. As a consequence of this and the plaintiff's perception of such act as being default, the plaintiff made a demand for payment against the shareholders in terms of the undertakings they had made. In an action for the recovery of the debt, the High Court found the shareholders liable and further declared that one of the shareholders who was also a director was amenable for prosecution under section 357 of the Companies Act for contracting a debt whilst aware that the company would not be able to pay.

It should be noted however that the decision in the above cited case was later nullified by the Supreme Court on account of lack of jurisdiction on

[14] DBZ VS JCN Holdings Limited and 2 others, 2009/HPC/0322

the part of the judge who heard the case[15]. The case was referred back to the High Court for re-trial and up to the date of this report the matter is still before the High Court. The case nevertheless demonstrates a major weakness in a scheme of arrangement in terms of its ability to protect the interests of a creditor who agrees to convert his debt into equity. This therefore goes to show that a scheme of arrangement cannot be an attractive vehicle to creditors given that it pauses so many challenges.

2.2.2 Receivership

Receivership, in an insolvency context, is where a secured creditor of a company enforces the security by appointing a receiver. According to Black's Law Dictionary a Receiver is a disinterested person appointed by a court, or by a corporation or other person, for the protection or collection of property that is the subject of diverse claims (for example, because it belongs to a bankrupt or is otherwise been litigated)[16]

The role of the Receiver generally is to realise the secured assets and pay off the creditor from the proceeds of sale.

According to Walton:

> *The general duty of a receiver is to take possession of the subject matter in dispute in the action and under the sanction of the court make the property productive or collect and realize as the owner himself could do if he were in possession.* [17]

A receiver is appointed either by the court or out of court by an individual or company through a Debenture.[18] A person may either be appointed as a receiver or as a receiver and manager.[19] A receiver is normally required to only receive rents and profits and to get outstanding property while a receiver and manager additionally carries on or oversees a trade, business or undertaking[20]. The receiver and manager has the power to deal with that property and appropriate the proceeds in a proper manner.[21]

[15] SCZ Judgement No. 22/2013
[16] Garner B. Black's Law Dictionary , 1275
[17] Walton R, *Kerr on the Law and Practice as to Receivers* (London: Sweet & Maxwell, 1983) 161
[18] Companies Act Section 108
[19] Companies Act Section 108 (2
[20] Walton R, *Kerr on the Law and Practice as to Receivers, 212*
[21] Walton R, *Kerr on the Law and Practice as to Receivers* ,212

The Act does not set out the functions of a receiver, but a receiver appointed by the court is an officer of the court and is expected to act in accordance with the directions and instructions of the court. [22]

In *Zambezi Portland Cement Limited and another v Stanbic Bank Zambia Limited*[23], the High Court emphasised the dual role of a receiver as that of being an agent of both the mortgagor and the mortgagee. This position was best illustrated by the dicta of Fox L.J in the celebrated case of *Gomba Holdings U.K Limited and Others v Minories Finance Limited and others*[24]. Fox L.J observed that:

> "*The agency of a Receiver is not an ordinary agency. It is primarily a device to protect the mortgagee or debenture holder. Thus a Receiver acts as agent for the mortgagor in that he has the power to affect the mortgagor's position by acts which though done for the benefit of the debenture holder, are treated as if they were acts of the mortgagor. The relationship set up by the debenture and the appointment of the Receiver however is not simply between the mortgagor and the Receiver. It is tripartite and involves the mortgagor, the Receiver and the debenture holder. The Receiver is appointed by the debenture holder on the happening of specified events and becomes the mortgagor's agent whether the mortgagor likes it or not. And as a matter of contract between the mortgagor and the debenture holder, the mortgagor will have to pay the Receiver's fees. Further, the mortgagor cannot dismiss the Receiver since that power is reserved to the debenture holder as another of that contractual terms of the loan. It is also to be noted that the mortgagor cannot instruct the Receiver on how to act in the conduct of Receivership. The result is that the Receiver in the course of the receivership performs duties on behalf of the debenture holder, as well as the mortgagor. As these duties may relate closely to the affairs of the entity which is the subject of receivership*."

The dual role of a receiver as indicated above has been found to be a source of problems in practice. The difficulty arises from the fact that the interests of the mortgagor and the mortgagee are obviously in conflict and therefore the position in which the receiver is placed as an agent of both is difficult to comprehend. The Supreme Court of Zambia made similar observations in the

[22] Companies Act Section 112
[23] (2010) ZR 499
[24] (1989) 1 ALL E.R. 761

case of *Goodwell Siamutwa v Southern Province Co-operative Union and another*[25] when it stated the following:

> *"It is trite law that a Receiver/ Manager, appointed pursuant to a debenture, is an agent of the company. The paradox however is that while he is an agent the Company, he is appointed to protect the interests of the debenture holder. There is no doubt therefore that this dual and conflicting loyalty of a Receiver may at times create untidy and difficult situations."*

Further it is worth noting that a receiver appointed under the Act is personally liable for any contract that the receiver enters into unless the contract provides otherwise. [26] The receiver is however entitled to indemnity [27] where that receiver enters into a contract in the proper performance of the receiver's duties.[28]

A receiver has several duties under the Act. A receiver, who is appointed over the whole or substantially the whole of the undertaking of any company, has the responsibility to submit a preliminary report [29] of the statement of affairs of the company, to the court. The receiver also has a duty to lodge his accounts of receipts and payments to the registrar and official receiver. [30]

Other duties of the receiver are to lodge an abstract of receipts and payments to the registrar[31] and to make a report to the registrar where the receiver, in the course of performing his duties, discovers a contravention of the Act or a failure to comply with the Act.[32]

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[25] SCZ Appeal No. 114 of 2002

[26] Companies Act Section 114

[27] This indemnity will arise from the property on which the receiver has been appointed to act on as receiver.

[28] Companies Act Section 114 (2)

[29] The preliminary report should disclose the amount of capital issued, subscribed and paid up and the estimated amount of assets and liabilities; the cause of the failure of the company, if it has failed; and whether in his opinion inquiry is desirable as to the matter relating to the promotion, formation or failure of the company or the conduct of its business.

[30] Companies Act Section 338 This must be done within a month after the end of the six months from the date of his appointment; the end of every subsequent period of six months; or after ceasing to act as a receiver or obtaining an order of release.

[31] Companies Act Section 117 This is where a receiver is appointed for a part but not the whole or substantially the whole of the undertaking of a company.

[32] Companies Act Section 118 The report must be made where the receiver believes that the directors of the company will not deal with it if it is brought to their attention.

Amendments effected to the Companies Act in July 2011 revised the provisions relating to receivership and liquidation amongst other things[33]. The amendments related to qualifications and remuneration of receivers, the receiver's duty to prepare a statement of a Company's affairs and accounts of receivers. Some of these amendments have been discussed in chapter five as part of examination of mechanisms for protecting creditor interests under the Zambian Companies' Act.

2.2.2.1 Shortcomings of receivership as an effective business rescue Procedure

The major shortcoming of receivership as an effective business rescue mechanism is the absence of an express provision requiring a receiver to draw up a rescue plan as the receiver manages the charged assets on behalf of the charge holder.

The High Court of Zambia in the case of *Magnum Zambia Limited v Basit Quadri (Receivers/Managers) & Grindlays Bank International Zambia Limited*[34] held that a receiver who was an agent of the company under receivership was there to secure the interests of the debenture holder and in those circumstances the company concerned is debarred from instituting legal proceedings against its receiver/manager.

A receiver, by this authority, is expected to exercise his powers in the best interest of the company and in good faith, honesty and loyalty. Although the law considers a receiver to be a fiduciary and requires the receiver to exercise his power in accordance with his fiduciary position, this still does not place an express duty on the receiver to draw up or propose a rescue strategy for the company.

One can argue that the duty to act in the best interests of the company does not extend to the receiver drawing up a rescue strategy for the company, but simply to ensure that that receiver, in recovering what is owed to the charge holder or creditor, manages the assets in a manner that is not prejudicial to the company.

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[33] Companies' Act (Amendment) Act no. 24 of 2011.

[34] (1981) ZR 14

A receiver who is appointed by the court is an officer of the court and is expected to conduct his duties according to the direction of the court. Where a receiver is also appointed, the court has the duty to make orders on how the receiver must manage the assets of the company. The Act does not expressly require the court to order a receiver appointed by it to propose a rescue strategy for the company.

The receiver's bias towards realization of the creditor's interest at the expense of all other stakeholders of the company, has led to the reform in the insolvency law of several jurisdictions. The New Zealand Receivership Act of 1993 [35] imposes an obligation on the receiver to act with reasonable regard to the interests of unsecured creditors, guarantors and others claiming an interest in the property through the debtor.

Even with the inclusion of these provisions in New Zealand and Australia, the two jurisdictions have enacted comprehensive business rescue legislation because of the apparent inadequacies in their corporate and insolvency laws.

Although recent amendments were made to some provisions relating to receiverships in Zambia, these amendments did not impose a duty on the receiver to consider a rescue strategy for a company in receivership so as to remedy the current problem. The amendments only introduced a requirement for accreditation of receivers with the Registrar as well as fixing of remuneration that a receiver may be entitled to.[36]

An inclusion of an express provision in the Act requiring a Receiver to consider a rescue strategy for the company while managing the assets of the company would be progressive. It would also compel Receivers to manage the assets of the company responsibly. Objections to such a provision would most likely be expressed by the chargees. The likely argument to be advanced would be that the chargees would have to incur a higher fee for the appointment of receivers because the receivers would have to provide this extra service. Further, the consideration or proposal of a rescue strategy for the company would not always be in the chargee's interest. The apprehension

[35] Receivership Act of 1993, Section 18. New Zealand
[36] Companies Amendment Act No 24 of 2011

is likely to emanate from the realisation that a receiver who has an added responsibility of rehabilitating or rescuing the debtor company would not prioritise realisation of the assets as asset dismemberment is obviously counter to rescue. The Chargee may also have fears that attempts at corporate rescue would result into a prolonged waiting period which may consequently lead to erosion of the value of the assets which are the subject of the charge.

These shortcomings highlighted justify the need for the enactment of a comprehensive business rescue law in Zambia. The state of affairs presented above, suggest that there is need for a specific procedure apart from receivership and schemes of arrangement aimed primarily at providing a mechanism for re-organising and rescuing troubled companies. This as we will see in the discussion that follows in the next chapter is the situation in the United Kingdom and New Zealand.

2.2.3 Liquidation

Liquidation is the end point for a financially troubled company. Black's Law Dictionary defines liquidation as the act or process of converting assets into cash, especially to settle debts[37]. It involves its winding up and the gathering in of the assets for the subsequent distribution to creditors[38]. Quite clearly when a company goes into liquidation, there is no room for its revival as the purpose of appointing a liquidator is to dismember the assets of the debtor company as can be seen from the general functions and powers of the liquidator in the Act. Section 289 (2) in relation to the powers of the liquidator is couched as follows:

> *289 (2)The liquidator may, with the authority either of the court or of the committee of inspection –*
>
> *(a) carry on the business of the company, so far as is necessary for the beneficial winding-up thereof, after the four weeks following the date of the winding-up order;*
>
> *(b) pay any class of creditors in full, subject to section three hundred and forty-six;*
>
> *(c) make any compromise or arrangement with creditors, persons claiming to be creditors, or persons having or alleging themselves to have any claim against the company, whether present or future, certain or*

[37] Garner B, *Black's Law Dictionary.* P 942

[38] Finch V, *Corporate Insolvency Law: Perspectives and principles*, P529

contingent, ascertained or sounding only in damages or whereby the company may be rendered liable;

(d) compromise any debts and liabilities capable of resulting in debts and any claims of any kind, whether present or future, certain or contingent, ascertained or sounding only in damages, that subsist or are supposed to subsist between the company on the one hand and a member, a debtor or person apprehending on the other;

(e) make arrangements on all questions in any way relating to or affecting the assets or the winding-up of the company; and

(f) take any security for the discharge of any such debt, liability or claim, and give a complete discharge in respect thereof.

The liquidator's role is mainly the realisation and distribution of the assets to the creditors. Liquidation therefore offers no room for corporate rescue and as such is not necessary to discuss in detail in this chapter.

2.3 Conclusion

The objective of this chapter was to examine the optional procedures to which an insolvent company may be subjected and whether any or all of these procedures is capable of providing the means for the rescue of a company in financial distress. From the foregoing, it is clear that there are essentially two mechanisms in the Zambian Companies Act which may be thought of as providing room for the rehabilitation and possible rescue of a financially distressed company. These are schemes of arrangement and receiverships. However, the study has revealed that both procedures have inherent weaknesses which render them unreliable forms of insolvency procedures for purposes of corporate rescue. It has been shown that schemes of arrangement may be inappropriate for corporate rescue in that there is a requirement that all creditors should consent to the arrangement. In practice it may not be easy to provide comfort to all the creditors that their interests will be protected under the arrangement. On the other hand, a receivership equally has its own shortcomings in that there is no provision in the Act which compels receivers to attempt to rescue the debtor company before realising the assets which are the subject of the charge upon which the receiver was appointed.

The next chapter considers the Insolvency Law regimes in England, New Zealand and the United States of America. The purpose of the next chapter is to highlight developments that have taken place in other jurisdictions and draw lessons from there.

CHAPTER 3

ANALYSIS OF INSOLVENCY LAW IN ENGLAND, NEWZEALAND AND THE UNITED STATES OF AMERICA

3.1 Introduction

This chapter examines the current insolvency legal regime in England, New Zealand and the United States of America (USA). The rationale for selecting England is that Zambian company law is premised upon English law and as such there can be no meaningful discussion of law reform without making reference to developments that have taken place in England. Secondly, New Zealand is one of the countries within the commonwealth that have recently reformed their insolvency legal regimes following developments that have taken place in England. Lastly the United States of America becomes an ideal benchmark in that the American insolvency legal regime is one of the oldest and one that has undergone consistent reform over the years.

The purpose of this discussion, therefore, is to highlight possible lessons Zambia can learn from the three jurisdictions. The chapter also examines and highlights the common features of insolvency law in the three jurisdictions mentioned above and in particular the concept of business rescue and how it is administered.

3.2 The Case for England

England began the process of reforming insolvency law and practice in 1982 when a review committee headed by Sir Henry Cork was appointed to conduct the exercise and make recommendations for reform. The Cork Report laid the foundation for a rescue culture and was clear on the legitimacy of considering the broader picture than focusing mainly in creating an Insolvency legal regime that could address only the narrow interests of the creditors. Thus, the report was categorical in asserting that a modern system of insolvency law should provide means for preserving viable commercial enterprises capable of making useful contribution to the economic life of the country.

In the Committee’s own words;

> *We believe that a concern for the livelihood and well-being of those dependent upon an enterprise which may well be the life blood of a whole town or even a region is a legitimate factor to which a modern law of Insolvency must have regard. The chain reaction consequences upon any given failure can potentially be so disastrous to creditors, employees and the community that it must not be over looked.*[1]

In agreeing with the view of the Cork Committee, one needs not to over emphasise the fact that the rescue mechanisms that an ideal insolvency law must provide should not only relate to viable enterprises but even to those where there is no immediate prospect of a return to profitability, if it is in the interest of the community. In Zambia, we are not short of examples of companies that could have been rescued for the benefit of many stakeholders including the Nation itself had it not been for a legal regime that does not provide mechanisms for corporate rescue. Examples of such companies include Zambia Airways Corporation Limited and Mansa Batteries Limited. These are companies that had wide asset bases and potential for re-organisation but were rushed into liquidation. There have been repeated comments by many who to this day bemoan the demise of these and other corporations. This researcher subscribes to the argument that these and many other companies that have collapsed could have been saved as going concerns if the law provided a procedure that offered a window for rescue. Therefore a suggestion that flaws in the law have been the main reason why the rescue of troubled companies in Zambia has not been attainable in almost all cases cannot be said to be a far-fetched assumption. Kenneth Mwenda argues that the reform of corporate insolvency laws in many of the African countries that follow English common law, including Zambia should introduce measures that enable corporate rehabilitation. He stresses that it should not always be the case that a company that is insolvent should end up in liquidation. According to Kenneth Mwenda, the legal regime should strike a balance between secured creditors and the debtor company itself as well as other stakeholders such as unsecured creditors and statutorily mandated

[1] Law review committee report (note 2) at p246

preferential creditors in order that the secured creditors may not have an upper hand and look after their narrow interests only.[2]

In response to a similar situation as is obtaining in Zambia, in England the Insolvency Act of 1985 was enacted which introduced the '*Administration Procedure'*. With several amendments over the years coupled with the enactment of the Enterprise Act of 2002, the administration procedure has been greatly enhanced. Administration may be defined as a procedure in which an insolvency practitioner is appointed in order to consider re-organisation with a view to restoring profitability or maintaining employment; ascertaining the chances of restoring a company of dubious solvency to profitability; developing proposals for realising assets for creditors and stakeholders; and carrying on the business when this would be in the public interest[3].

The Administration Procedure places emphasis on the rescue of troubled companies[4]. The characteristic of re-organisation is that the business is preserved and an arrangement concluded with creditors by which the debts owed by the company are restructured, for example by rescheduling, by acceptance by the creditors of less than the amount due or by conversion of debt into equity, so that creditors become converted into shareholders. In practice, by far the most commonly achieved purpose of administration to date has been a more advantageous realization of the company's assets than would be effected on a winding-up. This involves restoring the company to a condition in which it can be sold as a going-concern.[5] The main effect of administration is to impose a moratorium on the enforcement of creditors' rights. This entails a suspension of the creditors' rights of enforcement of security including that of commencement of any actions against the debtor company during the period of administration[6]. Furthermore, under this procedure, the company is placed under the administration of an external

[2] Mwenda K, *The future of Corporate Insolvency law and secured transactions in commonwealth Africa* (Africa Growth Agenda, SA, July-Sep 2007) 43
[3] Finch. V, Corporate Insolvency Law, Perspectives and principles p364
[4] Section 8 (2) of the Insolvency Act of 1986 of England
[5] Insolvency Act of 1986, sch.B1 of the United Kingdom
[6] Keay .A. & Walton. P., *Insolvency law; corporate & personal* (London: Longman, 2003) 18

manager, a qualified insolvency practitioner. The English Insolvency Act provides that;

3(i) the administrator of a company must perform his functions with the objective of:

(a) *Rescuing the company as a going concern, or*

(b) *Achieving a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being in administration).*

It can be seen that the distinction between the administration procedure as provided for in the English Insolvency Act compared to Receivership in the Zambian Companies Act is that the former places an explicit duty upon the Insolvency Practitioner to focus on corporate rescue or at least if rescue is not possible, preserve value in the assets for the benefit of not some but all the creditors.

3.3 The Case for New Zealand

There exists a procedure for corporate rescue in New Zealand that is very similar to the one existing in England. The "Voluntary Administration" procedure was introduced into law by the Companies Amendment Act of 2006 of New Zealand. The main reason for introducing this procedure was that hitherto, the existing choices (i.e. liquidation and receivership) available to a company in distress were limited and in some cases flawed[7]. The situation then was very similar to what is currently obtaining in Zambia. It was clearly recognized even in New Zealand that the two available procedures were not suitable for corporate rescue. The new 'voluntary Administration "procedure provides a mechanism by which the Directors of the company or the court on application by a secured creditor, any liquidator or the Registrar of Companies may appoint an administrator. One main purpose of voluntary administration within the context of statutory objects is to provide breathing space from creditor enforcement steps and proceedings, during which the administrator can assess and investigate the company's situation and put together a proposal to save the company[8]. In order to provide the debtor company with

[7] Heath P, Whale M, Insolvency *Law in New Zealand*, (Auckland:Lexis Nexis 2011), 331.
[8] Heath P, & Whale M, Insolvency *Law in New Zealand*,335.

such breathing space, a moratorium or "*stay*" commences from the time of appointment of the administrator. The moratorium prevents court proceedings against the company, other than with consent of the administrator or leave of court. It also prevents other forms of rights by owners and landlords, with certain exceptions.[9]

In Zambia on the other hand, the only time that leave of court is required before a person can commence proceedings against a company is when a Winding-up Order has been made or a provisional liquidator has been appointed.[10] Since both of the circumstances can only occur at the company's terminal stage, the requirement for leave is not intended to give chance to any rescue attempts but rather to give chance to the liquidator to properly carry out his function of asset realisation and distribution of proceeds according to priority ranking of creditors.

3.4 The case for the United States of America

The corporate insolvency regime encountered in the USA offers contrasting characteristics but equally emphasizes corporate rescue. Chapter 11 of the United States Bankruptcy Code of 1978 is a 'reorganisation' procedure whose policy objective is strongly oriented to avoiding the social costs of liquidation and retention of the corporate operation as a going concern.[11] The procedure in the USA is unique in that there is no requirement that the debtor be insolvent or near insolvent in order to apply for chapter 11 protection: the process is an instrument for debtor relief, not a remedy for creditors[12]. The essence of chapter 11 is perhaps best summarized by Jay Lawrence Westbrook and Elizabeth Warren who have observed that;

> *American Law claims many innovations, from the Bill of Rights to the superfund. In the pantheon of extraordinary laws that have shaped the American economy and society and then echoed throughout the World, chapter 11 of the U.S. Bankruptcy Code deserves a prominent place. Based on the idea that a failing business can be*

[9] Heath P, & Whale M, *Insolvency Law in New Zealand*, 335
[10] Companies' Act section 281
[11] Bankruptcy Reform Act of 1978 of the United States of America
[12] Lewis P, "Corporate Rescue Law in the United States" in Gromek Broc and Parry, Corporate Rescue, p 333

> *reshaped into a successful operation, chapter 11 was perhaps a predictable creation from a people whose majority religion embraces the idea of life from death and whose central myth is the pioneer making a fresh start on the boundless prairie. So powerful is the idea of reorganization that chapter 11 has influenced commercial law reform throughout the World.*[13]

As in England, the central purpose is to preserve the value of the enterprise where this is likely to be greater than the liquidation value. There is an automatic moratorium or stay on the enforcement of claims against the company and its property. This is triggered by filing a chapter 11 petition by the debtor[14]. Secured creditors and landlords have a right to initiate court action to lift the stay but the moratorium will be upheld if the debtor can show that they have provided the creditors with sufficient security which may consist of periodic payments. The debtor company is in turn restricted in the use of cash as a means of providing security for the creditors.

Commenting on the American system compared to England before the latter made legislative reforms aforesaid, Moss observed that:

> *In the US, business failure is very often thought of as a misfortune rather than wrong doing. In England the judicial bias towards creditors reflects a general social attitude which is inclined to punish risk takers when the risks go wrong and side with creditors who lose out. The US is still in the spirit of a pioneering country where the taking of risks is thought to be a good thing and creditors are perceived as being greedy.*[15]

The point that Moss is asserting is that jurisdictions should aim more at designing insolvency regimes that are supportive of corporate rescue and that the dismemberment of the assets of the company should be the very last of considerations especially given the social costs of liquidating companies. This however, does not mean that the law should then induce directors to run unnecessarily risks or even engage in wrongful acts which are injurious to the interests of other stakeholders including creditors. There should be sufficient safeguards within the law to hold culpable directors responsible.

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[13] Warren E & Westbrook J.L, *The success of chapter 11: A challenge to the critics* (Michigan law review: Feb 2009) 107

[14] Sec 362 Bankruptcy Reform Act of 1978 of the United States of America

[15] Moss G, ''*Comparative Bankruptcy cultures",* Brooklyn Journal of international law vol. 23, 18

As pointed out in chapter one, business rescue is essential in that it not only ensures the survival and continued existence of a company but also ensures that the company continues to contribute to the growth of the economy through the payment of taxes, the provision of other services and the creation of employment opportunities.

While it is true that most enterprises in Zambia are small and may find it challenging to meet the expenses associated with business rescue, that in itself should not prevent the country from putting legislative mechanisms to facilitate business rescue. The benefits of business rescue as opposed to liquidation far outweigh the costs associated with the process. As indicated in chapter one, again the survival of an enterprise as a going concern is to the benefit of wider stake holders and the nation at large.

Pieter Kloppers has observed that 'it is widely recognized today that small and medium companies play an important role in the economy of any developing or developed economy and because of this, a small company is as worthy of a corporate rescue as a big company with many employees'.[16]

As can be seen from the overview of the business rescue in England, New Zealand and the U.S., each business rescue regime is similar to the others but different in some aspects in order to suit the unique needs of the country. It would therefore be extremely unwise for Zambia to simply transplant one of these regimes and implement it. The legislature and the policy makers must therefore come up with a rescue mechanism that meets the needs of the Zambian business environment, the size and type of registered companies and the planned national growth through the National Development Plan. The business rescue law to be enacted will also need to be cost effective so that a wide range of companies may be able to utilize the mechanism.

As pointed out earlier, attempts at enhancing accountability in receiverships have been made through legislative reform in the Companies Amendment Act[17]. The rationale for these amendments was to regulate receivership and the fees charged for the receiver's services. In as much as the aim was good, it did not remedy the attendant inadequacy of receivership

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[16] Kloppers P, "Judicial Management – *A Corporate Rescue Mechanism in need of reform"* Stellenbosch Law Review *417 (1999): 425.*

[17] Act no 24 of 2011

as a 'business rescue' mechanism. However, the Insolvency Bill for Zambia[18] does provide that:

> 17. (1) *A receiver shall before disposing of any charged assets, manage those assets so as to realise the moneys owed to the secured creditor without selling the assets unless such management will further deplete the assets of the company or will not satisfy the debts owed to the secured creditor.*

It still remains doubtful as to whether even this provision would render receivership as an effective corporate rescue mechanism. This is so because the receiver will still retain a power of sale and the determination as to whether management of the assets would lead to further depletion of the assets will remain a subjective issue to be determined by the receiver.

3.5 Common features of Business Rescue mechanisms

This part of the chapter considers and examines the features that are common in most jurisdictions whose legal regimes have embraced corporate rescue.

It may be argued that there are certain features that are common to insolvency legal regimes that have embraced the concept of corporate rescue or rehabilitation.

Rajak discusses six common components of a modern business rescue regime. These components relate to: (a) the type of entity or entities to be subjected to business rescue; (b) the mechanism by which eligible entities move from unprotected to protected status; (c) how heavy the burden of showing the likelihood of success should be; (d) what the nature of the protection should be; (e) how and by whom the business debtor should be administered during the protection period; (f) by what process it is to be determined that a rescue has been effected and that the debtor should emerge from the protective regime[19].

[18] This is intended to be a new statute separate from the Companies'Act.
[19] Rajak H & Henning J, "Business rescue for South Africa", South African Law Journal 116 (1999): 270

3.5.1 The Companies to be protected

The business rescue law must firstly prescribe the types of companies that it will apply to. The definition should state whether the scope of the law will extend to companies that are in addition to being formed under the Companies Act have other regulatory statutes such as the Banking and Financial Services Act[20], the Insurance Act[21] and the Pension Scheme Regulation Act[22]. This researcher proposes that business rescue in Zambia should only apply to companies registered under the Act. This is because the Bankruptcy Act[23] already regulates individuals who are bankrupt whilst the Banking and Financial Services Act[24], the Insurance Act[25] and the Pension Scheme Regulation Act[26]regulate insolvent banks, insurance companies and pension schemes respectively. A detailed discussion into the rescue provisions included in these pieces of legislation is however beyond the scope of this dissertation.

Additionally, the business rescue law must be simple and flexible enough to apply to a wide range of companies under the Act.[27]

In designing a business rescue regime, it is important to firstly design provisions that are appropriate for small enterprises and then add on provisions that are necessary for larger enterprises. [28]

Although what is termed as a small company in the United Kingdom may in certain instances be the size of a large company in Zambia[29], the important point made by McCormack is that a business rescue regime should be simple enough to be utilized by both small and large companies.

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[20] Chapter 82,Laws of Zambia

[21] Act No. 27 of 1997

[22] Act No. 28 of 1996

[23] Chapter 82, Laws of Zambia.

[24] Chapter 387, Laws of Zambia.

[25] Act No. 27 of 1997

[26] Act no 28 of 1996

[27] www.unicitral.org viewed on April 24th, 2014

[28] McCormack G, *'Rescuing small businesses: designing an "efficient"* legal regime' *Journal of Business Law 1 (2009) :9*

[29] This conclusion is premised on the definition of a small company in England in this article. It is one that satisfies two out of three conditions. (a) turnover is less than 6.5 million pounds; (b) the balance sheet is less than 3.26 Million pounds; or (c) has fewer than 50 employees.

3.5.2 Who should invoke the moratorium and commence business rescue

Careful consideration must be taken in deciding on who should trigger the moratorium and the entire process of business rescue. Additionally, the procedures must adequately protect the rights and interests of the creditors.
In support of this, Rajak[30] points out that framing legislation which allows the suspension of a creditor's right to seek enforcement of a debt owed by the debtor is a sensitive matter as the creditor ordinarily has the right to demand the payment of what a debtor owes.[31] Protecting a debtor from the enforcement simply means that the rights of the creditor and the contractual principle of sanctity of the contract are interfered with.[32]

Although court involvement in the commencement of the proceedings would seem necessary to protect the interests of the creditors, the expenses that a person would have to incur to initiate a moratorium and rescue proceeding where the commencement is court based should also be considered.

'Out of court' and 'court based' commencements should therefore be balanced and the number of people that commence the business rescue process needs to be regulated.

Zambia requires a cost effective rescue regime which is simple to commence but which will adequately protect the interests of the creditors. One would suggest that Zambia partially adopts the "Voluntary Administration" mode of New Zealand in respect of business rescue. This would entail that the directors of the company, a fully secured creditor or a liquidator be the persons to commence business rescue.

Additionally, it would be helpful in a case where no fully secured creditor exists among the creditors of a company, creditors who are owed at least fifty percent of the company's debts should be permitted to commence business rescue.

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[30] Rajak H & Henning J, "*Business rescue for South Africa* ,p273
[31] Rajak H & Henning J, "*Business rescue for South Africa* ,p273
[32] Rajak H & Henning J, "*Business rescue for South Africa* ,p273

Further, the court should have overall supervisory powers to oversee the whole business rescue process and to hear applications arising out of the process. In this way, the commencement procedure will be less expensive, restricted only to the category of persons mentioned, and will prevent frivolous and vexatious proceedings.

It would be better that the interests of the employees and the shareholders are taken into account. Where the employees and shareholders have reasonable belief that a company is insolvent or about to become insolvent, they should have the right to petition the board to consider commencing business rescue. Where the board does not respond favourably and continues to trade, shareholders and employees should be entitled to bring an action against the board for insolvent trading which should be an offence included in the Act.[33] The Act does not currently provide for this but an inclusion of such a provision would oblige the board to act appropriately in order to avoid the sanctions for the commission of this offence.

3.5.3 Who should show that the company is capable of being rescued?

The requirement to show the likely success of business rescue will vary depending on which category of persons commence business rescue.
A common feature of the three business rescue regimes discussed earlier in the chapter is that an entity is entitled to commence business rescue only if it is capable of being rescued. This is the only way that it would make business sense to commence the business rescue procedure. Further, the aim in all three regimes is to rescue the company as a going concern and in the alternative, to ensure that the creditors get a better return than they would have, had that company been immediately liquidated.

The board’s decision to enter into a business rescue should clearly show that this consideration was taken into account and that in their reasonable opinion, the company should be rescued. This requirement will serve to protect the interests of the creditors as it will prevent directors from

[33] Kaulungómbe K.G*, ‘Business Rescue for Zambia, suggestions for legislative Reforms’*: An obligatory essay submitted to the faculty of Law at University of Cape Town in partial fulfilment for the award of the Master of Laws Degree, February 2012

avoiding the fulfilment of obligations to creditors on the pretext of entering into business rescue where it is evident that a company cannot be rescued.

The insolvency practitioner, when commencing business rescue proceeding must also be required to show that he addressed his mind to the existing company's assets and liabilities and concluded that there is a likelihood that the company could be rescued or that a better return could be realized for the creditors. This evidence should then be given to the creditors to justify the moratorium and the suspension of the creditors' rights.

3.5.4 To which creditors and to what extent the moratorium must apply

There are three main types of creditors namely the fully secured, secured and unsecured creditors. It is clear that the moratorium should bind the unsecured creditors and the secured creditors who do not hold a floating charge over all the assets of the company. The biggest question that remains to be answered is whether the moratorium should also cover a fully secured creditor.

Zambia, like New Zealand and the United Kingdom, has a credit and security system of the floating charge.

Although recommendations will be considered in detail in Chapter six some of those relating to this chapter will be outlined. Considering the arguments that have been expressed in support of the moratorium binding the fully secured creditor and those against it, the legislators and the policy makers will have to make a choice between the two available options.

The first option will be to adopt the Voluntary Administration approach where the moratorium applies to the unsecured creditors and all other secured creditors that are not fully secured. This will reserve the fully secured creditor's right to commence receivership proceedings before business rescue commences. It will also mean that the fully secured creditor would not be bound by any moratorium after the business rescue plan is approved and will be able to enforce the security covered by that charge. The problem with this is that business rescue will wholly rely on the good will of the fully secured creditor.

The second option would be to follow the steps taken by the United Kingdom and abolish receivership except in exceptional cases. This will compel a fully secured creditor to see the rescue process through as that will be the only way that the fully secured creditor will be able to realize the value of the floating charge or the money owed to the fully secured creditor by the company. This approach may not be received well by fully secured creditors as they may feel that they are being forced into a business rescue procedure when an easier option would be to initiate receivership.

One would recommend the adoption of the first option especially if the part regulating receivership in the Act is amended. This is because even when the floating charge holder invokes receivership, the receiver would be statutorily obliged to consider the prospects of rescuing the business.

It may be necessary to suggest that the moratorium should apply until the rescue practitioner determines whether or not a full or partial rescue of the company is possible. Where the rescue is possible, the moratorium should apply throughout the implementation of the rescue plan. Where it is not possible, the moratorium should end and the company should then be liquidated and the proceeds paid to the creditors in order of preference.

3.5.5 How and by whom should the business be administered during the moratorium period

In this researcher's view, liquidators may not be the best persons to rescue a company because they have more expertise in company dissolution than resuscitation.

It would be advisable that the rescue practitioner be considered an officer of the court and be regulated by the court. Additionally, the practitioner should be regulated by the professional body to which the practitioner is a member, in order to ensure that the practitioner performs all duties with integrity and observes the ethics of that profession.

The practitioner should be in charge of the management of the company but that the directors and other officers should remain in office to assist the practitioner. The practitioner should also perform the duties of a director and have the same liability as that imposed on directors of the company for acts or omissions done in the course of duty to ensure that the practitioner performs to the expected standard.[34]

3.5.6 The role of the business rescue plan

The rescue of a company should ideally be conducted through a rescue plan that sets out how the rescue will be conducted and the procedures to be followed in detail. Further the moratorium must continue to apply during the implementation of the rescue plan in order to protect the assets of the company throughout the process and to ensure that the assets are utilized to support the rescue. This is consistent with the position in all three jurisdictions considered above.

If the policy makers and the legislature decide to enact business rescue legislation, they may also need to amend the Companies Act to include further provisions that will promote a rescue culture particularly among the directors of the company as they are usually the first people to observe the early signs of company insolvency.

(i) A provision preventing the formation of phoenix companies

A phoenix company is one formed by directors who have failed to properly operate one company and to escape honouring that first company's agreements and obligations to creditors', form the second company[35]. The English Insolvency Act of 1986[36] contains a provision that curbs the setting up of phoenix companies. The provision prohibits a director of an insolvent company that has gone into liquidation from being a director of a second company using the same or similar name to the failed company for a period of five years.[37]

Although the Insolvency rules of the United Kingdom provide exceptions[38], Kloppers suggests that the provision helps to curb the

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[34] Compare with the Statutory Instrument No. 27 of 2011 which regulates the accreditation and registration of receivers and liquidators in Zambia.

[35] www.wikipedia.org, viewed on 16 April 2015

[36] Insolvency Act of 1986, sch B1

[37] Insolvency Act 1986, sch B1 Section 216

[38] The Insolvency Rules of the UK provide for three exceptions. The first is where the successor company buys that whole or substantially the whole of the business from the insolvency practitioner acting in respect of the first company in liquidation. The second is where a director

undesirable practice of unscrupulous businessmen reinventing themselves while leaving a mass of unpaid debts in their wake'. [39] The provision applies automatically, without the need to prove the director's guilt or blame worthy conduct. The penalty for the breach of this provision is that of a fine, imprisonment or both.[40]

Such a provision needs to be included in the Law as it would encourage directors to be more responsible in handling the affairs of the company in order to avoid the prohibition of holding a position of director in a future company.

3.6 Possible challenges in enacting and implementing the Business Rescue Legislation in Zambia

There are a number of possible challenges that are likely to arise should the law be amended to include business rescue mechanisms. Thus, it would be prudent to create initiatives aimed at mitigating some of the challenges which would include the following;

(i) Changing the mind-set of the creditors

One of the major challenges that may face the introduction of this law will be to change the mind-set of the creditors and get them to appreciate the positive attributes of business rescue. A creditor's main concern is to get back what is owed by the debtor. Banks are often the major creditors of a business and have a lot of power in cases of insolvency. A bank, by virtue of being a major creditor with the overwhelming majority of votes, decides the future of a company by either choosing business rescue or liquidation even when other creditors are willing to be lenient to the debtor.[41]Banks can sometimes be merciless in their attempt to recover loans even in situations where there is no actual insolvency but only commercial insolvency. [42] Zambia may take a leaf

seeks the leave of the court to act as the director of the second company. The third is where the second company was known by the relevant name for the whole of the twelve months prior to the liquidation of the first company and the former must not have been dormant for any portion of these twelve months.

[39] Kloppers P, "Judicial management – *A Corporate Rescue Mechanism in need of reform": 431*

[40] Insolvency Act 1986, sch B1 Section 216 (4)

[41] Kloppers P, "Judicial management – *A Corporate Rescue Mechanism in need of reform" 427*

[42] Kloppers P, "Judicial management – *A Corporate Rescue Mechanism in need of reform" 427*

from England where receivership has been reserved only for a few exceptional circumstances and Administration is now the dominant procedure.

(ii) Judiciary's ability to handle business rescue cases

As will further be pointed out in chapter 5, Zambia lacks a system of specialisation among judges. This state of affairs is likely to pose serious challenges to the judiciary in handling business rescue cases. The fact that business rescue would be a new concept which many judges may not be familiar with, raises concern about the judiciary's ability to adjudicate over business rescue matters. It may therefore be necessary to conduct some specialised training so that the judiciary appreciates the intricacies of business rescue and its objectives.

(iii) Legal Practitioners' ability to handle business rescue cases

The ability of the legal practitioners to adequately handle business rescue cases may be another challenge that may be faced in implementing the business rescue law. As previously discussed business rescue will be a new concept that many lawyers may not be familiar with. This challenge is further compounded by the fact that business rescue has not been taught in the past as part of the company law course at the local universities in Zambia. As a short term measure, it may be necessary to conduct workshops for legal practitioners to understand the concept of business rescue to equip them to adequately handle their clients' court cases. Additionally, as a long term measure, local universities should be encouraged to incorporate insolvency law into their curricular and encourage specialization in insolvency law.

(iv) Availability of post commencement finance

Another challenge that may be faced is the availability of post commencement finance for the companies that may require finance during the business rescue process.

The policy makers will have to decide on whether to make statutory provision for post commencement finance and priority of post commencement creditors or to leave the provision of the finance to the markets to decide. The statutory regulation on the provisions of post commencement finance is however preferable.

Additionally, there may be a need to regulate the creditors, especially the banks in order to ensure that they do not charge exorbitant interest rates on post commencement finance and consequently defeat the whole purpose of business rescue.

3.7 Conclusion

The objective of this chapter was to highlight possible lessons that Zambia can learn from England, New Zealand and the United States of America all of whom have undertaken extensive reforms in Insolvency Law over the years. The chapter has demonstrated that the maintenance of financially distressed companies as going concerns is primarily dependent upon the design of the insolvency law regime. We have seen that jurisdictions that have sought to encourage corporate rescue have invariably focused on creating legal processes and procedures that are supportive of rescue such as provisions for moratoria, prohibition of phoenix companies, among others. The foregoing discussion brings to light the fact that the business rescue approach requires an environment in which players such as the judiciary and legal practitioners alike are well trained in this specialised field of insolvency practice particularly business rescue. The United Kingdom, New Zealand and the United States have all introduced into their laws procedures that focus on the company itself and grant it some ‘breathing space’ where evidence suggests that there is room for reorganization and consequently rescue from collapse. It should therefore be Zambia’s quest to embark on insolvency law reform in order to bring about positive trends in dealing with financially troubled enterprises.

The next chapter will consider mechanisms available in the Zambian Companies Act for the protection of creditor interests.

CHAPTER 4

EXAMINATION OF MECHANISMS FOR PROTECTING CREDITOR INTERESTS UNDER THE ZAMBIAN COMPANIES ACT

4.1 Introduction

One of the functions of insolvency law is to provide mechanisms by which the interests of the creditors will be protected. Thus, it can be asserted that the law should aim at fostering commercial activity by providing some form of assurance to financiers that their interests will be protected even in times of financial troubles having afflicted the debtor company. In light of this, this chapter begins by evaluating the nature of liquidators and receivers as provided for in the Zambian Companies Act. The evaluation seeks to examine the provisions relating to liquidators and receivers and further seeks to determine whether these provisions are capable of engendering efficiency, expertise, accountability and fairness among receivers and liquidators. Although liquidators and receivers were discussed in chapter two, the focus in that chapter was an evaluation of the two procedures in terms of their being capable of functioning as corporate rescue mechanisms. This chapter however focuses on evaluating the two procedures in terms of ability to guarantee protection of creditor interests when a company is insolvent. Further, the discussion will specifically critically examine the provisions relating to ability to effectively protect the interests of a creditor where the debtor company is a multi-national corporation whose insolvency proceedings have been commenced outside Zambia. The chapter then evaluates provisions relating to floating charges, fraudulent trading by directors among other things. It should be pointed out from the onset that insolvency provisions in the Companies' Act are far and wide. For instance, part XI deals with schemes of arrangements, take overs and protection of minorities and comprises six chapters while part XIII deals with winding up and consists of over one hundred sections. Invariably, all these parts contain provisions which are aimed at among other things, protecting the interests of creditors. The aim of this chapter however, is to focus only on areas of inadequacy in the law in pursuit of protecting creditor interests.

In chapter two, it was observed that there were basically three procedures in Zambia's insolvency law regime namely; Receivership, Liquidation and Schemes of Arrangement. This part accordingly will examine the laws, procedures and actors involved in receivership and liquidation and evaluate them against the benchmarks of efficiency, expertise, accountability and fairness. In so doing, we will be attempting to ask whether provisions relating to receivership and liquidation do provide sufficient safeguards against misfeasance by liquidators and receivers in order to guarantee protection of creditor interests.

4.2 Efficiency and Expertise

The practice of receivership and liquidation in Zambia has for many years been dominated by Accountants and Lawyers. However, until the 2011 amendments to the Companies Act[1] , the law was silent on the professional qualifications of persons eligible for appointment as receivers or liquidators. The amendments introduced a new provision that the Minister shall prescribe the qualifications for persons to be accredited as receivers or liquidators[2]. However to this day, no regulations have been issued as to which professional qualifications would render a person eligible for appointment as a receiver or liquidator.

There is no doubt that insolvency practice is a complex field. Both receivers and liquidators practically face very complex situations requiring high levels of legal knowledge as well as analytical skills including managerial capacity to get the best result out of the situation. Thus, a lack of prescription in the law regarding the minimum qualifications of a person(s) capable of performing the functions of either receiver or liquidator poses a great risk in so far as professional efficiency and effective performance of the practitioners is concerned. In fact, Insolvency Practitioners, particularly Receivers, must be legally obliged to perform their functions with certain levels of skill. It is clear

[1] Companies (Amendment) Act of 2011
[2] Companies (Amendment) Act of 2011

from the decision of the House of Lords in *Medforth v Blake*[3] that a Receiver, if managing the business, owes the company more than a duty to exercise good faith. Reasonable competence must also be displayed and an equitable duty of care is owed. This goes to augment the assertion that the practice of insolvency should not be left open to anybody without regard to their qualification and experience. There must exist a strict regulatory framework to screen all those wishing to perform the functions of Insolvency Practitioners.

While it is a commendable initiative to prescribe qualifications that one must possess in order to be eligible for appointment as an insolvency practitioner, the same may not produce any positive result in terms of guaranteeing efficiency, effectiveness and competency if not well thought out . It is important to note that the skills set required to turn around an enterprise may not readily reside in an individual simply because they possess a certain qualification or belong to a particular profession. There is need for a person to undergo some formal training in insolvency practice as well as be subjected to some form of examination. For instance, in England, insolvency is a regulated profession under the Insolvency Act of 1986 and anyone who wishes to practice as an Insolvency Practitioner needs to pass a set of examinations set by the Joint Insolvency Examination Board (JIEB). Once the examinations have been passed, it is necessary to meet the authorizing body's insolvency experience requirements as well.[4]

From the foregoing, it is apparent that the qualification provisions in the Companies (Amendment) Act of 2011 do not provide a guarantee that the law would assist in restricting the practice to appropriately qualified and experienced people. It is not enough that a person is a lawyer, accountant, a banker or belongs to any other profession. The law should create an environment in which insolvency practice is regulated by a professional body designated primarily for that purpose. Merely listing down the professional bodies such as the Law Association of Zambia, the Zambia Institute of Certified Accountants and others from which practitioners may be appointed will not resolve the problem. Thus the law in its current form does not seem to

[3] (1999) 3 ALL ER 97

[4] www.wikipedia.org/insolvency_practitioner accessed on 12 May 2015

adequately address the question of expertise. Taking a leaf from England experience suggests that the answer lies in the law providing for the establishing of a distinct insolvency profession with a cadre of members who are duly certified as qualified and experienced and possessing the appropriate managerial skills to be able to turn-around financially troubled enterprises or at least be capable of strategically realizing the best value for the debtor's assets in case of a complete failure to rescue the business. The argument being put across here is that insolvency practice is a very specialized field which should be left only to people who are specifically qualified and experienced. The regulation of the practitioners should also be undertaken by a specific body rather than be left to depend on other professional bodies such as Law Association of Zambia (LAZ) and Zambia Institute of Certified Accountants (ZICA).

4.3 Accountability and Fairness

As indicated in chapter three, the receiver plays a dual role as agent of both the debtor company and the creditor under whose charge he was appointed. This situation is likely to affect the receiver's effectiveness as he obviously has been placed in a position of conflict given that he is expected to serve the interests of two parties who are at the opposite ends of the rod[5].
There have been instances when even the courts have suggested that a company in receivership cannot bring an action against the receiver since the company lacks locus standi independent of the Receiver. In *Magnum (Zambia) Limited v Basit Quadri and another*[6] , the plaintiff was a company in receivership and the first defendant the Receiver/ Manager. The action was primarily an attempt by the plaintiff to restrain the Receiver/Manager from further dealing with the assets of the company until such time that he had accounted for his receipts and payments. A preliminary issue arose as to whether it would be in order for the Court to allow proceedings to continue on the basis that the plaintiff was a company in receivership and the first defendant it's Receiver/Manager. In the court's own words;

[5] SCZ Appeal No. 14 of 2002
[6] (1981) Z.R. 141

> *A Receiver who was an agent of the company under receivership was there to secure the interests of the debenture holder and in those circumstances the company concerned was debarred from instituting legal proceedings against its Receiver/Manager. It would be an absurd proposition to suggest otherwise. If the action was allowed to proceed in its present form, it would be tantamount to suggesting that the Receiver can institute proceedings against himself. Quite clearly a company under receivership has no locus standi independent of its Receiver. As long as the company continues to be subjected to receivership, it is the Receiver alone who can sue or defend in the name of the company. Thus on the preliminary issue, I hold that legal proceedings in the instant case have been irregularly commenced because in law, the plaintiff company which is under receivership is precluded from suing its Receiver/Manager.*

Although the position taken by the court in the above case can be quite misleading in that it is now settled law that the company can commence proceedings against its receiver if the latter commits a misfeasance. The case nevertheless goes to demonstrate the helpless situation in which companies in receivership may find themselves, especially in circumstances where even the courts cannot allow them audience to seek intervention where they suspect improper conduct on the part of Receivers.

It should be noted however that the Supreme Court in a later case of *Avalon Motors Limited (In Receivership) v Bernard Leigh Gasden Motor City Limited*[7] has ruled that whenever the current Receiver is the wrong doer (as where he acts in breach of his fiduciary duty or with gross negligence) or where the directors wish to litigate the validity of the security under which the appointment has taken place or in any other case where the vital interests of the company are at risk from the Receiver himself , the directors should be entitled to use the name of the company to litigate. The brief facts of this case are that the company borrowed money from a bank and upon defaulting, the bank appointed the first respondent to be the receiver. There were allegations to the effect that the receivership was being conducted in a delinquent fashion to the serious disadvantage of the company, the shareholders and all concerned. As a result, a new receiver was appointed. Meanwhile, an action

[7] (1998) ZR 41

was commenced against the former receiver who was the first respondent and also against the second respondent who sold the companies properties and assets allegedly at a grossly undervalued or give away price. The action was commenced in the company's name and a preliminary objection was taken by the defendants that the director and shareholder was not entitled to sue in the name of the company as only the receiver could do so. In the High Court, this argument was sustained. However, the Supreme Court overturned the ruling emphasising the ability of the directors entitlement to litigate in the name of the company were a receiver allegedly commits a wrong. The position is similar in England where it has been decided that a company can bring a direct action against its receiver[8]

In substance, receivership turns out to be a private procedure that allows enforcement of the appointer's security rights to the potential detriment of other stakeholders. Procedurally, it is unfair because the interests of these parties may be affected by the Receiver's actions but there is no appropriate legal obligation to allow access and input into decision –making for such potentially prejudiced parties. The receiver's statutory obligations are minimal and limited to the production of an abstract showing receipts and payments after a period of six months following the receiver's appointment and thereafter, every three months[9]. In this modern day of serious concern about corporate governance considerations, receivership as an insolvency procedure is clearly out of tune. It is one procedure that allows the debtor company to be handed over and dealt with by one interested party with little or no concern at all for the other claimants.

Receivership places too much power in the hands of one creditor and causes unfairness in so far as there is no incentive for the charge holder to consider the interests of any other party. The charge holder can make decisions having a significant impact on the returns to other creditors without there being any requirement for their consent. The widespread criticisms of the conduct of Receivers, with reference to cases which have taken inordinately

[8] Watts v. Midland Bank plc (1986) BCLC 15

[9] Companies Act as amended by (Amendment) Act No. 24 2011, Section 117

long or where assets have diminished in value and allegations that almost all proceeds have been absorbed in receivership fees cannot come as a surprise. In view of the above short-comings, the English reform process has sought to drastically minimize the role of receivership in the entire Insolvency legal regime. The Enterprise Act of 2002 has made 'Administration' as opposed to 'receivership' as the governmentally preferred procedure for attempting to rescue troubled companies[10]. It is therefore ironical that the 2015 draft Insolvency Bill in Zambia proposes to re-introduce receivership in its present form. A look at part IX of the draft bill suggests that the provisions therein are nothing but a mirror image of the provisions of the current Companies Act in respect of receivership[11].

It is doubtful whether the proposed business rescue provisions would produce any tangible results if receivership as a procedure would be retained in its current form. One would argue that the time has come that on grounds of efficiency and equity, the law should be skewed towards collective insolvency procedures –procedures in which all creditors participate and under which a duty is owed to all creditors and in which all creditors may look to an office holder for an account of his dealings with a company's assets.

Thus, while receivership may not be completely obliterated from the law, it should be reserved for very limited qualifying circumstances.

4.4 Lack of Cross Border insolvency provisions

Cross border insolvency has been defined as "one where the insolvent debtor has assets in more than one state or where some of the creditors or the debtors are not from the state where insolvency is taking place. It includes where proceedings concerning the same debtor have been commenced in more than one state or country"[12]. A look at the wide provisions relating to insolvency in the Companies' Act which touch on critical issues such as appointment and powers of liquidators and receivers clearly indicate that the law does not provide for recognition of a liquidator or receiver appointed

[10] Finch .V., *corporate Insolvency Law: Perspectives and principles* 360
[11] Companies' Act Sections 107 to 188
[12] United Nations Commission on International Trade Law Model law (Available at http://www.unicitral.org/unicitral/unicitral_texts/insolvency accessed on 14th May, 2015.

through proceedings outside the jurisdiction. Thus safeguards provided under the Act such as the mandatory requirement under section 281 of obtaining leave of Court prior to commencement of any action or proceeding against a company where a winding up order has been made would not be available. To this end, a single creditor would proceed and enforce his debt against the company even notwithstanding that there are insolvency proceedings going on outside the Republic which may require that the assets of the company are pooled and the realization of such assets conducted in a manner that takes care of the interests of all the creditors.

4.4.1 United Nations Commission on International Trade Law Model Law on Cross Border Insolvency

The United Nations Commission on International Trade Law (UNICITRAL) Model Law on Cross Border Insolvency provides an international legal framework for co-operation and co-ordination in cross border insolvency proceedings among member States that have adopted and ratified the Model Law. The objective of the Model Law are broadly stated as;[13]

> *(a)co-operation between Courts and other competent authorities of this state and other Foreign States involved in cases of cross- border insolvency*
> *(b) create legal certainty for trade and investment;*
> *(c) fair and efficient administration of cross border insolvencies that protects the interests of all creditors and other interested persons including debtors;*
> *(d) protection and maximization of the debtor's assets;*
> *(e) facilitation of the rescue of financially troubled business, thereby protecting investment and preserving employment.*

Under the Model Law, member states are required to enact domestic legislation to give effect to the provisions of this convention. To date, over 20 countries have ratified the UNICITRAL Model Law on Cross- Border Insolvency[14]. Zambia, has however not ratified this Treaty.

The Model Law is anchored on co-operation and co-ordination between judicial systems of member countries and is meant to assist judges; law

[13] Article 1 of the UNICITRAL Model law
[14] www.jus.uio.no viewed on 16 April 2015

enforcement officers and insolvency practitioners in resolving cross-border insolvency disputes. The Model Law therefore, provides an international legal framework for resolving complex and usually highly technical insolvency cases including those involving increasing incidences of cross border insolvency proceedings and the difficulties associated with such proceedings. Generally speaking the Model Law provides standards for ensuring that there is equitable sharing of assets of the insolvent company, irrespective of which country the creditors are based. The Model law seeks to achieve this by providing for direct access to the Courts by foreign representatives and recognition of foreign proceedings[15]. Thus Courts of member countries are able to seek each other's assistance in terms of interim reliefs; standard stays as an effect of recognition and other discretionary reliefs.

It goes without saying therefore that lack of domestication of the UNICITRAL Model Law in Zambia renders insolvency provisions in the Companies' Act inadequate to deal with issues relating to cross-border insolvency. Given the number of multi-national corporations existing in Zambia today, one would submit that it is a matter of urgency that the law be reformed to take care of matters aforesaid.

4.5 Inadequacy of protection for Floating charge holders

The Companies' Act makes it mandatory that every charge placed on any of the assets of the company should be registered with the Registrar within twenty-one (21) days of creating such a charge. The provision is couched so widely that every conceivable transaction involving the placing of any asset of the company as security is registerable. Section 99 is couched as follows;

> *(1) This section applies to the following charges over the property of the company:*
> *(a) a charge for the purpose of securing any issue of a series of debentures;*
> *(b) a charge on uncalled share capital of the company;*
> *(c) a charge to which the Trade Charges Act applies;*
> *(d) a floating charge on the whole or part of the undertaking or property of the company;*
> *(e) a charge on land, wherever situated, or any interest therein;*

[15] See Arts.9, 15, 26 & 27, UNICITRAL Model Law (Note 82)

(f) a charge on any present or future book debts of a company;
(g) a charge on calls made but not paid;
(h) a charge on a ship or aircraft or any share in a ship or aircraft;
(i) a charge on goodwill, on a patent or license under a patent or on a trademark, or a copyright or a license under copyright;
(j) a charge over shares in another body corporate.

The correct import of section 99 is that the directors of a debtor company have a legal obligation to register and lodge with the Registrar every instrument evidencing the placing of any asset as security for a debt.

Arising from the fact that any document lodged with the Registrar may be inspected by any member(s) of the public upon payment of a prescribed fee[16], it is apparent that the rationale for requiring that every charge be registered was to protect creditors. In other words, the main consideration is the provision of information to persons who wish to assess the financial position of the company. The most notable users of such information include credit reference bureaux, prospective charge holders and financial analysts, who are able to ascertain from the register whether or not the assets of the company are encumbered. The registration requirement is also a key test for a receiver or liquidator in considering whether to acknowledge the validity of the charge. The controversy however arises further in section 99 itself. Subsection 11 provides;

99(11)If particulars and documents relating to a charge that are required by this section to be lodged with the Registrar are not lodged within the time frame required;
(a) the charge shall be void against the liquidator and any creditor of the company; and
(b) the full debt secured by the charge shall become payable immediately by the company.

The above provision means that if a company placed a charge on an asset but did not comply with the registration requirement, and in the event that the company was placed in liquidation, the liquidator or any other creditor would be entitled not to acknowledge the validity of the charge. As such, the

[16] The Companies' Act Section 374

affected creditor will thus be rendered an unsecured creditor with no priority ranking during payment of the company's debts. This seems to be a very unfair placement of the affected creditor's interests into jeopardy especially that the obligation to lodge instruments creating charges rests with the debtor company[17]. One would think that it would have been much more equitable to hold the debtor company or its directors responsible for failure to comply with the registration requirements. Although some may still argue that the interests of the creditor are protected by rendering immediately payable, the full debt secured by the charge, consideration of the wider picture still reveals gross unfairness to the creditor. It should be noted that creditors particularly those who grant secured debts are mostly financiers who are in the business of providing finance and earning a return on the principle. Thus, merely providing that the creditor can recover the full debt immediately upon realizing that the charge has not been registered does not provide any form of assurance that the creditor will be restituted. It may just be that the company at that stage does not have sufficient resources to repay the full debt. In such a situation, the party to be disadvantaged would be the creditor despite the absence of culpability on his part.

4.6 Insufficiency of protection for creditors of Group Companies

There is now a prevalence of group companies sometimes creating very complex group structures of a parent-subsidiary relationship. In spite of this prevalence of group companies, insolvency law in Zambia fails to take on board the interdependency of many companies.

The law is focused almost exclusively on the individual company. The creditors of companies within a group can only assert claims against their particular debtor company, not the group. The potential for unfair treatment stems from the ability of a parent company's directors to move resources around the group. Creditors of subsidiaries within a group may be misled about the ownership of assets that are available to pay their debts. Furthermore, creditors of a subsidiary company may not even find comfort in the common law governing directors' duties. The tradition of the law dictates

[17] Section 99 (2) Companies Act

that directors owe their duties to their own company not to the subsidiaries that their decisions may nevertheless affect.[18]

In England, prior to the reforms, the Cork Report in analysing the law described it as being “seriously inadequate” and that the position of the law was ‘offensive to ordinary canons of commercial morality’ and also absurd and unreal to allow the commercial realities to be disregarded.[19] One may not be faulted for describing the state of insolvency provisions in the companies Act in Zambia in the same words of the Cork Report in England. This is so because the law in Zambia today depicts exactly what the situation was in England prior to the reforms. One of the scenarios observed by the Cork committee was a situation where a wholly owned subsidiary was mismanaged and abused for the benefit of a parent company. The parent company gave loans to the subsidiary company which were the very resources that the parent company would then abuse. When the subsidiary company went into liquidation, its creditors awoke to a rude shock when the parent company submitted proof in respect of secured loans and therefore substantial proportions of the funds from the liquidator went to the parent company to the detriment of the unsecured creditors.[20]

The above clearly demonstrates a dire need to reform insolvency law in order to truly protect the interests especially of the unsecured creditors in Zambia. One possible approach would be to subordinate debts owed by companies within the group to the claims of non-group creditors. This would mean creating a provision that would defer same group debts to the claims of external creditors. A second major response to unfair risk shifting by group companies is to provide for lifting the veil of the group in order to deal with commercial realities and to order a pooling of assets of related companies in liquidation so as to improve the dividend prospects for creditors. In New Zealand, legislation provides for a power by the courts to order one company in a group to contribute towards the assets of a fellow group company in the event of the latter’s insolvency[21]. Such orders are to be granted when the court

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[18] Lindgreen v L & P Estates Ltd (1968) Ich 572
[19] Report of the Review Committee on Insolvency Law and Practice (Note 5), Para. 1934
[20] Power v Sharp Investments (1994) 1 BCLC 111
[21] Companies’ Act of 1993 Section 271 of New Zealand

considers this just and equitable paying particular attention to the role of the parent company, especially its part in the subsidiary's collapse.

In the USA, the court may order consolidation (known as substantive consolidation) under the auspices of its general equitable powers and will do so where the companies' affairs are inextricably linked or the creditors can be shown to have dealt with the debtor companies as a single unit. In such consolidations, the group assets are dealt with as a single unit as part of a pooling arrangement[22].

In light of the foregoing, it is therefore imperative that the law reformers in Zambia do take a leaf from the developments that have taken place elsewhere to ensure that the law is tightened to safeguard the interests particularly of unsecured creditors. The draft insolvency bill currently being articulated should be reviewed to ensure that the codification of measures to deal with group companies is incorporated. The draft in its current form simply transplants the provisions of the current Act in respect of preferential debts.[23] In other words, there is nothing both in the current and proposed legislation aimed at protecting unsecured creditors of group companies.

4.7 Inappropriateness of directors' fraudulent trading provisions

The World Bank's guide on insolvency recommends that the law should provide for director's liability for decisions detrimental to creditors particularly if those decisions were made when the enterprise was insolvent.[24] The aim is to promote responsible corporate behaviour while fostering reasonable risk taking by directors. The guide further recommends that at a minimum, standards should address conduct based on knowledge of or reckless disregard for the adverse consequences to creditors.

In Zambia, the Companies Act criminalizes the act of contracting a debt on behalf of the company by any officer, if at the time; the officer had no reasonable or probable grounds of expectation that the company

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[22] Sampsell v Imperial Payler & Color Cay, 313 U.S. 215 (1941).
[23] Draft Insolvency Bill of Zambia Section 361
[24] Http://www.worldbank.org Principle 7 site accessed on 24/04/2014

would be able to pay its debts.[25] Section 357 of the Act is couched as follows:

> *357. (1) If an officer of a company who is knowingly a party to the contracting of a debt by the company has, at the time the debt is contracted, no reasonable or probable ground of expectation (after taking into consideration the other liabilities, if any, of the company at the time) of the company's being able to pay the debt, the officer shall be guilty of an offence, and shall be liable on conviction to a fine not exceeding two hundred and fifty monetary units or to imprisonment for a period not exceeding three months, or to both.*

The above section by creating an offence provides only punitive action for an erring officer and does not provide for compensation of the creditor who falls victim of the erring officer. Additionally, there are criminal sanctions for frauds by officers of companies which have gone into liquidation. The types of frauds referred to in the provision are those aimed at disadvantaging the creditors such as, stripping the assets of the company[26].

The provisions mentioned above are clearly inadequate to ensure that directors and other officers are held liable for decisions detrimental to creditors made when an enterprise is insolvent. The provisions as they are couched in the current Act cannot promote responsible corporate behaviour while fostering reasonable risk taking. At a minimum, Zambia needs standards to deter conduct adverse to the interests of creditors or reckless disregard for the adverse consequences to the creditors. The statutory provisions we need are not those that create a burden to prove fraud before a director may be held liable but those that provide remedies in the event that a director continues trading past the point where the director knows or should have known that the company would be unable to avoid insolvent liquidations. The English legislation refers to "wrongful trading" other than "fraudulent trading" because the latter tends to create much higher standards of proof.[27]

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[25] DBZ V JCN Holdings & 2 others 2009/HPC/00332

[26] Companies' Act Section 360

[27] See wrongful Trading Provisions under UK. Insolvency Act 1986 as reformed.

There is need for Zambia as well to shift from the use of the term "fraudulent trading" which is more restrictive to a much broader civil term of "wrongful trading". Jurisdictions that have reformed their insolvency law seem to have taken an inclination towards providing for erring directors to compensate affected creditors. In New Zealand for example, the new Insolvency Act of 2006 empowers the court to inquire into the conduct of the directors, and order the director(s) to repay or restore the property or money (together with interest) or contribute such sum to the assets of the company by way of compensation as the court thinks just.[28] The standard approach taken by the court is to begin by looking to the deterioration in the company's financial position between the date inadequate corporate governance became evident (the "breach" date) and the date of liquidation. Once that figure has been ascertained, the extent to which loss has been caused by trading, and the overall culpability including the duration of trading.[29]

All in all, the suggestion being made here is that the preferred provisions dealing with director's liability should be those that aim to recompense affected creditors. Restitutionary remedies would be much more meaningful to a creditor than criminal sanction imposed on an erring director(s).

4.8 Conclusion

The objective of this chapter was to examine the extent to which the Zambian Companies Act provides sufficient mechanisms that are capable of fostering protection of the interests of all the creditors even when a company is insolvent.

From the foregoing, it is clear that the provisions of the current Companies' Act may not be said to provide sufficient safe guards for the protection of creditor interests during financial distress of corporate bodies. This is so because the main players in insolvency practice being liquidators and receivers are not the subject of robust legal regime that is

[28] Insolvency Act of 2006 Section 301 of New Zealand.
[29] Heath P, & Whale M, *Insolvency Law in New Zealand*, 526

capable of compelling them to act with transparency, expertise and fairness. Additionally, the dual role imposed on a receiver as agent of both the debtor company and the appointing creditor means that the receiver is likely to have divided loyalty to the detriment of the creditor. It has also been demonstrated that provisions relating to floating charges seem to lack capacity to provide effective means to ensure that a creditor whose corporate debtor has defaulted may be sufficiently restituted. Additionally, provisions relating to group companies lack an effective framework for the treatment of such type of enterprises so as to ensure prevention of abuse of the separate legal personality concept by companies in a group whose motive may only amount to escaping their legal obligations to creditors. Finally, the discussion has demonstrated a need for reforming provisions relating to director's fraudulent trading to ensure that remedies which are meaningful to creditors are introduced as opposed to the traditional criminal sanctions upon erring Directors.

The next chapter is intended to assess the effectiveness of the judiciary in ensuring that the insolvency regime is efficient and meets the expectations of all the stakeholders of a company.

CHAPTER 5

EVALUATION OF THE ZAMBIAN JUDICIARY'S EFFECTIVENESS IN INSOLVENCY MATTERS

5.1 Introduction

A number of jurisdictions including Zambia administer insolvency law through the courts. As a result, the efficacy of these systems is significantly influenced in the way the Courts apply and administer the laws. It is therefore not in dispute that Judges and the judiciary play a crucial role in insolvency matters and therefore it is important that the national insolvency regime is designed in such a way that the judiciary is able to act as an effective player in responding to cases of corporate distress. Gordon Stewart, President of the International Organisation for insolvency and restructuring Professionals (INSOL) observes that a good insolvency system rests on four pillars: the law, the culture, the practitioners and the courts. He asserts that;

> *One can have the most inspired laws, an unimpeachable rescue culture and a cadre of talented, seasoned professionals and the structure will still founder without the critical forth pillar. Be they in a civil law or common law jurisdiction, stakeholders look for reasonable certainty of outcome, integrity of process and rulings delivered in a timely manner[1].*

This chapter is intended to assess the effectiveness of the judiciary as a player in ensuring that the insolvency regime is efficient and responsive to the needs of different stakeholders.

The word "Judiciary" has been defined as "the judges of a country collectively" as well as a "system of law courts in a country"[2]. The Zambian Constitution provides that the courts are the Supreme Court of Zambia, the High Court for Zambia, the Industrial Relations Court, the Subordinate Courts; Local Courts and such lower courts as may be prescribed by an Act of Parliament[3]. The Supreme Court is the final court of appeal for the country and has jurisdiction

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[1]The 10th Multinational Judicial Colloquium on Cross-Border Insolvency, (The Hague 18th-19th May, 2013.) Available on http://www.insol.org

[2] Kunda G , *"The Zambian Judiciary in the 21st Century"*, Zambia Law Journal, 30,(1998): 29

[3] Article 91 of the Zambian Constitution

and powers as conferred by the Zambian Constitution[4]. It has the jurisdiction to hear and determine appeals in civil and criminal matters as well as original jurisdiction[5]. The High Court for Zambia has unlimited and original jurisdiction to hear and determine any civil or criminal proceedings[6].

5.2 Operation of the Courts in the Corporate Insolvency law system

The Zambian court system is mainly based on the English common law system[7]. Acts of Parliament and some accepted components of customary law also form part of the Zambian Court system. The principles of judicial precedent as well as the practice of the adversary system are the hallmarks of this system. Precedent therefore forms a very important aspect of judicial decisions. It is worth noting that Zambia is a constitutional democracy so judicial powers of the Courts are below the legislative powers of parliament. The consequence of this is that any decision of the courts can be overridden by subsequent Parliamentary enactments.

Debts, both unsecured and secured can be recovered through established legal provisions which are found in Acts of Parliament. As noted in earlier chapters, the principal body of insolvency laws for both the individual person and incorporated company lie in the Companies Act,[8] the Bankruptcy Act[9] and the Deeds of Arrangement Act[10]. However it is important to note that Banks and other financial institutions registered under the Banking and Financial Services Act (BFSA)[11] are subject to the insolvency, dissolution and liquidation provisions of that Act. Section 85 of the BSFA provides that the Act shall to the extent of any inconsistency prevail over any other law.

A secured creditor may enforce its security under a mortgage through the appointment of a receiver and manager under the Companies Act upon

[4] Constitution of Zambia, Chapter 1 of the Laws of Zambia, Article. 92
[5] Supreme Court of Zambia Act, Chapter 25 of the Laws of Zambia. Section 7
[6] Constitution of Zambia Article. 94
[7] Munalula M.M, "*Legal Process: Zambian Cases, Legislation and Commentaries'* , (Lusaka: UNZA Press, 2004) 17
[8] Companies' Act CAP 388 of the Laws of Zambia
[9] The Bankruptcy Act Chapter 82 of the Laws of Zambia
[10] The Deeds of Arrangements Act of Zambia of , Chapter 84 of the Laws of Zambia
[11] The Banking and Financial Services Act of Zambia of ,Chapter 386 of the Laws of Zambia

application to the court[12]. A receiver may also be appointed under a power contained in any instrument[13]. The Receiver of any property or undertaking of a company appointed by the court shall be an officer of the court and shall be deemed, in relation to the property or undertaking, to act in accordance with the directions and instructions of the court[14]. Where the appointment is under the security instrument, the Receiver is deemed to be an agent and officer of the company and not an agent of the persons by or on behalf of whom he is appointed and shall act in accordance with the instrument under which he is appointed and with any directions of the court made[15].

Section 234 (2) of the Companies Act provides that the court may on the application of the company or any creditor or member of the company or the liquidator, order a meeting of creditors or class of creditors etc. to consider the compromise or arrangement. Such compromise or arrangement is only binding if it has been approved by order of the court[16].

The court may appoint a liquidator or may give directions as to the appointment of a liquidator as it thinks fit.[17] Section 269 of the Companies' Act, gives the court jurisdiction to wind up a body corporate incorporated in Zambia as well as a body corporate incorporated in a foreign country and registered as a foreign company or having any business or undertaking or assets in Zambia. The Court may order the winding up of a company if it is unable to pay its debts. By Section 272 (3), a company is unable to pay its debts if:

(a) *there is due from the company to any creditor (including a creditor by assignment) an amount exceeding fifty monetary units, and-*
(i) the creditor has, more than twenty-one days previously, served on the company a written demand under his hand requiring the company to pay the amount so due; and
(ii) The company has failed to pay the sum or to secure or compound it to the reasonable satisfaction of the creditor; or

[12] Under section 2 of the Companies Act, 'court' is defined as the High Court for Zambia
[13] Companies Act section.113(1)
[13] Companies Act Section 113(1)
[14] Companies Act sections 112-113
[15] Companies Act Section 113(1)
[16] Companies Act Section 234(6)
[17] Companies Act Section 282

(b) *execution or other process issued on a judgment, decree or order of any court in favour of a creditor of the company is returned unsatisfied in whole or in part; or*

(c) the company is unable to pay its debts as they fall due.

Further evidence of the role of the Court in winding up of a company as part of the insolvency laws is demonstrated by section 401 of the Companies Act which provides that:

> *401. The Chief Justice may make Rules of Court governing the practice and procedure for the winding-up of companies in Zambia and with respect to the procedure in any application to the court under this Act, and enabling all or any of the powers and duties conferred and imposed on the court in respect of the winding-up of companies to be exercised or performed by the Registrar or by the official receiver, or by the liquidator as an officer of the court and subject to the control of the court.*

In exercise of this power, the Chief Justice promulgated the Companies (Winding- Up) Rules[18] which apply to any winding-up proceeding or judicial management under the Companies Act.

5.3 Length of court processes in insolvency matters

As has been demonstrated in the preceding paragraphs, the court system plays a pivotal role in the insolvency system of the country. Therefore the state of the judiciary both in terms of the legal framework establishing it as well as the resources available to it has potential to affect the efficiency and effectiveness of the insolvency system. The major criticism levelled against the Zambia Court system is that the wheels of justice take far too long to turn, meaning that court cases take inordinately long to be disposed of. There are many cases one can cite to demonstrate this fact. Take for instance, the case of *Credit Africa Bank Limited (In liquidation) v Elias Namo Kundiona*[19] in which the plaintiff a company in liquidation commenced an action against the defendant for recovery of monies allegedly owed. This action was commenced

[18] Statutory Instrument No 86 of 2004
[19] SCZ Judgement No. 9 of 2003

in 1998. However, before the commencement of trial, a preliminary issue arose. The preliminary issue arose as a result of the defendant's application to proceed with a counter-claim against the plaintiff. The application was as a result of section 317 of the Companies' Act which requires leave of the Court before one can proceed with any action against a company in liquidation. The Plaintiff, being dissatisfied with the ruling of the Court on the preliminary issue appealed to the Supreme Court. The Supreme Court only rendered its judgement on this preliminary issue five years later in 2003. This situation has serious adverse repercussions especially in matters relating to insolvency in that part of the aims of any insolvency legal regime is to provide mechanisms that seek to derive the best value out of the assets of the insolvent enterprises. Assets by their nature depreciate with time and therefore delays in insolvency proceedings brought about by lengthy court processes are counterproductive. Indeed these criticisms are not new. In 1992, the Law Association of Zambia initiated a special committee to look into the problem of delays in the administration of justice and delivery of judgments[20]. There are a number of reasons that can be advanced for the delay:

5.3.1 Lack of adequate physical infrastructure to provide sufficient judicial fora

Like any other developing country, Zambia faces the challenge of inadequate court infrastructure particularly court rooms. The implication is that there are very few courtrooms that are available in relation to the ever increasing demand on the judicial system from the citizens of Zambia. For instance, Zambia only has five High Courts at Livingstone, Lusaka, Kabwe, Ndola and Kitwe. The low number of courtrooms and the strain that each must face was aptly illustrated by Chief Justice Ernest Sakala as he then was during the Ndola High court jubilee celebrations. The Chief Justice stated the following:

> *The Ndola High Court presently services Mufulira, Luanshya, Masaiti, Mpongwe Districts and Ndola itself. It also caters for civil and criminal cases in Luapula and*

[20] Kunda G , *"The Zambian Judiciary in the 21st Century"*, Zambia Law Journal, 30,(1998): 29

> *Northern Provinces. Judges travel to Mansa and Kasama four times in a year to hear cases. The population of the jurisdictional area serviced by Ndola High Court has substantially increased over the years. The infrastructure, however, has remained as it was when it was constructed in 1959.The increased workload has necessitated the number of Judges to be increased from two in 1959 to five as of to-day. This has created a problem of office space for both the adjudicators and the support staff. This building [the Ndola High Court building] was built to accommodate two Judges. The current establishment of five Judges means that the three additional Judges have to operate from improvised Chambers. This scenario is not peculiar to Ndola High Court alone but to the entire Judiciary physical infrastructure.*[21]

The continued increases in the Zambian population as well as increased commercial activity, amongst other factors have led to an increase in the number of cases being litigated before the courts. This has therefore put pressure on the court system. Chief Justice Sakala acknowledged this when he further noted:

> *I would like to submit that physical facilities of any court system play a major role in ensuring judicial autonomy and independence for effective smooth administration of justice. In the widest sense, physical facilities must include court buildings, housing, equipment, transport and support staff. To secure these facilities, the judicature often has to compete with the needs and requirements of other departments and so justify its own needs to the Treasury. Under sourcing, therefore, tends to be a common* complaint. *Indeed, in the end the quality of justice delivery is affected as the judges become demotivated.*[22]

5.3.2 Lack of specialisation by the judges

Supreme Court and the High Court judges handle both civil and criminal matters of various types. The handling of civil cases such as divorce and commercial cases implies that there is non-specialisation. The judges are likely

[21] Speech by the then Chief Justice Ernest Sakala at the Ndola High Court Jubilee celebrations, 4 December 2009 4

[22] Speech by the then Chief Justice Ernest Sakala, 5

to fail to fully appreciate the need to act expeditiously in matters relating to insolvency. It is however worth noting that, in recognition of the need for commercial cases to be dealt with in a timely manner and the need for judges to specialise, a Commercial List [23] was established through the High Court (Amendment) Act of 1999. Commercial action in the amendment act means "any cause arising out of any transaction relating to commerce, trade, industry or any action of a business nature"[24]. The result of this is that any insolvency actions fall under the jurisdiction of the commercial list as it ordinarily arises from a transaction relating to commerce. The Chief Justice has the power to designate judges that are dedicated to the Commercial List[25]. The amendment Act further provides for the creation of a user committee whose purpose is to provide a forum for the exchange of ideas or views, and for making recommendations for improving the operations of the Commercial List[26]. Section 12 of the Amendment Act defines the membership of the committee as consisting of:

(a) The judge in charge of the commercial list as Chairperson
(b) Judge of the commercial list
(c) One representative from the Law Association of Zambia
(d) One representative from the Zambia Association of Chambers of Commerce and Industry.
(e) The Chief Administrator of the Judiciary
(f) The Registrar of the commercial list, as Secretary and
(g) Two members of the public appointment by the Chief Justice

In an effort to lessen the work load that the judges had, the government decided to increase the number of judges that served on the High and Supreme Court benches[27](High Court judges where increased to 50 while Supreme Court Judges where increased to 11). However one must note that despite the number of judges being increased this has still not helped expedite the insolvency cases as not all judges are trained to handle matters of

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[23] High Court (Amendment) Act of 1999,section 2
[24] High Court (Amendment) Act of 1999,section .1
[25] High Court (Amendment) Act of 1999,section .4
[26] High Court (Amendment) Act of 1999,section .13
[27] The Supreme Court And High Court (Number of Judges) Act Chapter 26 of The Laws of Zambia as amended by Act No.26 of 2009

insolvency. The solution is not only to increase the number of judges but to specifically equip them with expertise on the law of insolvency.

As mentioned above, the judiciary is an important component of insolvency law system. The level of efficiency and effectiveness in the operations of the judiciary has a strong bearing on the court's application and administration of the law. The courts have been criticised for delayed disposal of cases as well as entertaining abuse of process through entertaining adjournments that generally lack merit by debtors as they attempt to frustrate the due process of litigation against them. The number of judges as well as the necessary support infrastructure such as courtrooms is inadequate to cope with the current demand from the public. This ultimately leads to a costly legal process as a long drawn out litigation is expensive in two ways: legal fees charged by lawyers and the fact that the assets which are used to secure the debt may diminish in value and condition with time with the result that any realisations from the sale of the assets is inadequate. It is clear from the discussion above, that the role of the judiciary is a key cog in the wheels of corporate law insolvency and directly affects the proper functioning of the insolvency system in the country.

5.4 Conclusion

It is clear from the discussion that the Judiciary has a critical role to play in ensuring that the insolvency legal system is efficient and effective. However, there are many areas of weakness both in law and in practice that seem to hinder the Judiciary's effectiveness in this important branch of law. Firstly, delays in completing judicial processes is a major stumbling block in the delivery of justice. Insolvency law by its nature and purpose requires speedy processes in order to ensure that the value of assets of an insolvent entity is preserved in the interest of various stakeholders. Additionally lack of specialised judicial officers in the field of insolvency law is equally a threat to the effectiveness and efficiency of the judiciary in the dispensation of justice in insolvency matters. This is so because insolvency law and practice is a very specialised field which like in other jurisdictions requires players who are specialists at every level. Lastly inadequate court infrastructure which adversely affects performance of the judiciary generally has not spared the judiciary’s role in insolvency matters.

The next chapter is a conclusion of the research. It outlines the major findings and recommendations of the study.

CHAPTER 6

CONCLUSION, FINDINGS AND RECOMMENDATIONS

6.1 Conclusion And Findings

The objective of this study was to establish whether the provisions of corporate insolvency law in the Zambian Companies Act[1] provide an effective mechanism for protecting the wider interests of different stakeholders who include shareholders, employees, the State including customers and suppliers of the enterprise. As stated in chapter one, the overarching objectives of insolvency laws are:

a. the allocation of risk among participants in a market economy in a predictable, equitable, and transparent manner; and
b. to protect and maximise value for the benefit of all interested parties and the economy in general.

In the absence of effective procedures that are applied in a predictable manner, creditors may be unable to collect on their claims, which will adversely affect the future availability of credit. Additionally the rights of debtors (and their employees) may not be adequately protected and different creditors may not be treated equitably. The capitalist run economy will thus not foster growth and competition and will result in increased risk. As a result, this may lead to economic failure and financial crisis as the world has recently experienced.

In attempting to answer the research questions, it was imperative to review the current legal provisions governing insolvency laws in Zambia to assess their adequacy, particularly in the narrow question of the extent to which it provides an option for a financially troubled but viable debtor company to be reorganised rather than face liquidation. In reviewing the Insolvency law, it was concluded that the current legal framework falls short of expected international standards as outlined in the United Nations Commission on International Trade Law's (UNICITRAL) Legislative Guide to Insolvency Laws as well as the World Bank principles on effective insolvency and creditor rights' systems.

[1] Chapter 388 of the Laws of Zambia

The hallmark of both the World Bank principles and the UNICITRAL guide is the proposition that an insolvency law regime should provide for effective mechanisms of turning around financially distressed companies and that liquidation of companies on account of insolvency should be the very last option available. Thus, most fundamental of all inadequacies as found out in chapter two is that the law in its current form only provides for receivership, liquidation and schemes of arrangement. As noted in the same chapter, none of these procedures are capable of effectively creating an opportunity for a financially troubled company to be rescued from collapse. It appears as though most of the current provisions under the Zambian Companies Act were never promulgated to reorganize financially troubled companies. Secondly, though the law may on face value be viewed to be skewed towards benefiting creditors during insolvency since there is no express provision in the Act that seeks to rescue an insolvent company thereby preserve the interests of all other stakeholders apart from the creditors, there are numerous loopholes in the law which adversely affect the effectiveness, efficiency including transparency of receivers and liquidators to the extent that creditors like other stakeholders are usually on the losing end in most insolvency processes.

In Chapter Three the study demonstrated that the maintenance of financially distressed companies as going concerns is primarily dependent upon the design of the insolvency law regime. The chapter highlighted the fact that England, New Zealand and the United States of America have all reformed their corporate insolvency laws to include concepts aimed at rehabilitating financially troubled companies. All the three jurisdictions have introduced procedures and processes that are supportive of rescue such as provisions for moratoria, prohibition of phoenix companies, among others.

In Chapter Four it was observed that the current insolvency provisions in the Zambian Companies Act although seemingly skewed towards protecting only the interests of creditors are in fact incapable of achieving even this one objective. Firstly lack of provisions relating to cross border insolvency means that the law in its current form is incapable of guaranteeing equitable sharing of proceeds among creditors of an insolvent debtor whose presence is in more than one jurisdiction. Additionally the Act does not provide sufficient mechanisms for holding Directors of insolvent companies responsible. This is so because criminalisation of fraudulent trading does very little to compensate a creditor who suffers loss at the hands of erring officers of a company.

It was also noted in Chapter Five that despite the law providing for active participation of the judiciary in insolvency matters to ensure fairness, the judiciary cannot be an effective player unless inevitable law reform is carried out. It was found out that there were many areas of weakness in both the law and in practice that may hinder the judiciary's effectiveness in insolvency matters. Among these weaknesses are delays in completing judicial processes, lack of specialisation in insolvency among judicial officers including inadequate infrastructure. The Zambian judiciary therefore is in dire need of reform in order for it to be able to effectively play its role in insolvency related matters.

6.2 Recommendations

The following recommendations arise from the findings of this study:

6.2.1 The need for the consolidation of insolvency laws into one Act or Statute

As noted in Chapter One, there is absence of a single piece of legislation to administer insolvency law in Zambia. The legal framework governing insolvency is scattered in various pieces of legislation namely Companies Act[2], Bankruptcy Act[3] and the Deed of Arrangement Act[4]. The Banking and Financial Services Act[5] also makes provision for dealing with banks that are facing financial difficulty while the insolvency of Co-operative societies and Insurance companies is dealt with in the Co-operative Societies Act[6] and the Insurance Act[7] respectively. Codification of the various relevant provisions that are found in the aforementioned Acts into one consolidated Insolvency Act would make the administration of insolvency law easier and more effective. This is so because a consolidated statute is likely to provide harmonised

[2] Chapter 388 of the Laws of Zambia
[3] Chapter 85 of the Laws of Zambia
[4] Chapter 82 of the Laws of Zambia
[5] Chapter 386 of the Laws of Zambia
[6] Chapter 397 of the Laws of Zambia
[7] Chapter 392 of the Laws of Zambia

procedures and processes which would apply to different types of companies irrespective of the sector in which they are conducting business. Additionally, it would be easier and cheaper to introduce any legal reforms relating to insolvency if there is only one statute to deal with as opposed to the current situation were there would be need to make changes to a multiplicity of statutes if an intention arose to make changes which are cross cutting.

6.2.2 The need to introduce comprehensive reorganization provisions as part of the country's insolvency laws

From the discussion in Chapter Two, it can be seen that it is imperative for Insolvency Law to strike a balance between reorganization and liquidation of a debtor company. It has been argued in chapter two that the ability to save a company from liquidation has positive results and benefits to society such as retaining employees as well as the value created from keeping together the assets of a company than breaking them into components to be sold. Insolvency laws the world over are undergoing much reform with a large number of the reforms focusing on reorganisations or rescue of the ailing entity rather than liquidation. With the focus by the Government on encouraging and promoting entrepreneurial activity[8], the shift from liquidation to reorganisation should tend to spur start-ups as the fear of liquidation is lessened.

Chapter 11 of the United States Bankruptcy Code, England's Insolvency Act of 1986 as amended including the Enterprise Act 2002 as well as the New Zealand companies Amendment Act of 2006 provide a good basis on which the Zambian provisions may be based. While it is conceded that it would not be wise let alone practical to adopt wholesomely, the provisions of a particular country's statute, it is hereby recommended that a hybrid of different ideas from the jurisdictions discussed in this study would enable Zambia create a code that does not only reflect international best practice but also suited to the countries unique circumstances. There are certain features that have now almost become universal in all legislations that have undergone reform, for example, provisions relating to automatic and mandatory stay or suspension

[8] The Government enacted the Citizen Economic Empowerment (CEE) Act in 2006, based on a belief that a country's long term economic as well as political growth should be driven by its citizenry who need to be economically empowered.

of actions and proceedings against the assets of the debtor affecting all creditors for a limited period of time. Such provisions no matter the style that the reform takes would be unavoidable. It is important however to also fully recognize that such a provision should have inbuilt mechanisms to ensure that it is not abused. Abuse is likely to occur where there are no time limits as to the period that the moratorium should last. Therefore unscrupulous Directors or even shareholders may take advantage of such weaknesses in the law to disadvantage creditors. In order to forestall such occurrences it would be necessary to put time limits for moratoria as well as introduce strict supervisory and regulatory mechanisms regarding companies under moratoria. The role of the Courts in this respect would be critical.

6.2.3 The need to improve accountability, expertise and fairness by Insolvency Practitioners

As has been shown in Chapter Three, a lot needs to be done to reform insolvency law so that the key players in insolvency practice can be more accountable, professional and fair to all stakeholders. The starting point is to create a properly functioning and regulated insolvency profession in Zambia whereby the practitioner will have to undergo formal training. Thus, insolvency practice should be restricted to duly qualified and experienced individuals. For instance in England Insolvency is a regulated profession under the Insolvency Act of 1986 and anyone intending to practice as an insolvency practitioner needs to pass a set of examinations set by the Joint Insolvency Examinations Board[9] . There is also need to strengthen the law relating to participation in the process by stakeholders. Reform should be aimed at for instance ensuring that creditors and debtors alike have an input in the decision making processes by Practitioners.

6.2.4 The need to introduce cross border insolvency provisions

As was observed in Chapter Four, the Companies Act in its current form does not have any provisions to deal with situations where the insolvent company has assets in more than one jurisdiction or where insolvency proceedings have been commenced outside the Republic. As a result of this

[9] Sec 391 (1) of the UK Insolvency Act of 1986

state of affairs, liquidators or receivers appointed through proceedings outside Zambia, cannot be recognised. Therefore, safeguards provided for under the Zambian Companies Act such as the mandatory requirement for obtaining leave of court prior to commencement of any action or proceeding against a company where a winding up order has been made[10] would not be available. This research recommends therefore that Zambia should ratify the UNICITRAL model law on cross border insolvency and domesticate it by introduction of provisions that would allow direct access to the courts by foreign representatives and recognition of insolvency proceedings commenced outside the Republic. The benefits of doing so would include a possibility of introducing cooperation between the Zambian courts and courts in foreign jurisdictions in insolvency matters involving multi-national corporations or any other company whose presence is in more than one jurisdiction. Furthermore, domestication of the model law would have the potential to create legal certainty for trade and investment as well as create a legal environment that guarantees fair and efficient administration of cross border insolvencies that protect the interests of all creditors and other stakeholders including the debtors[11].

6.2.5 The need to reform the Judiciary

As was noted in Chapter Five of this study, the judiciary is an important component of insolvency law system. The level of efficiency and effectiveness in the operations of the judiciary has a strong bearing on the court's application and administration of the law. The courts have been criticised for delayed disposal of cases as well as entertaining abuse of process. The Zambian Judiciary faces a number of challenges ranging from inadequate number of Judges and support staff to lack of support infrastructure such as inadequate law libraries, physical court buildings, office equipment and transport. Judges also need to be fully trained in the various specialist areas of law such as Insolvency. An ineffective judicial system loses the credibility of society and this ultimately leads to costly legal processes.

[10] Sec 281 of the Companies Act
[11] Article 1 UNICITRAL Model law

The creation of the Commercial List has not helped much in relation to issues of long delays and non-appreciation of many commercial matters by the court. It is also important to note that Judges on the Commercial List are bound not to entertain any applications for adjournments except in compelling and exceptional circumstances[12]. However, the terms "compelling and exceptional circumstances" have not been defined in the Amendment Act.

It is therefore recommended that specialised Insolvency Courts manned by specialised judicial officers need to be introduced. This is so because as indicated in chapter five, insolvency Law is a very specialised branch of law requiring a bit more understanding of none legal disciplines such as Accounting, Business Administration, among others . This research therefore submits that for as long as the judiciary remains a critical part of insolvency processes no legal reforms would yield much result if such reform does not touch the judiciary.

[12] High Court (Amendment) Act of 1999, section.9

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