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I. Introduction

> *The primary aim of this reform is to evolve a comprehensive body of legal principles and rules governing companies and suitable for the circumstances of the country. These rules should facilitate business activities in the country and protect the interests of the investors, the public and of the Nation as a whole.*[1]

A. General Background

The quotation above is a summary of the objective of the Nigerian Law Reform Commission in its 1988 review of the old Companies Act of 1968 (1968 Act).[2] The review culminated in the enactment of the Companies and Allied Matters Act of 1990 (the Act or CAMA),[3] the extant legislation on the law of corporations. The CAMA is a fairly comprehensive statute which has codified[4] a number of statutory and common law rules relating to corporations, including corporate reorganization, the principal

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[1] NIGERIAN LAW REFORM COMM'N, REPORT ON THE REFORM OF NIGERIAN COMPANY LAW 4 (1991) [hereinafter NIGERIAN COMPANY REPORT].

[2] Companies Act of 1968, No. 51 (Nig.) [hereinafter 1968 Act]. This Act was based on the U.K. Companies Act of 1948.

[3] Companies and Allied Matters Act, No. 1 (1990) (Nig.) [hereinafter CAMA].

[4] The term "codified" is used loosely here. Although comprehensive, the CAMA is certainly not a Code.

focus of this paper.[5] Amazingly (and in spite of the reform effort), this area of the law has received relatively little attention over the entire period of its existence. Noteworthy in this regard is the fact that the CAMA and the 1968 Act have virtually identical provisions on the subject.[6]

One of the mechanisms put in place by the above enactments for the restructuring of companies in distress is a scheme of arrangement or compromise subject to approval by members and creditors of a company and to supervision by the court.[7] Historically, schemes of arrangement first appeared in the English Joint Stock Companies Arrangements Act of 1870, which allowed companies in liquidation to make compositions or arrangements with creditors.[8] With slight modifications, this statutory procedure survived in Nigeria in its original form.[9] It is the only *internally* generated procedure available for the *rehabilitation* of *distressed* companies. For this reason, it is considered to be part of the law on insolvency.[10] Other legal procedures for dealing with corporate failure in Nigeria are receivership and liquidation.[11]

Judicial incursion into the subject area is rare and usually merely procedural.[12] The paucity of cases shows that companies in Nigeria hardly ever resort to the supposedly remedial procedure.[13]

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5 *See* CAMA, Pt. XVI.

6 *Compare id. with* Companies Act of 1968 §§ 197-200 (employing similar language in the sections dealing with corporate reorganization).

7 For provisions relating to compositions and schemes of arrangement with non-corporate debtors (individuals and firms), see the Bankruptcy Act, No. 16 (1990) (Nig.), amended by Bankruptcy (Amendment), No. 109 (1992) (Nig.).

8 *See* English Joint Stock Companies Arrangements Act of 1870. This provision was amended by § 24 of the English Companies Act of 1900 to include participation by members. English Companies Act of 1900. In 1907, § 38 of the Companies Act of 1907 entitled companies outside of liquidation to use the facility. Companies Act of 1907, (Eng.); *see also* David Milman, *Reforming Corporate Rescue Mechanisms*, *in* THE REFORM OF UNITED KINGDOM COMPANY LAW 415, 416 (John de Lacy ed., 2002) (detailing a brief summary of the evolution of schemes of arrangement in England).

9 *See generally* CAMA.

10 *Id.*

11 *See id.* Pt. XIV-XV.

12 *Cf.* P.O. ADEREMI, MODERN DIGEST OF CASE LAW 40-42 (2000) (citing cases related to the winding up of corporations, though not specifically citing cases related to arrangement and compromise).

13 *See id.*

Broadly speaking and without attempting to be exhaustive, this non-utilization may be explained in two ways. First, it could be that corporate failure is a rare phenomenon in Nigeria. Secondly, it may be that companies find the provisions inconvenient, ineffective, and, by extension, inefficient.[14] Without necessarily concluding at this point that the second reason is entirely satisfactory, it must be pointed out that the first explanation is quite untenable, particularly in light of the wave of bank failures in the early nineties.[15]

It is rather unfortunate that the current law on corporate reorganization in Nigeria still smacks of antiquated nineteenth century British experimentation gone sour.[16] At the time of the introduction of the scheme of arrangement in England, corporate entities were generally viewed with a measure of suspicion.[17] One commentator describes the prevalent attitude in the following words:

> Early companies legislation paid little attention to the rehabilitation of distressed companies. The assumption was that if a company fell into difficulties the problem

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14 Throughout this paper, any reference to efficiency should be interpreted in the context of Kaldor-Hicks Efficiency. A transaction is efficient in this sense if there is a total wealth increase for the affected parties or the aggregate monetary gains exceed the aggregate monetary losses. The main problem with this model in the present context is that it may promote exploitation of minority interests. As is detailed in Pt. II, this paper will also adopt the concept of equity, which will be used to mitigate the exploitative effects of Kaldor-Hicks Efficiency. Another model usually employed by scholars of law and economics is Parteo Efficiency. A transaction is said to be Parteo-efficient if all affected parties experience a net utility gain or no party experiences a loss. This model is often criticized for its non-pragmatism because in reality there are hardly any policies that do not leave at least one party worse off.

15 *See Nigeria*: *Bank Failure Not Yet Over*, AFR. NEWS ONLINE, Apr. 13, 2003, *at* http://allafrica.com/stories/200304130041.html (highlighting a period of commercial and merchant bank growth in Nigeria from 1985 to 1992 and the subsequent decline in the number of banks from 120 to 89 due to bank failures).

16 *See* CORK COMMITTEE REPORT: A GUIDE FOR BANKERS, FINANCE DIRECTORS AND OTHERS CONCERNED WITH THE PROVISION OF CREDIT TO BUSINESS, 1982, Cmnd. 8558 [hereinafter Cork Committee Report]. Between 1977 and 1982, a major review of the insolvency law and practice in England was carried out by the Cork Committee. This effort led to dramatic changes in the area of corporate reorganization in England. The changes further developed the concept of corporate rescue and put mechanisms in place for the salvation of distressed companies. The emphasis was more on *rescue* than on *satisfaction of claims against company assets*. *See id.*

17 *See* Milman, *supra* note 8.

> would be terminal and the best solution would be liquidation. Companies were artificial legal entities, viewed with considerable suspicion in many quarters, and few persons would shed a tear about an untimely "death."[18]

In spite of a global attitudinal change towards corporations in the twentieth century, the law in Nigeria has remained unchanged.[19] Today, the corporate form is seen as a veritable vehicle for economic development.[20] It is the most significant form of business association throughout the developed and developing world.[21] As Professor Farrar put it, "it is a characteristic of the modern economy that production is typically carried out by firms, not by individuals."[22] According to Willard Hurst, with specific reference to the United States, "the corporate form has served to increase market activity by assisting entrepreneurs to muster scattered capital and to control its use when it has been assembled."[23] In the area of corporate reorganization, the present trend worldwide is manifested by the growing literature on the concept of corporate rescue.[24]

Shortly, it will become apparent that the law of corporate

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18 *Id.*

19 *Compare* CAMA, No. 1, Pt. XVI, *with* 1968 Act, §§ 197-200 (noting the similarities in the wording of the two acts).

20 *Cf.* WILLARD HURST, LAW AND MARKETS IN UNITED STATES HISTORY: DIFFERENT MODES OF BARGAINING AMONG INTERESTS 48-50 (1982) (discussing the evolution of the corporate form in the United States in response to new technology, larger markets, entrepreneurial ambition, and the possibility for greater economies of scale).

21 *Cf.* Elisa Westfield, *Globalization, Governance, and Multinational Enterprise Responsibility: Corporate Codes of Conduct in the 21st Century*, 42 VA. J. INT'L L. 1075, 1082 (2002) (discussing the importance of corporate responsibility, since corporations are the planet's dominant institution).

22 JOHN H. FARRAR ET AL., FARRAR'S COMPANY LAW 3 (3d ed. 1991).

23 HURST, *supra* note 20, at 48-49.

24 *See, e.g.*, ALICE BELCHER, CORPORATE RESCUE: A CONCEPTUAL APPROACH TO INSOLVENCY LAW (1997); DAVID BROWN, CORPORATE RESCUE: INSOLVENCY LAW IN PRACTICE (1996) [hereinafter BROWN 1996]; JAMES R. LINGARD, CORPORATE RESCUES AND INSOLVENCIES (2d ed. 1989); ANKER SORENSON & PAUL J. OMAR, CORPORATE RESCUE PROCEDURES IN FRANCE (1996); Broude, *How the Rescue Culture Came to the United States and the Myths That Surround Pt. II*, 16 INSOLVENCY L. & PRAC. 194 (2000); Campbell, *Company Rescue in Australia: Does the New Voluntary Arrangement Procedure Provide Guidance for Possible Reforms in the UK?*, 10 INSOLVENCY L. & PRAC. 18 (1994); Rajak & Henning, *Business Rescue for South Africa*, 116 S. AFR. L.J. 262 (1999).

reorganization in Nigeria is in dire need of reform. This paper addresses that need. The objective is not different from that of the Nigerian Law Reform Commission fifteen years ago at the time of the last major revision of company law in Nigeria.[25] The timing is significant for two reasons. First, in view of the resolve by the present administration of President Olusegun Obasanjo to attract foreign investors to Nigeria,[26] a sophisticated insolvency law and practice regime is indispensable in the realization of this goal. Second, in recent times, there has been some activity – both nationally and internationally – toward reform of insolvency laws around the globe.[27] In a recent forum on "Insolvency and Risk Management" hosted by the World Bank, Gordon Johnson, the Bank's chief legal advisor, made the following remark: "Insolvency has become a pressing issue not only for the developing countries, but now also for the industrial countries. The current state of the world economy underscores the importance of having effective insolvency and creditor rights systems to allay investor fears and enable better management of default risks."[28] Indeed, Nigeria needs a pro-investment regime.

As an emerging market in sub-Saharan Africa, the country can no longer afford to ignore the advantages of a corporate rescue regime, not only to domestic and foreign investors, but also to the country at large. As predicted by the Law Reform Commission, "[t]aking into consideration the present economic climate where companies are competing for dwindling finances, raw materials, markets, skilled manpower etc., it is envisaged that these methods

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25 *See* NIGERIAN COMPANY REPORT, *supra* note 1.

26 President Olusegun Obasanjo, Inaugural Speech Following His Swearing-in as President of the Federal Republic of Nigeria (May 29, 1999) (transcript available at http://www.nopa.net/Useful_Information/Presidential_Speeches/29may99.htm) (citing the creation of an environment conducive for investment as one of his top priorities).

27 *See generally* DAVID BROWN, CORPORATE RESCUE: REPORT FOR THE MINISTRY OF ECONOMIC DEVELOPMENT (Nov. 2000), *at* http://www.med.govt.nz/ri/insolvency/tiertwo/rescue/rescue.pdf [hereinafter Brown 2000] (discussing the need to reform insolvency laws in New Zealand in order to regulate and minimize the cost of corporate failure).

28 *See* Press Release, World Bank, Rebuilding the Trust: World Bank Hosts Global Forum on Insolvency and Risk Management (Feb. 4, 2002), *at* http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:20089489~menuPK:34457~pagePK:34370~piPK:34424~theSitePK:4607,00.html (on file with the North Carolina Journal of International Law and Commercial Regulation).

of re-organizing company structure for the optimum utilization of these resources will take on more significance in the near future."[29]

In a fiercely competitive marketplace, access to capital is certainly a key factor in the equation of company survival.[30] The ability of a company to raise capital to carry out its authorized business or objectives depends on a combination of factors, including, but not limited to the following: the market outlook for its products and services, the quality of its management team, the state of the economy and level of development of the capital markets, the ability of an investor (shareholder or debt holder) to enforce mutually agreed upon terms against a company, and the extent to which investors have control over arrangements or proposals to alter their financial entitlements or other obligations that attach to a company as a result of capital contribution.[31] This paper is directly concerned with the regulation of such arrangements.

B. Scope of the Paper

The guiding philosophy behind the proposed reform is twofold: (a) to create an enabling environment for the development of a reorganization plan that maximizes the chances of an insolvent (or nearly insolvent) company, or as much as possible of its business, *successfully* continuing in existence;[32] and (b) to ensure fair treatment of all the parties directly affected by an arrangement. It should be noted that while the first prong is basically an *efficiency* question, the second prong relates to *equity*. The paper will take on the arduous task of balancing these two important, but often conflicting, approaches. In reconciling the approaches, the overriding consideration will be what the individual parties would have agreed upon *ex ante*.

In a chronological manner, the second part will set out, in

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29 NIGERIAN COMPANY REPORT, *supra* note 1, at 241.

30 *See* LINGARD, *supra* note 24, at 2.

31 *Cf. id.* at 1-5 (stating that the success of a company depends upon its performance in three broad categories: production, marketing, and financial controls).

32 *Cf.* Corporations Act of 2001, Pt. 5.3A, § 435A(a) (Austl.). As Judge Jacob stated in *R. A. Securities v. Mercantile Credit Co.*, 3 All E.R. 581, 584 (1995), "It is better to keep the show on the road than close it down even if creditors have to accept less than their nominal (but not achievable) entitlement." Of course, this statement is too broad and is qualified in later parts of the decision.

considerable detail, the law on arrangements and compromise in Nigeria. This part will also identify key issues and topical areas of discourse to be addressed in later parts. Employing the twin standards of efficiency and equity, the third part will evaluate the pros and cons of the present regime. The part will begin by highlighting the peculiar features of the operating environment for corporations in Nigeria. It will then proceed to summarize other procedures which can be used for the treatment of "sick" companies, and this section will be followed by an evaluation of the law *as it is*, bearing in mind all the surrounding circumstances.

Finally, in adopting a comparative law approach, the paper will conclude with an attempt to proffer solutions to previously identified problems. Specifically, the possibility of adopting a mediation-based approach to corporate reorganization will be given special attention, with emphasis on the advantages it offers in terms of quick resolution of cases and sympathy to the interests of the various parties. Some of the other issues to be addressed in this part include: the desirability or otherwise of extensive court involvement in the reorganization process, the relative costs involved in reorganizing a company, the need for a moratorium or stay on all enforcement proceedings against a company about to undergo reorganization, and the question whether an incumbent management team should be allowed to remain in control while the company is being restructured.

C. Terminology

While the CAMA provides a definition of the expression "arrangement," it is silent on the meaning of "compromise."[33] An arrangement is a form of corporate restructuring defined as "any change in the rights or liabilities of members, debenture holders or creditors of a company or any class of them or in the regulation of a company."[34] A somewhat narrower meaning is usually attributed

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[33] *See* CAMA § 537.

[34] *Id.*; *see also* Corporations Act of 2001 § 9 (defining an arrangement as including "a reorganization of the share capital of a body corporate by the consolidation of shares of different classes, by the division of shares into shares of different classes, or by both of those methods"). This definition, though restrictive in nature, has been given a liberal meaning by Australian courts. *See e.g.*, *In re* International Harvester Co. of Australia Pty. Ltd. (1953) VLR 669, 672 ("It is now plain that the word 'arrangement' is not restricted in its meaning by its association with 'compromise.'" (citing *In re* Guardian

to the expression "compromise." It has been described as involving "a settlement of dispute and some degree of give and take by each side." [35] It is similar to a composition which entails an agreement between an insolvent debtor and two or more of his creditors by which the creditors agree to accept a partial satisfaction of their claims and forgive the balance.[36] It seems, therefore, that while a compromise necessarily involves a dispute, an arrangement does not.[37] Nevertheless, both terms are used interchangeably throughout this paper. The term "reorganization" includes "arrangements" and "compromise."

A company is insolvent if it is unable to pay its debts as they become due.[38] An insolvent company has insufficient current assets to satisfy the claims of all its creditors.[39] In addition, a company may be *practically* insolvent even though it is still *technically* solvent.[40] The term "distressed company" shall be used to denote both categories of companies. "Rescue" is a term of art meaning "the application of formal legal rescue procedures

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Assurance Co., 1 Ch. 431, 450 (Eng. C.A. 1917)).

35 ROMAN TOMASIC & STEPHEN BOTTOMLEY, CORPORATIONS LAW IN AUSTRALIA 829 (1995) (citing Isles v. Daily Mail Newspaper Ltd. (1912) 14 CLR 193, 196-98). In *In re Interfirst Fin. & Sec. Ltd.* [1993] FHCLR 421, 424, Judge Eigbedion adopts the JOWITT'S DICTIONARY OF ENGLISH LAW 404 (2d ed. 1977) definition, defining a compromise as "an adjustment of claims in dispute by mutual concession."

36 ROBERT W. HAMILTON & RICHARD A. BOOTH, BUSINESS BASICS FOR LAW STUDENTS: ESSENTIAL CONCEPTS AND APPLICATIONS 229 (3d ed. 2002).

37 *See In re* Guardian Assurance Co., 1 Ch. 431, 431 (Eng. C.A. 1917)). In *Yinka Folawiyo & Sons Ltd. v. T.A. Hammond Projects Ltd.* 3 FRCR 143 (1977), Judge Karibi-White made the following distinction:

> An 'arrangement' in my view is not *stricto sensu* synonymous with a 'compromise' . . . . [A]greements which enable the majority of the creditors to accept less than is due to them may be a compromise on the Pt. of the creditors as a whole. But where . . . the shareholders do not give up anything in the amalgamation of the company . . . no compromise as such [is] involved, but only an arrangement resulting in the fusion of the two companies.

38 According to § 408(d) of the CAMA, this constitutes a ground for petitioning the court to wind up a company.

39 *Cf.* HAMILTON & BOOTH, *supra* note 36, at 231 (stating that an entity is insolvent when its liabilities greatly exceed its current assets).

40 *See id.* (discussing how an entity may still appear solvent when its property value exceeds its debt value on the company's balance sheet, and yet is technically insolvent because its liabilities exceed assets).

at the point of the imminence or actuality of insolvency."[41] It involves pulling a company from the jaws of death in order to give it a new lease on life.[42]

II. Arrangements and Compromise in Nigeria

A. Introduction

Part XVI of the CAMA deals exclusively with arrangements and compromise,[43] and will be the primary statutory point of reference. Because of the relatively undeveloped state of the area of the law, only a handful of cases on questions relating to arrangements and compromise have actually come up before local courts in Nigeria.[44] It is therefore not uncommon for learned text writers and commentators in enunciating the law on the subject to refer to decisions of foreign courts regarding similar provisions.[45] Such decisions are of persuasive authority before Nigerian courts.[46]

An initial question is: *why reorganize*? Briefly, a company in distress may wish to reorganize its finances in order to attain an optimal capital structure which will allow it to carry on business in a more efficient manner, settle outstanding claims of creditors, retain valued employees, and still have some leftover value for its shareholders.[47] Predictably, not every reorganized company eventually becomes successful, and quite a number end up in

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41 BROWN 1996, *supra* note 24, at 1.

42 *Cf.* SORENSON & OMAR, *supra* note 24, at xiii (discussing how the procedure of corporate rescue can give a bankrupt company a chance at survival and avoid liquidation).

43 *See* CAMA, Pt. XVI.

44 *See, e.g.*, Alli v. Okulaja, 2 All NLR 35 (1972); Nig. Nat'l Supply Co. Ltd. v. Alhaji Hamajoda Sabana and Co. Ltd. and Others, 5 NWLR (Pt. 40) 205 (1988); Oladiran v. State, 1 NWLR (Pt. 14) 75 (1986).

45 *See* C.O. OKONKWO, INTRODUCTION TO NIGERIAN LAW 1-8 (1980) (noting the influence of British law); A.E.W. PARK, THE SOURCES OF NIGERIAN LAW 132 (1963) (noting the coexistence of English and Nigerian customary law).

46 *See Alli*, 2 All NLR at 35; *Nigeria Nat'l Supply*, 5 NWLR at 205; *Oladiran*, 1 NWLR at 75.

47 *Cf.* SORENSON & OMAR, *supra* note 24, at 7 (describing the various reasons to consider corporate rescue as opposed to liquidation).

liquidation.[48] Even where this is the case, sophisticated reorganization regimes help to maximize the returns to creditors and shareholders alike.[49] The question will be addressed in greater detail in the final part of this Comment.

B. Initiating an Arrangement or a Compromise

Section 539(1) confers jurisdiction on the Federal High Court (the court) to order a meeting or meetings of members or classes of members or creditors or classes of creditors of a company where an arrangement or a compromise is proposed between the company and the said members or creditors.[50] The application to the court may be made by the company, any of its members or creditors, or, in the case of a company being wound up, by the liquidator.[51] From the wording of the section,[52] it seems that the court is not required to go into the substance of the matter at this stage. The application is *preliminary* and the court need only concern itself with determining whether the company has satisfied the prerequisites for undertaking an arrangement or a compromise.[53]

The court's power in ordering the meeting or meetings is discretionary in view of the non-obligatory language of the section.[54] The applicant is required to show sufficient cause why the court should exercise such discretion in its favor and also that there is likelihood of securing the required majority vote in support of the arrangement or compromise.[55] In reaching a decision, the

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48 *See* LINGARD, *supra* note 24, at 36.

49 *Cf. id.* at 41 (showing how a partial rescue, which involves the liquidation of a major subsidiary, can nonetheless benefit creditors and shareholders).

50 *See* CAMA § 539(1).

51 *Id.*

52 Note in particular the phrase "on application, in a summary way." *Id.*

53 *See id.* § 539(3) ("If the court is satisfied as to the fairness of the compromise or arrangement, it shall sanction the same and the compromise or arrangement shall be binding . . . .").

54 *See id.* § 539(1) ("Where a compromise or arrangement is proposed between a company and its creditors or any class of them, the court may . . . order a meeting . . . .").

55 *See* Yinka Folawiyo & Sons Ltd. v. T.A. Hammond Projects Ltd., 3 FRCR 143 (1977). In *Mrs. Scholastica O. Casagrande v. Mayas Quarry Indus. Ltd. & Ors.* [1993] FHCLR 82, 88, Judge Egbo-Egbo described these two conditions as "prerequisites . . . *sine qua non* for . . . success of this type of application."

court considers both the memorandum of the scheme and an explanatory statement made pursuant to section 540 of the CAMA, which are to be produced before it along with the application.[56]

In addition, before ordering the holding of the meeting or meetings, a court will ensure that the proposed "arrangement" or "compromise" falls within the meaning of the terms as used under the CAMA. Thus, a *unilateral* proposal made to the court by a company stipulating how the company intends to or plans to settle its indebtedness has been held to fall outside the meaning of the expression "compromise" under section 539 of the CAMA.[57] In order to propel the court into action, the proposed arrangement or compromise has to be *between* the company and its members or any class of them and/or between the company and its creditors or any class of them, as the case may be.[58] Similarly, a court may refuse to order a meeting if the arrangement does not have the approval of the company either through the board or, if appropriate, by means of a simple majority of the members in general meeting.[59] Nonetheless, the court may exercise its discretion in favor of ordering the meeting if it is satisfied that there is reasonable probability that it would serve a useful or functional purpose.[60]

Furthermore, the provisions relating to arrangements and compromise under the CAMA apply only to companies "liable to be wound up under [the] Act."[61] Section 408(d) of the Act provides: "A company may be wound up . . . if the company is unable to pay its debts." Apparently, a company approaching insolvency cannot take advantage of the procedure unless a resolution that the company be wound up is first passed.

56 *See* CAMA §§ 540(1)(a), 540(2). The statement must be sent with every notice summoning the meeting or meetings of members and/or creditors to be convened. It is meant to explain the effect of the compromise or arrangement and state any material interests of the directors of the company.

57 *See In re* Interfirst Fin. & Sec. Ltd. [1993] FHCLR 421, 424 ("To act on [a] one-sided proposal by a company, the court will be unwittingly lending its aid to fraud on the public."); *see also* Andruchue Inv. Plc. v. Fin. Mediators (Nig.) Ltd. [1994] FHCLR 51 (on the same point).

58 *In re* Interfirst Fin. & Sec., Ltd [1993] FHCLR at 424.

59 *In re* Savoy Hotel Ltd., 3 All E.R. 646, 657 (Ch. 1981).

60 *Id.*

61 *See* CAMA § 539(6).

Ironically, this is no longer the position in England.[62] Worthy of mention is the finding of the Cork Committee on Insolvency Law and Practice to the effect that the procedure was used mostly by solvent companies in England and rarely by insolvent ones.[63] This is intuitive from the perspective of a company wishing to act quickly in order to overturn a perceived downward trend in business and in anticipation of future prosperity.

This preliminary application for an order of court convening the appropriate meeting or meetings is the first of two applications that need to be made to the court. At the time of the second application, the court will be called upon to sanction or approve the arrangement or compromise. The fact that a court grants the first order does not necessarily mean that the proposed scheme will be sanctioned in the second application. As the Full Court stated in *In re Norfolk Island and Byron Bay Whaling Ltd*,[64] "[I]t is going too far to say that the grant of leave to summon meetings under [section 411(1) of the Australian Corporations Law][65] necessarily amounts to a determination that the proposed arrangement is one which falls within the scope of the section."[66] In ordering the meeting or meetings, a court may also order that a moratorium be put in place if specifically sought by the applicant.

C. Classification

In making an order under section 539(1), the court is empowered to summon meetings of different *classes* of members and creditors where appropriate. Because individual members of a particular class are in the best position to determine their fate, a great deal of attention is paid to classification in order to prevent the occurrence of confiscation or injustice.[67] The question of what constitutes a class is perhaps the most problematic issue for

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62 *See supra* note 8.

63 *See* CORK COMMITTEE REPORT, *supra* note 16, at 404. Between 1977 and 1982, this Committee conducted a major review of Insolvency Law and Practice in the United Kingdom.

64 [1970] 1 NSWR 221, 241 (Wales).

65 This is similar to section 539(1) of the CAMA.

66 *In re* Norfolk Island [1970] 1 NSWR 241.

67 *See* Sovereign Life Assurance Co. v. Dodd [1892] 2 QB 573. (Eng.); *see also* TOMASIC & BOTTOMLEY, *supra* note 35, at 196.

practitioners in the field.[68] Unfortunately, the CAMA does not provide any useful guidance on division of members and creditors into classes. In practice, the applicant is usually saddled with the responsibility of ensuring that the classes are properly constituted. Where the applicant fails to do this, the court may refuse to sanction the arrangement or compromise.[69]

It remains to be decided whether or not the court lacks jurisdiction to sanction a scheme of arrangement approved by the requisite majorities at improperly constituted meetings, whether of classes or otherwise.[70] This writer believes that the paramount consideration in any application for the sanctioning of a scheme is fairness. If, in spite of an improper classification, a scheme is found to be fair, it should be sanctioned. However, improper classification is a strong, though inconclusive, indication of lack of fairness.[71]

Proper classification is crucial because, once approved by the court, an arrangement becomes binding not only on the company, but also on all members and creditors alike, whether or not they were entitled to vote at the meetings.[72] The creation of too many classes should not be encouraged, however, because it could prevent approval of potentially pie-increasing schemes. In *In re Crusader Ltd.*, Judge Thomas was of the view that it "causes unnecessary inconvenience, artificiality, and increases the possibility of veto by a limited group."[73] Maintaining the delicate balance between recognition of the right of individual class members to determine their own interest and the need to protect

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68 *See* BROWN 1996, *supra* note 24, at 626; *see also* THE COMPANY LAW REVIEW STEERING GROUP, MODERN COMPANY LAW FOR A COMPETITIVE ECONOMY: FINAL REPORT, Vol. 1, 276 (2001) [hereinafter COMPANY LAW REVIEW].

69 *See In re* Hellenic and Gen. Trust Ltd. [1976] 1 WLR 123.

70 *See In re* Hawk Ins. Co. Ltd. [2001] 2 B.C.L.C. 480. (Eng.) (The position in England is that the court lacks jurisdiction even when no one objects to the scheme.); *see also* COMPANY LAW REVIEW, *supra* note 68, at 276.

71 *See* CAMA, § 539 (3). I find support for this view in the mandatory language of the section, which states, "If the court is satisfied as to the *fairness* of the compromise or arrangement, it *shall* sanction the same . . . ." *See also* EPHRAIM MADUELOSI ASOMUGHA, COMPANY LAW IN NIGERIA UNDER THE COMPANIES AND ALLIED MATTERS ACT 395 (1994).

72 *See* CAMA, § 539 (3); *see also* BROWN 1996, *supra* note 24, at 628; *see also* the section of this paper on "Effect of Court Approval," at 25, *infra*.

73 *See In re Hawk Insurance*, 2 B.C.L.C. at 519.

the whole process from derailment is what gives this area its special significance.

According to Judge Bowen, in his classic formulation of the test to be applied in the constitution of separate classes, a court is bound to

> give such a meaning to the term 'class' as will prevent the section[74] being worked so as to result in confiscation and injustice, and it must be confined to those persons whose rights are so dissimilar as to make it impossible for them to consult together with a view to their common interest.[75]

In that case, holders of matured policies who had a vested cause of action in respect of their claims were held to constitute a separate class distinct from holders of subsisting policies whose claims were contingent in nature. However, when the same court was presented with a similar set of facts in *re Hawk Insurance Company Ltd.*,[76] the application of the test led to a different outcome.

According to the facts, the liquidators of a company engaged in writing motor-vehicle insurance and non-life business submitted a petition for the approval of the court to a scheme of arrangement made between the company and the scheme creditors as defined under the scheme. There were two types of creditors – those with vested rights and those with contingent rights. Creditors with admitted claims (that is, the creditors with vested rights) were entitled to receive 100% of their claims, while the other creditors were entitled to either 75% or 50% depending on the nature of their claims. After holding that "[n]either the rights released or varied, nor the new rights given under the scheme were so dissimilar as to make it impossible [for] the creditors . . . to consult together with a view to their common interest," the English Court of Appeal upheld a single meeting of all the creditors and

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74 The equivalent of section 539 of the CAMA.

75 Sovereign Life Assurance Co. v. Dodd [1892] 2 QB 573, 583 (Eng.). In the United States, by virtue of the Bankruptcy Reform Act of 1978 (Bankruptcy Code), 11 U.S.C. § 1122(a) (1978), a reorganization plan may place a claim or an interest in a particular class only if such claim or interest is *substantially similar* to the other claims or interests of such class. Accordingly, all creditors of equal rank with claims against the same property should be placed in the same class. *In re* Martin's Point Ltd. P'ship, 12 B.R. 721 (1981).

76 [2001] 2 B.C.L.C. 480 (Eng.).

sanctioned the scheme under section 425 of the Companies Act of 1985.[77]

A rule of thumb is that every case should be decided on its facts. As these two cases illustrate, the application of the test is rather eclectic, particularly within broad groupings of members or creditors, such as unsecured creditors or preferred shareholders. Nevertheless, it is comforting to know that a few settled principles of law exist in this fuzzy terrain. For instance, where there are secured and unsecured creditors, separate meetings will usually be ordered.[78] Meetings of members and of creditors are also held separately. The inevitable conclusion, however, is that questions of classification will continue to be a thorn in the flesh of judges for quite some time to come.

D. Voting Requirements and the Importance of Disclosure

Apart from classification, the Act also allows members and creditors to be the architect of their commercial fate through its voting requirements. Section 539(2) provides for approval of the scheme by a majority representing no less than 75% in value of the shares held by members or of the creditors' interest.[79] This reliance on the will of the majority *in ascertaining the interest of the whole group* is absolute. There is no provision for discounting or disqualifying the votes of interested persons.[80] In addition, the approval requirement applies only to members and creditors "*present* and *voting* either in person or by proxy." Thus, with one narrow exception,[81] other members and creditors are deemed to lack sufficient interest in the outcome of the vote.

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77 *Id.* at 480. One of the factors that influenced the court's decision was the fact that no creditor sought to oppose the scheme in the application of the sanction. The issue of classification was raised by the court on its own. *See also id.* § 425.

78 *See* In re Bond Corporation Holdings Ltd. [1991] 5 A.C.S.R. 304. (Austl.).

79 *See* Bankruptcy Reform Act, 11 U.S.C. § 1126(c) (1978). In the case of creditors under the Bankruptcy Code, the United States treats 'majority' not only in terms of value of interest, but also in terms of creditors holding such interest. Thus, in addition to approval by two-thirds majority, there must also be approval by more than one-half in number of the allowed claims held by the creditors.

80 *Id.* Also referred to as "connected" or "related" persons. This includes shareholders and directors with significant interests as creditors.

81 *See* pg. 23, *infra*. Without notifying absentee members and creditors, if there are material changes to a proposed scheme at the time of the meeting, a court may refuse to sanction the scheme.

Under Section 540(1) of the CAMA, the notice summoning the meeting must be accompanied by a statement explaining the effect of the compromise or arrangement and, in particular, stating any material interests of the directors of the company (whether as directors, members or as creditors of the company or otherwise) and the effect of the arrangement or compromise on those interests in so far as it is different from the effect on the like interest of other persons. Where the reorganization affects the rights of debenture holders, subsection (2) of the same section requires the directors to provide similar explanation concerning the trustees of any deed for securing the issue of the debenture.

The Act adopts a disclosure-based system as the principal means of guaranteeing fair treatment of all the concerned parties. The logic is that, if adequately informed, stakeholders will be able to form a reasoned judgment as to whether to vote for or against a scheme. The required standard of disclosure was well enunciated by Judge Belgore in *In re Lipton of Nigeria Ltd*: "I consider the explanatory statement fair, giving reasonable and necessary information to enable each of its recipients understand the issue and enable him to vote with a clear mind."[82] Beyond this, however, there is little guidance for companies contemplating reorganization.[83] Each company has to decide for itself the kind of information to be revealed in the light of its peculiar circumstances. Where the information is subsequently found by the court to be inadequate, it would refuse to sanction the scheme.

E. The Process of Sanctioning by the Court

The second application to the court is one for an order sanctioning the proposed scheme. As Judge Chadwick stated in *In re BTR Plc*, "the court is not bound by the decision of the meeting. A favorable resolution at the meeting represents a threshold which must be surmounted before the sanction of the court can be sought."[84] At this stage, section 539(2) of the CAMA empowers

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82 [1985] FHCLR 113, 122 (Nig.).

83 In Australia, for example, Regulation 5.1.01(1) of the Corporations Regulations itemizes some of the matters that must be included in the explanatory statement. For an explanation, see paragraph 3.06 of the Policy of the Director concerning Arrangements under Section 192 of the Canada Business Corporations Act of 1998.

84 [2000] 1 B.C.L.C. 740 at 747 (Eng.).

the court to refer such a scheme to the Securities and Exchange Commission (SEC) which, in turn, is directed to "appoint one or more inspectors to investigate the *fairness* of the said compromise or arrangement and to make a written report thereon to the court within a time specified by the court."[85] The most important provision under this part of the CAMA[86] is arguably section 539(3). It stipulates the court's function during the sanctioning process. For the sake of clarity, the subsection is set out below:

> If the court is satisfied as to the fairness of the compromise or arrangement, it shall sanction the same and the compromise or arrangement shall be binding on all the creditors or the class of creditors or on the members or the class of members as the case may be, and also the company or in the case of a company in the course of being wound up, on the liquidator and contributories of the company.[87]

One thing is clear from the above provisions - the court has no power to sanction a scheme of arrangement unless it is satisfied as to its fairness. The Herculean task therefore is in determining when a scheme is fair. Because judges are not versed in corporate and commercial matters, the CAMA gives the SEC a prominent role in this area. While it is true that a major function of the SEC is the regulation of investments and securities business in Nigeria,[88] one has to wonder why the mandate was not bestowed upon the Corporate Affairs Commission (CAC) whose duty it is to administer the provisions of the CAMA including part XVI.[89]

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85 It is appropriate to mention at this stage that referral of questions of fairness to the SEC was introduced for the first time under the CAMA. According to the Law Reform Commission,

> The Courts through no fault of theirs are generally ill-equipped to determine to any degree of exactness whether such a scheme is actually fair or not. They lack the necessary economic and accounting skills. We feel that in such a situation the Courts should be in a position to refer such questions to experts in the field. We propose that the Court should refer such matters to the Securities and Exchange Commission, so that they may obtain expert and impartial report upon which to base their decisions.

See NIGERIAN COMPANY REPORT, *supra* note 1, at 244. This is the only one of two recommendations made by the Commission that is directly relevant for our purposes.

86 *See* CAMA, Pt. XVI (detailing arrangements and compromise generally).

87 CAMA, § 539(3).

88 *See* Investments and Securities Act, No. 45, section 8(a) (1999) (Nig.) [hereinafter ISA].

89 *See id.* § 7(1)(a); *see also* CAMA, § 539(4) (providing that an order of court

Perhaps the matter is one of pure expediency since the SEC is the sole regulatory body empowered to approve schemes of arrangement for the merger of two or more companies.[90] This issue is dealt with in part III.

In interpreting the equivalent English provisions, Judge Maugham in *In re Dorman, Long and Co. Ltd.* stated:

> It is plain that the duties of the court are two-fold. The first is to see that the resolutions are passed by the statutory majority in value and number . . . at a meeting or meetings duly convened and held. The other duty is in the nature of a discretionary power . . . . In my opinion, then, so far as this second duty is concerned, what I have to see is whether the proposal is such that an intelligent and honest man, a member of the class concerned and acting in respect of his interest, might reasonably approve.[91]

The objective test enunciated in this case is the test of fairness employed by the courts.[92]

With the newly carved out role for the SEC, it is yet to be seen whether or not the courts will become more laidback in the sanctioning process. This aside, a court has considerable discretion in sanctioning or withholding sanction from a scheme. In scrutinizing the voting process, "the court must see that the class was fairly represented by those who attended the meeting and that the statutory majority are acting *bona fide* and are not coercing the minority in order to promote interests adverse to those of the class whom they purport to represent."[93] Where the court

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sanctioning a scheme has no effect until a certified true copy of the order is delivered to the CAC for registration).

90 *See* ISA, §§ 100(2)–(3). These provisions were formerly under Pt. XVII of the CAMA before it was repealed by ISA.

91 [1934] Ch. 635, 655-57 (Eng.).

92 *See* In re Lipton of Nigeria Ltd., [1985] FHCLR 113, 122 (Nig.); In re Cheseborough Prod. Indus. Ltd. and Lever Brothers Nigeria Ltd., Suit No. FHC/L/M49/88 (Unreported).

93 *In re* Alabama, New Orleans, Texas & Pacific Ltd. [1891] 1 Ch. 213, 239. (Eng.). In *In re Cheseborough Products Industries Ltd.*, Judge Belgore also stated that the pattern of voting will not be accepted at its face value "if a large percentage of the majority shareholders that approved the scheme are shown to be in a position to gain a disproportionate advantage from the scheme than other members of the class by reason of their interest in some other capacity."

feels that the majority did not decide the case in good faith, it may refuse to sanction the scheme.[94] In the absence of any statutory provision disqualifying the votes of interested persons, this inquiry is perhaps the only protection available to the minority.

The court, however, is usually reluctant to substitute its own judgment for that of the majority and will hardly do so where the majority has made adequate disclosure of other interests. Accordingly, in *In re London Chartered Bank of Australia*, the court opined that:

> if the creditors are acting on sufficient information and with time to consider what they are about, and are acting honestly . . . they are much better judges of what is in their commercial advantage than the court can be. . . . [T]he court ought to be slow to differ from them. It should do so without hesitation if there is anything wrong; but it ought not to do so, unless something is brought to the attention of the court to show that there has been some material oversight or miscarriage.[95]

As previously mentioned, another ground for refusing to sanction a scheme is failure by a company to provide adequate explanatory material in the statement accompanying every notice summoning the statutory meeting or meetings. Apparently, this omission is taken quite seriously by the Act because section 540(4) provides that where a company makes default in complying with the requirement, the company and every officer in default, including any liquidator of the company, shall be liable to a fine. However, the cases show that the courts are considerably flexible on this issue, and the extent of information required to be disclosed

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94 *See* Bankruptcy Reform Act, 11 U.S.C. § 1126(e) (1978). In the United States, the court may discount any acceptance or rejection not in good faith at the request of a party in interest.

95 [1893] 3 Ch. 540, 544-45. (Eng.) (quoting *In re* English, Scottish, and Australian Charted Bank [1893] 3 Ch. 385 (Eng.)); *see also In re* Hoare and Co. Ltd. [1933] 150 L.T. 374 (Eng.). In the context of compulsory acquisition of the shares of minority shareholders, Judge Maugham had the following to say:

> [T]he court ought to regard the scheme as a fair one inasmuch as it seems to me impossible to suppose that the court, in the absence of very strong grounds, is to be entitled to set up its own view of the fairness of the scheme in opposition to so very large a majority of the shareholders are concerned.

Id.

in each individual case must be decided on its facts. For an omission to be relevant, it must be of such magnitude that it would materially affect the pattern of voting.[96]

Courts also take into consideration the issue of classification in the sanctioning process. In *In re Bond Corp. Holdings Ltd.*,[97] Judge Owen held that in determining classes of creditors, the court must balance the danger of a compromise being forced on dissenting creditors by a majority against the danger of a minority of creditors having the power to veto a scheme. One problem with classification is the risk of over-classification which may lead to inefficient hold-ups. The interests of individual members or individual creditors will not usually be identical. The test of "dissimilarity making it impossible to consult together with a view to a common interest" is rather vague and is bound to produce different results with different judges. In drawing the line in individual cases, the court must identify the underlying legal character of the rights and obligations of the concerned parties against the company, and must assess the way in which those rights will be affected in the implementation of the scheme.[98]

As a scheme need only be approved by a three-fourths majority in value of the shares of members or interest of creditors *being present and voting*, courts are usually vigilant in scrutinizing amendments made at the meeting. Thus, if there is a material change not brought to the prior notice of the non-attending shareholders, the court will not sanction the scheme unless it is satisfied that no reasonable shareholder would alter his decision as to how to act on the scheme if the changes had been disclosed.[99]

Recall that the definition of "arrangement" under section 537 of the CAMA does not include certain changes "effected under any other provision of [the Act] or by the unanimous agreement of

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96 *See* In re Heron International NV [1994] 1 B.C.L.C. 667. (Eng.).

97 (1991) 5 A.C.S.R. 304 (Austl.).

98 *Id.* In *In re Osiris Insurance Ltd.*, 1 B.C.L.C. 182 (1999) (Eng.), creditors who were holders of different types of insurance policies with the applicant company were held to belong to the same class because their interests were similar under the proposed scheme.

99 *In re* Adams Int'l. Food Traders Pty. Ltd. (1988) 13 A.C.L.R. 586, 590 (Austl.). *See also In re* Minster Assets Plc, (1985) B.C.L.C. 200 (Eng.); *In re* Jessel Trust Ltd., (1985) B.C.L.C. 119 (Eng.).

all parties affected thereby."[100] This provision has the effect of taking away the power of a court to sanction a scheme covered by another section of the Act unless there is compliance with the additional requirements of that section. A good example is in the case of an arrangement or compromise involving a reduction of capital. In such a case, a company is obliged to observe the provisions of sections 105 through 111 of the Act.[101] Another example is a scheme having the effect of converting a limited liability company to an unlimited company.[102] Section 51 sets out an elaborate and mandatory procedure for accomplishing this task.[103]

The doctrine of *ultra vires* also limits the power of the court in the sanctioning process. It is said that a court has no power to sanction an unlawful or *ultra vires* arrangement or compromise.[104] However, if an *ultra vires* scheme is inadvertently approved by the court, the order of court remains valid until it is set aside by another valid judicial process.[105] The corollary of the latter principle is arguably that the court *is* vested with the power to sanction an *ultra vires* scheme (but not an unlawful scheme). All the same, a court will be hard-pressed to sanction a scheme which is manifestly *ultra vires*, particularly in the face of strong opposition.

By way of judicial construct, it is submitted that a court will be inclined to apply something akin to the *feasibility test* as adopted in the United States[106] in cases involving a 'hopelessly insolvent'

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[100] CAMA § 537.

[101] These sections prescribe the procedure to be followed by a company proposing a reduction of its share capital.

[102] *See* Australian Sec. Comm'n. v. Marlborough Gold Mines Ltd. (1993) 177 C.L.R. 485 (Austl.); *see also In re Glendale Land Dev. Ltd.* (1982) 7 A.C.L.R. 171 (Austl.).

[103] *See* CAMA, § 51.

[104] *See In re Oceanic Steam Navigation Co. Ltd.*, Ch. 41 (1939) (Eng.); *see also* re Northumberland Ins. Co. Ltd. (No. 3) (1977) 3 A.C.L.R. 15.

[105] *See* Barclays Bank v. British & Commonwealth Holdings Plc., B.C.C. 19 (1995); *aff'd.* British & Commonwealth Holdings Plc. v. Barclays Bank, 1 W.L.R. 1 (1996) (Eng. C.A.); *see also* Nicholl v. Eberhardt Co. Ltd., 1 Meg 402, 59 L. J. Ch. 103 (1889) (Eng. C.A.).

[106] The U.S. Bankruptcy Code, 11 U.S.C. §1129(a) (1978), provides that the court will not confirm a reorganization plan if it is likely to be followed by liquidation or further reorganization.

company.[107] In *In re The South Melbourne Club Ltd*,[108] an Australian court refused to grant an order convening the meetings of members and creditors on the ground, *inter alia*, that it was "impossible to say that [the] scheme [was] 'perfectly safe' or that the public in the future would not be caused to suffer further financial loss."[109] Even though it is not expressed in the Act, the power to "scrutinize the scheme . . . is implicit in the inherent power of the court and it can be invoked even if there is no opposition to the scheme. . . ."[110] The above proposition is essential not only to avoid inefficient recurrence of restructuring, but also to prevent the abuse of the statutory regime aimed primarily at facilitating the earliest recovery of insolvent companies.

F. Effect of Court Approval

An order of court sanctioning the proposed scheme takes effect upon delivery by the company of a certified true copy of the order to the CAC for registration.[111] It operates as to bind "*all* the creditors or the class of creditors or . . . the members or the class of members *as the case may be*, and also the company or in the case of a company in the course of being wound up . . . the liquidator and contributories of the company."[112] A literal interpretation of this provision would seem to suggest that only those members and creditors who are summoned to the meetings or class meetings will be bound by the scheme. However, in *In re Tea Corporation Ltd.*,[113] the court held that members (and creditors) excluded from the court-ordered meetings on the ground that their rights were not affected (unaltered) by the scheme were nevertheless bound by it.

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107 *See* TOMASIC & BOTTOMLEY, *supra* note 35, at 126-32.

108 (1983) 1 A.C.L.C. 1063 (Austl.); *see also* re Mascot Home Furnishers Pty. Ltd. (1970) V.R. 593 (Austl.).

109 (1983) 1 A.C.L.C. 1063, 1068 (Austl.)

110 *In re* Cheseborough Prod. Indus. Ltd. and Lever Brothers Nigeria Ltd., Suit No. FHC/L/M49/88 (Unreported). Admittedly, the learned Judge in this case was referring to the power of a court to go behind a statutory majority in investigating the fairness of a scheme. However, it is submitted that the principle also applies in the above scenario with equal force.

111 CAMA § 539(4).

112 *Id.* § 539(3).

113 1 Ch. 12 (1904) (Eng. C.A.).

The rights of claimants will be deemed unaltered in two circumstances – where there is proof that they (usually subordinate claimants) are not entitled to anything under an arrangement which contemplates liquidation because the assets of the company are insufficient to satisfy all claims and where their claims are to be settled fully. In the latter case, it is said that the claim or interest is not *impaired*.[114] In both cases, it is possible to exclude the claimants from the meetings.

Quite expectedly, this power of the court to bind disenfranchised claimants is exercised with extreme caution. In one case, the court refused to exclude stockholders from the meetings even though it was highly unlikely that they would be entitled to participate in any distribution of assets upon satisfaction of the preferential claims of the creditors.[115] The court was reluctant to proceed on this basis without some form of concession by the excluded group that such non-entitlement was indeed the case.[116] Furthermore, where a class of claimants is wrongfully excluded from the meetings, such a class will not be bound by the scheme and the rights of the claimants will not thereby be affected.[117] An example is where a class is excluded on the basis of non-impairment when, in fact, it is required to give up certain rights under a proposed scheme.

Given that it is essentially a contract between a company and its members and creditors, a scheme of arrangement could have varied effects depending upon its terms. It could lead to the loss of priority hitherto enjoyed by the secured creditors or make provision for the contribution of new value to the company. This way the parties have total control over its provisions subject to the

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114 *See also* U.S. Bankruptcy Code, 11 U.S.C. §1124 (1978).

115 *See In re* British & Commonwealth Holdings Plc. (No. 3), 1 W.L.R. 672, 680 (1992) (Eng.).

116 *See id.* The Court held that:

> The claim that there is even a remote possibility that sufficient [assets] might be realized in the course of the administration or in a winding up to meet the claims of the scheme creditors in full seems to me to verge on the fanciful. However, in the absence of any concession, I cannot in this application proceed on the assumption that there is no possibility that the claims of the scheme creditors will be met in full. (Vinelott, J.)

Id.

117 *See* Sovereign Life Assurance v. Dodd, 2 Q.B. 573 (1892) (Eng. C.A.).

constraint of according fair treatment to all the claimants. Hence,

> it is the duty of the Court before sanctioning a scheme of arrangement which would have the effect of binding [dissenting] members of a class to give up legal rights, to be satisfied that sensible business people might reasonably consider the scheme was for the benefit of that class as such.[118]

G. Implementation and Termination of the Scheme

Unless the company is already in liquidation, the board of directors will normally be in charge of implementing the terms of the approved scheme. However, in view of its contractual nature, it is possible to provide for the scheme to be supervised by an independent person. At the proposal stage, this *debtor-in-possession* model is different from what occurs in the United States. Whereas any interested party may initiate an arrangement or compromise in Nigeria, only a debtor company in the United States is permitted to file a plan of reorganization within a specified period of exclusivity.[119] At the level of implementation, the practice in both jurisdictions is similar.

Usually, a scheme will provide for its own termination and, prior to such termination, it may be modified by a subsequent scheme which receives the sanction of the court.[120] While it is still in operation, the rights of claimants bound by its provisions must be derived solely from the scheme. In other cases involving either a failed scheme or a "once for all" scheme, the natural approach is to hold claimants bound only to the extent that timely payments of the various sums due to them under the scheme are made.[121] Where there is failure to make payment when due and, in the absence of any provision for extension, the parties must revert to the pre-arrangement position.

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118 *In re* Chevron (Sydney) Ltd. (1963) V.R. 249, 254 (Austl.).

119 *Cf.* CAMA § 539(1) and the U.S. Bankruptcy Code, 11 U.S.C. §1121 (1978).

120 This is the only way of altering a scheme prior to its termination. *See In re* Gasweld Pty. Ltd. (1986) 5 N.S.W.L.R. 494 (Austl.). *See also* Srimati Premila Devi v. Peoples' Bank of Northern India, 4 All E.R. 337 (1938) (Eng. P.C.) (appeal taken from Lahore H.C.).

121 *See In re* Master Butchers Ltd. (1976) C.L.C. 40-260 (Austl.).

III. Perceived Problems

A. The Corporate Environment in Nigeria and Access to Capital

There are two broad groupings of companies allowed to be incorporated in Nigeria: public and private companies.[122] A private company is a company – usually a small company – with less than fifty members,[123] a minimum authorized share capital of ₦10,000.00,[124] and articles of association restricting the transfer of shares.[125] For such a company, it is unlawful to raise capital publicly, be it equity or loan capital.[126] On the other hand, a public company – being typically a large company – is required to be registered with a minimum authorized share capital of ₦500,000.00. Subject to compliance with other provisions of the Investments and Securities Act of 1999 (ISA), a public company is also permitted to source its funds directly from the public.

The Act itself defines a small company as a private company having a share capital with a yearly turnover of not more than ₦2 million and net assets of not more than ₦1 million.[127] For our purposes, strict adherence to this definition is not necessary. The point to be made is that most Nigerian companies are characteristically small whether in terms of turnover, assets, or revenue. These small companies considerably lag behind the large public companies in competing for scarce resources. A reporter captured the apparent imbalance when he noted:

> [w]ith hundreds of small companies forced to close in recent years by the deterioration in economic conditions,

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122 CAMA § 21(2). Also, by section 21(1), there are three types of companies: a company limited by shares, a company limited by guarantee and an unlimited company.

123 Not including persons who are *bona fide* in the employment of the company, or were while in that employment and have continued after the termination of that employment to be, members of the company. *See* CAMA § 22(3).

124 CAMA § 27(2)(a). This is roughly the equivalent of $75.00.

125 *Id.* § 22(2).

126 ISA § 44(1); *see also* CAMA § 22(5). In addition, one of the requirements for listing on the Nigerian Stock Exchange is that the company to be listed must be registered as a public limited liability company under the CAMA.

127 CAMA §§ 650, 351. Furthermore, the membership must not include aliens, governments or government corporations or agencies and the directors must hold not less than 51% of the equity share capital. *See* CAMA § 351(1)(d)-(f).

> especially inadequate credit, rising production costs and diminishing consumer demand, the capacity of the economy to provide full-time employment has diminished. . . . [M]any banks are still reluctant to extend credit to small- and medium-scale producers and prefer to lend to big businesses and engage in foreign-exchange related transactions.[128]

Sadly, the banking sector continues to be rather unsympathetic towards the plight of small companies. Even when some banks are willing to extend credit to these companies, by the statutorily mandated requirement of obtaining adequate security before loan disbursement, a hurdle is created.[129] Invariably, this has the effect of disqualifying the majority of small companies, which have little or no assets to offer as collateral. In one sentence, the hostile operating environment for the typical Nigerian corporation not only demands prudent and efficient use of scarce resources; it also demonstrates the need to develop a proactive insolvency regime to instill confidence in corporate lenders. These factors have to be taken into consideration in fashioning a corporate reorganization regime that is best suited to local circumstances.

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128 TUNDE OBADINA, *Nigeria's Economy at the Crossroads: New Government Faces a Legacy of Mismanagement and Decay*, AFRICA RECOVERY, UNITED NATIONS, June 1999, at 13, 14, *available at* http://www.un.org/ecosocdev/geninfo/afrec/subjindx/subpdfs/131nigr.pdf; *see also* FARRAR, *supra* note 9, at 523 ("Small firms are at a greater disadvantage than larger firms in raising finance. External equity finance is difficult to find . . . . Loan capital is more expensive and the security requirements are more onerous.").

129 The Banks and Other Financial Institutions Act (No. 25) § 20(1)(b) (1991) provides,

> A bank shall not, without prior approval in writing of the [Central Bank of Nigeria], grant . . . any unsecured advances, loans or credit facilities unless authorized in accordance with the bank's rules and regulations and where any such rules and regulations require adequate security, such security shall be provided or, as the case may require, deposited with the bank.

Even more profound is the Failed Banks (Recovery of Debts) and Financial Malpractices in Banks Act (No. 18) § 19(1)(a) (1994) which provides that

> any director, manager, officer or employee of a bank who knowingly, recklessly, negligently or willfully or otherwise grants, approves or otherwise connected with the grant or approval of any credit facility without adequate security or with no security as normally required, or with a defective security, or without perfecting a security is guilty of an offense punishable with five years imprisonment without an option of fine.

B. *A Word on Alternative Regimes*

Depending on whether rescue or recovery of debt is the objective, there are some other options open to creditors and members of a distressed company, such as putting the company into liquidation or receivership or merging it with another company. Suffice it to say at this point that these options should not be viewed as *substitute regimes*, but rather as *alternative regimes*. According to David Brown, one of the goals of corporate insolvency law should be to provide "a 'menu' of procedures from which creditors, directors and others and/or the court can select."[130] In analyzing these procedures, it is essential to consider the extent to which they reinforce the individual strengths and weaknesses of one another.

1. *Receivership*

A receiver of any property of a company is a person appointed by the court or pursuant to a power under a debt instrument (debenture), to take possession of and protect the property, receive the rents and profits, recover the interest due and discharge all ascertained outgoings. But, unless he is also appointed as a manager, he will not have any power to manage the property, in the sense of buying and selling or carrying on the debtor's business.[131] The terms of a debenture usually spell out the circumstances in which a receiver or manager can be appointed. If, for instance, the principal amount borrowed, or the interest thereof, is in arrears or the security or other assets of the company are at risk, a receiver or manager may be appointed under standard terms.[132] Another standard term is that a demand for repayment has not been met.

As from the date of appointment of a receiver or manager, the powers of the directors to deal with the property or undertaking over which he is appointed will cease until such time as he is discharged.[133] Whereas a receiver or manager appointed by the

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130 BROWN 1996, *supra* note 24, at 17.

131 CAMA § 393; *see also In re* Manchester and Milford Ry. *Co.*, 14 Ch. D. 645, 653 (1880) (Eng.).

132 *See id.* § 389 on grounds for appointment by the court.

133 *Id.* § 393(4). The powers of liquidators in a members' voluntary winding up shall also cease until the receiver or manager is discharged. *Id.*

court is deemed to be an officer of the court, a receiver or manager appointed out of court is deemed to be an agent of the person or persons on whose behalf he is appointed.[134] A manager of the whole or any part of the undertaking of a company stands in a fiduciary relationship to the company and is obliged to act in its best interests as a whole so as to preserve its assets, further its business, and promote the purposes for which it was formed.[135] A receiver is also bound by prior encumbrances over the property he is to administer.[136]

One advantage of receivership is the fact that heavy reliance on the court for direction or guidance is absent. The freedom given to parties to determine the *modus operandi* unclogs the whole system and ensures that the procedure is a speedy one. In addition, because a receiver or manager "has the power to step into the shoes of the directors and continue to manage the business of the company as a going concern,"[137] receivership holds a measure of attraction as a rescue device. It also allows creditors to take immediate steps to ensure that their exposure is not increased after an initial default.

There are, however, quite a number of demerits. First, any rescue agenda is greatly undermined by the fact that a receiver (appointed out of court) is an agent of the person or persons on whose behalf he is appointed. It goes without saying that it is to this person or persons, and not the company, that he owes his allegiance.

Second, the procedure is often a forerunner to liquidation in at least two senses: (a) as a practical matter, the receiver will often not realize sufficient funds to pay his appointer in full and the company will proceed to liquidation; and (b) the appointment of a receiver does not impose a moratorium on other creditors and in fact may act as a catalyst galvanizing them into action by putting the company into liquidation.[138]

Third, in spite of the extensive powers given to a receiver or

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134 *Id.* §§ 389(2), 390(1).

135 *Id.* § 390(2). The test for determining what is "in the best interests of the company" is a subjective one.

136 *Id.* § 393(1).

137 BROWN 1996, *supra* note 24, at 20.

138 FARRAR, *supra* note 22, at 663-64.

manager under the CAMA,[139] he has no power to investigate any allegations of fraud, incompetence, mismanagement or irregularity in the management of the affairs of the debtor company.[140] In cases where such information is needed to facilitate the process of rescue, a serious handicap may indeed be occasioned by the omission.

Finally, the irrepressible issue of cost must be mentioned. By and large, it is the company's responsibility to pay for the costs of appointing a receiver though it is possible to make an application to the court to fix the amount to be paid by way of remuneration to the receiver.[141] A 1997 survey of forty-three small business receiverships carried out in New Zealand concluded the direct costs of receivership were approximately 23.5% of receivership proceeds.[142] An English Judge surmised the whole situation in the following words:

> Having . . . set out the figures objectively I cannot escape saying that I find them profoundly shocking. If the amounts claimed are allowed in full, this receivership will have produced substantial rewards for the receivers and their lawyers and nothing at all for the creditors of the estate. I find it shameful that a court receivership should produce this result . . . .[143]

In conclusion, receivership remains an attractive option for companies with a small number of creditors – especially secured creditors. However, with the exception of liquidation, it holds the least attraction as a rescue mechanism because its primary purpose is the management of property with a view to the beneficial realization of the security of those on whose behalf the receiver is appointed.[144] This statutorily created agency certainly makes it

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139 *See* CAMA § 393. *See also* CAMA sched. 11 (entitled "*Powers of Receivers and Managers of the Whole or Substantially the Whole of Company's Property*").

140 *See* CAMA § 393. *Cf.* 11 U.S.C. § 1104(c) (2000).

141 *See* CAMA § 395(1).

142 See Ed Vos & Philippa Webber, *Impact of Receivership Costs on the Optimal Capital Structure for Small Businesses*, *at* http://www.sbaer.uca.edu/Research/1999/ICSB/99ics227.htm (1997) (on file with the North Carolina Journal of International Law and Commercial Regulation).

143 Mirror Group Newspapers v. Maxwell (No. 2), [1998] 1 B.C.L.C. 638, 645 (1998).

144 *See* CAMA § 393(2).

difficult for the receiver to serve two masters – his principal and the company – at the same time.

2. *Liquidation*

One key distinguishing factor between liquidation and receivership is that, unlike his counterpart in liquidation, a receiver is under no obligation to act for the general body of creditors. Liquidation is the legal process of winding up the affairs of a company through the realization of its assets to discharge its liabilities and the distribution of any surplus to the shareholders. It is a "means of ending the legal life of [a] company."[145] While it is true that liquidation leads to the death of a *company*, it should be noted that it does not always entail the death of its *business*. Section 425(2)(a) of the CAMA vests the liquidator of a company with the power to sell the business as a going concern.[146]

There are basically two modes of winding up: compulsory and voluntary.[147] In the former, creditors and members (referred to as contributories) are able to present a petition to the court for the winding up of a company on grounds, *inter alia*, of inability of the company to pay its debts.[148] On the other hand, a company may be wound up voluntarily upon the passing of a resolution to that effect.[149] In addition, depending on whether the company is solvent or insolvent, the winding up could be either a member's voluntary winding up or a creditor's voluntary winding up.[150]

Following the appointment of a liquidator, all the powers of

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145 ASOMUGHA, *supra* note 71, at 377.

146 CAMA § 425(2)(a); *see also* CAMA § 481(1)(b).

147 *See id.* § 401(1). Section 401 provides for three modes: winding up by the court or compulsory winding up; voluntary winding up; and winding up subject to the supervision of the court. The third mode is essentially a winding up which begins voluntarily, but ends up being supervised by the court. *See id.*

148 *See id.* § 408(d). Other grounds for compulsory winding up are where: (a) a special resolution that the company be wound up is passed; (b) default is made in delivering the statutory report or in holding the statutory meeting; (c) the number of members is reduced below two; and (d) the court is of the opinion that it is just and equitable that the company should be wound up. *See id.*

149 *See id.* § 457. If the articles provide that the company shall be dissolved upon the expiration of a fixed period of time or on the happening of a specific event, an ordinary resolution will suffice after the period has expired or the event occurred. In all other cases, a special resolution is required. *Id*

150 *See id.* § 462.

the directors will cease and the liquidator will then become vested with the power to carry on the business of the company so far as may be necessary for its beneficial winding up.[151] Quite often, the liquidator is paid a percentage of the liquidation proceeds, the cost of which is borne by the liquidating company. In view of the provisions of section 494, certain preferential payments – such as income tax deductions, wages, or salary of any employee for services rendered to the company, and accrued compensation for injuries suffered in the course of employment by workmen – have to be made before there can be any repayment of a debt.[152]

Liquidation is hardly considered to be a rescue procedure. Indeed, it has the exact opposite effect. Vis-à-vis other insolvency procedures, its main limitation is that as a result of the stigma society attaches to firms being wound up, it leads to systematic "under-pricing" of the assets of those firms.[153] Hence, whether the assets are sold off piecemeal or as a going concern, the tendency is that they will be grossly undervalued. Another major disadvantage of liquidation is that it gobbles up a sizeable portion of the liquidation proceeds as administrative expenses. Needless to say, the procedure is unduly elaborate under the present scheme. It involves a number of court applications as well as the convening of several general meetings of members and/or creditors.

Nevertheless, liquidation continues to be the only sensible option for companies that are hopelessly insolvent. Rather than allow such companies to become a burden to society, liquidation offers creditors (whether secured or unsecured) an opportunity to intervene in order to minimize their losses and maximize their returns. Not to be left out is the power of a liquidator to investigate offences of fraud committed by officers (both past and present) within twelve months of the commencement of winding up and thereafter.[154] Yet another advantage of liquidation is the moratorium it provides against other enforcement actions by

151 *See id.* § 425(1)(b); *see also id.* § 489(2).

152 CAMA § 494.

153 Concealment of the fact that it is undergoing liquidation is not an option: section 512 of the CAMA provides that where a company is being wound up, every invoice, order for goods or business letter issued by or on behalf of the company, being a document on or in which the name of the company appears, shall contain a statement that the company is being wound up. Failure to comply constitutes a criminal offence.

154 *See* id. §§ 502, 508(2).

creditors, thereby preventing a race to the courthouse syndrome.[155]

3. *Mergers and Acquisitions*

A distressed company could also merge with or be acquired by another company. A merger is an "amalgamation of the undertakings or any part of the undertakings or interest of two or more companies."[156] This wide definition appears to include a "take-over," the acquisition by one company (bidder) of sufficient shares in another company (target) to give the bidder control over the target.[157] It seems that while the term "merger" is used to denote a friendly acquisition, a "take-over" often implies a hostile or unilateral acquisition. This aspect of corporate reorganization is regulated largely by the Investments and Securities Act of 1999 (ISA).

Under Nigerian law, the following are the legal vehicles for effecting a merger or take-over: (a) private treaty for the sale of control blocks; (b) reconstructions under section 538 of the CAMA involving the voluntary winding up of a company followed by a transfer of its business to another company; (c) reconstructions involving a scheme of arrangement (under section 539 of the CAMA) which must be approved by the shareholders of each of the merging companies;[158] (d) reconstructions in pursuance of a compromise or arrangement under section 100 of the ISA; (e) stock market purchases; and (f) take-over bids as regulated by sections 103 to 122 of the ISA.[159]

One question is – what does any company stand to gain by merging with or acquiring another company in distress? The answer lies in the possible existence of operating, financial, and managerial synergy gains which may arise from economies of scale and scope.[160] The *product/market-portfolio model* developed

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155 *See id.* §§ 414, 488.

156 *Id.* § 590 (now repealed). It is curious that this definition of merger was somehow left out of section 99 of the ISA, the provision that replaced section 590.

157 ISA § 99(1) (1999).

158 *See generally In re* Lipton of Nigeria Ltd., [1985] FHCLR 113, at 122-23 (Nig.).

159 See TUNDE OGOWEWO, *The Market for Corporate Control and the Investments and Securities Act 1999*, THE BRITISH INSTITUTE OF INTERNATIONAL AND COMPARATIVE LAW OCCASIONAL PAPER NO. 4, at 19-30 (2000).

160 On the meaning of these terms, see RONALD GILSON & BERNARD BLACK, THE LAW AND FINANCE OF CORPORATE ACQUISITIONS 268-89 (2d ed. 1995).

by the Boston Consulting Group gives an insight into how such synergies can be created. Expounding on the model, Salter and Weinhold are of the view that there are four business categories, each having its own pattern of cash generation and use: the *Stars* are relatively self-sufficient companies with high cash use and generation, the *Cash Cows* are the net providers of cash because they are only able to use little of the high cash flows they generate in their low-growth market, the *Question Marks* are ventures which require a great deal of cash for investment in a high-growth market, and the *Dogs* are non-viable businesses with low cash generation in a low-growth market.[161] The idea is that while it makes economic sense for a *Dog* to be liquidated, the cash flow generated by a *Cash Cow* could be used to boost the market share of a *Question Mark* and possibly turn it into a *Star.*[162]

A *Cash Cow* and a *Question Mark* will therefore be good merger candidates provided the former possesses the requisite "accumulated experience" needed to increase production volumes at declining costs.[163] The model is certainly more relevant in a country where the capital market is relatively undeveloped (like Nigeria) than in a country with a developed capital market which facilitates the raising of capital at relatively low costs. One major disadvantage, however, is that it depends on several external factors beyond the control of a company in distress, such as the requirement of a high-growth market and the need for participation by an *interested acquiring Cash Cow with accumulated experience.* With such fortuitous preconditions, successful mergers and acquisitions will turn out to be more of an exception than the rule itself.

C. *Two-Pronged Approach*

This paper seeks the introduction of an alternative approach to

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[161] MALCOLM SALTER & WOLF WEINHOLD, DIVERSIFICATION THROUGH ACQUISITION: STRATEGIES FOR CREATING ECONOMIC VALUES 65-78 (1979).

[162] *Id.*

[163] *See id.* at 66-67. "Accumulated experience" encompasses knowledge relating to: (1) labor efficiency; (2) new processes and improved methods; (3) product redesign that conserves material, allows greater efficiency in manufacture, and takes advantage of less costly resources; (4) product standardization; and (5) scale effects. Cash generation is said to be a function of accumulated experience, while cash use is a function of market growth. *Id.* at 67.

corporation reorganization in Nigeria. As stated in the introductory part, the underlying principles (of efficiency and equity) behind the new approach are: (a) the creation of an enabling environment for the development of an optimal reorganization plan that maximizes the chances of an insolvent (or nearly insolvent) company, or as much as possible of its business, *successfully* continuing in existence; and (b) the fair treatment of all the parties directly affected by the plan.[164] The efficiency question is addressed from the perspective of both *ex ante* and *ex post* consequences of the reorganization process. The most fundamental expression of the efficiency principle is that *reorganization should be pursued if and only if the value of the reorganized firm will be greater than the value of the firm if liquidated.* Where this is not the case, other options such as liquidation should be considered. In addition to the need to maximize the size of the pie, the requirement of fair treatment is imposed in order to ensure the equitable treatment of all parties. This element has *ex ante* effects on the ability to attract capital.

According to Lucian Bebchuk, in order to maximize the total value of the company's assets *ex post*, it is desirable that as little value as possible is dissipated during the reorganization process and that the company's assets are allocated to their highest-valued use.[165] Mark Roe has also suggested three principal characteristics desirable for a reorganization mechanism: speed, low cost, and a resulting sound capital structure.[166] Consequently, any alternative procedure should be as short and inexpensive as possible, particularly in light of the relatively small size of the purse of most Nigerian companies. Overly elaborate and expensive procedures will probably be shunned by these companies and explain why the rescue procedure is rather unpopular at the moment. A company undergoing reorganization should also emerge with the least burdensome capital structure.

Other hallmarks of a good corporate reorganization regime are certainty and fairness. In its report, the Cork Committee stated that one of the aims of modern insolvency law is the distribution

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164 *Cf.* Corporations Act of 2001, Pt. 5.3A, § 435A(a) (Austl.).

165 *See* LUCIAN ARYE BEBCHUK Pt. 11, at 2 (Nat'l Bureau of Econ. Research, Working Paper No. 6473, March 1998).

166 MARK J. ROE, *Bankruptcy and Debt: A New Model for Corporate Reorganization*, 83 COLUM. L. REV. 527, 529 (1983).

of proceeds amongst creditors in a fair and equitable manner, returning any surplus to the debtor (company and shareholders).[167] Admittedly, the notion of fairness is quite elusive. It entails doing what is just and equitable *ex post*, that is, at the point of reorganization. For instance, the process would indeed be *unfair* if certain classes are made much better off at the expense of others who end up worse off. Matters of certainty and fair treatment are given considerable weight by investors in deciding whether or not to part with their funds and, therefore, have significant *ex ante* implications. Without doubt, a system which guarantees members and creditors greater control over the whole reorganization process will go a long way in satisfying these goals.

In view of the foregoing, this paper shall take the following position: creditors and shareholders should be given the autonomy to decide the fate of their investment with as little outside interference and as much predictability as possible. Indeed, this should always be the case so long as the process of decision-making is an *informed* one. This means that each individual creditor or shareholder must be made to understand not only the effect of a proposed plan of reorganization, but also the underlying interests, motives, and concerns of all the other parties. A direct consequence of this increased ability to exercise considerable *ex post* control over the state of affairs of a distressed company is that many investors will more readily be swayed into parting with their funds. Such a regime will foster greater cooperation between creditors and debtor companies with the overall objective of facilitating corporate turnaround. How does the present regime fare under these standards? Not very well.

D. Cost Problems

The last thing an insolvent company has to throw around is *money*, the lack of which is the reason for its insolvency in the first place. At this stage in the life of any company, prudent and justifiable spending is (or should be) the order of the day. Undergoing reorganization will only make sense if more value can be generated through the process than through liquidation. In computing the excess value, both direct and indirect costs of reorganization have to be taken into account. Reorganization

167 *See* CORK COMMITTEE REPORT, *supra* note 16, Pt. 4.

becomes an undesirable option when such costs exceed the potential benefits. Research has shown that these bankruptcy costs are more significant for small companies than large ones.[168] From this cost analysis perspective, it is easy to see why, despite over thirty-five years of existence, arrangements and compromise continue to be a redundant area of corporate law in Nigeria.

Prominent on the list of expenditures are expenses involving two court hearings and engagement of outside counsel and the convening of the court-ordered meeting or meetings. These expenses could easily run into millions of Naira or other amounts beyond the reach of small companies in financial distress. At least one writer has questioned the need for a first application to court, describing it as "unnecessary and wasteful."[169] Others have leveled criticisms on the "high degree of court control, especially as much of this is 'rubber-stamping.'"[170] In order to realize the objectives of rescue, a balance has to be struck between the need to have an inexpensive procedure and the need for supervision by a competent authority (e.g. a court or an insolvency expert), both of which are relevant from efficiency and fairness perspectives. While it is desirable to minimize costs by limiting the level of outside interference, there is a lot to be said in favor of an independent body which acts as a check to ensure that values are maximized and parties are accorded fair treatment.

E. Speed

More mature jurisdictions have long discovered that the scheme of arrangement procedure is unsuitable for small companies and that "by no stretch of the imagination could [it] be said to represent an emergency response to a company in distress."[171] Speed in this sense entails not only prompt treatment,

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168 *See* VOS & WEBBER, *supra* note 142.

169 ASOMUGHA, *supra* note 71, at 411. Even though the learned author made this criticism in the specific context of arrangements and compromise proposed for the merger of companies, his reasoning also commends itself to the present discourse.

170 BROWN 1996, *supra* note 24, at 641; *see also* CORK COMMITTEE REPORT, *supra* note 16, Pt. 7.

171 Milman, *supra* note 8, at 416. *See also* TOMASIC & BOTTOMLEY, *supra* note 35, at 160. US Federal legislators were particularly concerned about "the patient [dying] on the operating table while the lawyers are diagnosing." H.R. REP. NO. 95-595, at 229 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5787, 6189.

but also early diagnosis; not only timely cure, but also prevention. The procedure fails on both scores. It requires a company to be insolvent (or in liquidation) in order to take (dis)advantage of its provisions. Apart from being counter-intuitive, this requirement is bound to produce some inefficiencies. Under such a system, the board of a solvent company in financial difficulty is denied the ability to act quickly to prevent a further shrinking of the pie.

From conception to approval by the court, a scheme of arrangement could easily take a period of up to one year. Some of the activities that will be carried out within this timeframe are: (a) preparation of an explanatory statement on the proposed scheme; (b) an application to court for an order convening the statutory meeting or meetings;[172] (c) preparation and sending out of meeting notices together with the explanatory statement; (d) holding of the meeting or meetings; (e) a second application to the court for approval of the scheme; (e) reference by the court to the SEC on issues of fairness; (f) investigation of fairness of the scheme by SEC appointed inspectors and submission of written report thereon to court; and (g) approval of the scheme by the court and the subsequent registration of a copy of the court order at the CAC.

It is no secret that proceedings before Nigerian courts are usually long and protracted. Relatively simple applications may take months to complete, while more complex cases (particularly contested cases) normally last for years. Administrative proceedings conducted by the SEC may well aggravate the situation.[173] During the period prior to approval, the whole future of the company is uncertain and new business opportunities are likely to be lost. Even more significant is the fact that the company is unable to concentrate on its existing businesses, and efforts to raise additional capital usually end up being frustrated. When coupled with other problems associated with the absence of a moratorium,[174] a decision to embark on this journey often signifies an intention to dissolve the company.

In a nutshell, the longer it takes a company to reorganize the

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172 In *Andruchue*, this application alone took nearly three months to complete. [1994] FHCLR 51.

173 This writer is not aware of any investigation that has actually been carried out by the SEC.

174 To be discussed in section 3.6.

more it loses in terms of business expansion opportunities, capable personnel, goodwill and capital. Of course, the foregoing should not be taken as suggesting a need to sacrifice fairness at the altar of speed – all in the bid to maximize efficiency. As much as possible, a proposed plan should not only reflect the will of all stakeholders, it should also be a product of their informed consent. Limited supervision by the court or by a competent expert is also desirable to facilitate timely resolution of potential disputes and prevent irreversible value destruction.

F. Moratorium Issues

One of the most delicate issues in any insolvency regime involves having to make a decision between two major concerns – the protection of a debtor from harassment and undue demands by creditors on the one hand, and recognition and enforcement of the rights of creditors (whose position may be at risk) on the other hand. A major flaw in the present system is the non-availability of a moratorium during negotiations prior to the time of the first court application. Indeed, the cases are clear on the point that a unilateral proposal made to the court by a debtor company falls outside the definition of a 'compromise or arrangement' as used in section 539 of the CAMA.[175] As a result, debtor companies are denied that element of surprise and protection necessary to prevent a floodgate of enforcement actions (including a petition that the company be wound up) by creditors during negotiations.

A 1988 report of the Australian Law Reform Commission states that:

> A constructive approach to corporate insolvency requires the preservation, if practical and possible, of the property and business of the company in the brief period before creditors are in a position to make an informed decision. This assists in an orderly and beneficial administration whether creditors decide to wind the company up or accept a compromise.[176]

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175 *See Andruchue*, [1994] FHCLR 51; *In re* Interfirst Fin. & Sec. Ltd. [1993] FHCLR 421. Also recall from Pt. Two that it is only at the time of the order convening the statutory meeting or meetings that an order of moratorium may also be granted.

176 AUSTRALIAN LAW REFORM COMMISSION, GENERAL INSOLVENCY INQUIRY para. 53 (1988).

However, deciding to put in place a moratorium is only the beginning; the duration and width of the moratorium are other pertinent considerations. These issues will be discussed in the final part.

Without directly saying that the presence of a moratorium is always value-maximizing, one may categorically assert that, on the whole, the complete absence of it is bound to be inefficient. It allows unscrupulous creditors to extract value from the company at a time when it requires breathing space to map out a comprehensive plan of recovery. Moreover, if a few creditors are able to recover their claims outside liquidation, others will invariably be left with a disproportionate size of the company's pie. The problem is real because not all creditors are sophisticated enough to know how to act punctually under these circumstances. A moratorium should therefore be seen as a cooling off period during which time a distressed company is afforded the opportunity to ensure the fair treatment of all claimants and prevent value losses occasioned by panic generated among creditors of the company.

G. Control of the Company and Reorganization Process

While control of the company remains in the hands of existing management (or the liquidator) under the current system, supervisory control over the scheme is exercised primarily by the court. At the onset, it should be noted that this is just one blend of a number of control options open to policy makers. Apart from the debtor-in-possession model, it is also possible to have an independent set of directors take charge of the affairs of the company or to establish a committee of creditors with power to shape decision-making by the board. Alongside this issue of who manages the company is the complementary question of authority to control the process, a power which may be vested in any of the following: the debtor company, a professional insolvency expert (scheme administrator), or the court.

These two aspects of control are not mutually exclusive and they both touch upon the all-important issue of competence. In order to take advantage of some of the benefits of reorganization, it is desirable to have competent persons at the critical stages of the process – specifically the proposal, approval, and implementation stages. It is undeniable that the separation of

powers (between the debtor company and the court) under section 539 of the CAMA is justifiable in light of the potential for abuse by management if the powers were to be concentrated in the debtor. However, the question is whether there can be a more efficient separation.

The quality of supervision undertaken by the court is rather doubtful for the simple reason that judges are not businessmen. They are limited by the information provided to them and lack the expertise to give a knowledgeable decision as to the feasibility and fairness of a proposed scheme.[177] Equally questionable is the role of the SEC in insolvency matters, an area which falls outside the Commission's ordinary scope of competence.[178] Besides, it is not unlikely that creditors may feel quite disenchanted at the point at which the court relinquishes control over the process to the debtor company – that is, after approval. At the stage of implementation, creditors have no way of monitoring the progress – or otherwise – of the scheme as approved and cannot take any 'preventive' action until there is default. Hence, what is paramount is a system of adequate checks and balances though, by way of caution, "[i]t should not be assumed that there will be widespread abuse simply because no outside professional takes control."[179]

H. Fairness

This section will consider the question of whether the existing reorganization regime guarantees the fair treatment of all stakeholders and will touch upon the related problem of how the fairness of a scheme is determined under the Act. As explained above, these issues have significant impact on the ability of a company to attract capital.

An ongoing struggle between measures put in place to prevent inefficient holdouts and those meant to ensure class autonomy in the decision as to whether or not members of a particular class should be bound by a scheme has led some commentators to

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177 The Nigerian Law Reform Commission also concluded that the courts "lack the necessary economic and accounting skills" to determine to any degree of exactness whether a scheme is actually fair or not. NIGERIAN COMPANY REPORT, *supra* note 1, at 244.

178 This is discussed further in section 3.8.

179 BROWN 1996, *supra* note 24, at 46.

question the veto power held by shareholders as a class.[180] The argument often advanced is that shareholders of an insolvent company have no tangible interest in its assets and should therefore not have any say in the asset distribution. There are, however, two reasons why this argument is not particularly persuasive. First, it is possible, albeit improbable, to exclude a class of shareholders from voting upon proof that its members are not entitled to anything under an arrangement which also contemplates liquidation, because the assets of the company are insufficient to satisfy all claims.[181] A second and more intuitive reason is that shareholders will, as a matter of fact, scarcely use the veto power unless it is value-maximizing to do so, because other alternatives to reorganization (possibly with the exception of a merger) hardly serve their interests.

There are more pressing concerns with the Act's voting requirements. The requirement of "being present and voting" fails to take into account the possibility that some claimants with relatively small claims may, in weighing the costs and benefits of attending the meeting, rationally decide against attending it. While there may indeed be other valid reasons for not attending the meeting, the Act fails to take any of these into consideration, and instead, creates a loophole which could result in a class vote not being a fair representation of the interests of the class taken as a whole. Even more egregious is the voting distortion generated by the votes of related or interested persons[182] and the absence of a rule excluding such votes. As noted above, a scheme takes effect as to bind all members within a class, whether or not they voted for its approval, and dissenting security holders have nothing (by way of appraisal remedy) to fall back on when the scheme is eventually sanctioned by the court.

In an attempt to develop a safety net for the protection of minority interests, a court will refuse to sanction a scheme on grounds of lack of fairness if it finds that the majority resolution

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180 *See* Milman, *supra* note 8, at 425.

181 This course of action involves ascertaining the reorganization value of the company together with all the undesirable consequences associated with its division. *See e.g.*, Mark J. Roe, *supra* note 166; Lucian Arye Bebchuk, *A New Approach to Corporate Reorganizations*, 101 HARV. L. REV. 775 (1988).

182 That is, persons with significant interests in two or more classes or insiders with security interests.

was not arrived at in good faith.[183] This brings the process of establishing the fairness of a scheme under the spotlight and, in particular, calls for greater scrutiny of the role of the SEC in this regard. It has been mentioned elsewhere in this paper that the SEC is not an appropriate body of reference for questions of fairness. There are a number of reasons for this assertion. Matters involving corporate insolvency or bankruptcy traditionally have been handled by the Corporate Affairs Commission (CAC) rather than the SEC. As a matter of fact, in the company law reform proposals, the CAC was originally put forward as the body to be responsible for deciding these questions of fairness.[184]

It is not surprising that all the rules and regulations made by the SEC fail to provide any form of guidance "as to the substantive and adjectival law surrounding [schemes of arrangement]."[185] The way things are, the Commission appears to be in danger of erroneously applying standards normally used for the approval of mergers and acquisitions to transactions limited to internal restructuring in distressed companies. The inevitable conclusion is that fair treatment of all stakeholders is not guaranteed under the existing regime.

IV. A Mediation-Based Approach

A. Introduction

On a spectrum between two extremes – informal, out-of-court arrangements on one hand and the existing formal court-sanctioned schemes of arrangement on the other hand – the new approach falls somewhere in the middle. It relies a great deal on mediation and seeks to give the parties considerable discretion in determining the outcome of an arrangement with minimal court involvement. Without compromising on the objective of fair treatment, it is built on the principles of value maximization and party autonomy. It also addresses some of the problematic areas

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183 *See In re* Cheseborough Prod. Indus. Ltd. Suit No. FHC/L/M49/88 (Unreported); *In re* Anglo-Cont'l Supply Co., [1922] 2 Ch. 723, 736.

184 *See* THE NIGERIAN LAW REFORM COMMISSION, 1 THE REFORM OF NIGERIAN COMPANY LAW – REVIEW AND RECOMMENDATIONS 314 (1987). No reasons have been given for the change from the CAC to the SEC.

185 BROWN 1996, *supra* note 24, at 642.

identified in the preceding part through the introduction of a moratorium for a specific period and the provision of a fallback remedy for dissenting class members.

By way of introduction, mediation may be defined as a process in which a neutral third party (the mediator) is employed to facilitate communication between negotiating parties in an effort to reach a mutually acceptable agreement.[186] It is usually referred to as the "sleeping giant" of business dispute resolution with, potentially, the most powerful means of bringing the parties to terms.[187] Its main focus is not on reconciling positions but on reconciling interests. As one writer put it, "mediation is informal, voluntary, forward-looking, cooperative and interest-based. A mediator helps willing parties craft an agreement that looks to the future, satisfies their needs, and meets their own standards of fairness."[188] In this model, the mediator should ideally be an insolvency expert or practitioner while the negotiating parties are the different classes of creditors and shareholders and the debtor company.

The design of the new approach is not radically different from the existing system, the beneficial aspects of which are still relevant. In particular, the debtor-in-possession model is to be retained since small companies usually (or arguably) require firm-specific skills rather than generalized skills which are better suited to larger companies. In this sense, therefore, it is more intuitive for an existing management team to remain in control of a distressed company while the company attempts to ride the tide of the insolvency wave. However, proposed changes will permit deviations in deserving cases, such as where it is shown that management lacks the skill and competence to run the company efficiently, or, if it can be proved, that egregious conduct by management is likely to lead to further depletion of corporate assets.

Recently, proposals for the reform of this area of the law in

186 See BENNETT G. PICKER, MEDIATION PRACTICE GUIDE: A HANDBOOK FOR RESOLVING BUSINESS DISPUTES 2 (1998).

187 JAMES F. HENRY & JETHRO K. LIEBERMAN, THE MANAGER'S GUIDE TO RESOLVING LEGAL DISPUTES 57 (1985).

188 GARY GOODPASTER, A GUIDE TO NEGOTIATION AND MEDIATION 204 (1997).

other jurisdictions have become rather common.[189] Countries are increasingly placing greater emphasis on the rehabilitation or rescue of distressed companies. While the search for the most effective corporate rescue regime continues, some comparative insights will provide a useful background to some of the features in the new approach.

B. United Kingdom

It all started with the Cork Committee on Insolvency Law and Practice, which first proposed the introduction of a corporate rescue regime for distressed companies in the United Kingdom and heralded the passing of the Insolvency Act of 1986.[190] Under the Act, a company contemplating rehabilitation may take advantage of two different but complementary procedures.[191] The first is the company voluntary arrangement (CVA) regime and the second is the administrative order procedure.[192] Initially, though, it should be noted that this new regime exists side by side with the traditional schemes of arrangement under section 425 of the Companies Act of 1985[193] and that in spite of its short title, the Act is not restricted to insolvent companies.

A CVA begins with the directors of a distressed company which is not in administration[194] or liquidation making a proposal to the company and its creditors for a composition in satisfaction of its debts or a scheme of arrangement of its affairs (both collectively referred to as "voluntary arrangements").[195] The proposal must provide for a qualified insolvency practitioner (the nominee) to act either as a trustee or a supervisor in relation to the voluntary arrangement.[196] Within twenty-eight days after he is given the proposal, the nominee is required to submit a report to

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189 *See e.g.*, Milman, *supra* note 8, at 415; COMPANY LAW REVIEW, *supra* note 68, at 275; NATIONAL BANKRUPTCY REVIEW COMMISSION, BANKRUPTCY: THE NEXT TWENTY YEARS – NATIONAL BANKRUPTCY REVIEW COMMISSION FINAL REPORT (1997).

190 Insolvency Act, 1986 (Eng.).

191 *See id.*

192 *See id.*

193 This is almost identical to part XVI of the CAMA.

194 That is, the administration order under part II of the Insolvency Act of 1986 is not in force in relation to the company.

195 Insolvency Act, 1986 cl. 1, § 1 (Eng.).

196 *Id.*

the court as to the desirability and/or mode of summoning meetings of the company and of its creditors.[197] If the voluntary arrangement is approved by the requisite majority at the meetings, it will bind all the creditors who had notice of and were entitled to vote at the meetings, whether or not they were present or represented.[198] Unless an administration order is also sought, the CVA does not contemplate the imposition of a moratorium.[199]

An application challenging the voluntary arrangement may be made to the court on two grounds: (a) that the approved arrangement unfairly prejudices the interest of a creditor, member or contributory of the company; or (b) that there has been some material irregularity at or in relation to the meetings. This application must be made within twenty-eight days after the making of a report of the meetings to the court. It may be made by any person entitled to vote at the meetings or by the nominee.[200] In implementing the arrangement, the directors are to be supervised by the nominee (now referred to as the supervisor) who has the power to apply to the court for directions or for an administration order or to petition for the winding up of the company.[201] However, the directors continue to be responsible for the day-to-day management of the affairs of the company.[202]

In contrast, the administration order procedure involves greater court participation. An administration order is defined under section 8(2) of the 1986 Act as "an order directing that, during the period for which the order is in force, the affairs, business and property of the company shall be managed by a person ('the

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197 *Id.* § 2.

198 *Id.* § 4(1). However, by sections 4(3) and 4(4), voters at the meetings lack the power to approve a proposal or modification which affects the rights of secured or preferential creditors, except with their concurrence.

199 Sections 10 and 11 of Part II of the Act provides expressly for what amounts to a moratorium in the case of Administration orders, but there is no equivalent provision for CVAs in Part I of the Act. In such cases, one may adopt the canon of statutory interpretation to the effect that a right (or power) not expressly conferred should not be inferred.

200 *Id.* § 6.

201 *Id.* § 7.

202 The "supervisor" mentioned in section 7 of Part I of the Act is not vested with the powers of managing the affairs of the company except insofar as it relates to carrying out the voluntary arrangement. Moreover, it is not contemplated that the directors be replaced in this scenario.

administrator') appointed for the purpose by the court."[203] The order may be used as a means for achieving several purposes, including: the sanctioning of a scheme of arrangement under section 425 of the Companies Act of 1985; the realization of the company's assets in a way more advantageous than liquidation; and the approval of a voluntary arrangement under Part I.[204] The procedure can be initiated by the company, its directors or creditors filing a petition in court.[205]

The effect of the petition and order gives the procedure its uniqueness. Upon presentation of the petition and until the making of the order sought or dismissal of the petition, a moratorium preventing the institution of enforcement proceedings including a winding up petition against the company is imposed unless the court otherwise permits.[206] The moratorium is automatically terminated if the petition is eventually dismissed.[207] If the order is made, however, the moratorium stays in force and may not be lifted unless *either* the administrator or the court consents to it. The administrator has more extensive powers than the supervisor under Part I and it is not uncommon for him to take charge of managing the day-to-day affairs of the company.

Realizing that, due to court costs and professional involvement, the procedure outlined above could still prove to be too expensive for small companies;[208] hence, the Insolvency Act of 2000 was passed. Under this Act, a debtor company becomes immediately entitled to a moratorium in support of a CVA upon the filing of certain documents in court (without the need for an order of court or a court-appointed administrator).[209] The significance of this is that incumbent directors remain in control while the company is availed the protection. However, the facility

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[203] *Id.* § 8(2).

[204] *Id.* § 8(3).

[205] *Id.* § 9(1).

[206] *Id.* § 10(1).

[207] *Id.*

[208] In order for a debtor company contemplating rescue or rehabilitation to avail itself of the moratorium, the CVA model needs to be combined with the administration order procedure. This involves an application to the court with adequate supporting financial documentation attested to by an independent expert. It is this combination that small companies may find expensive. *See* Milman, *supra* note 8, at 423-24.

[209] Insolvency Act of 2001, § 1 (Eng.). *See id.* sched. 1.

is only available to companies which satisfy two or more of the requirements for being a "small company" under section 247(3) of the Companies Act of 1985.[210]

Within the Nigerian context, the English procedure (particularly under the Insolvency Act of 2000) will score fairly high on an efficiency scorecard because it removes the need for extensive court involvement and quickens the pace of restructuring. However, it shows an inclination to move away from a creditor-oriented model of reorganization without putting adequate measures in place to guarantee the fair treatment of those creditors. In particular, it fails to provide a fallback remedy for dissenting creditors seeing that the outcome of the vote binds all the creditors.[211] Also, as a practical matter, creditors are hardly given the opportunity to participate in the formulation of the reorganization plan and their contribution to the restructuring process is more often than not restricted to the statutory meetings. While these lapses may not necessarily work any hardship in an economy where capital is easily and readily available, remedial steps need to be taken in other economies not only to facilitate *ex ante* investment by risk-averse creditors, but also to improve their propensity to be cooperative *ex post* should the company become distressed.

C. Australia

The 1988 Report of the Australian Law Commission titled "General Insolvency Inquiry,"[212] and popularly referred to as the Harmer Report, paved the way for the introduction of the Voluntary Administration procedure through the enactment of the Corporate Law Reform Act of 1992. The objective of the new procedure, as stated in section 435A of the Australian Corporations Law, is to allow the

> business, property and affairs of an insolvent company to be administered in such a way that: (a) maximizes the

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210 The requirements under the subsection are: (a) a turnover of not more than £2.8 million; (b) a balance sheet total of not more than £1.4 million; and (c) not more than fifty employees. Companies Act of 1985, § 247(3).

211 However, secured creditors cannot be bound without their consent. *See* Insolvency Act, § 1.

212 *General Insolvency Inquiry*, Report of the Australian Law Commission (1988), *available at* http://www.austlii.edu.au/au/other/alrc/publications/reports/45.

chances of the company, or as much as possible of its business, continuing in existence; or (b) if it is not possible for the company or its business to continue in existence – results in a better return for the company's creditors and members than would result from an immediate winding up of the company.[213]

Where the directors of a distressed company are of the opinion that the company is insolvent or that it is likely to become insolvent at some time in the near future, they may initiate a voluntary administration by appointing an administrator who immediately takes charge of the company's property, business and affairs.[214] The administrator may also be appointed by a liquidator, provisional liquidator or a chargee entitled to enforce a charge over the whole or substantially the whole of the company's property (i.e. secured creditors).[215] The administrator must be licensed to practice as a liquidator by the Australian Securities and Investments Commission (ASIC).[216] His primary function under section 438A of the Corporations Law is to investigate the financial position of the company with a view to making a recommendation to a meeting of creditors about what should be done with the company and its business.[217]

A twenty-eight day moratorium is automatically triggered by the appointment of an administrator. Up to this point, there is no requirement for any application to be made to the court. One important exception to the moratorium is that the chargee mentioned above is given an opportunity to appoint a receiver within fourteen days of the appointment of the administrator. The administrator takes control subject to the powers of the receiver appointed under this exception. However, if no receiver is appointed, the administrator retains full control over the management of the affairs of the company. He is required to convene the first meeting of creditors within five business days of

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213 Corporations Act of 2001, Pt. 5.3A, § 435A (Austl.).

214 *Id.* §§ 436A(1)(a), 437A(1)(a).

215 *Id.* §§ 436B, 436C.

216 *Id.* § 448B.

217 Andrew Sellars, *Corporate Voluntary Administration in Australia* (2001), *available at* http://www.oecd.org/dataoecd/7/36/1873984.pdf (a paper delivered at the Forum for Asian Insolvency Reform – Insolvency Reform in Asia: An Assessment of the Recent Developments and the Role of Judiciary in Bali, Indonesia, Feb. 7-8, 2001).

his appointment.[218] At this meeting, the creditors will consider, *inter alia*, whether to remove the administrator and appoint someone else in his place.

After investigating the financial affairs of the company, the administrator is required, within twenty-eight days of his appointment, to convene a second meeting of creditors to determine the company's future.[219] He must provide the creditors with a statement containing an opinion as to each of the following three options upon which they may pass a resolution: (a) whether it would be in the creditors' interests to execute a deed of company arrangement; (b) whether it would be in the interests of the creditors for the administration to end; and (c) whether it would be in the interests of the creditors for the corporation to be wound up.[220] A vote on a resolution is determined "on the voices" unless a poll is demanded. If a poll is taken, it must be approved by a simple majority in number and value of debt owed. The court may set aside a resolution or order that a meeting be reconvened if it finds that: (a) the vote would have gone another way if the votes of related parties are disregarded; and (b) the result of the vote is contrary to the interests of creditors as a whole, or likely to prejudice the interests of the creditors who voted the other way.[221]

A few problems may arise under the above approach. First, directors of a distressed company lack the incentive to act quickly by putting the company in voluntary administration because they are likely to lose their jobs upon the appointment of an administrator.[222] Secondly, in at least two ways, the success of the procedure is heavily dependent on securing the cooperation of secured creditors. An administrator has no power to administer

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218 Corporations Act of 2001, § 436E (Austl.).

219 Or within thirty-five days of his appointment where Christmas or Easter intervenes. *See* Sellars, *supra* note 217.

220 Corporations Act of 2001, § 439A(4),

221 *See generally*, Sellars, *supra* note 217.

222 It should be noted though that directors of an insolvent company may be held personally liable to pay the tax on the salaries of employees if they delay in putting the company in voluntary administration or liquidation *after the Australian Taxation Office has issued a notice informing the directors that the company has failed to remit the taxes.* Nevertheless, it is submitted that this penalty ultimately may prove to be ineffective because it is dependent on a prior default in tax remission – an occurrence which can be avoided.

assets under the control of a receiver appointed by a secured creditor and a deed of company arrangement binds only those secured creditors who agree to be bound by it. Apparently, secured creditors are given unrestrained freedom to create inefficiencies *ex post*. Finally, a minor criticism relates to the substantial costs involved in holding, not one, but two meetings of creditors as mandated by the statute.

D. United States

The corporate reorganization regime in the United States is contained in Chapter 11 of the U.S. Bankruptcy Code. Section 362 of the Code makes provision for an automatic stay which takes effect upon the filing of a bankruptcy petition against any person with a claim against the debtor company, whether or not such person had prior notice of it. The filing may be voluntary or involuntary depending on whether it is done by the debtor company or by creditors. In spite of the stay, the debtor-in-possession (DIP) remains in control and continues to operate the business in the ordinary course. The DIP has far-reaching powers, including the power to assume or to breach outstanding executory contracts, the power to set aside certain security interests in the debtor's property, and the power to void fraudulent conveyances.[223]

After the initial filing, negotiations between the DIP and major creditors commence. For this, a creditors' committee is usually appointed to negotiate on behalf of the creditors. There is a 120-day exclusivity period within which only the DIP is allowed to file a plan of reorganization.[224] If the plan is approved by the specified majorities of security holders voting in classes, the court will confirm it so long as it is feasible.[225] On the request of a party in

223 11 U.S.C. §§ 365, 544(a), 547, 548, 544(b) (2003). It should be noted that at any time after the commencement of the case, but before confirmation of a plan by the request of a party in interest, the court has the power to order the appointment of a trustee for cause. This includes fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management or if such appointment is in the interests of the creditors and equity holders. 11 U.S.C. § 1104(a) (2003).

224 11 U.S.C. § 1121(b) (2003). This period may be reduced on the request of a party in interest or extended to 180 days if the DIP has proposed a plan that has not yet been accepted. 11 U.S.C. § 1121(c)-(d).

225 11 U.S.C. §§ 1126(c)-(d), 1129(a)(11) (2003).

interest, the court may discountenance any acceptance or rejection not made in good faith.[226]

Unlike the position in the UK and Australia, there is a fall-back remedy for dissenting security holders under Chapter 11. Specifically, an individual security holder who votes against a plan is nevertheless entitled to receive an amount no less than he would have been entitled to receive in liquidation.[227] Where the plan is rejected by a class of security holders, it may still be confirmed by the court if it does not discriminate unfairly and is fair and equitable with respect to each impaired class of claims or interests.[228] Upon confirmation, the debtor company is discharged from all of its pre-petition debts except as provided in the reorganization plan.

The court is empowered by section 1104(c) of the Code to order the appointment of an examiner if the debtor company's debts exceed $5 million or if such appointment is in the interests of the creditors and equity holders – provided no trustee has been appointed. While the primary duty of a trustee is the management of corporate assets going forward, the examiner's main task is to investigate any allegations of fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor. It is possible for a DIP or creditor to convert a Chapter 11 reorganization to a Chapter 7 liquidation. However, in the case of creditors, sufficient cause must be shown, such as continuing loss to or diminution of the estate and absence of a reasonable likelihood of rehabilitation, inability to effectuate a plan, and unreasonable delay that is prejudicial to creditors.[229]

According to Lucian Bebchuk, "the existing bargaining-based process appears to fall substantially short of the goal of maximizing total reorganization value."[230] It is time-consuming and involves substantial administrative and litigation costs in the form of fees paid to accountants, investment bankers, and lawyers.

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226 11 U.S.C. § 1126(e) (1978).

227 11 U.S.C. § 1129(a)(7) (2003).

228 11 U.S.C. § 1129(b) (2003). This section codifies what is popularly referred to as the absolute priority rule. It also provides the basis for "cram down" litigation or the imposition of a plan on a dissenting class by order of court. *See id.*

229 11 U.S.C. § 1112(b)(1)-(10) (2003).

230 BEBCHUK, *supra* note 165, at 4.

The degree of court involvement, and accompanying court discretion is more pronounced in the United States than in any of the countries mentioned thus far.[231] It is no wonder then that the empirical evidence shows that a large fraction of the companies emerging out of reorganization go through some form of financial restructuring within a few years.[232] Moreover, the procedure undoubtedly favors the debtor company because it is given an unfair advantage in terms of agenda control and improved bargaining power which may be used to extract substantial value from creditors. At least one writer has shown that these *ex post* deviations from absolute priority may have some negative effects on *ex ante* decisions taken by shareholders.[233]

E. A Mediation-based Approach

It should be made clear right from the onset that mediation is a *mandatory* part of the approach being put forward. This form of mediation, better known as mandatory mediation, is often criticized for its disregard of what is regarded by many to be a fundamental element of mediation – the element of voluntary participation. After all, there is some wisdom in the saying that "you can lead a horse to water, but you can't make it drink." However, in the particular context in which mediation is to be adopted, the argument loses its force for the following reasons. First, arrangements and mediation may both properly be described as negotiation-based processes involving extensive bargaining on the part of the negotiating parties. The law is clear on the point that a unilateral or one-sided reorganization plan proposed by a debtor company does not fall within the definition of an arrangement or a compromise.[234] Mediation (or *assisted negotiation* as it sometimes called) should therefore be seen as a close substitute to the negotiation which already forms part of the reorganization process. Using this line of argument, the response

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231 *See generally* BROWN 1996, *supra* note 24.

232 E. Hotchkiss, *Post-Bankruptcy Performance and Management Turnover*, 50 J. OF FIN. 3, 21 (1995).

233 Lucian Arye Bebchuk, *Ex Ante Costs of Violating Absolute Priority in Bankruptcy*, THE HARVARD JOHN M. OLIN DISCUSSION PAPER SERIES, Discussion Paper No. 328, *available at* http://www.law.harvard.edu/programs/olin_center/ (2001).

234 *In re* Interfirst Fin. & Sec. Ltd., [1993] FHCLR 421; Andruchue, [1994] FHCLR 51.

to the adage would therefore be "you don't need to make a thirsty horse drink."

Secondly, the mediation-based approach is not meant to replace the traditional schemes of arrangement but to supplement the "menu" of rescue procedures already available.[235] The negotiating parties are free to choose whichever procedure they wish to utilize. The desirability of minimizing the risk of an imposed outcome and the availability of a fall-back remedy for persons who refuse to participate in the mediation process also serve to mitigate any negative consequence of forced participation. In any case, the only mandatory part is that mediation takes place; participation is voluntary. Other advantages to be derived from mediation include confidentiality, speed, reduced costs and the prospect of preserving continuing relationships.

Another possible objection to a mediation-based approach is the usual claim by critics that mediation is ineffective in complex, multiparty cases. According to Edward Morse, the complexity of the dispute and the opportunity for misunderstanding multiply as the number of parties increases, "thus erecting greater barriers for the mediator to help the parties overcome."[236] This is hardly the case. Generally speaking, multiparty disputes create more room for generating innovative settlement options. In addition to having most of the advantages of a mini-trial (without some of the complications), mediation is flexible enough to be adaptable to business disputes of all sizes and complexity.[237] Mediators vary according to expertise on different issues, whether substantive or procedural, with some specializing in complex, multiparty dispute resolution. It is perhaps safe to say that "mediation in multiparty suits is particularly effective because it allows each creditor the opportunity to be heard and to pool resources with other creditors."[238]

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235 In the conclusion, various reasons are given in support of the call for the retention of a modified court-sanctioned approach.

236 *See* Edward A. Morse, *Mediation in Debtor/Creditor Relationships*, 20 U. MICH. J.L. REFORM 587, 593 (1987).

237 LINDA R. SINGER, SETTLING DISPUTES: CONFLICT RESOLUTION IN BUSINESS, FAMILIES, AND THE LEGAL SYSTEM 70 (1994).

238 Cassandra G. Mott, *Macy's Miracle on 34th Street: Employing Mediation to Develop the Reorganization Plan in a Mega-Pt. 11 Case*, 14 OHIO ST. J. ON DISP. RESOL. 193, 205 (1998).

1. *Initiating the Process and Moratorium Issues*

Any company in financial difficulty (irrespective of size) would qualify to enter into the procedure which could be initiated either by the debtor company upon a mere declaration or by creditors after the fulfillment of certain conditions. Where the directors of a company are of the opinion that the company is insolvent, or is likely to be insolvent at some time in the near future, they would be entitled to file for reorganization under the procedure with the CAC. On their part, creditors would be required first to establish that the company is unable to pay its debts before being allowed to file for reorganization. In order to do this, reliance would be placed on section 409 of the CAMA which provides for three situations in which a company is deemed to be unable to pay its debts: (a) where it is unable to pay an amount due within three weeks after the service of a demand notice; (b) where execution on a court judgment is returned unsatisfied; and (c) where the court, after taking into account any contingent or prospective liability of the company, is satisfied that the company is unable to pay its debts.

Upon filing for reorganization, a forty-five day moratorium against all enforcement actions would be triggered.[239] The court would have a discretion as to whether or not to extend this period and should exercise this discretion with extreme caution and only for "good reason."[240] Among other things, the moratorium would prevent the following: immediate liquidation of the company, enforcement of charges against corporate assets or the appointment of a receiver or manager under any instrument, and the institution or continuation of enforcement proceedings against the company in court. Within the moratorium period, the company would be afforded breathing space to prepare for mediation by making the requisite disclosures to all stakeholders, setting a date for the mediation,[241] and appointing an independent bankruptcy mediator. However, the moratorium would not give the debtor company

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239 The moratorium would not apply to criminal proceedings against the company or its directors. Later, the grounds for lifting the moratorium will be considered.

240 It is not possible at this point to enumerate the exact circumstances that would qualify as "good reason." Suffice it to say that the expression is best interpreted on a case by case basis. In addition, the burden of proof would be on the applicant.

241 The date would be no later than forty-five days after the moratorium is triggered.

unrestrained freedom to deal with corporate assets, particularly secured assets, in a manner adverse to the interests of creditors.[242]

The general principle that would govern disclosure requirements is that security holders should receive timely and sufficient information to enable them to make an informed decision as to whether or not to accept any proposed plan of reorganization. Examples of matters to be disclosed include: the expected return that would be available to the security holders if the company were to be wound up immediately;[243] a list of all known creditors and the amount owed to each of them; a list of all interested persons – e.g., a creditor who is also a director or shareholder (or a relative or spouse of such person); a report on the financial position of the company; the name of the bankruptcy mediator including the remuneration to be paid for his services; and a brief explanation of what mediation is all about, its benefits, the effect of participation, and the consequences of non-participation (i.e., the fall-back remedy).[244]

Arguably, a forty-five day moratorium period is not long enough to create incentives for its abuse by directors in spite of the fact that debtor initiation (of reorganization) under this model is practically unconditional. David Brown has also contended that, in the case of creditor initiation, the same test as is used for initiation by directors should not be applied. His argument is that "it would be unfair (and impracticable, given informational disadvantages for most creditors) if a company was involuntarily placed into any sort of formal procedure unless creditors could show that their rights were at risk due to insolvency or imminent insolvency."[245] He therefore suggested that the test for creditor initiation should be the same as under a winding up. This explains why it is suggested that entry into reorganization, where the initial filing is by creditors, should be premised upon proof of the company's inability to pay its debts.

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242 This is one of the grounds for lifting the moratorium.

243 The bankruptcy mediator will play a prominent role in determining the liquidation value of the company.

244 The provisions of the Australian Corporations Regulations of 1990 (Regulation 5.1.01(1) (Austl.)) are particularly instructive in this regard.

245 BROWN 2000, *supra* note 27, at 44.

2. *The Role of the Bankruptcy Mediator*

At the moment, there is no distinct group of professionals who may be called upon to perform the role of bankruptcy mediators in Nigeria. As the name suggests, it is envisaged that these persons would be experienced bankruptcy practitioners (whether as investment bankers, accountants, or legal practitioners) and mediators. It is also expected that, at some point in the future, the CAC would create a special bankruptcy mediation division with the aim of making mediators available to distressed companies at reduced costs – though parties would still be free to appoint an independent individual professional not affiliated with the CAC.

In addition to his primary role as a facilitator of negotiation between the parties, the mediator would also be responsible for determining the liquidation value of the company. This is an important piece of the information to be provided in the notices summoning all interested parties to mediation. At the request of a party in interest, the mediator could also perform the role of an "examiner,"[246] in which case he would be obliged to investigate the affairs of the debtor company, including any allegations of fraud, incompetence, misconduct or mismanagement. The result of such investigation should ideally be disclosed to the parties prior to mediation, but may also be disclosed at the beginning of mediation.

The directors of the debtor company along with all the members and creditors of the company must be invited to mediation. On the first day of mediation, the mediator should go over his role with the parties, reiterating the *voluntary* and confidential nature of mediation. He also should inform the parties of the consequences of deciding not to participate or to sign the reorganization plan at the end of mediation.[247] The mediator should then lay down procedural ground rules to be followed throughout the mediation. *Everyone* must be given an opportunity to speak in joint sessions, but nothing should prevent the mediator from holding private sessions (caucuses) with particular groups or individuals. On average, it is estimated that the process would usually take a day or two, depending on the level of cooperation among the parties, the competence of the mediator, and the degree

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246 This term is borrowed from the U.S. Bankruptcy Code, 11 U.S.C. § 1104 (2003).

247 This idea is discussed below.

of complexity involved.

Finally, the mediator would be required to draw up a reorganization plan and to explain its contents to the parties. Those who accept to be bound by the plan would be asked to sign it – with the directors signing on behalf of the company. The agreement would, however, not be valid until the mediator has *certified that the plan is feasible by appending his signature to it.* In determining the feasibility of a plan, he should take the following factors into consideration: (a) the adequacy of the capital structure; (b) the earning power of the business; (c) economic conditions; (d) the ability of management; and (e) the probability of the continuation of the same management.[248] This is essential in order not to delay liquidation any further should it prove to be inevitable.

3. *Failed and Successful Mediations*

Persons who refuse to participate in mediation or to be bound by the reorganization plan would nevertheless be entitled to receive *no less than what they would have received if the company were to be liquidated immediately.* This is very important from both efficiency and fairness perspectives. As an exit strategy, the value seems to be equitable since it takes the best interest of the security holders outside of reorganization into account. Hence, no one would be structurally coerced into accepting a reorganization plan against his wishes. From an efficiency standpoint, the exit strategy also provides a means of ensuring that reorganization would only be pursued if the value of the reorganized company is greater than its liquidation value. Intuitively, a security holder would only consider reorganization if it promises him something over and above his entitlement in liquidation. It is, however, up to him (after perusing disclosed materials and with the guidance of the mediator) to decide when the reorganized value is greater than the liquidation value.

There are two circumstances in which mediation would be deemed to have failed: (a) where the parties reject the reorganization plan; and (b) where the mediator concludes that the plan is not feasible. In both situations, there should be an automatic conversion to liquidation. On the other hand, where

248 *See In re* Landmark at Plaza Park, 7 Bankr. 653 (Bankr. D.N.J. 1980).

mediation is successful, the reorganization plan should bind the debtor company and only those claimants who accept to be bound by it. This is a marked departure from the existing regime which is dominated by classification and voting (or majority rule) requirements. By eliminating both requirements, security holders, especially minority claimants, would be given the opportunity to decide their commercial fate themselves.

Typically, the incumbents would remain in control of the debtor company and also assume responsibility for implementing the reorganization plan. However, after an adverse report from the mediator in his role as an examiner, the plan could also provide for the removal of an incumbent board or the appointment of a director to the board to represent the interests of the creditors. This director would monitor the implementation of the plan and report back to the creditors in case anything goes wrong. In the event that the implementation proves to be unsuccessful, the parties would revert to their respective positions prior to reorganization and the company would proceed straight into liquidation unless the parties agree otherwise.

4. *The Role of the Court*

In order to prevent abuse of the system, the court would still have a considerable (though minimal) supervisory role to play. At various stages in the reorganization process, the court would have the power to make an order voiding an approved reorganization plan or the appointment of a bankruptcy mediator on specified grounds, including incompetence or lack of independence on the part of the mediator, fraud, and non-feasibility of the proposed or approved plan. The court would also have power to entertain applications challenging the stated liquidation value of the company, to lift the moratorium, or to extend its period. All applications would have to be brought within a period of one month after the approval of the plan.

In deciding whether or not to lift the moratorium, the court should strike an equitable balance between the interests of the debtor company, the creditors as a group, and the applicant. In the United States, relief is granted upon a "showing of cause which has no clear definition and is determined on a case-by-case

basis."[249] Indeed, such decision is "committed to the sound discretion of the bankruptcy court."[250] Section 362(d)(1) of the U.S. Bankruptcy Code provides one example of sufficient 'cause' – lack of adequate protection of an interest in property of an applicant party in interest. In the proposed model, the court should exercise its discretion to prevent rapid and imminent dissipation of corporate assets. The importance of this role cannot be overemphasized and the court has to be proactive in guarding against value-destroying applications.

V. Conclusion

Under the existing regime, it is possible to implement the mediation-based approach outlined above *if all affected parties unanimously agree to do so.* However, this paper should be seen as a call for the reform of the law of corporate reorganizations in Nigeria through legislative action. Even though there is no substantial reason for restricting the application of the new approach to small and medium-scale corporations, a more streamlined version of Part XVI of the CAMA should be applied by large corporations if, at an early stage in its implementation, the approach proves to be ineffective for these companies.

Finally, a good follow-up to this paper would entail conducting empirical research relating to the principal interests of secured creditors in reorganization. The outcome of this study would help shed more light on the general attitude of these creditors to reorganization, particularly on the question whether secured creditors are interested only in recovering their money or whether they are also interested in maintaining continued relationships with debtor companies; thus, laying the foundation for future research work in the area.

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249 *In re* PATEL, 2003 Bankr. LEXIS 263, *7-8; *see also* U.S. Bankruptcy Code, 11 U.S.C. § 362(d) (2003).

250 *In re* Conejo Enters., Inc., 96 F.3d 346, 351 (9th Cir. 1996).