

BANKRUPTCY AND WINDING UP

PROCEEDINGS:

POTENTIAL

MECHANISMS

FOR

SPEEDIER DEBT RECOVERIES

**BEING A PAPER
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If empirical evidence were required to underscore emerging concerns about the phenomenon of loan defaults and the alarming prospects it portends for the banking industry, it would be found in the recent establishment, by the Central Bank, of a Committee on Distressed Banks. The Committee has on its agenda (among other things) the mandate to explore aggressive methods for debt recoveries. Indeed, some banks have begun to pursue an aggressive debt recovery programme as a means of weathering the "liquidity squeeze" storm that followed the introduction of the Central Bank's Open Market Operations (OMO). Liquid funds are scarce and banks have woken up to the need to call in outstanding debts.

But an aggressive debt recovery programme must be accompanied by a re-evaluation of existing debt recovery mechanisms. The core point in this paper is that we need to redefine our approach to the problem of debt recoveries. The present approach focuses on maximum use of existing legal methods, viz; action for debt and enforcement of securities. But it may well be that these methods have become saturated beyond the point at which they can effectively serve the volume of debt recovery requirements. A new approach must focus on expanding the range of debt recovery procedures by the introduction of new techniques. This will require a considerable amount of legislative innovation, but the process must also be catalyzed by pressure groups such as the nascent Association of Banks' Lawyers, if meaningful reform is to be achieved within a short time.

A good starting point, perhaps, will be to re-examine the present state of insolvency law and practice in Nigeria. We use the term "insolvency" rather loosely to refer to the legal process by which a company is divested of the right to administer its property and business on the ground that it is unable to pay its debts (winding up) and the equivalent procedure in the case of individuals and partnership firms (bankruptcy). The potential efficacy of insolvency proceedings as a debt recovery mechanism lies in the grave consequences it carries for subjects of such proceedings - consequences that most debtors would prefer to avoid by promptly settling their liabilities. These consequences are aptly captured

by Oluwole Akanle in his book *Bankruptcy, Law and Practice*, thus:-

"On the eventual discharge of a bankrupt by the court, he is restored to the status quo ante and thereby relieved of any liability or claims of the creditor which formed the basis of the bankruptcy proceedings instituted against him. However, the social consequences of having been once declared a bankrupt endures as it attaches a stigma either on the personality or corporate image of the person affected by the order. It ordinarily conveys the impression that a bankrupt notwithstanding the fact that he has been discharged is incapable of conducting his private or financial affairs now or in the future. Consequently, he is shunned by clients, professional or business colleagues and potential creditors who may be unwilling

to engage in any form of commercial transaction with any person who has once been adjudged bankrupt.

Despite its potential as an effective debt recovery facility, the insolvency process has not hitherto played any significant role in the debt recovery endeavours of banks and other credit institutions. Again, as Oluwole Akanle observes in relation to bankruptcy proceedings;

"the Nigerian enactment (on bankruptcy) has not been operated at all despite the fact that it has existed in the statute books for over a decade".

The problem, as we will demonstrate, lies with the legal framework governing the insolvency process. With bankruptcy proceedings (ie where the debtor is an individual or a partnership firm), the problem is structural, and would require a complete overhaul of the relevant legislation, ie the Bankruptcy Act of 1979. As regards winding up proceedings (where the debtor is an incorporated limited liability company), the legal framework is more conducive, and this explains why the relevant procedure under the Companies and Allied Matters Decree has enjoyed a relatively better degree of implementation when compared with its counterpart under Bankruptcy Law. Nevertheless, it is still our contention that the implementation of the law regulating winding up proceedings requires some judicial re-thinking, prompted, perhaps by minimal legislative intervention, if the mechanism is to serve as a better aid to debt recovery endeavours. The immense potentials of the insolvency process as a debt recovery mechanism, the limitations imposed on it by the structure of the present legal framework, and the urgent need for reform are best demonstrated by proceeding from the following hypothetical (but typical) scenario:-

A owes bank B a substantial amount of money from overdraft facilities extended to him by the bank, which amount is due for payment. Two variations are possible on this: (i) either the loan is unsecured or (ii) the loan is secured. In (i), Bank B, takes out a simple action for debt against A, and eventually obtains judgement in its favour either after a lengthy trial (where A files a defence which the court considers worthy of investigation) or upon summary/default judgement procedure (where A either files no defence or files one which the court considers to be a sham). From this point a new set of proceedings arise. The process has virtually only just commenced, for bank B must now, at additional expenses, enforce the judgement it has obtained against A. It must locate A's movable or immovable properties, or bank accounts, (depending on which enforcement procedure it chooses), and proceed to attach them. The difficulties may be compounded if A is an influential member of society and decides to utilize extra legal methods (as it so often happens) to resist enforcement of the judgement obtained against him. Under variation (ii), ie where the loan is secured, Bank B may proceed to realize its security without recourse to the court. (Again it is important to note that certain types of securities, eg equitable mortgages,

personal guarantees, are not enforceable except through court action). Even where the security is realizable other than by court action, A (the debtor) may institute court action to challenge the bank efforts to realize the security.

Bankruptcy proceedings may be utilized to circumvent these problems. Firstly, one of the legal effects of a successful bankruptcy petition is the making of a "*Receiving Order*" by the court. A receiving order vests the properties of the debtor in the Official Receiver for the benefit of the debtor's creditors. And if the debtor is eventually adjudged bankrupt, his properties become divisible among his creditors, and accordingly vest in a trustee appointed by them. Thus, in an ideal legal situation, bankruptcy proceedings could be utilized at once to *establish* as well as *enforce* the obligations of the debtor. In effect, the period of time that may otherwise elapse between taking out a simple action for debt, obtaining judgement and taking out a separate set of proceedings (writ of fife, garnishee, judgement debtor summons, etc) to enforce the judgement debt is abridged. In bankruptcy proceedings, the order establishing the debtors liability is at once the order "attaching" the debtor's properties for the benefit of his creditors. The second, (and perhaps the most obvious) advantage of bankruptcy proceedings in the factual context set out above, is the compelling influence such proceedings are likely to have on the debtor, where the latter is a person with a political, social, commercial or professional reputation/aspirations, and who, anxious to avoid the adverse publicity and stigmatizing consequences of bankruptcy proceedings may be compelled into settling his obligations or making concrete proposals to settle.

However, all the foregoing can only obtain in an ideal legal environment. We have added this caveat because the Nigerian Law on Bankruptcy in its present state is far from ideal. In Nigeria bankruptcy proceedings *cannot* play the dual role of *establishing* and *enforcing* a debtor's obligations. For a creditor's petition to succeed under the Nigerian bankruptcy law, the creditor must establish, among other things, that the debtor has committed "*an act of bankruptcy*". (See Section 7 of the Bankruptcy Act, 1979). Under the Act there are only *four* situation recognized as constituting "Acts of Bankruptcy", to wit:-

- a) Where the creditor obtains a *final judgement* or *final order* against the debtor and serves a bankruptcy notice on the debtor;
- b) Where execution is levied against the property of the debtor under process in an action or proceedings in court, and such property have been sold or held by the bailiff for twenty one days;
- c) Where the debtor files in court a declaration of his inability to pay his debts, and
- d) Where the debtor presents a bankruptcy petition against himself.

It will be seen that apart from situations (c) and (d) above, in which the debtor himself initiates legal proceedings to acknowledge his indebtedness (which in practice would be rare), bankruptcy proceedings have been relegated to a purely secondary/ancillary role in the debt recovery process. They can only come into play after the debt has been judicially established in an action for debt. Bankruptcy therefore plays no more significant role than the conventional modes of enforcing court judgements, (eg garnishee, fife, etc), and in fact ranks on a scale lesser than these conventional modes, because of further limitations implicit in the provisions governing it. For example, in situation (a) above, it is implicit that bankruptcy proceedings *cannot* be initiated where the judgement or order is one obtained in default proceedings, for a default judgement will not be considered to be a final order as it does not render the court *functions officio*. See IFEDIORAH VS UME (1988) 2 N.W.L.R. (Part 74) Page 5. And in situation (b), it is obvious that bankruptcy proceedings, can only be initiated *after* one of the conventional modes (ie fife) has first been successfully pursued. These severe limitations on their scope and application probably explains the little attention that has hitherto been paid to the bankruptcy process as a potential debt recovery mechanism.

The legal position in Nigeria contrasts sharply with the position in England under the English Insolvency Act 1986. Under that Act, the creditor's right to present a bankruptcy petition against the debtor is *not* dependent on the debt having first been established in judicial proceedings. It is enough if the creditor alleges that the debtor owes him a liquidated sum payable to him (the creditor) wither immediately or at some certain, future time, and that the debtor appears either to be unable to pay or to have no reasonable prospect of being able to pay the debt. For this purpose, the debtor would be considered to appear unable to pay the debt if the debt is payable immediately and either: (a) the petitioning creditor to whom the debt is owed has served on the debtor a statutory demand requiring him to pay the debt or to secure or compound for it to the satisfaction of the creditor, and at least three (3) weeks having elapsed since the demand was served on the debtor, the debtor has neither complied with the demand nor set it aside, *OR* (b) execution or other process issued in respect of the debt on a judgement or order of any court in favour of the petitioning creditor has been returned unsatisfied in whole or in part. The clear implication of option (a) above is that, under the English Insolvency Act, 1986, the creditor needs not proceed to court to establish the debtor's liability in an action for debt, as a condition precedent to instituting bankruptcy proceedings. All he needs do is to serve a statutory demand on the debtor which, if not complied with or set aside within three weeks, becomes authority for initiating bankruptcy proceedings. Thus in England, the bankruptcy process performs the role of a primary, substantive debt recovery mechanism, and is not merely ancillary to the court action for debt.

But what if the debtor disputes the debt? There is obviously something unjust in subjecting a man to the embarrassing circumstances of bankruptcy proceedings in respect of an alleged debt which may eventually be proved not to be justly owed.

Again the English Insolvency Act contains provisions to guard against such possibilities. The presentation of the creditor's petition is the commencement of the bankruptcy process. However, (except the debt has already been established in a simple action for debt) a creditor's petition cannot be presented unless a statutory demand has first been served on the alleged debtor. Within 18 days after the debtor is served with the statutory demand, he may apply to court to have the demand set aside. The debtor's application to set aside the statutory demand then becomes the forum at which the question of his indebtedness may be investigated. At this forum the debtor may, among other things raise a counter claim, set off, or cross demand to the creditors claim, or contend that he disputes the debt on a substantial ground, and in respect of either of these, he must satisfy the court by evidence that there is a "*genuine triable issue*". The scope of inquiry and the powers exercisable by the court, at this forum are somewhat analogous to what obtains under the summary judgement (Order 10) procedure as practiced in the Lagos State High Court, for the court may investigate the evidence presented by the debtor to reach a conclusion whether or not there is a "genuine triable issue. If the court is satisfied that there is a "*genuine triable issue*" it may set aside the statutory demand, and thereby preclude the commencement of bankruptcy proceedings. If the court is not so satisfied, it will dismiss the debtor's application to set aside the statutory demand, and thereupon make an order authorizing the creditor to present a bankruptcy petition.

Thus it is obvious how, in England, bankruptcy law plays a primary substantive role in the debt recovery process, as opposed to the secondary/ancillary role performed by bankruptcy law in Nigeria. However, in Nigeria, where the debtor is a company incorporated under the Companies and Allied Matters Act 1990, the process of "*Winding Up*" plays a similar role as bankruptcy in England. The combined effect of Sections 408, 409 and 410 of the Companies and Allied Matters Act is that a creditor can present a winding up petition against a debtor company on the ground that the company is unable to pay its debts. And for this purpose, a company is deemed unable to pay its debts if, among other things a creditor to whom the company is indebted in a sum exceeding 2,000.00 then due, has served a written demand on the company requiring the company to pay the amount due and the company has for three weeks thereafter neglected to pay the sum or to secure or compound for it to the reasonable satisfaction of the creditor. There is therefore no need to first establish the liability of the debtor in a separate action for debt before filing a winding up petition. In effect, winding up proceedings can be pursued as a substantive, primary debt recovery mechanism where the debtor is a company.

Again, if the debt is genuinely disputed by the company, it may suffer grave injustice (eg loss of commercial patronage, lack of confidence by other credit sources) from exposure to winding up proceedings in which it may eventually be established that the debt is not justly owed. Unlike the position under English bankruptcy law, there is nothing in the Companies and Allied Matters Act or the Companies Winding Up Rules which permits an alleged debtor company to take out preliminary proceedings to set

aside the statutory notice served under Section 409 of the Companies and Allied Matters Act. But it is judicially recognized that in practice a company which genuinely disputes a debt may avoid the adverse publicity of winding up proceedings by instituting an action for injunctive reliefs to restrain the advertisement or further prosecution of a winding up petition, as was done in *MANN VS GOLDSTEIN (91968) 2 ALL ER 769*. Again the scope of enquiry in the course of such pre-emptive proceedings is limited to the question whether the alleged debtor has shown he has a "triable" defence or cross claim to the creditors claim. If the court finds there are triable issues, it may make an injunctive order restraining advertisement and further prosecution of the petition. The creditor then has to establish the debt in separate judicial proceedings (in an action for debt) before he can proceed with the winding up process.

A common objection that can be taken to the legal position under English bankruptcy law and winding up under the Nigerian Companies and Allied Matters Act, is that the scope of enquiry in debtors' preemptive proceedings is too narrow. Since the court can only inquire into whether the debtor has a "triable" defence or cross claim, it cannot make a final order on the merits that the debt is actually owed or not. Separate proceedings have to be instituted for this purpose.

We may therefore with a view to making the insolvency process in Nigeria a more effective machinery for debt recovery endeavours, propose that the following measures be urgently put in place through legislative reform:

1. Overhaul the basic framework of the Nigerian Bankruptcy Act 1979 by removing the provisions which reduce the bankruptcy process to a merely secondary/ancillary procedure for debt recoveries. There is no obvious reason why *bankruptcy* (in relation to individuals) should play a secondary role when *winding up* (in relation to companies) plays a primary role in the debt recovery process.
2. Widen the scope of enquiry in debtor's pre-emptive proceedings (in both bankruptcy and winding up). When a debtor applies to set aside a statutory notice served upon him by a creditor on the ground that he disputes the debt, the court should inquire whether the debt is actually owed, rather than limit its inquiry solely to the question whether these is a "triable issue", which necessitates that the creditor take out a separate action for debt. Our courts are too congested, we simply cannot afford the luxury of multiple proceedings just for the purpose of establishing a single, simple debt.