RESCUING A BUSINESS IN FINANCIAL DIFFICULTIES: MODERN TRENDS AND TANZANIA'S LEGAL PERSPECTIVE

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Abstract: The modern insolvency laws are increasingly incorporating rescue procedures, which provide for rescue of insolvent or financially distressed companies. In its modern sense, insolvency laws are not merely confined to liquidation but also addresses the possibilities of having an insolvent or financially distressed company rescued. This trend is attributable to the fact that in the modern times, the functioning company embraces more interests economically than the financial interests of creditors and owners. The paper explores the Tanzania's legislative trends as regards to the nature and structure of corporate rescue provisions in light of the modern trends worldwide. It also looks at the need and relevance of rescue provisions in Tanzania. The paper observes that unlike the *Companies Ordinance*, a colonial peace of legislation inherited by the independence government, the new *Companies Act, 2000* envisages a positive direction towards the modern corporate rescue approaches. It is however too early to comment precisely on the practicability of the Act as it is even yet to be brought into force. The paper argues that, following the liberalization drive and the judicial trends pointing to the acceptance of the rescue culture, institutionalisation of the rescue regime in Tanzania's insolvency legal framework is much awaited and needed.

INTRODUCTION

The insolvency provisions contained in the *Companies Ordinance, cap212*[1] have been in place since colonial days. The provisions have never been met with significant application owing to the type of economy Tanzania was leading since independence, which placed emphasis on public sector economy at the expense of the private sector. In such type of economy, insolvency incidences and socio-economic impact thereof could hardly be felt. This accounts for lack of amendment or improvement on the law.[2] It is only recent that following the liberalization drive of the Tanzania economy, the State saw a need for reform. It is however not clear whether the reform was prompted by the liberalization drive or the apparent shortcomings in insolvency provisions under the *Companies Ordinance*. It can however be argued that the collapse of public enterprises and attempts to deal with them had in a number of ways revealed most of issues and was the blue print for the changes

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1 This Ordinance was enacted in 1932 in line with the *U.K Companies Act of 1929*, which was twenty ninth of a series of statutes, the object of which were to consolidate and amend the law in England relating to companies.

2 It is interesting that even the specific legislation which established public enterprises did not contains provisions to cater for instances of insolvencies.

and enactment of the *Companies Act, 2002.*[3] The new enactment makes a significant development in the law of Companies.

This paper examines the nature and structure of corporate rescue provisions built in the *Companies Ordinance*, the outgoing legislation and the *Companies Act, 2002* with a view to identifying the legislative trends and to determine whether or not there is any improvement made. The assessment is made against the modern hallmarks of corporate rescue regimes applicable in such countries like the United Kingdom (UK), United States of America (US), France and Australia.

THE CONCEPT OF CORPORATE RESCUE

The concept of corporate rescue culture initially manifested itself in the opinion of judges in the form of a policy, which may be summed up by a Latin tag, which was the ancient canon for the construction of deeds and documents. That rule was expressed as *ut res magis valeat quam*, that is to say, "so that the transaction shall not perish but flourish."[4] It was in many countries a combination of events and coincidence of social and economic conditions, which generated the pressure leading to major reform and reconstruction of insolvency law, which gave way to the modern rescue systems.[5]

In modern times, insolvency law which is increasingly treated as a distinct branch of law in most developed countries, is not only confined to liquidation of an insolvent or financially distressed company but also provides for possibilities of having an insolvent company nursed back to financial health so as to once more resume its place in the market for the benefit of both past and future creditors and other stakeholders.[6] Unlike the traditional concept of liquidation, which is concerned, only with payment of its creditors, rescue provisions facilitate the continuation of the business of an insolvent or financially distressed company where practicable through for instance reorganization or rehabilitation of the legal relations of the company and its creditors.

Generally, business rescue provisions are invoked where insolvency is believed to be temporary and where the business of the insolvent or financially distressed company is capable, with assistance, of returning to commercial life as an active and successful undertaking.[7]

However, the successful application of the rescue provisions depends a lot on the extent to which creditors are prepared to support the rescue process as they are often expected to accept a lesser amount in satisfaction of the claim as a price for restoration of a business in financial difficulties to commercial effectiveness. As Smits rightly argued without creditors participation and support, it is almost inevitable that any proposed rescue plan by a company will fail.[8]

The foundation and essence of rescue lies, among others, on the fact that in the modern times the functioning company embraces more interests economically than the

[3] This is Act No. 12 of 2002. It is however yet to become operational.

[4] Hunter,M. "The Nature and Functions of a Rescue Culture" [1999] *JBL*, Nov. Issue 491 p.498

[5] *Ibid* p. 495. See also Honsberger, J. " Bankruptcy in France" *The Canadian Bar Review*, Vol. 1 pp. 58-59

[6] Smits,A. J "Corporate Administration: A Proposed Model" 1999 *DeJure* 80 p.83. See also Hammer, R. " Comparison of Trends in National Law: The Pacific Rhim" 1997 *Brook J. Int.L* 140

[7] Rajak,H. " Business Rescue for South Africa" 1999 *South Africa Law Journal* 262

[8] Smits, A. J. *op.cit.* p. 90

financial rights of creditors and owners. Thus, failure of the company's business tends to have wide repercussions, not only upon those intimately connected with the conduct of the business, such as directors, shareholders and employees, but on other interests such as the State, suppliers, customers and neighbours.[9] Worse still, as the *Cork Committee* noted the effect of the failure upon the realisable value of stock, plant and goodwill can be disastrous, and not infrequently there is a general feeling of desperation which needs to be solved.[10]

There is no specific definition of rescue as applied in insolvency law in modern time. Rajak appropriately described it in the following words:

> [Rescue]... include[s] cases where the debtor's recovery is complete, that is to say where the debtor emerges from protective period solvent, with the business intact and capable of being continued successfully from the point where the protection began... Rescue must however also be understood to encompass cases where the recovery of the company in difficulties is partial but where the overall result is one of great benefit to various interests concerned (including the public interest) than would have arisen on liquidation.[11]

In terms of the *Cork Committee* recommendations and as it is the focus in the US, the term refers to rescue of a business and jobs, but not necessarily the company itself. It is in this respect that most rescues of businesses in the UK have been said to involve the sale of the businesses to other entities while the insolvent rumps of the corporations have generally gone into liquidation.[12]

MODERN CORPORATE RESCUE HALLMARKS

Modern corporate rescue regimes have in many countries been incorporated in insolvency systems of such countries within the last twenty to thirty years mostly under the influence of the US approach. This is attributable to the fact that the U.S. is the first country in capitalist and free market economy since the days of successful railroad reorganisations of early 1930s, to incorporate fully and more comprehensively the concept of corporate rescue in its insolvency law system.[13]

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[9] See The *Cork Committee Report on Insolvency Law and Practice*, Dept of Trade, Cmnd 8558 (1982) para. 203 also quoted in Hunter, M. *op.cit* p. 497

[10] *Ibid.* The *Cork Committee* was appointed on January 1986 to review the law and practice relating to insolvency, bankruptcy, liquidation, and receiverships and to suggest less formal procedures as alternative to bankruptcy and company winding up. It was as a result of the recommendations of this committee that the *UK's Insolvency Act, 1986* was enacted

[11] Rajak, H. *op.cit* p. 277

[12] Moss,G. "Comparative Bankruptcy Cultures: Rescue or Liquidation? Comparison of Trends in National Law-England" 23 *Brooklyn J. Int'l L.* 115 p.121

[13] Herbet, M.J. *Understanding Bankruptcy*, U.S.A, Mathew & Bender pp.50 and 51. See also Husband, W.H *et el. Modern Corporation Finance*, 6th ed, Richard D. Irwin Inc., 1966 p. 661. Note that in 1933 the *US Bankruptcy Act, 1893* was amended to provide for extension of payment for secured and unsecured debtors. This was later followed by a procedure providing for corporate reorganizations which was introduced by a further amendment of 1934 whose intention was to rescue through reorganizations and restructurings the American railroad and other business which were then in financial difficulties.

Although the modern rescue regimes seem in many cases to have common origin and similar objectives, they nevertheless vary from one another. Just as every legal system has its own unique features, so are the various rescue models. This variation is attributable to such factors like the history of subject matter in a country, the philosophical outlook, the rules of private and public law in use as well as the community's policy and ends sought.[14]

Eligibility for Rescue

In most of the modern corporate rescue systems an indebted company may file for rescue proceedings in the courts of law when such a company is not actually insolvent. The US just like Germany and Australia does not even require a proof of imminent insolvency.[15] It is only France that requires cessation of payments to have occurred before a company avails itself for rescue proceedings.[16]

The approach seeks to encourage companies in financial difficulties to file early to maximise chances of recovery. From an efficiency standpoint, early filing is desirable, both because it minimises losses to creditors if the company is liquidated and because it maximises the likelihood of saving the company if an attempt is made to reorganise.[17]

In a bid to encourage early filing for insolvency proceedings, most European countries tend to penalise managers of financially distressed companies for delay in filing in court for insolvency proceedings. As such, in the UK directors can be held personally liable for extra losses sustained by creditors if a company continues to operate after becoming insolvent.[18] Similarly, in France managers are obliged to file for insolvency proceedings within 15 days of the date an indebted company becomes unable to pay debts as they become due. Accordingly, managers who delay to file face the possibility of being held personally liable for the company's debt and being barred from managing any other enterprise in future. In contrast, the U.S encourages early filing by treating managers more leniently as they are allowed to continue to manage the business throughout the rescue process.[19] It would seem that the assumption in the US it is managers only and not creditors or other venture capitalist that have the know how to continue the business in operation.[20]

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14 Martin, J.F. "The French Law of Bankruptcy" *Reveue de Detroit des Affaires*, No. 3, 1989 p. 315. See also Smits, A. J *op.cit* p.87

15 See Smits, A.J *op.cit*. p. 87, Lipton, P. " Voluntary Administration: Is there Life After Insolvency for the Secured Creditor?" in Lessing, J. P. G. *et al.*(ed.) *Corporate Insolvency Law*, Taxation & Corporate research center, Queensland, 1995 pp. 72-89. King,R. "Voluntary Administration: Proposal for Change" in Lessing, J. P.G. *at al. ibid* pp.91-105. See also the *Australia's Corporate Law Reform Act, 1992* (Part 5.3A).

16 See the *French Bankruptcy Law of 1985*. See also Beardsley, J. " The New Bankruptcy Statute" *International Lawyer*, Vol. 19, No. 3 p. 976

17 White, M. J. " The Costs of Corporate Bankruptcy: A US- European Comparison" in Bhandari, J. S and L.A. Weiss (eds) *Corporate Bankruptcy, Economic and Legal Perspective*, Cambridge Univ. Press, 1999 p. 470

18 *Ibid*

19 *Ibid*. See also the *USA Bankruptcy Code of 1978* which repealed and replaced the *Chandler Act of 1938*

20 Bhandari,J.S. *et al op.cit* p. xi

Filing and Initiation of Proceedings

Initiation of the rescue process of the business of an insolvent or financially distressed company is in most cases through formal petition to the court though in many corporate models the role of the court tends to be limited and in some cases excluded. In the U.S the commencement of bankruptcy proceedings is automatic upon the filing of statutorily prescribed petition to the court. As far as Australia is concerned, there is no requirement of petition to court but a simple written appointment of an administrator, which allows the financially distressed company to stay out of liquidation until such time when there is no alternative left.[21]

Normally, the company itself, creditors or liquidators, can initiate rescue proceedings. It is only in France where workers may as well initiate the proceedings.[22]

Management Control

An outside official is normally appointed who either replaces the existing management or have authority over it in operating and managing the business of the financially distressed company.[23] This is a common feature in most European countries. The outside officials are normally licenced specialized insolvency practitioners. In the UK, for instance, the Board of Directors relinquishes control of the company when the administrator is appointed.[24] The approach seemingly takes care of suspicious of the financially distressed company sending abuses that may follow with unsupervised rescue attempt.

In contrast, in the US, existing managers typically remain in control of business as debtors – in – possession although the company is subject to detailed supervision in the court.[25] The court can appoint an outside official called trustee to replace the manager but only for a cause such as fraud, incompetence and normally such opportunities are rare.[26] Apparently, the assumption in the U.S. is that if managers are automatically divested of control, they will most likely resist a system that immediately loses them their investments. The idea is to encourage the management to seek relief early enough to provide realistic chance of rescue.[27]

Court Supervision

Almost all regimes maintain an element of court supervision by general or specialized bankruptcy court. However, the degree of court's involvement varies from one jurisdiction to another. The US probably because it allows the debtor company to remain in possession, exercises a higher degree of court supervision by specialised bankruptcy court.[28] In Australia it is quite possible for a corporate rescue process to be

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[21] Lipton, P. *ibid* and King, R. *ibid* . See also the *Australia's Corporate Law Reform Act, 1992.*

[22] See article 3 and 4 of the *French Bankruptcy Law of 1985* cited also in Beardsley, J. " The New Bankruptcy Statute" *ibid* p. 976

[23] Smits, A. J. *op.cit* p. 91

[24] See for instance sections 388 and 389 of the *UK Insolvency Act, 1986* as cited in Fletcher, I *Insolvency Law*

[25] See Chapter11 of the *US Bankruptcy Act of 1978.* See also White, M.J. " The Costs of Corporate Bankruptcy: A US-European Comparison" *ibid* p. 471

[26] *Ibid.*

[27] Smit, A.J *op.cit* p. 89

[28] *Ibid* p. 90

effected without any court intervention whatsoever.[29]

The French system has gone a bit further by entrusting the bankruptcy court and not the creditors and/or the insolvent company with power to place the company, which has filed for bankruptcy proceedings under observation period in which the company remains under the supervision of outside official for six months. At the end of the period the outside official decides whether or not the company can be saved. If the decision is made to liquidate the company, the court appoints a liquidator to liquidate it. And if the decision is to save the company the outside official formulates a plan of rehabilitation.[30] This approach basically divests creditors from decision making in crucial matters affecting the continuation of the company.

The Place of Creditors

Creditors participation and involvement in rescue process is a salient feature in almost all modern corporate rescue models, though the nature and extent of such participation varies from jurisdiction to jurisdiction. In the UK, Australia and Canada, secured creditors holding security over substantially all of the debtor's assets may opt out usually through the appointment of out of court receiver.[31] In the US and France an insolvent company may even force secured creditors to bargain which means more leverage for the company through delay caused.

Rescue Plan

A proposal for rescue plan, which must be formulated in order to rehabilitate an insolvent or financially distressed company, is a cornerstone of all rescue models. In most countries like the UK, France and Australia the plan is prepared by an outside official appointed by the court. Whereas in France the outside official is assisted by creditors, employees representatives and two other persons appointed by the court, in Australia the outside official in conjunction with the indebted company must formulate the plan.[32] It is only in the US where the plan is formulated and implemented by the financially distressed company.[33] Likewise, in all models the plan must be approved by creditors and confirmed by the court before it is implemented.

The French's approach is such that the court, which has sovereign power to decide whether to adopt a rescue plan, based on the ends of the law or committing the business to liquidation. As such, the creditors have no right to vote on the plan, and are in fact restricted to the opportunity to be heard by the court. This radical approach is based on

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[29] *Ibid.* See also Lipton, P. *op.cit* and King, R. *op.cit*

[30] See White, J. M. *op.cit* pp. 471 and 472

[31] See Rajak, H. " The Challenges of Commercial Reorganisations in Insolvency: Emperical Evidence from England" in Ziegel, J.S. (ed) *Current Developments in International and Comparative Corporate Insolvency Law*, Clarendon Press, Oxford, 1994 p. 205. H. Rajak's finding is that the power to appoint receiver has in the U.K not been widely invoked. See also Moss, G. *op.cit* pp. 25 – 33.

[32] See articles 3 and 4 of the *French Bankruptcy Law of 1985* cited also in Beardsley, J. *op.cit* p. 976. See also section 436A of Part 5.3A of the *Australia's Corporate Law Reform Act, 1992*, and King, R. *op.cit* p. 91.

[33] See generally Chapter 11 Reorganisation Procedure of the *US Bankruptcy Code of 1978*.

a belief that large enterprises, although financed originally by investors and creditors, may be so important to local and national economies that the State is justified in interfering with individual rights, thus resulting in renewed economic activity and continued employment for employees.[34]

In a bid to avoid possibility of a plan being disapproved by creditors, the current US practice is for creditors and management of insolvent or financially distressed company to file in the bankruptcy court what is now commonly known as "pre-packaged bankruptcy petition" in which the company files for rescue with rescue plan that has already been accepted by the required number of claim holders, which is a result of prior negotiation and arrangement between creditors and the management.[35]

Automatic Stay

In all rescue models court filing for rescue procedure has the effect of restraining all creditors from taking any action against the insolvent or financially distressed company to collect their claim or enforce their liens. This in effect allows the company to carry on its business with hope of recovery and it increases the possibility of achieving a successful rehabilitation of an insolvent or a financially distressed company.

A conventional justification for the automatic stay (i.e. moratorium) focuses on the collective action problem. If there were many creditors trying to seize the assets of the company, their efforts might prove self-destructive. This is very important because in order to organize successfully, an insolvent or a financially distressed company must retain assets, which are essential to its operations.[36] Some few jurisdictions, notably Australia and the UK secured creditors may however still opt out usually through the appointment of an out of court receiver. In the U.S the automatic stay is applied to secured creditors in the reorganization procedure and it prevents them from removing their security.

THE NEED AND RELEVANCE OF RESCUE CULTURE IN TANZANIA

During the public sector economy which lasted for the past three decades in Tanzania, the state controlled and planned actions of most economic actors, such as enterprises, banks and the allocation of investments, credits and wages as well as subsidizing the banks and enterprises even when they were not credit worthy. As the state commanded economic activity, it was unlikely for a state owned and controlled enterprise to be ousted from business through liquidation by reasons of insolvency or financial difficulties as the state was always there to intervene and bail out the enterprise from difficulties without necessarily looking into its going concern value.[37]

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[34] Flessner, A. "Philosophies of Business Bankruptcy Law: An International Overview", Homboldt University, Berlin p. 22

[35] See Franks, J. R. and W. N. Torous " Lessons From a Comparison of US and UK Insolvency Codes" in Bhandari, J.S. *et al. op.cit.* pp. 458 and 459

[36] White, M. J. *op. cit* p. 474. See also Bhandari, J. S. *et al op.cit* p.xi

[37] Financially strapped parastatals were fully insulated by the State against collapsing through provision of financial subventions, subsidies,

The implementation of the economic reform measures, which started in mid 1980s, has led to some significant changes and developments in Tanzania socio-economic set up. The private sector and therefore the private corporations which form the essence of a free market economy has ever since been increasingly becoming the dominant feature of the Tanzania economy responsible for the creation of wealth, jobs, enhancing government revenue and more importantly providing the means to sustain the social services sector. While the private sector expands, its contribution to the national economy is steadily increasing and gaining importance.[38] More significantly, the sector is increasingly swallowing the key activities of the economy, which hitherto were in the full ownership, and control of the State. As in other functioning market economies, it is definite that some of these entities within the private sector will succeed in business and meet the challenges of market forces, whilst others will fail as a result of enormous and fundamental problems or liabilities[39] and in turn face yet another challenge of insolvency proceedings. Nonetheless, the taking of legitimate business risk is the very cornerstone of a functioning market economy.[40]

More importantly, the private sector is increasingly becoming a crucial employer of Tanzania labour force whose current growth rate is at least 3% higher than the official population growth rate of 2.9% per annum.[41] Of late, the labour market has been registering a growing number of labour forces amounting to not less than 650,000 each year.[42] It is now becoming a fact that most private companies are gradually becoming so important to the economy that the community could not tolerate or wish to see them collapsing and ousted through the liquidation.

Various national policies, like the *Sustainable Industrial Development Policy (SIDP1996 - 2020), the National Employment Policy, 1997* and the *Investment Promotion Policy, 1996* emphasise on the urgent need of reviving, promoting and

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shifting of resources and other similar measures. And when compelled to borrow from financial markets, they did so from State banks where they enjoyed preferential conditions. See Mihyo, P. *Non-Market Controls and the Accountability of Public Enterprises in Tanzania*, Macmillan, London, 1994 p. 18. See also United Nations *Legal Aspects of Privatisation in Industry*, Newyork, 1992 p. 24

38 See the Guardian, August 18th, 1997 p. 2

39 Liabilities may arise from the business activities of those concerned or from their contractual activities.

40 See Ailola, D.A. " Recognition of Foreign Proceedings, Orders and Officials in insolvency in Southern Africa: A Call for a Regional Convention" A Paper presented as an inaugural lecture at the University of South Africa on 11th June 1998.

41 See United Republic of Tanzania, Speech by the Minister for State, President's office, Planning and Privatisation Presenting to the National Assembly the Economic Survey for the Medium Term Plan and Expenditure Framework for 2003/04 - 2005/05, the President's Office, Dar es salaam, June 2003 pp. 47, 48, 49 and 50. Out of 17.8 Million able bodied people 15.5 Million are employed, of which 13.0 Million are engaged in traditional agricultural, 0.9 Million in the informal sector, 0.6 Million in the private formal sector, 0.5 Million domestic work and 0.4 Million the government. Unemployment for the whole country by 2002/2003 stood at 2.3 million people which is equivalent to 12.9% of the total labour force.

42 *Ibid* p. 49

protecting the private sector. These policies place priority on rehabilitation and consolidation of existing industrial capacities through financial capital and management restructuring.

Predictably, a corollary of the liberalization policy and legislative developments which are evidence of a trend towards a true free market economy are not only stimulating development of the private corporate businesses but also the concomitant heightening of potential for business competition and business failures. Hence, an apparent need for parallel legal measure providing for a requirement with respect to protection of viable businesses in financial difficulties but having real prospects of being revived.[43]

RESCUE APPROACHES TO FINANCIALLY DISTRESSED COMPANIES IN TANZANIA

The Existing Companies Legislation

The legislation, which presently provides for insolvency provisions in Tanzania, is none but the *Companies Ordinance, Cap. 212*.[44] As it is well known, this is a colonial piece of legislation, which has actually remained in force without any substantial amendment.

The Ordinance lacks an explicit definition of what insolvency is. However, under section 168 of the Ordinance insolvency is inferred as the inability of a company to pay its due debts. This, apparently, envisages a cash flow test and not balance sheet test that goes down to compare the ratio between the assets and liabilities of the company.

The statutory provisions in this Ordinance, which cater for corporate insolvency to a large extent, embody a liquidation culture. The winding up procedure under the Ordinance is apparently the dominant scheme when it comes to dealing with insolvent or financially distressed companies.[45] A creditor of a company that is unable to pay its debts has a right *ex debto justitiae* to cause liquidation of the company.[46] As such, when a business is in financial difficulties, the normal outcome if it is subjected to the relevant provisions of the *Companies Ordinance* is a break-up of the business, a forced sale of the assets and consequently dissolution of the respective company. The primary object of these provisions is maximisation of creditors recovery through the orderly liquidation of the insolvent business by allowing the pooling of its assets and a centralised

[43] One commentator writing on *The African* of Feb. 24th – March, 1998 observed in this respect in the following terms: " As the private sector takes the role of creating wealth the minimum it needs at its infancy stage is to be nursed so that it can stand firm. A fact remains that the growth of strong private sector if well nursed…will in the long run be a major source of government revenue and employer to the already saturated unemployed labour force…. it is better to … rejuvenate the presently mixed up private sector which sees no way ahead with the shadow of huge unrepayable loans housing on it…if they are forced in liquidation, it is the investors and society that will ultimately be losers; that must be avoided.

[44] *Cap. 212*. The Ordinance is still enforce as the new *Companies Act, 2002* is not yet brought into force.

[45] See sections 157- 287 of Part VI of the *Companies Ordinance, which* provides for the Winding up procedure.

[46] See for instance sections 167, 168 and 169 of the *Companies Ordinance.*

liquidation of those assets for the benefit of all creditors.[47] This approach has elsewhere been described as:

> A conservative insolvency process, which reflects the immediate or prompt cessation of the business activities of an insolvent debtor; a sale of the assets usually in piece meal form, and ultimately, the distribution of the proceeds to creditors. The debtor enterprise, or corporation is usually extinguished during or as a result of the process.[48]

The Ordinance lacks a procedure, which is specifically set or designed to effect rescue of a financially distressed company.[49] There is however a statutory procedure which (though it was not strictly speaking insolvency procedure) could operate as such and could effect the rescue of distressed business or business undertaking or could at least effect a better outcome for the business or asset, than could under liquidation or winding up procedure. The procedure is none but reconstruction scheme which provides which provides for a compromise or arrangement for reconstruction.[50]

47 See sections 172, 176, 177, 225, 236, and 256 of the *Companies Ordinance, cap. 212*

48 Smits, A. J *op. cit* p. 82 quoting Harmer, R "Comparison of Trends in National Law: The Pacific Rim" 1997 *Brookl. J. Int L.* 140

49 See "*Winding Up Of Companies in Tanzania in a Changing Economic Environment*" a Paper presented at a Workshop on Review of the Companies Ordinance (cap. 212) held on 26th May 1999 at Hotel Sea Cliff, Dar es Salaam.

50 Sections 154-156 of the *Companies Ordinance, cap 212.*

The Scheme of Reconstruction

This scheme consists of a statutory facility, which enable the shareholders or creditors to reorganise or restructure the company, or to compromise on debts and other claims so as to enable the company or a successor to continue in business. The scheme applies whether or not the company is insolvent or is likely to become insolvent. Step one of this procedure involves the making of an application to the court to call a meeting of creditors to consider the proposal. Step two is to obtain the necessary vote of a majority in number representing three-fourths (¾) in value of the creditors or class of creditors present and voting. And in step three once the court has confirmed the proposal; it is implemented and binds all creditors. The court however is not mandated to sanction a proposal that has not been approved by the majority of the creditors, nor can the court compel creditors and the company to strike a reconstruction arrangement for the purpose of rescuing a business.

The procedure has a number of serious defects. The main one is that commencement of proceeding under this procedure does not create a statutory stay on creditors' remedies. Thus unless such protection is neither necessary nor desirable, implementation of this procedure is vulnerable to attack by dissident creditors prior to the proposal's confirmation by the court.[51] As the procedure from the start involves applications to the court considerable expense and time are likely to be involved. Difficulties may as well

51 The procedure requires approval of the proposal by majority of the creditors representing three-fourths in value.

be encountered in obtaining the requisite majorities in favour of the proposal for reconstruction. Worse still, the procedure lacks time frame within which it could be affected. As such, although the procedure has all along remained uncommon among the business community in Tanzania, it could not operate so effectively in a case where there was a need for urgent rescue.[52]

Receivership

Receivership is another procedure that can be applied to a financially distressed company and result in rescue of the company's business undertaking.[53] The procedure involves the management by the receiver of the assets of the company for the benefits and more particularly of secured creditors. It ensures realization of the company's assets and distribution of all accumulated funds to creditors in accordance with statutory rules. It vests powers to the receiver to deal with the property of the company in a manner that ensures settlement of secured creditor's debts. One key factor is the receiver's wide powers of trading as contrasted with a liquidator's narrow power to trade only for the purpose of winding up the company.

It may be initiated by applying to the court for appointment of a receiver on behalf of debenture holder or creditors in respect of a company, which is unable to pay its debts.[54] It may as well be initiated through appointments of a receiver made outside of the court by a debenture security holder usually a banker or some other species of financier.[55] According to Moss the latter type of receivership is not uncommon in countries where the practice provides for debenture document containing a rich cocktail of fixed and floating security tying up all the business and assets.[56]

The problem is that the operations of the receivership has the world over proved to precipitate into liquidation which ultimately ensure that the value of business and assets suffer a rapid decline unless they are sold quickly.[57] The procedure also poses a possibility of a receiver concentrating on getting the secured creditors repaid, even if that means an early sale, and bad news for

52 It is only recent that the reconstruction procedure was applied to rescue the financially distressed Fahari Bottlers companies, which were facing liquidation on ground of inability to pay debts. For this purpose you may wish to read *Fahari Bottlers Limited Versus the Registrar of Companies and N. B. C (1997) Ltd and others Misc. Civil cause No. 155 of 1998* as per Kalegeya J.

53 See Moss, G. " Comparative Bankruptcy Cultures: Rescue or Liquidation? Comparison of Trends in National Law-England" *Brooklyn J. Int'l L.* 115 pp. 117- 120. This Observation is also shared by G. Moss in his afore cited work.

54 See sections 287 and 290 of the *Companies Ordinance, cap 212*

55 According to *Halsbury's Law of England 4th ed., Vol. 39* p.804 "[A] person appointed for the collection or protection of property, he is appointed either by the court or by individuals or corporations. If the court appoints him, he is an officer of the court, deriving his authority from the court's order. If he is appointed out of court, he is an agent and has such powers, duties and liabilities as defined by the instrument or statute under which he is appointed and derives from general law of agency."

56 *Ibid* p. 118

57 Farrar, J. H. " Corporate Insolvency and the Law" *JBL* (1976) p. 217

jobs or for the unsecured creditors. Further, since out of court receivership does not enjoy the protection of statutory stay, the company or the unsecured creditors can not be prevented from petitioning to the court for winding up order to pre-empty the receivership.[58] Intrudingly, as it is the case with liquidators, the Ordinance does not lay down qualifications, which must be possessed by a person before being appointed as a receiver.[59] Interestingly also the procedure lacks a convenient device to bring prolonged receiverships to an end, or to compel the receiver to continue the business if it worthy more to have it continued than realizing its assets for the benefits of secured creditors.[60]

SOME RECENT DEVELOPMENTS POINTING TO DEVELOPMENT OF RESCUE CULTURE

The State has recently effected some measures, which could well be regarded as steps in the right direction towards an enhanced acceptance and recognition of rescue culture for financially troubled businesses. They include the spirit envisaged in the legal framework for restructuring and privatisation of ailing State owned enterprises as well as the recent enactment of the *Companies Act, 2002*[61], which is yet to become operational.

Insolvency Provisions Under the Companies Act, 2002

The insolvency provisions under the *Companies Act, 2002* are by far the most significant overhaul of insolvency law ever undertaken in Tanzania. They institutionalize the modern concept of rescue culture, which is applicable in other jurisdictions, and more importantly they shift the focus of insolvency proceedings away from exclusively protecting creditors interests and towards a balance between protecting creditors versus saving financially distressed business.

What is inferred under this Act as insolvency encompasses not only inability of a company to pay its debts as they fall due but also when the value of the company's assets is less than the amount of its liabilities, taking into account the contingent and prospective liabilities of the company.[62]

Apart from retaining the procedure of reconstruction, the Act goes further to introduce two other new forms of alternatives insolvency procedures namely the administration and the scheme of voluntary arrangement, which apply on impending or actual insolvency of a company or in a situation where a company has not satisfied a debt or is unable to satisfy its debts.[63]

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58 See *Fahari Bottlers Ltd and Southern Highland Bottlers Ltd. Versus the Registrar of Companies and the National Bank of Commerce (1997) Ltd.* Civil Revision No. 1 of 1999 (C.A).

59 The only restriction in the *Companies Ordinance* is that found under section 286 whose effect is to bar a body corporate from being appointed as a receiver.

60 It is only Section 291 of the *Companies Ordinance* that provides for the enforcement of duty of receiver to make returns and accounts.

61 Act 12 of 2002

62 See section 280 of the *Companies Act, 2002* that defines inability to pay debts by setting out instances occurrence of either of which renders a company to be deemed as unable to pay its debts. The last instance, which covers a situation where it is proved to the satisfaction of the court that the value of the company's assets is less than the amount of its liabilities, taking into account the contingent and prospective liabilities of the company is among aspects, which are missing in the *Companies Ordinance*, cap. 212

63 Section 247 – 266 of the *Companies Act, 2002*

The Administration Procedure

The administration procedure, which is found under chapter 11 of Part VII of the *Companies Act*, 2002 is specifically geared towards rescuing insolvent or financially distressed companies. The procedure is a close to the institution of administration procedure, which is a feature of the *UK's Insolvency Act 1986*.[64]

The procedure is elaborate and formal.[65] Upon presentation of a petition for administration order to the court, an administrator, who must be a qualified insolvency practitioner, is appointed by order of the court.[66] This is only effected if the court is satisfied that statutory grounds for such appointment exist. The administrator takes charge of the company's business, calls for a statement of the company's affairs from directors and on the basis of the information, formulates a proposal for consideration at a meeting of the companies' creditors.[67] If the proposals are approved at the meeting the administrator then proceed to the company's affairs in accordance with the proposals until either the proposals' purpose is achieved or reaches the opinion that the purpose cannot be attained, in which case steps will have to be taken to deal with the company otherwise than by administration procedure.

The petition for administration order is granted if the court is satisfied that the company is or likely to become unable to pay its debts and where the making of such order is likely to achieve either of the following purposes namely, the survival of the company, and the whole or any part of its undertaking as a going concern; the approval of a scheme of compromise or arrangement; and a more advantageous realization of the company's assets than would be affected on winding up.[68]

The wide range of purposes for which an order may be made is likely to result into a modest success of the new regime. On the other hand, the test of likelihood if it is subjected to unduly exacting standards by the courts most potentially viable companies might end up being denied opportunity to rehabilitate under the procedure.[69]

The Act does not contemplate the co-existence of administration with receivership. Accordingly, if a receiver is already in office, an administration order will not be made unless the charge holder by whom the receiver was appointed consents to the making of the administration order.[70]

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64 This Act is a result of the *UK's Cork Committee's Report, supra*

65 See sections 247 – 266 of the *Companies Act, 2002*

66 See sections 248 and 252 of the *Companies Act, 2002*. Section 3 of this Act defines insolvency practitioner to mean: " i) a certified accountant certified by the NBAA or other regulatory body of the profession as having the requisite experience of insolvency; ii) a qualified advocate of the High Court having the requisite experience of insolvency; iii) such other person as may be specified by Minister in regulations."

67 See sections 259 – 263 of the *Companies Act, 2002*

68 See section 247(1) & (3) of the *Companies Act, 2002*

69 The experience in the UK was such that the test of likelihood, which is available in the UK's Insolvency Act, 1986, was initially (before *Re Harris Simons Construction Ltd [1989] 1 WLR 368)* given a very strict and limited interpretation. This was likely to deny most potentially viable companies opportunity to rehabilitate under the administration procedure.

70 See sections 248(3), 249(3) and 250(2) of the *Companies Act, 2002* and

The filing of a petition for an administration order brings into operation an automatic stay (i.e. moratorium) that is continued if the order is made.[71] In keeping with the intended objectives, the administrator is given wide powers to manage the company's business and deal with its assets including the power to sell property, raise or borrow money and grant security therefore over the property of the company.[72]

Although the proposal is the cornerstone of the administration procedure, the *Companies Act, 2002* provides little guidance regarding its formulation. There is no requirement for instance on the administrator to exercise reasonable care and diligence to inform himself about all relevant facts, for example, the requirement to take fresh review of the company's present and prospective business operations, other than statements of company's affairs from directors or such other persons that were in a way connected to the company.

Similarly, the fact that the new lenders are not granted super priority, which would rank ahead of all pre-petition creditors the implementation of this procedure, is likely, at the end of the day to deny finances to a company, which is under administration. Hopefully, this will be taken care by the rules, which are currently being worked out.

Voluntary Arrangement Procedure

The other procedure under the Act is the Voluntary arrangement procedure, which provide a scheme within which a company and its creditors may enter in an arrangement with the object of reviving the company's business.[73] The initiative in setting up voluntary arrangement can only be taken by the directors or, if the company is in liquidation or under administration, by the liquidator or administrator.

Under this scheme, a proposal to the company and its creditors for a composition in satisfaction of its debtors or a scheme of arrangement of its affairs must provide for a person to act in relation to the scheme as a trustee or otherwise as a supervisor of the proposal implementation.[74]

The appointed person, upon being given notice of appointment as well as a document setting out the terms of the proposed voluntary arrangement and a statement of the company's affairs or such other relevant information, submit a report to the court stating whether meetings of the company and its creditors should be summoned to consider the proposal.[75] Once such meetings are held the appointed person shall have to report the results of the meetings to the court.[76] If the proposal is accepted at the respective meetings, it becomes binding upon the company, all of its creditors, including dissentients but without prejudice to the rights of secured and preferential creditors, unless they consent.[77] A party aggrieved by the voluntary arrangement so approved may under section 245 of the Act make an application to the court to challenge the approval on one or both of the following, namely that the voluntary arrangement

[71] See generally sections 249 and 250 *ibid*

[72] See generally sections 253, 254,and 255 *ibid*

[73] See section 240 of the *Companies Act, 2002*

[74] Section 240(2) *ibid*

[75] Section 241(2) & (3) *ibid*

[76] Section 243(6) *ibid*

[77] Sections 243 (1) and 244(1) *ibid*

unfairly prejudices the interests of a creditor, member or contributory of the company and or that there has been some material irregularity at or in relation to either of the meetings.

The person so appointed to administer the scheme must be a qualified insolvency practitioner.[78] However, the Act is silent on the role or power of such person who is by necessary implication an administrator of the scheme. It would seem that such person has little room to depart from the details of the scheme approved by the meetings.

As a matter of fact, this procedure has two main drawbacks. In the first place, the company voluntary arrangement procedure cannot be made binding upon secured or preferential creditor without his consent. And in the second place, there is no provision in the Act for securing a stay of proceedings (i.e. moratorium) while the proposal for voluntary arrangement is being considered. It would therefore seem that in order to bring about a moratorium, it is necessary to invoke voluntary arrangement procedure along with administration order or liquidation, an expensive and cumbersome routine which will frustrate the voluntary arrangement's speed which ought to be its main attractions.

Transition From Administration to Winding up

Although the *Companies Act, 2002* is a step in the right direction the new rescue procedures are not explicitly integrated with the winding up procedures. It would therefore seem that where the creditors resolve that the company be wound up or the company fails to effect the proposal within the prescribed time, it is not clear whether the company will be deemed to have entered into creditors voluntary winding up and the administrator, for instance, will be taken to have been appointed the liquidator.[79]

The Procedures for Dealing with Financially Distressed Parastatals

The procedures envisaged under the *Public corporation (Amendment) Act, 1993*[80], which provides for the manner into which the state ought to deal with insolvent specified public corporations is again an indication of acceptance and recognition of the spirit of rescue well before the enactment of the *Companies Act, 2002.*

The spirit envisaged in this procedure is such that when a specified public corporation is insolvent, the Commission (PSRC)[81] is empowered to cause its liquidation or determine an alternative restructuring option that would result into rehabilitations and thus survival of the corporation albeit under different ownership and management. The relevant provision in part reads thus;

> ... the Commission shall (a) in relation to a public corporation which is insolvent:
> (i) have power to determine whether the public corporation should be liquidated.
> (ii) have power to determine an *alternative restructuring option* provided that in the event of determining an alternative restructuring option the commission

[78] See sections 3 and 240 *ibid*

[79] See generally sections 245, and 256 of the *Companies Act, 2002*

[80] Act No. 2 of 1993

[81] PSRC means the Presidential Parastatal Sector Reform Commission. In this part of this article the commission will be used interchangeably with PSRC

> shall prior to proceeding with such option inform all the interested parties in writing of reasons for preferring that alternative option.[82] *(Emphasis supplied by the author)*

The available alternative options include privatization of management (e.g. management contract), lease with option to purchase, public offering, joint venture/trade sale especially where the joint venture partner is expected to bring finance and expertise required in production, marketing, management and capacity to expand business.[83]

Before any decision is taken the Commission is required to conduct a feasibility study with a view to determining how best such a corporation can be dealt with, the primary focus being attainment of natural objectives and specific objective for the specified corporation.

According to the *Public Corporation (Amendment) Act, 1993* and the PSRC Master plan, liquidation as an option is to be resorted to as of last resort only if a specified public corporation proves to be completely hopeless and a chronic loss maker and where it is appropriate to release its assets for wide redeployment.[84] The approach is applicable to all specified public corporations irrespective of whether or not they are incorporated under the *Companies Ordinance, Cap. 212.*

By mid 1999 the PSRC had already divested a total of 245 public corporations out of which it is only 61 corporations that were liquidated.[85] The rest had been dealt with by employing the other non-liquidation option. This procedure notwithstanding, there has been a general public outcry on the manner into which the privatization exercise is conducted in practice.[86] This however is not the concern of this present article.

Apparently, the State by introducing this approach, while such insolvent corporations could well be dealt with by liquidation procedure under the Companies Ordinance, had envisaged the socio-economic impact that would have occurred had all the financially troubled corporation been liquidated forthwith.

The Loans and Advances Realisation Trust Act, 1991[87] is another legislation in this regard, which was designed to deal with insolvent enterprises owed to the statised financial sector. The spirit of this legislation is such that while dealing with insolvent enterprise or that which is unable to settle its over due debts, the LART ought "where possible give priority to ensure sale on going concern basis failing which the LART has to embark on liquidation sale or any other legal

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82 Section 43 *ibid*

83 See for instance " Parastatal Sector Reform: 1994 Review and Action Plan for 1995 and Beyond", 1995 pp. 8 and 9. See also *PSRC Review and Action Plan for 2000-2004 and PSRC Master Plan 2000-2004*

84 *Ibid*

85 See the PSRC Review and Action Plan for 2000-2001

86 See Mushi,H. P. B. "Parastatal Sector Reforms and Privatisation" in ESAURP "*Tanzania's Tomorrow*, Dar es salaam, 1996 p. 319. See also generally Shaaban, B. "Citizenry Protection and Participation in Privatisation of Public Enterprises: A Survey of Legal Situation in Tanzania" Fourthcoming *Journal of Finance and Management, 2003*

87 Act No. 6 of 1991

process which seems to be most convenient and cost effective in dealing with assets of an insolvent enterprise."[88] It is in this regard that under section 5 of the Act, the trust may advise, direct, or facilitate the measures that have to be taken by or in respect of the debtor so as to enhance the capacity to pay its debts. The trust is as well empowered to enter into a workable arrangement with financially distressed enterprise with a view to formulating a modality under which the enterprise might settle the overdue debts without having the enterprise liquidated.[89] This is only applicable to enterprises that have proved to be viable and that have not completely ceased to operate.

Business Rescue Culture in the High Court of Tanzania: Recent Trends

A few cases related to financially distressed companies that have recently been dealt with in the High Court indicate a positive and encouraging trend on the part of the judiciary as to the recognition and acceptance of the rescue culture as an alternative to liquidation culture, which is the salient feature of the insolvency provisions under the present *Companies Ordinance, Cap. 212.*

In *Adesemi Tanzania Ltd Vs Registrar of Companies*[90] the petitioner company petitioned for compulsory winding up by reasons of financial difficulties. Upon filing of the petition, the court appointed a provisional liquidator charged among others with a duty of looking into the possibility of coming up with a scheme of arrangement, which could salvage the situation. However, as it was observed by the court while granting the order for compulsory winding up of the petitioner company despite the provisional liquidators effort to carry out the task bestowed on him, he failed to come out with any noble scheme for the company was grossly insolvent such that its liabilities seriously exceeded its assets.

It is worth noting that since the petition before the court was for winding up by the court, the basic issue to be considered and determined by the court in terms of the requirement of the *Companies Ordinance* was whether or not to grant the petition. It was not primarily bound to bestow the provisional liquidator with the task of examining the possibility of rescuing the company.

In more similar terms, in *Fahari Bottlers Ltd Versus The Registrar of Companies and NBC (1997) Ltd and Others*[91] the petitioners who were petitioning for compulsory winding up of their companies implored the court

[88] See rule 11 of the *LART Seizure and Disposal of Asset Rules, 1993* made under section 16 of the *Loans and Advances Realisation Trust Act, 1991*

[89] *LART's operating procedures* made under rule 12 of the *LART's Seizure and Disposal of Assets Rule, 1993 supra.*

[90] Misc. Cause No. 5 of 2000 (High Court Commercial Division), as per Kalegya, J. 12/10/2000

[91] Misc. Civil Cause No. 155 of 1998 [consolidated with Misc. Civil Causes Nos. 146, 147, 148, 149, 150, 151, 152, 153, and 154 by Order of the Court dated 16th July 1999] as per Kalegeya J. It is important to note that the consolidation was effected for ease of approach in view of the fact that all the petitioners were under the same group of companies and having common background, interests and prayers. It is also worth noting that the petitioners had no scheme of arrangement in place when proposing before the court that the companies be placed under such a scheme.

which consequently conceded to appoint a provisional liquidator who would look into a formulation of a scheme of arrangement if feasible in the circumstances. The petitioners being under the same group of companies and having common background, interests and prayers for ease of approach, all the ten petitions were consolidated and dealt with in one petition.

The provisional liquidator did his job and subsequently the scheme was accepted by the creditors and approved by the court in terms of the provisions of section 154 of the *Companies Ordinance Cap. 212*. Researches need to be done to establish how implementation of the scheme has fared in practice.

CONCLUSION

The review of relevant legislation touching on the emerging aspect of corporate rescue has made it clear that unlike the *Companies Ordinance, cap. 212*, the *new Companies Act, 2002* envisages a positive direction towards the rescue approach. The new Act in a number of ways envisages an approach, which is similar to that found in particular the *UK Insolvency Act, 1986*. Regrettably, the Act has not accommodated some good features of rescue available in other jurisdictions for instance the affording post petition financing priority over the other debts in the event the company is liquidated. Despite the weaknesses pointed out above with regard to the Act, which is even yet to become operational, we cannot at this stage comment on how the legislation fares in actual practice. Apparently, a lot of public awareness activities and especially among the financiers and business community as to the nature and application of these procedures needs to be made, as this is likely to change their attitudes towards companies in financial difficulties. Sometime in 1958, the *Companies Ordinance, cap.419* was enacted basing on the *English Companies Act, 1948*.[92] It is unfortunate that this legislation, which sought to repeal and replace the *Companies Ordinance, cap. 212* was just shelved and never brought into force. Hopefully, the *Companies Act, 2002* will soon be made operational so that the history could not be taken to have repeated itself.

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[92] See Spry, J. F. "Companies Legislation" in Thomas, P. A. *Private Enterprise and the East African Company*, TPH, Dar es salaam, 1969 p. 59

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