FOUNDATION CERTIFICATE IN INTERNATIONAL INSOLVENCY LAW

Module 7B Guidance Text

Kenya

2023 / 2024

INSOL INTERNATIONAL
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IN INTERNATIONAL INSOLVENCY LAW

CONTENTS

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1. INTRODUCTION TO INTERNATIONAL INSOLVENCY LAW IN KENYA

Welcome to **Module 7B**, dealing with the insolvency system of **Kenya**. This Module is one of the elective module choices for the Foundation Certificate. The purpose of this guidance text is to provide:

- a general overview, including the background and history, of Kenya's insolvency laws;
- a relatively detailed overview of Kenya's insolvency system, dealing with both corporate and consumer insolvency; and
- a relatively detailed overview of the rules relating to international insolvency and how they are dealt with in the context of Kenya.

This guidance text is all that is required to be consulted for the completion of the assessment for this module. You are not required to look beyond the guidance text for the answers to the assessment questions, although bonus marks will be awarded if you do refer to materials beyond this guidance text when submitting your assessment.

Please note that the formal assessment for this module must be submitted by **11 pm (23:00) BST (GMT +1) on 31 July 2024**. Please consult the web pages for the Foundation Certificate in International Insolvency Law for both the assessment and the instructions for submitting the assessment. Please note that no extensions for the submission of assessments beyond 31 July 2024 will be considered.

For general guidance on what is expected of you on the course generally, and more specifically in respect of each module, please consult the course handbook which you will find on the web pages for the Foundation Certificate in International Insolvency Law on the INSOL International website.

2. AIMS AND OUTCOMES OF THIS MODULE

After having completed this module you should have a good understanding of the following aspects of insolvency law in Kenya:

- the background and historical development of Kenyan insolvency law;
- the various pieces of primary and secondary legislation governing Kenyan insolvency law;
- the operation of the primary legislation in regard to liquidation and corporate rescue;
- the operation of the primary and other legislation in regard to corporate debtors;
- the rules of international insolvency law as they apply in Kenya;
- the rules relating to the recognition of foreign judgments in Kenya.

After having completed this module you should be able to:

- answer direct and multiple-choice type questions relating to the content of this module;
- be able to write an essay on any aspect of Kenyan insolvency law; and
- be able to answer questions based on a set of facts relating to Kenyan insolvency law.

Throughout the guidance text you will find a number of self-assessment questions. These are designed to assist you in ensuring that you understand the work being covered as you progress through text. In order to assist you further, the suggested answers to the self-assessment questions are provided to you in **Appendix A**.

3. AN INTRODUCTION TO KENYA

Kenya is a democratic country with a Presidential system of Government. The national government is composed of three arms: the legislature, the executive and the judiciary. Each arm is independent of the other and their individual roles are set by the Constitution of Kenya. The executive in charge of the day to day running of the country is two tiered. One tier is the National Government and the second tier is the relevant County Government. The country is comprised of 47 counties, each county with its own semi-autonomous government headed by a Governor who is assisted by executive members (county cabinet). The legislative branch comprises of parliament which is divided into two houses, namely: the National Assembly and the Senate.[1] The full name of the country is the Republic of Kenya. The Judiciary is led by the Chief Justice. The highest court is the Supreme Court, the decisions of which are binding on all the other courts. The courts are divided into two levels: Superior Courts and Subordinate Courts. Superior Courts are in terms hierarchy superior and are presided over by Judges. These are the Supreme Court, the Court of Appeal, the High Court (which has original exclusive and unlimited jurisdiction and hears almost every type of case), the Environment and Land Court (which deals with land cases) and the Employment and Labour Relations Court (which deals with employment matters).

The subordinate courts consist of the magistrates courts, the Kadhi's courts, the Courts Martial and any other court or local tribunal as may be established by an Act of Parliament, other than the currently established courts. All Judges, including the Chief Justice and the Deputy Chief Justice, are selected by the Judicial Service Commission but are officially appointed by the President. However, the persons selected to be the Chief Justice and Deputy Chief Justice must first be vetted by Parliament before being appointed by the President. All other High Court Judges do not need Parliamentary vetting and approval. Magistrates who preside over the subordinate courts are selected and appointed by the Judicial Service Commission without the involvement of the President or Parliament.

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[1] The mandate of each of these houses is set out in the Constitution. The National Assembly passes laws in conjunction with the Senate. The Senate is usually involved in instances where the law in question falls under certain categories listed in the constitution. Generally, the Senate is involved in law making where the law in question affects counties or is a finance Bill (defined to be a law that has monetary implications in counties).

The Kenyan legal system consists of a mix of Kenyan statutory (written) law and Kenyan and English common law, mixed with elements of customary and Islamic law.

Kenya's basic legal system and body of law is founded on English law. This is as a result of Kenya having been a part of the British empire for many decades until its independence in 1963. Kenya is still a member of the British Commonwealth. Kenya is the economic, financial, and transport hub of East Africa. Kenya's real gross domestic product (GDP) growth has averaged over 5% for the last decade. Since 2014, Kenya has been ranked as a lower middle-income country because its *per capita* GDP crossed a World Bank threshold. Its neighbours Tanzania and Uganda are ranked as lower income countries. While Kenya has a growing entrepreneurial middle class and steady growth, its economic development has been impaired by weak governance and corruption. Although reliable numbers are hard to find, unemployment and under-employment are high, and could be near 40% of the population. In 2013, the country adopted a devolved system of government with the creation of 47 counties, and the process of devolving state revenues and responsibilities to the counties.

Agriculture remains the backbone of the Kenyan economy, contributing one-third of its GDP. About 40% of Kenya's population of roughly 52.1 million work in the agricultural sector, including livestock and pastoral activities. Over 75% of agricultural output is from small-scale, rain-fed farming or livestock production. The Covid-19 shock hit Kenya's economy hard through supply and demand shocks on both the external and domestic fronts and caused activity to slow sharply in 2020 (real gross domestic product is estimated to have contracted by 0.3% in 2020). Agricultural output grew robustly, but manufacturing and many services subsectors (for example, tourism and education) were severely disrupted.

A regional locust infestation, which started in early 2020, also affected some parts of Kenya, especially the North East. Nevertheless, moving into 2021 a significant economic recovery had been underway, although it remains highly uneven across sectors (with some, such as tourism, remaining under severe pressure), and there continues to be elevated uncertainty regarding the economic outlook. The downside risks include a weaker than expected global economic recovery undermining Kenya's export, tourism and remittance inflows, renewed disruption to domestic economic activity from the pandemic, fiscal slippages, and weather-related shocks.

Kenya's economy has rebounded strongly post-Covid with last year's numbers placing GDP growth at 7.5% - the fastest pace in 11 years. The 2022 World Bank report on the outlook of Kenya's economy notes that Kenya's economic performance remained strong in the early months of 2022, but external challenges have mounted. The economy is vulnerable to the commodity price shocks resulting from the war, particularly through fuel, fertilizer, wheat and other food imports. Global financial conditions have also tightened sharply, increasing external financing costs. However, Kenya's exposure to the war in Ukraine through direct trade linkages is small, with Russia and Ukraine accounting for only 2.1% of total goods trade between 2015 and 2020. Similarly, tourists from Ukraine and Russia do not account for a significant share of Kenya's tourism market.

On the upside, measures by the Central Bank of Kenya that maintained an accommodative monetary policy stance cushioned the economy and helped bolster recovery. Inflation has recently moved higher to 7.1% year-on-year in May 2022 as domestic food prices, and fuel prices in March to May, increased following the surge in global commodity prices due to the war in Ukraine. The full impact of the global oil price and other commodity prices shock on domestic prices has been cushioned by government subsidies which have, however, come at a fiscal cost. Consequently, in late 2022 the energy regulator scrapped fuel subsidies. In response to the ongoing surge in global commodity prices and supply disruptions that have added to inflationary risks, the Central Bank of Kenya increased the Central Bank Rate from 7% to 7.5% in their meeting of 30 May 2022 to anchor inflationary expectations. Against the continuing backdrop of persistent global uncertainties, this was further raised following the 29 March 2023 meeting by the Monetary Policy Committee to 9.5%.

The growth outlook is however positive. The economy grew by 5.5% in 2022 against a projected outlook of 5.5% and is projected to grow by 5.6% in 2023 driven by services and household consumption. The rebound assumes that economic activity will normalise due to a full reopening of the economy, the Economic Recovery Strategy being successfully implemented, and Kenya capitalising on an expected improvement in external liquidity and benefiting from initiatives to meet its external financing needs. The external initiatives could include debt refinancing, restructuring and debt service relief, and additional concessional loans.

4. LEGAL SYSTEM AND INSTITUTIONAL FRAMEWORK

4.1 Legal system

Judicial precedents are outcomes of reinterpreting and reinvigorating sources of law. Judicial precedents are also sources of law when they engender what can pass as an enactment of a new law. Some of the Kenyan sources of law are listed in section 3 of the Judicature Act. They are as follows:

(a) the Constitution of Kenya;

(b) statutes, which include Acts of the Parliament of Kenya and subsidiary legislation;

(c) some specified Acts of the Parliament of the United Kingdom (UK);

(d) some specific foreign legislation and statutes of general application in force in England on the 12 August 1897;

(e) the substance of the common law, the doctrine of equity and the procedure and practice observed in the courts of justice in England as at 12 August 1897; and

(f) African customary law.

There are other sources of law not mentioned in the Judicature Act but given force through the Constitution and other Acts of Parliament. Pursuant to Article 2 of the Constitution, international treaties and customary practices are a source of law in Kenya. Islamic law and Hindu law are also sources of law so far as personal law is concerned.

4.1.1 *Insolvency regime*

The Insolvency Act, 2015 (the Insolvency Act) was enacted with the key objective of amending and consolidating the legislation relating to the insolvency of natural persons and incorporated and unincorporated bodies. It aims to provide for and regulate the bankruptcy or liquidation of natural persons and incorporated and unincorporated entities, to enable their affairs to be managed for the benefit of their creditors.

Prior to the enactment of the Insolvency Act, corporate insolvency was dealt with under the winding-up provisions in the Companies Act[2] (the repealed Companies Act) while the insolvency of natural persons was covered in the Bankruptcy Act of Kenya[3] (the Bankruptcy Act).

Unlike the previous legislation, the Insolvency Act seeks to redeem insolvent companies through administration as opposed to liquidation. The Insolvency Act introduces provisions that are intended to help rescue insolvent entities to continue operating as going concerns so that they may be able to meet their financial obligations to the satisfaction of their body of creditors. The Insolvency Act is largely adopted from the UK Insolvency Act 1986, and the administration provisions in the UK Enterprise Act. The procedural aspects of insolvency law in Kenya is governed by the Insolvency Regulations of 2016 as amended by the Insolvency Regulations of 2018.

4.2 Institutional framework

4.2.1 *Judicial system*

The Judiciary is one of the three State organs established under Chapter 10, Article 159 of the Constitution of Kenya. It establishes the Judiciary as an independent custodian of justice in Kenya. Its primary role is to exercise judicial authority given to it by the people of Kenya.

The institution is mandated to deliver justice in line with the Constitution and other laws. It is expected to resolve disputes in a just manner with a view to protecting the rights and liberties of all, thereby facilitating the attainment of the ideal rule of law.

The Judiciary and its related institutions (the Judicial Service Commission (JSC), Kenya Law (previously National Council for Law Reporting (NCLR), Tribunals and the Judiciary Training Institute (JTI)) perform the following functions:

- the administration of justice;
- formulation and implementation of judicial policies; and
- compilation and dissemination of case law and other legal information for the effective administration of justice.

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2 Cap 486 of the Laws of Kenya.
3 Cap 53 of the Laws of Kenya.

The courts under the Constitution operate at two levels, namely superior and subordinate courts.

The court system has been decentralised and made independent with each of the Supreme Court and the Court of Appeal having its own President and the High Court having a Principal Judge as the heads of the respective institutions.

The Supreme Court of Kenya was newly established under Article 163 of the Constitution of Kenya. It comprises seven judges: the Chief Justice, who is the president of the court, the Deputy Chief Justice, who is the deputy to the Chief Justice, the vice-president of the Supreme Court and five other judges.

The Court of Appeal is established under Article 164 of the Constitution of Kenya 2010 and is the first appellate court from the High Court.

The High Court is established under Article 165 and is organised and administered in the manner prescribed by an Act of Parliament, the High Court (Organization and Administration) Act.[4] The Court has a Principal Judge, who is elected by the judges of the High Court from among themselves.

The High Court has been restructured into several divisions: Anti-corruption and Economic Crimes, Commercial and Admiralty, Constitutional and Human Rights, Criminal, Family, and Judicial Review. Both the Environment and Land Court and Employment and Labour Relations Court are established under Article 162(2) of the Constitution with limited jurisdiction and equal status to the High Court.

The subordinate courts are established under Article 169. They consist of the magistrates' courts, Kadhis courts, court martial and any other court or local tribunal established by an Act of Parliament.

In 2011, Kenya had only 53 judges and 330 magistrates for a population of 41.4 million. There was a massive backlog of almost 1 million cases. Litigants often bribed staff to get earlier court dates or to "lose" case files and prevent hearings altogether. In 2010, 43% of Kenyans who sought services from the judiciary reported paying bribes, according to Transparency International. The courts were also widely seen as politically biased. Until the passage of the new constitution in 2010, the President had unilateral power to appoint not only the Chief Justice of the Court of Appeal, then Kenya's highest court, but also all the members of the Judicial Service Commission, responsible for hiring and disciplining judges.

Kenya's judicial reforms have led to some concrete, measurable successes. The judiciary hired more than 200 new judges and magistrates and established 25 new court stations since 2011 in an effort to increase capacity and access to the judiciary in remote areas. Many other stations continue to be open year in year out depending on needs. While these reforms must be acknowledged, backlogs continue and cases can still take very long to conclude. For example,

4 High Court (Organization and Administration) Act, No 27 of 2015.

commercial disputes in the High Court can take two to three years to conclude and seven to eight years if it goes to appeal. However, Kenya has appointed a new Chief Justice (the first female Chief Justice) who has promised to solve backlog issues with measures such as automation of court processes like filings and the establishment of the Small Claims Court that is characterised by simplicity of procedure, timely disposal of proceedings, fairness of process, and reasonable court fees. Following the 2022 general election, the new President also commenced government business by appointing new High Court and Court of Appeal judges.

4.2.2 *The Official Receiver*

The office of the Official Receiver is established under the Insolvency Act and plays various supervisory roles in matters related to insolvency. The Official Receiver *inter alia* deals with the licensing and supervision of insolvency practitioners, the administration and supervision of bankruptcy cases for natural persons and the administration of the liquidation of companies. The Official Receiver's office has been consolidated with other departments at the State Law Office and is now under the Business Registry Service.

Self-Assessment Exercise 1

Study the basic aspects dealt with in the previous section.

Question 1

Briefly discuss the court system in Kenya and various court levels and their respective jurisdictions.

Question 2

Briefly discuss the Kenyan legal system and sources of law in Kenya.

For commentary and feedback on self-assessment exercise 1, please see APPENDIX A

5. SECURITY

5.1 Generally

A wide range of assets can be the subject of security in Kenya, including land, shares, receivables, bank accounts, aircraft, ships and movable tangible and intangible assets. Some of these are analysed generally as below:

(a) a charge may be taken over land (including buildings). The form of instrument and the execution requirements of security over land must conform to the mandatory requirements of the land laws. Under the Constitution of Kenya, a person who is not a citizen of Kenya may own land on the basis of a leasehold tenure only, not exceeding a period of 99 years. An asset permanently fixed to the land (such as a building) will automatically form part of the land over which security is taken;

(b) a charge may be created over specific movables assets, such as a plant and machinery, motor vehicles and other tangible assets;

(c) a company may create security over all its assets present and future by way of an all-assets debenture, but where the charged assets include land, aircraft or ships, a separate security will be required to be created and registered at the Lands Registry;

(d) intellectual property rights may be assigned as security to a lender. Further, the rights of a party under any contract can be assigned as security, provided that there is no restriction in the contract preventing the creation of a security interest;

(e) it is possible to take an assignment by way of security over the benefit of an insurance policy. In order to perfect the security, a written notice of the security interest should be given to the insurance company which should also acknowledge the arrangements;

(f) security may be created by way of a charge over shares. In addition, it is recommended that the charge / shareholder obligor execute a blank share (stock) transfer form and surrender the transfer form and the original share certificate in respect of the shares to the chargee. An appropriate authority to undertake the transfer should be included in the security document, or the chargee executes an irrevocable power of attorney granting the chargee the right to sell the shares. This will assist in the event of enforcement; and

(g) a charge may be taken over cash deposits in a bank account. To perfect this kind of security, it is recommended that the borrower issues a notice to the bank advising them that the account has been charged to the lender. With this type of security, however, there is a legal conundrum that arises in that it can be argued that the asset being created is flawed. This is because conceptually it is not possible to create security over a debt that is owed by the bank, as that amounts to a deposit. This has not been tested in the Courts in Kenya but has been the subject of case law in the UK. It is hard to tell the approach that Kenyan courts would take regarding this issue but, as highlighted above, Kenyan courts consider UK case law as persuasive authority. In practice, lenders in Kenya regularly take security over deposits held in banks.

An assignment may be taken over receivables and rights under contracts.

Special rules apply regarding the taking of security over aircraft and ships. For aircraft, a security interest is noted on the certificate of registration which is issued by the Kenya Civil Aviation Authority and registered at the International Registry of Mobile Assets (and the Companies Registry, if the chargor is a company registered in Kenya). In addition, it is advised that aircraft securities be registered at the Cape Town International Registry.[5] For ships, the security interest (either over the ship or a share in the ship) should be registered at the Kenya Maritime Authority Registry.

5.2 General perfection formalities

5.2.1 Stamp duty

Subject to certain limited exemptions, stamp duty is payable on most types of security documents. Certain instruments are exempted under the Movable Property Security Rights Act which provides for securities registered under that act in the Collateral Registry to be exempt. The stamping process must be completed within 30 days of executing the document (or, if the security was executed outside Kenya, within 30 days of the security document entering into Kenya). The person taking security bears the stamp duty cost, although typically the security provider bears this cost. The failure to stamp a security document can result in a fine, an inability to register the security document and the security document being declared inadmissible in court. Stamp duty is typically payable at the rate of 0.1% of the amount secured by the principal security document. Stamp duty is payable on supplemental security documents at the nominal rate of KES 200.[6] Securities that do not require registration under any registry other than the Collateral Registry are, however, exempt from payment of stamp duty.

5.2.2 Registration

Depending on the nature of the security and the asset, registration is a prerequisite for purposes of achieving third-party effectiveness and granting fixed charge priority to the security holder in the event of enforcement. For land, the fixed charge security must be registered at the relevant Land Registry and, if the land owner is a company, registration at the Companies Registry is also required. For security comprising fixed or floating charges created by companies, registration at the Companies Registry within 30 days of the creation of the security is a necessity for the security to be valid against a liquidator or creditor of the company. Registration at the Collateral Registry for movable assets,[7] which are widely defined, is also a prerequisite for purposes of achieving third party effectiveness. In addition, registration at the Collateral Registry grants priority for purposes of insolvency and it is therefore crucial that securities are registered under

[5] The International Registry of Mobile Assets provides a means to establish the priority of interests in airframes, aircraft engines and helicopters. The International Registry permits individuals and organisations to register financial interests in assets using the following information: (i) manufacturer's name, (ii) model designator, and (iii) manufacturer's serial number. Its role is to electronically record international interests in aircraft objects, for the purpose of establishing the priority of those interests. The Registry operates under the legal framework of the Cape Town Convention and the Aircraft Protocol adopted on the 16th of November 2001 at Cape Town, which provides for the registration and protection of International Interests that are recognised by all ratifying states, with priority being determined on a first-to-file basis. Registration of interests in existing assets serves as a notification mechanism to the user community and is considered to be best practice for owners and agents to protect their financial interest in an asset.

[6] Approximately USD 2.

[7] Movable assets are defined as all types of goods and includes motor vehicles, crops, machineries, livestock and includes receivables, choses in action, deposit accounts, electronic securities and intellectual property rights.

the Kenya Moveable Property Security Rights Act, 2017 to provide a secured creditor with effective security over movable assets.

5.3 Secured creditors and insolvency proceedings

Secured assets do not form part of the insolvent's estate and the secured creditor is at will to sell the assets and realise the security. However, while a moratorium is in effect (either sanctioned by the court or via automatic application in the case of an administration process), a secured creditor may only sell the secured asset with the approval of the court or with the consent of the relevant insolvency practitioner.

For floating charge holders however, it should be noted that if the security has not crystallised into a fixed charge, the floating charge security will rank after preferential creditors.

Self-Assessment Exercise 2

Study the basic aspects dealt with in the previous section.

Briefly discuss the various forms of security that are available in Kenya and their perfection formalities.

For commentary and feedback on self-assessment exercise 2, please see APPENDIX A

6. INSOLVENCY SYSTEM

6.1 General

The Insolvency Act consolidated and amended the various laws relating to the insolvency of natural persons, incorporated and unincorporated bodies. The Insolvency Rules, 2016 as amended by the Insolvency Regulations, 2018, supplement the provisions of the Insolvency Act and provide for the procedural legislation with respect to insolvency processes. The Insolvency Act consolidates both individual person and corporate insolvency into one piece of legislation.

The Insolvency Act applies to natural persons, partnerships, limited liability partnerships, companies and other corporate bodies established by any written law. This application is inclusive and encompasses entities and bodies established under statutory laws, incorporated and unincorporated entities. Once an insolvency process is commenced against an individual or an entity, the entities' or individuals assets are usually vested with the insolvency practitioner in charge of the insolvency process. However certain assets are excluded and the insolvency practitioner may not exercise their powers over such assets. These excluded assets, for companies include assets where the company has no beneficial interest, assets held or obtained by way of bailment or hire purchase and assets held in trust for third parties. With regard to insolvency of natural persons, excluded assets include the bankrupt's necessary tools of trade;

necessary household furniture and personal effects (including clothing) for the bankrupt and the bankrupt's relatives and dependants; and a motor vehicle valued at not more than KES 1 million.

The High Court of Kenya (Commercial and Admiralty Division) handles bankruptcy and insolvency proceedings. Appeals from the High Court lie in the Court of Appeal; in some instances with the leave of the court and in some instances without leave of the court, depending on the specific decision being challenged. The Court of Appeal requires that the appellant posts security for costs that are assessed based on the value of the appeal and the nature of the relief sought.

6.2 Personal / consumer bankruptcy

6.2.1 Insolvency of natural persons

6.2.1.1 Bankruptcy application

One or more creditors can make a bankruptcy application to the High Court under sections 15(a) and 17 of the Insolvency Act. The debtor or the supervisor (of a voluntary arrangement) can also make an application for bankruptcy.

Previously, a bankruptcy application would only be capable of being made where the debtor was domiciled in Kenya or, if within a year before the date of presentation of the petition, the debtor had ordinarily resided or had a place of business or carried on a business in Kenya. Section 15(3) of the Act now provides that an application can also be brought if the debtor is personally present at the date of application or had ordinarily resided or carried on business within three years of the date of application. The Insolvency Act has therefore widened the scope for bankruptcy applications to be brought against debtors ensuring that creditors' interests, such as those of lending institutions, are protected.

6.2.1.2 Powers of a bankruptcy trustee over charges

Section 200 of the Insolvency Act provides that a bankruptcy trustee can on its own initiative cancel a charge over any property of a bankrupt if the charge was created within two years immediately before the bankruptcy commenced and, immediately after the charge was created, the bankrupt was unable to pay the bankrupt's due debts. However, a charge may not be cancelled if it either secures money actually advanced or paid, if it secures the actual price or value of property sold or transferred, or if any other valuable consideration was given in good faith by the secured creditor at the time when the charge was created. This means that where a lending institution advances money to a debtor secured by a charge, this will not be subject to cancellation of the charge by the bankruptcy trustee.

6.2.1.3 Secured creditors' options in the event of bankruptcy

Previously, the Bankruptcy Act provided three options available to secured creditors when selecting the course of action to take to realise a debt owed to them. These provisions are mirrored in sections 226 and 228 of the Insolvency Act. In particular, the secured creditor has the option to:-

(a) realise the charged asset, that is, sell the charged asset and use the proceeds of such sale to settle the debt owed by the bankrupt;

(b) surrender the charged assets to the bankruptcy trustee for the benefit of all creditors; or

(c) have the charged asset valued and prove for the balance due after deducting the amount of the valuation.

The Bankruptcy Act did not provide a time frame within which a secured creditor could exercise these options. The Insolvency Act now provides that the bankruptcy trustee may, at any time by notice, require the secured creditor who holds a charge over a bankrupt's property to choose any of the options within 30 days after receipt of the notice.

Should a secured creditor choose to surrender its charge to the trustee for the benefit of creditors, or have the charged property valued and prove for the balance due after deducting the amount of the valuation, then this has to be done within the 30-day period. It is important to note that failure to comply with the notice with respect to selecting an option will be deemed to be a surrender of the charge to the bankruptcy trustee for the general benefit of the creditors. This means that the secured creditor will have to prove its whole debt as an unsecured creditor.

6.2.1.4 Claim for interest by a creditor

A creditor may claim interest on the debt up to the date on which the bankruptcy commences. Where the debt relates to a contract, interest is levied at the rate specified in the contract and where the debt is with respect to a judgment debt, then the interest is at the rate payable on the debt or the court rate (currently at 14%) if the contract does not provide an interest rate. Post-bankruptcy, the bankruptcy trustee can only pay interest on the allowed creditors' claims, if surplus assets remain after the bankruptcy trustee has paid the claims of the other creditors in full.

6.2.1.5 Power of the court to order disposal of charged property

The power of the court to order the disposal of charged property as provided in rule 62 of the repealed Bankruptcy Rules, has been retained in sections 227(1) and (2) of the Insolvency Act. However, under the Bankruptcy Rules, the court, if satisfied that a sale was necessary, would give notice as to when, where, how and by whom the property must be sold. The Insolvency Act now provides that the bankruptcy trustee may make an application to court and that the court may make an order enabling the bankruptcy trustee to dispose of the property as if it were not subject to the security, but only if the court is satisfied that the disposal of the property would be likely to provide a better overall outcome for the creditors of the bankrupt.

Section 227(3) of the Insolvency Act provides that such an order, if granted, is subject to the condition that the bankruptcy trustee applies the net proceeds of disposal of the property (and any additional money) required to be added to the net proceeds towards discharging the amounts secured by the security. This is so as to produce the amount determined by the court as the net amount that would be realised on a sale of the property at market value. In contrast, Rule 64 of the repealed Bankruptcy Rules provided that monies would in the first place be applied in payment of the costs, charges and expenses of the trustee occasioned by the application and the sale. It can therefore be deduced that a secured creditor will now rank in priority in receiving the proceeds of the sale over the trustee's costs.

6.2.1.6 Where a secured creditor realises the security

Section 228(3) of the Insolvency Act states that a secured creditor is required to account to the bankruptcy trustee for any surplus remaining after payment of the debt, interest and any proper payments to the holder of any other charge over the property. It is therefore necessary that a creditor accounts for any surplus to the trustee upon realising its security.

6.2.1.7 Automatic discharge of a bankrupt

The repealed Bankruptcy Act previously did not provide a time frame within which a bankrupt would be discharged. Section 254 of the Insolvency Act now provides for an automatic discharge of a bankrupt after three years except under the circumstances set out under subsection 2. A bankrupt is not automatically discharged under subsection 2 if:

(a) the bankruptcy trustee or a creditor has objected and the objection has not been withdrawn by the end of the three-year period:

(b) the bankrupt has to be publicly examined, on request by a creditor or the bankruptcy trustee, and has not completed that examination; or

(c) an objection by a creditor or the bankruptcy trustee to the discharge has been raised.

On being discharged, a bankrupt is released from all debts provable in the bankruptcy except debts incurred by fraud, fraudulent breach of trust, or amounts payable under the Matrimonial Causes Act or the Children's Act.

However, it is expected that a secured creditor would have already realised his security before the end of this period and would therefore not generally be affected by an early discharge of the bankrupt.

6.2.1.8 Alternatives to Bankruptcy

Voluntary arrangement

The Insolvency Act allows a debtor to enter into an arrangement with his creditors as an alternative to bankruptcy. A debtor's proposal (with or without modifications) takes effect as a voluntary arrangement by the debtor on the day after the date on which it is approved by the court. On taking effect, the approved proposal binds every person (including a secured creditor and a preferential creditor) who was entitled to vote at the meeting or would have been so entitled if the person had received notice of the meeting, as if the person were a party to the arrangement. The provisional supervisor thereafter becomes the supervisor of the arrangement.

Pursuant to section 310(7), if a proposal or a modification to a proposal affects the right of a secured creditor to enforce his security, the proposal or modification may not be approved unless the secured creditor consents to it. If the secured creditor does not consent to it, it will not be approved unless the secured creditor would be in a position no worse than if the debtor were adjudged bankrupt, or would receive no less from the assets to which the creditor's security relates, or from their proceeds of sale, than any other secured creditor having a security interest in those assets that has the same priority as the secured creditor. Also, where the secured creditor does not consent to it, it will not be approved unless the secured creditor would be paid in full from those assets, or their proceeds of sale, before any payment from them or their proceeds is made to any other creditor whose security interest in them is ranked below that of the creditor, or who has no security interest in them.

Composition

The creditors of a debtor may accept a composition in satisfaction of the debts due to them from the bankrupt by passing a special resolution that contains the terms of the composition. If there is more than one class of creditors, the delay of one class in accepting, or the failure of one class to accept, does not prevent any other of the classes from accepting the composition.[8]

If the proposal for composition provides for the payment in full of all creditors whose respective debts do not exceed a specified amount, that class of creditors is not to be counted either in number or value for the purpose of counting the requisite majority of creditors for passing the confirming resolution. A composition is not binding until it is approved by the Court upon application by the bankrupt or the Official Receiver. Before approval the court considers the report of the Official Receiver on the terms of the composition and any objection raised by any creditor. When approved by the Court, a composition binds all the creditors in respect of provable debts due to them by the bankrupt.

As soon as practicable after Court approval of a composition the bankrupt and the Official Receiver execute a deed of composition for putting the proposal into effect. The Official Receiver then applies to the Court for confirmation of the deed. If it is satisfied that the deed conforms with the composition that it has earlier approved, the Court directs that the deed be lodged in the Court and on lodgement of the deed quashes the relevant bankruptcy order. The deed binds all the creditors in all respects as if they had each executed the deed.[9]

6.2.1.9 No-asset procedure

This procedure is for dealing with a debtor who has no realisable assets. The Official Receiver must admit a debt to the no asset procedure if he is satisfied that the debtor has:

[8] Insolvency Act, s 276.
[9] *Idem*, ss 281 and 282.

(a) no realisable assets;

(b) not previously been admitted to the no-asset procedure; and

(c) not been declared bankrupt and has total debts that are not less than KES 100,000 and not more than KES 4 million.

A debtor is disqualified from entering into a no-asset procedure if:

(a) the debtor has concealed assets with the intention of defrauding the debtor's creditors (such as by transferring property to a trust);

(b) the debtor has engaged in conduct that would, if the debtor were adjudged bankrupt, constitute an offence under the Act;

(c) the debtor has incurred a debt or debts knowing that the debtor does not have the means to repay them; or

(d) a creditor intends to apply for the debtor to be adjudged bankrupt and it is likely that, if the debtor were to be adjudged bankrupt, the outcome for the creditor would be materially better than if the debtor were admitted to the no-asset procedure.

A debtor who has applied for entry into the no-asset procedure should not obtain credit, either alone or jointly with another person for more than KES 10,000 without first informing the credit provider that the debtor has applied for entry into the no-asset procedure. Creditors may not begin, enforce or seek to recover or enforce any debts of a debtor admitted to no-asset procedure. However, debtors must still make payments of orders made under the Matrimonial Causes Act, the Children Act and for amounts owed in respect of a loan to secure the education of a dependent child. The no-asset procedure is terminated by either the Official Receiver or if the debtor applies for bankruptcy or if a debtor is discharged under section 359 (automatically after 12 months after the debtor was admitted to the procedure unless extended by the Official Receiver) or if a creditor applies for the debtor's bankruptcy.

On termination of a no-asset procedure, except under section 359, the debtor's debts that became unenforceable become enforceable and the debtor becomes liable to pay any penalties and interest that may have accrued. Discharge under section 359 is different as the debtor's debts do not become enforceable and they are no longer liable to pay any part of the debts including any penalties and interest that might have accrued.

Self-Assessment Exercise 3

Study the basic aspects dealt with in the previous section.

Briefly discuss the options that a secured creditor has in the event of bankruptcy.

For commentary and feedback on self-assessment exercise 3, please see APPENDIX A

6.3 Corporate insolvency

6.3.1 Winding-up of a company under Kenyan law

The liquidation of companies in Kenya is governed by the Insolvency Act. Under the Insolvency Act there are two types of liquidation:

(a) voluntary liquidation; and

(b) liquidation by the court.

6.3.1.1 Voluntary liquidation

A company may be liquidated voluntarily:

(a) if the company in a general meeting has passed a resolution providing for its voluntary liquidation when the period fixed for the duration of the company by the articles of association expires, or on the occurrence of an event upon which the articles provide that the company is to be dissolved; or

(b) if the company resolves by special resolution that it be liquidated voluntarily.

Before passing a resolution for voluntary liquidation, the company must give notice of the resolution to the holder of any qualifying floating charge in respect of the company's property. The resolutions are made in the prescribed Form 32A.[10]

Where a notice is given proposing a resolution for voluntary winding-up, it may only be passed after the expiry of seven days from and including the date on which the notice was given, or if the person to whom the notice was given has consented in writing to the passing of the resolution.

Within 14 days of the passing of such a resolution, a company must publish a notice setting out the resolution:

(a) once in the Kenya Gazette (the Gazette);

(b) once in at least two newspapers circulating in the area in which the company has its principal place of business in Kenya; and

(c) on the company's website.

[10] Insolvency Regulations, Reg 77A.

If the company fails to comply with the publication, each officer of the company is liable on conviction to a fine not exceeding KES 500,000.

The directors of the company are required to make a solvency declaration within five weeks immediately before the passing of the resolution for a voluntary declaration, stating that they have made a full inquiry into the company's affairs and that they have formed the opinion that the company will be able to pay its debts in full, together with interest at the official rate, within such period as may be specified in the declaration. This solvency declaration is to be issued in the prescribed Form 32B.[11]

A director who makes a solvency declaration without having reasonable grounds for such opinion, is liable on conviction to a fine not exceeding KES 2,000,000 or to imprisonment for a term not exceeding five years, or both.

The company is further required to lodge a copy of the solvency declaration with the Registrar of Companies within 14 days after the date on which the resolution for liquidation is passed, failing which the company and each officer of the company who is in default, commits an offence and on conviction are each liable to a fine not exceeding KES 200,000.

Voluntary liquidation can either be:

(a) a members' voluntary liquidation; or

(b) a creditors' voluntary liquidation.

Members voluntary liquidation

The company in general meeting must appoint one or more authorised insolvency practitioner(s) to act as liquidator. On the appointment of a liquidator, all the powers of the directors cease, except in so far as the company in general meeting, or the liquidator, sanctions their continuance.

If the liquidation continues for a period of 12 months or more, the liquidator must convene a general meeting of the company within three months and thereafter every three months after the end of each subsequent 12-month period. The liquidator is required to lay before the meeting an account of the liquidator's acts and dealings, and of the conduct of the liquidation, during the preceding year.

If a liquidator does not call the meeting within the set time frames, he commits an offence and upon conviction is liable to a fine not exceeding KES 500,000.

The liquidator must convene the final meeting after completion of the liquidation of the company's affairs by publishing an advertisement specifying the time, date, place and purpose of the meeting, once in the Gazette, once in at least two newspapers circulating in the area in

[11] *Ibid*.

which the company has its principal place of business and on the company's website at least 30 days before the meeting. The liquidator must lay before the meeting the final liquidation accounts showing how the company's property has been disposed of.

Within seven days after the meeting, the liquidator must lodge with the Registrar of Companies a copy of the liquidation account. If the liquidator fails to lodge the liquidation account with the Registrar of Companies and continues to fail to do so, he commits an offence and on conviction is liable to a fine not exceeding KES 500,000, or KES 50,000 for each day that such offence continues.

Where the liquidator is of the opinion that the company will be unable to pay its debts in full within the period stated in the directors' declaration, the liquidator must convene a creditors' meeting for a date not later than 30 days after forming that opinion.

The liquidator must lay before the meeting a statement setting out the financial position of the company. The statement must specify:

(a) the prescribed details of the company's assets, debts and liabilities;

(b) the names and addresses of the company's creditors;

(c) the securities respectively held by them and the dates on which they were respectively given; and

(d) such other information as may be prescribed by the insolvency regulations.

As from the date on which the creditor's meeting is held, the liquidation shall be converted from a members' voluntary liquidation to a creditors' voluntary liquidation.

Creditors voluntary liquidation

A company that is in the course of liquidation must convene a meeting of the company's creditors not later than the 14th day after the meeting at which the resolution for voluntary liquidation is to be proposed.

The company is required to send the notices of the creditors' meeting to the creditors not less than seven days before the meeting day and ensure that notice of the creditors' meeting is published once in the Gazette, once in at least two newspapers circulating in the area in which the company has its principal place of business in Kenya and on the company's website. Failure to issue the notice together with all the information required without any reasonable excuse is an offence and an officer of the company in default is liable on conviction to a fine not exceeding KES 500,000.

The directors of the company are required to prepare and present a statement setting out the financial position of the company to be laid before the creditors' meeting. This statement is to be made in the prescribed Form 32.[12] This statement must be verified by a statutory declaration signed by two or more of the company's directors verifying it to be true.[13] The statement must specify:

(a) the details of the company's assets, debts and liabilities prescribed by the insolvency regulations;

(b) the names and addresses of the company's creditors;

(c) the securities respectively held by them respectively given;

(d) the dates when the securities were respectively given; and

(e) such other information as may be prescribed by the insolvency regulations.

It should be noted that where a members' voluntary liquidation has been converted to a creditors' voluntary liquidation, the requirements discussed above for the creditors' meeting and the requirement for directors to submit a statement setting out the financial position before creditors, does not apply.

Creditors may, if they think appropriate, appoint a liquidation committee of not more than five persons at the creditors' meeting or at any subsequent meeting. Where such a committee has been appointed, the company may also appoint a number of persons, not exceeding five, to be members of the committee. However, the creditors may resolve that persons appointed by the company are disqualified from being members of the liquidation committee.

On appointment of the liquidator, all powers of the directors cease except as the liquidator, the liquidation committee or the creditors, where there is no liquidation committee, may sanction.

If the liquidator continues in office for a period of more than 12 months, he must convene a general meeting of the company within three months after the end of the 12-month period and within three months after the end of each subsequent 12-month period. The liquidator is required to lay before each of these meetings an account of the liquidator's acts and dealings and of the conduct of the liquidation during the preceding year.

If a liquidator does not call the meeting within the set time frames, the liquidator is liable on conviction to a fine not exceeding KES 1,000,000.

After the liquidation of the company's affairs is complete, the liquidator must, as soon as practicable, prepare an account of the liquidation showing how the liquidation has been conducted and how the company's property has been disposed of and convene a general meeting of the company for the purpose of laying before it the account and giving an explanation of it. Within 30 days after preparing the account, the liquidator is required to

12 *Ibid*.
13 Statutory Declaration Form 32B.

convene the meeting by publishing a notice in the Gazette, once in at least two newspapers circulating in the area in which the company has its principal place of business and on the company's website.

The liquidator is further required, within seven days of the meeting, to lodge with the Registrar of Companies a copy of the liquidation account, together with a return giving details of the holdings of the meetings and the dates on which they were held. If the liquidator does not file the liquidation account with the Registrar of Companies, he is liable on conviction to a fine not exceeding KES 200,000.

Provisions applying to both members' and creditors' voluntary liquidation

Upon a company's voluntary liquidation, the company's property is to be applied in satisfaction of the company's liabilities equally and without preference. Thereafter, it is to be distributed among the members according to their rights and interests in the company unless the company's articles of association provide otherwise.

If for any reason there is no liquidator or the liquidator is unable to act, the court may appoint one. The acts of a person appointed by the court as a liquidator of a company are valid despite any defect in the person's appointment. Further, only a licensed insolvency practitioner is eligible for such appointment.

Within seven days of his appointment, the liquidator is supposed to publish a notice of his appointment in the Gazette, in two newspapers circulating in the area in which the company has its principal place of business in Kenya and on the company's website (if it has one). Within 14 days after publishing the notice, the liquidator is required to lodge a copy of the notice with the Registrar of Companies.

Where the whole or part of a company's business or property that is proposed to be, or is being voluntarily liquidated is proposed to be, transferred or sold to a transferee company, or to a transferee limited liability partnership, the transferor's liquidator may, with the approval of the members, the court or the liquidation committee (as applicable), receive in compensation or part compensation for the transfer or sale and for distribution among the members of the transferor company:

(a) in the case of a transferee company, shares, policies or other similar interests in the transferee company; or

(b) in the case of a transferee limited liability partnership, membership rights in the transferee limited liability partnership.

The approval required above is, in the case of a members' voluntary liquidation, a special resolution of the members of the company and, in the case of a creditors' voluntary liquidation, the approval of either the court or the liquidation committee.

The liquidator may also, with the required approval, enter into any other arrangement under which the members of the transferor company may:

(a) in the case of the transferee company, participate in the profits of, or receive any other benefit from, the transferee company instead of or in addition to receiving cash, shares, policies or similar interests; or

(b) in the case of the transferee limited liability partnership, instead of receiving cash or membership rights (or in addition to them), participate in some other way in the profits of, or receive any other benefit from, that partnership.

Pursuant to section 420 of the Insolvency Act, the liquidator, or a contributory or creditor may apply to the court to determine any question arising in the liquidation of a company and the court may make such other order on the application as it considers appropriate, upon which the Registrar of the Court shall without delay forward a copy of any order halting the proceedings in the liquidation to the Registrar of Companies for registration.

Where a company is in voluntary liquidation and a liquidator has not been appointed or nominated by the company, the directors may exercise their powers only with the approval of the court. This, however, does not prevent directors from exercising their powers to dispose of perishable goods and other goods the value of which is likely to diminish if they are not immediately disposed of. The directors can also do all such other things as may be necessary for the protection of the company's assets.[14]

In all cases, the voluntary liquidation of a company does not prevent a creditor or contributory from seeking to have the company liquidated by the court. However, the court is required to be satisfied that the rights of the other contributories will not be detrimentally affected where a contributory makes such application.

6.3.1.2 Liquidation by the court

A company may be liquidated by the court:

(a) if the company has by special resolution resolved that the company be liquidated by the court;

(b) being a public company that was registered as such on its original incorporation –

   (i) if the company has not been issued with a trading certificate under the Companies Act, 2015; and

   (ii) more than 12 months have elapsed since it was so registered;

[14] Insolvency Act, Third Sch.

(c) if the company does not commence its business within 12 months from its incorporation or suspends its business for a whole year;

(d) except in the case of a private company limited by shares or by guarantee, if the number of members is reduced below two;

(e) if the company is unable to pay its debts;

(f) if at the time at which a moratorium ends, a voluntary arrangement does not have effect in relation to the company (this can only be made by one or more creditors);

(g) if the court is of the opinion that it is just and equitable that the company should be liquidated; or

(h) by an application made by the Attorney General.

An application for the liquidation by the court may be made by the following persons and is to be made in the prescribed Form 32C and accompanied by a statutory demand and a verifying affidavit in the prescribed Form 32E and Form 32 D respectively:[15]

(a) the company or its directors;

(b) a creditor or creditors (including any contingent or prospective creditor or creditors);

(c) a contributory or contributories of the company;

(d) a provisional liquidator or an administrator of the company; or

(e) if the company is in voluntary liquidation, the liquidator.

Once a judgement has been made, the liquidation order is to be issued by the court in the prescribed Form 32G.

The Attorney General may apply to the court if it appears that it would be in the public interest for the company to be liquidated based on his review of the following documents or information:

(a) a report made or information obtained from investigations carried out or inspection of documents produced under the Companies Act, 2015;

(b) a report made, or information obtained, by the Capital Markets Authority under the Capital Markets Act;

(c) information provided by the Registrar of Companies;

[15] Insolvency Regulations, Reg 77B.

(d) as a result of the company or its directors having been convicted of an offence involving fraudulent conduct; or

(e) a report made by an inspector appointed to conduct an investigation into the affairs of a company under the Companies Act, 2015.

In a liquidation ordered by the court, any disposition of the company's property and any transfer of shares, or alteration in the status of the company's members, is void. Additionally, any attachment, sequestration, distress or execution instigated against the assets of the liquidation, is void.

Within seven days after a liquidation order is made in respect of a company, the company is required to lodge a copy of the order with the Registrar of Companies (for registration) and within 30 days a copy must also be lodged with the Official Receiver in the prescribed Form 32F.

Where the court has made a liquidation order or appointed a provisional liquidator in respect of a company, the Official Receiver may require some or all of the prescribed persons to make out and submit to the Official Receiver a statement of affairs relating to the company. The "prescribed persons" have been defined to include those who:

(a) are or have been officers of the company;

(b) have taken part in the formation of the company at any time during the 12 months before the relevant date;

(c) are in the company's employment, or have been in its employment during that period and are in the Official Receiver's opinion capable of providing the information required; and

(d) are or have been within that period officers of, or in the employment of, a company that is, or within that period was, an officer of the company.

The prescribed persons are required to submit the statement of affairs within 21 days from the date of the notice of the requirement and verify their statements with a statutory declaration. This is to be submitted in the prescribed Form 32. The statement of affairs of the company should include the following information:

(a) particulars of the company's assets, debts and liabilities as are prescribed by the insolvency regulations;

(b) the names and addresses of the company's creditors;

(c) the securities held by them respectively;

(d) the dates when the securities were respectively given; and

(e) such further or other information as the Official Receiver may reasonably require.

On the making of a liquidation order, the Official Receiver must conduct an investigation to discover why the company failed and generally to investigate the promotion, formation, business, dealings and affairs of the company. The Official Receiver must then make a report to the court as he considers appropriate and such report is evidence of the matters stated in it until the contrary is proved.

The Official Receiver may, at any time before the dissolution of the company, apply[16] to the court for the public examination of any person who:

(a) is or has been an officer of the company;

(b) has acted as provisional liquidator, liquidator or administrator of the company; or

(c) any other person who is or has been concerned, or has taken part in the promotion, formation or management of the company.

The court may appoint a provisional liquidator either on or after, or at any time before, the making of a liquidation order in respect of a company. Only the Official Receiver or a licensed insolvency practitioner are eligible for appointment as provisional liquidator.

Where the court makes a liquidation order, the Official Receiver becomes the liquidator of the company and continues in office until some other person becomes the liquidator. The Official Receiver may convene separate meetings of the company's creditors and the company's contributories for the purpose of choosing a person to be liquidator of the company in place of the Official Receiver.

The Official Receiver is supposed to exercise that power within three months. If the Official Receiver does not wish to, the Official Receiver gives notice to the court, creditors and contributors; provided that if the Official Receiver is requested to do so by creditors who hold not less than one quarter in value of the total amount of the company's debts, he is obliged to do so.

The Official Receiver (being the liquidator) may, at any time, appoint a qualified person as liquidator instead and immediately notify the court of the appointment. The person appointed liquidator must not later than seven days after being appointed, send a notice of the appointment to the company's creditors or upon application made to the court advertise the appointment in accordance with the directions of the court.

Where separate meetings of the company's creditors and contributories are held, the creditors' choice will prevail if the meetings nominate different liquidators. However, a contributor or creditor has the power to apply to court for their choice of liquidator to be confirmed as liquidator.

[16] This application can also be made by the Official Receiver at the written request of creditors of the company holding not less than one-half in value of the total amount of the company's debts, or by contributories of the company holding not less than three-quarters of the voting rights at general meetings of the company.

The creditors may at the creditors' meeting establish a liquidation committee to perform such functions as may be imposed. However, in so far as the insolvency regulations provide, a liquidation committee may not be required to perform its functions while the Official Receiver is liquidator.

After making a liquidation order, the court must settle a list of contributories, with power to rectify the register of the members in all cases in which the rectification is required and take all practicable steps to have the company's assets collected and applied in discharge if its liabilities.

The liquidator must ensure that the assets of the company are realised and distributed to the company's creditors or, if there is a surplus, distribute the surplus to the persons entitled to it.

If the liquidator (not being the Official Receiver) is satisfied that the liquidation of the company is complete, the liquidator must convene a final meeting of the creditors. Those present at the meeting must consider the liquidator's report of the liquidation.

The court has the power to:

(a) order money due to the company to be paid into a Central Bank of Kenya account of the liquidator, instead of to the liquidator;

(b) fix deadlines by which creditors are required to prove their debts or claims;

(c) make orders enabling creditors and contributories to inspect the company's records; and

(d) issue a warrant authorising the arrest of an absconding contributory.

These powers of the court can, however, be delegated by the court to the liquidator. Section 459 of the Insolvency Act provides that the insolvency regulations may enable or require all or any of the functions imposed, or powers conferred, on the court to be performed or exercised by the liquidator as an officer of the court and in accordance with its directions.

6.3.2 Administration

The Act provides an option for the administration of an insolvent company. Under section 522, the objectives of administration are to maintain the company as a going concern, to achieve a better outcome for the company's creditors as a whole than would likely to be the case if the company were liquidated and to realise the property of the company in order to make a distribution to one or more secured or preferential creditors. Whereas previously a company could be wound up immediately it became insolvent, the Insolvency Act now provides the company and its creditors an opportunity to operate as a going concern and not necessarily engage in the sale and realisation of its assets as a primary option.

6.3.2.1 Appointing an administrator

An administrator may be appointed by the court, the holder of a floating charge or by the company or its directors. The administrator is deemed an officer of the court, whether appointed by the court or not. With respect to a holder of a floating charge, section 534 of the Insolvency Act provides that the holder must be a holder of a qualifying floating charge in respect of the whole or substantially the whole of the company's assets. A qualifying floating charge is one which is created by a document that states that section 534 of the Insolvency Act applies to the floating charge, or purports to empower the holder of the floating charge to appoint an administrator of the company. The holder of a qualifying floating charge may also apply to court for an administration order. The court has the power to make an administration order in respect of a company even if a company may be able to pay its debts.

6.3.2.2 Position of creditors once a company is under administration

Once appointed, the administrator assumes control of all the property to which the administrator believes the company is entitled and has to manage the affairs and property of the company. While a company is under administration, a creditor may take steps to enforce a security over the company's property only with the consent of the administrator, or with the approval of the court. The administrator may also make a distribution to creditors of the company and where a creditor is neither a secured nor a preferential creditor, a payment may be made to the creditor as part of a distribution only with the approval of the court. It should be noted that while the company is in administration an automatic moratorium becomes effective prohibiting any legal action being brought against the company or any execution, attachment or sale or execution of its assets without the administrator's consent or court approval.

6.3.2.3 Administrator's powers over charged property

The administrator of a company may dispose of, or take action relating to, property that is subject to a floating charge as if it were not subject to the charge. If this is done, the holder of the floating charge has the same priority in respect of acquired property as that holder had in respect of the property disposed of.

However, where a company's property is subject to a fixed charge, the administrator (should he intend disposing of the property) must make an application to court under section 588 of the Insolvency Act; if the court believes that disposal of the property would be likely to promote the purpose of the administration of the company, it may authorise the sale. However, the Act still provides protection to secured creditors where it expressly provides that an administrator's statement of proposals may not include action that affects the right of a secured creditor of the company to enforce the creditor's security.[17]

[17] Insolvency Act, s 590.

6.3.3 *Company voluntary arrangement*

The provisions in regard to a voluntary arrangement in respect of an insolvent company are similar to those for an insolvent natural person. Therefore, there are restrictions where a proposal's effect is to affect a secured creditor's right to enforce their security. A voluntary arrangement, once approved, is binding on every person, including secured creditors.

6.3.3.1 Pre-insolvency moratoria

An amendment to section 643 of the Insolvency Act introduced pre-insolvency moratoria that may be granted for a 30-day period in cases of financially distressed companies. The provision sets out the following acts that may not be undertaken while the moratorium is in place:

(a) an application for liquidation of the company may not be made;
(b) a meeting of the company may be convened or requisitioned (A) only with the consent of the monitor or with the approval of the court; and (B) if the court gives approval—subject to such conditions as the court may impose;
(c) a resolution for the liquidation of the company has no effect;
(d) the court may not make an order for the liquidation of the company;
(e) an application for an administrator to be appointed in respect of the company may not be made and if made is of no effect;
(f) an administrator of the company may not be appointed by a secured creditor or the directors of the company;
(g) an administrative receiver of the company may not be appointed;
(h) a landlord or other person to whom rent is payable may exercise a right of forfeiture in relation to premises let to the company in respect of a failure by the company to comply with any term of its tenancy of the premises (A) only with the approval of the court; and (B) if the court gives approval—subject to such conditions as the court may impose;
(i) steps may be taken to enforce any security over the company's property, or to repossess goods in the company's possession under a credit purchase transaction (A) only with the approval of the court; and (B) if the court gives approval—subject to such conditions as the court may impose; and
(j) other proceedings (including execution or other legal process) may be commenced or continued, and distress may be levied, against the company or its property (A) only with the approval of the court; and (B) if the court gives approval—subject to such conditions as the court may impose.

During the moratorium period, the directors of the company remain in control save for certain actions that approval from the licensed insolvency practitioner (for purposes of this amendment referred to as 'monitor' (previously it was a 'supervisor')) must be sought. The monitor oversees the implementation of the pre-insolvency moratorium. The moratorium stops creditors and landlords from taking enforcement action against the company without the consent of the court or the monitor.

The moratorium is not available to companies already in administration, liquidation, provisional liquation or where an administrative receiver has already been appointed. However, companies against whom a liquidation application has been made in court but liquidation order has not been issued, qualify to file for a pre-insolvency moratorium. During the moratorium period, creditors may apply to court for appropriate remedial orders if they are unsatisfied with the monitor's conduct during the moratorium. Further, during the moratorium period creditors have a right of remedy for example, if a property to be disposed of is subject to a security, the holder of the security must consent to the disposal or the court must give its approval and the holder of the security retains priority upon distribution of the proceeds.

The directors of the company are required to file a document in court establishing why the moratorium is required. The document should be accompanied by a statement from the proposed monitor which confirms that the pre-moratorium has a chance of success and the company will have sufficient funds to operate during the duration of the moratorium.

6.3.3.2 Moratorium during a company voluntary arrangement

The directors of a company applying for a voluntary arrangement have the right to apply for a moratorium against any legal action against the company by creditors. The moratorium protects the company from legal action being brought by creditors before the voluntary arrangement is finalised. Unlike administration, the effect of the moratorium in a voluntary arrangement is not set out in the Insolvency Act and its effect is therefore dependent on the nature of the orders given by the court.

There is an eligibility criteria applied to determine whether a company qualifies for a moratorium during a company voluntary arrangement (CVA) and includes the requirement that the debts of a company applying for a moratorium should not exceed KES 1 billion. Companies with debts that exceed this monetary threshold are not eligible for a moratorium. In addition, this moratorium is only valid until such time that the creditor meetings are held to approve a voluntary arrangement.

When a company's directors propose a voluntary arrangement, for a moratorium to take effect an application has to be made to court. The moratorium is only effective during the period between when the proposal is made and ends when the proposal takes effect. The implications of a moratorium are that the company is restricted in obtaining credit or paying its debts and liabilities during this period. Further, any steps taken to enforce any security over the company's property can only be done with sanction of the court and the court may impose some conditions on such sanction. Also, approval of the court is required where proceedings are commenced against the company or its property.

Security given by a company at a time when a moratorium has effect in relation to the company can only be enforced if, at that time, reasonable grounds existed for believing that enforcement of the security would benefit the company. A company in respect of which a moratorium has effect may dispose of any of its property only if there are reasonable grounds for believing that the disposal will benefit the company and the disposal is approved by the moratorium committee. It is important to note, however, that a company may transfer property as if it were not subject to the security only where the holder of the security consents, or the court gives its approval.

6.3.4 Repealed Acts and transitional provisions

The Insolvency Act repealed the Bankruptcy Act, certain provisions of the Companies Act and section 89 of the Law of Succession Act.[18] The transitional and savings provisions of the Insolvency Act provides that the Bankruptcy Act and the relevant provisions of the Law of Succession Act will continue to apply to any past event and to any step or proceeding preceding, following, or relating to that past event, even if it is a step or proceeding that is taken after the commencement of the Insolvency Act. Past events include where a bankruptcy notice is issued, making an application for a bankruptcy order or entering into a voluntary arrangement, amongst others.

Self-Assessment Exercise 4

Study the basic aspects dealt with in the previous section.

Discuss the liquidation procedures under the Insolvency Act in both voluntary and involuntary liquidation.

For commentary and feedback on self-assessment exercise 4, please see APPENDIX A

6.4 Receivership

6.4.1 General introduction

The legal position in Kenya stemming from common law and practice is that a receiver's powers and obligations are governed by the security document under which the receiver is appointed. The Insolvency Act does not make reference to receivers but there is a move to amend the law to include specific provisions on receivership.[19]

The concept of receivership is not enshrined in the Insolvency Act and the question therefore arises as to what rights a security holder has. It is worth noting that corporate receivership is not a creature of statute but one founded on the contractual relationship between the parties and derives its force from the principles of common law and the rules of equity.[20] In similar vein, the Repealed Companies Act did not state expressly that security holders had the right to appoint receivers but stated that receivers appointed by debenture holders had certain rights.[21] What was clear, however, was the fact that the power to appoint a receiver was derived from the

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[18] Section 89 of the Law of Succession Act (Cap 160, Laws of Kenya) provided for the commencement of bankruptcy proceedings where a deceased person's estate had become insolvent as a result of the succession process.

[19] There is a proposal to amend the Insolvency Act to provide for the appointment of receivers and to provide a link between the Land Laws receivership and the contractual right to appoint a receiver. It is not known when these changes will be brought into effect.

[20] S Rajani, *Tolley's Corporate Insolvency* (2nd ed, Tolley Publishing Company Limited, 1994) at p 388.

[21] Repealed Companies Act, s 347.

contractual provisions in the security document itself and the receiver's powers and obligations were also set out therein with ancillary rights contained in the repealed Companies Act.

Further, the Insolvency Act also does not make reference to receivers appointed in accordance with the provisions of a charge created over land registered under the Land Act, 2012. The appointment of a receiver by a fixed charge holder over land is enshrined in law and there is a conflict between the Insolvency Act and the provisions of the Land Act. For example, the question that would arise under the process of administration as envisaged under the Insolvency Act is that when an administrator wants to take control over all the assets of a company in order to try and rescue the business of the company as a going concern, what control (if any) would the administrator have if the primary asset of the company is the land which is at that moment under the control of a receiver appointed under the Land Act?

Receivers appointed pursuant to a contract will generally only act on behalf of the secured creditor that appointed them and will realise the assets specifically covered by the security document.

The contractually-appointed receiver is appointed to take possession of and sell or liquidate the assets secured by the security agreement in order to repay the outstanding debt. In a receivership, a secured creditor may also appoint a receiver manager to operate and manage the business until it is sold as a going concern.

The receiver is tasked with selling the assets secured under the security agreement and, after deducting the receivership's fees and expenses, distributing the proceeds from the sale to creditors on a priority basis. In situations where the proceeds from the sale of assets are not sufficient to fully repay the liabilities of the secured creditor, none of the proceeds will be available for distribution to the unsecured creditors.

6.4.2 Effect of receiver's powers of disposition post commencement of insolvency

Receivers need to seek leave of the court if they wish to undertake any dispositions after the commencement of administration, a voluntary arrangement or where a court order has been issued restricting dispositions in liquidation.

Case law provides some guidance on how courts interpret the issue of receivership prior to the new insolvency regime:

(a) In the case of *Alvik Prestige Limited,*[22] after the deemed commencement of a winding-up of the company by the creditor who petitioned the court, a bank holding an all assets debenture and charge over land appointed a receiver to sell the land. The petitioning creditor challenged the bank's right to appoint a receiver and the purported sale of the land by the receiver. The court held as follows:

[22] *In the matter of Alvik Prestige Limited winding cause No of 2003* [2006] eKLR.

> "The thrust of the authorities cited to me by Counsel for the Receivers (the Bank) is that the court has a wide discretion to allow a Receiver, appointed by secured creditors, whether Debenture holders or Mortgagees to be appointed in precedence to that of the Court…..there is no question as to when the Winding-Up commenced. It was on the day of presentation or filing the Petition in Court. There is also no question that the Receivers disposed of the property of the debtor company without reference to the court. There is no indication either in the Replying Affidavit or the Further Affidavit of the Applicant's Advocate that the Receivers were unaware of the presentation of the Petition. The Receivers took the view that so long as they were appointed under a valid debenture, their positions too as Receivers were immune to the process of court. I do not think that is either the position of the Companies Acts here or in England, nor is it the practice and procedure of Receivers in England (so far as the cited authorities show), and cannot be in light of the clear provisions of the law as cited above…instead of applying to the Winding Up Court for leave to sell or realize the secured assets, the Receivers in the name of realizing the security without undue delay, ignored not only the law, but also the practice, procedure and process of court…if I understand this area of the law correctly it is a correct proposition of law to say that where a winding up petition has commenced as in this case, the property of the debtor company is in a manner of speech subject to the custody or orders of the court, and if there are any legal or equitable rights in that property whether or not vested in parties in the action or the persons before the court, which legal or equitable rights are not the subject of the administration then going on, then the court, (not, the law) requires that the person who claims to enforce those rights shall apply to court for leave to enforce them. The right may be a right to take possession, or a right to do various other things, but the practice and procedure of the court requires an application to be made to it…there being no application before Court to validate the action of the Receivers vis-à-vis the Petition, there can only be one conclusion in this matter and that is to say, the purported sale and transfer by the Receivers of the assets of Alvik Prestige Limited (In Receivership) by or under the Sale Agreement dated 9th March, 2004 is contrary to the provision of Section 224 of the Companies Act (repealed), and is therefore void."

(b) In the 2019 case of *Athi River Steel Plant Limited v KCB Bank Kenya Limited*[23] the Court was faced with the question of whether a receiver appointed pursuant to a debenture security after the commencement of the Insolvency Act, 2015 was valid. The Court held that such an appointment was valid despite the Insolvency Act not providing for receivership. The Court stated that:

> "…[the Court's] considered view is that the … provisions in the Debentures gave power to the [Secured Creditor] to appoint a Receiver in the event of default of payment. The law applicable at the time the amount became payable was the Insolvency Act, however, the instruments creating the debenture defined the

23 *Athi River Steel Plant Limited v KCB Bank Kenya Limited, the Receiver and Others* (2019) eKLR.

powers of the Receiver. [Clause 13] of the debenture gave power to the lender for the appointment of Receiver and Manager and not just a Receiver. The power of a Receiver and Manager (also called Receiver Manager) is wider than that of a Receiver. The Receiver and Manager has the extra and important managerial function. Once appointed under the Debenture, the Receiver and Manager takes up many of the roles which ordinarily belong to the Directors of the Company. A key function of the Receiver and Manager is to keep the company as a going concern…."

(c) Recent jurisprudence has however created uncertainties as to whether pre-2015 debenture holders (that is holders of debentures created before the Insolvency Act, 2015) are able to appoint administrators. In the case of *I & M Bank Limited v ABC Bank Limited & another* [2021] eKLR one of the banks ABC Bank had argued that it had power to appoint an administrator under its debenture which was created before 2015. The Court however disagreed and in doing so also disagreed with the decisions under earlier cases such as in the *Athi River* case referred to in (b) above. The Court stated that:

"…to appoint an administrator without making an application to the court, the floating charge must meet either of the conditions set out in section 534, that is it must state that section applies to it or empowers the holder to appoint an administrator. The debenture of ABC is not a qualifying floating charge within the meaning of section 534(2) of the Insolvency Act thus ABC could not appoint an administrator without making an application to the court thus its action of purporting to appoint administrators under its debenture is null and void and of no effect."

(d) What does the above analysis mean? There appears to be some disconnect in the jurisprudence being established by the courts. Accordingly, at present it is not clear whether a holder of a pre-2015 debenture can appoint an administrator without making an application to the courts.

6.4.3 Land security

The Land Act[24] separately provides for the appointment of a receiver to realise a land security. The office of the Official Receiver has acknowledged the disconnect between the Insolvency Act (that does not provide for receivership) and the Land Act (which has its own receivership process for land securities). The Land Act and the Land Registration Act[25] both require that a fixed charge be registered at the Lands Registry for security over land to take full effect.[26]

In the case of immovable property, the steps provided for in statute in relation to the enforcement of the chargee's security interests ought to be followed. The procedure also depends on whether the charge is informal or formal. A formal charge is perfected and duly

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24 No 6 of 2012.
25 No 3 of 2012.
26 It is important to note that an all-asset debenture does not count as a fixed charge in Kenya and a separate charge over the land must be prepared and registered.

registered at the relevant Lands Registry, whereas an informal charge involves depositing the title documents of the land with the lender without formal registration.

6.4.3.1 Informal charge

The chargee must obtain the leave of the court prior to taking possession or selling the property.[27] If the borrower is insolvent and is undergoing an insolvency process, that is, liquidation or administration, the lender would need to seek the consent of the administrator or liquidator in control of the borrower before realising the security.

6.4.3.2 Formal charges

The chargee may exercise the following enforcement remedies for formal charges:

(a) sue the chargor for any money due and owing under the charge;

(b) appoint a receiver to demand and recover income derived from the charged land;

(c) lease the charged land or, if the charge is in the nature of a lease, sublease the land;

(d) take possession of the charged land; or

(e) sell the charged land via a statutory power of sale (the chargee may with leave of the court purchase the charged property).[28]

Enforcement of the above remedies is subject to the provisions provided in the Land Registration Act. The provisions applicable to the exercise of the chargee's statutory power of sale and appointment of a receiver of income are set out below.

6.4.3.3 Statutory power of sale

The steps that would be taken by the chargee are:

(a) the issue of a three-month statutory notice to the chargor pursuant to section 90(1) of the Land Act. The statutory notices must be in the form and manner prescribed under the Land Act and served on the persons prescribed;

(b) the issue of a 40-day notice to sell the property to the chargor pursuant to section 96(2) of the Land Act;

(c) the issue of a 45 days' notice as required under the Auctioneers Act, 1996 by the auctioneer to the chargor;

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27 Land Act, s 79(9).
28 *Idem*, s 90(3).

(d) the undertaking of a forced sale valuation by the chargee prior to exercising its right of sale;[29]

(e) if the sale is by way of public auction and not a private contract, the chargee must ensure that the sale is publicly advertised in the prescribed form and manner and that the laws applicable to public auctions are complied with; and

(f) the chargee may then exercise its power of sale. If the sale is of the whole or part of the land, by way of subdivision, for the purchase price to be payable in one sum or by instalments or such other conditions as the chargee may think fit taking into account the chargee's duty to obtain the best price reasonably possible.[30]

6.4.3.4 Appointment of a receiver

The steps that would be taken by the chargee are:

(a) to issue a three-month statutory notice to the chargor; and

(b) to issue a 30-day notice to appoint a receiver to the chargor.

Following the issue of the statutory notices set out above, the receiver may be appointed by the chargee.

6.5 Corporate rescue

6.5.1 General

The process of corporate rescue is primarily initiated when a company is in financial distress. Legally, this is referred to as the company being unable to pay its debts as and when they fall due. Section 384 of the Insolvency Act provides that a company is deemed unable to pay its debts if:

(a) a creditor (by assignment or otherwise) to whom the company is indebted for KES 100,000 or more has served on the company, by leaving it at the company's registered office, a written demand requiring the company to pay the debt and the company has for 21 days afterwards failed to pay the debt or to secure or compound for it to the reasonable satisfaction of the creditor;

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

(c) 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 (including its contingent and prospective liabilities).

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29 *Idem*, s 97(2).
30 Land Act, s 98(1).

6.5.2 Administration under the Insolvency Act

Administration was introduced as a concept in 2015 under the Insolvency Act. The Insolvency Act does not expressly define what administration is, but from the provisions relating to the process of administration it can be inferred that it relates to the placing of an insolvent company under the management of an administrator. It is known as a rescue process from which a company and / or its business can survive. Section 522 of the Insolvency Act provides that the objectives of administration are to:

(a) maintain the company as a going concern;

(b) to achieve a better outcome for the company's creditors as a whole than would likely to be the case if the company were liquidated (without first being under administration); and / or

(c) to realise the property of the company in order to make a distribution to one or more secured or preferential creditors.

Under the new insolvency regime, business rescue is prioritised over recovery by secured creditors. The new law requires administrators to first and foremost consider business rescue as an option in the conduct of administration proceedings.

6.5.2.1 Who can appoint an administrator?

Section 523 states that an administrator can be appointed in respect of a company:

(a) by a court – in such an instance the appointment is commenced by an application for an administration order lodged by either the company, the directors of the company or one or more creditors of the company. An administration order will be made by the court only if it is satisfied that the company is or is likely to become unable to pay its debts and the administration order is reasonably likely to achieve an objective of administration;

(b) by the holder of a qualifying floating charge (QFC) under section 534 of the Insolvency Act – a holder of a QFC is only able to appoint an administrator if the charge is created over the whole or substantially the whole of the company's assets and contains provisions stating that section 534 applies to it, or empowers the holder to appoint an administrator; or

(c) by the company or its directors.

In addition, Regulation 101A of the Insolvency Regulations, 2016 as amended by the Insolvency Regulations, 2018 provides that the following categories of persons can also make an application for administration to the court:

(a) the Official Receiver;

(b) the Registrar of Companies; and

(c) the employees of the company.

Each of these category of persons is required to make the application for administration in the prescribed form (Form 36). The administration order, if granted, is issued in the prescribed form (Form 37).[31]

6.5.2.2 Advantages and disadvantages of administration

The advantages of an administration would include:

(a) better outcome for all creditors: administration is geared towards rescuing the company and achieving a better result for the insolvent company. This is the recurrent theme evidenced by the provisions of the Insolvency Act which requires the administrator to act in the best interest of the insolvent company with a view to achieving a better outcome for all creditors. Administrations generally produce a better outcome for creditors than a liquidation. A key point to note is that section 525 of the Insolvency Act provides that the administrator is an officer of the court regardless of who appoints him and as such his loyalty is first and foremost to the court, to the company and to the creditors as a whole;

(b) moratorium against legal actions: for insolvent companies, one of the greatest stresses can be aggressive legal action from creditors seeking remedies for their debts. However, when a company is placed into administration, under section 559 of the Insolvency Act a moratorium is placed on all legal action. As well as providing relief for worried shareholders and directors (and, as in this case, secured creditors whose options are limited due to the diminishing value of the security and the time that realisation may take), this can allow the company time to regroup and assess the best course of action so that it can continue trading;

(c) allows for company restructuring: bearing in mind that one of the primary objectives of administration is to rescue the business as a going concern, the broad powers of the administrator empowers him to carry out processes, including restructuring, that would benefit the company. Under the Fourth Schedule of the Insolvency Act, paragraphs 15 and 16 provide that an administrator has the power to establish subsidiaries of the insolvent company and to transfer to the subsidiaries the whole or any part of the business and property of the company. An equity investor may insist on a hive-down of assets into a new company in order to protect themselves against unknown liabilities or unacceptable known liabilities. In this regard, the Insolvency Act offers an avenue for an administrator to restructure the business of a company to maximise and / or optimise the successes of the administration. In addition, while under administration the company has the option of entering into voluntary arrangements and / or compromises; and

(d) possibility of survival of the company: for companies that are in financial distress, options are usually few and far between. Administration offers the possibility for a company to survive and continue trading as opposed to the finality of liquidation.

[31] Insolvency Regulations, Reg 101A.

The disadvantages associated with administration include the following:

(a) administration is expensive: administrations can be lengthy and often costly. The administrator must be a licensed insolvency practitioner under the Insolvency Act. It is likely that receivers who may have been appointed by secured lenders under the old regime are now licensed insolvency practitioners under the new regime. The Second Schedule of the Insolvency Act sets out the priority to be followed when making distributions and the expenses of an administration rank in priority. Further, company administrations also involve professional fees payable to the various professionals that an administrator procures to assist and advise in the administration process and these are also payable in priority to other preferred creditors. Having said that, the potential costs should be weighed against the potential recoveries and the potential outcome of other alternatives, such as liquidation;

(b) decrease in realisations for floating charge holders: section 474(2) of the Insolvency Act provides that when realising assets secured by floating charges, the administrator is required to set aside 20%[32] of the proceeds of the realisation to cater for the debts due to unsecured creditors. This means that where the assets of the company are not sufficient to cater for unsecured creditors, secured creditors holding floating charges only receive 80% of the realised debt due. Section 474(8) of the Insolvency Act provides that floating charges created before the enactment of the Insolvency Regulations, that is, before 21 March 2016, will not be subject to the rule of setting 20% aside; and

(c) negative publicity may impact trading: companies undergoing administration are obligated to state in all correspondence and company documents that they are in administration. The Insolvency Act, in section 563 and Regulation 108 of the Insolvency Regulations, requires an administrator to notify the public of his appointment via advertisements in local daily newspapers. In addition, all correspondence by the insolvent company has to indicate that the company is in administration.

6.5.2.3 Procedure for appointing administrator by a qualifying charge holder pursuant to section 534 of the Insolvency Act

Before making an appointment, a qualifying charge holder is obligated, under section 535, to give at least three days prior notice to other holders of qualifying floating charges, notifying them of their intention to appoint an administrator. Once the administrator has been appointed, the administration does not commence or take effect unless the provisions of section 537 of the Insolvency Act are complied with.

Section 537 provides that a person who appoints an administrator of a company under section 534 is required to lodge the following documents in court:

(a) a notice of appointment notifying the court of the appointment of an administrator (in the prescribed form set out under the Insolvency Regulations being Form 35);

[32] *Idem*, Reg 91.

(b) the notice is accompanied by a statutory declaration of the qualifying charge holder making the appointment and has to include statements to the effect that:

(i) the person making the appointment is a qualifying charge holder in respect of the company's property;

(ii) the qualifying charge relied on in making the appointment is (or was) enforceable on the date of the appointment; and

(iii) the appointment is in accordance with the Insolvency Act; and

(c) the notice is also accompanied by a statement by the administrator who is appointed which has to contain the following:

(i) that he consents to the appointment; and

(ii) in the administrator's opinion, the purpose of administration is reasonably likely to be achieved.

Once the above requirements are complied with, the administration will take effect.

6.5.2.4 Procedure for applying for administration via court process by creditor

This process is commenced by the making of an application to court requesting the court to issue an administration order. Pursuant to section 535 of the Insolvency Act, this application can be made by a single creditor (or more than one) and may also include the company and / or its directors as applicants. The creditor making the application is required to also notify any qualifying charge holders that they have made an application for an administration order. The application for administration is made to the court as prescribed in Form 36. The application must be accompanied by an affidavit from the applicant stating the reasons they are relying on in requesting an administration order. It is not clear under the Insolvency Regulations whether an applicant can choose who they want appointed as an administrator, but Form 36 suggests that this is possible.

The court then considers the application, determines whether the grounds for placing a company in administration have been met and, if so, issues an administration order in Form 37.

6.5.2.5 Process of administration after appointment administrator

Once the administration is effective, or where a petition for administration is pending, an automatic moratorium comes into effect pursuant to section 560 of the Insolvency Act. The moratorium has the following effects:

(a) a resolution may not be passed for the liquidation of the company;

(b) the court may not make an order for the liquidation of the company;

(c) a person may take steps to enforce security over the company's property only with the approval of the court;

(d) a person may take steps to repossess goods in the company's possession under a hire purchase agreement only with the approval of the court;

(e) a landlord may exercise a right of forfeiture by peaceable re-entry in relation to premises let to the company only with the approval of the court;

(f) a person may begin or continue legal process (including legal proceedings, execution, distress and diligence) against the company or property of the company only with the approval of the court;

(g) a person may take steps to enforce security over the company's property only with the approval of the court; and

(h) a person may take steps to repossess goods in the company's possession under a hire purchase agreement only with the approval of the court.

Once appointed, the administrator is under a duty to publish a notice of his appointment in the Gazette and two newspapers of wide circulation. Additionally, the administrator has to send a formal notice to the Official Receiver within seven days of the order and within 14 days to the companies' registry, the registered office of the insolvent company and individual notices to each and every creditor of the company whose debt the administrator is aware of.[33]

Thereafter, as soon as is reasonably practicable a notice to provide the company's information is required to be sent to the directors and / or other officers of the company who are under a duty to provide the company's state of affairs as prescribed in the Insolvency Regulations (within 12 days of receipt of notice), which include the following:

(a) list of the company's assets, divided into such categories as are appropriate for easy identification and with each category give an estimated value;

(b) in the case of any property on which a claim against the company is wholly or partly secured, particulars of the claim and how and when the security was created;

(c) the names and addresses of the preferential creditors, with the amounts of their respective claims;

(d) the names and addresses of the unsecured creditors, with the amounts of their respective claims;

(e) particulars of any debts owed by the company to persons connected with it;

(f) particulars of any debts owed to the company by persons connected with it;

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[33] *Idem*, Reg 108.

(g) the names and addresses of the company's members, with details of their respective shareholdings; and

(h) any other particulars that the administrator considers appropriate for inclusion in the statement.

After reviewing the company's status, the administrator must draft proposals setting out how he intends to achieve the objectives of administration. Regulation 110 of the Insolvency Regulations as amended by the Insolvency Regulations, 2018 sets out more details that are to be included in the administrator's proposals, including (i) an account of the circumstances giving rise to the administration, and (ii) a summary of the statement of affairs of the company. Section 566 stipulates that the administrator can make proposals for voluntary arrangements or compromises to be sanctioned under the Companies Act. The proposal is required to be sent to the insolvent company's creditors and shareholders within 60 days from the date commencement of the administration and thereafter an initial creditors' meeting is to be convened for purposes of reviewing the administrator's proposals not later than 70 days from the date commencement of the administration.

It should be noted that the administrator may either elect to seek consent of the creditors with respect to the proposals or, in the alternative, proceed to implement the proposals without the creditors' consent. Regulation 110 (1)(l) of the Insolvency Regulations provides that during the creditors' meeting the administrator must inform the creditors as to whether or not he will require their consent for the purposes of his proposals, but in that case he must state reasons as to why he will not be seeking their consent. There is no general requirement that the administrator must seek approval for all his actions, save for the purpose of taking loans using assets already secured with previous securities, for which the consent of the secured creditors will be required and, in its absence, an approval of 75% in value of the creditors. The administrator's powers / actions are however not unchecked as section 591 of the Insolvency Act empowers a creditor or a shareholder to make an application to court claiming that the administrator's actions are detrimentally affecting their interests.

Subsequent creditors' meetings may be convened by the administrator on his own motion, or upon court direction, or upon request by creditors holding at least 10% in value of the insolvent company's proven debt[34] All decisions taken at the creditors' meeting are to be notified to the court and the Official Receiver and if proposals are approved by the majority in value of the creditors, the administrator is under a duty to implement the proposals if approved.

6.5.2.6 Conduct of creditors' meeting by administrator

Section 567 of the Insolvency Act provides that conduct of the creditors' meeting is to be undertaken in accordance with the Insolvency Regulations, which in turn at Regulation 124 provide that the procedure to be followed is as set out in the Third Schedule. The following are some key points to note:

[34] Insolvency Act, s 573.

(a) notices, voting and venues for meetings: notices, voting and venues for meetings: The administrator is required to send notices in the prescribed form (Form 16). The notice should contain the date and venue of the meeting, a statement of the date by which the creditor is required to send a proof in respect of the creditor's claim failure to which a creditor risks losing voting rights and a statement that a creditor owed an amount that is in total less than one million shillings (KES 1,000,000/=) and who does not send a proof to the convenor shall not be able to vote;

(b) constitution of meetings: a creditors' meeting may not proceed unless there is a quorum, the requisite quorum being one (1) creditor. The implication here is that there is no correlation between the voting rights and the value a creditor has in an insolvent company, seeing that a meeting can proceed with only one creditor;[35]

(c) creditors' voting rights and majorities: creditors are entitled to vote at a meeting only if they have proved their debt. The proof of claim has to be sent to the convenor of the meeting by 16:00 on the day preceding the date of the meeting and the proof has to be admitted and accepted. Votes are calculated according to the amount of each creditor's claim in a company administration.[36] In regard to voting rights, decisions are made by creditors when a majority (in value) of those voting have voted in favour of the proposed decision;[37] and

(d) Regulation 25(8) of the Insolvency Regulations (Third Schedule) provides that the value of a debt of a secured creditor for purposes of voting is "nil" where the debt is fully secured. Regulation 25(9) goes on to provide that where the debt is partially secured, the value for purposes of voting will be the portion of the unsecured debt. This means that a secured creditor is not entitled to vote in a creditors' meeting if the debt is fully secured. However, what is not clear is who determines (and how do they determine) whether a creditor is fully or partially secured if the asset has not been realised at the relevant date.

6.5.2.7 Distribution and payment of debts by administrator

An administrator has the power to dispose of the unsecured assets of a company and make distributions to the creditors. Section 582 provides that unsecured creditors must be paid in accordance with the priority of debtors schedule as set out in the Insolvency Act. Section 583 and paragraph 13 of the Fourth Schedule recognise that the payment of debts in the order of priority set out in the Insolvency Act may not be prudent at all times and an administrator may pay creditors without regard to the priority captured in the Insolvency Act if the administrator believes it likely to assist achievement of the purpose of the administration. It should be noted that the process of administration continues for a statutory period of up to 12 months which can be extended by the court for a further period at the court's discretion. Secured creditors and unsecured creditors with a value exceeding 50% of the unsecured debt can also by consent extend the administration for a period not exceeding 6 months.

[35] Insolvency Regulations, Reg 15; Third Sch.
[36] *Idem*, Regs 24 and 25, Third Sch.
[37] *Idem*, Reg 30, Third Sch.

6.5.3 *Company voluntary arrangements under the Insolvency Act*

A CVA is defined in the Insolvency Act to mean a composition or arrangement proposed by the directors of a company which sets out the solutions that the directors propose be adopted to change the fortunes of a financially distressed company. It takes effect once approved by the court.[38] A proposal for a CVA is made by the directors of the company and, if approved by the creditors and the court, a monitor is appointed to oversee the implementation of the arrangements under the proposals. Where a company is in administration the administrator also has the right to propose that the company enters into a CVA if he deems it fit that such course would be the best for the insolvent company.[39]

6.5.3.1 Procedure for commencing a company voluntary arrangement

The proposal for a CVA (once prepared) is to be provided to the creditors and the shareholders of the insolvent company. The proposal may contain the name of the person that the persons proposing would wish to act as provisional monitor and this could also be the administrator. It should be noted that the supervisor is required to be a qualified insolvency practitioner under the Insolvency Act.

Once an administrator is appointed in an administration, he is obligated to prepare a proposal setting out how he intends to achieve the objectives of the administration. In terms of the Insolvency Act the administrator may include the proposal for a voluntary arrangement while preparing the proposals for the administration .[40]

Where the monitor appointed is not the administrator or the liquidator, the monitor (who is deemed to be a provisional monitor before confirmation by the court) is required to submit a report to the court within 30 days of receiving the notice of his appointment, setting out the following:

(a) whether, in the monitor's opinion, the proposal has a reasonable prospect of being approved and implemented;

(b) whether, in the monitor's opinion, meetings of the company and of the company's creditors should be convened to consider the proposal; and

(c) if the monitor believes that those meetings should be convened the date on which, and the time and place at which, it is proposed to hold the meetings.

The directors making the proposal for a CVA are obligated to provide information to enable the monitor to prepare the report, including: (i) a document setting out the terms of the proposal, and (ii) a statement of the company's financial position containing particulars such as information relating to its creditors, debts, other liabilities and assets as prescribed by the Insolvency

38 Insolvency Act, s 630.
39 *Idem*, s 625(4)(a).
40 *Idem*, s 566.

Regulations.[41] The information must be provided 14 days before the proposal is lodged in court for approval. The provisional monitor may be removed from office by an application made to court by a creditor, the makers of a proposal or the monitor in his own capacity if he has failed to file the report within the prescribed time or is unable to act by reason of some incapacity. Once the monitor files his report in court, if he is not the liquidator or administrator and if the report contains a proposal that creditors' meetings should be convened for purposes of approving the proposal for a voluntary arrangement, he is obligated to convene the meetings as prescribed in his proposals unless the court otherwise directs.[42] Where the monitor is the administrator or liquidator, the convening of the creditors' meetings is based on the administrator's or liquidator's discretion. The persons to be summoned to a creditors' meeting are all the creditors of the company of whose claims and addresses the provisional monitor is aware.

6.5.3.2 Approval of a proposal by a creditors' and shareholders' meeting

Where the monitor proposes that creditors' and shareholders' meetings should be called, the main purpose of the meetings is to decide whether to approve the proposal for a CVA with or without modifications. The creditors' meeting is required to appoint a chairman as the first order of business who will oversee the conduct of the meeting. Once appointed, during the first meeting the chairman is required to divide the creditors into three classes for voting purposes, with the first class comprising secured creditors (if any), the second class comprising preferential creditors (if any) and the third class comprising unsecured creditors.[43]

An approval or modification of a proposal is deemed to be passed

(a) if:

(i) passed by a majority of the members of the company present (either in person or by proxy) at the meeting of the company; and

(ii) by a majority (in number and value) of the members of each group of creditors present (either in person or by proxy) at the meeting of creditors; or

(b) if, despite not being not approved by a majority of the members referred to in paragraph (a)(i), it is approved by a majority (in number and value) of the members of each of the classes of creditors referred to in paragraph (a)(ii).

From the above it would appear that a combination of both thresholds in (a)(i) and (a)(ii) above may not be necessary for a decision to be deemed to have been made. This is because, in circumstances where the threshold in (a)(i) is not met but a decision has been approved by a majority (in number and value) of each of the classes of creditors in (a)(ii), then the decision is still held to have been validly passed. The consequence of this is that the votes of the shareholders do not have an impact where the company has creditors.

[41] *Idem*, s 626(3).
[42] *Idem*, s 627(1).
[43] *Idem*, s 628(3).

Secured creditors enjoy certain protections in regard to the security rights they enjoy. If the proposal or a modification to it affects the right of a secured creditor of the company to enforce such creditor's security, it may not be approved unless:

(a) the secured creditor consents to it; or

(b) if the secured creditor does not consent to it, the secured creditor –

 (i) would be in a position no worse than if the company was in liquidation;

 (ii) would receive no less from the assets to which the secured creditor's security relates, or from their proceeds of sale, than any other secured creditor having a security interest in those assets that has the same priority as the secured creditor's; and

 (iii) would be paid in full from those assets, or their proceeds of sale, before any payment from them or their proceeds is made to any other creditor whose security interest in them is ranked below that of the secured creditor, or who has no security interest in them.

The above carve-out protects secured creditors who do not consent to proposals in that a decision cannot be passed regardless of whether or not it was passed by the majority or the voting majority thresholds have been met, if it will prejudice the rights of the secured creditor. This is especially so in instances where a secured creditor is outvoted by other creditors who may want to impose the proposal on a secured creditor.

Any creditor or member who was entitled to attend and vote at a meeting has the right to make an application to the court seeking an order for the approval of a proposal with or without modifications. The court is duty bound, before making an order, to have regard to the various interests and rights accruing to the various classes of creditors and should make an order only if a proposal or modification:

(a) has been approved by a majority of the secured creditors' class;

(b) does not discriminate amongst the members of the dissenting group or groups of creditors and ensures that they will be no worse off than they would have been if the company had been liquidated; and

(c) respects the priorities of preferential creditors over unsecured creditors.[44]

6.5.3.3 *How is a company voluntary arrangement implemented and what are the consequences?*

When a proposal takes effect as a CVA, the monitor becomes responsible for "monitoring" the implementation of the arrangement by the directors in the interests of the company and its creditors and monitoring compliance by the company with the terms of the arrangement.[45]

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44 *Idem*, s 629.
45 *Idem*, s 633.

6.5.3.4 Moratorium

The directors of a company have the option of applying to court to be granted a moratorium against legal action while the company is reorganising its affairs. Only eligible companies are allowed to apply for a moratorium. A company is ineligible if:

(a) it is in liquidation, under administration or a receiver has been appointed over its assets, or it underwent administration within 12 months prior to the application for a moratorium; or

(b) it underwent a CVA within 12 months prior to the application for a moratorium;[46] or

(c) the company has debts due under an agreement that exceed KES 1 billion,[47] whether or not such debts are contingent or certain.

The application for a moratorium accompanies the application for a CVA. Where a company elects to apply for a moratorium, the application to court for a CVA proposal should also include, *inter alia*, a statement to the effect that the company is eligible for a moratorium under the Insolvency Act. Unlike administration, a moratorium is not automatic.

A moratorium takes effect on the date the application is filed in court. Once effective, the monitor has to advertise in at least two newspapers and in the Gazette informing the public that a moratorium over the company is in effect. The moratorium comes to an end on the date that the creditors' and shareholders' meetings are held to approve a CVA proposal.

6.5.3.5 Who does the company voluntary arrangement bind?

On taking effect, a CVA binds:[48]

(a) every member of the company who:
    (i) was entitled to vote at the meeting of the company (whether present or represented at the meeting or not); or

    (ii) would have been so entitled if the member had received notice of that meeting; and

(b) every person (including a secured creditor and a preferential creditor) who:

    (i) was entitled to vote at the meeting of creditors (whether present or represented at the meeting or not); or

    (ii) would have been so entitled if the person had received notice of that meeting, as if the member or person were a party to the arrangement.

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46 *Idem*, s 640.
47 *Idem*, s 642.
48 *Idem*, s 630(2).

It is not, however, clear whether this applies to instances where the CVA was orchestrated by an administrator as the Insolvency Act speaks of a CVA proposed by the directors of the company as opposed to an administrator.

6.5.4 Schemes of arrangements or compromises under the Companies Act, 2015

6.5.4.1 Introduction

A scheme of arrangement or compromise (in contrast to an administration or CVA) is a procedure under the Companies Act. Under these arrangements, a company may make a compromise or arrangement with its members or creditors (or any class of them). There is nothing in the legislation that prescribes the subject matter of a scheme or what it should or should not entail and therefore the particulars of the process itself are determined by the relevant stakeholders. In theory, a scheme could be a compromise or arrangement about anything that the company and its creditors or members may properly agree on among themselves. A company can effect almost any kind of internal reorganisation, merger or demerger using a scheme, as long as the necessary approvals have been obtained as per the Companies Act. The use of the words "arrangement" or "compromise" is based more on practice and the words do not have a definite legal meaning, although the word arrangement is defined in the Companies Act, but not in an exhaustive manner.[49] In practice a "compromise" envisages the existence of a dispute ("disagreement") which is solved by parties settling their differences by making mutual concessions. Arrangements do not necessarily need compromises or the existence of a dispute and as such reference to a scheme of arrangement includes a compromise, reconstruction and amalgamation. These concepts will be referred to as schemes or schemes of arrangement below.

6.5.4.2 What is the procedure for a scheme of arrangement?

Schemes can be proposed between a company and its creditors or any class of its creditors, or between the company and its members or any class of its members.

An application to court for the approval of a scheme of arrangement can be made by:[50]

(a) the company;

(b) any creditor or member of the company; or

(c) if the company is in liquidation or under administration, the liquidator or administrator.

On application, the court may issue preliminary orders for a meeting to be held by the creditors (or class of creditors) or by the members (or class of members) and the modalities for convening such meetings. Once the order is made, the company is obligated to ensure that each notice

[49] An "arrangement" is defined to include a reorganisation of the company's share capital by the consolidation of shares of different classes, or by the division of shares into shares of different classes, or by both of these methods.

[50] Companies Act, s 923(2).

convening the meeting that is sent to a creditor or member includes, or is accompanied by, a statement which provides the following information:

(a) the effect of the proposed scheme, any material interests of the directors (whether as directors or shareholders or as creditors) and the effect of those interests on the scheme; and

(b) where the proposed scheme affects the rights of debenture holders, the company is obliged to include in the statement similar disclosures as those made with respect to the directors, that is, an explanation on the debenture holder's material interests and the effect of those interests on the scheme.[51]

6.5.4.3 *Voting for approval of the scheme of arrangement*

Once the meeting has been convened, the threshold required for the approval of a scheme is 75% in value of either:

(a) the creditors or a class of creditors; or

(b) the members or a class of members,

present and voting in person or by proxy.[52]

Once the voting threshold has been met, the company, any creditor or member, or the liquidator / administrator may apply to court for the sanctioning of the scheme.

Once a scheme has been sanctioned by the court it is binding on the creditors or class of creditors, including the creditors who may not have consented and / or voted for the scheme. The scheme also binds the company and the liquidator or administrator. The order of the court sanctioning a scheme has no effect until a copy of it has been lodged with the Registrar of Companies for registration.

6.5.4.4 *Ancillary orders a court can make upon sanctioning of a scheme*

Once an order approving a scheme is made, the court can also make orders in relation to the following matters which would be contained in the proposal filed in court (if such matters are before the court):

(a) the transfer to the transferee company of the whole or any part of the undertaking and of the property or liabilities of a transferor company;

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[51] It is an offence not to provide this information and each officer found guilty may be liable to a fine not exceeding KES 500,000. For the purposes of s 924, an officer of the company is defined to include an administrator, liquidator or the trustee of a debenture holder. As such, debenture holders may be held liable for not providing information to the company.

[52] Companies Act, s 926.

(b) the allotting or appropriation by the transferee company of any shares, debentures, policies or other similar interests in that company that, under the scheme, are to be allotted or appropriated by that company to or for any person;

(c) the continuation by or against the transferee company of any legal proceedings pending by or against a transferor company;

(d) the dissolution, without liquidation, of a transferor company;

(e) the provision to be made for any persons who, within such period and in such manner as the court directs, dissent from the scheme; and / or

(f) such incidental, consequential and supplemental matters as are necessary to secure that the reconstruction or amalgamation is fully and effectively carried out.

Once the court pronounces itself on matters related to the transfer of property and liabilities of a company, the property is deemed to vest in the transferee company as do the liabilities. Transferred property is deemed to be free from all charges and / or encumbrances if the court issues such an order.

Each company affected by the order is required to file the order with the Registrar of Companies within seven days of the court making the order.

Unlike in the case of supervisors under the Insolvency Act, the Companies Act is not clear on who supervises the process but since the process is sanctioned by the court, the court would presumably have overall oversight. The concerned stakeholders would also retain the right to challenge the actions of any person appointed by the court to implement the process if they do not comply with the court orders. Where the company is also under administration or in liquidation under the Insolvency Act, the administrator or liquidator would be in charge of the process.

6.6 General aspects relating to insolvency generally

6.6.1 Priority of claims

Schedule 2 to the Insolvency Act determines priority claims, as set out below:

6.6.1.1 First priority claims

(a) Costs of the liquidator's / administrator's remuneration and operational costs for the administration or liquidation; and

(b) Reasonable costs incurred during the court proceedings and costs incurred by a creditor to preserve an insolvent company's assets.

6.6.1.2 Second priority claims

(a) Wages and salaries payable to employees, up to a maximum of KES 200,000 per employee;

(b) Statutory deductions from employees' salaries that were not paid (for example, PAYE, NSSF (retirement benefits contribution), NHIF (statutory health insurance contributions));

(c) Other amounts required by other written law to be paid in accordance with the priority established by this second priority claims provision paid by the buyer to a seller on account of the purchase price of goods; and

(d) All amounts that are held on behalf of the Kenya Revenue Authority by a person licensed under the Banking Act who has been appointed as an agent for revenue banking services by the Commissioner of Domestic Taxes at the point of receivership or liquidation of the bank or institution.

6.6.1.3 Third priority claims

Third priority claims are for unpaid taxes, such as individual income tax, customs, non-resident and resident withholding tax and excise duty.

6.6.1.4 Fourth priority claims

Fourth priority claims are for holders of floating charges (non-crystallised).

6.6.1.5 Fifth priority claims

Fifth priority claims are for unsecured creditors.

These claims, having the same priority, rank equally among themselves and are payable on a *pari passu* basis.

Secured assets do not form part of the insolvent's estate. The secured creditors have priority with respect to the secured assets they hold and have the right to realise the security and set-off debts due to them, but must account for any excess funds from the realisation which must be remitted to the liquidator / administrator for distribution to the unsecured creditors of the debtor.

Contractual subordination of competing interests is possible and is usually in instances where lenders with competing interests enter into inter-creditor agreements to determine how their respective rights will be addressed in the event of enforcement. These inter-creditor agreements differ, depending on the parties' mutual understanding and they can, for example, be *pari-passu*. These inter-creditor agreements survive the insolvency of the borrower and the liquidator or administrator will respect such agreements provided they conform to the provisions of the Insolvency Act and subject to Schedule 2, which lists the preferred creditors.

6.6.2 *Set-off*

Even though the Insolvency Act is based on the UK Insolvency Act, 1986, the Kenyan Insolvency Regulations are not a replica of the UK 1986 Regulations. For example, they do not contain the mutual dealings and set-off provisions found in UK legislation, but they recognise that for voting purposes the value may be adjusted on account of set-off. The statutory demand for bankruptcy makes reference to set-off but there are no other substantive provisions on the issue. It is anticipated this will be addressed once the regulations are amended.[53]

Section 560(1)(a) of the Insolvency Act provides that while a company is under administration a person may not take steps to enforce a security over the company's property unless they have obtained consent of the administrator or approval of the court. Further, Section 561(4)(f) of the Insolvency Act provides that if an application for administration in respect of a company has been made and the application is yet to be granted or dismissed, or the administrative order is yet to take effect, a person cannot begin or continue legal process (including legal proceedings, execution, distress and diligence) against the company or property of the company without the approval of the court. The exercise of early contractual termination, netting or set-off rights would arguably not be stayed by sections 560 and 561. Judicial interpretation of this new insolvency law in Kenya is still in its formative stages and it is not certain what view the courts in Kenya will take on this issue.

6.6.3 *Director liability*

Directors are appointed to promote the success of the company and to preserve, protect and grow their investments. Success in the context of directors' duties is accepted to mean not just financial success, but long-term financial success. Where a company is performing badly or is in financial difficulty, there is potential for directors to become the target of criticism and face a number of issues. These issues include:

(a) what can directors do to keep the company in business without committing an offence or incurring personal liability; and

(b) at what stage must directors cease trading?

6.6.3.1 Wrongful trading

If in the course of the liquidation of a company it appears that whilst the company was conducting business a person knew or ought to have known that there was no reasonable prospect that the company would avoid being placed in insolvent liquidation, the liquidator may make an application to the court[54] and the court may make an order declaring the person to be

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[53] Under English law, insolvency set-off is provided for in s 323 of the UK Insolvency Act 1986 for bankruptcy and r 4.90 for winding-up. An administrator in the UK would be allowed to set-off under r 2.85 of the Insolvency Rules 2016 (similar to r 4.90). Kenya adopted the 1986 Act but not the rules, and the Kenyan insolvency rules do not include an equivalent to r 2.85 or r 4.90.

[54] Insolvency Act, s 506(3).

liable to make such contribution to the company's assets as the court considers appropriate.[55] No order can be made if the court is satisfied that the person took steps to avoid potential loss to the company's creditors as the person ought reasonably to have taken.[56] Where an order is made, the court may also disqualify the person from being (or acting as) a director of a company or a limited liability partnership for any period not exceeding 15 years.[57]

In the UK, the test for determining the quantum of directors' liability for wrongful trading is both a subjective and objective test and the same test is likely to be applied in Kenya. The two standards are:

(a) the general knowledge, skill and experience that that director has (the subjective test); and

(b) the general knowledge and experience that may be reasonably expected of a person carrying out the same functions that were carried out by the director (the objective test).

Directors are at risk of liability for wrongful trading at any time after they knew or ought to have known that the company could not avoid insolvent liquidation. Where the company is in financial difficulty, it is important that there are regular board meetings and that any directors' decisions are reported in full in the company's minutes.

6.6.3.2 Fraudulent trading

The consequences of fraudulent trading are the same as the consequences of wrongful trading. If in the course of liquidation of the company it appears that any business of the company has been carried on with the intent to defraud creditors (or for any other fraudulent purpose) and the liquidator believes that such persons participated (directly or indirectly) in the business with the knowledge that the business was being carried on in that manner,[58] the court may order the person to make such contributions to the company's assets as the court considers fair and reasonable.[59] Additionally, where a court order is made the court may also disqualify the person from being or acting as a director of a company, or a limited liability partnership, for any period not exceeding 15 years.[60]

Fraudulent trading is also a criminal offence under the Companies Act[61] and the offence is applicable whether or not the company has been liquidated or is in liquidation. A person found guilty of fraudulent trading is liable on conviction to imprisonment for a term not exceeding 10 years, or a fine not exceeding KES 10,000,000, or both.[62]

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55 *Idem*, s 506(5).
56 *Idem*, s 506(6).
57 *Idem*, s 506(8)(a).
58 *Idem*, s 505(1).
59 *Idem*, s 505(2).
60 *Idem*, s 507(4)(a).
61 Companies Act, 2015, s 1002.
62 *Idem*, s 1002(3).

There is a lower burden of proof in order to prove wrongful trading compared to proving fraudulent trading. In principle it is therefore easier for a liquidator to obtain an order for wrongful trading than for fraudulent trading and the consequences are the same, as the court on consideration of the application may order the directors to contribute personally.

Additional offences under the Insolvency Act that can apply to directors include, *inter alia*, fraud in anticipation of winding-up,[63] transactions to defraud creditors,[64] misconduct in the course of liquidation,[65] falsification of the company's books,[66] material omissions from a statement relating to the company's affairs[67] and false representations to creditors.[68]

6.6.4 *Impeachable transactions*

6.6.4.1 Preference transactions

Where a company enters into transactions that prefer certain creditors over others and give them an advantage over other creditors, a preference is deemed to arise. A preference is deemed to occur if it offers the beneficiary of such a contract a better position than they would have been in had the company been liquidated and such beneficiary is a creditor, guarantor or surety of one of the company's liabilities. Further, under section 591 a creditor has the right to challenge the actions of an administrator or liquidator (including preference pay-outs) on the basis that the administrator or liquidator is acting or has acted so as to detrimentally affect the interests of the applicant (whether alone or in common with some or all other members or creditors of the company). Arguably, in proving that an administrator's or liquidator's actions were detrimental to the applicant it is possible to argue that a preference payout need not be fraudulent and can be reversed if it grants an unfair advantage to one or more creditors over others (that is, same-level creditors).

Pursuant to section 683 of the Insolvency Act, the definition of "preference" does not expressly state that the preference has to be fraudulent. Section 683(4) states that a company gives a preference to a person if:

(a) the person is one of the company's creditors or a surety or guarantor for any of the company's debts or other liabilities; and

(b) the company does any act or allows an act to be done that (in either case) has the effect of placing the person in a position that, if the company were in insolvent liquidation, is better than the position the person would have been in had that act not been done.

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63 Insolvency Act, s 498.
64 *Idem*, s 499.
65 *Idem*, s 500.
66 *Idem*, s 501.
67 *Idem*, s 502.
68 *Idem*, s 503.

6.6.4.2 Transactions at an undervalue

A transaction is deemed to be at an undervalue if the company does not receive any valuable consideration, or the value received is considerably lower than the consideration the company is providing for the transaction.[69]

6.6.4.3 Extortionate credit transactions

A transaction is deemed to be extortionate if it occurs within the last three years before a company's insolvency, the transaction required the company to make exorbitant payments without any valuable return, or it otherwise grossly contravened the ordinary principles of fair dealing.[70]

In any of the above cases, if it is proved that a transaction was a preference, at an undervalue or extortionate, the court may issue an order for clawback, which would see the unfairly advantaged party ordered to reverse the disposition in question.

6.6.5 Impact of insolvency on existing contracts

Existing contracts do not terminate automatically once an insolvency procedure becomes effective. One of the fundamental principles of contract law is that the parties' freedom to contract with each other must be respected (meaning that a court will not generally interfere with a contract and / or seek to re-write it for the parties).[71] The moratorium that is in place while an insolvency process is effective does not automatically terminate existing contracts. Certain rights of the parties are protected and English courts have held that a moratorium does not extend to the taking of non-judicial steps, such as the service of contractual notices.[72] Kenyan courts would consider English cases as persuasive authorities in deciding such cases. What this means is that parties can issue notices under their respective contracts, or even terminate them, if the debtor becomes insolvent.

However, it should be noted that in liquidation, the liquidator has the right to disclaim onerous contracts. The Insolvency Act does not provide for the disclaimer of onerous contracts in any other instance other than in liquidation.[73] However, considering the wide powers that an administrator has, it is arguable that they include the power to disclaim an onerous contract. This is because an administrator is allowed to do all other acts that may assist in achieving the objectives of administration.

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69 *Idem*, s 682(5).
70 *Idem*, s 686.
71 The principle of freedom of contract is founded on English common law, which has the force of law in Kenya. In the case of *Printing and Numerical Registering Co v Sampson* (1875) All ER 19, the court stated that "contracting parties are the best judges of their own interests and should they freely enter into a contract, then the sole function of the courts would be to enforce it." The freedom of contract principle is, however, subject to many qualifications in modern day practice. For example, insolvency law interferes with the principle by the imposition of statutory rules and procedures and therefore involves from conception an interference with the freedom of parties to a contract.
72 *In Re Olympia & York Canary Wharf Limited* (1993) BCC 154.
73 Form of disclaimer in Reg 98A.

Can a creditor then enforce its contracts where an insolvency practitioner does not perform? The issue of whether a contract is automatically terminated on commencement of an insolvency process and whether a creditor can enforce the contract, are two distinct issues. Whereas on the one hand the creditor has rights under its contract, enforcement actions against the company may only be instituted with the leave of court if there is a moratorium in place, that is, during the automatic moratorium in administration and during the court-sanctioned moratorium in voluntary arrangement and liquidation. However, this is not to say that the creditor cannot issue non-judicial notices under the contract. These notices would include the creditor's right to invoke the event of default clause in the contract and issuing a notice of its intention to exercise any remedies applicable (if any).

6.6.6 *Proofs of debt*

A creditor is entitled to vote at a meeting only if he has proved his debt. The proof of claim has to be sent to the convenor of the meeting by 16:00 on the day preceding the date of the meeting and the proof has to be admitted and accepted. Votes are calculated according to the amount of each creditor's claim.[74] In regard to voting rights, decisions are made by creditors when a majority (in value) of those voting have voted in favour of the proposed decision.[75]

Self-Assessment Exercise 5

Study the basic aspects dealt with in the previous section.

Question 1

Discuss the process of administration under the Insolvency Act.

Question 2

Discuss a company voluntary arrangement procedure.

Question 3

Discuss the procedure of schemes of arrangement under the Companies Act, in an insolvency context.

Question 4

Briefly discuss the priority of claims as set out in the Insolvency Act.

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[74] Insolvency Regulations, items 24 and 25, Third Sch.
[75] *Idem*, item 30, Third Sch.

Question 5

Discuss the process of receivership in the context of a charge over land.

For commentary and feedback on self-assessment exercise 5, please see APPENDIX A

7. CROSS-BORDER INSOLVENCY LAW

The Insolvency Act applies to companies incorporated in Kenya as well as any foreign company registered under the Companies Act, 2015 (by way of registration of a branch).

The purpose of the relevant cross-border insolvency provisions of the Insolvency Act is to promote the objectives of attaining:

(a) co-operation between the courts and other competent authorities of Kenya and foreign States involved in cases of cross-border insolvency;

(b) greater legal certainty for trade and investment;

(c) fair and efficient administration of cross-border insolvencies that protects the interests of all creditors and other interested persons, including the debtor;

(d) protection and maximisation of the value of the debtor's assets; and

(e) facilitation of the rescue of financially troubled businesses with a view to protecting investment and preserving employment.

The cross-border insolvency provisions in the Insolvency Act apply in cases where assistance is sought in Kenya by a foreign court or a foreign representative in connection with a foreign proceeding. However, a court can refuse to entertain any application in relation to a foreign proceeding where the action is manifestly contrary to the public policy of Kenya.

Pursuant to the cross-border insolvency provisions in the Insolvency Act:

(a) a foreign representative is entitled to apply directly to the court; and

(b) foreign creditors have the same rights regarding the commencement of, and participation in, a proceeding under the Insolvency Act as creditors in Kenya.

In order to benefit from the cross-border insolvency regime in Kenya, a foreign representative may apply to the court for recognition of the foreign proceeding in which the foreign representative has been appointed (the Recognition Application).

The Recognition Application must contain the following supporting documentation:

(a) a certified copy of the decision commencing the foreign proceeding and appointing the foreign representative;

(b) a certificate from the foreign court affirming the existence of the foreign proceeding and of the appointment of the foreign representative;

(c) any other evidence acceptable to the court of the existence of the foreign proceeding and of the appointment of the foreign representative; and

(d) a statement identifying all foreign proceedings in respect of the debtor that are known to the foreign representative.

The court is required to accept the Recognition Application where:

(a) the foreign proceeding is a collective judicial or administrative proceeding in a foreign State, including an interim proceeding, under a law relating to insolvency and in which proceeding the assets and financial affairs of the debtor are subject to control or supervision by a foreign court, either for the purpose of reorganisation or liquidation;

(b) the foreign representative is a person or body, including one appointed on an interim basis, authorised in a foreign proceeding to administer the reorganisation or the liquidation of the debtor's assets or financial affairs, or to act as a representative in the foreign proceeding;

(c) the criteria set out in the preceding paragraph (namely, that there is a certified copy of the decision commencing the foreign proceeding and appointment of a foreign representative, or other acceptable evidence of the foreign proceeding or appointment) have been met; and

(d) the application has been submitted to the court.

Following the submission of the Recognition Application but prior to it having been determined, the court has the power to grant the following interim measures:

(a) staying execution against the debtor's assets (in Kenya);

(b) entrusting the administration or realisation of all or part of the debtor's assets located in Kenya to the foreign representative or another person designated by the court, in order to protect and preserve the value of assets that, by their nature or because of other circumstances, are perishable, susceptible to devaluation or otherwise in jeopardy;

(c) suspending the right to transfer, encumber, or otherwise dispose of any assets of the debtor; or

(d) providing for the examination of witnesses, the taking of evidence, or the delivery of information concerning the debtor's assets, financial affairs, rights, obligations or liabilities.

On recognition by the court of a foreign proceeding, if necessary to protect the assets of the debtor or the interests of the creditors, the court may, at the request of the foreign representative, grant any appropriate relief, including:

(a) staying the commencement or continuation of individual actions or individual proceedings concerning the debtor's assets, rights, obligations or liabilities;

(b) staying execution against the debtor's assets;

(c) suspending the right to transfer, encumber or otherwise dispose of any assets of the debtor;

(d) providing for the examination of witnesses, the taking of evidence or the delivery of information concerning the debtor's assets, financial affairs, rights, obligations or liabilities;

(e) entrusting the administration or realisation of all or part of the debtor's assets located in Kenya to the foreign representative or another person designated by the court; and

(f) extending any of the interim remedies.

Upon recognition by the court of a foreign proceeding, certain provisions of the Insolvency Act in respect of the protection of creditors and other interested persons, apply. These are considered in more detail below.

At the outset, the court is under a duty to ensure that the interests of the creditors and other interested persons, including the debtor, are adequately protected. This is a wide-ranging power and the court therefore has inherent jurisdiction pursuant to such a power to grant such relief as it sees fit with respect to the protection of creditors and other interested parties.

Furthermore, on recognition by the court of a foreign proceeding, the foreign representative has standing to initiate any action that an insolvency administrator may take in respect of a proceeding under the Insolvency Act that relates to a transaction (including any gifts or improvement of property or otherwise), security, or charge that is voidable or may be set aside or altered.

In regard to paragraph 13 of the Fifth Schedule, the Insolvency Act provides that where it is determined that a foreign company has given a preference to a person, the court must make an order voiding the act constituted by giving the preference and restoring the position to that which would have existed if the preference had not been given.

For the purposes of paragraph 14 of the Fifth Schedule, a company gives a preference to a person if the person is one of the company's creditors or a surety or guarantor for any of the company's debts or other liabilities and the company does any act or allows an act to be done that (in either case) has the effect of placing the person in a position that, if the company were in insolvent liquidation, is better than the position the person would have been in had that act not been done.

The Insolvency Act further provides that no order may be made by the court to void any "preferential" transactions unless it is satisfied that the company that gave the preference was influenced in deciding to give it by a wish to produce in relation to that person the effect referred to paragraph 15 of the Fifth Schedule.

Self-Assessment Exercise 6

Study the basic aspects dealt with in the previous section.

Briefly discuss the process of enforcement of a cross-border insolvency proceeding in Kenya.

For commentary and feedback on self-assessment exercise 6, please see APPENDIX A

8. RECOGNITION OF FOREIGN JUDGMENTS

8.1 Choice of law and jurisdiction

There is no specific statute dealing with conflict of laws in Kenya. However, it is a general principle that where the parties to a contract expressly stipulate that the contract shall be governed by a particular law, that law will be the proper law of the contract, provided that the selection is *bona fide* and there is no objection on the grounds of public policy, even where the law has no real connection with the contract. Accordingly, courts in Kenya generally respect the choice of law provisions agreed to by the parties to a contract and the application of foreign law in such a case would not be viewed as an infringement of Kenya's sovereignty. Choice of law in commercial contracts is a well-recognised principle and the courts will generally enforce a clause ousting their jurisdiction and the application of Kenyan law, provided that certain prerequisites are met.

The general rule is that the exclusive jurisdiction clause should normally be respected because the parties themselves freely fixed the forum for the settlement of their disputes; and the court should carry out the intention of the parties and enforce the agreement made by them. This rationale is partially founded on the common law principle of privity and freedom of contract between parties and that a court should not rewrite a contract for the parties.

The recurrent theme in cases where Kenyan courts have been faced with the question of whether or not to respect an exclusive jurisdiction clause, is that the courts should exercise their discretion by taking into account all the circumstances of the particular case to determine whether or not to uphold an exclusive jurisdiction clause. The following are issues that Kenyan courts have held, that need to be considered on questions of choice of law and jurisdiction:

(a) in what country the evidence on the issues of fact is situated or more readily available and the effect of that on the relative convenience and expense of a trial as between the court of the country and the court of the foreign country. The rationale here is that it would not be proper in all reasonableness to have a matter heard in a different country whereas all the evidence is situated in a different country and that it would be expensive and inconvenient to try the matter in a different country;

(b) whether the law of the foreign court applies and, if so, whether it differs from the law of the country in any material respects;

(c) with what country either party is connected, and how closely;

(d) whether either of the parties to the dispute genuinely desires trial in the foreign country, or is only seeking procedural advantage. The rationale here being that it would not be proper to allow forum shopping where the only objective it to defeat a claim by the other party; or

(e) whether either of the parties would be prejudiced by having to sue in the foreign court because they would be deprived of security for their claim, be unable to enforce any judgment obtained or be faced with a time bar not applicable in their country.

It should be noted that the choice of law or legal system is construed as referring to the substantive law of that state and not to its conflict of laws rules or procedural rules. Therefore, if a contract stipulates, for example, that English law is to apply, a Kenyan court would uphold English law but apply Kenyan conflict of laws and procedural rules.

8.2 Recognition of foreign judgments

Foreign judgments are enforceable in Kenya if they originate from countries whose courts are recognised under the Foreign Judgments (Reciprocal Enforcement) Act (the FJEA) as "designated courts". A designated court is defined in section 2 of the FJEA as a superior court of a reciprocating country which is a Commonwealth country, a superior court of any other reciprocating country which is specified in an order made under section 13, or a subordinate court. The foreign judgments enforceable under the FJEA are set out in sections 3(1) and 3(2) of the FJEA:

(a) a judgment or order of a designated court in civil proceedings whereby a sum of money is made payable;

(b) a judgment or order of a designated court in civil proceedings under which movable property is ordered to be delivered to any person;

(c) a judgment given in any court on appeal against a judgment or order or a designated court referred to in paragraphs (a) and (b);

(d) a judgment of a designated superior court for the costs of an appeal from a subordinated court, whether or not a designated court, or from an award referred to in paragraph (e); and

(e) an award in arbitration proceedings, if the award has become enforceable (under the laws in force in the country where it was made) in the same manner as a judgment given by a designated court in that country.

The FJEA however applies to a judgment referred to in section 3(1) in instances where the foreign judgment requires the judgment debtor to make an interim payment of a sum of money to the judgment creditor, or the judgment is final and conclusive as between the parties thereto. It should be noted that a judgment is deemed to be final and conclusive notwithstanding that an appeal may be pending against it, or that it may still be subject to appeal, in the courts of the country of the original court.

Once a judgment is obtained in a foreign jurisdiction, the judgment needs to be registered in the High Court of Kenya upon the making of an application. The application must comply strictly with the requirements set out in section 5 of the FJEA. Elaborate rules are set out under the FJEA setting out how the application for registration is to be made, how the order is to be drawn up, notice of registration to the judgement debtor, how an application to set aside registration is to be made and for appeal.

Once the judgment has been registered it will be recognised by the Kenyan courts and it will have the same force and effect as if the judgment was entered in Kenya. The enforcement thereof will then follow the same procedure set out in the Civil Procedure Act. The registration of the judgment must however be done within six years from the date of the judgment, save where the judgment is subject to appeal, in which case the six-year period is from the date of the determination of the appeal. Judgments registered in Kenya for enforcement are payable in the Kenyan shilling equivalent of the currency in which the judgement was entered, at the exchange rate prevailing at the date of registration of that judgment. Where the High Court is satisfied that the judgment is partially satisfied in the country in which it was made, the judgment may be registered only in respect of the sums or the items of movable property remaining payable or deliverable in the proceedings. Kenyan courts may also reserve jurisdiction over some peripheral matters or on issues dealing with immovable property located in Kenya, even though parties have settled on the laws of another country as the choice of law.

In regard to the finality of the foreign judgment, section 9 of the Civil Procedure Act provides that a foreign judgment shall be conclusive as to any matter thereby directly adjudicated upon between the parties, or between parties under whom they or any of them was claiming. What this means is that Kenyan courts will not seek to revise and / or review the foreign judgement on its merits, or seek to review the facts and will enforce it as it was passed in the foreign court.

However there are certain instances when the Kenyan courts will not recognise a foreign judgment. These instances include:

(a) where a foreign court lacked jurisdiction to adjudicate on the matter;

(b) where the merits of the case were not considered by the foreign court;

(c) where the proceedings in the foreign court were based on an incorrect view of Kenyan law, in cases where such law is applicable;

(d) where the proceedings in the foreign court were in contravention of the rules of natural justice;

(e) where the judgment was obtained by fraud; and

(f) where the judgment sustains a claim founded on a breach of any law in force in Kenya.

Judgments obtained in the English Courts are enforceable in the courts of Kenya by registration under the FJEA.

8.3 Judgments from non-reciprocating countries under the Foreign Judgments (Reciprocal Enforcement) Act

Kenyan courts have on various occasions been faced with instances where parties have sought to enforce judgments from non-reciprocating countries. In the absence of a reciprocal enforcement arrangement, a foreign judgment is enforceable in Kenya as a claim in common law. Under English common law, which has the force of law in Kenya, the judgment of a competent foreign court condemning a party to pay a certain sum constitutes a good cause of action and is regarded as creating a debt in respect of which a suit may be filed. The process entails instituting a claim in a competent court with the resultant effect of obtaining a judgment using the foreign judgement. The Court of Appeal in Kenya has previously held that the following requirements must be fulfilled before enforcement in such a case:

(a) the party seeking to enforce the foreign judgment must file a plaint at the High Court of Kenya, providing a concise statement of the nature of the claim, claiming the amount of the judgment debt, supported by a verifying affidavit, list of witnesses and bundle of documents intended to be relied upon. A certified copy of the foreign judgment should be exhibited to the plaint. It is open to a defendant to challenge the validity of the foreign judgment under the grounds set out in Section 9 of the Civil Procedure Act (set out in the analysis in paragraph 8.2 above);

(b) a judgment creditor is entitled to summary judgment under Order 36 of the Civil Procedure Rules, unless the defendant judgment debtor can satisfy the court that there is a real prospect of establishing at trial one of the grounds set out in section 9 of the Civil Procedure Act;

(c) if the foreign judgment creditor is successful after trial, the judgment creditor will have the benefit of a High Court judgment and the judgment creditor will be entitled to use the procedures of the Kenyan courts to enforce the foreign judgment, which will now be executed as a Kenyan judgment;

(d) the money judgment in the foreign judgment must be final and conclusive and must be filed within six years from the date of judgment. It may be final and conclusive even though it is subject to an appeal; and

(e) the foreign court must have had jurisdiction, (according to the Kenyan rules on conflict of laws) to determine the subject matter of the dispute and the parties to the foreign court's judgment and the enforcement proceedings must be the same, or must derive their title from the original parties.

The High Court will generally consider the foreign court to have had jurisdiction where the person against whom the judgment was given:

(a) was, at the time the proceedings were commenced, habitually resident or incorporated in or having a principal place of business in the foreign jurisdiction; or

(b) was the claimant or counter-claimant in the foreign proceedings; or

(c) willingly submitted to the jurisdiction of the foreign court; or

(d) agreed, before commencement, in respect of the subject matter of the proceedings to submit to the jurisdiction of the foreign court.

Where the above requirements are established to the satisfaction of the High Court, the High Court will not re-examine the merits of the foreign court judgment. The foreign judgment will be enforced on the basis that the defendant has a legal obligation as a matter of common law, recognized by the High Court, to satisfy the money decree of the foreign judgment.

8.4 Enforcement of foreign arbitral awards

Arbitral awards can be enforced in Kenya under the Arbitration Act[76] (Arbitration Act) or the FJEA. The main distinction between the enforcement of arbitral awards under the two statutes is that whereas an international arbitral award can be directly enforced under the Arbitration Act, it must first be registered as a judgment of the court of the country in which the award was given before it can be enforced under the FJEA. This is, however, subject to whether the relevant countries are party to a treaty recognising the enforcement of foreign arbitral awards in their respective jurisdictions. Kenya is a party to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention) which was domesticated through the Arbitration Act.

Under the Arbitration Act, an international arbitration award will be recognised by the courts in Kenya as binding and will be enforced in accordance with the provisions of the New York Convention. The New York Convention provides that each contracting state shall recognise arbitral awards as binding and enforce them in accordance with the rules of procedure of the territory where the award is relied upon, under the conditions set out in the Convention.

[76] Act 4 of 1995.

A party applying for the enforcement of an arbitral award must furnish the High Court with the original or certified copy of the arbitral award and the arbitration agreement according to section 36(3) of the Arbitration Act. The recognition or enforcement of an arbitral award may be refused only if the party against whom it is sought proves any of the following matters, namely;

(a) a party to the arbitration agreement was under some incapacity;

(b) the arbitration agreement is not valid under the law to which the parties have subjected it or, failing any indication of that law, under the law of the state where the arbitral award was made;

(c) the party against whom the award is invoked was not given proper notice of the appointment of an arbitrator or of the arbitral proceedings, or was otherwise unable to present his case;

(d) the arbitral award deals with a dispute not contemplated by or not falling within the terms of the reference to arbitration, or it contains decisions on matters beyond the scope of the reference to arbitration;

(e) the composition of the arbitral tribunal was not in accordance with the agreement of the parties or, failing any agreement by the parties, was not in accordance with the law of the State where the arbitration took place;

(f) the making of the arbitral award was induced or affected by fraud, bribery, corruption or undue influence;

(g) the arbitral award has not yet become binding on the parties, or has been set aside or suspended by a court of the state in which or under the law of which the arbitral award was made;

(h) the court finds that the subject matter of the dispute is not capable of settlement by arbitration under the laws of Kenya; or

(i) the court finds that the recognition or enforcement of the arbitral award would be contrary to the public policy of Kenya.

The process of enforcing an arbitral award under the Arbitration Act is by filing an application for leave to enforce the award as a decree in the High Court of Kenya. Once the application is heard and allowed, the award is considered a judgment of the court and can be executed in the same manner as an ordinary judgment of the court.

There are different ways in which the judgment may be executed and these include attachment and sale of the judgment debtor's property and committing the judgment debtor to a civil jail (or directors of the judgement debtor in the case of a company).

Self-Assessment Exercise 7

Study the basic aspects dealt with in the previous section.

Question 1

Briefly discuss the process of enforcement of a foreign judgment in Kenya.

Question 2

Briefly discuss the circumstances in which foreign judgment will not be enforceable in Kenya.

For commentary and feedback on self-assessment exercise 7, please see APPENDIX A

9. INSOLVENCY LAW REFORM

There is a move by the office of the Attorney General to amend the Kenyan insolvency legislation (main statute and regulations) to bring about certain changes. These changes include the recognition of common law receivership, land law receivership and the introduction of the concept of administrative receivership. The proposed changes have been drafted but implementation has been slow.

10. USEFUL INFORMATION

(a) The Chambers Global Insolvency Guide is a very useful resource material which Anjarwalla & Khanna prepared and provides some further insights on the insolvency regime in Kenya: https://www.africalegalnetwork.com/kenya/new-pub/sonal-sejpal-contributes-insolvency-2018-global-practice-guide/;

(b) http://kenyalaw.org/kl/fileadmin/pdfdownloads/Acts/Insolvency_Act18of2015_-_compressed.pdf;

(c) https://gettingthedealthrough.com/area/35/jurisdiction/44/restructuring-insolvency-kenya/;

(d) https://www.lw.com/taking-security-in-africa/kenya;

(e) https://cfllegal.com/priority-of-claims-under-the-kenya-insolvency-act-2015/;

(f) https://www.cytonn.com/topicals/restructuring-an-insolvent-business-case-study-of-nakumatt-holdings; and

(g) https://www.mondaq.com/insolvencybankruptcy/1133748/pre-pack-administrations-in-kenya.

APPENDIX A: COMMENTARY AND FEEDBACK ON SELF-ASSESSMENT EXERCISES

Self-Assessment Exercise 1

Question 1

Briefly discuss the court system in Kenya and various court levels and their respective jurisdictions.

Question 2

Briefly discuss the Kenyan legal system and sources of law in Kenya.

Commentary and Feedback on Self-assessment Exercise 1

Question 1

Suggested answer:

- Establishment of judiciary under Chapter 10, Article 159 of the Constitution of Kenya.
- Discuss judiciary's related institutions (the Judicial Service Commission (JSC), Kenya Law (previously National Council for Law Reporting (NCLR), Tribunals and the Judiciary Training Institute (JTI)) perform the following functions: i) administration of justice, ii) formulation and implementation of judicial policies, and iii) compilation and dissemination of case law and other legal information for the effective administration of justice
- Discuss court levels, being Superior (Supreme Court, Court of Appeal and High Court) and Subordinate courts (Magistrates courts).

The Court system has been decentralised and made independent with each of the Supreme Court and the Court of Appeal having its own President and the High Court having a Principal Judge as the heads of the respective institutions.

The Supreme Court of Kenya was newly established under Article 163 of the Constitution of Kenya. It comprises of seven judges: the Chief Justice, who is the president of the Court, the Deputy Chief Justice, who is the deputy to the Chief Justice, the vice-president of the Supreme Court and five other judges.

The Court of Appeal is established under Article 164 of the Constitution of Kenya 2010 and is he first appellate court from the High Court.

The High Court is established under Article 165 and is organised and administered in the manner prescribed by an Act of Parliament, the High Court (Organization and Administration) Act. The Court has a Principal Judge, who is elected by the judges of the High Court from among themselves.

The High Court has also been restructured into four divisions: Division of Land and Environment; Division of Judicial Review; Division of Commercial and Admiralty; and Division Constitution and Human Rights Division.

The subordinate courts are established under Article 169. They consist of the Magistrates' Courts, Kadhi's Courts, Court Martial, and any other court or local tribunal established by an Act of Parliament.

Question 2

Discuss:

Judicature Act and the sources listed in section 3:

- The Constitution of Kenya;
- Statutes) which includes Acts of the Parliament of Kenya and subsidiary legislation;
- Some specified Acts of the Parliament of the UK as set out in the Judicature Act;
- Some specific foreign legislation and statutes of general application in force in England on the 12 August 1897;
- The substance of the common law and the doctrines of equity and the procedure and practice observed in courts of justice in England as at 12 August 1897; and
- African customary law.

Further, discuss additional sources in the Constitution, that is i.e. There are other sources of law not mentioned in the Judicature Act but given force through the Constitution and other Acts of Parliament. Pursuant to Article 2 of the Constitution international treaties and customary practices are a source of law in Kenya. Islamic law and Hindu law are also sources of law so far as personal customary law is concerned.

Self-Assessment Exercise 2

Briefly discuss the various forms of security that are available in Kenya and their perfection formalities.

Commentary and Feedback on Self-assessment Exercise 2

In this question you should discuss:

The various forms of security available, noting to state what perfection formalities are required for each (for example, stamping and registration at various registries (as applicable). Suggested answer:

A wide range of assets can be the subject of security in Kenya including land, shares, receivables, bank accounts, aircraft, ships, movable tangible and intangible assets.

These include:

- a charge may be taken over land (including buildings). The form of instrument and the execution requirements of security over land must conform to the mandatory requirements of the land laws. Under the Constitution of Kenya, a person who is not a citizen of Kenya may own land on the basis of a leasehold tenure only not exceed 99 years. An asset permanently fixed to the land (such as a building) will automatically form part of the land over which security is taken.
- a charge may be created over specific movables assets such as plant and machinery, motor vehicles and other tangible assets.
- a company may create security over all its assets present and future by way of an all assets debenture but where the charged assets includes land, aircraft or ships, a separate security will require to be created and registered at the Lands Registry.
- Intellectual property rights may be assigned as security to a lender. Further, the rights of a party under any contract can be assigned as security provided that there is no restriction in the contract preventing the creation of a security interest.
- It is possible to take an assignment by way of security over the benefit of an insurance policy. In order to perfect the security a written notice of the security interest should be given to the insurance company which should also acknowledge the arrangements.
- A security may be created by way of a charge over shares. In addition, it is recommended that the chargor execute a blank share (stock) transfer form and surrender the transfer form and the original share certificate in respect of the shares to the chargee. An appropriate authority to undertake the transfer should be included in the security document or the chargor shares execute an irrevocable power of attorney granting the chargee the right to sell the shares. This will assist in the event of enforcement.
- A charge may be taken over cash deposits in a bank account. To perfect this kind of security it is recommended that the borrower issues a notice to the bank advising them that the account has been charged to the lender. With this type of security however there is a legal conundrum that arises in that it can be argued that the asset being created is flawed. This is because conceptually it is not possible to create security over a debt that is owed by the bank as that is what a deposit is.
- An assignment may be taken over receivables. The assignment is registrable at the Collateral Registry pursuant to the Movable Property Security Rights Act.
- Special rules apply regarding the taking of security over aircraft and ships. For aircraft, a security interest is noted on the certificate of registration, which is issued by the Kenya Civil Aviation Authority and registered at the International Registry of Mobile Assets (and the Companies Registry, if the chargor is a company registered in Kenya). In addition it is advised that aircraft securities be registered at the Cape Town International Registry . For ships, the security interest (either over the ship or a share in the ship) should be registered at the Kenya Maritime Authority Registry.

General perfection formalities:

Stamp Duty: Subject to certain limited exemptions, stamp duty is payable on most types of security documents. The stamping process must be completed within 30 days of executing the document (or, if the security was executed outside Kenya, within 30 days of the security document entering into Kenya). The person taking security bears the stamp duty cost. Although typically, the security provider bears this cost. The failure to stamp a security document can result in a fine, inability to register the security document and the security document being declared inadmissible in court. Stamp duty is typically payable at the rate of 0.1% of the amount secured by the principal security document. Stamp duty is payable on supplemental security documents at the nominal rate of KES 200 (approximately USD 2). Securities that do not require registration under any registry other than the Collateral Registry are however exempt from payment of stamp duty.

Registration: Depending on the nature of the security and the asset, registration is a pre-requisite for purposes of achieving third party effectiveness and granting fixed charge priority to the security holder in the event of enforcement. For land, the fixed charge security must be registered at the relevant Land Registry and if the land owner is a company registration at the Companies Registry is also required. For security comprising fixed or floating charges created by companies, registration at the Companies Registry within 30 days of the creation of the security is a necessity for the security to be valid against a liquidator or creditor of the company. Registration on the Collateral Registry for movable assets which are widely defined is also a pre-requisite for purposes of achieving third party effectiveness. In additional, registration at the Collateral Registry grants priority and securities registered thereunder rank first over other securities.

Self-Assessment Exercise 3

Briefly discuss the options that a secured creditor has in the event of bankruptcy.

Commentary and Feedback on Self-assessment Exercise 3

The secured creditor has the option to:-

- realise the charged asset (sell the charged asset and use the proceeds of such sale to settle the debt owed by the bankrupt);
- surrender the charged assets to the bankruptcy trustee for the benefit of creditors; or
- have the charged asset valued and prove for the balance due after deducting the amount of the valuation

The Bankruptcy Act did not provide a time frame within which a secured creditor could exercise these options. The Insolvency Act now provides that the bankruptcy trustee may, at any time by notice, require the secured creditor who holds a charge over a bankrupt's property to choose any of the options within 30 days after receipt of the notice.

Self-Assessment Exercise 4

Discuss the liquidation procedures under the Insolvency Act in both voluntary and involuntary liquidation.

Commentary and feedback on Self-assessment Exercise 4

In this question you should discuss:

The difference between voluntary and involuntary liquidation, the various forms of liquidations, who can commence the liquidations under each category and discussion on the roles and powers of the liquidator and the procedure for finalising the liquidation.

Suggested answer:

Liquidation of a company under Kenyan law

There are two types of liquidation: (a) voluntary liquidation (in this kind of liquidation the company or members by resolution resolve to liquidate the company), and (b) liquidation by the Court (involuntary) where a creditor, attorney general applies to court for liquidation for the company. The court may also on its own motion decide to liquidate a company if in the opinion of the court it is just and equitable to do so.

Voluntary liquidation

- A company may be liquidated voluntarily: (a) if the company in a general meeting has passed a resolution providing for its voluntary liquidation when the period fixed for the duration of the company by the articles expires, or on the occurrence of an event upon which the articles provide that the company is to be dissolved, or (b) if the company resolves by special resolution that it be liquidated voluntarily.
- Before passing a resolution for voluntary liquidation, the company must give notice of the resolution to the holder of any qualifying floating charge in respect of the company's property.

- The directors of the company are required to make a solvency declaration within five weeks immediately before the passing of the resolution for voluntary declaration stating that they have made a full inquiry into the company's affairs and that they have formed the opinion that the company will be able to pay its debts in full, together with interest at the official rate, within such period as may be specified in the declaration.
- On a company's voluntary liquidation, the company's property is to be applied in satisfaction of the company's liabilities equally and without preference. Thereafter, it is to be distributed among the members according to their rights and interests in the company unless the company's articles provide otherwise.
- If for any reason there is no liquidator or the liquidator is unable to act, the Court may appoint one. The acts of a person appointed by the Court as a liquidator of a company are valid despite any defect in the person's appointment. Further, only an authorised insolvency practitioner is eligible for appointment.

Liquidation by the Court

- A company may be liquidated by court on application by: (a) the company, (b) creditors, (c) shareholders, or (d) an administrator of the company. The Attorney General may also apply to the Court if it appears that it would be in the public interest for the company to be liquidated.
- In a liquidation ordered by the Court any disposition of the company's property and any transfer of shares, or alteration in the status of the company's members is deemed to be void. Additionally any attachment, sequestration, distress or execution instigated against the assets of the liquidation is also considered void unless the court has authorised.
- On the making of a liquidation order, the Official Receiver shall conduct an investigation to discover why the company failed and generally, to investigate the promotion, formation, business, dealings and affairs of the company. The Official Receiver shall then make a report to the Court as he / she considers appropriate and such report shall be evidence of the matters stated in it until the contrary is proved.
- The liquidator ensures that the assets of the company are realised and distributed to the company's creditors or if there is a surplus, distribute the surplus to the persons entitled to it. If the liquidator is satisfied that the liquidation of the company is complete, the liquidator convenes a final meeting of the creditors. Those present at the meeting consider the liquidator's report of the liquidation and if satisfied, approve the minutes. The final report is filed with Official Receiver and the company's name is thereafter struck off from the Register of Companies.

Self-Assessment Exercise 5

Study the basic aspects dealt with in the previous section.

Question 1

Discuss the process of administration under the Insolvency Act.

Question 2

Discuss a company voluntary arrangement procedure.

Question 3

Discuss the procedure of schemes of arrangement under the Companies Act, in an insolvency context.

Question 4

Briefly discuss the priority of claims as set out in the Insolvency Act.

Question 5

Discuss the process of receivership in the context of a charge over land.

Commentary and Feedback on Self-assessment Exercise 5

Question 1

The difference between voluntary and involuntary administration, who else can commence the liquidations under each category and discussion on the roles and powers of the administrator and the procedure for finalising the administration. The candidate should also mention the effects of administration and the impact of the automatic moratorium.

Suggested answer:

1. General

The objectives of administration are to maintain the company as a going concern, to achieve a better outcome for the company's creditors as a whole than would likely to be the case if the company were liquidated and to realise the property of the company in order to make a distribution to one or more secured or preferential creditors. Whereas previously, a company could be wound up immediately it became insolvent, the Insolvency Act now gives the company an opportunity to operate as a going concern and not necessarily engage in the sale and realization of its assets as a primary option.

2. Appointing an Administrator

An administrator may be appointed by (i) the Court, (ii) a holder of a floating charge, or (iii) by the company or its directors. The administrator is deemed an officer of the Court, whether appointed by the Court or not. With respect to a holder of a floating charge, section 534 of the Insolvency Act provides that the holder must be a holder of a qualifying floating charge in respect of the whole or substantially the whole of the company's assets. A qualifying floating charge is one which is created by a document that states that section 534 of the Insolvency Act applies to the floating charge or purports to empower the holder of the floating charge to appoint an administrator of the company. The holder of a qualifying floating charge may also apply to Court for an administration order. The Court has the power to make an administration order in respect of a company even if a company may be able to pay its debts.

Procedure for appointing administrator a QFC holder pursuant to section 534 of the Insolvency Act

- Before making an appointment a QFC holder is obligated under section 535 to give at least three days prior notice to other holders of QFC's notifying them of their intention to appoint an administrator. Once the administrator has been appointed, the administration does not commence or take effect unless the provisions of section 537 of the Insolvency Act are complied with
- Section 537 provides that a person who appoints an administrator of a company under section 534 is required to lodge a notice of appointment notifying the court of the appointment of an administrator in the prescribed form set out under the Insolvency Regulations as Form 35. The notice is accompanied by a statutory declaration of the QFC holder making the appointment stating that the appointment is in accordance with the Insolvency Act.
- The notice is also accompanied by a statement by the administrator who is appointed which has to state that the administrator consents to the appointment; and that in the administrator's opinion the purpose of administration is reasonably likely to be achieved. Once the above requirements are complied with section 538 provides that the administration takes effect.

3. Procedure for applying for administration via court process by creditor

The process is commenced by the making of an application to court requesting the court to issue an administration order. According to section 535 of the Insolvency Act, this application can be made by a single creditor (or more than one) and may also include the company and/or its directors. The creditor making the application is required to also notify any qualifying charge holders that they have made an application for an administration order.

The application for administration is made to the court as prescribed in Form 35 under the Insolvency Regulations. The application is supposed to be accompanied by an affidavit from the applicant stating the reasons that they are relying on in requesting for an administration order. It is not clear under the Insolvency Regulations whether an applicant can choose who they want appointed as an administrator but the draft Form 35 suggests that this is possible.

The court then considers the application and determines whether the grounds for placing a company in administration have been met and issues an administration order in Form 37.

4. Position of Creditors once a Company is under Administration

Once appointed, the administrator shall assume control of all the property to which the administrator believes the company is entitled to and is to manage the affairs and property of the company. While a company is under administration, a creditor may take steps to enforce a security over the company's property only with the consent of the administrator or with the approval of the Court. The administrator may also make a distribution to creditors of the company and where a creditor is neither a secured nor a preferential creditor, a payment may be made to the creditor as part of a distribution only with the approval of the Court.
The process of administration continues for a statutory period of up to 12 months which can be extended by the court for a further period at the court's discretion. Secured creditors and unsecured creditors with a value exceeding 50% of the unsecured debt can also by consent extend the administration for a period not exceeding 6 months. Whilst the insolvent company is in administration, the administrator is in charge as agent of the Company and directors cannot act without the administrator's consent. A key point to note is that the administrator is an officer of the court regardless of who appoints him and as such his loyalty is first and foremost to the court and to the insolvent company.

An administrator has broad powers including the power to borrow money and charge the insolvent company's assets. The administrator may borrow money to cover operating expenses if the insolvent company's cash flow cannot fund its operations. Such loans will rank first in order of priority and will be deemed to be part of the administrator's expenses.

The order of preferential creditors in the Insolvency Act stipulates that the costs of administration, liquidation or bankruptcy are to be paid in priority over other creditors. Creditor consent is required if the administrator's borrowings are secured by assets of the insolvent company that are already encumbered. If the secured creditors refuse their consent, the administrator may create security over such assets if all classes of creditors approve with the requirement being that approval will be deemed to have been given if 25% of the creditors (in value) consent to the borrowing.

Question 2

The process of voluntary arrangement and who is entitled to commence it; the application for the moratorium, the proposal preparation, the role of the monitor, the impact of the CVA, who it binds and its effects once the process commences.

Suggested answer:

A CVA is defined in the Insolvency Act to mean a composition or arrangement proposed by the directors of a company which sets out the solutions that the directors propose be adopted to change the fortunes of a financially distressed company. It takes effect once approved by the court. A proposal for a CVA is made by the directors of the company and if approved by the creditors and the court then a monitor is appointed to oversee the implementation of the arrangements under the proposals. Where a company is in administration the office holder (administrator) also has the right to propose that the company enters into a CVA if he deems it fit that such course would be the best for the insolvent company.

A voluntary arrangement as an insolvency recovery procedure allows a company to settle debts by paying only a proportion of the amount that it owes to creditors or come to some other arrangement with its creditors over the payment of its debts. The biggest advantage is that a voluntary arrangement has, is that it allows a company to continue trading with the directors being in control (subject however to supervision by the monitor, who can take legal measures against them in the event they become rogue). This in turn improves the company's cash flow by reducing debts owed albeit over time and allows for the company to consider restructuring its business models to regain profitability.

Undertaking voluntary arrangements has its disadvantages key among them being that it may be difficult to carry out the creditors and member meetings and in particular get a consensus for voting purposes where there are perceived competing interests. In addition, future credit for the company may be affected and the company may be unable to secure financing because lenders maybe be hesitant to lend to a company that is perceived to be financially straining. It is also worth bearing in mind that a voluntary arrangement is a fairly inexpensive process, because once it is approved and implementation commences, it would serve to keep the company's debts on reduced level.

The court will however not halt a voluntary arrangement if it is satisfied that the process is in the best interest of the company and the creditors as a whole. Secured creditors have a higher protection when it comes to approval of voluntary arrangements against their will and as an example, a voluntary arrangement will not be approved by a court if its implementation without the secured creditors consent would leave such creditor in a worse off position than if the company were liquidated.

Procedure for commencing a CVA

The proposal for a CVA once prepared is to be provided to the creditors and the shareholders of the insolvent company. The proposal may contain the specifics of the person that the person proposing would wish to act as provisional monitor and this could also be the administrator. It should be noted that the monitor is required to be a qualified insolvency practitioner under the Insolvency Act. In an administration, the administrator while preparing the administration proposals may include the proposal for a voluntary arrangement.

Where the monitor appointed is not the administrator or the liquidator, the monitor (the monitor is deemed to be a provisional monitor before confirmation by the court). The monitor is required within 30 days of receiving the notice of his appointment, to submit a report to the court setting out the following:

- whether, in that monitor's opinion, the proposal has a reasonable prospect of being approved and implemented;
- whether, in that monitor's opinion, meetings of the company and of the company's creditors should be convened to consider the proposal; and
- if that monitor believes that those meetings should be convened the date on which, and the time and place at which, it is proposed to hold the meetings.

The directors making the proposal for a CVA are obligated to provide information to enable the monitor prepare the report, including: (i) a document setting out the terms of the proposal, and (ii) a statement of the company's financial position containing particulars such as information of its creditors and of its debts and other liabilities and of its assets as maybe prescribed by the Insolvency Regulations. The information is to be provided 14 days before the proposal is lodged in court for approval. The provisional monitor may be removed from office by application made to court by a creditor, the makers of a proposal or the monitor in his own capacity if he has failed to file the report within the prescribed time or is unable to act by reason of some incapacity such as death.

Once the monitor files his report in court and if the report contains a proposal that creditors' meetings should be convened for purposes of approving the proposal for voluntary arrangements, he is obligated to convene the meetings as prescribed in his proposals unless the court otherwise directs.

Approval of a proposal by a creditors' and shareholders' meeting: with respect to passing of decisions, a decision (an approval or modification of a proposal) is deemed to be passed if:

- passed by a majority of the members of the company present (either in person or by proxy) at the meeting of the company; and
- by a majority (in number and value) of the members of each group of creditors present (either in person or by proxy) at the meeting of creditors.

When a proposal takes effect as a CVA, the monitor becomes responsible for implementing the arrangement in the interests of the company and its creditors and monitoring compliance by the company with the terms of the arrangement. A CVA binds all creditors whether or not they voted.

Question 3

The process of schemes of arrangement and who is entitled to commence it; whether a moratorium is possible under a scheme, the proposal preparation, whether there is a monitor, the impact of the scheme, who it binds and its effects once the process commences. Here the candidate should demonstrate their understanding that the procedure is under the Companies Act.

Suggested answer:

A scheme of arrangement or compromise (in contrast to an administration or CVA) is a procedure under the Companies Act. Under these arrangements, a company may make a compromise or arrangement with its members or creditors (or any class of them). There is nothing in the legislation that prescribes the subject matter of a scheme or what it should or should not entail and therefore the particulars of the process itself are determined by the relevant stakeholders. In theory, a scheme could be a compromise or arrangement about anything that the company and its creditors or members may properly agree on among themselves. A company can effect almost any kind of internal reorganisation, merger or demerger using a scheme, as long as the necessary approvals have been obtained as per the Companies Act. The use of the words "arrangement" or "compromise" is based more on practice and both words do not have a definite legal meaning although the word arrangement is defined in the Companies Act, but not in an exhaustive context . Compromise in practice envisages the existence of a dispute (disagreement) which is solved by parties settling their differences by making mutual concessions. Arrangements do not necessarily need compromises or the existence of a dispute and as such reference to a scheme of arrangement includes a compromise, reconstruction and amalgamation. These concepts will be referred to as schemes or schemes of arrangement below.

What is the procedure for schemes of arrangement?

Schemes can be proposed between a company and its creditors, or any class of its creditors or between the company and its members or any class of its members.

An application to court for the approval of a scheme of arrangement can be made by: (i) the company, (ii) any creditor or member of the company, or (iii) if the company is in liquidation or under administration, the liquidator or administrator. On application, the Court may issue preliminary orders for a meeting to be held by the creditors (or class of creditors) or by the members (or class of members) and the modalities for convening such meetings. Once the order is made, the company is obligated to ensure that each notice convening the meeting that is sent to a creditor or member includes or is accompanied by a statement which provides the following information:

- the effect of the proposed scheme, any material interests of the directors (whether as directors or shareholders or as creditors) and the effect of those interests on the scheme; and
- where the proposed scheme affects the rights of debenture holders, the company is obligated to include in the statement similar disclosures as those made with respect to the directors (an explanation on the debenture holder's material interests and the effect of those interests on the scheme).

Voting for approval of the scheme of arrangement

Once the meeting has been convened, the threshold required for the approval of a scheme is 75% in value of either:

- the creditors or a class of creditors; or
- the members or a class of members present and voting in person or by proxy .

Once the voting threshold has been met the company, any creditor or member or the liquidator / administrator may apply to court for the sanctioning of the scheme.

A scheme once sanctioned by the court is binding on the creditors or class of creditors including the creditors who may not have consented and / or voted for the scheme. The scheme also binds the company, the liquidator or administrator. The order of the court sanctioning a scheme has no effect until a copy of it has been lodged with the Registrar of Companies for registration.

Once the court pronounces itself on matters related to transfer of property and liabilities of a company, the property is deemed to vest in the transferee company and the liabilities are also deemed to vest in the transferee company. Property transferred is deemed to be free from all charges and/or encumbrances if the court gives an order declaring as such.

Each company affected by the order is required to file the order with the Registrar of Companies within seven days of the court making the order.

Unlike in the case of supervisors under the Insolvency Act, the Companies Act is not clear on who supervises the process but since the process is sanctioned by the court, the court would presumably have overall oversight. The concerned stakeholders would also retain the right to challenge the actions of any one of the implementers if they do not comply with the court orders. Where the company is also in administration or in liquidation, under the Insolvency Act, the administrator or liquidator would be in charge of the process.

Question 4

Suggested answer:

Schedule 2 of the Insolvency Act sets out the preferential debtors in priority as below:

First priority claims:

- Costs of the liquidator's / administrator's remuneration and operational costs for the administration or liquidation;
- Reasonable costs incurred during the court proceedings and costs incurred by a creditor to preserve an insolvent company's assets.

Second priority claims:

- Wages and salaries payable to employees up to a maximum of Kshs. 200,000 per employee;
- Statutory deductions from employees (for example, PAYE, NSSF (Retirement benefits contribution), NHIF (statutory health insurance contributions)); and
- Other amounts required by other written law.

Third priority claims: Unpaid taxes such as customs duty and excise duty.

Fourth priority claims: Holders of floating charges (non-crystallised).

Fifth priority claims: Unsecured creditors. These claims having the same priority rank equally among themselves and are payable on a *pari-passu* basis.

Secured assets do not form part of the insolvency estate in Kenya and the secured creditor has priority with respect to the secured assets and has the right to realise the security and set off debts due to them but must account for any excess funds from the realisation which must be remitted to the liquidator for distribution.

Question 5

Demonstrate understanding of common law receivership *vis-à-vis* the statutory land law receivership briefly) and explain the process of appointment of receivership on enforcement (briefly).

Suggested answer:

The legal position in Kenya stemming from common law and practice is that a receiver's powers and obligations are governed by the security document under which the receiver is appointed. The Insolvency Act does not make reference to receivers but there is a move to amend the law to include specific provisions on receivership.

The concept of receivership is not enshrined in the Insolvency Act and the question therefore arises as to what rights a security holder has. It is worth noting that, corporate receivership is not a creature of statute but one founded on the contractual relationship between the parties and derives its force from the principles of common law and the rules of equity. The Repealed Companies Act in similar manner did not state expressly that security holders had the right to appoint receivers but stated that receivers appointed by debenture holders had certain rights. What was clear however was the fact that the power to appoint a receiver was derived from the contractual provisions in the security document itself and the receiver's powers and obligations were also set out therein with ancillary rights contained in the repealed Companies Act.

Further, the Insolvency Act also does not make reference to receivers appointed in accordance with the provisions of a charge created over land registered under the Land Act, 2012. The appointment of a receiver by a fixed charge holder over land is enshrined in law and there is a conflict between the Insolvency Act and the provisions of the Land Act. For example, the question that would arise under the process of administration as envisaged under the Insolvency Act is that when an administrator wants to take control over all the assets of a company in order to try and rescue the business of the company as a going concern, what control (if any) would the administrator have if the primary asset of the company is the land which is at that moment under the control of a receiver appointed under the Land Act?

Receivers appointed pursuant to contract only will generally act on behalf of only the secured creditor that appointed them and will realise on the assets specifically covered by the security document.

The contractually appointed receiver is appointed to take possession of and sell or liquidate the assets secured by the security agreement in order to repay the outstanding debt. In a receivership, a secured creditor may also appoint a receiver-manager to operate and manage the business until it is sold as a going concern.

The receiver is tasked with selling the assets secured under the security agreement and after deducting the receivership's fees and expenses, distributing the proceeds from the sale to creditors on a priority basis. In situations where the proceeds from the sale of assets are not sufficient to fully repay the liabilities of the secured creditor, no realizations will be available for distribution to the unsecured creditors. Receivers need to seek leave of the court if they wish to undertake any dispositions after the commencement of administration, voluntary arrangement or where a court order has been issued restricting disposition in liquidation.

Self-Assessment Exercise 6

Briefly discuss the process of enforcement of a cross-border insolvency proceeding in Kenya.

Commentary and feedback on Self-assessment Exercise 6

Who has capacity to commence the insolvency process; discuss who is a foreign representative; mention the adoption of the UNCITRAL Model Law on Cross-Border Insolvency and Recognition Application and Interim Remedies.

Suggested answer:

The Insolvency Act applies to companies incorporated in Kenya as well as any foreign company registered under the Companies Act, 2015 (by way of registration of a branch).

The Fifth Schedule deals with Cross-border insolvency,

The purpose of the relevant cross-border insolvency provisions of the Insolvency Act is to promote the objectives of attaining:

- co-operation between the courts and other competent authorities of Kenya and foreign States involved in cases of cross-border insolvency;
- greater legal certainty for trade and investment;
- fair and efficient administration of cross-border insolvencies that protects the interests of all creditors and other interested persons, including the debtor;
- protection and maximisation of the value of the debtor's assets; and
- facilitation of the rescue of financially troubled businesses with a view to protecting investment and preserving employment.

The cross-border insolvency provisions in the Insolvency Act apply in cases where assistance is sought in Kenya by a foreign court or a foreign representative in connection with a foreign proceeding. However, a court can refuse to entertain any application in relation to a foreign proceeding where the action is manifestly contrary to the public policy of Kenya.

Pursuant to the cross-border insolvency provisions in the Insolvency Act:

- A foreign representative is entitled to apply directly to the Court; and
- Foreign creditors have the same rights regarding the commencement of, and participation in, a proceeding under the Insolvency Act as creditors in Kenya.

In order to benefit from the cross-border insolvency regime in Kenya, a foreign representative may apply to the Court for recognition of the foreign proceeding in which the foreign representative has been appointed (the Recognition Application).

The Recognition Application must contain the following supporting documentation:

- a certified copy of the decision commencing the foreign proceeding and appointing the foreign representative;
- a certificate from the foreign court affirming the existence of the foreign proceeding and of the appointment of the foreign representative;
- any other evidence acceptable to the Court of the existence of the foreign proceeding and of the appointment of the foreign representative; and
- a statement identifying all foreign proceedings in respect of the debtor that are known to the foreign representative.

The Court is required to accept the Recognition Application where:

- the foreign proceeding is a collective judicial or administrative proceeding in a foreign State, including an interim proceeding, under a law relating to insolvency in which proceeding the assets and financial affairs of the debtor are subject to control or supervision by a foreign court, either for the purpose of reorganisation or liquidation;

- the foreign representative is a person or body, including one appointed on an interim basis, authorised in a foreign proceeding to administer the re-organisation or the liquidation of the debtor's assets or financial affairs or to act as a representative in the foreign proceeding; and
- the application has been submitted to the Court.

Following the submission of the Recognition Application but prior to it been determined, the Court has the power to grant the following interim measures:
- staying execution against the debtor's assets (in Kenya);
- entrusting the administration or realisation of all or part of the debtor's assets located in Kenya to the foreign representative or another person designated by the Court, in order to protect and preserve the value of assets that, by their nature or because of other circumstances, are perishable, susceptible to devaluation or otherwise in jeopardy;
- suspending the right to transfer, encumber, or otherwise dispose of any assets of the debtor; or
- providing for the examination of witnesses, the taking of evidence, or the delivery of information concerning the debtor's assets, financial affairs, rights, obligations or liabilities,

On recognition by the Court of a foreign proceeding, if necessary to protect the assets of the debtor or the interests of the creditors, the Court may, at the request of the foreign representative, grant any appropriate relief, including:
- staying the commencement or continuation of individual actions or individual proceedings concerning the debtor's assets, rights, obligations, or liabilities;
- staying execution against the debtor's assets
- suspending the right to transfer, encumber, or otherwise dispose of any assets of the debtor;
- providing for the examination of witnesses, the taking of evidence, or the delivery of information concerning the debtor's assets, financial affairs, rights, obligations or liabilities;
- entrusting the administration or realisation of all or part of the debtor's assets located in Kenya to the foreign representative or another person designated by the Court; and
- extending any of the interim remedies.

Upon recognition by the Court of a foreign proceeding, certain provisions of the Insolvency Act in respect of protection of creditors and other interested persons apply. These are considered in more detail below.

At the outset, the Court is under a duty to ensure that the interests of the creditors and other interested persons, including the debtor, are adequately protected. This is a wide ranging power and the Court therefore has inherent jurisdiction pursuant to such a power to grant such relief as it sees fit with respect to the protection of creditors and other interested parties.

Furthermore, on recognition by the Court of a foreign proceeding, the foreign representative has standing to initiate any action that an insolvency administrator may take in respect of a proceeding under the Insolvency Act that relates to a transaction (including any gifts or improvement of property or otherwise), security, or charge that is voidable or may be set aside or altered.

Where it is determined that a foreign company has given a preference to a person, the Court shall make an order voiding the act constituted by giving the preference and restoring the position that which would have existed if the preference had not been given.

A company gives a preference to a person if the person is one of the company's creditors or a surety or guarantor for any of the company's debts or other liabilities and the company does any act or allows an act to be done that (in either case) has the effect of placing the person in a position that, if the company were in insolvent liquidation, is better than the position the person would have been in had that act not been done.

Self-Assessment Exercise 7

Question 1

Briefly discuss the process of enforcement of a foreign judgment in Kenya.

Question 2

Briefly discuss the circumstances in which foreign judgment will not be enforceable in Kenya.

Commentary and Feedback on Self-Assessment Exercise 7

Question 1

The process of enforcement of a foreign judgement from a reciprocating country and a non-reciprocating country. Discussion should also include foreign arbitral awards.

Suggested answer:

Foreign judgments are enforceable in Kenya if they originate from countries whose courts are recognised under the Foreign Judgments (Reciprocal Enforcement) Act (Chapter 43, Laws of Kenya) (the FJEA) as "designated courts". A designated court is defined in section 2 of the FJEA as a superior court of a reciprocating country which is a Commonwealth country, a superior court of any other reciprocating country which is specified in an order made under section 13 or a subordinate court. The foreign judgments enforceable under the FJEA are set out in sub-sections 3(1) and 3(2) of the FJEA in instances where, for example:

- a judgment or order of a designated court in civil proceedings whereby a sum of money is made payable;
- a judgment or order of a designated court in civil proceedings under which movable property is ordered to be delivered to any person;
- a judgment given in any court on appeal against a judgment or order or a designated court referred to in paragraphs (a) and (b);

- a judgment of a designated superior court for the costs of an appeal from a subordinated court, whether or not a designated court, or from an award referred to in paragraph (e); and
- an award in arbitration proceedings, if the award has become enforceable (under the laws in force in the country where it was made) in the same manner as a judgment given by a designated court in that country.

Once a judgement is obtained in a foreign jurisdiction, the judgement needs to be registered in the High Court of Kenya upon the making of an application. The application must comply strictly with the requirements set out in section 5 of the FJEA. Elaborate rules are set out under the FJEA setting out how the application for registration is to be made, how the order is to be drawn up, notice of registration to the judgement debtor, how an application to set aside registration is to be made and for appeal.

Once the judgement has been registered it will be recognised by the Kenyan courts, and it will have the same force and effect as if the judgement was entered in Kenya. The enforcement thereof will then follow the same procedure set out in the Civil Procedure Act (Cap 21, Laws of Kenya). The registration of the judgement must however be done within six (6) years from the date of the judgement save where the judgement is subject to appeal in which case the six-year period is from the date of the determination of the appeal. Judgements registered in Kenya for enforcement are payable in the Kenyan shilling equivalent of the currency in which the judgement was entered at the exchange rate prevailing at the date of registration of that judgement. Where the High Court is satisfied that the judgement is partially satisfied in the country in which it was made, the judgement may be registered only in respect of the sums or the items of movable property remaining payable or deliverable in the proceedings. Kenyan courts may also reserve jurisdiction over some peripheral matters or on issues dealing with immovable property located in Kenya even though parties have settled on the laws of another country as the choice of law;

With respect to the finality of the foreign judgement, section 9 of the Civil Procedure Act provides that a foreign judgement shall be conclusive as to any matter thereby directly adjudicated upon between the parties or between parties under whom they or any of them was claiming. What this means is that Kenyan courts will not seek to revise and/or review the foreign judgement on its merits or seek to review the facts and will enforce it as it was passed in the foreign court.

Enforcement of foreign arbitral awards

Arbitral awards can be enforced in Kenya under the Arbitration Act (Act 4 of 1995 Laws of Kenya) (the Arbitration Act) or the FJEA. The main distinction between enforcement of arbitral awards under the two statutes is that whereas an international arbitral award can be directly enforced under the Arbitration Act, it must first be registered as a judgment of the court of the country in which the award was given before it can be enforced under the FJEA. This is however subject to whether the relevant countries are party to a treaty recognising the enforcement of foreign arbitral awards in their respective jurisdiction. Kenya is a party to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention") which was domesticated through the Arbitration Act.

Question 2

The requirements for the recognition of foreign judgments by the courts. Here distinction should be made between judgments of a reciprocating country and a non-reciprocating country (for example, the foreign court's judgment must be final and conclusive, the foreign court must have had jurisdiction to hear the matter before it in accordance with its laws, the recognition of the foreign judgment must not be contrary to public policy or to the laws of natural justice, etc.).

Suggested answer:

Judgements from non-reciprocating countries under the FJEA. Kenyan courts have on various occasions been faced with instances where parties have sought to enforce judgments from non-reciprocating countries. In the absence of a reciprocal enforcement arrangement, a foreign judgment is enforceable in Kenya as a claim in common law. Under English common law, which has the force of law in Kenya, a judgment of a competent foreign court condemning a party to pay a certain sum constitutes a good cause of action and is regarded as creating a debt in respect of which a suit may be filed. The process entails instituting a claim in a competent court with the resultant effect of obtaining a judgment using the foreign judgement. The Court of Appeal in Kenya has previously held that the following requirements must be fulfilled before enforcement in such a case:

- The party seeking to enforce the foreign judgment must file a plaint at the High Court of Kenya providing a concise statement of the nature of the claim, claiming the amount of the judgment debt, supported by a verifying affidavit, list of witnesses and bundle of documents intended to be relied upon. A certified copy of the foreign judgment should be exhibited to the plaint. It is open to a defendant to challenge the validity of the foreign judgment under the grounds set out in Section 9 of the Civil Procedure Act (set out in the analysis above in paragraph 2.6).
- A judgment creditor is entitled to summary judgment under Order 36 of the Civil Procedure Rules unless the defendant judgment debtor can satisfy the Court that there is a real prospect of establishing at trial one of the grounds set out in Section 9 of the Civil Procedure Act.

- If the foreign judgment creditor is successful after trial, the judgment creditor will have the benefit of a High Court judgment and the judgment creditor will be entitled to use the procedures of the Kenyan courts to enforce the foreign judgment which will now be executed as a Kenyan judgment.
- The money judgment in the foreign judgment must be final and conclusive and must be filed within six years from the date of judgement. It may be final and conclusive even though it is subject to an appeal;
- The foreign court must have had jurisdiction, (according to the Kenyan rules on conflict of laws) to determine the subject matter of the dispute and the parties to the foreign court's judgment and the enforcement proceedings must be the same or must derive their title from the original parties.

The High Court will generally consider the foreign court to have had jurisdiction where the person against whom the judgment was given:
- was, at the time the proceedings were commenced, habitually resident or incorporated in or having a principal place of business in the foreign jurisdiction; or
- was the claimant or counter-claimant in the foreign proceedings; or
- willingly submitted to the jurisdiction of the foreign court; or
- agreed, before commencement, in respect of the subject matter of the proceedings to submit to the jurisdiction of the foreign court.

Where the above requirements are established to the satisfaction of the High Court, the High Court will not re-examine the merits of the foreign court judgment. The foreign judgment will be enforced on the basis that the defendant has a legal obligation as a matter of common law, recognized by the High Court, to satisfy the money decree of the foreign judgment.

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