An analysis of the Zambian Corporate Insolvency Act No. 9 of 2017

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1. Introduction

1.1. This alert sets out the key provisions of the Zambian Corporate Insolvency Act No. 9 of 2017.

1.2. Traditionally, insolvency legislation in Zambia has been part of the Companies Act Chapter 388 of the Laws of Zambia. In 2017 the Parliament of Zambia enacted the country's first stand-alone Corporate Insolvency Act No. 9 of 2017. The new legislation was brought into force through a Commencement Order, Statutory Instrument No. 47 of 2018, issued in June 2018. The prescribed forms for the implementation of the act were issued in July 2019, through statutory orders No. 40 and 41 of 2019.

2. New legislation signals a shift in approach from recovery to business rescue

2.1. As with the legislative changes in other countries, the focus of the reformed insolvency legislation has changed – this move has come with the recognition that the rescue approach (rather than the traditional recovery only approach) leads to a better overall outcome for all parties involved.

2.2. The key objectives of this new insolvency act are to:

i. align Zambian insolvency law with international best practice;

ii. enhance transparency and accountability in insolvency proceedings; and

iii. provide a mechanism for salvaging financially distressed but viable companies.

3. Insolvency practitioners now need to be licensed by the Patents and Companies Registration Agency ('PACRA')

3.1. Under the new Act, a person is eligible for accreditation as an insolvency practitioner only if that person is a chartered accountant or a legal practitioner who has practised for at least seven years, as defined in the Accountants Act of 2008 or Legal Practitioners Act, respectively. Accreditation by the Registrar is valid for one year subject to renewal.

3.2. This is in line with international best practices such as in the United Kingdom, South Africa and Kenya, where insolvency practitioners require licences from defined regulatory agencies.

3.3. We have noted that other jurisdictions require insolvency practitioners to have prior experience in the insolvency space before accreditation. This is a requirement that the Zambian regulator might consider including in future amendments to further strengthen the insolvency practice in Zambia.

4. The Corporate Insolvency Act No. 9 of 2017 introduces a new insolvency proceeding – business rescue

4.1. The Corporate Insolvency Act No. 9 of 2017 introduces the business rescue (BR) route of insolvency.

Commencement of business rescue

4.2. BR proceedings can be started through a board resolution if the company's board believe that:

a) the company is 'financially distressed'; and

b) there appears to be a reasonable prospect of rescuing the company; and there is need to:

i. maintain the company as a going concern; or

ii. achieve a better outcome for the company's creditors than is likely to be the case if the company were to be liquidated; or

iii. realise the property of the company to make a distribution to one or more secured or preferential creditors.

4.3. Alternatively, an affected person may apply to the court for an order to place the company under supervision and begin BR proceedings.

4.4. The BR process benefits from a moratorium during the period of the BR proceeding that prevents any legal or enforcement action from being taken against the company by any other creditor. This allows the appointed administrator to execute his mandate to rescue the business without the pressure of enforcement action or litigation from other creditors.

4.5. BR proceedings have the potential of yielding better results to the key stakeholders because they involve the participation of all creditors. This provides a better platform for building consensus and focus on the going concern of the business as opposed to winding up proceedings.

4.6. According to the Corporate Insolvency Act No.9 of 2017, 'financially distressed' means a company is likely to be insolvent within the immediately ensuing six months. 'Insolvent' in the context of this legislation has been interpreted in recent cases to mean a situation where the value of a company's liabilities exceeds the value of its assets.

4.7. The limitation in the definition of 'financially distressed' to cover only balance sheet insolvency is likely to deny entities that are eligible for business rescue but do not fit the above definition a chance to be rehabilitated through business rescue.

4.8. In the South African Companies Act 2008, Section 28(f), for example, in addition to the balance sheet insolvency definition, 'financially distressed' is defined to mean 'that it appears to be reasonably unlikely that the company will be able to pay all of its debts as they fall due and payable within the immediately ensuing six months'.

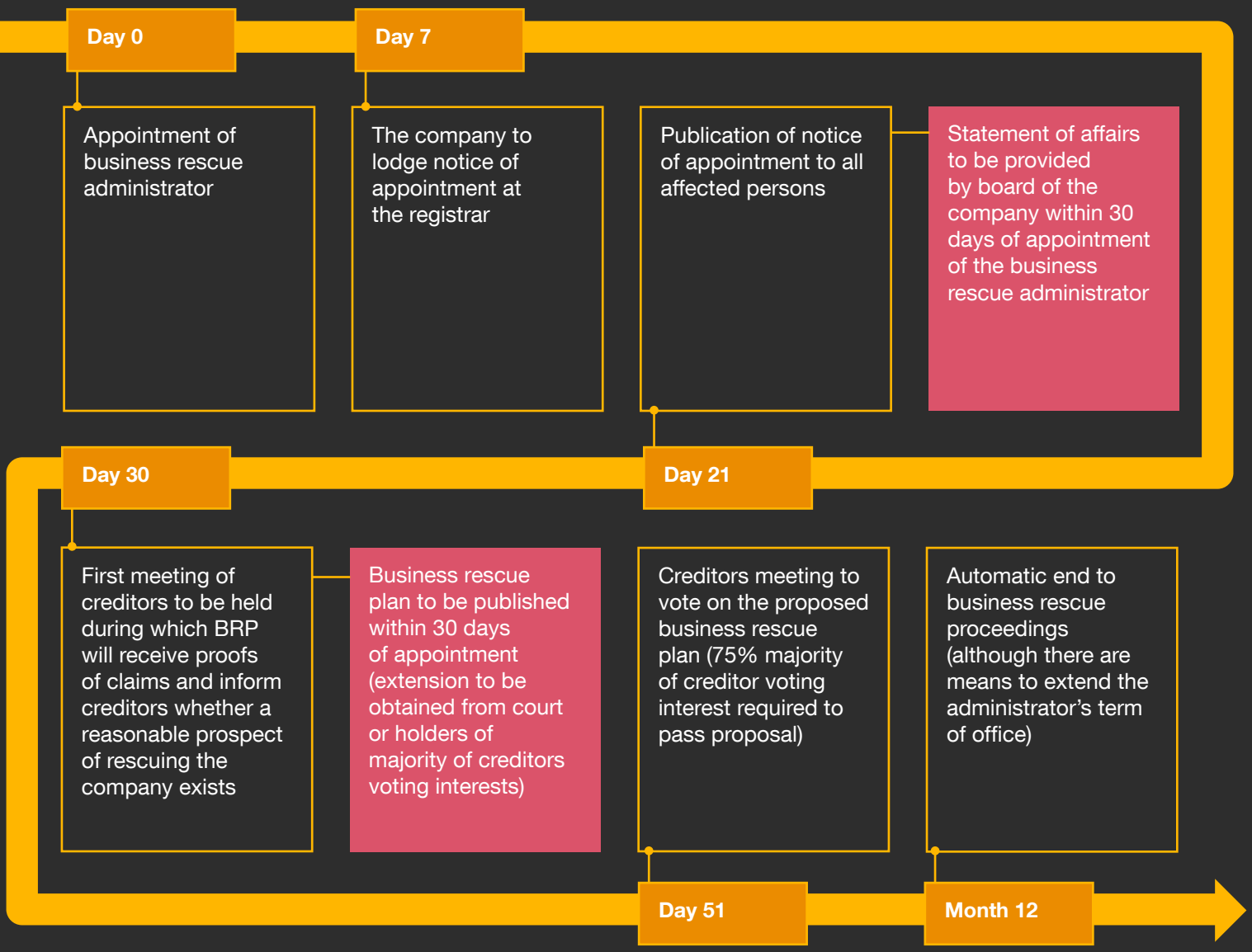
4.9. On 9 May 2013 the Supreme Court in the United Kingdom (BNY Corporate Trustee Services Ltd v Eurosail [2013] UKSC 28) found that the 'balance sheet' test for insolvency must take account of the wider commercial context, and that courts must look beyond the assets and liabilities used to prepare a company's statutory accounts when deciding whether a company is insolvent.

4.10. For example, a company that is balance sheet insolvent might still have enough cash flow from trading activities to meet all its debt obligations coming due. On the flip side, a company can be balance sheet solvent but not be able to generate adequate cash to settle the short-term debt obligations falling due.

4.11. There may be a need to address this going forward if the envisaged positive impacts of preservation of value while rehabilitating distressed entities are to be fully realised.

Key statutory timelines in business rescue

4.12. The new regulation clearly defines the major BR timelines. These timelines provide structure and, in other territories, have expedited insolvency proceedings compared to prior regimes. In our experience, value can be preserved where proceedings are conducted in a timely manner. The timelines as set out by the Act are illustrated overleaf:



5. Winding up of companies

5.1. Winding up is the process of settling accounts and liquidating assets in anticipation of a company's dissolution.

Commencement of the winding up process

5.2. The new legislation provides for either voluntary winding up or winding up by the court.

5.3. On the other hand, voluntary winding up can take two forms:

a) A member's voluntary winding up, which is the termination of a corporation, initiated by the board of directors and approved by the shareholders; or

b) A creditor's voluntary winding up, which is the voluntary winding up of a company by the creditors.

5.4. Members voluntary winding up may be initiated through a special resolution of the directors of the company.

5.5. The directors may make a declaration of solvency before issuing a notice for a meeting to wind up the company voluntarily and would need to provide a statement of affairs of the company showing the company assets, liabilities and the estimated winding up expenses.

5.6. A director who makes a written declaration knowing that the company does not satisfy the solvency test commits an offence and is liable to a fine on conviction. This provision will promote transparency in the company winding up process by promoting accountability in the provision of accurate information to the relevant parties.

5.7. Where a resolution for the voluntary winding up of a company has been proposed, and no declaration of solvency was made, the company shall convene a meeting of the creditors at which the resolution for a creditor's voluntary winding up shall be put and passed by the creditors.

5.8. The new regulation provides that in the case where different persons are appointed by the creditors and the company, then the person nominated by the creditors shall be the liquidator.

5.9. Although winding up provisions were present in the old Companies Act, the new insolvency legislation includes a lot more detail on the route any type of liquidation should take and the duties of all parties in this respect. In particular, the duties of liquidators and the role of creditors in all three types of liquidations are clearly delineated. We expect this additional clarity will improve the transparency with which liquidations will be handled over time, making them less costly to undertake.

6. Introduction of voluntary arrangements

6.1. A voluntary arrangement (VA) is an agreement between a company and its creditors to renegotiate or restructure its obligations to them. The proposal for a VA is usually made by the directors of a company to the company and its creditors but can also be initiated by a creditor or a member of a company. VAs can be made whether the company is in financial distress or not.

6.2. The directors will also propose a supervisor, an individual who will supervise the implementation of the VA. The supervisor must be a qualified and licensed insolvency practitioner.

6.3. A company, creditor or member of a company may apply to the court for an order that a meeting of the creditors or shareholders be convened and conducted to consider a VA.

6.4. Approval of a VA is reached by passing an extraordinary resolution which requires 'seventy-five percent of the votes of the members entitled to vote in person or by proxy at a meeting of creditors'.

6.5. The voting power at a meeting of creditors is assigned to the creditors in proportion to the amount of the debt outstanding from the company to each creditor.

6.6. Where a meeting, by extraordinary resolution, agrees to a VA, the VA:

i. shall be binding on all the creditors or class of creditors as may be the case; and

ii. shall be binding on the company if and when it has been approved by order of the court and a copy of the order of the court has been lodged with the Registrar.

6.7. Creditors then become unable to take any alternative action to recover their debt in full.

6.8. In a VA, creditors are typically able to get more involved in the solution to rescue the company or to recover their debts – they may modify the proposals presented to them before voting and, as such, influence the way in which the company handles their debt. In this way VAs are more flexible than administrations.

7. Further clarity on cross-border insolvency

7.1. Whether in Africa or Europe, cross-border insolvency is difficult to navigate between differences in insolvency processes in different jurisdictions and possible instances of legal action being taken to protect local creditors or to ringfence local assets for the benefit of local creditors.

7.2. The Corporate Insolvency Act No. 9 of 2017 includes provisions of the Model Law on Cross-Border Insolvency adopted by the United Nations Commission on International Trade Law. Some of the provisions have been adapted to the Zambian context, but, in general, the legislation aims at clarifying the provisions for cross-border insolvency where a Zambian company is concerned to facilitate trade and investment and clarify the route cross-border insolvency proceedings should take.

7.3. Even with this clarity on basic principles, considerations regarding cross-border insolvency will vary greatly on a case-by-case basis depending on the circumstances of the jurisdiction involved, among other factors.

7.4. Cross-border insolvency proceedings will rely on a commercially aware and business-minded judiciary for successful implementation.

8. Introduction of a cap to fees payable to insolvency practitioners

8.1. The Corporate Insolvency Act No. 9 of 2017 caps the fees payable to insolvency practitioners, enforced through the Statutory Instrument No. 41 of 2019.

8.2. The fee payable to a receiver, business rescue practitioner or liquidator shall not exceed:

- 10% of the net proceeds of receivership or liquidation; and
- 5% of the net assets of the company in the case of business rescue.

8.3. 'Net assets' means the amount by which the aggregate amount of the company's assets exceeds the aggregate amount of its liabilities taking the amount of both assets and liabilities to be stated in the company's accounting records; and

8.4. 'Net proceeds' means gross proceeds of the receivership or liquidation less expenses and disbursements.

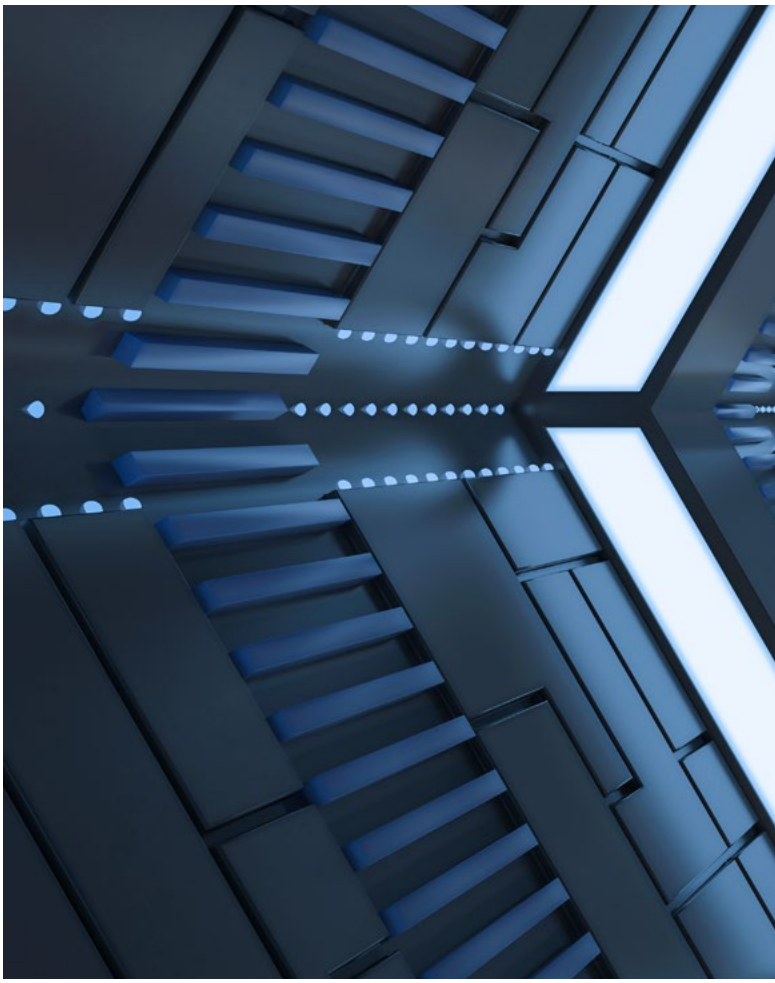
Observation

8.5. The overall purpose of business rescue is to rehabilitate companies that are financially distressed and are highly likely to become insolvent in the short term.

8.6. Financially distressed entities in most cases have minimal net assets by the time they seek business rescue. This makes the introduced fee cap based on a percentage of net assets problematic. It might result in some distressed entities missing out on the opportunity for rehabilitation and resorting to winding up, which spells the death of such entities.

8.7. The new legislation assumes that in business rescue proceedings the company will always be solvent enough for the 5% of net assets fee cap on be sufficient to settle the costs of business rescue. We however note that expenses and disbursements of business rescue proceedings are often neither predictable nor easily controllable, due to external factors such as long litigations that may arise during the business rescue proceedings.

8.8. The Corporate Insolvency Act of 2017 makes no exceptions for situations when the business rescue fees may be higher than 5% of the net assets of the company undergoing business rescue proceedings.



9. Conclusion and recommendations

9.1. The enactment of the Corporate Insolvency Act No. 9 is a positive milestone in the Zambian insolvency legislative framework. Through proper implementation, Zambia can replicate the success of similar legislations in other countries.

9.2. In Kenya, for example, the implementation of the Insolvency Act 2015 of the Laws of Kenya has had a positive impact on the insolvency practice in the country. The legislation played a big role in the elimination of rogue insolvency practitioners, through clear definition of the requirements and qualifications of insolvency practitioners.

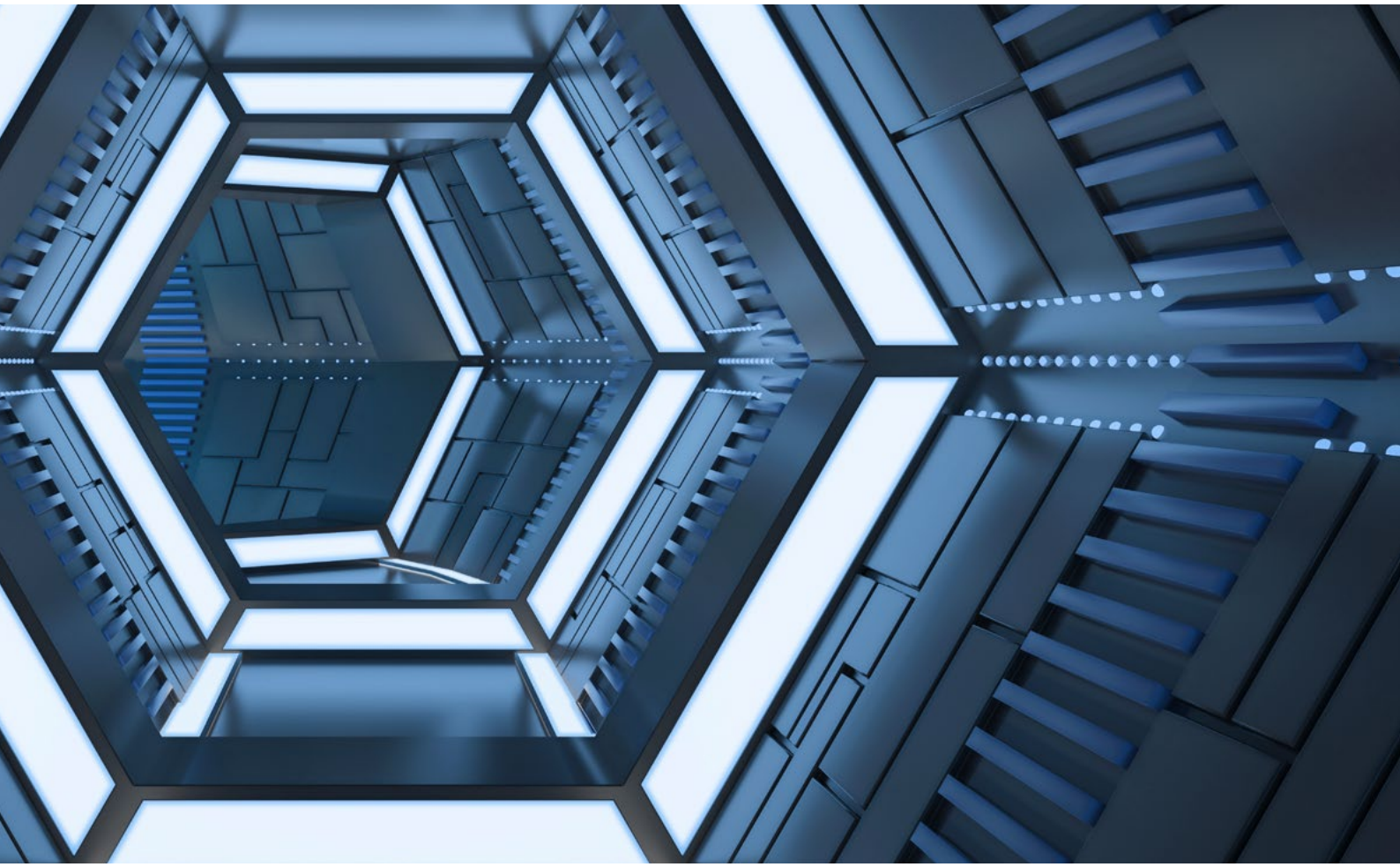
9.3. This had the impact of increasing transparency and boosting public confidence in insolvency processes.

9.4. Kenyan banks have since been more proactive in seeking business rescue focused solutions for their non-performing accounts. Additionally, banks are embracing proactive approaches in assisting their distressed clients to ease loan repayment pressures, through processes such as independent business reviews, which culminate in informed debt restructuring solutions.

9.5. A good insolvency law is a useful tool, but not all situations call for an insolvency process. We have seen an increase in out-of-court financial restructuring cases across the East African region. These mainly relate to several large distressed private corporations that have multiple fragmented facilities with various lenders in non-syndicated situations.

9.6. Our experience suggests that the success of such restructuring initiatives depends on the level of coordination. This is more effectively achieved where one involved party takes leadership of the exercise and coordinates activities to assist in building consensus on the restructuring solution, as well as in the implementation.

9.7. Lenders' and borrowers' main objective should be to act early, decisively and collaboratively to avoid costly and time-consuming insolvency proceedings. This can be made possible through close and regular monitoring of financial information, focusing not only on profit forecasts but also on cash position and industry. Ensuring airtight credit policy and loan security documentation at the outset helps to mitigate the risk of a debt going bad.



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