Practical Aspects of Insolvency Law

Corporate Insolvency

Emmanuel Turatsinze, (LL.B, LL.M, MCIArb, PhD (C))

Aims of the training

- To train legal practitioners about general and specific issues in insolvency and bankruptcy law, on both international and domestic levels.
- To introduce participants to legal concepts of insolvency policy and law and international best practices underlying effective and efficient insolvency systems.
- To discuss the current bankruptcy reliefs available under Rwandan insolvency law in view of international insolvency standards.
- To discuss the domestic developments in domestic insolvency law.

Learning Outcome

- By the end of the training, participants will have an advanced level knowledge about:

❖ Insolvency policy and key objects of efficient insolvency systems.

❖Legal framework of insolvency law in Rwanda.

❖Types of insolvency proceedings and reefs provided by Rwandan insolvency law and areas of improvement.

❖Case law development in corporate bankruptcy in Rwanda.

Course Outline

- Sources of Rwandan insolvency law.
- General Concepts.
- Collection Law (Creditor-debtor laws)
- Types of Bankruptcy proceedings
- Voluntary vs involuntary bankruptcy proceedings
- Effects of initiating bankruptcy proceedings
- Stay of execution of actions.
- Avoidance of pre-bankruptcy transfers (p.95)/preferential payments/fraudulent conveyances.
- Forms of bankruptcy relief (p.20 Nutshell)
- Dismissal, conversion

A Look into development of Rwandan Insolvency Law

- The first insolvency regime in Rwanda was Decree of 12 December 1925 (Law Relating to Prevention of Insolvency).
- This was subsequently followed by Decree of 27 July 1934 (Law Relating to Commercial Insolvency).
- Both of these Decrees were duplicates of Belgian-French insolvency laws.
- The first modern insolvency Law was the “Law No. 12/2009 of 26/05/09 relating to commercial recovery and settling issues arising from Insolvency.”

Development of Rwandan Insolvency Law

- This law was amended and supplemented by the Law No. 35/2013 of 29/05/2013 Modifying and Complementing Law No. 12/2009 relating to Commercial Recovery and Settling of issues arising from insolvency.
- This was also modified by the Law N° 14/2015 of 05/05/2015 modifying and complementing Law n° 12/2009 of 26/05/2009 relating to commercial recovery and settling of issues arising from insolvency, as modified and complemented to date
- The 2009 Insolvency Law was was entirely abrogated and replaced by the Law No 23/2018 of 19/04/2018 relating to Insolvency and Bankruptcy.
- The 2018 Law has been replaced by the Law No 075/2021 of 06/12/2021, which is the current Law in force.
- Both the recent modern insolvency law are closely related/influenced by European and British Insolvency Laws.

General Concepts

Insolvency vs Bankruptcy

- **Insolvency:** Generally, the term “insolvency” refers to a financial state where a person cannot meet debt payments on time, while “bankruptcy” is a legal process that happens when the individual files a case to court that they are no longer able to pay back his or her debts to creditors.

- **Jurisdictional differences**: The use of these terms differ depending on the jurisdiction/country. In the UK and other common law systems, the term “Insolvency” law refer to legal proceedings corporate entities, while the term “bankruptcy” refers to natural persons.

- Contrary, in the US and systems formed after the US laws, the term “Bankruptcy” is an umbrella term used to mean legal proceedings initiated by an insolvent person, wether corporate or natural persons.

General Concepts

Insolvency vs Bankruptcy

- **In Rwanda?**

- Art. 3 (29) of Insolvency Law (2021) defines “bankrupt” as “an individual in respect of whom a bankruptcy order has been made”.

- Chapter VIII, from art. 166 contains provisions on “bankruptcy” defined as individual insolvency proceedings. Henceforth, the term insolvency in Rwanda concerns corporate corporate proceedings, while “bankruptcy” designates insolvency proceedings for an individual.

- In this presentation, the term bankruptcy shall be used to designate legal proceedings initiated whether by a corporate entity “corporate bankruptcy” or by an individual person “personal bankruptcy”,

- The term insolvency shall be used as a generic term to designate a financial situation under which an individual or a company can not pay its debts when they are due.

Historical background

- The term “bankruptcy” is said to have a literal origin from the Italian “banca” and “rotta” which literally means “broken bench or table”.
- Traditional lending business worked in medieval Italy, in which lenders worked on benches placed on an open market. When a lender could no longer continue his business due to default, his bench was broken openly and that put an end to his business career.
- This act put such defaulting debtor to open shame and ensuing in an unending stigma.

Historical background

- Early bankruptcy laws include the UK Bankruptcy Act of 1542 (At the end of Ruganzu II Ndoli's reign in Rwanda). These early laws were just about creditors' collection mechanisms, which included debt-imprisonment.
- Bankruptcy was a crime and failure to pay debt, was punished by imprisonment.
- Failure to pay debt was considered as a 'moral failure'.
- 1803, the US had the first Bankruptcy Act. By 1821 States within the US had decriminalised debt repayment failure, and by 1839 the criminal punishments were abolished in most states.

Historical background

- This was a major change of perspective from viewing bankruptcy and debt repayment as a ‘moral failure’ for which an imprisonment of the debtor was due, into a rather ‘economic failure’ view, leading to decriminalisation of failing debtors[2] and significantly reducing bankruptcy stigma.
- By mid 19th century, the bankruptcy policy had shifted to being a tool of solving business failure, rather than a collection mechanism.

Why do we need bankruptcy law?

- **Key statistics (EU).**
- The European Commission report indicates that around **200,000 businesses** are bankrupt every year and this leads to loss of over **1,7 Million jobs**. (EU Commission report, 2019).
- According to the European Economic and Social Committee (“EESC”), **50%** of businesses in Europe encounter economic failure in the first 5 years.
- **43%** of Europeans are not into business due to fear of bankruptcy.

Why do we need bankruptcy law?

- **How is the situation in Rwanda?** There are statistics on business failure rates yet. However, key considerations in RDB report (for the year 2022).
- In 2021, RDB registered 18,922 new businesses. How many will actually survive and how long? We can’t tell, but we know they need an enabling environment to survive financial distress.
- Indebtedness is also higher, actually higher than the number of new businesses. In the year 2022, RDB registered 25,493 new mortgages.
- Inevitably, debt-collection laws will not be enough to provide long-term solutions to business sustainability.

Why do we need Bankruptcy law?

- With the world facing constant temporary or long-term economic depressions, bankruptcy law is a necessity to provide sustainability for viable businesses around the world and create an environment for second chance.
- According to the EESC, creditors in the Member States with systems inclining to bankruptcy restructuring over liquidation, have a high recovery rate of 83% against 57% in those hasting to liquidation.
- Which interests are at stake when a business fails? Creditors, shareholders, suppliers, employees, government/tax authorities, other stakeholders (banks, security, outsourced services, etc).
- Should all these stakeholders interests be forsaken by an individual creditors' greed? Who should pay the price for business recovery? What to sacrifice?

Understanding Bankruptcy Law

- Bankruptcy proceedings is part of the body of laws governing creditor-debtor relationships, in particular where the debtor has failed to honour its obligations of paying the debt when due.
- The distinctiveness of bankruptcy law from general creditor-debtor law lies in that, the latter deals with creditors' rights to exercise certain actions to collect their debts from failing debtors, while the former concerns collective arrangements to remedy a failing business

Understanding bankruptcy law

- Prof. Elizabeth Warren divides bankruptcy law into two scenarios: (i) liquidation proceedings of a failing business comparable to a '**funeral**' and the administration of the **testament** and (ii) restructuring proceedings for turning around a failing business, comparable to as a **nearly dying** hospitalized person with some **chances to live** if certain sacrifices are made.

General concepts

- Advantages of encouraging preservation of financially distressed businesses through restructuring laws have been, all taken together, their effects on preservation of “economic value” and maximising chances of recovery for all creditors as a whole, instead of scattering the debtor’s potentiality into pieces to benefit the few, i.e., the secured creditors.
- Understandably, the turnaround process gives a second chance to the restructured business, which is our dying patient, to live again.

Understanding Bankruptcy

- In that sense, the restructuring process has proven to benefit both the debtor and creditors, as well as other stakeholders of the failing business.
- In certain countries like the US, whose economy is a trade-based, bankruptcy law is a constitutional matter. Art 1 (8) of the US Constitution (1787) mandates the US Congress to put in place federal bankruptcy law across the whole United States.

Forms of Bankruptcy reliefs

- There are normally two forms of bankruptcy reliefs: (1) rehabilitation or reorganisation of the business and (2) liquidation.
- Either relief depends on what is in the **best interest** of the bankruptcy estate, creditors and other stakeholders.
- The principle that governs each relief sough by the applicant is the maximisation of the estate value: liquidation value vs going concern value.

Practical Aspects of Rwandan Bankruptcy Law

One proceedings aiming at best relief

- From 2009-2015, the Insolvency Law had a german-kind combined relief proceeding.
- According to Article 7 (bis):
- “the appointed administrator must perform the obligations below which shall prevail in the following priority order:

1º to rescue the company as a going concern;

2º to achieve a better result for the general body of the creditors than results expected from the company’s immediate liquidation;

3º to liquidate the company.”

Practical Aspects of Rwandan Bankruptcy Law

One proceedings aiming at best relief: 2009-2015 Era.

- Under this system, an insolvent debtor could initiate the “commencement of insolvency proceedings”, which was a combined relief, whereby the administrator had to administer the debtor’s estate, first trying rehabilitation and failure of which, liquidation would come as a last resort.

- Under this law, there was a singled procedure called “Application for Commencement of Insolvency Proceedings (aiming at either relief) (Art. 16)” aiming at either relief.

- In the amendment, Art. 84 (bis) gave room for applying for reorganisation and submit a reorganisation plan.

- Sometimes courts confused both proceedings. See for instance: CMB RCOM 01710/2016/TC/NYGE NA RCOM 01914/2016/TC/NYGE.

Practical Aspects of Rwandan Bankruptcy Law

New Era: 2018-present: 3 Types of Bankruptcy Proceedings

- From 2018, the new law has abolished the previous single-combined bankruptcy proceedings, into different types of proceedings aiming at either relief.
- Now the debtor should choose for which proceedings to file for, depending on their specific conditions.
- Looking at the current law, there are **5 different types of bankruptcy proceedings:**

1. **Application for commencement of insolvency proceedings under Art. 8;**
2. **Request for appointment of a provisional administration, Art. 41.**
3. **Application for reorganization of a company, Article 84.**
4. **Commencement of liquidation, Article 102.**
5. **Personal bankruptcy, Article 166.**

Practical Aspects of Rwandan Bankruptcy Law

1. Application for commencement of insolvency proceedings under Art. 8

- This procedure is similar to the previous combined proceeding, which was provided before 2018.
- According to art. 8 “An application for commencement of insolvency proceedings for a company is done by filing the application with a competent court.”
- This action can be initiated **voluntarily** by an insolvent debtor or **involuntarily** by either of the following stakeholder, namely: 1° creditors; 2° the Directors or one of them; 3° the Registrar General; 4° shareholders or partners; 5° the regulatory authority. See Art. 8.

Practical Aspects of Rwandan Bankruptcy Law

1. Application for commencement of insolvency proceedings under Art. 8

- Conditions of admissibility of this application are provided under Art. 7: 1° the debtor is **unable to pay its debts when they fall due** in the normal course of business; 2° the **assets** of the debtor **are less than** its liabilities plus its stated capital.

- Surprisingly, the Commercial court in the case RCOM 00345/2021/TC, rejected this proceeding, confusing it with the proceedings provided under Art. 41 which relates to the appointment of the provisional administrator.

- It is not yet clear on the court's interpretation of this proceeding, independent of other proceedings.

Practical Aspects of Rwandan Bankruptcy Law

2. Request for appointment of a provisional administration, Art. 41

1. According to Art. 41 of the Bankruptcy Law, this procedure can be initiated by filing an application to the Registrar General of companies, either voluntarily by the debtor or involuntary by either of the following stakeholders: directors; an insolvency practitioner; a creditor; shareholders or partners and/or the regulatory authority.

2. When the Registrar General does not appoint the provisional administrator within the prescribed time limit, the applicant may file the case to court requesting it to appoint the provisional administrator.

3. The notice appointing the provisional administrator must include a proof certifying that, at the time of the appointment, there is reason to believe that the company is or will be unable to pay its debts.

Practical Aspects of Rwandan Bankruptcy Law

3. Application for reorganization of a company, Article 84.

- Application for reorganisation, is one of the specific insolvency proceedings, which aims at granting a breathing space to a struggling debtor, to reorganise his business as going concern over liquidation.
- According to Art. 84, this proceeding can be initiated by an application to the commercial court, either voluntary by the debtor or involuntary by either of the following stakeholders: directors of a company; a creditor; the Registrar General; the regulatory authority.
- The application for reorganization of a company must include a certificate signed by the applicant certifying that there is a reason to believe that there is a prospect for rescuing the business.

Practical Aspects of Rwandan Bankruptcy Law

3. Application for reorganization of a company, Article 84.

- The Administrator must come up with the reorganisation plan within 45 days from the court's order.
- The reorganisation plan must indicate that the creditors will receive as much as they would in liquidation or more.
- Within fifteen (15) working days from the completion of the company reorganization plan, the administrator convenes a meeting of creditors to approve the company reorganization plan.
- The administrator gives in not less than ten (10) working days before the meeting is held, a notice of meeting to each known creditor and a public notice, indicating the intention to convene a meeting of creditors or any class of creditors for the purpose of approving the proposed reorganization plan.

Practical Aspects of Rwandan Bankruptcy Law

3. Application for reorganization of a company, Article 84.

- A reorganization plan is approved by creditors or any class of creditors who may be affected by the proposed company reorganization if voted by not less than seventy-five per cent (75%) of creditors or class of creditors having taken part in the vote. Art. 90.
- **Duties of appointed administrator:** According to Art. 93, During company reorganization, the administrator has the following duties:

1° to take custody and control of the company’s business and property and affairs;

Practical Aspects of Rwandan Bankruptcy Law

3. Application for reorganization of a company, Article 84.

2° investigate the company's business and take possible measures for rescuing the company's business in the interests of creditors and shareholders;

3° carry on the business and manage the property of the company with the objective of rescuing business in the interests of creditors and shareholders;

4° perform any function that the company or its officers could perform if the company was not in reorganization.
5. to keep company money, separate from other money which he or she holds or is under his or her control;
6° to keep, in accordance with generally accepted accounting procedures and standards, full accounts and other records of all receipts, expenditure and other transactions relating to the company and retain the accounts and records for not less than ten (10) years after the administration ends.

Termination of a reorganisation

Approval of the plan or conversion

- According to Art. 96

The reorganization of a company ends where:

1° the reorganization plan has been implemented by the administrator;

2° the company creditors resolve that the reorganization should end;

3° the company creditors appoint a liquidator by a resolution passed at a meeting to determine the future of the company;

- However, under international standard, conversion from reorganisation to liquidation should be a decision taken by the court.
- In the case RCOM 00373/2021, the court followed the same norm.

Practical Aspects of Rwandan Bankruptcy Law

4. Commencement of liquidation, Article 102.

- This procedure is applied by a debtor who has wants to turn all his assets to the disposal of the creditors, and be distributed accordingly.
- Normally, this should be in exchange to obtaining discharge. However, there is no clause related to discharge to a company going to liquidation.
- It is not clear if creditors can collect pre-liquidation debts, taxes. Consequently, many debtors who file for liquidation, they also dissolve their business (if at least they can-tax barriers)

General effects of commencement of insolvency proceeding

1. Creation of the Estate

- Upon filing for commencement of insolvency, the debtor’s assets are considered as “estate”- a separate entity from the debtor him/herself, which must be put into custody of the trustee.
- In reorganisation proceedings, the trustee is the appointed administrator. He manages the estate together with the meeting of creditors. The administrator can sue and be sued on behalf of the estate.
- In liquidation proceedings, the trustee duties are exercised by the by the liquidator.
- The debtor is not allowed to make preferential payment after or soon before filing bankruptcy. Neither is he allowed to make any further payment from the estate after filing.

General effects of commencement of insolvency

2. Stay of actions

- According to Article 11, the following rights of third parties are stayed by commencement of insolvency proceedins:

1. the commencement or continuation of individual actions or proceedings
2. obligations or liabilities;
3. the execution of judgments related to the assets of the debtor’s property;
4. the right of counterparty to terminate any contract with the debtor;
5. the right to transfer, mortgage or otherwise dispose of any assets of the debtor.

General effects of commencement of insolvency

2. Stay of secured creditors' actions

- The rights of secured creditors and holders of the right of retention are not stayed by the commencement of insolvency proceedings.
- However, where the debtor shows the intention to submit a reorganisation plan along with the application, all claims including secured claims and rights of retention are stayed effective from the date of application.
- The debtor must submit to the court a reorganization plan within a period not exceeding three (3) months from the date of instituting the court case.
- The period of stay does not exceed six (6) months including the three (3) months of submitting the reorganization plan. If the period referred to in Paragraph 4 of this Article lapses without a court decision on the application, the secured creditor is automatically entitled to enforce the security in accordance with relevant Laws.

General effects of commencement of insolvency

2. Stay in reorganisation

- From the commencement of reorganization company proceedings, no legal proceeding, including enforcement action, against the company, or in relation to any property belonging to the company, or lawfully in its possession, may be commenced or continued.
- However, in relation to secured creditors, the stay for application lasts for six (6) months from the date of application for commencement of reorganization. This period may be renewed three (3) times at most. Art. 87.

General effects of commencement of insolvency

3. Avoidable transactions and fraudulent conveyances

- The appointed administrator can avoid transactions concluded in the last 6 months. See Art. 215.