KENYA
KAPLAN & STRATTON

FIRM INFORMATION

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TYPE OF GOVERNMENT

Democratic Republic

POLITICAL SYSTEM

Multiparty Democracy

LEGAL SYSTEM

Common Law Based

BACKGROUND

Insolvency is now governed by the Insolvency Act No. 18 of 2015 (Insolvency Act) which is designed to consolidate the laws relating to the insolvency of natural persons and incorporated and unincorporated bodies, and to provide for matters relating to insolvency in greater detail. The Insolvency Act contains a framework for the administration of companies as an alternative to liquidation. Certain institutions (notably banks and other financial institutions licensed by the Central Bank of Kenya, insurance companies, and financial intermediaries licensed by the Capital Markets Authority) are subject to special insolvency legislation under the specific Acts of Parliament which regulate the licensing of the institutions in question.

TESTS FOR INSOLVENCY

What are the tests for insolvency (ie liquidation)?

Under the Insolvency Act the test for insolvency is the company's inability to pay its debts. The threshold of outstanding debts warranting the liquidation of a company has however been significantly increased from Ksh. 1000 to Ksh. 100,000. Under the Insolvency Act, a company will be deemed incapable of paying its debts and therefore suitable for liquidation under the following circumstances:

- where a creditor owed Ksh. 100,000 or more demands, in writing, payment of the indebtedness and the company fails to comply within 21 days either by settling the debt,securing or compounding it to the creditor's satisfaction;
- where a judgment or decree against the company remains unsatisfied either in whole or in part; and/or
- where it is proved to the court's satisfaction that the company is unable to meet its debts as they fall due and payable; and/or
- where it is proved that the value of a company's assets is less than the amount of both its contingent and prospective liabilities.

What are the tests for financial distress?

While there are no specific statutory provisions regarding financial distress under Kenyan law, the Insolvency Act provides that the Court may make an administration order in relation to a company 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:
  - to maintain the company as an ongoing concern;
  - to achieve a better outcome for the company's creditors as a whole than would be likely if the company was liquidated (without first being under administration);
  - to realise the property of the company in order to make a distribution to one or more secured or preferential creditors.

The High Court in some decisions has emphasized that it will not proceed with insolvency proceedings where the debt is disputed. The Insolvency Act also contains elaborate provisions on voluntary arrangements by a company. This includes a composition or scheme of arrangement.

INSOLVENCY AND RESTRUCTURING PROCEDURES

Formal insolvency procedures

There are two ways to liquidate a company under the Insolvency Act, namely:

- Voluntary liquidation - where the period fixed for the duration of a company expires or on the occurrence of an event which would lead to a dissolution of the company under the company's Articles of Association.
- Compulsory liquidation - by the Court.

Formal restructuring procedures

The Insolvency Act contains elaborate provisions on voluntary arrangements by a company. This includes a composition or scheme of arrangement. A proposal for voluntary arrangement may be made by the directors, an administrator or a liquidator to the company and the creditors of the company to enter into a composition in satisfaction of its debts or a scheme for arranging its financial affairs. An authorized insolvency practitioner may be appointed to supervise implementation of the voluntary arrangement.

The proposed scheme of arrangement must be approved by a majority of members present at the members' meeting or by a majority in number and value of the creditors at a meeting of creditors. A member or creditor may also make an application to the Court for an order approving the proposed scheme of arrangement. A company will be deemed to be under voluntary arrangement the day after the date on which it is approved by the Court and would then be binding on the members and creditors of the company. The Insolvency Act also contains extensive provisions for the administration of a company, further details of which are set out further below.

Informal insolvency or restructuring procedures

Informal restructures and workouts are uncommon in Kenya except when the enforcement of securities is done through the appointment of a receiver and manager. In the financial sector, a number of institutions (e.g. banks and insurance companies) have been placed under statutory management under the legislation applicable to those institutions.

LIQUIDATION

What is the aim of liquidation?

The main purpose of liquidating a company is to bring the operations of the company to a close, to realise its assets, and distribute its proceeds amongst its creditors and contributories in accordance with their rights and interests. This would be followed by dissolution of the company.

Process required to commence a voluntary liquidation

There are two kinds of voluntary liquidation i,e. members voluntary liquidation and creditors voluntary liquidation.

- **Members voluntary liquidation**
  - The period (if any) fixed for the duration of the company by the Articles of Association expires, or the event (if any) occurs, on the occurrence of which the Articles of Association provide that the company is to be dissolved and the company in general meeting has passed a resolution providing for its voluntary liquidation; or
  - A company resolves by special resolution that the company be wound up voluntarily.

- **Creditors voluntary liquidation**
  - This is initiated by the creditors of the company where the company is unable to pay its debts. The first step is a meeting of creditor's convened by the company within 14 days of a meeting at which a voluntary liquidation is to be proposed. Notice of this creditors' meeting should be sent out to the creditors not less than 7 days before the meeting date. The notice to creditors should also be published in the Kenyan Gazette (a weekly Government publication), in at least 2 newspapers circulating in the area in which the company has its principal place of business in Kenya, and on the company's website (if any). At their respective meetings, the creditors and the company may nominate a liquidator for purposes of liquidating the company's affairs and distributing its assets. Such liquidator must be an authorized insolvency practitioner under the Insolvency Act.

In both cases, before passing a resolution for voluntary liquidation, the company is required to give notice of the resolution to the holders of any qualifying floating charge in respect of the company's property. The resolution for voluntary winding up can only be passed after the expiry of 7 days from the date of the notice to the holders of any qualifying floating charge or if the person to whom the notice was given has consented in writing to the passing of such resolution. Within 14 days after the company has passed a resolution for its voluntary liquidation, it shall publish a notice setting out the resolution in the Kenyan Gazette, in at least 2 newspapers circulating in the area in which the Company has its principal place of business in Kenya, and on the Company's website (if any).

Liquidation by the court

A company may be liquidated by the court if -

- The company has by special resolution resolved to be liquidated by the Court;
- Having been originally registered as a public company, the company has not been issued with a trading certificate under the Companies Act and more than 12 months have lapsed since it was registered. Liquidation on this ground may only be done upon an application by the Attorney General;
- The company fails to commence its business within 12 months of its incorporation or suspends business for a whole year;
- The number of members is reduced below 2 in the case of a non-private company;
- The company is unable to pay its debts;
- A voluntary arrangement made with one or more creditors does not take effect;
- The Court is of the opinion that it is just and equitable for the company to be liquidated;
- On grounds of public interest, it is just and equitable to do so, upon application by the Attorney General where a report is obtained from the capital markets authority, from an investigation or inspection of documents produced under the Companies Act or from information provided by the Companies Registrar indicating that it would be in the public interest to liquidate the company. This may also be done as a result of the company or its directors having been convicted of an offense involving fraudulent conduct.

The process commences when an application for winding up is made to the Court by any or all of the following -

- The company or its directors;
- Creditors (including any contingent or prospective creditor or creditors);
- Contributories where the number of members is reduced below 2 or the relevant shares were originally allotted to

the contributory or have been held in his name for at least 6 months in the preceding 18 months or have devolved to him following the death of a former holder;
- A provisional liquidator or administrator of the company;
- The liquidator where the company is in voluntary liquidation.

At what point does the liquidation process commence?

With a voluntary liquidation, the process is deemed to have commenced at the time of passing the resolution for liquidation. The liquidation of a company by the Court is deemed to commence when the liquidation order is made.

Duration of the liquidation process

Under the previous regime, it was difficult to estimate the duration to complete the liquidation process as this varies so widely. We expect this to remain the same but may be aggravated by the uncertainty of some of the provisions of the Insolvency Act. The liquidation process continues until all the assets have been realised and distributed.

Extent of court involvement in the liquidation process-

Liquidation by the court

The Courts will be involved at every stage of liquidation by the Court. This includes -
- Confirmation of compliance with advertisement procedures;
- Hearing of the liquidation application;
- Granting the liquidation order;
- Appointment of the official receiver and supervision of its functions; and
- Collection and distribution of the company's assets.

Voluntary liquidation

Subject to any application being made to the Court, the Courts would usually not be involved in a voluntary liquidation. The Court may appoint a liquidator if for any reason there is no liquidator or the liquidator is unable to act.

Management of the company whilst in liquidation

When a company is in liquidation, the board of directors are displaced from their office, and in their stead the affairs of the company is placed in the hands of a liquidator. The Insolvency Act extensively provides for the powers of a liquidator which are exercisable with approval. The powers exercisable without approval include:

- Power to do all acts and execute, in the name and on behalf of the company, all deeds, receipts and other documents and for that purpose to use, when necessary, the company's seal;
- Power to sell any of the company's property by public auction or private contract;
- Power to draw, accept, make and endorse any bill of exchange or promissory note in the name and on behalf of the company;
- Power to appoint an agent to do any business that the liquidator is unable to do personally; and
- Power to take all other action that may be necessary for the beneficial liquidation of the company.

Filing of claims

- Creditor Voluntary Liquidation - in practice, debts may be proved by delivering an affidavit verifying the debt.
- Liquidation by the Court - the Court may fix a time or times within which creditors are to prove their debts or claims or to be excluded from the benefit of any distribution made before those debts are proved. A claim is sent to the liquidator or official receiver (not the Court) with a verifying affidavit. The liquidator or official receiver may allow or disallow the claim.

Factors which influence the period of a liquidation

The following are some of the factors that cause delays during the liquidation process:
- In the case of liquidation by the Court, the Court's diary;
- Challenges by the company, creditors or contributories in respect of the liquidation process;
- The level of cooperation among the parties; and
- The cost of appointing a liquidator especially in cases of voluntary liquidation where a company does not have significant assets.

Effect of liquidation on employees

All employees of a company stand to be automatically dismissed at the commencement of liquidation. Employees would enjoy preferential payments (being second priority claims) as follows:
- Wages or salaries payable to employees in respect of services provided to the company during the 4 months before the commencement of the liquidation;
- Any holiday pay payable to employees on the termination of their employment before, or because of, the commencement of the liquidation;
- Any compensation for redundancy that accrues before or due to commencement of the liquidation;
- Amounts deducted by the company from the wages or salaries of employees in order to satisfy their obligations to other persons (including amounts payable to the Kenyan revenue authority in accordance with the Income Tax Act);
- Any reimbursement or payment provided for or ordered by the Employment and Labour Relations Court under the Labour Institutions Act to the extent that the reimbursement or payment does not relate to any matter specified in the Labour Relations Act in respect of wages or other money or remuneration lost during the 4 months before commencement of the liquidation provided that the total amount may not, in the case of any one employee, exceed KES. 200,000 as at the commencement of the liquidation and will be subject to the relevant adjustments.

Effect of liquidation on contracts

Once liquidation commences, the company ceases to carry out business except in so far as is necessary for the liquidation. In line with this, existing contracts would continue only to the extent as may be necessary for the beneficial winding up of the company. It is, however, usual for commercial agreements to provide that the commencement of liquidation proceedings would constitute an event of default enabling the counterparty to terminate the contract. During the process of liquidation, the Court has the power to rescind a contract entered into by a company in liquidation as it considers appropriate upon application.

Effect of liquidation on shareholders

Subject to the satisfaction of all of the expenses of liquidation and the company's liabilities, the company's property is to be distributed among members according to their rights and interests in the company.

Effect of liquidation on creditors

Creditors are entitled to be paid out of the assets of the company after expenses of the liquidation and payments due to employees have been satisfied with secured creditors having preference over unsecured creditors.

Pending claims, litigation and arbitration

At any time after the presentation of a liquidation order to Court, and before a liquidation order has been granted, pending proceedings against the company may be stayed (if the proceedings are pending in the Court) or restrained (if the proceedings are pending in another Court) on application by the company, a creditor or contributory. When a liquidation order has been made or a provisional liquidator has been appointed, legal proceedings against the company may be begun or continued only with the approval of the Court and subject to such conditions as the Court considers appropriate.

Voidable transactions

In the case of a liquidation ordered by Court, any dispositions of a company's property and any transfer of shares made by a company after commencement of liquidation are void unless the Court otherwise orders. The Court may also void any preferences as it deems just where the preference was intended to defeat the effects of a possible liquidation. Any transaction that can be shown to have been entered into to favour some creditors at the expense of others or to defraud creditors may also be set aside.

How is the liquidation process terminated?

Liquidation by the Court

When the affairs of the company have been completely liquidated, the Official Receiver is required to lodge a notice with the Registrar of Companies to the effect that the liquidation by the Court is complete. Upon receipt of the notice, the Registrar is required to register the notice. Upon expiry of 3 months after the date of registration of the notice, the company is deemed to have been dissolved. Where an order for the liquidation of a company has been made by the Court and the Official Receiver is the liquidator of the company, the Official Receiver may apply to the Registrar for the early dissolution of a company.

Creditors Voluntary Winding Up

As soon as practicable after the liquidation of the company's affairs has been completed, the liquidator is required to prepare an account of the liquidation and provide an explanation showing how the liquidation has been conducted and how the company's property has been disposed of. Within 30 days of preparing the account, the liquidator is also required to convene a meeting of the company and a meeting of the creditors to have the accounts presented and the explanation considered. Within 7 days of the meetings being held the liquidator is required to lodge a copy of the account together with a return giving details of the meetings. After receiving the accounts and returns, the Registrar registers the accounts and on expiry of 3 months from the date when the accounts and returns are registered, the company is deemed dissolved.

Director or Officer Liability

If a liquidation commences within 12 months after the date on which payment was made out of capital in respect of the redemption or purchase by a company of any of its own shares, the directors who prepared the statement that the company will be able to continue to carry on business as a going concern for purposes of the redemption or purchase, shall, to the extent necessary to satisfy the insufficiency, be liable to contribute to the company's assets except a director who shows that the director had reasonable grounds for forming the opinion set out in the declaration. The Insolvency Act also provides for comprehensive offences that would be committed by officers of a company (which includes directors) during a liquidation. These include:

- fraudulent acts in anticipation of liquidation;
- transactions to defraud creditors of a company in liquidation;
- misconduct committed in the course of the liquidation of company;
- falsification of documents in relation to a company in liquidation;
- making of material omissions from a statement relating to financial position of company in liquidation;
- making of false representations to creditors of a company in liquidation.

Consequences of director or officer liability

An officer found guilty of the offences listed above is liable, on conviction, to a fine, imprisonment or both. The Court also has the power to make various orders against delinquent directors and liquidators, officers of the company and other persons found to have participated in fraudulent trading by a company in liquidation and officers of a company engaging in wrongful trading.

BUSINESS RESCUE/ADMINISTRATION

Certain institutions (notably banks and other financial institutions licensed by the Central Bank of Kenya, insurance companies, and financial intermediaries licensed by the Capital Markets Authority) are subject to special insolvency legislation under specific Acts of Parliament which regulate the licensing of the institutions in question. The Insolvency Act has introduced extensive provisions in respect of voluntary arrangements and administrations of insolvent companies that provide a regime for business rescue. An application to the court for an administration order in respect of a company may be made by a company or its directors, one or more creditors and any other person of a class prescribed by the insolvency regulations. On the making of an administration order in respect of a company, there will be a moratorium on insolvency proceedings and legal proceedings against the company. Under the voluntary arrangement provisions, when a proposal takes effect as a voluntary arrangement, the supervisor 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. If the directors of an eligible company wish to make a proposal for a voluntary arrangement, they would be able to apply to obtain a moratorium for the company.

Instances in which securities might be vulnerable to attack

The Insolvency Act confers wide powers on the Court to conduct an inquiry into an insolvent company's dealings on application by the official receiver or a liquidator. In relation to companies under administration or in liquidation, the Court has powers to set aside transactions that were entered into at a relevant time if such transactions gave preference to a person which places such persons in a better position during insolvency than they would otherwise have been. The order by the Court may require the release or discharge (in whole or in part) of any security given by the company. The relevant time for purposes of this section includes:

- During the 2 years immediately preceding the onset of insolvency;
- The period between the making of an administration application in respect of the company and the making of an administration order; or
- The period between lodgement with the Court of a copy of a notice of intention to appoint an administrator and the making of the appointment.

Requirements for the recognition of a foreign trustee, business rescue practitioner or insolvency practitioner

The Insolvency Act requires insolvency practitioners to be authorised. A person acts as an insolvency practitioner in relation to a company if the person acts as the liquidator, provisional liquidator, administrator or a supervisor of a voluntary arrangement. A person who wishes to act as an insolvency practitioner is required to apply to the Official Receiver for authorisation to act as an insolvency practitioner. While the Insolvency Act and Insolvency Regulations provide for persons who would be qualified to act as an insolvency practitioner, there are no provisions on the recognition of foreign practitioners.

Provisions on cross border insolvency

Certain aspects of the Model Law on Cross-Border Insolvency (adopted by the United Nations Commission on International Trade Law) are applicable in Kenya, including where:

- assistance is sought in Kenya by a foreign Court or a foreign representative in connection with a foreign insolvency proceeding;
- assistance is sought in a foreign State in connection with a proceeding under the Insolvency Act, and any other written law relating to insolvency in Kenya;
- a foreign proceeding and a proceeding relating to Insolvency in Kenya in respect of the same debtor are taking place concurrently; or
- creditors or other interested persons in a foreign State have an interest in requesting the commencement of, or participation in, proceedings under law relating to insolvency in Kenya.