Chapter 01

Bankruptcy & liquidation: A contemporary approach
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Bankruptcy & liquidation: A contemporary approach

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ABSTRACT

It is an in-depth and cross-disciplinary coverage of the topic of bankruptcy and liquidation that provides a comprehensive but thorough concept of legal, financial, accounting, managerial, and technological aspects of insolvency practice. It is written in a manner that is friendly to the students, practitioners, policymakers and researchers in order to systematically analyze the historical background of bankruptcy, the development of insolvency laws, the role of major participants, and the economic aspects of corporate failure in both national and international settings. It examines the entire range of insolvency practices, such as restructuring, administration, receivership, liquidation, debt resolution, and cross-border insolvency, and links the general principles to modern realities with regard to business, financial institutions, and regulatory agencies. The most important contribution of this textbook is that it incorporates current technological advances into conventional insolvency models. The article explores the transformation of insolvency cases prediction, management, documentation, and resolution using artificial intelligence (AI), the use of big data analytics, blockchain technology, distributed ledger systems, metadata forensics, robotic process automation, and smart contracts. The work identifies how these technologies can increase early warning about financial distress, enhance creditor verification transparency, enhance digital asset tracking, improve ease of administration of cases and reduce fraud. Moreover, the textbook evaluates the opportunities and threats of digital transformation with a critical approach, which encompasses issues related to cybersecurity, data protection, algorithmic bias, and that of virtual assets and decentralized autonomous organisations (DAOs) that exist in a precarious legal position. It gives future-moving talks about the future of the bankruptcy practice in a fast globalizing digitalized economy as a way of providing frameworks to adapt to regulations, professional upskilling, and integration of technology. Through the integration of the doctrinal, case studies, regulatory, technological and international viewpoints, this textbook provides the reader with the comprehensive information, they need to negotiate and manipulate the ever-changing environment of bankruptcy and liquidation. It places insolvency not as a legal system but as a system of dynamism that is more technologically influenced, more global, and incorporates new ways of handling financial distress.

Keywords: Bankruptcy; Liquidation; Insolvency; Modern Technology; Receivership.

Learning Objectives

Upon reading this chapter, it is expected that a reader would be able to:

1. Explain the meaning of such terms as bankruptcy, insolvency, liquidation, restructuring, and receivership.
2. Describe the use and applicability of bankruptcy and liquidation systems.

3. Explain the history of insolvency law in Nigeria and the rest of the world.
4. Find out the key legal and institutional frameworks of insolvency in Nigeria.
5. Identify personal and corporate insolvency.
6. Evaluate the importance of courts, regulators and insolvency practitioners.
7. Describe key reasons why businesses fail and go under.
8. Talk about the theoretical basis on which bankruptcy systems are based.
9. Appreciate the economic value of insolvency systems.
10. Consider the relevance of learning bankruptcy and liquidation.

INTRODUCTION

The issues of bankruptcy and liquidation are extremely important parts of the corporate and financial regulatory framework which dictate how people and companies who cannot fulfill their financial commitments are handled. The importance of such processes has been on the rise owing to the growing complexity of international and domestic economies, particularly in the developing countries such as Nigeria, where financial mismanagement, risk mismanagement, and macroeconomic instability tend to cause firm crashes. (1)

The legal and institutional framework that the corporate sector in Nigeria follows is presented by the Companies and Allied Matters Act, Bankruptcy Act (Cap B2, Laws of the Federation of Nigeria, 2004), and, more recently, by the Business Facilitation (Miscellaneous Provisions) Act (2023) that modernizes the insolvency procedures. These are laws that guarantee that in situations where firms or individuals fail in their obligation to honor their duties, there are clear procedures of either salvaging the viable ones or equitably selling properties to save the creditors and other interested parties. (2)

Bankruptcy and liquidation is a critical topic in the world, as financial discipline is essential and serves to foster investor confidence. Finch (3) notes that the insolvency systems serve as economic stabilization mechanisms and as moralizing tools to ensure that there is no wanton trading to take place though they create accountability. Therefore, bankruptcy and liquidation is a subject of study that cuts across the accounting practice and it involves law, ethics, economics, and management science.

DEVELOPMENT

The evolution and Historical Development

The idea of going bankrupt was first formulated in medieval Italy with the phrase being banca rotta (broken bench) being used to depict the humiliation of a merchant unable to pay his debts. Formal rules of recovering debts were established in England through the Bankruptcy Act of 1542. The development of the insolvency law moved on through the Bankruptcy Acts of 1869, 1914, and 1986, which shifted the emphasis less on punishment and more towards rehabilitation of debtors. (4)

In Nigeria, the English tradition of the law of insolvency was bequeathed by the colonial rule. The current day Bankruptcy Act (Cap B2 LFN 2004) was based on the Bankruptcy Ordinance of 1929. Nevertheless, the current advances like CAMA 2020 and Insolvency Regulations 2021 have localized the practice of insolvency and have put together a structure that accommodates both individuals and corporate entities.

The insolvency practice has been recognized in the country; this is evidenced by the formation of organizations such as Business Recovery and Insolvency Practitioners Association of Nigeria

(BRIPAN). The development has changed the focus of the evolution of punitive bankruptcy procedures to systems that focus on the business rescuing and corporate rearrangement.

Conceptual Clarification

Bankruptcy

Bankruptcy is a legal procedure by which individuals or the owners of an enterprise unable to repay their loans request that some or all of their debts be discharged. It is used primarily to individuals and partnerships in Nigeria and it is governed by the bankruptcy act. When a debtor declares himself or herself bankrupt, the court transfers the assets of the latter into a trustee who manages the capital in the interests of creditors.[5]

Liquidation

Liquidation on the other hand is applicable to corporate bodies. It is the process of winding up the affairs of a company, realisation of the assets and distribution of the resultant proceeds to creditors and shareholders. This can be either a compulsory process (through court order) or a voluntary process (through shareholders or creditors). Granting liquidation under CAMA 2020 also can be done under the court or debenture holder appointed receiver or administrator [2].

Insolvency

Insolvency is a wider financial situation in which the liabilities of an entity exceed the assets or in situations in which an entity cannot take its obligations as they fall due [6]. In the case of individuals, insolvency can result in bankruptcy, whereas in the case of companies, insolvency can result in liquidation.

Receivership

Receivership is a debt recovery procedure that consists of a creditor, who appoints a receiver or manager, to assume control of the assets of a debtor company to repay the debts. It can be a pre liquidation remedy.

Reorganization and Business Rescue

The current insolvency regimes focus on corporate rescue procedures instead of liquidation. Business reorganization enables the possible firms facing financial turmoil to reorganize the debt and continue their operations [7].

The purpose of this paper is to examine and discuss the nature of objectives and significance of studying bankruptcy and liquidation.

Bankruptcy and liquidation are critical research in accounting, finance and management students as it equips them with the knowledge of managing the termination, salvage or recovery of the failing organizations. The key objectives include:

1. Knowledge of Legal Compliance: To introduce the student to laws of insolvency and liquidation in Nigeria.
2. Financial Accountability: To promote fair sharing of assets between creditors as well as safeguarding the interest of the people.
3. Corporate Ethics and Governance: To ensure that there are good practices of management that helps in avoiding insolvency.
4. Economic Stability: Insolvency systems can ensure that resources are efficiently redistributed and that the capital markets are not trusted.
5. Professional Relevance: In insolvency, accountants and auditors are usually trustees

or liquidators or receivers.

According to Adegbite [2], a good insolvency framework will boost corporate responsibility, improve governance, and investor confidence in emerging economies.

Legal and Institutional Environment in Nigeria

The laws that regulate bankruptcy and liquidation in Nigeria consist of a number of important documents and legal institutions:

1. Companies and Allied Matters Act:
    a. Regulates the winding-up companies.
    b. Offers voluntary and forced liquidation.
    c. Authorizes the Corporate Affairs Commission (CAC) to regulate the filing of liquidation.

2. Bankruptcy Act (Cap B2 LFN, 2004):
    a. Controls the declaration of bankruptcy on individuals.
    b. Establishes acts of bankruptcy, partition of property and trustees.

3. Insolvency Regulations (2021):
    a. Explain the procedural issues of liquidation and business rescue.

4. Business Facilitation Act (2023):
    a. Facilitates ease of doing business by streamlining the insolvency processes.

5. Professional Bodies:
    a. Business Recovery and Insolvency Practitioners Association of Nigeria (BRIPAN) is a guarantor of professional standards.
    b. The role of the accountants in the insolvency engagement is regulated by Institute of Chartered Accountants of Nigeria (ICAN) and Association of National Accountants of Nigeria (ANAN).

6. Courts and Law enforcement agencies:
    a. Bankruptcy and winding-up of companies are within the jurisdiction of the Federal High Court.
    b. The Official Receiver oversees and administers insolvent estates.

1.6 Comparative International Perspectives

The United Kingdom

Insolvency Act (1986) gives provisions to voluntary arrangements, administration, receivership, and liquidation. It highlights administration as the remedy of the company salvaging and not immediate dissolution.[4]

The United States

There is a distinction between Chapter 7 (liquidation) and Chapter 11 (reorganization) of the U.S. Bankruptcy Code (Title 11, 1978). The two-fold arrangement promotes reforming of companies by restructuring debts.[8]

South Africa

Business rescue has been brought about in the Companies Act (2008) and is the same process as administration in the UK. It is geared towards striking a balance between protecting the creditors and saving the jobs.[9]

The implementation of CAMA 2020 in Nigeria is in line with the best practice of the world because it only incorporates the modern concepts of insolvency such as the rescue of a company, voluntary winding-up of creditors, and regulation of insolvency practitioners.

Theoretical Framework

The study of bankruptcy and liquidation is based on several theories:

i. Agency Theory[10] (Jensen and Meckling, 1976): When there is a clash between the management (agents) and the owners (principals) a situation of insolvency is prone to occur and thus making risky financial decisions.

ii. Stakeholder Theory[11] (Freeman, 1984): Insolvency has impact on all stakeholders which includes creditors, employees, shareholders and the government. As such, liquidation should be able to harmonize the conflicting interests.

iii. Systems Theory[12] (Parsons, 1967): Businesses are systems in the interaction with the environment; the collapse of a single element (finance, operations, system of governing) can cause the entire system to collapse and become insolvent.

iv. The Political Economy Theory[13] (Miliband, 1969): The nature of the allocation of power in the economy shapes the bankruptcy laws, insolvency systems tend to echo the political contest to safeguard capital interest.

All these theories are used to explain the role of structural, managerial and institutional dynamics in the financial failure and the regulation of insolvency.

SUMMARY

The chapter has brought out the basics of bankruptcy and liquidation in the legal and economic landscape of Nigeria. It has described a history, the conceptual distinction between insolvency, bankruptcy and liquidation and touched on the most important regulatory tools used to govern these processes. It also associated theoretical frameworks to the causes and consequences of bankruptcy.

It is essential to note with consideration of the following chapters that it is imperative to understand these basic aspects before proceeding to the procedural, accounting, and ethical aspects discussed in the subsequent chapters.

REVIEW QUESTIONS

1. Draw the line between insolvency, liquidation and bankruptcy.
2. Discuss the development of the bankruptcy legislation in Nigeria.
3. Discuss the key goals of bankruptcy and liquidation study.
4. Determine major legislations that regulate insolvency in Nigeria.
5. Compare insolvency regime in Nigeria with in the United Kingdom.
6. Explain the relationship between Agency Theory and the Stakeholder Theory with insolvency.

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