Protection of Creditors Under the Company Law in Nigeria.

Ikonne, Ugwueze Oluchukwu Esq. *M.Sc, Ll.M.*
Abia State Polytechnic, Aba.
Email orasicom@yahoo.com, ugwuezeikonne80@gmail.com. 08037487402

Abstract

This paper examined the protection of Creditors under the Company law, evaluating all the enabling statutes, laws and Acts in respect to the management and promotion of companies in Nigeria. The researcher adopted the doctrinal research method which involves the study of primary data of statutes, legislations, treaties, case laws, among others. It is research into law as it stands in the books. The objectives of the study among others therefore are to investigate who the creditor is and the protection mechanism which can be applied in event of default or negligence by the managers of the companies. The findings revealed that applying most sections of the Companies and Allied Matters Acts (CAMA) 2020 and enforcement of the contractual agreement can protect the creditors. It was also concluded that capital maintenance in its current regime is no longer an appropriate concept to employ in the protection of the interest of Creditors. The protection therefore can be accomplished by further deregulating of the capital maintenance rules leaving the protection of large and sophisticated creditors to contract and insolvency provisions. It is recommended that the solvency test used in other jurisdictions which is basically a cash flow test be modified by including the balance sheet test as a measure of protecting the interest of Creditors in Nigerian companies.

Key Words: Capital Maintenance, Creditors, Creditors' Protection, Mechanisms for Protection, Companies and Allied Matters Acts.

Introduction

Since the history of Joint-Stock Companies in the United Kingdom and the events that led to the eventual enactment of the Bubble Act, Creditors have sought protection from opportunistic behaviour of the Company Managers in the promotion and management of companies by acts, rules and other statutory provisions[1]

Creditors need to be protected against the Controllers, Chief Commanding Officers, Managers, Directors etc. who run day to day business of the Company and have the power to decide on the firms' actions. Being in such a position, the Directors or Controllers may use the company and her assets to serve their personal financial interests and thus prejudice the legitimate interest of the firm's creditors[2].

Creditors share in the business risks and cost of the firm but would not normally have the possibility to participate in the business decision-making of the firm

Creditors mostly consist of banks, bondholders, and various suppliers. They lend monies to the companies for an exchange for a fixed return on their debt capital, usually in the form of interest payments which the companies in principles agree to pay back the principal amount also.[3]

Section 191 of CAMA 2020[4] expressed;

> *A company may borrow money for the purpose of its business or object and may mortgage or charge its undertaking, property and uncalled capital, or any part*

[1] Digman, A &Lowry, J. *Company Law.* (5th Ed.) Oxford University Press, 2009 p.433
[2] Ibid. p.435
[3] Grower,G *Principles of Modern Company Law*, 4th Ed, London, Stevens & Sons (1979)
[4] *CAMA 2020. S.191*

thereof and issue debenture, debenture stock and other securities whether outright or as security for any debt, liability or obligation of the company or any third party

Creditors' Protection means the individual as well as the pool of mechanisms, the aim of which is to protect the interest of the persons known as Creditors. These mechanisms which could not only be statutory or instrumental mechanism in company law but also contractual as well as other mechanisms the operations of which serves to ensure that the debtor satisfies the claims of the creditors.[5]

In the recent times, there has been total closure, winding up and collapse of companies occasioned by fraud, negligence and lack of business vision by management of companies in Nigeria. In the event of such calamity and mismanagement, the creditors are worst hit as they are the ones who provide the chuck of financial resources which the company used in their operations and may likely not be able to recoup or recover her resource if not well protected. For this reason, the creditors need protection against such event. These protections could be in form of contractual agreements, statutory legislation and other legal mechanism to guarantee the safety of funds advanced to the debtor [6]

In Nigeria, the Corporate Affairs & Allied Matters Acts which regulates companies made provisions for Companies to borrow money from creditors to run the affairs of the companies and issue debenture certificates to acknowledge the loan granted by the creditors. The company may also create a charge over the assets to secure the loan.

Conceptual Review

Creditor

The term creditor generally includes any third party who has a payable or in the future to become payable claim against a debtor. This definition includes not only incumbent creditors who knowingly and willingly are in a credit relationship with the debtor, but also persons who are to become creditors and against whom the debtor could become liable for other reasons[7] .When a party accepts voluntarily a claim, either current or future, against a debtor, one talks of a voluntary creditor. When a third party did not choose nor could have chosen to accept a claim against a debtor, one talks of an involuntary creditor. This type of third parties becomes creditor and thus becomes aware of the status only after the claim has arisen due to a certain occurrence.[8] A typical example of this kind of creditors is tort creditors. Within these two major groups of creditors, one can differentiate the creditors further according to, for example, their nature (e.g. institutional or non-institutional), time span of their relationship to the debtor (short term or long-term creditors), or ability to enforce their claims (strong or weak creditors).[9]

The creditor of a company is clearly distinct from an investor in the company. They are un-identical twins and bare different legal status in law. The implication of their commitments to the company varies so does their rights. The investor is a shareholder of the company while the creditor is not a member of the company. His interest in the company is to the extent of his financial grant to the company[10]. While the shareholder gets dividends when the company declares profits, the creditor gets his money back whether or not the company makes profit.[11]

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[5] *Ibid p.462*

[6] *Ibid(3)*

[7] Akin, O. O *The Relevance of the Corporate Practice & Law Practice,* Abuja: Bosem Pub. Ltd 2013 p.57

[8] Ibid p.62

[9] Ibid p.64

[10] Yagba, T. T,Kanyip, B.B & Ekwo, S. A. *Elements of Commercial Law.* Zaria-Nigeria: Tamaza Pub.1994 p.190

[11] Ibid p.192

Types of Creditors

Secured Contractual Creditors.

They are generally well- informed creditors and aware of the transactions in which they are part and are also able to estimate the risks they are taking over. Due to this awareness and willingness to enter into such transaction, this type of creditors is also able to provide contractually for the risk they are willing to pay for under the specific terms. Because this kind of creditors relies on their ability to collect information about the debtor in order to accurately assess the probability of the debtor to repay its debts and thus obtain the appropriate security, the risks these creditors face is the risk of failure to obtain adequate information about the debtor and to accurately assess that information.[12]

Unsecured Contractual Creditors

They are creditors which are typically less informed and possess little leverage to dictate or co-design the terms of the contract, face the risks that the firm owners and managers will behave opportunistically ex-post without respecting the terms of the contract they agreed ex-ante, risking in this way also to cause the firm to go insolvent[13]. Eventually, these creditors face the risk that the company would not be able to fulfill its debt leading to insolvency with the creditors bearing the risk of default[14].

Non-Contractual Creditors.

The non-contractual creditors are typically non-informed, non-secured and are usually tort creditors that face the risks of defaults because he is not aware of his claims against the company until the claim arises. This type of creditor has no possibility to avoid the risk or take measure against it[15]

Corporate /Legal Personality

Upon satisfying the preliminary requirements, the Registrar is obliged to register the company and issue certificate evidencing registration and by the virtue of ***Section 42 of CAMA 2020****,*[16] *the effect of this, is that,*

> *"as from the date of Incorporation, the subscriber of the Memorandum together with such other persons as may, from time to time become members of the company, shall be a body corporate by the name contained In the memorandum, capable forthwith of exercising all powers and functions of an incorporated company including the power to hold land and having perpetual succession and a common seal, but with such liability on the part of the member to contribute to the assets of the company in the event of its being wound up as is mentioned in the Act"*

Corporate firms are legal entities, and therefore they are distinct from natural persons. A typical feature of a legal person that distinguishes them from natural persons is the availability of a pool of assets distinct from the personal assets that is needed for the firm to bond itself credibly to fulfill the contract the firm is party to. The separation of the pool of assets owned solely by the firm from the pool of assets owned the firms' owners or managers constitutes an essential element of the corporate firm as a legal entity.

The company therefore is responsible for payment or meeting its own obligations and not the individual shareholders. The creditors do not pursue the members, as the liability for the debts and other obligations of the company but strictly that the company to bear.[17]

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[12] CharlesWorth, J. *Business Law,*16th Ed. UK: Thomson,Sweet & Maxwell. 1977 p.204

[13] Ibid p.205

[14] Adeniyi, S *Protection of Creditors in Nigeria https:www.robertsandshoda.com.ng accessed on23/4/024*

[15] Ibid (10) p.207

[16] *Section 42 of CAMA 2020*

[17] Akanki, O. *The Relevance of the Corporate Personality.* Ibadan: VOSS Publishing.1980 p.75

The ability to raise large amount of money by borrowing money from commercial institutions is an advantage of the incorporated companies. The company through the devise of a floating charge may raise money by executing a debenture and charging all its assets of the company. The company is allowed to continue using its assets and the money is not due until the charge crystallize and it becomes fastened to the property of the company (***CAMA 2020 S.191***)[18].

Debenture

Companies are incorporated with share capital provision that allows them to sell their shares to raise money to finance the company's business. Sometimes, this money may not be enough. The company may need quick money and so has to borrow from creditors. In doing so, companies usually issue documents acknowledging their indebtedness to creditors called Debenture Deeds. In some cases, the company pledges its assets as security for the loan. When this happens, the company is said to have created a charge over its assets. Debentures are usually issued pursuant to the company's borrowing powers which are contained in its Memorandum or Articles of Association.

Section191 of CAMA[19] provides;

"a company may borrow money for purposes of its business or objects and may mortgage its undertaking, property and uncalled (unissued) share capital or thereof and issue debentures or debentures stock or other securities whether outright or as security for any liability or obligation of the company or any third party"

The company therefore has statutory power to borrow money and issue debenture to acknowledge the debt. It may also create a charge over its assets to secure the loan.

Lifting the Corporate Viel.

The doctrine of Corporate Personality is fundamental and by and large, it is adhered to strictly and rigidly when there is no compelling reason to the contrary. There are cases when the courts and legislature have allowed the veil to be lifted in order to determine the natural persons behind the corporate veil. This is important because just as the concept of corporate personality may and is being used to achieve lofty and great purposes, it may also be used to defeat some important value in law. It has been used for various nefarious and wholesome reasons which are basically to evade the law or to use the concept to defraud and to avoid legal obligations[20].

Section 44 of CAMA 2020[21] provides that;

A company shall not carry on any business expressly prohibited by its memorandum and shall not exceed the powers conferred upon it by its memorandum or this Act.

Section 670 of CAMA 2020[22] provides that;

A person who being at the time of the commission of the alleged offence is an officer of the company which is subsequently ordered to the winding up by the Court, or subsequently passes a resolution for voluntary winding up;

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[18] *CAMA 2020 S.191*

[19] *Section 166 CAMA 2020*

[20] Gallagher,I.E & Zeigher,W.F." *Lifting The Veil In The Pursuit of Justice" 1990, Journal of Business Law, 292*

[21] *Section 44 CAMA 2020*

[22] *Section 670 CAMA2020*

(a) Has by false pretense or by means of any other fraud induced any person to give credit to the company,
(b) With intent to defraud Creditors of the company, made or caused to made any gift or transfer of or charge on, or has cause or connive at the levying of any execution against the property of the company; or
(c) With intent to defraud Creditors of the company, has concealed or removed any part of the property of the company, or within two months before the date of any unsatisfied judgment or order for payment of money obtained against the company, he commits an offence and is liable on conviction to imprisonment for a term of two years.

Another Statutory Lifting the Veil is offered in the provisions of ***Section 672(1) of CAMA 2020***[23] which was formally ***Section 309 of the 1968 Companies Act***[24] provides that;

"if in the course of the winding up of a company, it appears that any business of a company has been carried on in a reckless manner or with intent to defraud creditors of the company or any other person for any fraudulent purposes, the court on the application of the official receiver, or liquidator or any creditor or contributory of the company, may if it thinks proper so to do declare any person who were knowingly parties to the carrying one of the businesses in manner aforesaid shall be personally responsible without any limitation of liability for all or any of the debts or other liabilities of the company as the court may direct"

This provision recognizes that the separate personality can be used for fraudulent purposes like borrowing which the management is aware that cannot be paid.

Doctrine of Capital in Company Law as a Protection Mechanism

The concept of 'capital' has a restricted and technical meaning within company law.[25] A company's capital adds up to all of the cash or the value of assets received by a company from investors in return for the company's shares. This is an important source of finance for companies. It should be noted that the company's capital in this technical sense is calculated in terms of the value initially received by the company when the shares are first issued, rather than the current value of those received funds and assets, since this will change with the business activities of the company.[26] Another important source of financing for a company is debt. A company may raise funds through issuing debt, by loan financing provided by banks and other lenders. This form of company financing is treated very differently to the raising of funds through issued shares. This is due to the fact that in company law, there is an important distinction made between the treatment of creditors who provide debt funds for a company and the treatment of shareholders who provide equity funding through share issues. Only the equity funds received by a company from shareholders are treated as the 'legal capital' of the company, subject to statutory regulations and restrictions[27]. The distinction made between the legal capital of a company and other assets is necessary, because the legal capital accounts act as a 'buffers' for the protection and benefit of the company's creditors. The shareholder capital contributions are there to mitigate the risks to which creditors are exposed to. If for example,

[23] *Section 672 of CAMA.*
[24] *Section 309 of 1968 Companies* Act
[25] Manning, B A *Concise Textbook on Legal Capital* (2nd Ed) London: Foundation Press 1981 p.260
[26] Gullifer, L.& Payne, J. *Corporate Finance Law*: Principles *and Policy* London: Hart Publishing 2015 p.544
[27] Ibid p.546

the company fails and it is put into liquidation, then whatever remains of the company's assets will be used to repay the company's creditors first before any of the shareholders are repaid any part of their contribution. Thus, the legal capital regime aims at creating some sort of balance between the rights of the shareholders and the rights of the creditors, the regulation of this interplay of interests is critical to the success of a company[28].

Capital Maintenance in Company Law

The doctrine of capital maintenance is an important principle of company law as it deals with the very essence of corporate financial operations and management. The legal doctrine of capital maintenance is a long-standing rule of company law that a company cannot return capital to its shareholders save in one of the ways expressly permitted by statute, which is a reduction of capital, the redemption or purchase of shares in accordance with the relevant statutory provisions and distribution in a winding up[29] For many years, the doctrine has been known as the rule by ***Trevor v Whitworth*** (1887).[30] In the *Trevor* case, Lord Watson explained on pages 423-424 that the law prohibits:

"...every transaction between a company and a shareholder, by means of which the money already paid to the company in respect of his shares, is returned to him unless the Court has sanctioned the transaction. Paid-up capital may be diminished or lost in the course of the company's trading; that is a result which no legislation can prevent; but persons who deal with, and give credit to a limited company, naturally rely upon the fact that the company is trading with a certain amount of capital already paid, as well as upon the responsibility of its members for the capital remaining at call. They are entitled to assume that no part of the capital which has been paid into the coffers of the company has been subsequently paid out, except in the legitimate course of its business."

This position has been repeatedly re-asserted by the courts in numerous, most recently in ***Progress Property Co Ltd v Moore*** **(2010)**[31], where the court held that capital maintenance is understood as a mechanism of protection of creditors' interests from unfair actions of members of the legal entity or as a general prohibition to distribute the company's capital and/or investments of creditors. A transaction that offends this principle is to be treated as *ultra vires* and void (***Rolled Steel Products (Holdings) Ltd v British Steel Corporation***, **1986**)[32] Thus, the doctrine entails that a company must receive proper consideration for shares that it issues. Having received such capital, it must not repay it to members except in certain circumstances (***Aveling Barford Ltd. v Perion Ltd.)***[33]. This is because making profits is the primary reason why companies engage in business activities ***(CAMA2020 S.131)***[34]**.**

In numerous common law countries and jurisdictions, capital maintenance is usually interpreted as a doctrine that requires the company to retain assets equivalent to the contributed capital to protect creditors, and distribution to shareholders must not be made out of the company's capital[35] The maintenance of capital principle is implemented by restrictions on distributions to shareholders and restrictions on reducing the share capital figures in the accounts. Distributable profits, broadly speaking, are defined as cumulative net realized profits minus the sum of dividends paid plus losses written off in capital reductions

[28] Payne, J. *Legal Capital and Creditors Protection in UK-Private companies.* European Company Law 5(5) 2008.
[29] Zahir, M *Company and Securities Law.* Bombai: The University Press Limited 2015.p.223
Trevor v. Whitworth 1887. P.423-424
[31] *Progress Property Co. Ltd v. Moore (2010)*
[32] *Rolled Steel Products (Holdings) Ltd. v British Steel Corporation 1986*
[33] *Aveling Barford Ltd v Perion Ltd.*
[34] *CAMA2020 S.131*
[35] Armour, J. Share *Capital and Creditors Protection: Efficient Rules for a Modern Company Law*. UK:2000 p.450

(Section 132 CAMA 2020)[36]**.** Hence, dividends must always be paid for out of profits and not out of assets representing the value of the capital that was contributed to a company in consideration for its shares, except insofar as the capital has subsequently been reduced.[37] A clear distinction is made between the company's capital and its profits.

As the court noted in ***D Growth Premium 2X Fund v RMF Market Neutral Strategies (Master) Ltd (Cayman Islands)*** **(2017)**[38]**,** dividends or distributions have always been allowed to be paid out of profits. Before the statutory restrictions under the Companies Act 2020 were imposed, the requirement to pay dividends out of profits was normally prescribed by a company's Articles of Association (***Scottish Insurance Corporation Ltd v Wilsons & Clyde Coal Co Ltd,*** **1949)**[39]**.** From the various court judgments over the years and the codification of the doctrine in both the ***Companies Act of 2004 and Companies Act of 2020***, the following key elements have been established with regards to the doctrine of capital maintenance such as:

(1) A company generally cannot purchase its own shares unless it follows the strict procedures laid down by the ***Companies & Allied Matter Act 2020 s.184;***[40]

(2) A subsidiary company generally must not be a member of its holding company ***CAMA 2020 s.190;***[41]

(3) It is generally unlawful for a company to give any financial assistance for the acquisition by any person of its own shares or those of its holding company ***CAMA2020 Section 183 (2b***)[42];

(4 Dividends must not be paid to the shareholders except out of the distributable profits; ***CAMA Section 428***[43]

(5) Where a public company suffers a serious loss of capital, a company meeting can be called to discuss the issue. ***CAMA 2020 S.487***[44]

There are certain exceptions to the principle as noted by the court in ***Chalcot Training Ltd v Ralph & Anor*** **(2020)**[45] to include:

(a) A company may redeem its shares if the Act concerned allows it. ***CAMA 2020 s.132***[46]

(b) if the law permits, a company may reduce its share capital with the consent of the court ***CAMA2020, Section 133 (1)***[47]***;***

(c) Capital may be returned to the members after the debts of the company have been paid in a winding up.[48]

(d) A company may purchase its own shares under a procedure prescribed by the law ***CAMA2020 s. 190.***[49]

In considering whether the rules on capital maintenance achieve any useful purpose, it will be asked if these rules are economically efficient and whether they can be objectively justified. It will be argued that the need for creditor protection is critical and the objectives

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[36] *CAMA 2020 S.132*

[37] Islam, M. S *The Doctrine of Capital Maintenance and its Statutory Developments: An Analysis.* The Northern University Journal of Law34.181 2013

[38] *D Growth Premium 2X Fund v RMF Market Neutral Strategies (Master) Ltd (Cayman) Islands) 2017.*

[39] *Scotish Insurance Co-operation Ltd v Wilson &Clyde Coal Co. Ltd (1949)*

[40] *CAMA 2020 S.184*

[41] *CAMA 2020 S.190*

[42] *CAMA 2020 S. 183*

[43] *CAMA 2020 S.428*

[44] *CAMA 2020 S.487*

[45] *Chalcot Training Ltd v Ralph& Anor (2020)*

[46] *CAMA 2020 S. 132*

[47] *CAMA2020 S.133 (1)*

[48] Ferrain, Eillis, Chan HO. *Principles of Corporate Finance Law*, Oxford University Press (2015).

[49] *CAMA 2020 S. 189*

that the maintenance rules try to achieve are of paramount importance. However, it will be discovered that the current regime does not effectively meet the objectives that it was intended to do, in particular with regards to creditor protection, and moreover that it does not enhance the efficiency of companies. It is argued that maintenance of capital in its current regime is no longer an appropriate concept to employ in safeguarding the interests of creditors. One way, it will be suggested; that this can be accomplished is by a further deregulating of the capital maintenance rules leaving the protection of large and sophisticated creditors to contract law and insolvency provisions.[50]

The rules governing the preservation of a company's capital can broadly be divided into five sub-headings: the rules on minimum capital requirements and nominal share requirements; the rules preventing a company paying out distributions out of anything other than distributable profits; the provisions on reduction of capital; the restrictions on a company providing financial assistance to potential shareholders; and the rules on redemption and repurchase of a company's own shares[51].

Minimum Capital Requirement and Nominal Share Requirement

The minimum capital rule requires that those incorporating a business must place assets of at least a specified minimum value into the corporate asset pool, this has been placed at #2,000,000.00 for public companies and #100,000 minimum capital requirement for private companies ***CAMA 2020 S.27(2)[52].*** Moreover, this contribution does not all have to be handed over to the company at the time of issue of the shares. It is enough that only one quarter of the nominal value of the share and the whole of any premium to be paid is contributed. This compulsory share capital requirement exists for the benefit of creditors; it is intended to provide a safety net for creditors and some sort of guarantee as to a company's creditworthiness. In addition to this minimum requirement, another rule is that if a public company's net assets fall below one-half of it called-up share capital, then the company is required to convene a shareholders' meeting 'for the purposes of considering whether any, and if so what, steps should be taken in order to deal with the situation'.[53].

The rule on minimum legal capital is considered to be the weakest of the legal capital provisions aimed at protecting creditors. One of the main criticisms expressed is that the legal capital put into the company can be used up quickly soon after incorporation, so the minimum capital requirement is not reliable as a benchmark for informing creditors about the assets of the company in the long term[54]. In addition, as the company grows, there will be less and less similarities between the value of the company's assets and the initial value of the shareholder's contributions as stated in the capital accounts. It has also been stressed by several authors that there is no meaningful link between the financial needs of an enterprise and the amount of its legal capital. This is primarily due to the fact that the diversity of enterprises makes it impossible to tailor legal capital requirements to fit the financial needs of every enterprise.[55] It is artificial to set a mandatory 'one size fits all' approach to the regulation of something as significant as a company's capital structure. Looked at from the point of view of creditors, several authors have observed that the minimum legal capital rule provides no useful protection either to voluntary creditors or to involuntary creditors. Sophisticated voluntary creditors in practice seem to rely on contractual means, e.g. loan

[50] *Ibid(23)*
[51] *ibid*
[52] *Akin, O. O A Synopsis on Corporate Law, Property Practice & Law In Practice,* Abuja*:* Bosem Pub. 2013 p.57
[53] *CAMA 2020 S. 487*
[54] Ibid (7) p.460
[55] Tomasie, R *The Rise and Fall of the Capital Maintenance Law: The Companies (Amendment) Act 2005* Singapore Academy of Law Journal 19.295 2015

agreements, using the risk of insolvency and the quality and certainty of future cash flow as benchmarks. It is argued that the relatively low requirement of minimum capital for public companies is insufficient and trivial to effectively meet any significant creditor protection[56].

Payment of Distributions to Shareholders

The rules on legal capital have their main impact as a control on the amount a company may distribute to its shareholders by setting a maximum limit on what may be so distributed. Distributions to shareholders reduce a company's net assets, making it more exposed to the risk of default. However, there may be circumstances in which transfers to shareholders are efficient, so rather than simply ban all asset transfers to shareholders, restrictions and limitations are placed on when such transfers can be made. The law has long sought to ensure that distributions paid by a company to its members are not whole or in part a return of the capital they have contributed. This is due to the fact that returning capital to shareholders may harm creditor's interests, even if the company does not actually become insolvent. Such transfers will still reduce the expected value of the creditors' claims. So, a rule prohibiting a company from making distributions of corporate assets to its shareholders, other than out of profits available for the purpose, has been put in place. Distributable profits being defined very widely, as the company's 'accumulated realized profits so far as not previously utilized by distribution or capitalization, less its accumulated realized losses so far as not previously written off in a reduction or reorganization of capital duly made'[57]. In addition to this fundamental capital maintenance rule, there is a further restriction applicable to distributions by public companies which does not apply to private companies. A public company may only make a distribution, if following the distribution, the amount of its net assets is not less than the aggregate of it called-up share capital and undistributable reserves[58]. The underlying purpose that the distribution rule is intended to achieve is to ensure that creditors are not prejudiced by the distribution to shareholders of funds part of the company's capital buffer. This rule, permitting distributions only out of profits, can be viewed as a beneficial constraint. It seeks to provide a guarantee to creditors that there is a certain amount of capital left in the company and that capital is not diminished by distributions to shareholders.

The current distribution regime, employing a balance sheet test for the legality of distributions, leads to a greater preservation of legal capital. It states that a company must not make a distribution if its net assets (assets minus liabilities) are or would be after the distribution less than it called-up share capital and undistributable reserves, including other accounts such as the share premium account[59]. Therefore, in order to make a distribution a company must have positive net assets to meet the dividend payment and still have assets in balance with its liabilities, share capital accounts and other undistributable reserves such as the share premium account and the capital redemption reserve. In addition, the rule requires the company to consider the state of its profit and loss account, as well as its balance sheet[60]. First, the company will need to assess its accumulated profits and losses over the years to determine whether at the point a dividend is under consideration, there are profits to support it. Then the company must subtract from the profits it has made over the years any amounts already paid out by way of dividend or any profits which have been capitalized, but it may also deduct from its losses it had made over the years any amount properly written off

[56] Ferran, Ellis. *Revisiting Legal Capital.* European Business Organization Law Review, 20(3), 521-545 https//doi org/10.1007/s 40804-01900161-z

[57] ibid (23)

[58] *CAMA 2020 S.428*

[59] Ibid (7) p.510

[60] Ibid (7) p.511

through a reduction or reorganization of capital. If the company's aggregate profits over the years exceed its aggregate losses over the years, a distribution may be made to the extent of the surplus profits[61]. The aim of the distribution provisions is to require companies to take into account legal capital when determining distributions. In doing so, public companies will have to take into account unrealized losses when determining the maximum amount payable by way of dividend but private companies need not do this[62].

The Reduction of Capital

A reduction of capital is where a company writes off some of the money stated to be in the company's capital accounts or decides not to seek payment of a sum due to be paid to a capital account. As this potentially means that there is less money available for its creditors, specific procedures under the ***Companies & Allied Matters Act 2020 s.130 to 133*** must be followed so creditors or investors have no grounds for complaint. Companies can reduce share capital for a number of reasons. The main reasons are where: the nominal value of the company's share capital is greater than the value of its assets; the company wishes to be rid of a certain class of shareholders; the company has more capital than it knows what to do with and wishes to return some to the members; or the company wishes to use unused funds held in a capital account for some other purpose. ***CAMA 2020, s132*** permit's a company to carry out a reduction of capital by special resolution, provided the resolution is either supported by a solvency statement or is confirmed by the court.

The purpose of the capital reduction provisions is to put in place mechanisms that are designed to ensure that a company's creditors are not unnecessarily prejudiced when a reduction of capital is performed. The object of requiring a courts sanction in a reduction of capital for public companies is threefold: to protect creditors dealing with the company, so that the fund available for satisfying their claims shall not be diminished except by ordinary business risks; to ensure that the reduction is equitable as between the various classes of shareholders in the company; and to protect the interests of the public by requiring disclosure. A procedure for settling a list of creditors and checking that each one of them has consented to the reduction or has had their claim adequately secured, is provided for. The court has discretion to dispense with this procedure, and in practice will usually do so if the company can show that all of its creditors have consented to the reduction or that, to the extent that such consent has not been obtained, an adequate form of creditor protection is in place[63]. If a reduction of a public company's capital brings the nominal value of the company's allotted share capital below #500,000 the company must be re-registered as a private company[64]. Also, in relation to public companies, if the net assets of a public company fall to half or less of it's called up share capital, the directors must within twenty-eight days convene a general meeting to discuss what steps can be taken to resolve the problem[65].

Other Mechanisms for the Protection of Creditors.

Flow Of Information.

When the Creditor and the debtor company maintain a close relationship, characterized by an intensive flow of information before and during the lending relationship, the lender (Creditor) tends to be better informed and therefore more effective in monitoring

[61] Ibid (13) p.4

[62] Cheffins, B. *Company Law: Theory, Structure and Operations*, Oxford University Press, (1997)

[63] *CAMA 2020 S.131 (a) 1*

[64] *CAMA 2020 S.*

[65] *CAMA 2020 S.487*

debtors' quality and intentions ex-ante and her behavior ex-post. A qualitative screening and monitoring should ensure better credit or protection, and this is a desirable result.[66]
When one of the parties to the contract needs to make transaction specific investment to fulfill the contract and when this cost cannot be shifted to the third parties in the market then, there is a danger that the other party to the contract will behave opportunistically and use this situation for self-enrichment (hold up situation)[67]. Opportunism as the complete or distorted disclosure of information, especially in calculated efforts to misled, distort disguise, obfuscate or otherwise confuse[68].

Because of the limited ability to obtain and process information regarding a transaction, the one party to the transaction will have more information or a different kind of information than the other party has, which creates for this party incentives to pursue own interest to the disadvantages of the other party to the transaction. Opportunism is the strongest form of pursuing own interest.[69]

Scheme of Arrangement

Section 710 (CAMA2020)[70] defined Arrangement as any change in the right or liabilities of members, debenture holders, or creditors of a company or any class of them or in the regulations of the company, other than a change effected under any other provision of this act or buy unanimous agreement of all parties affected.
Scheme of Arrangement and Compromise under ***Section 711 of CAMA***[71] may be adopted by companies though not in financial distress but to position itself for better capital reorganization and to maximize profits. Scheme of Arrangement and Compromise are regulated by law in order to protect the rights and investments of the shareholders and creditors of the company. Under the Nigerian law, a company cannot sanction a Scheme of Arrangement and Compromise without securing an Order of Court to validate it. Before the Order of Court is granted, the company is required to hold a meeting of all shareholders, creditors and debenture-holders disclosing to them the details of the Scheme and how it will affect their investments and the company as a whole.

The essence of this procedure is to the effect that the Scheme is in the best interest of the company and the creditors. And that the stakeholders of the company are not left out of any arrangement that may affect their investment and agree to the arrangement.

Meeting of creditors is used to define a meeting which has been set up by the company to formulate a scheme for an arrangement with the creditors (***Section 686 CAMA2020***)[72]. The Companies Act, gives out the power of the company to negotiate with the creditors and the mechanism by which it can be done. The creditors and the company can both approach the CAC, with different propositions in mind. The company would approach the Arbitration court for any kind of relief in which they can settle dues with the creditors. This is when the creditors take the defaulting company to court, a committee of creditors takes over the management of the company and an Administrator is appointed. [73]

Furthermore, an Administrator comes up with a resolution plan to resuscitate the company and settle the creditors. In the case of the company approaching the CAC, the

[66] *Ibid*(12)
[67] Igweike, Kingsley. *Nigeria Commercial Law: Agency,* Jos-Nigeria: Fab Educational Books p.134
[68] Washart , D. *Company Law in Context,* Oxford University Press (1994)
[69] Ibid p.135.
[70] *Section 710 of CAMA*
[71] *Section 711 of CAMA.*
[72] *Section 686 of CAMA.*
[73] *Section 539(1) of CAMA.*

management comes up with a plan to settle with the creditors. An informed decision would be when a company can predict that the creditors will approach the CAC and the company approaches the CAC under section whereby the management can retain control on the company[74].

Corporate Debt Restructuring (CDR)

CDR is a mechanism where the lenders to the concerned corporate can come together and form a forum to restructure the debt. The lenders see the company's business model and try to see if the problem being faced by them is temporary or permanent. Further, the banks take the help of specialists to help them assess the market and how that particular company is positioned. Post these forensic audits and analysis, they restructure the corporate debt lent to the company by rescheduling the payments so that the company gets a breathing space to sort matters out or give a top or an additional loan for stabilizing the operations of the company. All these activities form part of CDR.[75]

Any scheme of Corporate Debt Restructuring has to be consented by more than 75% of the secured creditors in value (***Section 715(2)***[76]. Further, the plan has to be given with the safeguards for the protection of other secured and unsecured creditors. Report by the auditor that the fund requirements of the company after the said restructuring shall conform to the liquidity test based upon the estimates provided by the board. Companies also have to give a statement to the effect, if they are proposing to adopt the corporate debt restructuring plan specified in the resolution. They have agreed to give an additional loan to make sure the company goes into operation to settle the debt owed to the creditors. This was done after they had 'satisfactorily' completed a forensic audit of the books and accounts of the company. The bankers are also expected to reassure the creditors where it will be shown that the company has a repayment plan which they will share with the creditors and are working towards secure funding. Companies can issue their shares at a discount to its creditors when their debts have been converted into equity in the pursuance of a resolution plan. Further, the companies who have defaulted in the payments of dues to any bank or any of the secured creditors will now have to take the prior approval of such lender before giving out managerial remuneration. There can be a cash flow monitoring by the creditors also.[77]

Summary

The interest of creditors, mainly the secured creditors are uppermost that they hold first charge on the company's assets as a guarantee on the loan advanced to the running of the company. They are also issued with a debenture certificate which gives them the advantage of being the first to be paid in the event of the winding up of the company. The Legal Personality doctrine which tends to shield the company from legal obligations as being distinct with owners of the business as separate entity can also be revoked when the promoters engage or carries any business in a reckless manner or with intent to defraud the creditors. All of these measures are geared toward ensuring protection to the creditor for the resources.

Conclusion

As noted above, the capital maintenance doctrine, first developed in the mid-19th century, is the premise on the rule that creditors provide a credit based on an express or

[74] Kaiser, D.B *Cases &Materials on Nigerian Company Law, Ile Ife Nigeria OAU Press Ltd (2013).*
[75] *Ibid(12)*
[76] *Section 715(2) of CAMA*
[77] *Ibid (12)*

implied representation, that consideration received for shares (the share capital) shall be applied only for the business and that it shall not be returned to the shareholders except in a winding up after all creditors have been paid. Whilst the doctrine of capital maintenance has developed principally for the protection of creditors, the rules also seek to protect shareholders, particularly the minority, from unequal treatment in selective distributions where only some shareholders receive benefits and dilute existing shareholders' rights [78]. In the United Kingdom, the key statutory provision embodying this "capital maintenance" rule is ***section 263 of the Companies Act 1985***.

This prohibits any form of distribution of corporate assets to shareholders except where the distribution value is less than that of the profits available for distribution. As the understanding of capital maintenance doctrine has evolved to prohibiting shareholders from taking undue priority in securing their interests, some of the rationales of the capital maintenance rules have become outdated and results in low efficiency of usage of corporate capital. Corporate capital is no longer the only factor for creditors to assess the company's credibility[79]. In fact, the capital maintenance principle has become less relevant nowadays because most companies only have a small issued share capital. Also, there have been arguments that considered the capital maintenance rules as unduly complex, often ill-targeted for their intended purpose, and somewhat overtaken by their exceptions. Though there have been slight reforms in clarifying and codifying the common law doctrine, it is not comprehensive enough. Also, it has been argued in some quarters that the reforms have generated conflicts between capital contribution rules and capital maintenance rules. While the UK, Australia, and Singapore have reformed their capital maintenance rules in recent years, each with some variations to suit their particular circumstances, the US and New Zealand have moved away from the capital maintenance regime to a general "solvency test" approach[80]. The theory underpinning the solvency test approach is that the law should focus on the core risk at stake – insolvency of the company – since this is the only condition in which creditors will be left unpaid. All forms of distribution to shareholders, including payment of dividends, capital returns, and buy-backs, are allowed provided that relevant solvency tests are met, without distinguishing between payment from capital or profits.

The argument for this method is that creditors are more concerned with a company's solvency than the preservation of its share capital[81]. Presently, the UK applies only the cash flow test of solvency in the non-court sanctioned reduction of capital process and the exception to the prohibition on buy-backs – which is a good step in the right direction.

Recommendations.

However, the researcher recommends that the solvency test currently used in the UK (which is basically a cash flow test) be modified by including a balance sheet test. The cash flow test basically requires the company to meet all debts as they fall due, whilst the balance sheet solvency test requires that liabilities must not exceed assets. In this way, creditors would be adequately protected under the Company Law in Nigeria.

[78] *Ibid(7) p.511*
[79] *Ibid(27) p.6*
[80] *Ibid (13) p.8*
[81] *Ibid (12) p.453*

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