VIABLE REVIVAL MECHANISM FOR COMPANIES IN DISTRESS: A CRITICAL ANALYSIS

Shanthi Segarajasingham
Senior Lecturer
Department of Commercial Law, Faculty of Law
University of Colombo,Sri Lanka
e-mail: shanthisegha@yahoo.com

ABSTRACT

Companies are legal fictions created mostly with a profit making motive except a few charitable or not for profit entities. A company during its life time may encounter financial difficulties due to many reasons. The Winding-up of companies in situations of continuous losses will be insolvent winding-up which is considered to be the last resort given the serious repercussions it would have on all stakeholders. On the other hand, in the event of a sudden collapse the consequences would be disastrous, it would result inter alia in creditors being unpaid, shareholders not getting their returns, employees losing jobs, society losing the benefits it received by way of corporate social responsibility and the State facing a downfall in the economy. Many countries have had such dreadful experiences of sudden collapses during the last two decades and Sri Lanka is no exception. Hence, it is essential that sick companies take timely measures to revive and regain their business status. Company law of modern States has provided for revival methods such as Administration, Compromise with Creditors, Amalgamation or Take-over. It is up to the respective sick company and its board of directors to adopt a tailor-made revival method since all modes will not suit every situation. If the revival method used is unsuccessful, the company may have to incur more losses including revival cost. Therefore, not only timely action but also the selection of the most appropriate mode of revival is obligatory. The writer seeks to analyze and compare the revival mechanism available under the laws of Sri Lanka and the laws of Malaysia and the United Kingdom in order to suggest reforms to existing law in Sri Lanka. The writer also envisages looking into the practical difficulties in each mode and suggesting appropriate mechanisms which would suit the particular needs of companies in distress.

Keywords: Companies in distress, revival

INTRODUCTION

The History of companies runs to more than five centuries and its study reveals that the legal term company is a creature for trading for the purpose of sharing profits. Togethernessthrough the medium of companies for the purpose of economic advancement gained widespread popularity very soon globally. This brings in the assumption that the term company encapsulates within it that it exists for giving financial returns.

Failure of objectives is quite common to mankind. When the motive of making profits fails the company enters into an arena of difficulty. Losses in businesses will gradually bring the company to a situation where either the company is unable to pay its dues or the liabilities of the company are more than its assets. This may be due to shortcomings on the part of the board or a failure to respond to competitive, economic or political changes; obtaining excessive loans at high interest; global economic conditions; natural disaster or any other similar issues.

Whatever it is, the consequences of business failure would bring in many issues not only in the legal sense but in the economic sense as well. The law provides situations in which a company would become insolvent asit would bring about serious repercussions. The demise of a company would result in its employees losing their jobs, creditors going unpaid, the goodwill of the company gettingtarnished, shareholders not getting their returns and the economy of the countrywould suffer. It is due to these reasons that rescue mechanisms have been introduced to provide for ways and means for companies in distress to revive themselves to their usual business lives.

WHAT IS RESCUE?

There have been bitter experiences of sudden collapses of companies in the business world. Hence,the aims of company law have changed in the recent past and moved one step forward towards creating a rescue culture. Rescue means saving from dangerous or distressing situation. 'Business rescue' generally means and includes proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for temporary supervision of the company and of the management of its affairs, business and property; or a temporary moratorium on the rights of creditors against the company or in respect of property in its possession; or development and implementation of a business rescue plan to suit the particular circumstances. In general terms corporate rescue is the process under which companies in financial crisis attempt to rescue themselves from an insolvency situation.

Companies may adopt easy informal methods tocover a range of different situations. They may agree for a consensual arrangement whereby the debtor company is prepared to restructure its balance sheet by obtaining new finance in return for the creditor acquiring an equity stake or a release of debt in return for shares. This may take place outside the legal framework.The law has provided few methods of revival of companies in distress and it is up to the distressed company todo a timely selection of the right method to get maximum benefit out of it. These revival methods are provided with the narrow idea of helping individual firms as well as with the broad idea of protecting the economy of the country.

It is correctly said by Cook and Pond that the law has an important influence on how financial distress will be tackled intwo fundamental ways. Firstly, the legal framework has an influence on thecosts and benefits of formal rehabilitation and liquidation procedures andtherefore also on their relative attractiveness. Secondly, particularly where insolvency law is pro-creditor, the threatof a formal insolvency procedure may improve incentives for an informalworkout.[1]

The establishment of a variety of efficient and effective rescue mechanisms put forward challenges to countries when those are adopted. Each method has its unique characteristics and involves different issues for consideration. It is essential that a proper balance is maintained between debtors and creditors, the role of the board that existed at the time of crisis and the extent of involvementof court. In any method, the crucial question is whether it is creditor control or debtor control. The latter one is known as the debtor-in-possession model which has shown success practically whereas the former is known as ‘creditor wealth maximization’ which is the paramount important concept in insolvency liquidation.Andrew Godwin opines that the creditor models in company rescue faces problems.[2]

STATUTORY DIRECT RESCUE MECHANISMS

COMPANY ADMINISTRATION PROCESS

The term Administration in the sense of companies in distress has a technical meaning. Administration is a very powerful process carried out by an officer called Administrator by gaining control of a company that is facing serious threats from creditors. This would be an alternative to liquidation or may be to avoid receivership or liquidation and would provide only a temporary breathing space for companies to revive themselves from the enforcement actions of the creditors. The Companies Act of most jurisdictions regulates Administration process.

In the UK, originally the Administration process was introduced by the Cork Committee through Part II of the Insolvency Act 1986 (IA-UK) to pave way for a rescue culture.[3] The present law on Administration is dealt under s. 248 of the Enterprise Act 2002 (EA-UK) which substituted a new Schedule B1 to Part II of the IA-UK.[4] This new regime is the result of a series of Consultations and Reports on the low number of Administration process since the introduction by IA-UK. One of the Reports suggested that,

> ‘The recognition of Administration as an important tool in providing a company in financial difficulties with a breathing space in which to put together a rescue plan or, alternatively, in providing a better return to creditors than would be likely in a liquidation, has increased steadily in recent years. Nonetheless, if Administration is to become a fully efficient procedure in all circumstances, it will need to be streamlined.’[5]

A historical analysis revealed that court-based Administration procedure under the former regime was cumbersome and not serving the objectives for which it was created. As a result the EA-UK provided for both court-based as well as a procedure without a court order.[6] Prior to the EA-UK, a floating charge holder was entitled to appoint an Administrative Receiver. Under the present EA-UK a qualifying floating charge holder, the company, majority of its directors or a combination of the above are empowered to appoint an Administrator.[7]

[1]Cook, G. and Pond, K., 2006, ‘Explaining the choice between alternative insolvency regimes for troubled companies in the UK and Sweden’. European Journal of Law and Economics, 22(1), pp 21-47

[2]Andrew Godwin, ‘Corporate Rescue in Asia – Trends and Challenges’, 2012, 34 Sydney Law Review, 163. The author quotes *inter alia* case studies of *Deutsche Bank AG v. Asia Pulp & Paper Co. Ltd* [2002] SGHC 257 & [2003] SGCA 19; *Re Legend International Resorts Ltd(No.3*)[2006] HKLRD 289 & [2006] HKEC 2157 in support of his view.

[3] However, the IA-UK did not give full effect to the Cork Committee approach.

[4] Although the EA-UK made certain important changes to the existed Administration regime, some provisions of the EA are similar to the IA and therefore Part II of the IA was not totally repealed. Instead, remains and will be relevant where the new EA provisions are identically worded as IA.

[5]Productivity and Enterprise: Insolvency-A Second Chance (Cm 5234 The Insolvency Service 2001) cited by Girvin D.Stephen& others, Charlesworth’s Company Law, 18th Edi, p.666

[6]Under the earlier IA, apetition forAdministration order must be filed. Under Para 2 of the EA Administrator may be appointed by an Administration order of the court.

[7]Para 2

The EA-UK provides for the following three objectives for Administration:

i) rescuing the company as agoing concern; or
ii) achieving better results for the creditors as a whole than would be likely in a winding-up; or
iii) realizing property in order to make a distribution to one or more secured or preferential creditors.[8]

Objective i) must be pursued by the Administrator unless he thinks that it is not reasonably practicable or objective ii) would be better in the particular circumstances. Objective iii) would be the last option and should be resorted to only when i) and ii) have failed. The Administrator should ensure that the interests of the company's creditors as a whole are not harmed. The Administrator appointed is considered as an officer of court and the qualification required of him is specified in the Act. However this is not the case in Sri Lanka.[9]

If the debtor company chooses to have the Administration process with a court order, an application to court for an Administration order may be filed by the company, the directors of the company or by one or more creditors of the company.[10] On hearing such an application the court may make the Administration order, make an interim order, adjourn the hearing or treat the application as a petition for winding up and make appropriate order. An Administration order for the appointment of Administrator by the court will be given only when the court is satisfied, according to the circumstance of the particular case that the company is or likely to become unable to pay itsdebts and an Administration Order is reasonably likely to achieve the purpose of Administration.[11] In this regard it was held in *Colt Telecom Group Plc, Re* [12] that the court must be satisfied that it is more probable than not that the company will become unable to pay its debts. However, in the case of *Logitext UK Ltd. Re*[13] a company had not traded for some time and had no assets except the claim against its own directors. The court considered the purpose of achieving a better result for the creditors than would be likely on a winding up. Although liquidation was an alternate to Administration in this case, the provision of funding might not be available in liquidation, but in Administration it was reasonably likely to be achieved, was the opinion of the court. Further, the court may order Administration even if the majority of the company's creditors object to it, as in *Professional Computer Group Ltd. Re.*[14] Further, it was held in *Auto Management Services Ltd v. Oracle Fleet UK Ltd* [15]that 'if it can be shown that the Administration will, in all but the most unlikely of circumstances, produce a result no worse than a liquidation and that is reasonably likely that the result in an Administration will be better, then an Administration will be made'. For example, if a 'pre-packaged' sale of a business of a firm of solicitors is proposed and the proposal will bring in the intervention of Law Society which will preserve the value of the firm's work in progress, an Administration order will be given, as in *DKLL Solicitors v. Revenue and Customs Commissioners*.[16] However, if the company's debts were under dispute and at the same time the Administrator's proposal is vague, the court may refuse to grant Administration order as in the case of *Corbett v. Nysir UK Ltd.*[17]These cases indicate that the court do a careful analysis considering all relevant circumstances before any order is given.

The above mentioned ready-made plan known as pre-pack Administration process is practiced well in the UK. It is a process of selling the assets of a company immediately after it has entered the process of Administration. The company prepares itself to enter administration and sells its assets to a new company or to an existing third party company. Sometimes the previous directors or management purchase the assets of the company from the Administrator and set up a new company. This process has a special advantage and that is, it enables the administrator to realize a greater amount for the assets due to business continuity and also it allows the goodwill of the company to be preserved. The employees of the company are also usually absorbed by the new company. Pre-packs have attracted criticism because of the appearances it gives to unconnected parties that the company has just continued without its creditors. [18]

Moratorium is the aspect that stimulates debtor companies to go for Administration process. No resolution may be passed for the winding up of the company, no step may be taken to enforce security over company's property, no steps may be taken to repossess goods in company's possession and no landlord may exercise the right of forfeiture during the period of

[8]Para 3(1)(a), (b), (c) Sch B1 EA -UK
[9]Qualifications for the Administrator as per s.390 IA-UK are that he should be an individual and be qualified to act as an insolvent practitioner either by virtue of membership of a recognized professional body (such as accounting bodies, Insolvent Practitioners Association etc) or by a direct authorization granted by a competent authority.
[10]Para 12. Application may also be filed by the justices' chief executive for a magistrate's court by virtue of powers vested under the Magistrate's Court Act 1980
[11]Para 11
[12][2002] EWHC 2815
[13][2004] EWHC 2899
[14] [2004]EWHC 1761
[15] [2007] EWHC 392
[16] [2007] EWHC 2067
[17][2008] EWHC 2670. Also see Girvin D.Stephen & others, Charlesworth's Company Law, 18th Edi, p.668
[18]See: Wikipedia

moratorium.[19]The period of moratorium is the breathing space given to the company to go ahead with the rescue process without fear of enforcement actions by creditors. Moratorium will be in force until such time the Administration is in process.

The new Administration procedure in the UK is expected to be exceedingly flexible and capable of being employed in similar fashion to the earlier procedure. It seems likely, therefore, that the take-up rate of the new procedure would be considerably higher than under the old law—as desired by the Review Committee.[20]

The Companies Act No.7 of 2007 of Sri Lanka (hereinafter referred to as CA-SL) provides for a separate Part on Administrators which did not exist under the predecessor. This particular Part XIII introduces simplified Administration procedure on the initiative of the board of the company without an order form the court, however subject to certain other restrictions. At the same time the Act provides that the Administrator can seek the assistance and/or guidance of the court by obtaining directions in relation to any matter arising in connection with carrying out his functions. [21]

The CA-SL provides for two situations under which the company would need to resort to Administration.

(a) When the company is or is likely to become unable to pay debts as they fall due;[22] and

(b) The appointment of Administrators will be likely to achieve -

(i) the survival of the company and the whole or any part of the undertaking as a viable concern; or

(ii) the preparation and approval of a compromise with creditors (under Part IX of the CA-SL) or a compromise or arrangement for amalgamation and compromise by court (under Part X of the CA-SL); or

(iii) a more advantageous realization of Company's assets than would be likely on a winding up.[23]

The phrase used in situation (a) above is similar to the phrase used for the solvency test.[24] It is clear therefore that the provision for Administrators is available when the company is likely to become insolvent. Situation (b)(i) above is an explicit provision for the survival and (b)(iii) is a step to safeguard creditors and shareholders who will be affected if the company goes for insolvent winding up.

It is the duty of the board of the company to pass a resolution to seek Administration by specifying the purpose. The board cannot go back on their resolution once passed without the leave of court.

The CA-SL has given a very short span of time for the Administrator to function which shows that the law recognizes rescue as an emergency. Accordingly, the Administrator so appointed has to summon an initial meeting with the creditors within 10 working days of appointment (S.404(1)); within 2 months after the initial meeting the Administrator shall prepare his proposal (s.406(1)); call a meeting with creditors to consider the proposal from 5-10 days after the dispatch of the proposal statement (s.406(2)); give notice of the result of the meeting with creditors within 10 working days (407(3)); if the proposal is not accepted the Administrator shall cease to hold office 5 working days after the meeting (s.407(5)); if there are revisions to the proposal, such revisions have to be placed before the creditors. The Act has failed to specify a time frame to work on a revised proposal. However, the meeting of creditors to consider the revised proposal shall be convened within 5-10 working days after the dispatch of the revision (s.409(2));

Instead of specifying the qualifications for an Administrator the CA-SL provided for disqualifications which too are very general. As mentioned earlier, the EA-UK provides that only an insolvent practitioner can be appointed as an Administrator.

In the exercise of his powers, the Administrator is deemed to act as the company's agent[25] and upon appointment he would take custody or control of all the property to which he thinks the company is entitled to. He would also manage the company's affairs.[26] The duties of an agent under the law of agency encapsulate within it the fiduciary duties. Hence, whether the Administrator would have fiduciary duties of good faith, duty of care and skill and not to make secret profits etc is a question.

[19]Para 42 & 43 of EA-UK. S.405 of Companies Act of Sri Lanka provides similar, but without use of the term moratorium.
[20]See: Armour J, 'Reforming the Governance of Corporate Rescue: The Enterprise Act 2002', ESRC Centre for Business Research, University of Cambridge Working Paper No. 289, *citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.167..*
[21] S.416(2)
[22] S.401(1)(a) CA-SL
[23] S.401(1)(b) read with 401(2) (a),(b) & (c)
[24]S.57(1)(a) CA-SL. See 4.1 of this writing
[25] S.416(5) CA-SL
[26] Ss.416 & 417

Moreover, another important point under the Sri Lankan law is that the Administrator is personally liable on a contract entered into by him in the exercise of his powers and for the payment of wages that during his administration, accrue under a contract of employment entered into before his appointment and no termination notice was given.[27]It is submitted that a provision of this nature may discourage genuine professionals from taking up the position of Administrator. However, the Administrator is entitled to get his personal liability indemnified out of company's assets.[28] It is to be noted that under the UK law the Administrator is an officer of the court and not personally liable for any contracts he or she enters into on behalf of the company.

COMPROMISE WITH CREDITORS

Another way of carrying out restructuring is by way of entering into arrangements with creditors. This is less procedural than the Administration process. Under this the debtor company may establish the key parameters that encompass creditor compromises, the rescheduling of liabilities and the connected formal arrangements without the involvement of court. This has to be done after a thorough diagnostic review of the affairs of the company especially the real extent of the financial problems after reviewing the legal documents of the creditors of the company, their entitlement and priorities. It is observed that the chances of compromise being successful are unpredictable in this process.

The CA–SL provides in Part IX compromise with creditors. The proponent[29] may propose compromise and compile a list of creditors who would be affected by the proposed compromise. It is important that the compromise proposal should be accepted by the creditors. Once accepted, the compromise would bind both the company and creditors.[30] As in the Administration process, the proponent may apply to court to obtain directions relating to the procedural requirements of the Act or to waive or vary any such requirements.[31] The Act cautiously retains the rights of creditors to apply to court for relief when there is insufficient notice of meeting of the creditors, there was material irregularity in obtaining the compromise or it is unfairly prejudicial to the creditor who voted against the compromise.[32]

In the UK the Company Voluntary Arrangement (CVA) is an informal agreement or compromise between the company and unsecured creditors. But once entered, it binds both parties. It is normally used to avoid or supplement any insolvency procedure such as liquidation or Administration. Creditors can propose a CVA and appoint a licensed insolvency practitioner as a nominee who will be duty bound to report to court as to whether the proposed CVA has reasonable prospects of being approved and implemented and whether it should be put to the creditors and members. If he believes so he will have to summon a meeting of creditors and members as it is or with modifications. The Law provides that it has to be approved by 75% of the creditors. Descending creditors are also bound by it, but not the secured and preferential creditors. Once approved, the nominee is responsible for its implementation under his own supervision. Small companies mostly use this by taking advantage of the optional moratorium of between 1-3 months.

Creditors Scheme of Arrangement in the UK is a court-approved compromise between the Debtor Company and creditors or class/es of creditors.[33] This does not include a moratorium on creditor action unless it is implemented in conjunction with formal insolvency proceedings. It can otherwise be implemented as a standalone basis by the company's directors. Company or any creditor may seek court order to propose compromise between company and creditors or a class. It is binding on all members of the relevant class once it is approved by a majority and sanctioned by court.[34]Since it binds both secured and unsecured creditors, the claims of secured creditors can therefore be compromised without their individual consent. The alternative procedure of CVA does not allow this. A CVA is generally used as a tool to push a debt restructuring through to completion, imposing an agreed solution on dissenting creditors, while Schemes of Arrangements are sometimes seen as being more complex and costly solutions than CVAs, and especially when dealing with secured claims, CVA is said to be not an available option.

Malaysian law does not provide for voluntary administration. However, Part VII of the Companies Act 1965 of Malaysia consists of provisions relating to Arrangements and Reconstruction. S.176 under this Part allows a company, any creditor or member of the company to make an application to court and propose a compromise or arrangement between a company and its creditors or any class of them. On such an application the court may order that a meeting of creditors concerned be summoned in such a manner as the court directs. It is vital to point out at this juncture that the CA-SL provides for a Schedule under the Act to govern proceedings of the meeting of similar nature.[35] The compromise proposal under the Malaysian law will be accepted by court when it is approved by 75% majority of creditors which is similar to other jurisdictions. Mak Lin Kum is of the view that when companies encounter economic downturn it is almost impossible to seek a compromise with each creditor individually as

[27] S.421(1) CA-SL
[28] S.421(7) CA-SL
[29]Proponent means the one who proposes the compromise proposal and it can be the board, the receiver, the Administrator, a liquidator or (with leave of court) any creditor or shareholder.
[30]S.250
[31]S.252(1)
[32]S.252(3)
[33] Part 26, Companies Act 2006
[34] See: Slaughter & May, 'An Introduction to English Insolvency Law', Nov 2011, evanflaschen.nt/UKInsolvency summary
[35]S.250

terms of compromise will not be standard and there will not be sufficient time to negotiate with creditors on a one to one basis.[36] Hence, scheme of arrangement may serve the purpose.

A successful compromise programme was reported in Origin Pacific Airlines. 345 creditors of the airlines were asked to vote on a rescue plan in an effort to stave off receivership or liquidation. Under the plan the airline's main unsecured creditors would get 40% of the $11.4 million owed to them over 5 years. Creditors who were owed less than $10,000 would be paid in full. This was in conflict with the usual practice in insolvency. It was said that the flexibility of the compromise contributed to its success. Unsecured creditors agreed to such payments of 40% on the basis that it was better to let the company trade on and pay them the balance later rather than receiving nothing in an insolvent liquidation.[37]

AMALGAMATION

Amalgamation is generally possible when the businesses of two companies are similar or one is very closely connected to the other. This is carried out not only as a rescue plan but also to cut cost. Under this process two companies will amalgamate and continue as one.[38]

TAKE-OVER

Take-over is an acquisition by the bidder company or the offeror company of a target company on obtaining approval from its board. This process involves many technicalities and procedures.[39] Under this method the target company that is facing financial downfall may be rescued by the offeror company. There are many types of take-over, such as, friendly take-over, hostile take-over, reverse take-over and backflip take-over available to suit the different needs.

INDIRECT MECHANISMS

Other than the above, the law has provided for certain mechanisms for companies to adopt to lead a healthy life. The main reason for the business failure of majority of companies in risk has been non-adherence to such strict discipline.

4.1 SOLVENCY TEST

The Solvency test is a financial discipline for all corporate entities and considered as a golden thread that runs through the fabric of the Companies Act. The solvency test ensures whether the company at any given moment is financially healthy or not and if not what steps ought to be taken by the company and the responsibility would lie with the board of the company. Solvency test is compared to a warning light of a fuel meter in a vehicle which blinks and informs the driver when the fuel level is low.[40] CA-SL provides that company is not solvent either when it comes to a situation that it is unable to pay its debts as they fall due or when the assets of the company are lower than the liabilities and the stated capital.[41] Nevertheless the law is not expecting the companies to be solvent all the times. Situations under which the solvency test has to be satisfied are provided and those are when distributions are made, when the capital is reduced, when the shares are redeemed and when the company gives financial assistance to acquire its own shares.[42] The latter three situations may be rare occurrence but the 1st instance occurs every year. The financial year-end profit and loss accounts and the balance sheet will reveal whether the company is in a position to give distribution.(Most known distribution is dividend.) It is a common law rule that dividends cannot be paid out of capital. Hence, the financial position that the company is not in a position to earn profits for a particular year will give a signal to the board to be cautious. The board that ignores such a signal would only end up in a financial crisis. A vigilant board will try to satisfy the solvency test not only when it is statutorily required but at all times possible. Prevention is better than cure is a good old tailor-made proverb for this type of situation.

4.2 ENFORCING DIRECTORS' DUTIES

The cause for collapse of companies has been mismanagement of the board in most cases except a very few where the causes may be other as said in the beginning of this writing. It was observed that no serious concern was given to the directors' duties in the previous Companies Acts. This was remedied by many States and director' duties are given prominence when the new (present) Companies Acts are enacted.[43] One of such directors' duties under the CA-SL is the duty of directors when the company is unable to pay its debts as they fall due. In such a situation the director whoever becomes aware shall forthwith call a

[36] Mak Lin Kum, 'Corporate Restructuring', 1 March 2009, http://www.iflr.com/Article/2117391/Corporate-restructuring.html
[37] Source: John McDermott, Understanding Company Law, LexisNexisNZ Ltd, 2011, p.214
[38] Part VIII of CA –SL & s.178 of Companies Act of Malaysia deal with amalgamation. Part 27 of Companies Act 2006 (UK) deals with Mergers.
[39] In the UK – Part 268 of the Companies Act 2006and in Malaysia s.179 of Companies Act deal with take-over. In Sri Lanka the procedure is governed by a Take-over & Mergers Code. 3.3 & 3.4 are merely mentioned without much details since it is not possible to analyse take-over &Amalgamation in detail in a short article.
[40] See:Harsha Cabral, Companies Act No.7 of 2007 and the Corporate Law of Sri Lanka, 2007, p.67
[41] S.57
[42] Ss. 57, 61, 67 and 70 respectively
[43] For example, the Companies Act 2006 of the UK and Companies Act 2007 of Sri Lanka

meeting of the board to consider whether the company should apply to court for winding up.[44] Although this can be considered as a welcome move that the law does not want the company to incur more and more losses by continuing the business, a question that arises is why the Act has not provided for an alternate rescue mechanism at a time when the company is unable to pay debts.

4.3 CORPORATE GOVERNANCE

Corporate Governance (CG) should be the underlying concept on which all modern companies carry on their business. Irrespective of the type, all companies should adopt the CG principles. If the company is governed properly it is very unlikely that it ends up in a financial crisis situation. The stock exchanges have implemented mandatory CG codes. In addition the companies should adopt self-governance codes or best practices which will take them in the long way with financial stability.

It is pertinent to mention at this juncture a real incident of restructure of Seylan Bank PLC (the bank) in Sri Lanka during 2009. The bank was the fifth largest bank in Sri Lanka with approximately 4,000 employees and had assets worth over SL Rs.100 billion. In December 2008, the bank was confronted by an unexpected crisis consequent to the fall of another company in the same group. Members of the public started pulling out their deposits from the bank and in few days the withdrawal amounted to SL Rs.7 billion. A run that could have been catastrophic was halted with the intervention of the Government and the Central Bank of Sri Lanka. The board was dissolved and a new board was appointed for this purpose. It was possible to revive the bank because of timely action.[45]

CONCLUSION

The aim of any restructure mechanism should be safeguarding the life of the company which is in crisis which involves creditor sacrifices. Lessons have shown that taking the right decision at the right time by selecting the appropriate mode will bring life back to the company. Success of any revival mechanism depends on the decision of the creditors and therefore the proposal should be prepared in a convincing manner taking into consideration all relevant factors. The expertise of the individual who is appointed to the office of Administrator is another crucial matter because the success of the whole process of Administration depends on his objective handling of company's affairs with a view of giving oxygen to the company while not allowing creditors to suffer more than in an insolvent liquidation. The UK law in this regard correctly stipulates qualifications for the Administrator. In the point of view of the creditors, the revival methods (whatever the mode it may be) will be welcome by them since an insolvent winding-up is always procedural, time consuming and unpredictable as to the full settlement. In addition, they will be attentive that they will lose business if they are inflexible. Further, laws have now formulated an order of priority for settlement of debts at winding-up and private unsecured creditors will be the last in such an order. The fear in the minds of creditors that they may be unpaid in an insolvent liquidation should be considered as strength to the board that proposes a rescue mechanism. A board that is mindful of the interests of the stakeholders will always choose a rescue method while a self-centered board might allow the company to die. In Sri Lanka, rescue mechanisms are not very popular due to the dearth of insolvency practitioners. The sudden collapse of Golden Key Credit Card (Pvt) Ltd resulted in filing cases in more than one court claiming more than SL Rs.350 million, creditors forming associations and some grief stricken creditors taking their own lives. The question is whether a lesson was learnt that rescue would bring in better results for all rather than allowing the company to die. An association bearing the name Business Recovery and Insolvency Practitioners Association has been formulated recently to overcome this problem. The writer hopes this association will have awareness programmes to brainwash the minds of the board members to take timely actions to save the life of the companies in crisis in the best interest of all stakeholders.

[44] S.219
[45] See; The Case Study, A Closer Look at the Extraordinary Efforts that Restored Financial Stability to Seylan Bank, Seylan Annual Report 2009