

# INSOLVENCY LAW: BALANCING THE INTERESTS OF CREDITORS AND DEBTORS

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# DEFINITION OF INSOLVENCY

“The state of things which exists when a man, being unable to pay his debts, his solicitor and an accountant divide all his property between them.”

# The Effects of Bankruptcy and Insolvency

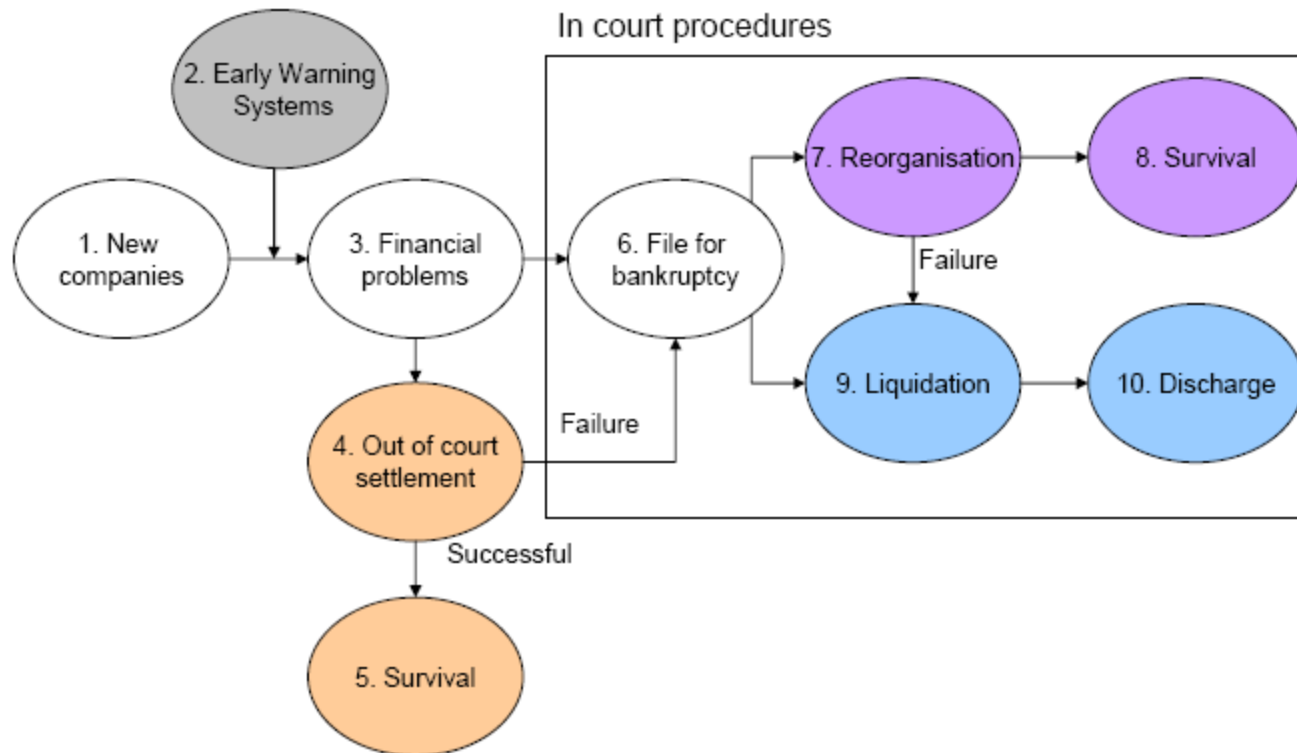
Bankruptcy and insolvency spells tragedy for:

- \* The individual bankrupt
- \* The indebted business owner
- \* Families
- \* Employees
- \* Banks and other creditors
- \* The broader community
- \* The economic development of countries

# Overview of the Bankruptcy Process

European Commission, Enterprise and Industry Directorate-General  
Report of the Expert Group

Figure 1. Overview of Bankruptcy Process



# The Financial Meltdown of the 1990's

Between 1995 and 1998, “...six commercial banks (accounting for 60 % of deposits in the population of nine commercial banks, five life insurance companies accounting for over ninety per cent of premium income in the business, one-third of all merchant banks, and several building societies have been found to be insolvent and closed... by March 1997 the Bank of Jamaica had to provide about J\$18 billion of special support to commercial banks in order to help them to meet withdrawals by depositors in the banks themselves and in affiliated insurance companies.”

Gladstone Bonnick, “Storm in a Teacup: Crisis in Jamaica’s Financial Sector” Adlith Brown Memorial Lecture Delivered at the Thirtieth Annual Conference of the Caribbean Centre for Monetary Studies held in Nassau Bahamas, October 1998 (Final version May 1999).

# The Financial Meltdown of the 1990's

The main factors commonly cited for contributing to the crisis:

- \* Mind-set of domestic entrepreneurs
- \* Management of financial institutions
- \* Macroeconomic policy
- \* Deficiencies in the regulatory environment
- \* Liberalization of the capital account
- \* Deficiencies in information flow.

# The Financial Meltdown of the 1990's

“... towards the end of 1996, the Government decided to adopt a comprehensive approach to the problems of institutions in the sector rather than to deal piecemeal with individual cases. In January 1997 FINSAC – The Financial Sector Adjustment Company was set up to deal with the troubled institutions.” Gladstone Bonnick

There were 3 phases which FINSAC needed to complete over a five to seven year period:

- \* Intervention
- \* Rehabilitation of institutions and strengthening of the regulatory and supervisory framework of the sector.
- \* Divestment of assets, review of the legislative framework, recovery of capital support and winding down of FINSAC operations.

# The Financial Meltdown of the 1990's

Rehabilitation had its' challenges, not least of which was the current insolvency regime, which has limited mechanisms for saving companies in the vicinity of insolvency.

Compromises and arrangements can be made between a company and its creditors with rights available to shareholders to apply to the court to order a meeting of creditors to sanction any arrangement or compromise.



# The Financial Meltdown of the 1990's

Schemes of Arrangement proved a useful mechanism during our financial crisis e.g. Blaise Financial entities and Century Financial entities, allowing the depositors in those institutions to be paid out entirely or substantially by the government through the Financial Institutions Services Limited in exchange for the transfer of all assets to Financial Institutions Services Limited, including the right to bring actions in the name of the entities.

National Commercial Bank benefited during the financial sector crisis from re-structuring through a member/shareholder

# The Financial Meltdown of the 1990's: Problems with Schemes of Arrangement

1. Procedure of calling a meeting of creditors and getting the required majority vote is complex and time consuming.
2. The court must sanction the scheme and the order must be filed with the Companies Office of Jamaica.
3. There is no power to prevent action being taken by creditors against the company to recover their debts or to petition for winding up until the court has sanctioned the scheme of arrangement

# The Financial Meltdown of the 1990's: Problems with Receivership

1. It is a creditors' remedy.
2. The duty of the receiver is to realize debt of the creditor who has secured his appointment.
3. The receivership regime does not provide real opportunities to consider a wider group of stakeholders.

# The Financial Meltdown of the 1990's: Problems with Liquidation and Winding-Up

1. Contemplates the termination of the life of the company unless interrupted.
2. Does not contemplate rescue and rehabilitation.

# The Financial Meltdown of the 1990's: The Problem of Unlimited Guarantees

“Personal guarantee of the guarantor, if unlimited, will continue to accumulate interest, It is clear from the wailings in the Finsac Enquiry that guarantors did not fully appreciate the implications of an unlimited guarantee.”

Marshall Hall, Jamaica Gleaner March 4, 2011

# Considerations in Favour of Debtors

## Unlimited Guarantee Provisions:

The UK Lending Code states that lenders should not take unlimited guarantees from individuals (other than to support liabilities under a merchant services agreement which, broadly speaking, would cover credit and debit card services provided to businesses). This applies to the capital amount, not interest or charges which can be uncapped.

# Considerations in Favour of Debtors

## Exemptions:

Some states in the USA provide for exemptions” or “exempt property” under their relevant Chapter 7 and Chapter 13 bankruptcy legislation. A debtor may keep all “exempt” property regardless of its value and amount. Florida has unlimited homestead exemptions in most cases and limited exemptions for other assets.

# Considerations in Favour of Debtors: Moral Hazard

Moral hazard occurs when an individual or an institution is insulated from the adverse consequences of its actions.



# PROPOSED INSOLVENCY ACT: Balancing Act?

One of the declared public policy objectives of the Committee:

To recommend the appropriate legislative changes with a view to primarily creating an environment which aids in the rehabilitation of debtors and the preservation of viable companies having due regard to the protection of the rights of creditors and other stakeholders; and a fair allocation of the costs of insolvencies, with the overriding interest of strengthening and protecting the country's economic and financial system.

# Recommended Provisions in Favour of Debtors

- \* Threshold and Acts of Bankruptcy
- \* Exemptions
- \* Proposals (even where on the path to insolvency?)
- \* Debtor in Possession Financing

# Recommended Provisions in Favour of Creditors

- \* Preservation of the rights of the secured creditor under current legislation subject to the proposals for rehabilitation of insolvent persons.
- \* Extension of the definition of “secured creditor”.
- \* Assets not available for distribution.
- \* Creditor preference from distributable assets.
- \* Certainty in cross-border insolvencies.

# DEBTORS AND CREDITORS SHARING THE BURDEN CONCLUSION

“If we as a society, support risk-taking behaviour because of the prosperity it brings, then we, as a society, must also be willing to bear the cost of failures - within reason – and to forgive instances where the taking of risks has a negative outcome.”

“... the level and depth of insolvency and economic prosperity are linked.”

Report of the Standing Senate Committee on Banking, Trade and Commerce, Canada November 2003

# THE END

THANK YOU FOR YOUR ATTENTION