

INSOLVENCY & INVOLUNTARY WINDING UP OF LEGAL ENTITIES

Description is provided herein, of a process whereby a business entity is confirmed as being unable to pay its debts. Such a business entity is said to be insolvent. The state of insolvency puts a business entity in a situation where it may be declared as such, by the court, and thus susceptible to winding up or to judicial management. The primary objective of providing this description is to show to the reader that the aim of the law of insolvency is to protect the interest of members of public. Insolvency is part of the business cycle although not a very bright factor in business – it is like death to a life cycle. As such it cannot be wished away.

The Business Cycle

Business and natural life are similar. A business has to be planned and conceived. It is given a name, which in most cases has to be registered under the law. It is nurtured through the injection of finances, implemented, monitored and has to undergo evaluation. Legal entities in particular, are businesses regulated by Companies Act 1967; and in cases of financial services providers, also by Financial Institutions Act of 1999. The planning, implementation, monitoring and evaluation take place within the confines of the Companies' and the Financial Institutions Acts respectively. The main objective of the legal control and monitoring of business entities is to protect the welfare of members of public against misfortunes of, and in some cases, the otherwise untoward behaviour of some business entities.

Industry

A cluster of business entities operating along the same principles *i.e* offering similar service or product is known as an industry. The following are some examples of industries found in the Lesotho economy:

- Health,
- Manufacturing,
- Education, and
- Financial services.

The list is endless.

Government's fundamental role is to guard against abuses by enacting and enforcing laws to guide, control and police business and other activity happening around society. Focus herein is placed on the control and regulation of the Financial Services Industry.

The Financial Services Industry

The sustenance of all life revolves around the activities of the financial industry. Money undoubtedly makes the world go round. However, this industry also has its own ups and downs. When the financial industry is experiencing hard times all life is adversely affected. Under the law financial institutions which operate banking services have to register as companies under the Companies' Act 1967.

Incidences Of The Downfall Of Some Financial Services Providers

A. Internationally

During the course of the year 2010 news media around the world reported on the case of a man called **Madoff**. He had for many years operated a **hedge fund**. Under this fund amounts received last were used to defray claims by earlier investors. The fund was distressed when, due to the credit crunch of 2010, many of its investors claimed their amounts all at the same time and it became evident that the fund could not sustain the payments. Madoff was taken to court and has been sentenced to a term of imprisonment. Similarly, earlier in history an international banking institution known as the **Bank of Credit & Commerce International [BCCI]** was liquidated in many of its countries of operation. The bank's downfall led to massive financial losses to many of its investors.

Lesotho

Lesotho is no exception to the eventuality of business insolvency and consequent pro-rata loss of investors' money. It will be recalled that sometime in the 1990's a pyramid or *ponzi* scheme [as it is known in other parts of the world] emerged. This scheme was known as **Thusano Trust**. Many *Basotho* invested in this scheme, and the earlier ones gained in returns on investment way above what the ordinary banking institutions had to offer. As word of the high returns passed around numbers of investors increased. Whilst claims by these earlier investors were duly paid, subsequent ones were not. At some point *Thusano Trust's* ability to meet its liabilities diminished until it reached a point where it ceased completely. Investors who had joined during the latter years of the fund's subsistence lost on both their principal amounts and the returns promised.

Later in history, around 2006 the **Millennium Goal Society** emerged. After some time in operation the Society was called to order by the Commissioner of Financial Institutions in a court application. Before court, the issues against the Society were that it was operating a banking institution without license and needed to be investigated. The Commissioner argued that the application was in the interest of the members of public. Following rigorous resistance to this application, the court ordered in favour of the Commissioner.

Supervision of Financial Institutions

Financial institutions are by definition all institutions which operate banking and insurance business. They can, in terms of the Financial Institutions Act 1999, only operate such businesses if licensed to do so by the Commissioner of Financial Institutions, who is defined in the Act as the Central Bank of Lesotho. Powers of the Commissioner include investigations of the affairs of any financial institution. Further, all the powers bestowed upon the Master of the High Court in insolvency proceedings of other industries, are given to the Central Bank in cases of financial institutions' insolvency proceedings. Lastly, a financial institution cannot be liquidated without the prior approval of the Central Bank.

Winding up of Financial Institutions

Generally, a legal entity is deemed insolvent and may consequently be liquidated on various grounds amongst which are:

- a) If it is unable to pay its debts;
- b) If the court is of the opinion that it is just and equitable that it should be wound up.

Inability to Pay Debts

A legal entity is deemed unable to pay its debts if such inability occurs during the course of ordinary business. An order of winding up of a legal entity can only be made by the High Court. The order, if made, is beneficial to all persons that the legal entity owes and has failed to pay. The benefit to the public manifests itself as follows:

1. In terms of S. 179 of the Companies Act 1967, [Currently under review] Court proceedings or suit against the insolvent is stayed by operation of the insolvency proceedings. No single individual or other legal entity may benefit from a lawsuit against the insolvent legal entity to the exclusion of all other creditors of the insolvent.
2. In terms of Section 180(b) of the Companies Act 1967 recent court orders that led to the execution or attachment of the property of the insolvent on the grounds of its inability to pay debts are nullified by operation of law after the commencement of the winding up process of the legal entity.
3. Every act purporting to dispose off the property of the insolvent legal entity made after the commencement of the winding up process is rendered null and void by operation of the law of insolvency.

4. Lastly, the estate of any other legal entity not being a financial institution is by operation of the law of insolvency placed under the custody of the Master of the High Court, whereas estates of Financial Institutions are placed under the custody of the Central bank.

Implications and Advantages of a Winding up Order

1. A winding up order effectively means that no person can be heard to pressurise the insolvent legal entity to pay him/her alone in a private arrangement. Such a person will, from the date of the order of winding up, join other creditors and prove his/her claim in a meeting of the body of all creditors.
2. It has the advantage of protecting the insolvent legal entity's available assets and preventing dissipation of same. In this manner the interests of all creditors are protected under the law. The insolvent legal entity is prevented from transferring any of its assets to any one, thus protecting the interest of the creditors in such assets which would subsequently be used to pay up the debts following due process of law.
3. It becomes the role of the Central Bank in the case of financial institutions, and the Master of the High Court in all other cases, to appoint a person responsible for receiving claims by the creditors, interrogate the insolvent entity's officials on the causes of the insolvency, and to eventually liquidate the assets of the legal entity by turning them all into liquid cash for subsequent distribution to creditors. Such a person is known as a liquidator. He/she is a neutral person nominated by the creditors in a meeting convened specifically for this purpose and if approved of, appointed by the Commissioner of Financial Institutions.

Resistance Against Winding Up Order

Resistance against winding up order by a legal entity is unlawful. If not rebutted such resistance will lead to prejudice against creditors of the legal entity as follows:

1. Firstly, the possibility of the insolvent legal entity going out to pay some of its debtors and not all, is increased, this the entity will try to do until all the funds are exhausted.
2. Secondly, to avoid the repercussions of insolvency, the legal entity might begin to dispose off items that make up its assets to family and friends leaving very little for distribution amongst the majority of the creditors.

3. Thirdly, creditors are not able to meet and know each other which would enable them to act in unison. They remain known to the insolvent legal entity alone who may maneuver amongst them paying only others and not all due to the former's diminished financial standing.

Judicial Management

An insolvent legal entity may be placed under judicial management if it is thought that there is hope to turn it around and make it profitable again. However, experience has shown that this rarely ever works. It usually operates in the midst of mistrust between the legal entity's officers and the judicial manager which does not lead to necessary cooperation between the two.