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Directors’ Duties in Relation to Creditor Protection in Developing Countries using a Comparative Study of United Kingdom (UK) and Zambia

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Abstract

Since the inception of limited liability, the risk falling on creditors increased with the implication of their claims being limited to company assets only. This created the need for mechanisms for creditor protection against risk of loss because doing business with an incorporated company became risky. The presence of limited liability meant that it was only a matter of time before the concept could be abused for externalization of risk by companies. Both company and insolvency law has failed to provide an effective mechanism for the behaviour of directors which can effectively improve creditor protection. After codification, directors are to act in good faith to promote the success of the company for the benefit of the members and in financial distress, they are to consider the interests of creditors. There is a dearth of literature in terms of creditor protection even though they are a source of corporate finance especially in developing countries like Zambia. The study analysed directors' duties in relation to creditor protection in developing countries using a comparative approach of UK and Zambia. The shifting of the duty from the focus of shareholders to creditors was found to have uncertainties which impede creditor protection. While in the UK the duty has interpretation and enforcement challenges, in Zambia this duty is non-existent. Empirical findings showed evidence of neglect for creditors through impractical provisions of law both in principle and in practice. The research makes a contribution to knowledge on the need to improve creditor protection within company law in the UK especially in Zambia. Directors in Zambia don't seem to understand what they are doing under common law because problems such as unawareness, lack of understanding and incompetence were found. Likewise, even though duties are legislated in the UK, they are surrounded by uncertainties specifically section 172(3) of the Companies Act 2006. These uncertainties relate to the effective time when directors are supposed to start considering creditors' interests and what it means to consider creditors' interests. Corporate governance needs to be strengthened in order to complement and enhance implementation of law by directors. This research is significant because it focuses on directors' duties in relation to creditor protection in developing countries where less academic attention has been given especially Zambia compared to developed countries.

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List of abbreviations

ACC	Anti-Corruption Commission
B.S.A	British South African Company
BFSA	Banking and Financial Services Act
BOZ	Bank of Zambia
CAQDAS	Computer Assisted Qualitative Data Analysis Software
CCPC	Competition and Consumer Protection Commission
DBZ	Development Bank of Zambia
FDI	Foreign Direct Investment
FIC	Financial Intelligence Centre
FOEs	Family Owned Enterprises
GATT	General Agreements Tariffs and Trade
GDP	Gross Domestic Product
IMF	International Monetary Fund
IODZ	Institute of Directors Zambia
LAZ	Law Association of Zambia
LuSE	Lusaka Stock Exchange
MDRI	Multi-lateral Debt Relief Initiative
MNC	Multinational Companies
SADC	Southern African Development Community
SANAC	Southern African Network Against Corruption
SEC	Securities Exchange Commission
SOEs	State Owned Enterprises
ZAMTEL	Zambia Telecommunications Company
ZANACO	Zambia National Commercial Bank
ZESCO	Zambia Electricity Supply Corporation
ZIALE	Zambia Institute of Advanced Legal Education
ZICTA	Zambia Information and Communications Technology Authority
ZIMCO	Zambia Industrial and Mining Corporation
ZRA	Zambia Revenue Authority

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CHAPTER 1: Introduction and scope of the study

1.1 Introduction

In every country, the legal system is the foundation for good corporate governance because competition for investment, the desire to conduct business where risk is understood, and the assurance of protection is a necessity.[1] After corporate scandals such as Enron, and Maxwell, the development of corporate governance increased.[2] Tricker stated that the board is the ultimate vehicle of the company, and directors' duties are centred on four principles namely; direction, executive action, supervision, and accountability.[3] Generally, the desire for transparency and accountability are factors leading to the development of corporate governance in order to increase investor confidence.[4] The lack of control and accountability for directors' actions including the misuse of corporate assets contributed to the corporate scandals in the UK and consequently led to the development of Corporate Governance Codes.[5] The Cadbury Report defined corporate governance as the way in which companies are directed and controlled.[6] This definition has been associated with interpretation arguments henceforth, this study adopts a definition by Tricker which states that 'corporate governance is concerned with activities of the board and its relationship with shareholders, management, as well as external stakeholders such as regulators and creditors.[7] Shareholder primacy model has been a ruling concept in corporate governance with arguments such as shareholders being bearers of residual risk[8] and that share value is a reflective index of growth and profitability of shareholders' investments for overall firm wealth.[9] Companies have been run principally for the benefit of shareholders who are regarded as owners.[10] Although theories and growth of corporate governance trace back to the nineteenth and twentieth century

[1] Peter Cornelius, 'Good Corporate Governance Practices in Poor Corporate Governance Systems' (2005) IJBS, 12
[2] Bob Tricker, *Corporate Governance: Practices, Procedures and Powers in British Companies and Their Boards of Directors*, (Gower Publishing, 1984) 33
[3] Bob Tricker, *Corporate Governance: Principles, Policies & Practices* (2nd ed. Oxford University Press, 2012) 8
[4] Christine A. Mallin, *Corporate Governance,* (4th ed. Oxford University Press, 2013) 26
[5] (Ibid)
[6] Cadbury Committee Report on the Financial Aspects of Corporate Governance (1992) Para. 2.5
[7] Bob Tricker, *Corporate Governance: Principles, Policies & Practices* (2nd ed. Oxford University Press, 2012) 38
[8] Andrew Gamble and Gavin Kelly, 'Shareholder Value and the Stakeholder Debate in the UK' (2001) CGIR, 9, 110
[9] Jean-Philippe Touffut, *Does Company Ownership Matter*? (Edward Elgar Publishing, 2009) 128
[10] Joseph E.O Abugu, 'Primacy of Shareholders' Interests and the Relevance of Stakeholder Economic' (2013) CL, 34, 202

respectively,[11] it was practiced as long as corporate entities existed.[12] Unincorporated companies, partnerships and sole proprietorships were the dominant forms of businesses.[13] The administration of unincorporated companies and conduct of directors to manage the affairs of the company were provided under the Companies Act 1844.[14] In the 19th century, the political and economic struggle which was designed to promote corporate activity by encouraging investment in corporate shares led to the development of limited liability.[15] Since the inception of the concept of limited liability, the risk that falls on creditors increased such that doing business with a company incorporated became uncertain.[16] In the UK limited liability corporations were provided for in 1855 and 1862.[17]

Whereas the foundation feature of corporate governance is company law, on which a body of different laws, rules and principles govern the activities of the corporations, [18] a company is an entity created by law for purposes of different parties to combine their expertise, capital and also labour for the benefit of them all.[19] This means that the investor participates in the profits of the enterprise without taking responsibility for its operations.[20] The management runs the company without taking responsibility of providing the funds.[21] In order to achieve these two propositions, shareholders have limited liability and involvement in the running of the company.[22] The court in the case of *Salomon v Salomon & Co. Ltd*[23] defined a corporation as a 'separate legal entity with the full attributes of a person having capacity to enter into legal relationships for purposes of business.'[24] It is undisputed that once a company has been formed with limited liability, it immediately acquires the rights, obligations and liabilities appropriate for its objectives. It is argued that the overall object of a company is to raise capital for the business for its members.[25]

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[11] Christine A. Mallin, *Corporate Governance*, (4th ed. Oxford University Press, 2013) 15
[12] Bob Tricker, *Corporate Governance: Principles, Policies & Practices* (2nd ed. Oxford University Press, 2012) 7
[13] Bob Tricker, *Corporate Governance: Practices, Procedures and Powers in British Companies and Their Boards of Director*, (Gower Publishing Ltd, 1984) 33
[14] Ibid
[15] Peter Muchlinski, 'Limited Liability and Multinational Enterprises: A Case for Reform?' (2010) CJE, 34, 915
[16] Christopher J. Cowton, 'Putting Creditors in their Rightful Place: Corporate Governance and Business Ethics in the Light of Limited Liability' (2011) JBE, 102, 21
[17] Bob Tricker, 'Re-inventing the Limited Liability Company' (2011) CGIR, 19, 384
[18] Bob Tricker, *Corporate Governance: Principles, Policies & Practices* (2nd ed. Oxford University Press, 2012) 8
[19] Robert A.G Monks and Nell Minow, *Corporate Governance* (5th ed. John Wiley & Sons, 2011) 6
[20] (Ibid)
[21] (Ibid)
[22] (Ibid)
[23] [1897] AC 22
[24] Ibid
[25] Section 172(1), Companies Act 2006

When the company became a legal entity, it can contract, own assets, and incur liabilities without shareholders being liable to creditors[26] implying that their claims are restricted to company assets and the need for protection emerged. Comprehensive reforms to corporate law of insolvency regulation 1985 was introduced based on recommendations from the Cork Committee known as the 'Cork Report'[27] The primary law governing insolvency procedures in the UK is found in the Insolvency Act 1986. It is supported by legislation such as;- Insolvency Rules 1986, which stipulates relevant procedural rules and requirements;- the Insolvency Act 2000, which introduced new guidelines on company voluntary arrangements and moratorium, the Enterprise Act 2002, which provided for administration, restricted the right to appoint administrative receivers, and changed the rules for distribution of company assets upon liquidation;- and the Companies Act 2006, which deals with schemes of arrangement.[28] When a company is financially distressed, there are five procedures available under statute, namely; - administration,[29] company voluntary arrangement,[30] scheme of arrangement,[31] receivership (including administrative receivership)[32] and liquidation.[33] Four procedures, except for schemes of arrangements which is governed under the Companies Act, are formal insolvency procedures governed by the Insolvency Act. The difference among them is that the first three may restore the company to financial stability,[34] whereas receivership and liquidation deals with distribution of assets if the company fails to return to financial strength.

Contemporary insolvency law has regard for creditors being able to procure as far as possible what is due to them, debtors' interests in providing for relief from harassment, and the public interest in ensuring that insolvencies are investigated and that the dishonest and reckless debtor is penalised.[35] While the debtor is concerned with using external funds for its business and to be relieved from creditors, creditors want to recover their money and are concerned with the management of

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[26] Bob Tricker, 'Re-inventing the Limited Liability Company' (2011) CGIR, 19, 384
[27] Richard Williams 'What Can We Expect To Gain From Reforming The Insolvent Trading Remedy' (2015) 78, 55
[28] Len Sealy and Sarah Worthington, '*Sealy & Worthington's Cases and Materials in Company Law*' (10th ed. Oxford University Press, 2013) 795
[29] Part 2, Insolvency Act, 1986
[30] Part 1, Insolvency Act, 1986
[31] Part 26, Companies Act, 2006
[32] Part 3, Insolvency Act, 1986
[33] Part 4, Insolvency Act, 1986
[34] David Milman, 'Winding-up of companies: recent litigation and legislative developments' (2003) Insolv. L, 4, 157
[35] Fiona Tolmie, '*Corporate and Personal Insolvency Law*' (2nd ed. Cavendish Publishing, 2003) 7

assets.[36] The fundamental issue arising from the interests of these three parties is a matter of policy, and finding a balance has been problematic if not complicated, especially creditors' interests.[37] This is because of the need to have justice for all the three parties. The complicated system of protection needs to recognise the dependency of the world on debt and therefore the need to create a corresponding insolvency procedure to: cope with its casualties, diagnose and treat an imminent insolvency in ample time to safeguard the procedures of realisation and distribution, ensuring that they are administered in an honest and competent way, and determine the grounds of the insolvent's failure, and if the conduct of its officers or agents merits retribution, to decide what actions are required to be taken against them.[38] However, the legal protection given to the company and the shareholders is beyond contract as it goes to the heart of company law.[39]

The aggregation of capital in the corporate entity provides an incentive for progress and expansion that could not be expected without the concepts of limited liability and legal personality.[40] The law permits the court to put aside the veil of incorporation if commercial irresponsibility has occurred.[41] It is important to note that this study does not go into details on insolvency law because its scope is limited to the mechanism identified as harmful to creditors if not well enforced and implemented. It focuses on the attributes of incorporation, directors' duties in the vicinity of insolvency, fraudulent and wrongful trading provisions, and the shareholder primacy model of corporate governance. It goes beyond the concepts of limited liability and legal personality to examine the responsibilities of those in charge of the affairs of the company, especially when the company is financially troubled. The purpose is to analyse and understand how directors' duties can be used to enhance creditor protection in the UK and in a developing country such as Zambia. Financial creditors are the focus of this research as they are providers of corporate finance especially in developing countries.[42]

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[36] Ibid

[37] Len Sealy and Sarah Worthington, '*Sealy & Worthington's Cases and Materials in Company Law*' (10th ed. Oxford University Press, 2013) 795

[38] Fiona Tolmie, 'Corporate and Personal Insolvency Law' (2nd ed. Cavendish Publishing, 2003) 17

[39] Susan Watson, 'The corporate legal entity as a fund' (2018) JBL, 6,467

[40] Susan Watson, 'The corporate legal entity as a fund' (2018) JBL, 6,467

[41] Gregory Allan, 'To pierce or not to pierce? A doctrinal reappraisal of judicial responses to improper exploitation of the corporate form' (2018) JBL, 7, 559

[42] Ellis Ferran, *Principles of Corporate Finance* (2nd ed. Oxford University Press, 2014), 269

1.2 Arguments that impede creditor protection

The study has four major arguments which impede the protection of creditors. The first is the concept of limited liability and how it affects creditors. This analysis focuses on how limited liability has been used to the disadvantage of creditors as the courts are usually not willing to pierce the veil of incorporation. The second argument is the role of the board to consider creditors' interests when a company is nearing insolvency and how it has been ineffective thereby impeding creditor protection. The third argument is the inefficiencies of fraudulent and wrongful trading provisions which affect creditor protection. The fourth argument is the shareholder primacy model of corporate governance and how it neglects creditors. These concepts are analysed with the purpose of improving creditor protection by focusing on their weaknesses and how they can be eradicated or improved for the benefit of creditors.

1.2.1 The concept of limited liability and creditors

The purpose for limited liability is to limit the liability of the members to their investment which entails that creditors' claims are asserted from company assets.[43] In *Salomon v Salomon & Co. Ltd*[44] the court stated that a company is a juristic person and the doctrine of limited liability accorded to members mean that creditors cannot claim against their personal property. The veil of incorporation protects shareholders from liability for company debts.[45] The introduction of limited liability has led to companies externalising risk for purposes of shifting the risk from shareholders to creditors.[46] The court put measures to curb abuse by allowing the corporate veil to be lifted in circumstances like breach of statute or fraud to the knowledge of the members.[47] In *Gilford Motor CO. Ltd v Horne,*[48] a corporate structure was created for purposes of evading a legal duty and the court held that the director responsible was liable and this was reasserted in the case of *Jones v Lipman*[49] where the court stated that fraud establishes the basis for piercing the corporate veil.

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[43] Christopher J. Cowton, 'Putting Creditors in their Rightful Place: Corporate Governance and Business Ethics in the light of Limited Liability' (2011) JBE 102, 21

[44] [1897] AC 22

[45] Rishi Shroff and Shwetank Ginodia, 'A Corporate Governance on Lifting the Veil in Group Companies in India and the United Kingdom' (2014) ICCLR, 25, 423

[46] Peter Muchlinski, 'Limited Liability and Multinational Enterprises: A Case for Reform' (2010) CJE, 34, 915

[47] Paul L. Davies and Sarah Worthington, *Principles of Modern Company Law*, (9th ed. Sweet and Maxwell, 2012) 39

[48] [1933] Ch. 935 CA

[49] [1962] 1 WLR 832 Ch D.

In 2013, a case that brought corporate law and family law together established that even though the courts are proactive on implementing the law, they are not keen on piercing the corporate veil as it must be done only as the last resort in exceptional circumstances.[50] This asserts the argument that even though the law has this exception for the purposes of protecting creditors, it is not willing to depart from Salomon's ruling. This creates an avenue for unprincipled behaviour among directors causing risk. This was one of the problems associated with the introduction of limited liability as there were concerns the concept would be abused for fraudulent behaviour as investors would only risk losing their subscribed shares in a company and thereafter externalise the risk to creditors.[51] It was submitted that with the presence of limited liability, shareholders would not restrain directors from implementing risky projects as they have nothing to lose in case the project failed and they would gain profits if it worked out.[52] In supporting the above argument, Davies stated that shareholders' interests in the company are low when it is financially struggling whereas creditors' are higher as they stand the risk of loss due to limited liability.[53] Also on the same argument Keay contended that because of limited liability, directors embark on risky projects during the vicinity of insolvency because they can't facilitate such business ventures using internal finance.[54] It is argued that this is abuse of limited liability. The risk of creditors conducting business with a company that has limited liability is higher because in instances where company assets do not meet their claims, they cannot have recourse to personal property of members.[55] It is asserted that the concept of limited liability is harmful to creditors. However, the law can be modified to allow piercing of the veil in a principled manner. This is because the concept of limited liability comes with certain responsibilities which can be taken away if not fulfilled by the company.[56] The repayment of debt is one of the responsibilities of a company and so if they cannot meet this legal obligation, the advantages of incorporation can be stripped from the company.

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[50] Prest v Petrodel Resources Ltd [2013] UKSC 34
[51] Jill Solomon, *Corporate Governance and Accountability* (4th ed. John Wiley & Sons, 2013) 9
[52] Ibid
[53] Paul Davies, 'Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency' (2006) EBOLR 7, 301
[54] Andrew Keay, 'Directors' Duties and Creditors' Interests' (2014) LQR, 130, 443
[55] Christopher J. Cowton, 'Putting Creditors in their Rightful Place: Corporate Governance and Business Ethics in the light of Limited Liability' (2011) JBE 102, 21
[56] Bob Tricker, 'Re-inventing the Limited Liability Company' (2011) CGIR, 19, 384

1.2.2 The duty to consider the interests of creditors during financial difficulties

Before the Companies Act 2006, directors had fiduciary duties relating to acting in good faith under common law. These duties were to be performed in good faith in the best interest of the company.[57] This included consideration of creditors' interests during financial difficulties as stated in *Lonrho v Shell Petroleum.*[58] Lord Diplock mentioned that the exclusivity of shareholders' interests may not only be the interests of a company without inclusion of creditors. Lord Buckley also stated in *Re Horsley and Weight Ltd*[59] that directors owe an indirect duty to creditors to ensure that the capital of the company is not unlawfully reduced. In the case of *Brady v Brady,* [60]it was stated by the House of Lords that directors needed to consider creditors' interest if they were to act in the best interest of the company by not allowing exploitation of company assets. These judgements illustrate how the courts established that the interests of a company included those for creditors. This was to inhibit externalisation of costs during financial difficulties especially when a company is relying on creditors' money for projects it could not finance with internal money.[61]

After codification, directors are to act in good faith to promote the success of the company for the benefit of the Members and in the process they are to consider other issues such as relationships of the company with its suppliers, employees or customers.[62] And in certain circumstances they are to consider the interests of creditors.[63] Codified duties are to be applied in a like manner as common law and equitable principles which existed before codification.[64] However, two problems associated with this duty include the effective time of the shift, and what it means to consider creditors' interests or to act in the interests of creditors.[65] The courts have used different factors to decide cases and despite the size of the case logs, there has been no standardized benchmarks to be use.

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[57] Andrew Keay, 'Shifting of Directors' Duties in the Vicinity of Insolvency' (2015) IIR 24, 140
[58] [1980] 1 WLR 627
[59] [1988] 3 ALL ER 617 (HL)
[60] [1989] 3 BCC 535 (CA)
[61] Andrew Keay, 'Shifting of Directors' Duties in the Vicinity of Insolvency' (2015) IIR 24, 140
[62] Section 172(2), Companies Act, 2006
[63] Section 172(3), Companies Act, 2006
[64] Section 170(4), Companies Act 2006
[65] Andrew Keay, 'The Shifting of Directors' Duties in the Vicinity of Insolvency' (2015) IIR, 24(2), 140

Nevertheless, certain statements from court decisions such as ‘when a company is in doubtful insolvency’[66] have been used to determine the time of effect. The purpose for shifting of duty is to protect creditors during financial difficulties yet its implementation is surrounded by uncertainties which then expose creditors to risk. Authors such as Grantham argued that where a company is rapidly approaching insolvency, it is rational for a company to make an investment which is riskier but offers the possibility, although remote, of a bonanza payoff that will prevent insolvency.[67] He further asserts that this rationality for riskier projects derives from the concept of limited liability for shareholders because upon insolvency, their investments would have already been lost and makes sense to use creditors in what may be a fruitless rescue attempt.[68] This shift in duty attempts to prevent companies from externalising costs because sometimes companies embark on ventures which they cannot sustain without relying on creditor funds when a company is in distressed mode.[69] It is argued that this duty regarding creditor protection is ineffective and triggered late. Hence the study analyses how creditor protection can be improved under this duty especially when a company is financially struggling. While most literature dwells on the uncertainties in law, this study dwells on the effect of these uncertainties on creditor protection and how they can change to enhance creditor protection. Clarifying directors’ duties towards creditors can effectively improve protection for creditors. This calls for effective implementation of the law on holding directors accountable for their decisions when a company has gone into insolvent liquidation. The law has provided certain measures for holding directors liable and these are fraudulent and wrongful trading provisions whose effectiveness in terms of enforcement could perhaps enhance creditor protection.

1.2.3 Fraudulent and wrongful trading provisions

Fraudulent trading provisions were introduced under the Insolvency Act which are meant to hold a director liable when he acts in a fraudulent manner.[70] The law provides that:

> “If in the course of the winding up of a company it appears that any business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose,…. the court, on the application of the liquidator may declare that any persons who were knowingly parties to the carrying

[66] Re Horsley & Weight Ltd [1982] 1 Ch 442
[67] Ross Grantham, ‘The Judicial Extension of Directors’ Duties to Creditors’ (1991) JBL, 1, 1
[68] (Ibid)
[69] Andrew Keay, ‘Shifting of Directors’ Duties in the Vicinity of Insolvency’ (2015) IIR 24, 140
[70] Vanessa Finch, *Corporate Insolvency Law: Perspectives and Principles*, (2nd ed. Cambridge University Press, 2009) 682

> on of the business in the manner above-mentioned are to be liable to make such contributions (if any) to the company's assets as the court thinks proper."[71]

And under wrongful trading provisions the law provides that:

> "….if in the course of the winding up of a company it appears that a company went into insolvent liquidation, a person who is or has been a director of the company, the court, on the application of the liquidator, may declare that that person is to be liable to make such contribution to the company's assets as the court thinks proper…..if some time before the commencement of the winding up of the company, that person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation…..The court, however shall not make a declaration under this section if it is satisfied that the person took every step with a view to minimising the potential loss to the company's creditors"[72]

However, these provisions are associated with enforcement and implementation problems because it is almost impossible for creditors to prove intent for fraud. This in practice puts the law beyond the reach of creditors. Weaknesses such as the discretion of the court in admitting evidence and awarding a declaration against directors have been exposed. The evidential burden on the liquidator and the potential preferential treatment for creditors is also exposed. The time of the wrongful trading as well as the need to show that there was loss suffered by creditors due to the wrongful trading is essential too. Where wrongful trading has been established, the courts can still decline to award a declaration for contribution as was exhibited in the case of *Re Continental Assurance Co of London plc*[73] and *Grant v Ralls.*[74] Further, where steps have been taken by directors to minimise the risk of loss, the court does not impose liability. However, these steps should only minimise the amount of the contribution rather than removing liability completely. The arguments concerning steps to be taken by directors to evade liability seem to be debatable as well. Where liquidators are strongly optimistic about the presence of wrongful trading, sometimes the court finds no liability. Wrongful trading provisions were recommended by the Cork Committee to supplement the provisions on fraudulent trading which were very difficult for creditors but the problems are still evident.[75] While these provisions are meant to protect creditors,

[71] Section 213, Insolvency Act 1986
[72] Section 214, Insolvency Act 1986
[73] [2007] 2 BCLC 287
[74] [2016] EWHC 243 (Ch)
[75] Marcus Gustafsson, 'Beating a dead horse? An assessment of wrongful trading' (2017) CL,38, 239

it can be argued that the problems surrounding its implementation and enforcement impede this purpose.

1.2.4 Shareholder primacy

The economists view a company as a nexus of contracts between providers of capital and managers for the purposes of making a return on their investment.[76] The foundation of the firm has been associated with firm value and profit maximisation for shareholders as its objective.[77] Shareholder model of governance neglects other stakeholders such as creditors and puts the interests of the shareholders as a priority.[78] It is claimed that the goal of corporate governance is based on shareholder primacy because share value is a reflective index of the growth and profitability of shareholders investments for overall firm wealth.[79] The important thing is to conduct affairs of the company in ways that lead shareholders getting a return on their investment.[80] Corporate governance in the UK has been centred on the idea of shareholder value management with companies run principally for the benefit of shareholders who are regarded as owners of the company.[81] This was further discussed by Armour et al who argued that in the UK shareholders' interests are paramount in corporate governance.[82] It was asserted that shareholders' risk is higher because in case of insolvency, they might lose their investment.[83] It was further indicated that a good model of corporate governance is capable of delivering an efficient and effective management system that can produce a shareholder value maximisation over time.[84] Several arguments for a shareholder primacy model have been put forward such as shareholders being bearers of residual risk. It has been argued that shareholders are the only ones vested with interests of making the firm perform very well financially because they own residual rights.[85] This is because claims of other stakeholders are fixed and not so much concerned as to whether a company

[76] Andrei Shleifer and Robert W. Vishny, 'A Survey of Corporate Governance' (1997) JF, 72, 737
[77] Shuangge Wen, 'Re-visiting the Corporate Objective Through the Economic Lens- the UK Perspective' (2013) ICCLR, 24, 302
[78] John Armour, Simon Deakin & Suzanne J. Konzelmann, 'Shareholder Primacy & the Trajectory of UK corporate Governance' (2003) JBIR 41, 531
[79] Joseph E.O Abugu, 'Primacy of Shareholders' Interests and the Relevance of Stakeholder Economic' (2013) Cl, 34, 202
[80] Andrei Shleifer and Robert W. Vishny, 'A Survey of Corporate Governance' (1997) JF, 72, 737
[81] Jean-Philippe Touffut, *Does Company Ownership Matter*? (Edward Elgar Publishing, 2009) 128
[82] John Armour, Simon Deakin & Suzanne J. Konzelmann, 'Shareholder Primacy & the Trajectory of UK corporate Governance' (2003) JBIR 41, 531
[83] Arnold Glen, *Corporate Financial Management* (5th ed. Pearson Education Ltd, 2013) 9
[84] Preamble 1.0, Combined Corporate Governance Code, 2008
[85] Frank H. Easterbrook and Daniel R. Fischel, 'Limited Liability and the Corporation' (1985) UCLR, 52, 89

is making profit or not as shareholders are concerned.[86] Because of this, it was argued that shareholders are in possession of the greatest incentives that could maximise the wealth of the company.[87] It is claimed that maximizing profits for equity investors automatically assist the rest including creditors in the sense that they will be assured of their fixed claims being successful.[88] This could not be said to be true because sometime even when the company has money to settle debts, they default and redirect the money into another projects and delay payments to creditors. So, a company being solvent does not automatically mean creditors are secure. Creditor protection extends beyond a company having money to the position where their vulnerability in law can be protected thereby reducing risk of loss.

Also, in instances of insolvency where unsecured creditors are more than company assets, they certainly become bearers of residual risk. It is therefore argued that shareholders are always not the only risk bearers but rather in certain circumstances qualified by the capacity of the company to meet its obligations. The other justification is owing to the initial contribution of capital which makes them ague that they own the company.[89] A company cannot be owned by shareholders in law. Having provided the initial investment of capital does not give shareholders rights on both tangible and intangible assets of the company otherwise even their own personal creditors will be able to make claims against company assets.[90] Shareholders do not own assets devoted to the business as a matter of law, the corporation owns the assets.[91] Investment is a transfer that is made within the legal and contractual framework that confers certain rights and obligations on the investor.[92] Once this investment is made, the funds no longer belong to the investor but the company. As already established above, a corporation is incapable of being owned because it has a separate legal personality as a natural person. Therefore, a corporate governance model that incorporates creditors is superior because even if their interests are not paramount during financially stability, in distressed times their interests supersede shareholders' interests thereby

[86] Frank Easterbrook and Fischel Daniel, *The Economic Structure of Corporate Law* (Harvard University Press, 1991) 188
[87] Frank H. Easterbrook and Daniel R. Fischel, 'Limited Liability and the Corporation' (1985) UCLR, 52, 89
[88] Andrew Keay and Rodoula Adamopoulou, 'Shareholder Value and UK Companies: A Positivist Inquiry' (2012) EBOLR, 13, 1
[89] Frank Easterbrook and Fischel Daniel, The Economic Structure of Corporate Law (Harvard University Press, 1991) 188
[90] Min Yan, 'Agency theory Re-examined: an agency relationship and residual claimant' (2015) ICCLR 26, 139
[91] Christopher J. Cowton, 'Putting Creditors in their Rightful Place: Corporate Governance and Business Ethics in the light of Limited Liability' (2011) JBE 102, 21
[92] Shuangge Wen, 'Re-visiting the Objective Through the Economic Lens- the UK Perspective', (2013) ICCLR, 24, 302

establishing a proper place for them in governance as argued by Cowton.[93] Even though shareholder primacy seems to be advocated for in the statute,[94] it is important to note that the subsequent sub-section draws the importance of directors not only to focus on the collective interests of shareholders, but have in mind the interests of creditors during financial difficulties.[95] This law establishes the fundamental place for creditors in that during financial difficulties they are more superior to shareholders. It is therefore submitted that the pure shareholder primacy model undermines and neglects creditors as a stakeholder group.

1.3 An overview of corporate governance in Zambia

As one of the richest independent African states with natural resources after independence in 1964, the subsequent 27 years under the one party state leadership of Kenneth Kaunda, saw Zambia become one of the poorest countries in Africa.[96] The first economic reforms announced in 1968 marked the beginning of government involvement in the corporate sector.[97] The presidential directive to the state owned Industrial Development Corporation Limited (INDECO) to engage into negotiations with the private sector for the government to acquire at least 51% shares in the companies marked the beginning of nationalisation in Zambia.[98] This was the genesis of parastatal companies defined as 'any company, board or statutory body in which the state owns the majority shares or has a control interest.[99] It was established that the intersection between politics and state control of the corporate sector was the beginning of corruption.[100] The corruption that occurred during the 27 years of one party state was only revealed in the early 1990s when the Movement for Multiparty Democracy (MMD) took over power and the Chiluba government brought in a new era of economic liberty.[101] The new government privatised most of the parastatals and encouraged foreign investments. It introduced the capitalist market driven reforms. Even though new drastic measures in the economic and political sector were later introduced in 1990s, the consequences of the 27 years reign are undisputedly evident in today's economy.

[93] Christopher J. Cowton, 'Putting Creditors in their Rightful Place: Corporate Governance and Business Ethics in the light of Limited Liability' (2011) JBE 102, 21
[94] Section 172, Companies Act, 2006
[95] Section 172(1) Companies Act, 2006
[96] Stuart John Barton, 'Why Zambia Failed' (2015) JIE, 11, 803
[97] J.M. Mulwila and R.K. Mushota, 'Company Law and Some Doctrinal Problems Concerning the Management of Parastatal Companies in Zambia' (1980) CILJ, 13, 265
[98] Ibid
[99] Section 2, Parastatal Bodies Service Commission Act, 1976
[100] Jotham C. Momba, 'The Intersection Between Politics and Corruption in Zambia' (2007) SAJIA, 14, 115
[101] Ibid

The corporate sector in Zambia is concentrated with parastatals, subsidiaries of foreign companies Family Owned Businesses (FOBs) and other Small and Medium Enterprises (SMEs).[102] Foreign equity participation is very significant with a contribution of about 75% of the total banking system capitalisation owing to the presence of a large number of foreign banks in Zambia.[103] Between 1990-2000, Zambia experienced the closure of nine banks as they were going through financial difficulties and lacked adequate measures to manage the troubled banks which had a lot of unpaid loans due to lack of regulation.[104] The Bank of Zambia (BOZ) is part of the institutional framework regulating corporate governance through the guidelines it published on corporate governance.[105] The other institution that promotes corporate governance in Zambia is the Institute of Directors Zambia (IODZ) which was launched on the 7th April 2000. The framework surrounding corporate governance in Zambia is found in the Companies Act 1994,[106] the Securities Act 1993,[107] and the Banking and Financial Services Act 1994.[108] In order to improve foreign and local investment, the Lusaka Stock Exchange formulated a corporate governance code (LuSE code) in 2005 which is used to regulate listed and quoted companies. Also, the Central Bank introduced corporate governance guidelines and incorporated certain benchmarks for the 'fit for purpose' test in relation to board members within the financial sector. Despite having these institutions to foster corporate governance, the concept itself is not fully developed. Some factors for failure of good governance have been associated with the lack of both internal and external control mechanism for regulating institutions especially the period after colonisation and privatisation of the economy. The governance structure of companies in Zambia is centred on shareholders and this was adopted from the English system of governance as evidenced in the corporate governance code. Zambia adopted a unitary board structure and the LuSE code is based on the 'comply or explain' principle used in the UK.

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[102] Kabanda R.K. Mushota, 'The Legal Validity of the Ministerial Directive Purporting to Dissolve Limited Liability Companies in Zambia' (1979) CILJSA, 12,140

[103] Nicholas M. Odhiambo, 'Interest Rate Liberalization and Economic Growth in Zambia: A dynamic Linkage' (2009) ADR, 21, 541

[104] Samuel Munzele Maimbo, 'Explaining Bank Regulatory Failure in Zambia' (2002) JID, 14, 229

[105] Banking and Financial Services (Corporate Governance) Guidelines, 2006, http://www.boz.zm/Instruments/CorporateGovernanceGuidelines.pdf accessed 29/01/2016

[106] Companies Act, Chapter 388 of the Laws of Zambia 1994

[107] Securities Act, Chapter 354 of the Laws of Zambia 1993

[108] Banking and Financial Services Act 1994, Chapter 387 of the Laws of Zambia

Corporate governance in Zambia is centred on shareholder principle which is like the UK. Legally speaking in theory, directors ought to be agents of the company and serving the interests of the company. However, this does not seem to happen in practice because it has been hampered by the authority shareholders have. Shareholders have more authority in the affairs of the company as illustrated in *Zambia Consolidated Copper Mines (ZCCM) v Kangwa & Others*[109] where the court stated that directors are only nominees who stand in a position of trust to the shareholders. The shareholders are the beneficiaries and hold overriding authority over the affairs of the company. In *Kasengele and Others v Zambia National Commercial Bank Limited*[110] the court upheld the decision that was taken in ZCCM v Kangwa above. Later in 2003, the Supreme Court in *Bank of Zambia v Chibote Meat Corporations*[111] held that the shareholders enjoy overriding authority as a matter of right over company affairs as well as over the board and the management. When a company is insolvent, the law protects creditors because they have the first claim on company assets nonetheless, the law is silent during financial difficulties as directors have no duty to take into account the interests of creditors because they are more focused on the interests of the shareholders. It is argued that for a company to have financial stability, it must take into account the interests of creditors who are providers of finance.[112] Although there is a huge reliance on debt finance in developing countries,[113] creditors are not adequately protected as they usually lose out on their funds upon insolvency.[114] The provisions of the law are essential for the protection of creditors nevertheless, it is the implementation and its enforceability that is vital.[115] It is argued that lack of transparency and mismanagement of accounts in the financial reports coupled with the weaknesses of the supervisory regulations were to blame for the closure of banks in the early 1990s.[116] Despite the closure of these banks, issues of corporate governance were not brought into consideration but only the banking sector regulations by the Bank of Zambia were revised. This is

[109] [2000] ZLR 109
[110] [2000] ZMSC 20
[111] [2003] SCJ, NO. 11
[112] Abraham Mwenda and Noah Mutoti, 'Financial Sector Reforms, Bank Performance and Economic Growth: Evidence from Zambia' (2011) ADR, 23, 60
[113] Mathew Tsamenyi, Elsie Enninful-Adu & Joseph Onumah, 'Disclosure and Corporate Governance in Developing Countries: Evidence from Ghana' (2007) JMA, 22, 319
[114] Richard S. Bradstreet, 'Should Creditors Rely on the Insolvency and Liquidity Threshold for Protection? A South African Case Study' (2015) JAL, 59, 121
[115] Mathew Tsamenyi, Elsie Enninful-Adu & Joseph Onumah, 'Disclosure and Corporate Governance in Developing Countries: Evidence from Ghana' (2007) JMA, 22, 319
[116] Samuel Munzele Maimbo, 'Explaining Bank Regulatory Failure in Zambia' (2002) JID, 14, 229

one way in which the issue of corporate governance has been neglected in Zambia. This brings to light the need for corporate governance reform. It has been claimed that corporate governance consists of the legal and regulatory frameworks concerned with the way power is exercised and the board need to ensure that managers manage the company on behalf of shareholders as if it was their own.[117] The legal system is the cornerstone of an effective corporate governance framework provided investors' protection is secure and risk is understood.[118]

It is argued that the legal system is a significant instrument for corporate governance to function effectively and the extent to which a country's laws protect investor rights, and laws are enforced, are the most basic determinant ways in which corporate finance and corporate governance evolve.[119] There is lack of effective legal, regulatory, and institutional framework to enhance creditor protection and foster corporate governance in Zambia.[120] There is need for harmonisation of law such as the new Companies Act, the Securities Act, and the Corporate Insolvency Act and also to have the corporate governance code revised and brought to speed with corporate development ideals and also to ensure they meet acceptable minimum international standards. Countries with good corporate governance attract high volume of investment and eventually they experience improved economic growth.[121] This research has employed a comparative method to analyse what Zambia needs to do for a better corporate sector and economy growth. The UK is used as a better but not ideal model for creditor protection for developing countries such as Zambia.

1.4 Literature statement

In the UK much of the literature on directors' duties is concentrated on uncertainties within the application of the law. However, this research is focusing on how these uncertainties harm creditors and what can be done to ensure that as a stakeholder group providing corporate finance and promoting corporate activities through business sustainability, creditors are protected legally. Whereas directors' duties during financial difficulties are analysed in this research, the focus is to

[117] Musonda Simwayi, 'A Critical Analysis of the Financial Intelligence Centre Act of Zambia' (2012) JBR, 13, 114
[118] Peter Cornelius, 'Good Corporate Governance Practices in Poor Corporate Governance Systems' (2005) IJBS, 5, 12
[119] Rafael La Porta, Florencio Lopez-de Sitanes, Andre Shleifer and Robert Vishny, 'Investor Protection and Corporate Governance' (2000) JFE 58, 3
[120] Kenneth Kaoma Mwenda, 'Corporate Insolvency Law and the Liability of Company Directors for Wrongful Trading and Fraudulent Trading' (2008) ZLJ, 65, 65
[121] Rafael La Porta, Florencio Lopez-de Sitanes, Andre Shleifer and Robert Vishny, 'Investor Protection and Corporate Governance' (2000) JFE 58, 3

find ways in which these duties can be implemented to improve creditor protection. There is lack of academic attention given to corporate governance especially creditors in developing countries. There is less literature on both directors' duties and creditors in Zambia hence the need to collect first-hand data through interviews which will help with finding out exactly how directors perform their duties and establish the challenges creditors face in Zambia. Having said that, literature is limited and unlike putting it in a single chapter, it has been integrated in every chapter.

1.5 **Statement of problem**

Firstly, both company and insolvency law has failed to provide an effective mechanism for the behaviour of directors which can protect creditors when a company is in financial distress including corporate governance. Secondly, little empirical research has been reported in the context of corporate governance on legal and regulation governing the conduct of directors with the relationship to shareholders and creditors.[122] Thirdly, there is a dearth of literature in terms of creditor protection even though they are a source of corporate finance especially in developing countries like Zambia. Fourth, there is a gap in literature on corporate governance in developing countries as less academic attention has been given to it.

1.6 **The reasons for choosing Zambia**

There are two main reasons why Zambia has been used in comparative with the UK. The first is that Zambia is a common law jurisdiction and a former protectorate of Britain. The English law being founded on common law and principles of equity, the Zambian legal system is based on English law. There are a few similarities between UK and Zambia such as the Zambian Companies Act which was adopted from the UK Companies Act 1948, the Corporate Governance Code for Lusaka Stock Exchange (LuSE) listed companies which was also formulated based on the UK Corporate Governance Codes, and both systems adopt the 'Comply or Explain' approach. This also takes into consideration the differences in the economic and social developments that exist between the two jurisdictions. Therefore, this does not mean that what works in the UK will work for Zambia, but it has to be applied with caution to the differences between the two countries. The second reason is that Zambia is one of the developing countries in the process of formulating a legal and regulatory frame work for corporate governance in order to attract investors and it is being used as a representative of other developing countries mainly the Members of Southern

[122] Marjan Marandi Parkinson, 'Corporate Governance During Financial Distress – An Empirical Analysis' (2016) IJLM, 58, 486

African Development Community (SADC). The reason for choosing SADC countries is to reduce geographical population from being too general. This is to ensure that the study is carried out within the limited time officially required.

1.7 Rationale for the study

It is evident from lack of literature available in corporate governance in developing countries that less academic attention has been given to developing countries as opposed to developed countries.[123] There is a gap in literature in terms of corporate governance and particularly protection of creditors in developing countries. Zambia as a developing country needs to strengthen its legal and regulatory framework especially implementation mechanisms within company law and corporate governance. An effective framework is needed for the protection of creditors. Zambia is used as a case study in comparison to the UK to assess the challenges of protecting creditors in developing countries like itself and analyse the lessons to be adopted.

1.8 Significance of the study

Countries with good corporate governance practices attract high volumes of investment which leads to economy growth and development.[124] The proper control and direction of companies is important for commercial development and wealth creation. This research is significant as it is pioneering for improved creditor protection through directors' duties and corporate governance practices in UK and Zambia not only during financial solvency but also when a company is financially troubled. This is owing to the lack of literature on creditor protection especially in Zambia where directors' duties have been given less attention.

1.9 Aim

The aim of this research is to analyse the legal mechanisms available for creditor protection in the UK in comparison to a developing country like Zambia.

[123] Thankom G. Arun & John Turner, 'Corporate Governance of Banks in Developing Economies: Concepts and Issues' (2004) CGIR, 12, 371
[124] Mathew Tsamenyi, Elsie Enninful-Adu & Joseph Onumah, 'Disclosure and Corporate Governance in Developing Countries: Evidence from Ghana' (2007) JMA, 22, 319

1.10 Objectives

The objectives of this study are:

1) To critically analyse the mechanisms for creditor protection in the UK.
2) To critically analyse the duties directors, have towards creditors in Zambia.
3) To assess the implementation of the legal framework for creditor protection in Zambia.
4) To systematically analyse the similarities and differences that exist between UK and Zambia.
5) To reflect on the challenges of ensuring creditor protection within the context of company law and corporate governance in a developing country like Zambia.

1.11 Research questions

1) What are the strengths and shortcomings of the legal mechanisms available for the protection of creditors in the UK?
2) How adequate and successful are the legal and regulatory mechanisms available for the protection of creditors in the context of quality of law in Zambia?
3) What are the challenges faced by creditors in Zambia?
4) What are the similarities and differences regarding creditor protection and what are the nature of these differences between UK and Zambia?
5) How can creditor protection in developing countries like Zambia be of better quality?

1.12 Research approach

The figure below illustrates the approach taken in relation to research questions and the method used to address them. This shows what research technique is used to answer the questions with doctrinal and qualitative methods being the major strategies.

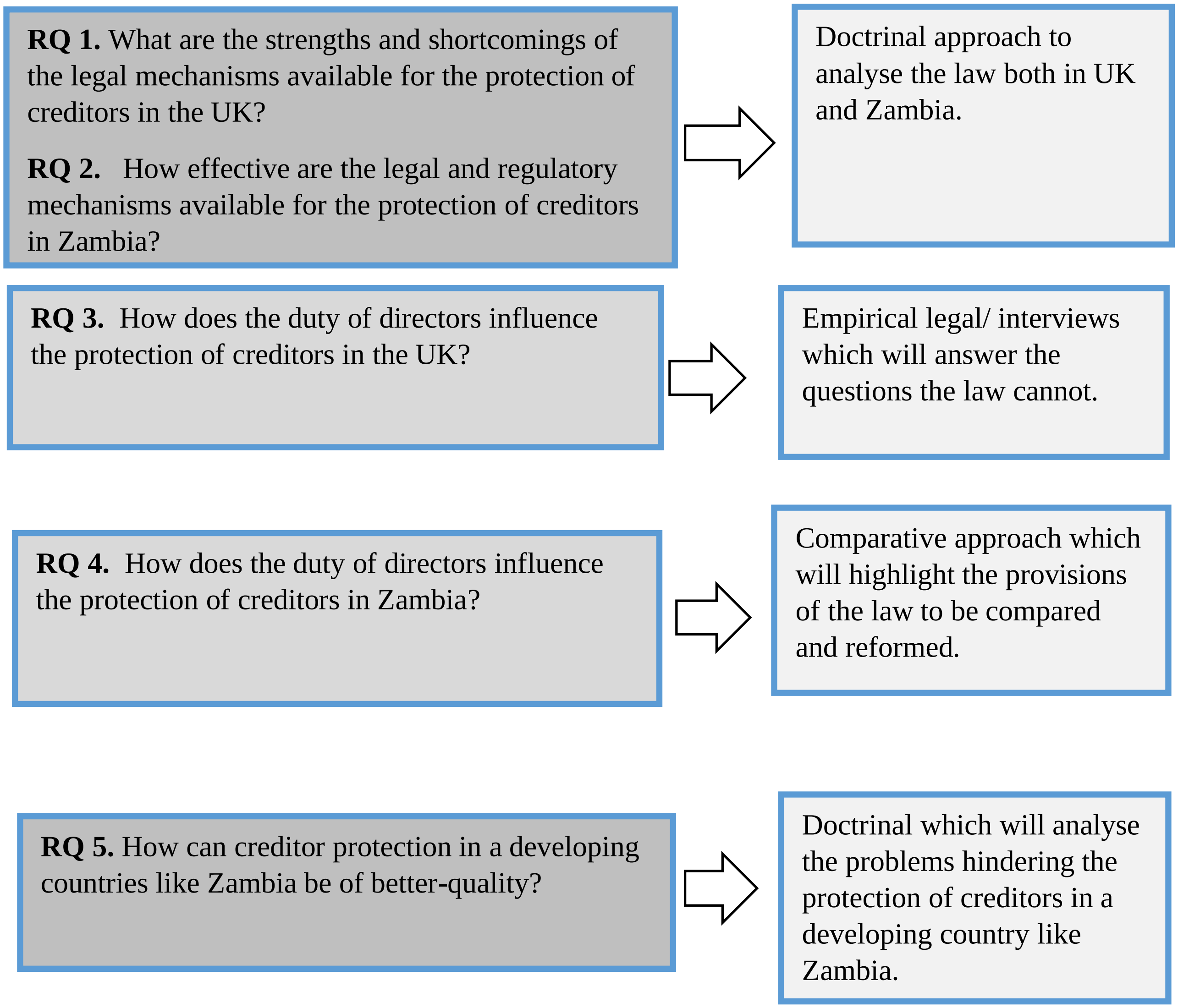

Figure 1:1 Research approach

1.13 Methodology

Research strategy simply means the methodology adopted for the study.[125] Methodology is the general orientation of conducting a research[126] or the study of the direction and implications of the research.[127] The strategy adopted is social-legal which is a combination of the doctrinal and

[125] Alan Bryman and Emma Bell, *Business Research Methods* (4th ed. Oxford University Press, 2015) 37
[126]Ibid
[127] Dawn Watkins & Mandy Burton, *Research Methods in Law* (Routledge, 2013) 2

qualitative empirical approach. The doctrinal approach is to critically analyse the law, legal principles, cases and qualitative is used to analyse primary data from the interviews. This is called the mixed method approach although it has only been designed on the social sciences because it combines quantitative and qualitative methods. This brings about the methodological question of whether the combination of two different methodologies from two different disciplines is qualified to be called a mixed method approach. Although literature does not address this question, scholars who have used this kind of approach used the word interdisciplinary.[128]Research that combines legal methods and social sciences has been referred to as social legal research. Conducting an inquiry in law is an entirely different approach in that it is examined in its own conceptual terms as it is a site or source of knowledge and authority.[129]

Central to legal research is the classic cannons of interpretation, reasoning and analysis assimilated from primary data which include statutes, case law, and general principles of law, customary law, and authoritative writings of prominent authors among other sources.[130] This normative analysis of law is known as 'doctrinal' and it has been at the heart of legal scholarship from the Roman times and it dominates legal research.[131] Qualitative research in social sciences involves the emphasis of words and it is inductive, constructionist and interpretive in nature its emphasis being on first hand data.[132] The data collected from interviews is measured qualitatively using thematic analysis both manually and on NVivo. This is a process of constructing an index of themes and subthemes that emerge from the interviews and it has been argued that the nature of the interviews generate a high volume of data which gives it a richness that one must be careful when analysing using the correct analysis tools.[133] This helped in the management and reporting of the data. Looking at the number of in-depth interviews of 45, the sample size was adequate to provide the information required to achieve the objectives of the study and make recommendations appropriately.[134]

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[128] Terry Hutchinson, 'The Doctrinal Method: Incorporating Interdisciplinary Methods in Transforming the Law' (2015) ELR, 8, 1065

[129] Terry Hutchinson and Nigel Duncan, 'Defining and Describing what we do: Doctrinal Legal Research' (2012) DLR, 17(1), 83-119: T. Brettel Dawson, Legal research in a social setting (1992) DLJ, 14, 445

[130] Mark Van Hoecke, *Methodologies of Legal Research: What Kind of Method for What Kind of Discipline?* (Hart Publishing, 2013) 11

[131] Tom R. Tyler, 'Methodology in Legal Research' (2017) ULR, 13,131

[132] Alan Bryman and Emma Bell, *Business research Methods* (4th ed. Oxford University Press, 2015) 392

[133] Alan Bryman and Emma Bell, *Business Research Methods* (4th ed. Oxford University Press, 2015) 430

[134] Alan Bryman, *Social Research Methods*, (4th ed. Oxford University Press, 2012) 160

1.14 **Conceptual framework**

The conceptual framework identifies the steps of the thesis leading to ideal creditor protection in the UK using legal analysis to address legislative gaps. The legislative gap between the UK creditor protection and Zambia is addressed using legal analysis to determine where Zambia can improve its framework for protecting creditors. Empirical analysis is used to analyse the implementation and enforcement gap between creditor protection in principle and in practice to determine challenges for creditors in Zambia.

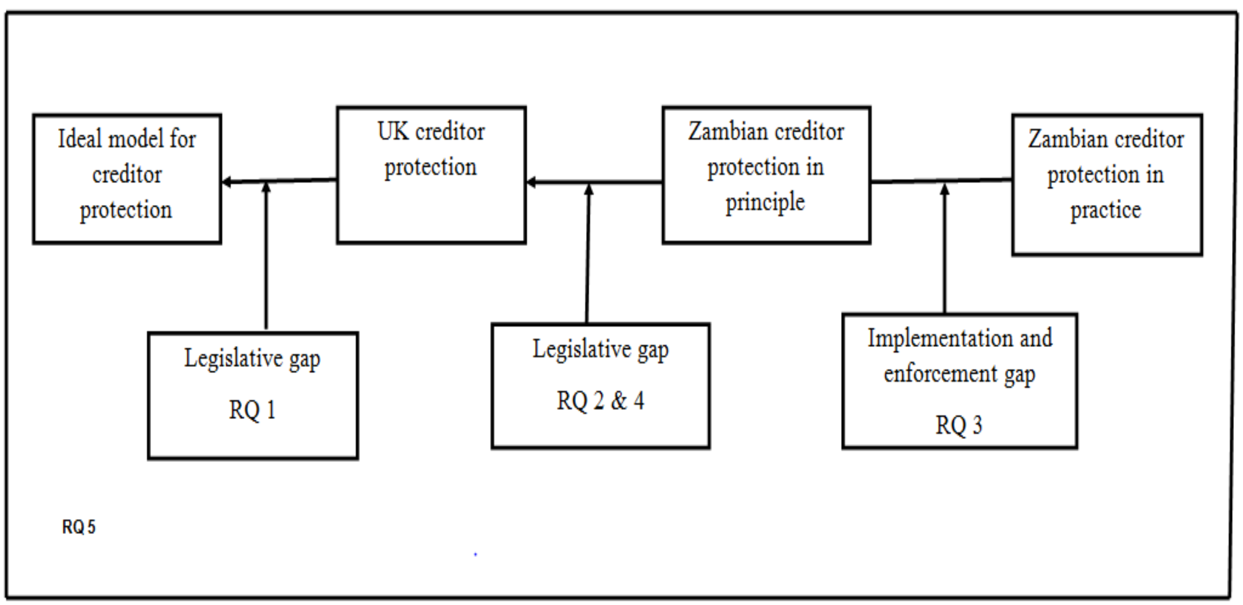

Figure 1:2 Conceptual framework

1.15 **Thesis structure**

The study consists of seven chapters. Chapter one is an introduction highlighting the scope and research questions, objectives and aim for the study. Chapter two is a critical analysis of the legal and regulatory framework for creditor protection in the UK and Chapter three consists of a critical analysis of the legal and regulatory framework for creditor protection in Zambia in comparison to the UK. Chapter four sets out the methodology and chapter five consists of the findings from the interviews. Chapter six consists of the discussion of findings. Chapter seven contains conclusions, contribution to knowledge, recommendations and limitations highlighting area for future research.

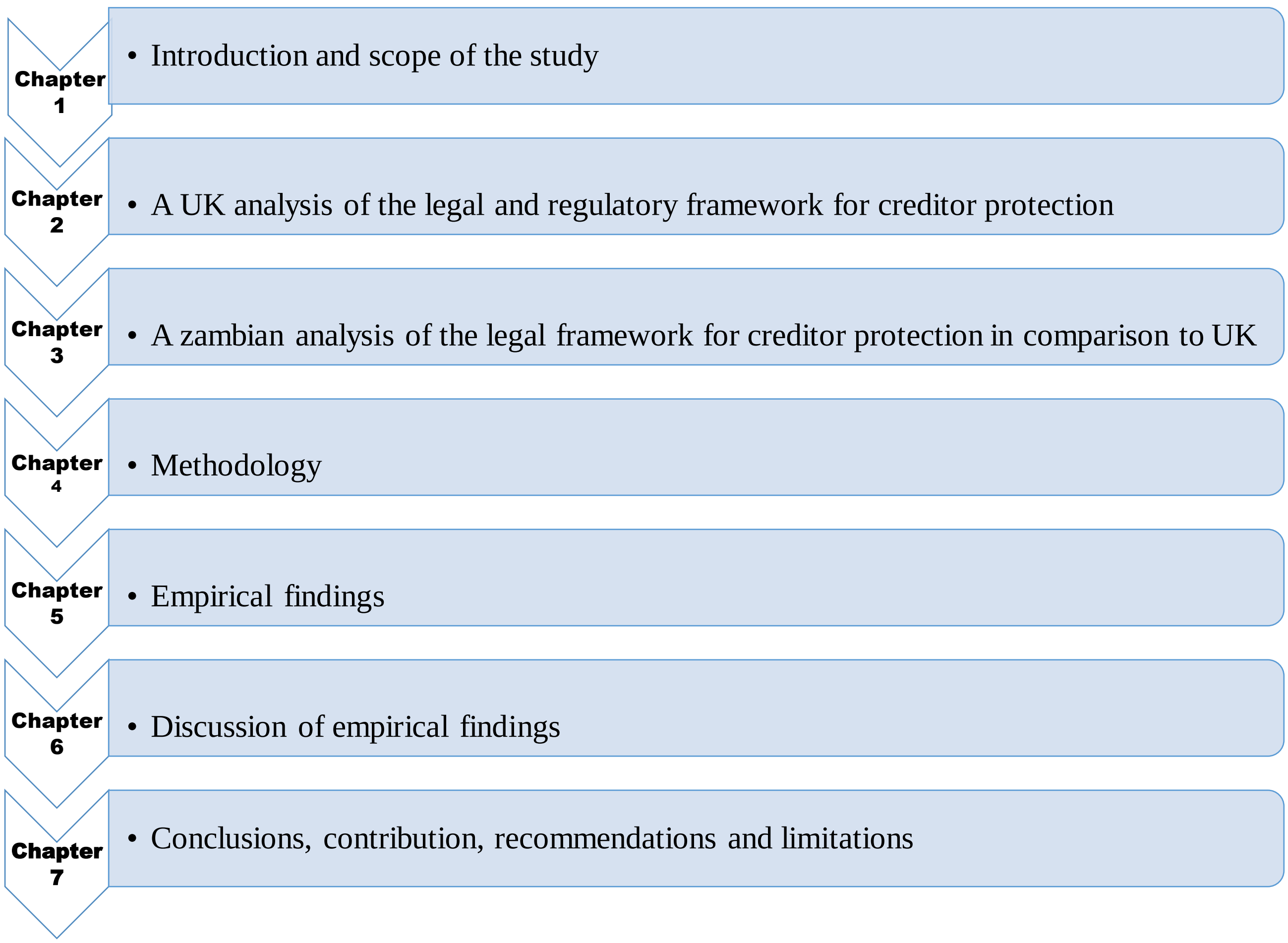

Figure 1:3 Outline of chapters

1.16 **Conclusion**

The chapter has highlighted the main arguments in relation to the protection of creditors. While the concept of limited liability was needed at the time of the economic revolution, it was only a matter of time before it became a problem for creditors. Although a company as a legal entity has advantages of incorporation that help to protect the company, this protection hinder creditor protection if not effectively used. In trying to ensure that shareholders are not abusing the corporate veil, the court allowed lifting the veil in instances where it has been established that it is used for fraud. However, this is one mechanism that the court has not been willing to implement because of the sanctity of the separateness of the company established in Salomon's case. This then leaves creditors needing more protection. The second issue is that during the governance of the firm, directors are to consider creditors' interests in time of financial difficulties. Although this was problematic under common law, the duty is still surrounded by uncertainties in terms of enforcement and implementation even after codification in the Companies Act 2006. Further to these problems, corporate governance has been formulated with the primacy model in which shareholders' interests are perceived to have the best interests of the firm and so companies are managed in their interest. In the process, this impede creditor protection and they are also neglected. These problems are also evident in Zambia especially with the lack of literature and a fully developed framework for corporate governance. Creditors are not protected adequately despite being the providers of corporate finance in developing countries. These issues raised in this chapter are analysed in detail in the subsequent chapters. The next chapter seeks to answer the first research question how effective the legal and regulatory mechanisms available for the protection of creditors in the UK are in terms of implementation and enforcement.

CHAPTER 2: **A critical analysis of the legal and regulatory framework for creditor protection and corporate governance in the UK**

2.1 **Introduction**

The analysis in this chapter consists of the enforcement of the legal and regulatory framework for governance in the UK focusing on mechanisms which impede creditor protection. These include attributes of incorporation, directors' duties in the vicinity of insolvency, fraudulent and wrongful trading provisions and shareholder model of corporate governance. While the above mechanisms could be argued to be good for governance of the company, the study argues that its ineffective enforcement and implementation including interpretational problems hinder creditor protection. The governance of the firm involves oversight, direction, stewardship and risk management by the board.[135] The company being created in the sight of law as an entity endowed with the attributes of a natural person,[136] its operations are carried out through the medium of human beings with different interests. This is made possible by three important clusters with representative powers, namely; shareholders, directors and management.[137] The shareholders subscribe equity shares in the company upon incorporation and appoint directors to manage the company, and directors appoint and monitor management, who also appoint employees.[138] Besides the three clusters and employees, there are other stakeholders with bona fide or vested interests in a company. These include customers, suppliers, creditors, regulators, and others.[139] The relationship between the company and these stakeholder groups is regulated within a set of rules and regulations provided by law or institutions empowered to govern such within company law and corporate governance.

The chapter is divided into three main parts. The first part is the analysis on the attributes of incorporation. This consists of the concepts that adversely affect creditors such as limited liability and legal personality. The second part looks at the duties of directors when a company is nearing insolvency. This covers the uncertainties surrounding directors' duties during financial difficulties and the weaknesses in the law on fraudulent and wrongful trading. The third part looks at

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[135] Bryant Smith, 'Legal Personality' (1928) YLJ, 37, 283
[136] Susan Watson, 'How a Company Became an Entity: A New Understanding of Corporate Law' (2015) JBL, 2, 120
[137] Bryant Smith, 'Legal Personality' (1928) YLJ, 37, 283
[138] Ibid
[139] Susan Watson, 'How a Company Became an Entity: A New Understanding of Corporate Law' (2015) JBL, 2, 120

shareholder primacy model of corporate governance and how it neglects creditors as a stakeholder group because it is based on the agency theory of governance.

2.2 Characteristics of a company and the implications for creditors

'A company is a corporate body or legal entity established following registration procedures in the Companies Act.'[140] For the investor to participate in profits without taking responsibility of the operations, and management to run the company without providing initial funds for it, shareholders have limited liability and their involvement is limited.[141] Monks and Minow defined a corporation as 'a structure established by law to allow different parties to contribute capital, expertise, and labour for their maximum benefit.'[142] This is because a company is designed to be a metaphor of a robust externalising machine for purposes of making profit.[143] Externalisation is an economic word which refers to a company keeping its earnings and reducing its costs by using external finance for its projects.[144] For this purpose to be accomplished, a company has two major attributes namely limited liability and legal personality.

2.3 The genesis of limited liability and the logic in Salomon v Salomon

General incorporation statutes enabling incorporation, registration and companies were all falling into the hands of different forms of legal organisations before the mid-19th century such as the Acts of Parliament or the grants from the Crown.[145] Apart from the above forms of incorporation, people had three ways in which they could do business and these included partnerships, sole trader business or unincorporated body.[146] In the 19th century, the political and economic struggle which was designed to promote corporate activity by means of encouraging investment in corporate shares led to the development of limited liability.[147] The law in the 1844 Companies Act brought about the first form of registered company which could be incorporated by registration unlike incorporation by Royal Charter or an Act of Parliament.[148] This was so provided the company had 25 members but the Act did not provide limited liability at the time as it was seen as a concern

[140] Section 1, Companies Act, 2006
[141] Robert A. G Monks & Nell Minow, *Corporate Governance* (5th ed. John Wiley & Sons, 2011) 6
[142] Ibid
[143] Ibid, 12
[144] Ibid
[145] Susan Watson, 'How a Company Became an Entity: A New Understanding of Corporate Law' (2015) JBL, 2, 120
[146] Bob Tricker, *Corporate Governance: Principles, Policies and Practices* (2nd ed. Oxford University Press, 2012) 7
[147] Peter Muchlinski, 'Limited Liability and Multinational Enterprises: A Case for Reform?' (2010) CJE, 34, 915
[148] Stephen Griffin, Company Law: *Fundamental Principles* (4th ed. Pearson Longman, 2006) 5

which could have exploited the body corporate to the detriment of the investing public and creditors.[149] While there was so much debate about limited liability and its absence, it was granted in the Limited Liability Act of 1855 with a minimum requirement of 25 shareholders.[150] The Act was then incorporated into the Joint Stock Companies Act 1856 which required that a company must have two constitutional documents vis a vis memorandum and articles of association.[151] In the bid to promote and encourage enterprises to register as companies for the purposes of business, the 1856 Act removed the requirement of the minimum share capital and reduced the number of required membership from 7.[152] The purpose of incorporating companies with limited liability was to promote corporate activities for shareholders and protect them from liability. This was fuelled by the desire to accelerate business activity which was inspired and generated by the industrial revolution and even though the concept was successful and precise, exploitation to the detriment of creditors started.[153]

There was reasonable need for external capital in order to expand businesses faster and yield profits.[154] Sealy argued that the company as was known during the 19th century was well established and its necessary features could be assumed both by judges and the Joint Stock Companies Act itself but this has changed.[155] Also it was asserted by Tricker that even though the concept was successful at that time, it was only a matter of time that corporations would start externalising the risk to the detriment of creditors but it was granted all the same. A company became a juristic person with rights separate from its members or shareholders and in law this means that the company is a legal person with rights and obligations.[156] This is a body corporate different from its members and also those that would become members in due course.[157] The body corporate can exercise its functions as required of an incorporated company.[158] In *Salomon v A.*

[149] Ibid
[150] Nicholas Bourne, *Bourne on Company Law* (7th ed. Routledge, 2016) 3
[151] Peter Muchlinski, ‘Limited Liability and Multinational Enterprises: A Case for Reform?’ (2010) CJE, 34, 915
[152] Ibid
[153] Bob Tricker, ‘Re-Invention the Limited Liability Company’ (2011) CGIR, 19, 384
[154] Bob Tricker, *Corporate Governance: Principles, Policies and Practices* (2nd ed. Oxford University Press, 2012) 7
[155] Len Sealy, ‘Directors' Wider Responsibilities - Problems Conceptual, Practical and Procedural’ (1987) MULR 13, 164
[156] Lean Sealy & Sarah Worthington, *Cases and Materials in Company Law* (10th ed. Oxford University Press, 2013) 33
[157] Section 16(2), Companies Act, 2006
[158] Section 16(3), Companies Act, 2006

Salomon & Co Ltd.[159] The House of Lords stated that the motives of the shareholders is irrelevant unless it is established that there was fraud involved. Lord Macnaghten stated that:

> '[T]he company is at law a different person altogether from the subscribers …..; and, though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them. Nor the subscribers liable, in any shape or form, except to the extent and in the manner provided by the Act.'[160]

This is argued to be the intention of the law that upon incorporation with limited liability, a company attains maturity henceforth, a body corporate made capable by statute cannot lose its individuality by issuing a bulk of its shares to one of the subscribers.[161] The House of Lords found that the purpose to which Mr Salomon and others were incorporated was lawful and arguments as to whether the company was a legal entity or not was resolved as the business belonged to the company and not to him. The important thing is to ascertain the existence of the legal attributes of the company which bring about obligations and rights including liabilities.

2.3.1 What did this mean for creditors?

Limited liability entails the limitation of liability of the members to the amount of the shares they subscribed to when incorporating a company.[162] The entity can sue and be sued in the corporate name and it can own assets and incur liabilities but the Members are not liable for its obligations.[163] This is argued to be one of the advantages of incorporation as it shields members from liability for company debt because of the separate legal personality which means that a company cannot be owned.[164] Tricker argued that the invention of limited liability was a significant concession of the society which promoted economic activities with clear objectives but later the concept has become besmirched.[165] It has been argued that the absence of limited liability could have led to the reduction of capital available for investment at such a critical time of modern economic growth.[166] Although the above argument has merits, the law failed to devise a mechanism protecting providers of external finance thereby exposing them to the consequences of limited liability. If introduction

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159 [1897] AC 22 (HL)
160 Alan Digman and John Lowry, *Company Law* (8th ed. Oxford University Press, 2014) 21
161 Len Sealy & Sarah Worthington, *Cases and Materials in Company Law* (10th ed. Oxford University Press, 2013) 33
162 Susan Watson, 'The corporate legal entity as a fund' (2018) JBL, 6,467
163 Bob Tricker, 'Re-Invention the Limited Liability Company' (2011) CGIR, 19, 384
164 Peter Muchlinski, 'Limited Liability and Multinational Enterprises: A Case for Reform?' (2010) CJE, 34, 915
165 Bob Tricker, 'Re-invention the Limited Liability Company' (2011) CGIR, 19, 384
166 Peter Muchlinski, 'Limited Liability and Multinational Enterprises: A Case for Reform?' (2010) CJE, 34, 915

of limited liability was surrounded by debates regarding externalisation of risk, it means that right from inception, legislators saw the problem associated with the concept but went ahead to grant it, nonetheless. Although it was important for development of economic activities, it is argued that the concept was also motivated by the need to protect individual shareholders from possible bankruptcy.[167] The purpose of legislation was to separate the company into a different persona with powers and privileges which meant that capital needed to be separated from the shareholders. However, this development was the beginning of challenges for creditors because of the corporate veil.[168] Salomon's case illustrated that a company is a separate legal entity capable of owning property in its own name independent of the members.[169]

The legal personality of a corporate entity is argued to be for functions which tend to ignore individuals in the corporate group but foster functions for responsible corporate activities.[170] The legal issue is the intention of the law when attributing such legal personality to a corporate entity. The answer is not clear though it has been argued that the purpose is to attach certain attributes on the company which empower it to create legal relations.[171] These legal relations relate to the abstractions of legal science like title, possession, rights, duties and obligations.[172] This suggests that the property belongs to the company and neither a member nor a creditor unless secured has an incurable interest in assets of the company.[173] Shareholders do not own company assets either individually or as a group and this applies to sole shareholders as well.[174] Cowton argued that this is a fundamental notion to the structural concept of legal personality that comes with a company having limited liability.[175] He went further to argue that even though corporate governance is focused on shareholders who argue that they own the company because it is founded on serving

[167] Susan Watson, 'How a Company Became an Entity: A New Understanding of Corporate Law' (2015) JBL, 2, 120
[168] Paul Davies, 'Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency' (2006) EBOLR 7, 301
[169] Christopher J. Cowton, 'Putting Creditors in their Rightful Place: Corporate Governance and Business Ethics in the Light of Limited Liability' (2011) JBE, 102, 21
[170] Bryant Smith, 'Legal Personality' (1928) YLJ, 37, 283
[171] Ibid
[172] Bryant Smith, 'Legal Personality' (1928) YLJ, 37, 283
[173] Len Sealy and Sarah Worthington, *Cases and Materials in Company Law* (10th ed. Oxford University Press, 2013) 41
[174] Christopher Cowton, 'Putting Creditors in their Rightful Place: Corporate Governance and Business Ethics in the Light of Limited Liability' (2011) JBE, 102, 21
[175] Ibid

and enhancing their objectives, the legal interpretation of a company deprives them of any interest in the assets of the company as a matter of law.[176]

Despite the debate surrounding ownership of the company, the law is clear on its intention to impose legal personality which implies that the assets of the company are independent of its members. In *Macaura v Northern Assurance Ltd*,[177] even though the major shareholder was the only unsecured creditor in the company, it was held that he had no legal relation with the property of the company. It was argued that his relation was to the company only and not assets. In *Prest v Petrodel*[178] it was stated that having more control of the company or owning a lot of shares is not an equitable interest in relation to company assets.[179] This legal principle if effectively implemented can be used to protect creditors. However, this has not been an effective means of enhancing creditor protection because of limited liability. How can the law protect creditors with the presence of legal personality of the company? The answer seems to suggest that this is not possible due to the arguments and abstractions that are found at the heart of the confusion in terms of the courts holding the sanctity of the company intact on one hand and on the other hand ensuring that it is not abused by showing that it can be taken away from the company. This is known as lifting the corporate veil.[180] The phrase 'lifting the veil' denotes the possibility of the judiciary going behind the framework of a company's legal personality to hold members liable for activities of the company.[181] The veil can be lifted on statutory or judicial grounds. Statutory grounds have included legal issues like evasion of existing legal obligations which seemingly is argued to be less problematic.[182] For example the law requires that group companies produce group accounts for purposes of paying tax.[183] On the other hand, judicial piercing has been problematic in achieving as the courts have not been consistent and in the process.

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[176] Ibid
[177] [1925] AC 619 (HL)
[178] [2013] UKSC 34
[179] Ibid
[180] Alan Dignam & John Lowry, *Company Law* (7th ed. Oxford University Press, 2012) 32
[181] Len Sealy & Sarah Worthington, *Cases and Materials in Company Law* (10th ed. Oxford University Press, 2013) 33
[182] Gregory Allan, 'The Corporate Veil and The Rise Of Alter Ego Companies' (2017) CL, 398, 1
[183] Section 399, Companies Act, 2006

2.3.2 Judicial disregard of the corporate veil

Although several attempts to explain circumstances in which the veil can be lifted through judicial means have been made, Digman and Lowry argue that none of them has been satisfactory.[184] This view is shared by Griffin[185] and is argued to lack definite methods, a burden which the courts have not yet resolved.[186] Scholars such as Easterbrook and Fischel observed that lifting the veil is severe and unprincipled.[187] Supporting this view Bainbridge described it as unjustifiable and arbitrary because it is vague and only creates uncertainty as it leaves judges with great discretion instead of achieving its purpose which is an effective policy outcome which can protect businesses.[188] Other scholars have advocated for its abolition because it exists as an exception to the general rule of limited liability and almost impossible to be used effectively.[189] Precedent indicate that there is no procedure henceforth, the courts have a tendency to use metaphysical terms such as 'mere fraud' 'sham', 'dummy', or 'alter ego' in their judgements which indicates challenges they face.[190] In analysing the cases in which the judiciary lifted the veil, the sequence by Ottelenghi in 1992 is adopted.[191] The analysis consist of four categories namely peeping behind the veil, penetrating the veil, extending the veil and ignoring the veil.[192] This is because it helps analyse circumstances in a categorical manner with distinctive cases. However, this does not provide a guide on how the court lifts the veil because sometimes they have refused to do.

2.3.2.1 Peeping behind the veil

This involves peeping through the company by lifting the veil to establish information involving shareholders and management, activities of the company, the inter-relationship of the shareholders and the management including the size of the shareholding.[193] This is for purposes of establishing control issues from the parent company. In *Daimler v Continental Tyres Co*,[194] the argument arising in the case included the justification of the attack on corporate personality. This was

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[184] Alan Digman and John Lowry, *Company Law* (7th ed. Oxford University Press, 2012) 25
[185] Stephen Griffin, *Company Law: Fundamental Principles* (4th ed. Pearson Education, 2006) 15
[186] Edwin C. Mujih, 'Piercing the Corporate Veil as a Remedy of Last Resort after Prest v Petrodel Resources Ltd: Inching Towards Abolition: Limited Liability' (2016) CL, 37, 39
[187] Frank Easterbrook and Fischel Daniel, *The Economic Structure of Corporate Law* (Harvard University Press, 1991) 187
[188] Stephen M. Bainbridge, 'Abolishing Veil Piercing' (2000) JCL, 26, 479
[189] Edwin C. Mujih, 'Piercing the Corporate Veil as a Remedy of Last Resort after Prest v Petrodel Resources Ltd: Inching Towards Abolition: Limited Liability' (2016) CL, 37, 39
[190] Lynn Gallagher and Peter Ziegler 'Lifting the Corporate Veil in the Pursuit of Justice' (1990) JBL, 1, 292
[191] S. Ottelenghi, 'From Peeping Behind the Veil to Ignoring it Completely' (1990) MLR, 53, 6026
[192] Ibid
[193] Ibid
[194] [1916] 2 AC 307

regarding the case being fitted into a cohesive analytical framework which is appropriate to corporate personality. The House of Lords decided that the question of a company having an enemy status was not dependent on the real legal person approaches but on a contractarian examination which goes further by considering the individualities of shareholders. As no general meaning of 'control' has been given, it can only adopt meaning within the context it is used. In *Bermuda Cablevision Ltd v Colica Trust Co Ltd*[195] the court said that the expressions such as control or controlling interest take their own colour from the context in which they appear.[196] This is to say that every case will adopt the meaning of control depending on the facts in the case and how these facts represent a controlling effect. Lord Parker stated that it was relevant to examine the idea of control as the connection between the shareholders personal characteristics and the activities of the company were prima facie relevant.[197] Thus peeping behind the veil enables the courts to establish the true legal status or position of the company. It is therefore argued that peeping behind the veil does not lead to personal liability of shareholders for debts of the company but it is a first and essential step in which the courts examine the features of the company such as the composition and control usually for tax purposes.[198]

2.3.2.2 Penetrating the veil

Penetrating the veil refers to the courts holding shareholders personally liable for the actions of the company.[199] The courts impose a principal-agent relationship in order to hold the shareholders responsible. Penetrating the veil is special because it imposes the agency relationship between the shareholders and the company (usually the controlling shareholders).[200] The imposition of the agency relationship was used as a persuasive argument in the case of Salomon however the House of Lords refused to impose such a relationship but laid down the strict principle of company law which is the separateness of the company. A good illustration of penetrating the veil by imposing an agency relationship was in *Wallersteiner v Moir*[201] where the defendant Mr Moir had accused the claimant of several counts of fraud. This was concerning the legality of loans from one company account to the other which was under the control of its director. The law that time

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195 [1998] 1 BCLC 1
196 Ibid
197 Christopher Raune, 'Metaphysical and the Corporate Veil' (2005) CL, 26, 62
198 S. Ottelenghi, 'From Peeping Behind the Veil to Ignoring it Completely' (1990) MLR, 53, 6026
199 Ibid
200 Nicholas Bourne, *Bourne on Company Law* (7th ed. Routledge, 2016) 27
201 [1974] 1 WLR 991

prohibited companies giving loans to its directors.[202] Lord Denning in delivering judgement stated that the company was merely a puppet of Dr Wallersteiner and therefore the loan was to him. Lord Denning stated that:

> '[T]he commercial concerns worked by Dr Wallersteiner were legal entities, even so, …. because he made all the decisions …to the exclusion of others…. he owned them as he directed them…. they were his agents and he was the principal…. Therefore, the court must hold him responsible for his creatures.'[203]

This statement suggests that the companies had no status of their own but were mere agents. By peeping through the veil the agency relationship was imposed by the court through looking into the relationship between the controlling shareholder and the company hence, the veil was lifted by penetration through imposition of agency relationship in order to make the controlling shareholder liable.[204] The court constructs direct interests of the shareholders into the activities of the company by imposing the agency relationship.[205] The court will hold shareholders liable for the activities of the company by imposing that the company is an agent through which the shareholders have perpetrated their actions. This position was earlier argued by Griffin when he proposed that it is necessary to first establish the degree of control involved in a company although he expresses a different view about the courts imposing the agency relationship. His argument being that in terms of pure theory, an agency relationship creates no disturbance to the subsidiary corporate veil because to establish an agency relationship, one must have a principal and agent. Nonetheless these are two distinct legal entities therefore, as a legal concept, agency is not a device by which the corporate veil can be dislodged. Although, notwithstanding the theory, the finding of an agency relationship between two distinct entities has the same effect as if the corporate veil had not been lifted, namely the principal will be held liable for the actions of an agent.[206] His argument is simply that if the court is imposing an agency relationship, it means there is no need to dislodge the veil as the principal is already liable by virtue of the relationship.

However, Griffins' argument does not take into consideration the process in which this is conducted, in the sense that, the court will not impose the agency relationship because facts have

[202] Section 197, Companies Act, 1948
[203] [1974] 1 WLR 991
[204] Ibid
[205] K. V Krishnaprasad, 'Agency, Limited Liability and the Corporate Veil' (2011) CL, 32, 163
[206] Stephen Griffin, *Company Law: Fundamental Principles* (4th ed. Pearson Education, 2006) 15

been brought forward but because of the corporate veil shielding the shareholders. Instead, the courts will peep behind the veil and establish the legal status and position of the company by examining the shareholding information and management and then, an order will be made if need is found to penetrate veil and if the subsidiary is being used as a puppet, the court will then impose the agency relationship. This is because without penetration of the veil, even though the agency relationship is imposed, it is unlawful to impose liability on shareholders. In *Adams v Cape Industries*[207] the court declined to impose an agency relationship as there was no control on the company from the shareholder. Griffin did not consider that the imposition of the agency relationship is needed because legally it does not exist between the company and the shareholders but directors. Which means unless the relationship is imposed, there is no ground for holding shareholders as principals or imposing liability on them.

2.3.2.3 Extending the veil

The third form is the extension of removal of the separate personality from each one of the components in group companies so as to draw attention to the parent company.[208] This usually happens in subsidiary companies when the court decides to remove the veil for the dominant company to hold it liable for the actions of subsidiaries.[209] This evolved from the decision of Salomon which was a one man company but now the modern phenomenon involves the corporate group having subsidiaries which are separate legal entities.[210] From that time, the courts have been reluctant on lifting the veil of incorporation because of the strict adherence to the rule in Salomon's case. The illustration can be seen in the statement by the Court of Appeal in the case of *Adams v Cape Industries.*[211] It was stated that:

> '[…] save in the case which turn on the wording of particular statutes or contracts, the court is not free to disregard the principle in Salomon merely because it considers that justice so requires. ….the law recognises the creation of subordinate corporations, which are creatures of the their parent companies, will nonetheless under the general law fall to be treated as separate legal entities with all the rights and liabilities which would normally be attached to separate legal entities.'[212]

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[207] [1990] Ch 433
[208] S. Ottelenghi, 'From Peeping Behind the Veil to Ignoring it Completely' (1990) MLR, 53, 6026
[209] Stephen Griffin, *Company Law: Fundamental Principles* (4th ed. Pearson Education, 2006) 15
[210] Brenda Hannigan, *Company Law* (4th ed. Oxford University Press, 2016) 58
[211] [1990] Ch 433
[212] [1990] Ch 433

Lord Denning in *DNH Food Distributors Ltd v Tower Hamlets LBC*[213] argued that a group of companies was a single economic entity and should be treated as one. However, two years later the House of Lords in *Woolfson v Strathclyde Regional Council*[214] disapproved Lord Dennings' judgement in the DNH case stating that: English courts have shown strong determination not to embark on such a development. This means that the courts are determined to adhere to the strict principle in Salomons' case by affording corporate personality to individual companies in group companies. The fundamental principle is that each company in a group is a separate legal entity. It has been argued that managerial autonomy, applicability of laws, tax benefits, the ability to circumscribe to group's exposure to risk are advantages of doing business as a corporate group.[215]

2.3.2.4 Ignoring the veil

This is when a company does not exist on sound and legitimate purposes but mere fraud and sham to defeat creditors.[216] The courts completely ignore the veil and hold the shareholders liable for the actions of the company because of fraud and it is argued that this is one of the most severe forms of lifting the veil.[217] Although others have questioned its existence, it was stated that despite the rule being an exception, the courts need to devise some coherent, practical and principles for it.[218] The landmark case of Salomon still reigns in that the courts are reluctant in piercing the veil. In *Jones v Lipman*,[219] Lipman sold a house to Jones but refused to complete the sale. He then executed a sham transfer of the house to a company which was held by him and the clerk to his solicitors and they were the only shareholders and directors of the company. The company was held to be a mere sham and a creature of the defendant. In *Prest v Petrodel Resources Ltd*,[220] Lord Sumption stated that:

> '[I] conclude that there is a limited principle of English Law which applies when a person is under an existing legal obligation or liability or subject to an existing legal restriction which he deliberately frustrates by interposing a company under his control. The court may pierce the veil for the purpose and only for the purpose of depriving the

[213] [1976] 3 ALL ER 462
[214] [1979] 38 P & CR 51
[215] Rishi Shrof and Shwetank Ginodia, 'A Corporate Governance Perspective on Lifting the Veil in Group Companies in India and United Kingdom' (2014) ICCLR, 25, 423
[216] Brenda Hannigan, Company Law (4th ed. Oxford University Press, 2016) 58
[217] S. Ottelenghi, 'From Peeping Behind the Veil to Ignoring it Completely' (1990) MLR, 53, 6026
[218] Edwin C. Mujih, 'Piercing the Corporate Veil as a Remedy of Last Resort after Prest v Petrodel Resources Ltd: Inching Towards Abolition: Limited Liability' (3016) CL, 37, 39
[219] [1962] 1 ALL ER 442
[220] [2013] UKSC 34

company or its controller of the advantage that they would have had obtained by the company's separate legal personality.'[221]

This brought family law and company law together. The ability of the court to grant relief to the wife who wanted properties to be transferred to her because they belonged to companies owned by her husband.[222] The Supreme Court granted the orders in favour of the wife. However, the veil was not lifted but another mechanism was used in granting the remedy.[223] The assets entitled to the husband in possession or reversion and the orders could be made in favour of the wife on grounds of trust for the controller company (the husband).[224] Lord Walker stated that:

> "[….] I consider that 'piercing the corporate veil' is not a doctrine at all, in the sense of a coherent principle or rule of law. It is simply a label - often, as Lord Sumption observes, used indiscriminately - to describe the disparate occasions on which some rule of law produces apparent exceptions to the principle of the separate juristic personality of a body corporate reaffirmed by the House of Lords in Salomon v A Salomon and Co Ltd [1897] AC 22."[225]

Hannigan argues this ruling may result in the need for creditors to consider the nature in which assets were acquired.[226] The significance of this case intersects both company law and family law and sets a precedent on how assets of the corporate structure can be claimed in a divorce case.[227] It also sets a high standard that piercing of the veil can only be done as a last resort in special circumstances only and the court has the discretion to decide these circumstances. Despite the merits associated with veil piercing, it has negative effects on the concept of corporate personality in that it leads the courts to distance themselves from the rule in Salomon which is the benchmark of company law, a process the courts are reluctant to convey in most cases. An example is the case of Prest where they used other means to come up with a fair relief commenting that lifting the veil should only happen as a last resort.[228] Thus by so doing, there is little hope for creditors to be

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[221] Brenda Hannigan, *Company Law* (4th ed. Oxford University Press, 2016) 58
[222] Section 24 (1) (a), UK Matrimonial Causes Act, 1973
[223] Edwin C. Mujih, 'Piercing the Corporate Veil as a Remedy of Last Resort after Prest v Petrodel Resources Ltd: Inching Towards Abolition: Limited Liability' (2016) CL, 37, 39
[224] Ibid
[225] Prest v Petrodel Resources Ltd [2013] UKSC 34, p.43
[226] Brenda Hannigan, *Company Law* (4th ed. Oxford University Press, 2016) 50
[227] Edwin C. Mujih, 'Piercing the Corporate Veil as a Remedy of Last Resort after Prest v Petrodel Resources Ltd: Inching Towards Abolition: Limited Liability' (3016) CL, 37, 39
[228] Leonora Onaran, 'The Trust Behind the Veil: Prest v Petrodel' (2013) PCB, 5, 273

protected. In *Re Polly Peck International PLC*,[229] the court acknowledged that the separate legal existence of group companies is particularly important when creditors are involved. While this works to the advantage of companies, it harms creditors especially that the law cannot devise mechanisms in which they can be protected from such an autonomous concept. In *Ord V Belhaven Pubs Ltd*,[230] the court acknowledged that companies decide on how the administrative structures of the business in group companies is designed. The court is expected to apply the doctrine in Salomon. The falling of liability on another company is not part of that duty for the court.[231] The principle use of corporate groups is claimed to be risk management[232] as stated in *Re Southard Ltd*[233] when Templeman L.J. stated that:

> '[A] parent company can discard a runt of the litter. A parent company may spawn a number of subsidiary companies, all controlled directly or indirectly by the shareholders of the parent company – if one to change a metaphor turns out to be a runt of the litter and goes into insolvency, to the dismay of the creditors, the parent company and other subsidiary companies may prosper to the joy of the shareholders without any liability for the debts of the insolvent subsidiary.'[234]

It is argued therefore that a legal mechanism for the protection of creditors is essential not only for the benefit of creditors but commercial industry as well. This is owing to companies continuously needing external finance. Although it has been argued that lifting the veil is for purposes of protecting creditors, its implementation is surrounded by legal challenges that inhibit creditor protection in practice. There is a gap between the concept in theory and how it is applied as demonstrated in the analysis above. Piercing the veil is argued to be a mechanism that can help creditors in theory. However, in practice the courts have shown that they are reluctant to do so. Whereas the veil legally protects shareholders, it does protect the company in general and this includes directors and management to a certain extent in the sense that it is like an umbrella over the company. Any attempts to remove it must first look at the activities of the company, especially the board. This is because they have the mandate to manage company affairs and fraud is the root to which the veil can be lifted. This therefore is the basis on which directors' duties need to be improved to enhance creditor protection. This is because the study argues that if directors' duties

[229] [1996] 1 BCLC 428
[230] [1998] 2 BCLC 447, CA
[231] Brenda Hannigan, *Company Law* (4th ed. Oxford University Press, 2016) 61
[232] Ibid
[233] [1979] 3 All ER 556
[234] Ibid

were effective, creditors could be well protected to a certain extent. This can improve by ensuring that the enforcement of the law and implementation mechanisms are effective such that a company is protected and if this done, the creditors too would be protected because they facilitate corporate finance. This means that directors duties ought to be enforced effectively without uncertainties.

2.4 Directors' duties to the company

In the UK shareholder primacy is the foundation on which companies are managed as directors are accountable to shareholders collectively.[235] The law requires that directors act in a distinctive way in the process of managing and controlling a company.[236] This is because of the separation between ownership and control thus, the shareholders are not involved in the management of the company hence they appoint directors to run the company.[237] Prior to the amendment of the companies Act in 2006, there were established fiduciary duties with an overriding principle that fiduciaries are not to benefit from their position of trust.[238] Among other duties, directors were required to act bona fide in the best interest of the company.[239] It could be argued that section 172 is only restating the duty with a more difficult approach in terms of implementation.[240] These fiduciary duties were of a trust and agency relationship as illustrated in *Re Lands Allotment Co*[241] where Lord Lindley stated that:

> '[D]irectors are not proper trustees yet they have been acknowledged as such for a long time now… treated as trustees of money which comes to their hands or actually which comes under their control; and ever since joint stock companies were invented, directors have been held liable to make good moneys which they have misapplied upon the same footings as if they were trustees.'[242]

The primary nature of trust brings about high standards of loyalty and integrity in the performance of duties because they have to manage the assets of the company.[243] The duties arising from a trustee relationship traces back to the 19th century before the Joint Stock Companies Act even

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[235] Ahmed Al-Hawamdeh, Iris H-Y Chiu, Marc Goergen, Chris Mallin and Eve Mitleton-Kelly, 'The Interpretation of the Director's Duty under Section 172 Companies Act 2006: Insights from Complexity Theory' (2013) JBL, 4, 417
[236] Ross Grathan, 'The Judicial Extension of Directors' Duties to Creditors' (1991) JBL, 1
[237] Brenda Hannigan, *Company Law* (4th ed. Oxford University Press, 2016) 121
[238] Alan Digman and John Lowry, *Company Law* (8th ed. Oxford University Press, 2014) 332
[239] Stephen Griffin, *Company Law: Fundamental Principles* (4th ed. Pearson Education, 2006) 296
[240] Andrew Keay, 'The Duty to Promote the Success of the Company: is it Fit for Purpose?' (2010) University of Leeds School of Law, Centre for Business Law and Practice Working Paper. https://ssrn.com/abstract=1662411
[241] [1884] 1 Ch 616
[242] Re Lands Allotment Company [1884] 1 Ch 616
[243] Len Sealy, 'Directors' Wider Responsibilities - Problems Conceptual, Practical and Procedural' (1987) MULR 13, 164

though today the analogue doesn't seem to hold grounds that directors are trustees of a company.[244] The courts framed fiduciary duties of trust from *Keech v Sandford*[245] where they decided that directors have no legal title to company property but they hold the property under a trust relationship. In *Re Smith v Fawcett Ltd,*[246] it was reaffirmed that duties relate to acting in the best interest of the company. This adopts a subjective test and case law did not provide an answer to what amounted to the 'best interest of the company' a problem still evident after codification.[247] Attempting to solve the interpretation problem, the court in *Howard Smith Ltd v Ampol Petroleum Ltd*[248] stated that, it interprets the actions of a director to find the purpose behind a power use in order to determine whether the duty for proper purpose has been infringed. In *Mutual Life Insurance Co. v The Rank Organisation Ltd,*[249] a company issued more shares, a proportion of which were to be made available to shareholders. The company then decided not to offer the shares to shareholders in the USA but to those in Canada which was prima facie discrimination. However, the court held that the decision not to offer the shares was not for the purposes of discrimination but rather to avoid the expenses that were involved in complying with share issue procedures in both countries and hence the decision was in the best interest of the company and for proper purpose.[250]

The debate surrounding directors' duties in relation to creditors is still present although the duty traces back to the Australian case of *Walker v Wimborne*[251] and the decision in the famous case of *Kinsela v Russell Kinsela Pty Ltd*[252] in which directors were required to consider the interests of creditors and that shareholders must not ratify decisions of directors if they seem biased to creditors respectively. Directors owing a fiduciary duty to creditors was echoed in the English courts in *Lonrho v Shell Petroleum*[253] where Lord Diplock stated that the best interests of the company may not exclusively be those of the shareholders but may include creditors. The implication of this decision was that in order to have the interests of the company as a priority, the welfare of creditors

[244] Ross Granthan, 'The Judicial Extension of Directors' Duties to Creditors' (1991) JBL, 1
[245] [1726] 25 ER 223
[246] [1942] Ch 304
[247] Stephen Griffin, *Company Law: Fundamental Principles* (4th ed. Pearson Education, 2006) 297
[248] [1974] AC 821
[249] [1985] BCLC 11
[250] Stephen Griffin, *Company Law: Fundamental Principles* (4th ed. Pearson Education, 2006) 298
[251] [1976] 137 C.L.R 1
[252] [1986] 4 N.S.W.L.R. 722
[253] [1980] 1 WLR 627

could as much qualify as interests of the company hence; the duty could extend to creditors for purposes of company interests. A similar principle was given in the case of *Re Horsley and Weight Ltd*[254] where Lord Buckley referred to the terminology of directors owing an indirect duty to creditors not to permit unlawful reduction of capital.[255] He stated that:

> [I]t may be somewhat loosely said that the directors owe an indirect duty to the creditors not to permit any unlawful reduction of capital to occur, but I would regard it as more accurate to say that the directors owe a duty to the company in this respect and that, if the company is put into liquidation when paid-up capital has been improperly repaid, the liquidator owes a duty to the creditors to enforce any right to repayment which is available to the company.[256]

This was endorsed in *Brady v Brady*[257] in which both the Court of Appeal and the House of Lords stated that directors needed to consider creditors' interests if they were to act in the interest of the company. In order to remedy the defects that existed with regards to directors' duties at common law, to enable greater clarity on what is to be expected of directors, and to make the law more accessible by providing authoritative guidance in governing modern business, and making development of law without hindering the courts, there was need to codify directors duties.[258] The above reasons among other issues led to the codification of directors' duties into the Companies Act in 2006.

2.4.1 Directors' duties after the Companies Act 2006 and its impact on creditors

After codification, the law requires that directors act in a way they consider in good faith, to promote the success of the company for the benefit of its members. [259] However, under certain circumstances directors are required to consider or act in the interests of creditors.[260] In construing the law, particularly section 172, it is imperative to note that when the company is in financial distress, section 172(1) is substituted by section 172(3) hence the focus is no longer the members but creditors.[261] This duty is applicable to directors when the company is insolvent, nearing

[254] [1988] 3 ALL ER 617 (HL)
[255] Nicholas Bourne, *Bourne on Company Law* (7th ed. Routledge, 2016) 179
[256] [1982] 3 W.L.R. 431
[257] [1989] 3 BCC 535 (CA)
[258] Len Sealy, 'Directors' Wider Responsibilities - Problems Conceptual, Practical and Procedural' (1987) MULR 13, 164
[259] Section 172(1), Companies Act, 2006
[260] Section 172(3), Companies Act, 2006
[261] Andrew Keay, 'The Shifting of Directors' Duties in the Vicinity of Insolvency' (2015) IIR, 24, 140

insolvency or in doubtful insolvency.[262] However, the interpretation of this section has attracted a lot of controversy because the law is not clear on the actual aspects of application. It has been argued that even though the duty flows from the traditional fiduciary duty to act in the best interest of the company, courts have been tentative in stating when the duty arises or comes into effect.[263] Keay stated that even after the duty was codified, it is inadequate in terms of principles attached to it hence he submitted that the law is not fit for purpose for which it was enacted.[264] Two major problems have been identified with this duty; the first being the trigger point and secondly, the meaning of 'considering or to acting in the interest of creditors.' These are analysed below separately.

2.4.2 The uncertainties on the trigger point in relation to creditors

Whereas this provision is meant to protect interests of creditors, its implementation has been surrounded by uncertainties rendering its purpose problematic. When a company is in financial difficulties, directors are required to consider creditors' interests because any reckless behaviour during this time could result in personal liability under the Insolvency Act.[265] For directors to be held liable under wrongful trading, the company has to be in formal insolvency proceedings. Another requirement is that directors knew or ought to have known that the company would not recover from such insolvency and that they did nothing to minimise the risk of loss on creditors.[266] The problem is that while directors would want to avoid personal liability, it is actually difficult to tell exactly when the company gets into distressed mode.[267] The first issue is that directors may have to be able to identify that the company has gone into financial distress. The duty is owed to the company and require that during financial distress, directors are to consider creditors' interests and in construing what this period means, case law has indicated a number of trigger points and four of them are discussed. The first is when a company is nearing or approaching insolvency, the second is when a company is in doubtful insolvency, the third is when a company is in actual

[262] Andrew Keay, 'Formulating a Framework for Directors' Duties to Creditors: An Entity Maximisation Approach' (2005) CLJ, 46, 614
[263] Andrew Keay, 'The Duty to Promote the Success of the Company: Is it Fit for Purpose?' (2010) University of Leeds School of Law, Working Paper, Accessed on 13/02/2017 from: https://ssrn.com/abstract1662411
[264] Ibid
[265] Section 214, Insolvency Act, 1986
[266] Ibid
[267] Andrew Keay, 'The Shifting of Directors' Duties in the Vicinity of Insolvency' (2015) IIR, 24, 140

insolvency and the fourth is when directors know or should know that the company is or is likely to become insolvent.[268]

The first is when a company is in actual insolvency, either cash flow or balance sheet insolvency.[269] This require directors to know for sure that the company is in cash flow[270]or balance sheet insolvency.[271] In *Kinsela v Russell Kinsela Pty Ltd*[272] the court stated that, when a company is financially stable, directors are allowed to have the interests of the shareholders within their duties. However, when it goes into insolvency, creditors' interests become paramount to directors because the assets of the company belong to creditors during this time. Any decision made by the board to put company assets beyond reach for creditors, is a breach of their fiduciary duty to the company. This decision had so much influence on the English courts and in *Liquidator of West Mercia Safetywear Ltd v Dodd*[273]the court was of the view that when a company is being run for purposes of saving itself not for shareholders during insolvency, it is run for the sole purpose of creditors. Similarly, in *Re Pantone 485 Ltd*, [274] the court stated that when directors perform their duties with interests of creditors, there is no breach of fiduciary duty. This means that, if creditors' interests are not considered during financial distress, directors are in breach of their duty to the company.

In the second scenario the duty applies when the company is on the verge of insolvency, nearing insolvency or approaching insolvency. In *Re Horsley & Weight Ltd*[275] it was stated that directors are liable if they made decisions against creditors knowing that the company was in doubtful insolvency. In the UK, the court in *Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd*[276] indicated that, for directors to act within their fiduciary duties, they have to contemplate on the impact of their decisions on the capabilities of creditors recovering their money. This puts

[268] Rosemary Teele Langford and Ian Ramsay, 'The Creditors' Interests duty: When Does it Arise and What Does it Require?' (2019) LQR, 135, 385
[269] Andrew Keay, 'The Shifting of Directors' Duties in the Vicinity of Insolvency' (2015) IIR, 24, 140
[270] Section 123(1), Insolvency Act, 1986
[271] Section 123(2), Insolvency Act, 1986
[272] [1986] 4 NSWLR 722
[273] [1988] BCLR 250
[274] [2002] BCC 899
[275] [1986] 4 ACLC 215
[276] [2002] EWHC 2748 (Ch)

directors in a position where every decision they make during this time, consideration of its impact need to be weighed against creditors.

The third is said to happen when there is a probability of insolvency or when there is a likelihood of insolvency.[277] In *Facia Footwear Ltd (In Administration) v Hinchliffe*[278] it was shown that cash flow insolvency had been established by directors and they acted in the best interest of creditors as they were fully convinced that the company would survive insolvency. In *Wessely v White*[279] it was held that the managing director had not breached his fiduciary duty because he acted in the interest of everyone including creditors, when he entered into a new contract believing that the advice of a trusted professional was genuine although it turned out to be a mistake. The decision raises a question as to whether going further to seek professional advice is a factor that can be used by directors to illustrate that they did consider creditors' interests. The other issue is whether reliance on such professional advice must be unequivocal considering it is given by a professional. All these questions are difficult to answer as the law does not address them. However, while directors could be free from liability after relying on professional advice, perhaps it could help creditors if, directors could show that relying on such advice was indeed in the best interest of creditors, and that it was independent, free from any influence. This could help in holding the third party liable if they give advice susceptible to misrepresentation in contract law. In such a scenario, the company can sue advisor and the proceeds is to be given to creditors. The idea is for creditors to have recourse within the law protecting them from loss resulting from actions of other people. Even though there has been a consensus on the duty arising when a company is nearing insolvency or on the verge of insolvency or almost insolvent, or in actual insolvency, there seems to be continuous uncertainties on what time exactly the duty is to arise. While these uncertainties are founded on inadequacies of the law in theory,[280] case law has equally not been able to address this question.

[277] Rosemary Teele Langford and Ian Ramsay, 'The "Creditors' Interests Duty": When Does it Arise and What Does it Require?' (2019) LQR, 135, 385
[278] [1988] BCLC 218
[279] [2018] EWCA 1499 (Ch)
[280] Donna McKenzie-Skene, 'Directors' Duty to Creditors of a Financially Distressed Company: A Perspective from Across the Pond' (2007) JBTL, 1, 499

The fourth scenario is when directors know or should know that the company is or is likely to become insolvent. In *BTI 2014 LLC v Sequana SA*[281] the court indicated that anything short of insolvency cannot trigger the duty, as such would not be part of present law, but the duty arises when directors know or should know that a company is or is likely to be insolvent. This requires a company to be in actual insolvency or on the verge of insolvency and it does require that directors should know, or the company must be in a position where directors should have known that insolvency is not only probable but inevitable. Perhaps it means that directors need to know for sure that the company might go into insolvency. However, what about the decisions made when directors think there is no risk of insolvency, yet the company ends up insolvent? This could mean that as long as directors are not certain about insolvency, they have no obligation to consider creditors' interests, or until the company gets into a position where it was inevitable for directors to know that the company was in a risk of insolvency. This could confirm how creditors are left unprotected until the financial position has changed. This is perilous because sometimes creditors might not recover everything even the secured creditors as security does not guarantee removal of risk. This duty attaches to directors the moment they know or are likely to know that the company can no longer pay for debts as it falls due not as a matter of choice.[282] Many have argued to the difficulties of establishing exactly when the company has gone into difficulties despite the guidance of case law as the courts have surely dealt with each case differently. Keay argues that the theoretical reason for the shift of the duty is because in the vicinity of insolvency, the residue risk bearers are no longer shareholders but creditors whose rights are equity-like.[283] While this problem has been identified on the part of directors as a practical issue, it represents a legal problem detrimental to creditors as well as to the intention of the law. It has been established that doing business with an incorporated company is a known risk for creditors. Lord Justice Richards in BTI stated that the purpose of incorporating companies is for businesses to be carried on for shareholders who want to make profits, and this happens through risk taking ventures. This is what shareholders want and for them to make more profits, they have to take certain risks and it is up to creditors to protect themselves using mechanisms like security because, considering creditors'

[281] [2019] EWCA Civ. 112
[282] James Morgan, 'Directors' duties in the insolvency context' (2015) II, 28, 1
[283] Andrew Keay, 'Directors' 'Duties and Creditors' Interests' (2014) LQR,130, 443; Andrew Keay, 'Shifting of Directors' Duties in the Vicinity of Insolvency' (2015) IIR 24, 140

interests when there is no likelihood of insolvency, will hinder risk taken by directors and economic benefits of doing business.[284]

This implies that until the company is in a financially dangerous position, creditors' interests are not to be considered by directors. It is suggested that this duty be considered while the company is financially stable to protect both the company and creditors. This arises from the argument that the best interests of the company could include those of creditors as established in *Brady v Brady*[285] If the company has corporate finance, it helps both the company and shareholders but at the same time, the providers of that finance need protection from risk. Also under section 172(1), 'a director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to the likely consequences of any decision in the long term, the interests of the company's employees, the need to foster the company's business relationships with suppliers, customers, the impact of the company's operations on the community and the environment, the desirability of the company maintaining a reputation for high standards of business conduct, and the need to act fairly as between members of the company'.[286] Based on this section, creditors as suppliers of corporate finance can as well be given consideration for purposes of maintaining a company's reputation with creditors and also fostering corporate relationships.

2.4.3 What does the duty to consider creditors interests mean?

The second problem is regarding the meaning of considering creditors' interests or acting in the interests of creditors.[287] The law is not clear on what directors are to be doing. There are three issues associated with this deficiency. The first issue is whether directors while performing their duty under section 172(1) need to balance the interests of shareholders alongside creditors' interests.[288] The second issue is whether during financial difficulties, directors have to prioritise the interests of the company alongside creditors' interests. The third issue is whether they have to prioritise the interests of creditors only when a company is financially struggling. [289] There is

[284] BTI 2014 LLC v Sequana SA [2019] EWCA Civ. 112 p. 202
[285] [1988] 2 All ER 617
[286] Section 172(1), Companies Act, 2006
[287] Andrew Keay, 'The Shifting of Directors' Duties in the Vicinity of Insolvency' (2015) IIR, 24, 140
[288] Rosemary Teele Langford and Ian Ramsay, 'The Creditors' Interests duty: When Does it Arise and What Does it Require?' (2019) LQR, 135, 385
[289] Andrew Keay, 'The Shifting of Directors' Duties in the Vicinity of Insolvency' (2015) IIR, 24, 140

enough evidence to indicate that in the UK, creditors' interests need to be paramount to directors during financial distress however, the meaning of what this entails of directors' behaviour is left to be decided according to facts of each case.[290] There is need to understand what directors are to be doing during this time to render the law effective. To begin with the duty under section 172(1) has been argued not to be fit for the purpose it was enacted because it does not solve the problems directors had prior to the enactment.[291] The duty enshrined in the statute is a reflection of the enlightened principle of the shareholder value model in the UK.[292] It has been said that section 172(1) is enshrined to promote the principle of enlightened shareholder value.[293] The section indicate that even though the duties are owed to the company, the ultimate benefit is for members. Does this suggest that directors' duties can eventually be extended to shareholders as directors have them as the ultimate group to which they owe their duties? The answer could be found from the interpretation of law and how the courts have applied it. On one hand within the law, directors' duties are owed to the company and not shareholders as stipulated under section 170.[294] On the other hand under section 172(1), the duties are to be performed with the ultimate benefit of the members who actually have influence and control over directors. This has promoted the shareholder primacy model of governing the firm to which directors seem to have in mind when performing their duties. This could mean that the uncertainties in the law are still present as under common law. Lynch argued that the law only changed in form and not in substance as it only restated the pre-existing duty and this is why Lynch called it 'a law dressed in nothing but air waiting for someone to point out the reality'.[295] Lynch went further to argue that although the purpose for codification was to clarify the challenges faced by directors and to make the law more accessible, the law did not achieve this purpose in terms of application because it brings nothing new to the table.[296] *Lord Glennie in Re West Coast Capital (LIOS) Ltd*[297] stated that the section in

[290] Rosemary Teele Langford and Ian Ramsay, 'The Creditors' Interests duty: When Does it Arise and What Does it Require?' (2019) LQR, 135, 385
[291] Andrew Keay, 'The Duty to Promote the Success of the Company: Is it Fit for Purpose?' (2010) University of Leeds School of Law, Working Paper, Accessed on 13/02/2017 from: SSRN: https://ssrn.com/abstract=1662411
[292] Jin Zhu Yang, 'The Role of Shareholders in Enforcing Directors Duties: A Comparative Study of UK and China: Part 1' (2006) ICCLR, 17, 318
[293] Alan Digman and John Lowry, *Company Law* (8th ed. Oxford University Press, 2014) 180
[294] Section 170, Companies Act, 2006
[295] Elaine Lynch, 'Section 172: A Ground-breaking Reform of Director's Duties, or the Emperor's New Clothes?' (2012) CL, 33, 196
[296] Ibid
[297] [2008] CSOH 72

the Companies Act brings nothing novel to the table except acknowledge of the pre-existing law. This view was also followed in *Cobden Investments Ltd v RWM Langport Ltd*[298] when Warren J. stated that:

> 'Perhaps the old-fashioned phrase acting 'bona fide in the best interest of the company' is reflected in the statutory words acting 'in good faith in a way most likely to promote the success of the company for the benefit of its members as a whole'. They come to the same thing with the modern formulation giving a more readily understood definition of the scope of the duty.'[299]

The ineffectiveness of this duty has a negative impact on creditors. There is a dearth of literature in terms of protection of creditors. While corporate law focuses on the obligations of directors and insolvency law focuses on the recovery of funds by creditors,[300] there is no practical mechanism on the protection of creditors before the company falls into insolvency thereby exposing creditors to risk. The implication is the challenge in knowing what exactly directors ought to be doing once the shift has been triggered. In obiter, Lord Richards in *BTI 2014 LLC v Sequana SA*[301] indicated that the integration of the duty under section 172(1) with creditors is problematic, if the interests of creditors are not taken as paramount.[302] This is owing to the conflict that could exist between the interests of creditors and what is meant by the success of the company. The duty once triggered could only be effective if creditors are given paramountcy in merit with the decision in *Kinsela v Russell Kinsela Pty Ltd* where it was stated that in a practical sense the assets of the company become assets of creditors under the management of directors.

While this seems to be a settled argument in this study, the ingredients of the duty itself remain unresolved. It is at this point that the key issues raised by Keay in his article[303] concerning the position of directors when negotiating new contracts during financial distress become significant. Keay discusses a lot of issues but three of them have been selected with keen interest based on the significance they have in relation to the objective of this research and have been used to construct

[298] [2008] EWHC 2810
[299] Ibid, p.52
[300]Marjan Marandi Parkinson, 'Corporate Governance During Financial Distress – An Empirical Analysis' (2016) IJLM, 58, 486
[301][2019] EWCA Civ 112
[302] Ibid p.99
[303]Andrew Keay, 'Directors Negotiating and Contracting in the Wake of their Companies' Financial Distress' (2015) JSCN, 1, 214

what has been referred to, as the Keay framework in this research.[304] The article focuses on the position of directors while negotiating during financial difficulties and what it could mean to consider creditors interests. Although it is noted that sometimes there would be no new contracts under negotiations, it is argued that during financial distress, it is more likely that new projects will be implemented to save the company. The authority of directors when negotiating contracts is guided by statute, articles of association, by-laws, and sometimes board decisions or minutes. This is because during this time, there is personal liability that could be imposed and sometimes they want to eliminate that risk by entering formal procedures like administration or other restructuring procedures in the statute. However, they are also guided by the duty of loyalty which requires them to act in the best interest of the company.[305] While this is true, during financial difficulties they will be under the duty to consider creditors' interests and it is within this time that their actions are considered. Once presented with an opportunity of a new contract during this time directors could take the following into consideration; the first issue is the size and nature of the company in question, the second is the nature of the contract under consideration, and the third is the level of risk involved.[306]

This is important because it helps to assess product and market risk in the industry. And certainly, the most important is that directors would not want to enter a contract with a company that is also in financial distress because it would be reckless. When assessing the nature of the business, great attention is to be given to the obligations and terms of the contract and how these will impact the contract. This is because during financial difficulties, directors need to consider the impact of their decisions on creditors as was held in *Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd*.[307] This is to assess the impact the contract will have on creditors as a class and the possibilities of recovering their money. The problem this could present is the fact that creditors are different however, the decision could perhaps consider them as a class. The second issue is the nature of the deal or the contract to be assessed if it can bring in money within a reasonable time to pay off

[304]Designed by the researcher to illustrate the importance of these issues in determining what it means to consider creditors interests based on Keay's Paper entitled: Directors Negotiating and Contracting in the Wake of their Companies' Financial Distress' (2015) JSCN, 1, 214

[305] David Milman, 'Company Directors: Maintaining the Balance Between Protecting Managerial Rights and Regulating Exposure to Liability in UK Law' (2016) CL, 390, 1

[306] Andrew Keay, 'Directors Negotiating and Contracting in the Wake of their Companies' Financial Distress' (2015) JSCN, 1, 214

[307] [2002] EWHC 2748 (Ch)

creditors. This helps to evaluate whether the nature of the contract can make money on a short term or a long-term basis. This is because creditors want to be assured that they will be paid, and time is of essence especially with the accumulation of interest. The third issue is the level of risk. This is assessed first in connection to the actual extent of the financial distress, and to the reality of how things would be if the deal is not entered. Directors will have to assess the risk factors such as impact of the contract if they enter into it and it fails to produce the money expected, the risk likely to be caused if such an opportunity of the contract is missed and also the implication of the risk on creditors. Is it a low risk project to creditors such that if implemented, there would be no substantial risk of loss and if so, what amounts to substantial risk considering the amount of debt in total? While this may seem easy in theory, in practice it is difficult because where trade creditors are involved, this could be more difficult with both secured and unsecured creditors because their interests are different and directors need to be careful not to treat any creditor differently. Special attention needs to be paid to the fact that directors may be committing wrongful trading in trying to save the company. This happened in the fall of Carillion and in the case of *Grant v Ralls.*[308] Directors on one hand have shareholders and their interests of wanting more profits during which they want the company to implement risky projects as stated by Lord Richards in *BTI 2014 LLC v Sequana SA.*[309] On the other hand directors have creditors' interests and these involve full payment, or at least reduced risk which means, they want the company to avoid risky projects because they might lose their money. What directors would want to do is to balance these interests however, this is difficult for directors henceforth, Keay stated that to substitute this problem, directors are more likely to adopt the entity maximisation approach in order to serve the interests of the company which seemingly might benefit both shareholders and creditors.[310] The entity maximisation approach will endeavour to increase the market value of the company[311] but this contemplates the interests of both shareholders and creditors as they have claims on the company.

The undisputed argument is that creditors' interests still need to be considered even during the entity maximisation approach because whatever the company ends up with, creditors will have the first claim. It is argued that if during this time, directors discontinued to consider shareholders'

[308] [2016] EWHC 243 (Ch)
[309] [2019] EWCA Civ. 112
[310] Ibid
[311] Michael Jensen, 'Value Maximisation, Stakeholder Theory, and the Corporate Objective Function' (2001) EFM, 7, 297

interests and concentrate on creditors, there would be no opportunity for the balancing problem. This is because legally directors ought to have as a matter of priority creditors' interests only until the company is financially stable.[312] Two issues have been added in this framework namely probability of fruitfulness of the deal and contingency plan in case it fails. Directors, after having assessed the three issues discussed, ought to have an indication of the probability for the contract to work. Most desirable this would also require directors to deal in good faith even if they do consult an expert. It is not enough to show that this was considered, but it must be supported that consideration was given with supporting evidence and that the decision taken was in the best interest of creditors. There is also great need for a plan workable for creditors in case the deal fails to yield any money. This contingency plan could include corporate rescue measures such as restructuring, administration, formal insolvency so that creditors can at least be paid but arguably this must be done in good timing. This is where skill and judgement come into effect for directors so that they do not injure the company, and in return creditors. These constructs must be evaluated for the benefit of creditors only because during this time, creditors' interests supersede the shareholders, and it is creditors' money which is used as external finance for any new deals or riskier projects. This was illustrated in the case of Grant v Ralls where fresh debt was acquired when the company was struggling which eventually was not paid back as the court found that directors were not liable for wrongful trading.

The implementation of the Keay framework does not guarantee that creditors will always get their money, but suggestive that perhaps these could be at least adopted as the initial steps into acting in the interests of creditors. This is because facts are likely to be different, but these steps can be assessed before extending the scope of the duty to other issues which could be of importance to assess depending on the circumstances of the distressed mode. So once all the five constructs have been evaluated for the benefit of creditors, it can be argued that this could amount to acting in the interests of creditors not only based on having them in mind but implementing the kind of projects that reduce the risk and also to ensure that during this time, creditors are a priority, and shareholders have nothing to do with these decisions. Shown below is a figurative structure for the Keay framework.

[312] Rosemary Teele Langford and Ian Ramsay, 'The Creditors' Interests duty: When Does it Arise and What Does it Require?' (2019) LQR, 135, 385

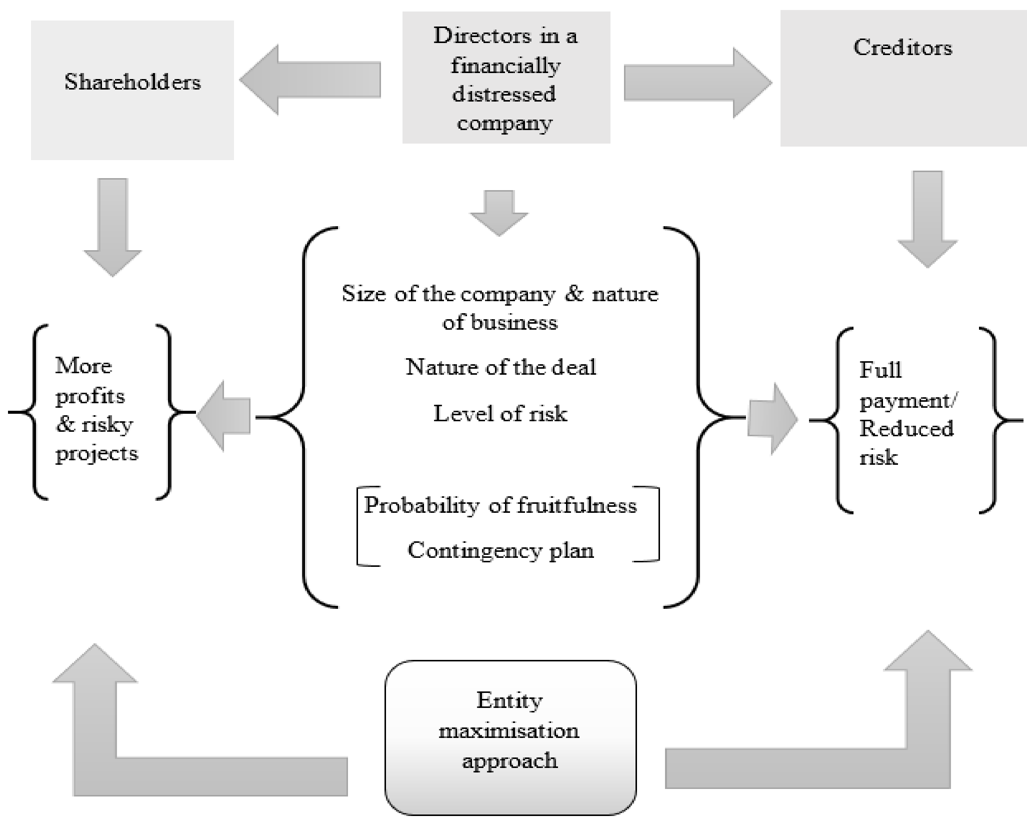

Figure 2:1 Keay Framework

2.4.4 The exposure of creditors through Section 172(1)

What amounts to interests of the company is vital because it helps to indicate what must be done and whose interests must be taken care of? Although at common law this was regarded as the best interest of the company, this entails using a subjective test to establish what was in the best interest of the company and at what stage. The subjective test was formulated in *Re Smith v Fawcett Ltd*[313] and it was reemphasised by the Charterbridge test (though objectively) in the case of *Charterbridge Corporation Ltd v Lloyds Bank Ltd*.[314] The Charterbridge test requires an examination of the individual director concerned if he reasonably believe that what he was doing

[313] [1942] Ch 304
[314] [1970] Ch. 62, 74

was in the best interest of the company, put in the same prevailing circumstances as existed before.[315] The court in *Hellard v Carvalho*[316] stated that: section 172 codifies the pre-existing common law duty notwithstanding the difference in the wording. Having established that directors have to act in the interest of the company to promote the success of the company, does it mean any actions taken without the interest of the company is breaching the duty? If the answer is affirmative, then the duty under section 172(1) requiring directors to consider the interests of the company with the ultimate benefit of the members is simply stating that the duties are owed to the members and not to the company. In the case of *Madoff Securities International Ltd (In Liquidation) v Raven*[317] where Popplewell J stated that:

> [W]here a director fails to address his mind to the question whether a transaction is in the interests of the company, he is not thereby, and without more, liable for the consequences of the transaction. In such circumstances the Court will ask whether an honest and intelligent man in the position of a director of the company concerned could, in the whole of the existing circumstances, have reasonably believed that the transaction was for the benefit of the company: If so, the director will be treated as if that was his state of mind.[318]

However, it must be noted that in *Hellard v Carvalho*[319] the court emphasised that the subjective test of the director acting in the interest of the company, is subject to directors considering the interests of creditors at the time. Randall J stated that, the interests of creditors must be 'paramount' when taken into account by directors exercising their discretion.[320] One other argument is that the law states that while directors are performing their duties for the success of the company, they ought to have regard to "the need to foster the company's business relationships with suppliers, customers and others,"[321] and also "the desirability of the company maintaining a reputation for high standards of business conduct."[322] The basis for this argument is the importance of the relationship between the company and its creditors owing to the fact that external finance is involved which the company is using for its projects. This money and any associated interest must be paid back to creditors and a good relationship is potentially built from the company having a

[315] Ibid
[316] [2013] EWHC 2876 (Ch) 2014 BCC 337 at 88
[317] [2013] EWHC 3147
[318] Ibid
[319] [2013] EWHC 2876 (Ch) 2014 BCC 337 at 88
[320] Rosemary Teele Langford & Ian M. Ramsay, 'Directors' Duty to Act in the Interests of the Company – Subjective or Objective?' (2015) JBL, 2, 173
[321] Section 172(1)(c), companies Act, 2006
[322] Section 172(1)(e), companies Act, 2006

good reputation in honouring its obligations towards the creditor. This creates lasting corporate relationship and the creditor will be willing to lend to such a company because of its good credit record in terms of its past obligations. This argument finds its authority from the decision in *Lonrho v Shell Petroleum*[323] where Lord Diplock stated that the best interests of the company may not be exclusively those of the shareholders but may include those of creditors. The implication of this decision is that if directors want to act in the interests of the company, a good relationship with creditors is also in the interests of the company hence, ensuring that this relationship is fostered, would benefit both the company and the shareholders ultimately.

The question of when this shift in the duties of the directors occurs was also revisited in the recent case of case of *BTI 2014 LLC v Sequana S. A.*[324] This case had two major legal issues. The first was whether statutory dividends declared in the case under the provisions of the Companies Act[325] can be contrary to the provisions of the Insolvency Act.[326] The second legal issue related to the time the duty to take into account creditors' interests ought to be effected.[327] Before the principle in the case can be analysed, in relation to dividends the law provides that: 'no dividend shall be payable to the shareholders of a company except out of the profits arising or accumulated from the business of the company.'[328] And in relation to undervalue transaction with the intention to make assets unreachable to creditors the law provides that:

> [..…] in the case of a person entering into an undervalue transaction, an order shall only be made if the court is satisfied that it was entered into for the purpose of…… putting assets beyond the reach of a person who is making, or may at some time make, a claim against him, or of otherwise prejudicing the interests of such a person in relation to the claim which he is making or may make, or for the purpose of putting assets beyond creditors reach….[329]

The court in deciding the first legal issue of the two dividends being challenged indicated that whereas the first dividend payment was lawfully made after a careful examination of the regulation involved, the second payment was made with purposes of putting company assets from the reach of creditors which fell under section 423. The section of the law has a broad interpretation of what

[323] [1980] 1 WLR 627
[324] [2019] EWCA Civ 112,
[325] Section 830, Companies Act 2006
[326] Section 423, Insolvency Act 1986
[327] Section 172(3), Companies Act 2006
[328] Section 85, Companies Act 1994, Chapter 388 of the Laws of Zambia
[329] Section 423, Insolvency Act 1986

‘transactions could fall under it and the advantage is that it does not require any financial status as it could be effected even when a company is financially stable or troubled. This is notably to the protection of creditors when directors are trying to hide company assets. However, the court indicated that the effective time of the duty has been associated with uncertainties and there is need for parliament to address it. The court went further to establish that the duty to consider creditors' interests does not arise whenever a ‘real’ risk of insolvency arises, but it requires actual insolvency. The duty arises when directors know or should know that a company is or is likely to be insolvent. This shows that directors need not take creditors' interests into consideration, except in matters of actual insolvency, which is detrimental to creditors because it is activated late. While others have praised this decision as settling the problem of the effective time,[330] it can be submitted that the problem of determining the point of insolvency still represents uncertainties as to the effective time. It is submitted that this duty be amended to ascertain when it is to take effect. It is also submitted that if this duty be given effect even when the company is financially stable, it will reduce the risk of loss for creditors and at the same time ascertain the duty to directors.

2.4.5 Fraudulent and wrongful trading provisions

The court may order that directors be personally liable for the debt of the company if they trade fraudulently or cause loss in the vicinity of insolvency. The management of companies by directors attracts personal liability if wrongdoing is established for purposes of safeguarding company assets.[331] The law has provided three principal mechanisms under which delinquent directors can be held personally liable for misfeasance.[332] These are fraudulent trading,[333] wrongful trading[334] under the Insolvency Act 1986 and fraud[335] under the Companies Act. Both provisions under the Insolvency Act attract civil liability, whereas the section under the Companies Act attract criminal liability as well.[336] The provision under the Companies Act does not require the company to be in the process of winding up and is not limited to directors. These benchmarks put directors in a position where they are susceptible to personal liability if they conduct the business of the company

[330] Rosemary Teele Langford and Ian Ramsay, ‘The Creditors' Interests duty: When Does it Arise and What Does it Require?’ (2019) LQR, 135, 385
[331] David Foxton, ‘Accessory Liability and Section 213 Insolvency Act 1986’ (2018) JBL, 4, 324
[332] Henry Skudra, ‘Fraudulent Trading as a Creditor's Remedy - Time for a Rethink?’ (2015) AC, 94, 11
[333] Section 213, Insolvency Act, 1986
[334] Section 214, Insolvency Act, 1986
[335] Section 993, Companies Act., 2006
[336] Henry Skudra, ‘Fraudulent Trading as a Creditor's Remedy - Time for a Rethink?’ (2015) AC, 94, 11

in a fraudulent manner, or if they do not take reasonable care to reduce potential loss to creditors.[337] Under the Companies Act 1948, the provision for fraudulent trading attracted both criminal and civil liability under section 332.[338] This was later split into two different provisions in the 1985 Companies Act which then became fraudulent trading under section 213 of the Insolvency Act. The civil liability to fraudulent trading became what is known as wrongful trading in form of a cause of action to section 213 of the Insolvency Act.[339] The inefficiencies of section 213 were to be dealt with under the wrongful trading provision under section 214 which will be discussed later.

2.4.5.1 Fraudulent trading and its shortcomings

Fraudulent trading as provided under section 213 of the Insolvency Act deals with those who engage in the carrying on of the company's business for fraudulent purposes, and those third parties whose transactions with the company assisted that dishonest purpose.[340] The law states that:

> (1) In the course of winding up of a company if it appears that any business of the company has been carried on, with intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose.[341]
> (2) The court, on the application of the liquidator may declare that any persons who were knowingly parties to the carrying on of the business in the manner above-mentioned are to be liable to make such contributions (if any) to the company's assets as the court thinks proper.[342]

The above provision has important elements that need to be satisfied if a claim is to be successful. The first prerequisite is that a company must be in the process of winding up.[343] This means that the claim for fraudulent trading cannot be instituted unless the company is in the process of winding up. The second element is that only the Liquidator has the legal standing to institute such a claim on behalf of the creditors of the company. This is one of the strengths for fraudulent trading as it is clear on who can bring a claim and the time the claim can be brought. This is the 'locus standi' the liquidator has under the law, in that he or she is the only one permitted to bring an action under section 213 of the Insolvency Act. This provision is different from the one provided by the

[337] Paul Davies, 'Directors' Creditor-regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency' (2006) EBOR, 7,301-337
[338] J.R. Spencer, 'The Criminal Liability of Directors Whose Companies Collapse' (2016) AR, 10, 5
[339] Ibid
[340] David Foxton, 'Accessory Liability and Section 213 Insolvency Act 1986' (2018) JBL, 4, 324
[341] Section 213(1), Insolvency Act, 1986
[342] Section 213(2), Insolvency Act, 1986
[343] David Foxton, 'Accessory Liability and Section 213 Insolvency Act 1986' (2018) JBL, 4, 324

Companies Act which does not require the company to be in any financial status. The law provides that:

> [A]ny business of a company that is carried on with intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purposes, and every person who is knowingly a party to the carrying on of the business in that manner commits an offence.[344]

This can be instituted at any time whether the company is solvent or insolvent. This includes any 'one time transaction' made with intent to commit fraud against creditors or any other person.[345] Originally, both the criminal and civil sanctions could be invoked only on winding up, but the criminal provision, which is now contained in section 993 of the Companies Act 2006, as stated above applies without limitation.[346] It was argued that civil liability should not be available only when the company is being wound up, because sometimes a company's viability may be testament to its success in fraudulent trading endeavours.[347] William argued that perhaps there is need for widening the scope to section 213 because it will help in halting the business or the transactions that are being carried on fraudulently.[348] However, this argument could be overstretching it because it would mean that, alongside the liquidator, creditors need to be given the right to bring these actions against directors, a concept the current legal system would not support. It could be argued that the restriction of a company being in liquidation is now supplemented by section 993 under the Companies Act because this section is without limitation. The third requirement is that the business has been carried on with intentions of defrauding creditors or any other fraudulent purpose. The onus to prove fraud is on the liquidator and now on the Administrator.[349] There must be evidence of dishonest transactions to the detriment of creditors. In *Re Patrick and Lyon Limited*[350] it was held that continuing to trade whilst the company is insolvent is not enough. However, dishonest can be inferred where the company continued to deliberately incur debts which would never be settled or had no intention to settle them.[351] This includes where directors made deliberate misleading statements about their actions or intentions, or took active steps to avoid

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[344] Section 993, Companies Act, 2006
[345] David Foxton, 'Accessory liability and section 213 Insolvency Act 1986' (2018) JBL, 4, 324
[346] Gabriel Moss, 'No Compensation for Wrongful Trading - Where did it all go Wrong?' (2017) II, 30, 49
[347] R C Williams, 'Fraudulent Trading' (1986) CSLJ, 14, 17
[348] Ibid
[349] Gabriel Moss, 'No Compensation for Wrongful Trading - Where did it all go Wrong?' (2017) II, 30, 49
[350] [1933] Ch. 786
[351] Gabriel Moss, 'No Compensation for Wrongful Trading - Where did it all go Wrong?' (2017) II, 30, 49

paying debt. In *R v Kemp*,[352] it was held to be wide enough to include fraud against potential creditors and evasion of tax. In *Manifest Shipping Co Limited v Uni Polaris Insurance Co Limited (The Star Sea)*[353] Lord Scott held that turning a blind eye was sufficient to a claim of fraud. He said that:

> […] blind-eye knowledge requires, in my opinion, a suspicion that the relevant facts do exist and a deliberate decision to avoid confirming that they exist. But a warning should be sounded. Suspicion is a word that can be used to describe a state-of-mind that may, at one extreme, be no more than a vague feeling of unease and, at the other extreme, reflect a firm belief in the existence of the relevant facts. …. for there to be blind-eye knowledge, the suspicion must be firmly grounded and targeted on specific facts. The deliberate decision must be a decision to avoid obtaining confirmation of facts in whose existence the individual has good reason to believe. To allow blind-eye knowledge to be constituted by a decision not to enquire into an untargeted or speculative suspicion would be to allow negligence, albeit gross, to be the basis of a finding of privity.'[354]

From the above quotation, it can be argued that if the liquidator has enough information about potential fraud, this should be a ground for a claim provided it has merit under section 213 because of the scarce of information available. The court in *Christopher Morris v Bank of India*[355]found that, having knowledge of fraudulent transactions, yet turning a blind eye to their existence was fraudulent. This judgement could mean that an omission on the part of directors is also fraudulent, although there is need to establish fraudulent intention. However, in *Morphitis v Bernasconi*,[356] the court found that not all manner of fraud committed by a company automatically implies the business was being carried on with intent to defraud creditors. Chadwick LJ stated that the liquidator must show the link between the loss suffered by creditors and the continuation of the carrying on of the business in a fraudulent manner. This implies that a claim for fraudulent trading must indicate that it caused loss to creditors. The intention of the company to cause loss to creditors must be established to succeed under section 213 of the Companies Act. Chadwick LJ described different types of cases where this approach should be taken. One of them being:

> '…. where the carrying on of the business with fraudulent intent had led to claims against the company by those defrauded. In such a case the appropriate order might be that those knowingly parties to the conduct which had given rise to those claims in liquidation to contribute an amount equal to the amount by which the existence of those claims would otherwise diminish the assets available for distribution to creditors generally; that is to

[352] [1988] QB 645
[353] [2001] UKHL 1
[354] [2005] EWCA Civ 693, at 116
[355] [2005] EWCA Civ 836
[356] [2003] EWCA Civ 289

> say an amount equal to the amount which has to be applied out of the assets available for distribution to satisfy those claims.[357]

The above is suggesting that where creditors have suffered loss due to fraudulent trading, that loss should be paid by the perpetrators outside the assets of the company. However, the court has discretion on the amount of contribution to be made if an order is awarded. Although the issue of the amount to be contributed is controversial, it is challenging for the liquidator to prove the requirement of 'intent to defraud' creditors.[358] The requirement for the liquidator to prove intent to defraud is applied in both criminal and civil proceedings.[359] This has led to conclusions about section 213 not being fully utilised due to the difficulties in proving intent to defraud.[360] Perhaps it is time the law removed the requirement of intent so that irresponsible behaviour cannot go without being accounted for by perpetrators. That way, the law will serve as a deterrent to management because they will be more careful not to make irresponsible decisions that can affect the capability of a company to meet its obligations to creditors. The difference between carrying on business for a fraudulent purpose (including defrauding creditors) and an incidentally fraudulent transaction in the course of business carried on for a legitimate purpose is easier to state than to apply.[361] The structural requirements of fraudulent trading makes it ineffective and calls for further reform of the law.

The fourth requirement is that the defendant is knowingly a party to the carrying on of the business. The court in *Re Company*[362] found a director liable for knowingly being a party to the carrying on of the company's business with intent to defraud creditors. He was ordered to pay £156,420 for its debts and liabilities. In *Re Sarflax Limited*[363] the court held that it is possible for the business of the company to be deemed as being carried on even in circumstances where the company is no longer trading. However, the court in *Carman v Cronos Group SA*[364] held that after the date of the winding up petition, the company cannot be deemed to have continued carrying on its business.

[357] Ibid
[358] Andrew Keay, *Company Directors' Responsibilities to Creditors* (Cavendish, 2007) 122
[359] Ian F. Fletcher, *The Law of Insolvency* (4th edn. Sweet & Maxwell, 2009) 851
[360] Henry Skudra, 'Fraudulent Trading as a Creditor's Remedy - Time for a Rethink?' (2015) AC, 94, 11
[361] David Foxton, 'Accessory Liability and Section 213 Insolvency Act 1986' (2018) JBL, 4, 324
[362] [1990] BCC 526
[363] [1979] Ch. 592
[364][2005] EWHC 2403 (Ch)

And the argument that one needs to have a management role for liability under section 213 to be applied was rejected in *Re Gerald Cooper Chemicals Ltd* (In Liquidation).[365] This is owing to the statute using the words "any person", which implies that the net is wide rather than restricted to a certain position. The important issue is to establish that the party participated in the carrying on of the business knowingly. However, wrongful trading specifies that liability can be imposed on directors and shadow directors only. While it was intended that the challenges under fraudulent trading would be dealt with under wrongful trading provisions, this has not been the case as the difficulties are still present.

2.4.5.2 Wrongful trading and its shortcomings

Wrongful trading was proposed as a measure to protect creditors from directors' careless decisions when the company is in the twilight zone.[366] At the time of its introduction, it was regarded as a progressive step in insolvency procedure but its efficacy is problematic[367] due to enforcement difficulties as has been evident in the scarce of reported cases.[368] Wrongful trading attracts personal liability for directors if they fail to recognise that a company would not avoid insolvent liquidation and fail to implement steps to minimise the risk of loss for creditors.[369] The law provides that:

> 'If in the course of winding up it appears that before the company went into insolvent liquidation, directors knew or ought to have known that there was no reasonable prospects of a company avoiding insolvency, they may be held liable for their wrongful decisions unless they prove that they took all reasonable steps to minimise potential loss for company creditors.'[370]

The company must be in insolvent liquidation,[371]and that 'at some point' before the beginning of winding up, the person(s) against whom proceedings have been brought, knew or ought to have concluded that there was no reasonable prospect the company would avoid insolvent liquidation,[372] and that such person(s) subjected to the proceedings were directors or shadow directors at the time.[373] The first requirement is that the company must be in insolvent liquidation and only the

365 [1978] 1 Ch. 262 Ch D
366 Rainer Werdnik, 'Wrongful Trading Provision - is it Efficient?' (2012) JII, 25, 81
367 D. D. Prentice, 'Creditor's Interests and Director's Duties' (1990) OJLS, 10, 265
368 Marcus P.L. Gustafsson, 'Beating a Dead Horse? An Assessment of Wrongful Trading' (2017) CL, 38, 239
369 Andrew Keay, Wrongful Trading and the Liability of Company Directors: A Theoretical Perspective (2005) JSLS, 25, 431
370 Section 214, Insolvency Act, 1986
371 Section 214(2)(a), Insolvency Act, 1986
372 Section 214(2)(b), Insolvency Act, 1986
373 Section 214(2)(c), Insolvency Act, 1986

liquidator can institute a claim under section 214 of the Insolvency Act (status of the company). The second requirement is that the liquidator shows that directors should have known that the company would not avoid insolvent liquidation (timing for the alleged wrongful trading). Thirdly, the claims under section 214 can only be brought against directors including shadow and former directors. The requirement of the liquidator to bring a claim is one of the strengths for wrongful trading. The second strength is that the company must be in insolvent liquidation which is also not a problem to enforce. The third strength is that the person against whom the claim is brought is a director or former director, and the fourth strength is that this claim is only brought while winding up. While the status of the company and persons subject to a claim has not been a challenging requirement as they are the strengths for wrongful trading, the discussion below focuses on the timing for the alleged wrongful trading and its enforcement problems. This is because it is a weakness for wrongful trading and if its' enforcement is improved, creditor protection would be enhanced.

2.4.5.2.1 Timing for the alleged wrongful trading

Insolvency prediction is about timing, and generally it is difficult to point when it is unavoidable.[374] The liquidator has to determine the point when wrongful trading started[375] and has to do this with care, because he or she may not be allowed to amend this at a later stage, although sometimes the courts have allowed such.[376] It is required that the liquidator proves that a director "knew or ought to have concluded that there was no reasonable prospect" the company would avoid insolvency.[377] The difficulties with procedural evidence were characterised by Gustafsson as the problems with wrongful trading which has rendered it not to live to its initial promise due to its enforcement mechanism.[378] On the challenge of timing, Keay argued that there are two ways to proving the exact point at which the wrongful trading starts, namely the restrictive and liberal approaches.[379] The restrictive approach is one whereby the liquidator argues for a specific date. This is due to the wording of the statute itself because of the words "at some time" before the commencement of the winding-up of the company, that person knew or ought to have concluded that there was no

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[374] Rainer Werdnik, 'Wrongful Trading Provision - is it Efficient?' (2012) JII, 25, 81
[375] Ibid
[376] Andrew Keay, 'Wrongful Trading and the Point of Liability' (2006) II, 19, 132
[377] Section 214(2)(b), Insolvency Act, 1986
[378]Marcus P.L. Gustafsson, 'Beating a Dead Horse? An Assessment of Wrongful Trading' (2017) CL, 38, 239
[379] Andrew Keay, 'Wrongful Trading and the Point of Liability' (2006) II, 19, 132

reasonable prospect that the company would avoid going into insolvent liquidation.[380] The liberal approach is one elected or imposed by the court as the day the alleged wrongful trading started.[381] This was illustrated in *Re DKG Contractors Ltd*[382] in which the liquidators argued that the wrongful trading began by end of July 1988. However, the court in holding the respondents liable, decided that it started on 31st April 1988. In *Re Continental Assurance Plc,*[383] while the judge said that he was not prepared to consider evidence or submissions that argued for a date later than the one pleaded because the case was so complex, his Lordship appeared to offer some hope to liquidators when he said that he would not:

> [….] wish his decision to be cited hereafter as authority for the proposition that in all cases under s 214 the Liquidator must always specify his starting date, and must lose the whole case if he cannot satisfy the Court that his case is made out by reference to that particular date. Cases vary in detail and complexity.[384]

Although there was no specific comment as to the date of the alleged wrongful trading, it indicated a leeway for liquidators. Likewise, in *Receiver v Doshi*[385] it was said that even though the date was not the actual start of wrongdoing, it did not matter. Besides the two approaches, Keay suggested what he called the "Right approach.[386] He stated that:

> [T]he sections only provides (in section 214(2)(b)) that 'at some time before the commencement of winding-up'… the respondent must have known or ought to have concluded that insolvent liquidation was unavoidable. So, provided the evidence demonstrates that wrongful trading commenced before the company entered winding up, then it might be arguable that the provision is satisfied, and it should not matter if the exact date, if any, pleaded is not correct.[387]

It appears just and reasonable that rigidity to the liquidator pinpointing a date for wrongful trading should not be adhered to if the court can find that directors were involved in wrongful trading before the commencement of winding up. It is possible for the liquidator to miss the actual date at which directors started wrongful trading. In *Re DKG Contractors Ltd*[388]the court found that the

[380] Section 214(2)(b), Insolvency Act, 1986
[381] Andrew Keay, 'Wrongful Trading and the Point of Liability' (2006) II, 19, 132
[382] [1990] BCC 903
[383] [2001] BPI.R 733
[384] [2001] BPIR 733 at 899
[385] [2001] 2 BCLC 235
[386] Andrew Keay, 'Wrongful Trading and the Point of Liability' (2006) II, 19, 132
[387] Ibid
[388] [1990] BCC 903

time at which suppliers refused to deliver, was the time directors should have identified that insolvency liquidation was unavoidable. A lot of signs however have been used by the courts to determine points of reference at which wrongful trading occurred. In *Re Purpoint Ltd*[389] it was held that the point when a company failed to pay its due trading and crown debts was the time at which directors should have known that insolvent liquidation could not be avoided, especially that the company kept no financial records. In *Re Brian D Pierson (Contractors) Ltd*[390] it was stated that "it would be unduly technical" if the success of a wrongful trading claim would be contingent on the date established and pleaded.[391] In *Re Bangla Television Ltd (in liquidation)*[392] insolvency liquidation was unavoidable when the company sold all its assets, and in *Re Idessa (UK) Ltd (in liquidation)*[393] it was held that the combination of losing external investors and a main contract were signs of imminent insolvency. The above cases reveal that there are always signs to look out for and it is arguably the duty of directors to monitor the financial status of the company to ensure they do not commit wrongful trading.

However, Keay further argued that if liquidators claim a particular date on which the respondent had the prerequisite knowledge, there is need to demonstrate that there was a depletion of assets or net deficiency.[394] There must be some incurred level of risk due to the alleged wrongful trading, otherwise it might be unfair to hold the respondents liable.[395] It can be submitted that the liquidator ought to nominate a time prior to winding up but should not be required to specify an exact date, and be permitted to nominate a reasonable period of time. It can be argued that in the spirit of interpretation, the phrase "at some time" should not be overly construed provided a period of time is given by the liquidator and loss was suffered by creditors, it should suffice to impose liability. Also, if the court find evidence that the respondent was engaging in wrongful trading at a time before or after the time nominated by the liquidator, the liquidator's case is proven. While reform of the law takes time, it is important at this stage to argue that if the Keay framework be implemented in firm governance, it is possible that wrongful trading would reduce thereby

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389 [1991] BCC 121
390 [1999] BCC 26
391 [1999] BCC 26 at 50
392 [2010] BCC 143
393 [2012] 1 BCLC 80
394 Andrew Keay, 'Wrongful Trading and the Point of Liability' (2006) II, 19, 132
395 Ibid

protecting creditors. Directors will be alert on the financial position of the company, in the process, creditors' interests would be considered in good time and there would be business sustainability. However, directors can escape liability where they can demonstrate to the court's satisfaction that they took reasonable steps to minimise potential loss for creditors.[396] The standard on which directors' conduct is judged is that of a reasonable man in the position of the director. For the purposes of subsections (2) and (3), the facts which a director of a company ought to know or ascertain, the conclusion which he ought to reach, and the steps which he ought to take are those which would be known or ascertained, or reached or taken, by a reasonable diligent person having both; -

(a) The general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company, and
(b) The general knowledge, skill and experience that a director has.[397]

The importance of this section in attaching liability is vested in the fact that, the court might assess the nature of the company and its business to evaluate the functions carried out by a director. In *Re Produce Marketing Consortium Ltd*,[398] which was involved in the business of importing fruits as an agent on a commission basis on a gross sale price, PMC's trading depended on bank overdrafts from 1981 because it was operating at a loss. There was evidence of directors authorising amounts exceeding overdraft limits, which put the company in excess debt exceeding £16,000 by the end of 1986. In 1987, the auditors' accounts were signed showing that PMC was in an insolvent state as its activities only depended on the overdrafts and directors were notified of the possibility of personal liability due to the continuation of trading and accumulation of debt. The liquidator argued that directors should contribute about £107,946 but the Court ordered a contribution order of £75,000. The court looked at the financial report for 1986 and concluded that directors should have known by then that there was no way the company could have avoided insolvent liquidation. They had full knowledge of what was happening and continued to accumulate debt without reasonable grounds that the company could get back to financial stability.

[396] Section 214(3), Insolvency Act, 1986
[397] Section 214(4), Insolvency Act, 1986
[398] [1989] BCLC 520

Hence, the court measured the contribution of the directors from this period. One of the challenges for wrongful trading has been the discretion of the court in determining the amount of contribution directors make towards the assets of the company. As stated earlier, the enforcement of wrongful trading provision has many challenges and these were illustrated in the case of *Re Continental Assurance of London Plc*[399] *and Grant and Another v Ralls and Others.*[400] These cases are analysed in order to understand the inefficiencies of wrongful trading provisions. In *Re Continental Assurance of London Plc,* on 4th June 1991, directors gathered to consider and approve the accounts for 1990 after bad results were revealed. The directors treated the situation as serious and made a report into the company's solvency as at 31st May 1991, as well as a forecast for 1991 from the finance director and the auditors. Four further meetings were held before 19th July 1991 (the crucial date in the case), when directors decided on the evidence before them, that the company was solvent and that it should continue trading, and be able to do so without sustaining new losses. There was a danger of further serious losses resulting from past business. Claims of this nature would be watched closely, and if necessary, the company's position would be reconsidered urgently. Directors thought that the company needed recapitalisation, and steps were taken with a view to find a buyer. The directors continued to meet frequently. The company also instructed an outside expert to prepare a report. As the year ended, the situation looked increasingly bleak, and on 20th December 1991 the board had to accept that the company was insolvent and could not continue to trade. However, a formal resolution to put the company into liquidation was only passed on 27th March 1992, when it finally became clear that no purchaser would be found for the company.

The judge found none of the defendants liable for wrongful trading under section 214. The date was significant, because the judge had ruled that the liquidators had to make out their case for a specific date and that they could not argue the case on the basis that Continental had no reasonable prospect of avoiding insolvent liquidation from at least 19th July 1991 or at such other date as the court may determine. In this event the liquidators' claim failed because the judge held that (i) the company was not insolvent on 19th July 1991, and (ii) assuming the company was insolvent on that day, the knowledge needed to establish this was technical accounting knowledge in relation

[399] [2001] 4 WLUK 505
[400] [2016] EWHC 243

to insurance companies that was of such a specialised and sophisticated nature that the directors (apart from the finance director, whose case was settled out of court) could not reasonably be expected to possess.

In *Grant and Another v Ralls and Others,*[401] the court found that the directors had continued trading after a period when they ought to have known that the company would not avoid insolvent liquidation. However, the court was of the view that there was no net deficiency because of the wrongful trading. The liquidator renewed the application to claim for a contribution on expenses and costs for the administration and asserting that the liquidation of the company had increased in expenses due to the continued wrongful trading. The court refused to award the contribution order pursuant to section 214 of the Insolvency Act 1986. Looking at the brief facts, wrongful trading proceedings were brought against directors for reduction of company assets that occurred during 31st August and 13th October 2010 when the company went into administration. Directors then decided to take the company into insolvent liquidation in January 2011. Although the court confirmed that the company was wrongfully trading from 31st August to 13th October 2010, the steps taken by directors to put the company into administration were enough to substantiate that they took reasonable steps to reduce potential loss to creditors. In passing judgement, the court stated that there was no evidence to indicate that what happened during this time had contributed to company indebtedness as this had not been increased but remained substantially the same. However, during this time fresh credit was acquired to settle other creditors. While there was a legal issue of insolvency, at the same time there could have been one of preferential treatment of creditors. Snowden J indicated that he was not persuaded on the preponderance of probabilities that the obligations of the company enlarged during the time of wrongful trading. This judgement acknowledged that directors committed the offence of wrongful trading, an important element that must be established by the liquidator. Secondly, directors stated that fresh debt was acquired to settle other creditors which brings an argument of preferential treatment.

While there are some strengths in both judgements such as the companies being in winding up process, it was shown in both cases that the courts have at least sided with directors even though wrongful trading is established. In Re Continental Assurance Ltd, the court found that directors

[401] [2016] EWHC 243

acted with diligence and they could not allocate any blame to them despite significant loss being suffered by the company such that a quarter of the share capital had been depleted.[402] It can be argued that the burden of proof placed on the liquidator goes beyond establishing that the company is in insolvent liquidation, that the directors ought to have known that there was no reasonable ground to avoid insolvency, but adds that reckless behaviour be proven by the liquidator even though this is not required by section 214 of the Insolvency Act 1986. Proving reckless conduct is difficult for liquidators, especially that when a company is in the twilight zone, directors are known to take on risky projects to gain huge profits.[403] Others have argued that wrongful trading provision hinders directors from risk-taking.[404] This incentive should not be to the detriment of creditors because wrongful trading has not been efficient in terms of implementation.[405] In both cases, wrongful trading was committed and no order for contribution was given by the courts even though creditors suffered huge losses especially in long litigation and depletion of company assets. Case law has shown that directors can get away with reckless conduct that is likely to attract personal liability especially when the company is financially struggling.[406] Both judgements exposed the weaknesses relating to the amount of discretion the court has on accepting evidence. While the liquidator has to prove that directors should have known that there was no way of avoiding insolvent liquidation, the court has so much discretion on awarding the order for contribution even though wrongful trading has been committed.[407] There is limitation of relief to the suffered damage only and even though the provision has this limitation, the courts have discretion to reduce the relief even further.[408] For instance in Re Continental Insurance, despite the loss suffered, the court refused to award an order for contribution.[409] It was argued that wrongful trading is a limited remedy and ineffective due to procedural and evidential challenges[410] and it can be submitted that wrongful trading itself is not an offence in practice as it is supposed to be in theory except it pleases the courts to award an order for contribution. This is demonstrated in the power of the court to

[402] Thomas Bachner, 'Wrongful Trading before the English High Court Re Continental Assurance Company of London plc (Singer v. Beckett)' (2004) EBOR, 5, 195
[403] Rainer Werdnik, 'Wrongful Trading Provision - is it Efficient?' (2012) JII, 25, 81
[404] Andrew Keay, 'Wrongful Trading and the Liability of Company Directors: A Theoretical Perspective' (2005) LS, 431
[405] Rainer Werdnik, 'Wrongful Trading Provision - is it Efficient?' (2012) JII, 25, 81
[406] Thomas Bachner, 'Wrongful Trading before the English High Court Re Continental Assurance Company of London plc (Singer v. Beckett)' (2004) EBOR, 5, 195
[407] Ibid
[408] Rainer Werdnik, 'Wrongful Trading Provision - is it Efficient?' (2012) JII, 25, 81
[409] [2001] BPIR 733
[410] Marcus P.L. Gustafsson, 'Beating a Dead Horse? An Assessment of Wrongful Trading' (2017) CL, 38, 239

accept evidence to its satisfaction. This is because the defence directors have exclusively rest on the court to exercise its discretion in accepting satisfying evidence. Once directors can show that they took steps to minimise the potential of loss for creditors, this exonerates them from liability.[411] The court in Grant v Ralls acknowledged that the judgement could possibly reveal statutory problems which only the legislators can solve by reforming the law.[412] Although the court said there was no evidence of increase in the indebtedness of the company, fresh debt was obtained which obviously increased the obligations of the company and at the same time existing creditors were paid during the wrongful trading period and unsecured creditors in the claim were not. The question is whether directors acted in good faith by permitting this to occur and whether acquiring of fresh debt to settle another debt amounted to a step to reduce risk of loss if the same action creates a new risk on a different creditor? This cannot amount to good faith even though they relied on the advice of an external expert and believed that there was an investor to buy the company. The decisions in these cases illustrate difficulties of implementation of the law. It can be argued that while the section requires that directors prove that they took reasonable steps to minimise the risk of loss on creditors, it seems at the same time preferential treatment of creditors is permitted. Although wrongful trading provisions can deter directors from acting recklessly, they have nothing to fear because its' enforcement has several hindrances. Therefore, reform of law is needed to improve or increase effectiveness on wrongful trading provision.

2.5 The regulatory framework for corporate governance in the UK

The need to improve investor confidence, board accountability and transparency are argued to be major reasons which led to the development of corporate governance Codes in the UK and around the world.[413] Although different countries have different requirements, the need for transparency and accountability is common in governance of corporations.[414] Even though a process of reform has been going on for years, the most influential changes on corporate governance in the UK was initiated by the response to corporate scandals such as Enron and the downfall of Maxwell.[415]

[411] Section 214(3), Insolvency Act, 1986
[412] Marcus P.L. Gustafsson, 'Beating a Dead Horse? An Assessment of Wrongful Trading' (2017) CL, 38, 239
[413] Christine A. Mallin, *Corporate Governance* (5th ed. Oxford University Press, 2013) 27
[414] Teerooven Soobaroyen & Jyoti Devi Mahadeo, 'Do Corporate Governance Codes Improve Board Accountability?' (2012) QRAM, 9, 337
[415] Francesco Denozza, 'Different Policies for Creditor Protection' (2006) EBOLR, 7, 409

Although the UK is generally acknowledged as one of the leading countries with good corporate governance, this does not mean there is no need for reform.[416] On the contrary, as the corporate world is developing, so is the need for reformation and improvements especially after the failures of corporate governance were exposed in British Home Stores (BHS) and Carillion. The global investment market which makes relations between shareholders and companies important, and the need to focus on creating long term relationships with investors based on trust and transparency has created the need for regular review of codes.[417] The Financial Reporting Council (FRC) is an independent body mandated to regulate corporate governance in the UK and regularly reviews Codes beginning from Cadbury Report in 1992 to the UK Corporate Governance Code 2018.[418] Corporate governance Codes apply only to publicly traded companies with a premium listing and large private companies are regulated under the Wates corporate governance principles of 2018.

The lack of confidence in financial reporting by the FRC coupled with corporate scandals led to the London Stock Exchange (LSE) and accountancy professional bodies to establish a committee on the Financial Aspects of Corporate Governance in 1991 which later became known as the Cadbury Report.[419] Although the mandate of the committee was to look into the inconsistencies surrounding financial reporting, the committee had to enlarge its mandate to include issues of corporate governance following the collapse of Bank of Credit and Commerce International (BCCI) which involved the keeping of secret files for fraudulent purposes and Maxwell which involved secret loans to disguise the financial status of the company.[420] Accountability to shareholders was central to the Cadbury such that the Code stated that: 'the issue for corporate governance is how to strengthen accountability of boards to shareholders.'[421] Cadbury expressly recognised the shareholder orientation of corporate governance as it stressed on directors being accountable to shareholders without regard for providers of external finance although the central issue was accountability of the board.[422] The committee was to investigate how companies were

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[416] Jill Solomon, *Corporate Governance and Accountability* (3rd ed. Wiley & Sons, 2010) 45

[417] Mitsuru Mizuno & Isaac T. Tabner, 'Corporate Governance Codes in Japan and the UK: Codes, Theory and Practice' (2009) PER, 14, 622

[418] https://www.frc.org.uk/directors/corporate-governance-and-stewardship;accessed28/02/2018

[419] Christine A. Mallin, Corporate Governance (5th ed. Oxford University Press, 2016) 31

[419] Ibid

[420] Jill Solomon, *Corporate Governance and Accountability* (3rd ed. Wiley & Sons, 2010) 45

[421] Para 6.1, Cadbury Report, 1992

[422] Andrew Keay, 'Assessing Accountability of Boards under the UK Corporate Governance Code' (2015) JBL, 7, 551

managed in light of corporate scandals especially that the responsibility of the board was diminishing slowly and the managing directors or CEOs were exerting so much influence in decision making.[423] The report was not comprehensive because of its discretionary nature of 'comply or explain' principle which required companies to either comply or give reasons for non-compliance.[424]

It is contended that the rationale for adopting the 'comply or explain' principle was based on the economic theory instead of imposing governance practices on companies, it is left to the market for enforcement as a matter of choice.[425] It has been said that Codes are non-binding, voluntary and built on market evaluation for purposes of deviations.[426] Although Cadbury wasn't successful, it strengthened internal monitoring control by laying fundamentals for empowering boards to take charge over the control of companies by limiting powers or influence possessed by CEOs, and the process of decision making.[427] It is argued that one of the reasons for weaknesses in the Cadbury was that the committee assumed that accountability to shareholders was the ultimate objective for corporate governance.[428] This led to the Greenbury and central to the report was accountability, remuneration and performance of directors.[429] However, it was argued that the remuneration committee only acted as a legitimising tool to intensify the huge pay-outs to directors.[430] The Hampel report was constituted to answer to the shortcomings of the Cadbury and Greenbury report but creditors were not recognised. The first Combined Code 1998 was also shareholder oriented and it recommended that the board should maintain a sound system of internal control to safeguard the investment of the shareholders.[431] This was and still is a prominent feature in the Code as from Cadbury to the corporate governance Code 2018. In 2001, 2008, Myners Report was established

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[423] Stephen Bloomfield, *The Theory of Corporate Governance: An Integrated Approach* (Cambridge University Press, 2013) 7
[424] Bob Tricker, *Corporate Governance: Principles, Policies and Practices* (2nd ed. Oxford University, 2011) 119
[425] Thomas Kaspereit, Kerststin Loppatta & Jochen Zimmermann, 'Does Compliance with the German Corporate Governance Code Pay Off?' (2015) JRF, 16, 344
[426] Francesca Cuomo, Christine Mallin & Alessandro Zattoni, 'Corporate Governance Codes: A Review and Research Agenda' (2016) CGIR, 24, 222
[427] Anna Zalewska, 'Challenges of corporate governance: Twenty years after Cadbury, ten years after Sarbanes–Oxley' (2014) JEF, 27, 1
[428] Hellen Short, 'Corporate Governance: Cadbury, Greenbury and Hampel – A review' (1999) JFRC, 7, 57
[429]Christine A. Mallin, *Corporate Governance* (5th ed. Oxford University Press, 2016) 30
[430] Hellen Short, 'Corporate Governance: Cadbury, Greenbury and Hampel – A review' (1999) JFRC, 7, 57
[431] Christine A. Mallin, *Corporate Governance* (5th ed. Oxford University Press, 2016) 31

to examine the legal requirements for trustees with the view of promoting shareholder activism as the Report centred on institutional investors.[432]

In 2014, the Code was updated to include appropriate reporting requirements and by so doing, companies needed to give information relating to solvency, liquidity, risk and viability. The central need of accountability to shareholders and not the company in general poses the agency problem and neglects creditors and other stakeholders in a corporation.[433] Corporate governance in the UK is centred on the shareholder primacy model with management running companies principally for the benefit of shareholders who are regarded as owners of the company.[434] This was further discussed by Armour et al who argued that in the UK the shareholders' interests are paramount in corporate governance.[435] The economists regard a corporation as a 'nexus' of contracts entered into primarily between the capital providers and the managers.[436] This notion seem to embrace shareholders' interests as being the ultimate interests of the company and that the company should endeavour to pursue maximisation of shareholder value as its objective.[437] This created the agency problem especially in the economic perspective.

Agency is a contract where one or more persons (principal) engage another person or persons (agent) to perform services on their behalf which involve delegating decision making authority to the agent.[438] The economists argue that the agency relationship exists between the shareholders (principal) and the directors/managers (agent).[439] This relationship having been created between the shareholders and the directors/managers, the directors/managers are therefore supposed to act in the interests of the shareholders.[440] The delegation of managerial authority to directors/management represents a separation of ownership and control which has culminated into

[432] Ibid 32
[433] Francesco Denozza, Different Policies for Creditor Protection (2006) EBOLR, 7, 409
[434] Jean-Philippe Touffut, *Does Company Ownership Matter*? (Edward Elgar Publishing, 2009) 128
[435] John Armour, Simon Deakin & Suzanne J. Konzelmann, 'Shareholder Primacy & the Trajectory of UK corporate Governance' (2003) JBIR 41, 531
[436] Muhammad Zubair Abbasi, 'Legal Analysis of Agency Theory: an inquiry into the nature of corporation' (2009) IJLM, 51, 401
[437] Shuangge Wen, 'Re-visiting the Corporate Objective Through the Economic Lens- the UK Perspective', (2013) ICCLR, 24, 302
[438] Michael C. Jensen & William H. Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs & Ownership Structure' (1976) JFE, 3, 305
[439] Christine A. Mallin, *Corporate Governance,* (4th ed. Oxford University Press, 2013) 17
[440] Ibid

the agency problem.[441] Problems such as abuse of discretion and the division of interest between shareholders and directors have been brought as a result of this relationship.[442] The foundation of the agency problem is the separation of management and finance, or ownership and control.[443] This problem is inevitable once powers have been vested on directors to run the company especially for public companies that have a dispersed shareholding and directors seem to have authority that is almost unchallenged.[444] It was noted that in the nineteenth century when there was multiplicity in the number of shareholders and directors, the authority shifted from the principal to the agent thereby bringing about abuse of authority by the agent.[445] It has been argued that in finance there is also the agency relationship of creditors as principal and shareholders through the activities of the agent.[446] This agency relationship exists for purposes of debt finance which shareholders would rather use for the purposes of riskier projects which they stand to gain as agents while creditors as principal will bear the risk of the loss.[447]

Nonetheless, the legal viewpoint establishes that directors are not agents of the shareholders but of the company as they owe their duties to the company not to shareholders.[448] The juridical relationship of agency arises when the principal assents to the agent that the agent shall act on behalf of the principal and under the control of the principal.[449] The implication of this relationship is that the agent must act on behalf of the principal and most importantly the principal must possess the ability to control the agent.[450] It has been argued that directors are agents of the company hence, they owe their duties to the company and by extension to creditors. This argument was forwarded

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441 Adolf A. Berle and Gardiner C. Means in Jill Solomon, *Corporate Governance and Accountability* (3rd ed. Wiley and Sons Ltd, 2010) 9
442 Michael C. Jensen & William H. Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs & Ownership Structure' (1976) JFE, 3, 305
443 Andrei Shleifer and Robert W. Vishny, 'A Survey of Corporate Governance' (1997) JF, 72, 737
444 Min Yan, 'Agency theory Re-examined: an agency relationship and residual claimant' (2015) ICCLR 26, 139
445 Adolf A. Berle and Gardiner C. Means cited in Bob Tricker, *Corporate Governance: Principles, Policies and Practices* (2nd ed. Oxford University Press, 2012) 59
446 Denzil Watson & Antony Head, *Corporate Finance: Principle and Practice* (5th ed. Pearson Education Limited, 2010) 14
447 (Ibid)
448 Muhammad Z. Abbasi, 'Legal Analysis of Agency Theory: An Inquiry into the nature of corporation' (2009) IJLM, 51, 401
449 Min Yan, 'Agency theory Re-examined: an agency relationship and residual claimant' (2015) ICCLR 26, 139
450 Ibid

by the House of Lords in *Winkworth v Edward Baron Development Co. Ltd*[451] where Lord Templeman stated that:

> [A] company owes a duty to its creditors, present and future. The company is not obliged to pay off every debt as soon as it incurred, and is not obliged to avoid all ventures that involve a risky element, but the company owes a duty to its creditors to keep its property inviolable for the repayment of debts. The conscious of the company as well as its management is confided to its directors. A duty is owed by directors to the company and to the creditors to ensure that the affairs of the company are properly administered and that its property is not dissipated or exploited to the detriment of the creditors.[452]

It was also pointed out by Lord Cranworth in *Aberdeen Rly Co Ltd v Blaikie Bros*[453] that:

> [D]irectors are a body to whom is delegated the duty of managing the general affairs of the company. A corporate body can only act by agents and it is the duty of those agents to act as best to promote the interests of the corporation whose affairs they are conducting. Such agents have duties to discharge of a fiduciary nature towards their principal.[454]

The interests of the company are arguably said to include the interests of creditors because financial stability is in the interest of every company. In *Lonrho v Shell Petroleum*[455] Lord Diplock stated that: the best interests of the company may not be exclusively those of the shareholders but may include those of creditors. The implication of this decision was that in order to have the interests of the company as a priority, the welfare of creditors could as much qualify as interests of the company hence; the duty to consider creditors' interests could take effect in ample time to ensure safety for the company, shareholders as well as creditors. In *Re Horsley and Weight Ltd,*[456] Lord Buckley referred to the terminology of "directors owing an indirect duty to creditors not to permit any unlawful reduction of capital."[457] Endorsing this judgement in *Brady v Brady*[458] the House of Lords stated that directors needed to consider creditors' interests if they were to act in the interests of the company. They stated that the interests of creditors would recover in the long term because the transaction was made in good faith and in the interest of the company. Although established that directors are agents of the company, it is argued that when a company is nearing

[451] [1986] 1 WLR 1512 (HL)
[452] Ibid
[453] [1854] 1 Macq 461
[454] Ibid
[455] [1980] 1 WLR 627
[456] [1988] 3 ALL ER 617(HL)
[457] Nicholas Bourne, *Bourne on Company Law* (7th ed. Routledge, 2016) 179
[458] [1989] 3 BCC 535 (CA)

insolvency, directors in practice still consider shareholders and it is for these reasons that the duty has not been very effective in terms of creditor protection. As directors endeavour to serve the interests of the company, it is considered that the interests of the shareholders are ultimately the interests of the company. If this is the case, then surely there is no need to impose an agency relationship between directors and shareholders because it vetoes the former claim. The company is to be run in the interests of all the stakeholders involved to reduce the influence of the shareholders. However, it has been argued that the goal of corporate governance is based on the shareholder primacy because share value is a reflective index of growth and profitability of shareholders' investment for overall firm wealth.[459] The important thing is to conduct the affairs of the company in ways that lead to shareholders getting a return on their investment.[460] This relationship brings about a lot of problems such as abuse of discretion, and division of interests between the shareholders and directors.[461] The foundation of the agency problem is the separation of management and finance, or ownership and control.[462] The need for shareholders to monitor directors causes them to expend resources known as the agency costs. This include monitoring expenditure by shareholders and the bonding expenditure by the agent.[463] It is argued that although this kind of monitoring of directors or managers by shareholders is costly, it is one way in which both their interests can be aligned.[464] These involve activities of shareholder engagement and incentive schemes and contracts that help keep directors and managers focused on shareholder maximisation.[465] While shareholders incur expenditure in monitoring agents, the agents are also in a bid to prove that they are working on a shareholder value maximisation, they incur costs known as the bonding costs.[466] In the process its directors focusing on expanding shareholder interests and neglecting creditors. This was illustrated in the cases below which exposed the failures of corporate governance in the UK.

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[459] Joseph E.O Abugu, 'Primacy of Shareholders' Interests and the Relevance of Stakeholder Economic' (2013) Cl, 34, 202
[460] Andrei Shleifer and Robert W. Vishny, 'A Survey of Corporate Governance' (1997) JF, 72, 737
[461] Michael C. Jensen & William H. Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs & Ownership Structure' (1976) JFE, 3, 305
[462] Andrei Shleifer and Robert W. Vishny, 'A Survey of Corporate Governance' (1997) JF, 72, 737
[463] Michael C. Jensen & William H. Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs & Ownership Structure' (1976) JFE, 3, 305
[464] Jill Solomon, *Corporate Governance and Accountability* (3rd ed. Wiley and Sons Ltd, 2010) 10
[465] Andrei Shleifer and Robert W. Vishny, 'A Survey of Corporate Governance' (1997) JF, 72, 737
[466] Brockman P and Unle E, 'Dividend Policy, Creditor Rights, and the Agency Costs of Debt' (2009) JFE, 92, 276

2.5.1 The fall of British Home Stores 2016 [Not reported]

The British Home Stores started retailing in United Kingdom in 1928 with its first store being opened in Brixton in South London.[467] In 2000, Sir Philip Green bought BHS at the value of £200 million and in December 2001, the business sold a total of 10 outlets to a company called Carmen Properties limited for £105.9 million which was at the time owned by Philip Green and his immediate family.[468] In the same year, BHS rented them back from the Jersey based company at £12 million a year. This resulted in a debate whether the rent was reasonable because it was above the average. The total rent for the duration of 11 years amounted to £153m.[469] Besides the inflated rent payments,[470] about £414 million was paid out in dividends from 2002 to 2004 and £317 million was for the Green family from the total sum.[471] This resulted into the business being left in unprofitable state and incapable of any further investments. Philip Green owned Arcadia Group of Companies and Taveta Investments Ltd the parent companies to BHS and these paid a record dividend of £1.3 billion in 2005 which was the highest dividend pay cheque in British history.[472] From 2009 the business started making losses of about £70 million annually and by 2014, it was in debt of £250 million to other Green family businesses which Philip Green decided to write off when he was selling the company for £1 to Retail Acquisitions in March 2015.[473] The law is clear that directors need to make decisions that are in the interests of the company or that promotes the interests of the company for the benefit of its members.[474] This duty applies to all directors in both private and public limited companies. The corporate governance code provides that all companies must be led by an effective board responsible for setting out values and standards including strategic aims that foster the business of the company. Even though the Code is a non-statutory regulation and applicable to public companies, private companies are advised to comply with the Codes to promote good governance practices. The Codes provide for the roles of the NEDS to challenge and scrutinise the decisions of the board in a constructive way but this wasn't the case

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467 Edward Curwen, 'Five Issues at the Heart of the BHS Story,' BBC Analysis and Research: http://www.bbc.co.uk/news/business-36175250 accessed 11/10/16

468 Ibid

469 Ibid

470 Edward Curwen, 'Five Issues at the Heart of the BHS Story,' BBC Analysis and Research: http://www.bbc.co.uk/news/business-36175250 accessed 11/10/16

471 UK work and Pensions Committee, 22/07/2016**:** http://www.publications.parliament.uk/pa/cm201617/cmselect/cmworpen/54/5409.htmaccessed 11/10/16

472Ibid

473 Ibid

474 Section 172, Companies Act 2006

with BHS most of the board members were trusted partners and family members of Philip Green, and they were also board members of the other companies owned by him such as Taveta Investments. There was no way they could perform their duties independently because of the influence of the appointing authority. There decisions had to be in line with the shareholders and this rendered their role ineffective. Although BHS is not subject to the FRC, upon the sale in 2015, Philip Green wrote off over £200 million of debt. This technically means that had that debt not been written off, creditors would have suffered greater loss. This exposes the weakness of law on directors' duties as well as distribution of dividends.

2.5.2 The fall of Carillon [Not reported]

This analysis is based on the report by Parliament.[475] On the 15th January 2018, Carillion went into liquidation and the court appointed the official receiver as the liquidator.[476] This is because their assets were insufficient to even attract further loans from the bank. The liabilities at the time Carillion went into liquidation were nearly £7billion and the company only had cash of about £29 million meanwhile £79 million had been paid out as dividends and bonuses to top executives in 2016.[477] The 2017 annual accounts were certified as true by KPMG and throughout the 19 years that KPMG audited Carillions' accounts, they were never qualified at any point but simply signed off.[478] Profit warning was later published in September 2017 with a reduction of £845 million in contract value and later increased to £1,045 million which was equivalent to its combined profits for the past seven years. There was total of £2.6 billion in the pension's liability and it had a debt of around £2 billion to its suppliers or creditors. Had creditors' interests come in consideration early, this would not have continued because steps would have been taken not to jeopardise the company to the detriment of creditors. The government launched an investigation to find out what happened. The question is what went wrong for this giant construction company and what was evidently overlooked? There are a number of issues under investigation and these include aggressive accounting, failure to halt acquisitions, not involving shareholders for assistance and continued pay out of dividends and high bonuses to top executives.[479] While the collapse affected a lot of stakeholders such as employees, creditors suffered a massive loss especially in the loans

[475] House of Commons Business, Energy and Industrial Strategy and Work and Pensions Committees on Carillion printed 9 May 2018
[476] Ibid
[477] Ibid
[478] Ibid
[479] https://www.ft.com/content/2cab2ac2-fb83-11e7-9b32-d7d59aace167 accessed31/03/2019

to the companies associated with Carillion such as Vaughan which collapsed with a debt of about £2.9 million to the bank. Interestingly the conclusions of the report found issues of corporate governance that have been exhibited before in other corporate failures.

One of the conclusions was that without further funding from the government, there was no possibility of external finance and wrongful trading was possible before 15th January 2018. Measures were not put in place by directors to reduce potential losses. This begs the question as to whether any proceedings will be brought against the directors and if not, the example being set is that directors can always get away with such kind of corporate misconduct without repercussions. There was evidence of refusal by the company to bring additional equity but rather used external finance. This indicates how companies favour the use of debt for projects even if they reasonably know that there is possibility of loss. However, this externalisation is supported by limited liability and in turn creditors suffer loss. Creditors such as Barclays, HSBC, Santander, Royal Bank of Scotland (RBS), and Lloyds were all affected for instance £127 million was lost by Barclays bank in April 2018.[480] There was evidence showing lack of transparency, accountability and integrity which attributed to lack of sanctions by the Financial Reporting Council which only has regulatory powers.

2.5.3 Comply or explain principle: a strength or weakness?

The 'comply or explain' approach does not have any legal effect, or it is not legally binding as it is based on the 'principle' approach and not the 'rule' approach.[481] The Code being built on the flexible foundation which allows companies to decide whether to comply or explain has been the trademark of corporate governance in the UK from the time of the Cadbury report in 1992 and it has attracted a lot of international attention of which most of the countries have adopted[482] with minor amendments. The major characteristic of the Code is voluntary approach and a mandatory disclosure statement as to whether the company has complied with provisions of the code. The mandatory disclosure statements in the annual reports allows the FRC to monitor the number of companies that are in compliant. It is argued that even though the Code has no legal binding effect, it has been adhered to by companies and this has led to the UK being recognised as the leading

480 https://www.bbc.co.uk/news/business-43152466accessedon31/03/2019
481 Sridhar Arcot, Valentina Bruno & Antoinie Faure-Grimaud, 'Corporate Governance in the UK: Is the Comply or Explain Approach Working?' (2010) IRLE, 30, 193
482 Corporate Governance Code (2014)

country with good corporate governance practices.[483] It is argued that the codes are referred to as 'soft law or soft regulation created for the market mechanisms for evaluation purposes upon which companies are given the flexibility to adopt or select a corporate governance structure that is suitable for their objectives while guaranteeing better transparency and accountability.'[484]

However, it has been argued that unlike the discretionary approach, mandatory requirements of governance practices required by law are much more effective such as the Sarbanes-Oxley Act in the United States of America (USA).[485] It is however argued that where the company decides not to comply with the code, but offers an explanation for non-compliance, the shareholders may challenge this explanation even though the code requires them to do so with regard to the fact that the approach is the alternative to the 'rule-based approach,' and so they must challenge the explanation with due regard to individual company circumstances. However, the code does not stipulate what happens when there is a dispute between the company and the shareholders regarding the explanation. This argument raises two questions the first being can the shareholders demand for compliance where the explanation is insufficient or unsatisfactory? The second question is, what then amounts to a satisfactory explanation for non-compliance? As regards the first question, this is where the law must come in and provide for legal enforcement of the provisions of the code. This is because the decisions of the board affect other stakeholders such as creditors. So, when a company does not to comply with the code on matters that are seemingly harmful to creditors, shareholders are likely not to have problems with such kind of non-compliance which then leaves creditors at risk. How then can this situation be rectified? They further propose that companies which do not comply with the code be made to comply legally but if this is the case, it is argued that legal enforcement must be attached for non-compliance. Explanations given for non-compliance have no required standard if the company can show that the deviation from the Code was explained, and why it is not in the goodwill of the company. Whether the explanation is satisfactory or not, is not provided for and there can be no strict rules about it. This is where the legal argument of giving codes legal effect comes into effect because companies will be more careful and accurate to comply for fear of breaching the law. It has been

[483] Francesca Cuomo, Christine Mallin & Alessandro Zattoni, 'Corporate Governance Codes: A Review and Research Agenda' (2016) CGIR, 24, 222
[484] Ibid
[485] Ibid

claimed that companies are now trying to provide a robust explanation for non-compliance than seeking to fully comply.[486] This demonstrates that corporate governance is not effective because companies are at liberty to comply or not.

2.6 Conclusion

After analysing the legal framework on creditor protection, several challenges or problems were found. The concept of limited liability is surely a good concept that can support and foster corporate activities thereby developing the economy of a country. However, limited liability impedes creditor protection by the very reason that the courts are reluctant to lift the corporate veil. While this is established, it leaves creditors searching for protection and directors' duties especially when a company is financially troubled can be used to protect them. However, this mechanism has uncertainties such as the time of effect and what it means for directors to act in the interests of creditors. It has been suggested that while uncertainties continue perhaps implementing initial steps in the Keay framework could be the beginning of understanding the meaning of considering creditors' interests. The study also found that the duty to consider creditors' interests during financial distress takes effect late which seem to allow wrongful trading to occur. As a result, there is potential for directors to commit wrongful trading and still get away from liability due to the enforcement challenges in the law. This provision was found to be ineffective and possible preferential treatment seem permissible due to the difficulties in interpretation of what it means to take every step to reduce risk of loss for creditors. The flexibility approach to corporate governance exposes its weaknesses as well as neglects creditors at the same time both in the laws and codes. However, for it to work effectively without exposing creditors, certain benchmarks must be put in place within the law to protect creditors. Although the legal framework for creditor protection is surrounded by uncertainties that impede creditor protection, the regulatory framework in terms of corporate governance has also exhibited neglect in relation to creditors' interests. Having identified the shortfalls to ideal creditor protection in the UK, this begs an analysis on the same concepts in Zambia with the aim of a comparative analysis in mind. This is addressed in the next chapter.

[486] Winfried Bischoff, Corporate Governance Review (2015) http://www.grantthornton.co.uk/globalassets/1.-member-firms/united-kingdom/pdf/publication/2015/uk-corporate-governance-review-and-trends-2015.pdf

CHAPTER 3: Legal and regulatory framework for creditor protection and corporate governance in Zambia in comparative to UK

3.1 Introduction

Having analysed the UK legal framework for creditor protection in the previous chapter, the objective of this chapter is to analyse the legal and regulatory framework for creditor protection in Zambia. The framework for corporate governance is recognised in the Companies Act which establishes the law regulating companies,[487] the Securities Act (SEC) establishes the Securities and Exchange Commission,[488] the Lusaka Stock Exchange Corporate Governance Code (LuSE Code) which governs and regulates companies listed on the Exchange, the Bank of Zambia Corporate Governance Guidelines (BOZ) and the Banking and Financial Services Act (BFSA).[489] Where Zambian case law is inadequate, English case law is applicable by virtue of the English Law (Extent of Application) Act.[490] Owing to this Act, this chapter refers to some English cases where necessary. The effectiveness of the legal and regulatory system is a significant mechanism for corporate governance to function effectively.[491] As indicated in Chapter One, literature on the subject matter is scarce hence the use of empirical data in the study. Emphasis is given to the fact that Zambia as a developing country is used as a representative of other developing countries in the Southern African Development Community (SADC) region. Zambia was rated as one of the poor highly indebted countries until after the 100% cancellation of the outstanding debt by the Group of Countries (G8) under the Multi-lateral Debt Relief Initiative (MDRI) which allowed it to re-allocate finances from external debt servicing to other sectors of the economy paving way for the economic development programs.[492] The World Bank index rankings for doing business improved from 90 to 76 in 2009 and 2010 respectively.[493] This ranking was from a total of 183 countries conducted by the World Bank in 2011 and since then, Zambia has been categorised as a

[487] Companies Act, Chapter 388 of the Laws of Zambia 1994
[488] Securities Act, Chapter 354 of the Laws of Zambia 1993
[489] Chapter 387 of the Laws of Zambia 1994
[490] English Law (Extent of Application) Act, 1963, Chapter 11 of the Laws of Zambia
[491] Racheal Ntongho, 'Self-regulation of Corporate Governance in Africa: Following the Band Wagon?' (2009) ICCLR, 20, 427
[492] Stuart J Barton, 'Why Zambia Failed' (2015) JIE, 11, 803
[493] Kabanda R.K. Mushota, 'The Legal Validity if the Ministerial Directive Purporting to Dissolve Limited Liability Companies in Zambia' (1979) CILJS, 12, 140

lower middle income country.[494] In order to maintain and improve this economic growth, diversification of the economy and improvement of policy framework became important to attract FDI.[495] However, several economic drivers have been a challenge for Zambia such as legal framework, regulatory structure, and institutional frameworks, oversight and enforcement of good corporate conduct. With a huge reliance on debt for corporate activities in Zambia,[496] it is imperative that law regulating companies and financial institutions be analysed to understand creditor protection. This is owing to the corporate sector which has been sustained by credit for a long time although the risk increased when limited liability was introduced which meant that claims against the company only went so far as company assets would meet. This concept is said to have been abused to the detriment of creditors. This has led to directors governing the firm in a way that neglects creditors to the satisfaction of shareholders.

The chapter has been divided into three sections with the first part discussing the background and attributes of company law in Zambia. The second part focuses on directors' duties, fraudulent and wrongful trading, and the third part discusses corporate governance. The strategy is to discuss issues discussed in Chapter Two except, a more descriptive analysis is given for a better understanding of how the Zambian system works.

3.2 **Background**

As a landlocked country centrally located in the southern part of Africa, Zambia is surrounded by eight neighbouring countries and has a population of about 16.5 million people mostly urban concentrated with the economic capital and administrative organs situated in Lusaka, the capital city which has about 1.8 million people.[497] Zambia being a British colony up until 1964, its laws are based on the English legal system and most of the statutes were adopted with little modification. One significant statute under review is the Companies Act 1994 which was based on the English Companies Act 1948.[498] The postcolonial rule has seen six political administrations with each one of them formulating their own economic and political policies and laws that have seen the country through till now. Though the country has political stability, each era has its own effects on the

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[494] Ibid

[495] Themba G. Chirwa and N.M. Odhiambo, 'The Dynamics of the Real Sector Growth in Zambia: Key Macroeconomic Drivers and Challenges' (2015) GJEME, 217

[496] Samuel Munzele Maimbo, 'Explaining Bank Regulatory Failure in Zambia' (2002) JID, 14, 229

[497]https://www.zamstats.gov.zm/phocadownload/Dissemination/The%20Statistician%202018.pdfaccessed01/04/2019

[498]Kabanda R.K. Mushota, 'The Legal Validity if the Ministerial Directive Purporting to Dissolve Limited Liability Companies in Zambia' (1979) CILJS, 12, 140

economic development of the country. The first era was from 1964-1991, characterised by nationalisation of industries, the second was from 1991-2001, which was characterised by privatisation of the economy, the third era was from 2002-2008, and this was characterised by policies for economic growth and investment, and also the fight against corruption, the fourth era was 2008-2011, the period after the global financial crisis saw a continuation of the preceding era but focused on financial regulation, the fifth era from 2011-2014 which was characterised by lack of accountability and governance policies. The sixth era is the current government characterised by some form of progress on legal, governance and regulation of the economic sector although having inadequacies and political financial crimes and corruption at the centre.[499] A landmark development in terms of the corporate sector has been the enactment of the Companies Act 2017 and Corporate Insolvency Act 2017 which is a step into creating a legal environment for economic activities in the country thereby attracting investors both local and foreign.

3.2.1 An overview of financial policies

The Zambian financial sector is small with the banks being the source of corporate finance.[500] Before independence, it was dominated by foreign banks that provided credit needs to expatriate businesses and the post-independence era reshaped the sector with economic reforms aimed at nationalisation of all foreign companies including banks.[501] After government took control of the sector, it established government owned banks such as Zambia National Commercial Bank (ZANACO), Indo-Zambia Bank and the Development Bank of Zambia (DBZ) and the need for financial policies arose.[502] These policies included administrative controls such as interest rates but credit guidelines were not detailed in a bid to promote lending to local businesses. The BOZ controlled the lending interests and kept them low to minimise the cost of borrowing and nominal rates were kept below the inflation rate with a preferential rate set aside for lending to the Agriculture sector.[503] Till 1984 commercial banks deposit rates remained between 3.5% and 8.5% and lending rates between 7% and 13% and nominal rates for inflation at an average of 10% in

[499]Jotham C. Momba, 'The Intersection between Politics and Corruption in Zambia' (2007) SAJIA, 14, 115
[500] Abraham Mwenda and Noah Mutoti, 'Financial Sector Reforms, Bank Performance and Economic Growth: Evidence from Zambia' (2011) ADR, 23, 60
[501] Ibid
[502] Samuel Munzele Maimbo, 'Explaining Bank Regulatory Failure in Zambia' (2002) JID, 14, 229
[503]Copestake, James, Bhalotra Sonia and Johnson Susan, 'Assessing the impact of microcredit: A Zambian case study' (2001) JDS, 37, 81

1970s and 20% in 1980s.[504] During the mid1980s, decontrols in interest rates and the breakdown of the International Monetary Fund (IMF) stabilisation programme, interest rates increased abruptly and later in 1987 it reached over 100% per annum.[505] In the early 1990s, the BOZ was more focused on compliance with regulation imposed by government such foreign exchange requirements and interest rate control while neglecting prudential regulation.[506] The legislative framework was the Banking Act[507] and the Bank of Zambia Act[508] and both statutes hindered effective prudential regulation. For example, banking licences were granted by the Registrar of Banks who was appointed by the Minister of Finance and not BOZ. The second challenge was that the BOZ had no authority to issue or update regulation, the third problem related the uncertainty of what bank directors were to do and also their experience and qualification and the grounds of rejection were not stated.[509] Lack of prudential regulation and supervisory policies were cited as some of the causes for bank failures. This created a situation where a bank that was financially struggling could appear stable. After revision of the Banking legislation, the enactment of the BFSA in 1994 gave authority to the Central Bank to issue and update financial policy and gave it supervisory authority.

The BFSA covers a lot of issues such as; while permitting licenses to financial institutions, consideration is to be given to financial resources, experience and character of applicants including proposed directors, restrictions on loan exposure and insider lending, although the latter is less restrictive, minimum capital requirement, restrictions on shareholder concentration, some degree of formal separation of the roles of ownership and management, issuing directives stipulating remedial action to revoking a bank's licence, against banks that conduct unsafe or unsound practices or infringe provisions of the BFSA and where the BOZ believes a bank is insolvent it has the power to take possession of it and appoint a receiver. In the prevailing lending environment in Zambia, having close supervision from the Central bank does not guarantee effective bank

[504] Ibid
[505] Abraham Mwenda and Noah Mutoti, 'Financial Sector Reforms, Bank Performance and Economic Growth: Evidence from Zambia' (2011) ADR, 23, 60
[506] Juliana Siwale and Ngozi Okoye, 'Microfinance Regulation and Social Sustainability of Microfinance Institutions: The Case of Nigeria And Zambia' (2017) APCE, 88, 611
[507] Chapter 700 of the Laws of Zambia
[508] Chapter 699 of the Laws of Zambia
[509] Abraham Mwenda and Noah Mutoti, 'Financial Sector Reforms, Bank Performance and Economic Growth: Evidence from Zambia' (2011) ADR, 23, 60

regulation however, the need for a framework for good governance was exposed. Having a lot of foreign owned banks in Zambia makes foreign equity participation very significant as it constitutes about 75% of the total banking system capitalisation.[510] The Bank of Zambia made numerous policy measures of managing liquidity to ensure that there is availability of credit to the corporate sector in order to support economic growth.[511]

3.3 The concept of a company and the legal personality in Zambia

Company law in Zambia dates back to 1921 when Zambia was known as the Northern Rhodesia under the governance of the British South African Company (B.S.A), which was a British Protectorate in charge of the Northern Rhodesia on behalf of the King. The first piece of legislation was the Northern Rhodesia Companies Proclamation.[512] This Proclamation was based on the British Companies Act,[513] which was the applicable company law in Britain at that time. Before the Companies Proclamation in 1921, Northern Rhodesia was using the system of registration of deeds and in 1898 there was a government notice[514] which was officially adopted from the B.S.A and it brought about the introduction of limited liability and the articles of association.[515] Since then, the sanctity of the legal foundation as set in the ruling of *Salomon v Salomon*[516] has been the applicable concept in terms of the legal status of a company.[517] This was also provided in the old Companies Act that a company is a body corporate that is separate from members who formed it and shall have such powers, rights and privileges as those of an individual.[518] The concept was echoed in the Zambian courts in the case of *Associated Chemicals Ltd v Hill and Delamain and Ellis and Co.*[519] where the respondents sued the appellants for the debt of services rendered. The appellants sold the company to new management and in the contract of sale, there were clauses endorsed by the vendor that they would indemnify the purchaser against financial liabilities incurred prior to the sale. Counsel for the appellants argued that in accordance with the share

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[510] Ibid
[511] Anthony Simpasa Boaz Nandwa Tiguene Nabassage, 'Bank Lending Channel in Zambia: Empirical Evidence from Bank Level Data' (2015) JES, 24, 1159
[512] Northern Rhodesia Companies Proclamation, (No 18 of 1921)
[513] British Companies (Consolidation) Act, 1908
[514] Government Notice No 68 of 1898 (Northern Rhodesia)
[515] Ibid
[516] [1897] ACC 22
[517] Kabanda R.K. Mushota, 'The Legal Validity if the Ministerial Directive Purporting to Dissolve Limited Liability Companies in Zambia' (1979) CILJS, 12, 140
[518] Section 22, Companies Act, 1994, Chapter 388 of the of the Laws of Zambia
[519] [1998] ZR 9

purchase agreement, the new management was not liable for the financial debts of the company incurred by the previous management. The court in delivering judgement stated that it was wrong in principle to separate new from old management because of legal personality of the company established in the case of Salomon. This permits the company to acquire its own property which does not extend to members. The principle is that the company owns the property and not the members hence, in the English case of *Macaura v Northern Assurance Ltd*,[520] the court held that despite Macaura being the only major shareholder, his incurable interest was in the company and not the assets of the company and on this ground, his claim failed. This has been a leading authority on company assets however, this decision was not followed in the Zambian courts thereby setting a new precedent in the case of *Nyimba Investments Limited v Nico Insurance Zambia Limited*.[521] An insurance policy was obtained for company property against all material damage and loss of profits and business interruption by the appellant company and a fire destroyed the property.

The insurance company settled the claim but declined to pay for loss of business and interruption when it was later discovered that the property was registered in the names of the shareholders, yet it was company property. The respondent sought to claim back the money paid after refuting the policy was void. The court ruled that the shareholders had an incurable interest in the property even though it lacked legal interest that was registered to its name. Therefore, the respondents were right to pay the company and it had to pay the shareholders for loss of business and interruption of business. The court said that: an insurable interest exists: if the assured has a legal or equitable title in the subject matter, or if the insured is in possession of the subject matter but may be either responsible for, or suffer loss in the event of, any damage to the subject matter.[522] This decision has been welcomed in Zambia as many have seen it as a way of holding insurance companies responsible for policies.[523] However, there are serious legal consequences that have not been paid attention to yet. The implication is that shareholders are entitled to have an interest in the assets of the company which means they can as well own company assets. Two arguments are involved in this position. The first is that this takes away the legal personality of the company and secondly, it authorises shareholders to misappropriate company assets to the detriment of creditors. In the

[520] [1925] AC 619 (HL)
[521] (2017) ZMSC 32
[522] Edward Sampa, Nyimba Investments Limited vs Nico Insurance Zambia Limited (Appeal No. 130/2016) [2017] (2019) SCR, 1, 38
[523] Ibid

former argument, this should mean that creditors as well can be able to claim against the property of the members if the separateness has been removed by case law. This although against the sanctity of the principle in the decision of Salomon, could improve creditor protection. However, even though the courts have ruled that shareholders have a legal interest in the assets of the company, this does not mean that they are willing to rule in favour of creditors to go after the assets of the shareholders. This leads to the later argument of misappropriation of assets due to greater protection accorded to shareholders by the courts. The fact that the court have rule in favour of shareholders, that they have a legal interest in the assets of the company, it is possible that misappropriation can occur based on that legal interest. This deteriorates the position of creditors within the law. The court was fully aware that this decision is against the principle in Salomon as it stated in passing the judgement that: while authorities of apex courts in England will remain persuasive on courts in Zambia, authorities will not be applied without consideration of the circumstances in which they were decided.[524] This exposure of creditors could also mean that assets can be put out of reach from creditors and be registered in the name of the shareholders. Unless clear guidance to this decision is given, this is arguably a bad precedent.

While there is limitation of liability just like the UK, the courts can lift the corporate veil. However, this has only been done on three occasions with the Supreme Court refusing to pierce the veil in the fourth case and restating the position in England that it should only be done as a last resort in exceptional circumstances. This is done in two ways namely by statute or judicial interpretation. The former is done where there has been a breach of law by a company and the later when the courts have been given discretion to decide whether fraud had been established on the part of directors under section 383.[525] Statutory piercing was illustrated in *Ethiopian Airlines v Sunbird Safaris.*[526] In this case, the company carried on business for a period of two years with a single director. It is an offence to carry on business with less than two directors for a period exceeding six months.[527] The application pursuant to section 26 and 383 of the Companies Act, was made for the veil to be lifted. The High Court did not find the managing director liable and so the veil was not lifted. On appeal however, the Supreme Court found the managing director

[524] Ibid
[525] Kenneth Kaoma Mwenda, 'Corporate Insolvency Law and the Liability of Company Directors for Wrongful Trading and Fraudulent Trading' (2008) Zam LJ, 65
[526] [2007] ZR 235
[527] Section 26, Companies Act, 1994, Chapter 388 of the Laws of Zambia

personally liable for the debt of the company based on violation of section 26 and the fact that he was a shareholder, the veil was lifted. In *Kitwe Super Market Ltd v Southern Africa Trade Ltd*[528] the court said that; where fraud has been established, the court is inclined to lift the corporate veil. It went further to lift the veil. In *Southern Cross Motors Ltd v Nonc Systems Technology Ltd* the veil was lifted on account of fraudulent trading. There seems to be a perception in Zambia that a director is protected by the corporate veil. While this argument can be stretched to the lack of accountability for directors' decisions, it lacks merit under the law only in circumstances where such a director is also a shareholder. However, this has been the trend and piercing of the veil under fraudulent trading provisions is unlawful unless such a director is a shareholder. There seems to be lacking a distinction between liability imposed because of lifting the veil and personal liability imposed on directors in their personal capacity and not as an employee of the company. However, the Supreme court in *Madison Investment, Property & Advisory Company Ltd v Peter Kanyinji,*[529] the respondent was an employee of the 1st appellant, a subsidiary of the 2nd appellant and from time to time the obligations under his contract of employment were extended to dealings with the parent company (Appellant). The shareholder was held liable for the debt of the company under section 383 without lifting the veil. There were two grounds against the ruling of the high court to pierce the corporate veil by looking at the parent company and its subsidiary as a single entity. The grounds were:

> 1) The learned trial judge erred in law and in fact when she held the appellant was liable to pay the terminal benefits of the respondent owed by a third-party entity, in which the 2nd Appellant was a shareholder, without lifting the veil of incorporation of the said entity.
>
> 2) The learned trial judge erred in law and in fact when she held the 2nd Appellant liable to pay a debt owed by another entity in the absence of evidence that the 2nd Appellant as a shareholder, run the said entity for a fraudulent purpose.[530]

On the first ground, it is legally wrong to hold a shareholder liable for the debt of the company without piercing the veil.[531] This is contrary to the principle of legal personality of the company as analysed earlier. The two entities were separate companies both having a juridical identity of their own as was established in Salomon.[532] Even though they are looked at as a single entity, without

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[528] [2011] ZMHC 243
[529] [2018] SCZ 48
[530] [2018] SCZ 48
[531] S. Ottelenghi, 'From Peeping Behind the Veil to Ignoring it Completely' (1990) MLR, 53, 6026
[532] Stephen M. Bainbridge, Abolishing Veil Piercing (2000) JCL, 26, 479

piercing the veil, a shareholder cannot be held liable for the debt of the company. On the second ground, if liability is to be imposed on the parent company before lifting the veil, there must be evidence of fraudulent or improprieties to the knowledge of the parent company unless the veil is pierced. The Supreme Court relying on the holding of *Prest v Petrodel*[533] granted the appeal on both grounds. They refused to lift the corporate veil stating that other methods of recovering the debt were available and could be used.

3.4 Directors' responsibilities to the company

Prior to the enactment of the Companies Act 2017, directors' duties applied under common law because these were not enshrined in the Companies Act 1994. Because this is a recent Act, the analysis is centred on common law duties as they applied before the Act because the research started before the new Act and data collection was also done before that. The analysis on the new legislation is in chapter 7. The law relating to director's duties in Zambia is founded on common law even though their authority is provided by legislation. The Companies Act in Zambia provides for the authority of directors[534] but their duties were not codified. Under common law, directors occupy a fiduciary position and the duties are owed to the company.[535] When a company is nearing insolvency, directors are more focused on shareholders although they are required to consider the interests of creditors.[536] This brings forth the argument as to whether the safety of creditors is not in the interest of the company or indeed the shareholders. There is lack of literature on directors' duties in Zambia under common law and therefore empirical data was used to understand how directors perform their duties and how this impact creditor protection. Whereas the uncertainties regarding directors' duties in the UK have been established in chapter two, the same cannot be argued for Zambia as there has been no literature proving this. However, from the decisions of the courts, it has been demonstrated that shareholders oversee the company as they have more authority than directors. This is notwithstanding the vast authority vested on directors under the Act.[537] The Act states that:

> "the business of a company shall be managed by the directors, who may pay all expenses incurred in promoting and forming the company, and may exercise all such powers of

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[533] [2013] UKSC 34
[534] Section 215(1), Companies Act 1994
[535] Len Sealy and Sarah Worthington, *Sealy and Worthington's Cases and Material in Company Law* (10th ed. Oxford University Press, 2013) 309
[536] Alan Digman and John Lowry, *Company Law* (8th ed. Oxford University Press, 2014) 332
[537] Section 215(1), Companies Act 1994, chapter 388 of the Laws of Zambia

> the company as required to be exercised by the company by resolution".[538] Without limiting the generality of subsection (1), the directors may exercise the powers of the company to borrow money, to charge any property or business of the company or all or any of its uncalled capital and to issue debentures or give any other security for a debt, liability or obligation of the company or of any other person."[539]

With this power, it means that directors are authorised to make any decisions concerning management of the company under any circumstances if the company is in existence. This may include decisions on company assets. Mweenda observed that with the above authority, when a company is in financial difficulties, directors have an incentive to continue trading because they have nothing to lose as the risk if the business fails rests on creditors because of the concept of limited liability.[540] The Supreme Court in *Boxtel v Kearney*[541] stated that shareholders enjoy, as a matter of right (emphasis), overriding authority over the affairs of the company. This judgement established the rights of the shareholders over the affairs of the company and it can be argued that directors always act in the interests of the shareholders regardless of the financial circumstances of the company, which is the reason why creditors' interests are not considered until the company goes into insolvency. This judgement was later re-affirmed in *Zambia Consolidated Copper Mines Ltd v Kangwa and others*[542] where the court went further to state that the shareholders have and enjoy as of right overriding authority over the affairs of the company even over the wishes of mere employees or directors.

It can be argued that even though the law gives authority to directors, in practice the shareholders do run the affairs of the company. This was evident in the case of the *Bank of Zambia v Chibote Meat Corporations*[543] where the court stated that directors are only nominees who stand in a position of trust to the shareholders who are the beneficiaries and hold overriding authority over the affairs of the company. The court stated that directors do occupy a position of trust and so should take the best interest into carrying out the duties to the best interest of the principal and the beneficiary who entrusted him with his property. It is argued that the rules of agency relationship

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538 Section 215(1), Companies Act 1994, Chapter 388 of the Laws of Zambia
539 Section 215(3), Companies Act 1994, Chapter 388 of the Laws of Zambia
540 Kenneth K. Mwenda, 'Wrongful Trading and Fraudulent Trading in Corporate Insolvency Law: The Case Study of Zambia' (2008) OUCLJ, 8, 93
541 [1987] ZR 63 (SC)
542 [200 ZR 109
543 [2003] ZR 11

on which the director and company relationship is built does not operate in reality as the agent does not serve the interests of the principal but rather of the third party (shareholders). The nature of the relationship between the director and the company is a fiduciary one and governed by the law of agency in which the director is an agent and the company is the principle thereby requiring the director to act in the best interest of the company.[544] It can be submitted that the agency theory in the economic perspective is the ruling concept in Zambia. It is contended that implementation of the law is problematic when directors are relying on common law which is the reason this study is proposing that directors' duties be codified so that the law will be precise on what is expected from directors both during financial stability and in financial difficulties. This uncertainty in duties has resulted into lack of accountability for directors despite the provisions of the law relating to fraudulent and wrongful trading.

3.4.1 Challenges with fraudulent and wrongful trading provisions

Both fraudulent and wrongful trading provisions attract both criminal and civil liability under the Companies Act. It provides that:

> In the course of the winding-up of a company or any proceedings against a company, the court may, on the application of the liquidator or any creditor or member of the company, if it is satisfied that a person was knowingly a party to the carrying on of any business of the company for a fraudulent purpose, make an order that the person shall be personally responsible, without any limitation of liability, for the debts or other liabilities of the company or for such of those debts or other liabilities as the court directs.[545]
>
> A person who is knowingly a party to the carrying on of any business of the company for a fraudulent purpose shall be guilty of an offence, and shall be liable on conviction to a fine not exceeding one thousand monetary units or to imprisonment for a period not exceeding twelve months, or to both.[546]

The criminal aspect of fraudulent trading is covered under section 384 and has five requirements. The first is that there must be 'a person who is a party.' This requirement is simple but does not define who this person is. The second requirement is that such a person must be 'knowingly party to a carrying on of a business.' This person must be involved in the fraudulent activities of the company which leads to the third requirement that 'this person must know that the business is fraudulent.' The implication is that without the person knowing that the business is carried on for

[544] Stephen Griffin, Company Law: Fundamental Principles (4th ed. Pearson Education, 2006) 296
[545] Section 383(1), Companies Act, 1994
[546] Section 384(1), Companies Act, 1994

fraudulent purposes, there is no liability. The fourth requirement is that only a 'liquidator, a creditor or a member of the company' can bring an action against such a person. This means that even unsecured creditors can bring an action and not only secured ones. The fifth requirement is that the court must be satisfied that such a person was knowingly a party to carrying on of the business for fraudulent purposes. This satisfaction under criminal liability can only be achieved by proving beyond reasonable doubt that an offence was committed because this is the standard of proof and the burden is on the creditor. While this fraudulent trading is an offence regardless of the financial situation of the company, either solvent or insolvent, the problem is that the burden of proof is heavy for creditors and it is almost impossible for them to prove that such an offence occurred because they have very little information concerning the company. Any suspense that fraudulent trading occurred is not sufficient to institute proceedings. The law under section 383 brings in the requirement of civil liability for fraudulent trading supplemented by sub-section 4 of 383.[547] The meaning of this liability is that if criminal liability is not imposed, it is possible for the court to find civil liability, if it can be proved on the preponderance of probabilities. However, this can only be brought while winding up a company or during any other proceedings against the company. While the former requirement is clear, it is not clear on the latter requirement in terms of how to proceed. Civil liability for fraudulent trading can be secured even if criminal liability is not found. However, where the court has found a director of a company guilty for fraudulent trading, whatsoever order is granted, does not disqualify such a director.[548] The challenge with implementation of this provision is the unavailability of quality information for creditors which has rendered the law almost unfeasible or less valuable. Coming to the issue of wrongful trading, it is provided that:

> If an officer of a company who is knowingly a party to the contracting of a debt by the company has, at the time the debt is contracted, no reasonable or probable ground of expectation (after taking into consideration the other liabilities, if any, of the company at the time) of the company's being able to pay the debt, the officer shall be guilty of an offence, and shall be liable on conviction to a fine not exceeding two hundred and fifty monetary units or to imprisonment for a period not exceeding three months, or to both.[549]
>
> Where a person has been convicted of an offence against this section, the court, on the application of the liquidator or any creditor or member of the company, may make an

[547] Section 383(4), Companies Act
[548] Kenneth K. Mweenda, 'Wrongful Trading and Fraudulent Trading in Corporate Insolvency Law: The Case of Zambia' (2008) OUCLJ, 8, 93
[549] Section 357(1), Companies Act., 1994

> order that the person shall be personally responsible, without any limitation of liability, for the debts or other liabilities of the company or for such of those debts or other liabilities as the court directs.[550]

This provision does not specifically to say directors but is applicable to officers of the company. The Act defined an 'officer' of the company as including:

> (a) a director, secretary, or executive officer of a body corporate
> (b) a local director of a foreign company
> (c) a receiver of any part of the undertaking of a body corporate appointed under a power contained in any instrument; and
> (d) a liquidator of a body corporate appointed by the members in a voluntary winding-up.[551]

This means that an officer of the company can be any of the above persons and these can be found criminally liable under wrongful trading. However, it is worth noting that the definition above does not include a member. However, once a shareholder becomes a director, he is an officer of the company and this section shall be applicable to such a shareholder. Just as fraudulent trading, this section also attracts both criminal and civil liability. Unlike fraudulent trading, this provision requires that a company be insolvent. However, the problem is that for civil liability to be imposed, criminal liability must be secured first. The imposition of civil liability is dependent on the conviction under the criminal offence. The implication for creditors is that they must be able to prove beyond reasonable doubt that the officers of the company knowingly contracted debt on behalf of the company without reasonable ground or probable ground of believing that the company would be able to pay back. If this is not proved, there cannot be any civil liability which is then problematic because it puts the law beyond practical measures for creditors. The law is as good as non-existence because of the impracticalities. Mwenda argued that this provision of the law is not useful because of the high standard of proof that is required for a criminal conviction.[552] Both fraudulent and wrongful provisions have impractical requirements which in return put directors in a position where they cannot be held accountable for their actions. Under wrongful trading, even though a conviction has been secured, there is no law requiring that such directors

[550] Section 357(2), Companies Act., 1994
[551] Section 2, Companies Act, 1994
[552] Kenneth K. Mweenda, 'Wrongful Trading and Fraudulent Trading in Corporate Insolvency Law: The Case of Zambia' (2008) OUCLJ, 8, 93

be disqualified from managing a company for a period. Directors have authority that is almost unchecked legally.

3.5 Legal provisions relating to creditor protection in Zambia

The regime that governs liquidation in Zambia can be traced from the report of the Committee on Insolvency Law and Practice (Cork Committee Report 1982) whose recommendations led to the enactment of the Insolvency Act in 1986 in the UK.[553] The main purpose was to facilitate a rescue culture for financially troubled companies before going into liquidation and some of the procedures that were laid down in this Act, have been reformed by the Enterprise Act of 2002.[554] Similar provisions in the Zambian context were found in the Companies Act 1994, but inserted into the Corporate Insolvency Act 2017. It could be argued that the ideal corporate framework would be one that allows all stakeholders in a company to participate in the business activities with all of them being satisfied as regards their different interests. Although it is difficult to achieve such an ideal model of corporate law, every regime must strive hard towards having an ideal model to protect the interested parties with vested rights in the company. An ideal corporate regime would embrace principles, practices and procedures that would lead to the restoration of defaulter companies to financial stability. This is to say that the shareholders will reap benefits from the investments and make profit while the company continues to operate effectively, and creditors realising their funds with the agreed interests and within the agreed period of time without losing any funds. It has been argued that credit arrangements are very complex and because of that it is important to first map the legal methods which bring out the options to companies that seek the use of credit.[555] Goode argued that the supply of credit facilitates a smooth running and expansion of businesses and where there are good trading conditions, it gives the company leverage to make more profit that would not be possible if it used its own money.[556] This is how important creditors are to the corporate sector and it can be stated that a world without credit is unimaginable as companies expand at the rate at which they do with availability of credit. Credit can be obtained by offering security, seeking an unsecured loan, using a sale as a de facto security arrangement or by a third-party guarantee.[557] The normal rule of corporate insolvency is that creditors are supposed

[553] Alan Digman and John Lowry, Company Law (8th ed. Oxford University Press, 2014) 451
[554] Ibid
[555] Vanessa Finch, *Corporate Insolvency Law: Perspectives and Principles* (2nd ed. Cambridge University Press, 2009) 74
[556] Roy Goode, *Principles of Corporate Insolvency Law* (3rd ed. Sweet and Maxwell, 2005) 2
[557] Vanessa Finch, *Corporate Insolvency Law: Perspectives and Principles* (2nd ed. Cambridge University Press, 2009) 74

to be paid based on the pari passu principle which is rooted on equality but security avoids the effects of this principle by creating rights that have priority over unsecured creditors.[558] The purpose of security is to give rights proprietary claim over assets in case of insolvency. A company may raise loans by debentures, or of a series of debentures which may either be secured by a charge over property of the company, or unsecured by any charge.[559]

The law regarding creditor rights and the procedures when a company is going through financial difficulties is very important because it establishes measures to be followed, and how a company is to be held responsible for the debts, how creditors can enforce the security, and how unsecured creditors can realise their money even without security.[560] When companies are going through financial difficulties or nearing insolvency, there are procedures provided for the rescue of the company to get back to a stable cash flow and this is known as corporate rescue.[561] Corporate rescue in Zambia is almost nonexistence however, the insolvency regime provided under the Companies Act is analysed comprising of mechanisms such as schemes of arrangement, receivership and insolvency. These are the only measures in the Act.

3.5.1 Schemes of arrangements

Schemes of arrangements help companies to come back to financial stability while bringing creditors on board or having to involve them in order to come to an agreement over the debts. These are court-sanctioned compromise or agreements between the company and its shareholders and or creditors of any class or classes of them made in accordance with the provisions of the law. They require that, majority of the participants approve it and also dependent on court approval.[562] The company through directors, members, creditors or liquidators need to make an application to the High court for such mechanism to be initiated.[563] These arrangements may include creditors coming up with another agreement over a debenture to have the initial agreement altered or interest reduced, or exchange it for equity shares.[564] This may include giving up their security or accepting part payment or indeed extending the time for repayment. This is because the word "arrangement"

[558] Ibid p.75
[559] Section 86, Companies Act 1994, Chapter 388 of the Laws of Zambia
[560] Donna McKenzie Skene, 'Insolvency' (2017) BLB, 146, 3
[561] John M. Wood, 'The Objectives of Administration' (2015) CL, 36, 1
[562] Section 234, Companies Act, 1994
[563] Ibid
[564] Ellis Ferran and Look Chan Ho, *Principles of Corporate Finance Law* (2nd ed. Oxford University, 2014) 270

has a variety of meanings. Although this process has been argued to consider creditors' interests when a company is financially distressed, it is a weak mechanism and does not render protection to creditors because it is inefficient.[565] The practical inefficiency of schemes of arrangements can be argued to include: firstly, the court could make an order for the affected member to exercise the appraisal right in which case, the company would be put in a situation of incurring more expenses notwithstanding the financial distress it is going through already. An appraisal right was defined as a right of a member who disapproves the outcome of the triggered events to have his shares bought off by the company at the market value but in most cases the court determines the value price of the shares. But this means the company starts to allocate funds to buy off shares from one of the members instead of apportioning those funds to creditors.

Secondly, the court process itself is expensive and time consuming, and dependent on the court to make an order, and could lead to undesirable insolvency as dissenting creditors may apply to court for receivership or insolvency to be triggered.[566] Thirdly, if the parties reach a compromise of converting the debt into equity, it renders creditors unsecured upon the conversion because they become shareholders and unsecured creditors. This was illustrated in *Development Bank of Zambia Plc v JCN Holdings Ltd and Two others.*[567] A loan secured by a fixed charge was given to the company by the plaintiff who was acting in consortium with other banks and upon default from the company, the plaintiff agreed to participate in the restructuring of the company where the debt was to be converted into equity. This was agreed upon by three shareholders and the company ceased operating and the plaintiff brought an action against the shareholders. It was held that the shareholders were liable. They later appealed but the appeal was nullified by the Supreme Court because the High court refused to join other parties who were dissenting creditors in the initial agreement but the weakness of using schemes of arrangements was exposed. At the centre of schemes of arrangement, is a very challenging and unpractical requirement that all creditors consent to waive their contractual rights in the covenants with the ailing company and as such, dissenting creditors may wish to trigger receivership or liquidation instead of reaching a compromise. This brings about misunderstanding among creditors as not all creditors are the same

[565] Kenneth K. Mwenda and Anna Laszczezynska, 'Legal Problems of Debt Subordination: A Comparative Study' (1998) JICL, 10, 674
[566] Ibid
[567] [2012] ZMHC 26

because some are secured, and others are not. When you have both classes of creditors it is unlikely that a consensus will be reached. Secured creditors will favour receivership or insolvency with the hope of realising their money and on the other hand unsecured creditors would favour an agreement to be reached with the hope of the company surviving so they could be paid in future.[568] Most corporate debt is private and usually provided by banks which happen to depend on contractual rights for protection when enforcing covenants.[569] It has been contended that the major public firms maintain a record of about eighty percent (80%) of private debt which is financed by private lenders usually the banks.[570] It can be submitted that this mechanism is ineffective both in principle and implementation. The law does not stipulate the required vote needed to bind the other parties in case some of them are dissenting. It can be argued that the law needs to be reformed in order to provide for measures that can make the mechanism work better both for corporate rescue and creditors.

3.5.2 Receivership and creditors

A comprehensive corporate rescue model can be provided as it is the objective of corporate insolvency.[571] Thus, every jurisdiction could provide a rescue mechanism that builds the confidence of the market and ensures investors that rules and laws will be followed in case a company goes into financial difficulties. This will enable creditors both secured and unsecured to know what to expect when the company is financially distressed. Receivership is one way in which creditors can be protected by enforcing a security when it is due through a receiver.[572] This mechanism is to an extent, effective where the company has enough assets in Zambia for secured creditors who are able to realise their funds through the appointment of a receiver. A receiver can be appointed by court upon application by a debenture holder[573] or outside court.[574] However, the receiver appointed by Court is an officer and agent of the court working according to the orders of the court for the benefit of the applicant whereas the one appointed outside court is an officer and

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568 Andrew Keay, 'Financially Distressed Companies, Restructuring and Creditors' Interests: What is a Director to do?' (2019) LMCLQ, 2, 297
569 Michael J. Mumfod and Alan J. Katz, 'Making Creditor Protection Effective' (2010) CRI, 3221
570 Claire A. Hill and Brett H. McDonnell, *Research Handbook on the Economics of Corporate Law* (Edward Elgar Publishing, 2012) 68
571 John M. Wood, 'The Objective of Administration' (2015) CL, 36, 1
572 Kenneth K. Mwenda and Anna Laszczezynska, 'Legal Problems of Debt Subordination: A Comparative Study' (1998) JICL, 10, 674
573 Section 112, Companies Act, 1994
574 Section 113, Companies Act, 1994

agent of the company performing duties in accordance with the instrument under which he was appointed and not the appointee.[575] The complication with receivership is found at the centre of the functions of the receiver who is an agent of the company yet dispensing work in the interest of creditors. This conflict of interest vested in a person so critical to creditors at the time of realisation of funds may raise challenges as to how effectively the duties can be performed without injuring the company. The conflict of interest created was qualified as a dual role in *Zambezi Portland Cement Ltd v Stanbic Bank Zambia Ltd*.[576] The principle in this case was the emphasis of the court in stating that the receiver has a dual role as an agent of the company and at the same time protecting the interests of the debenture holder. The court in supporting this duality relied on the obiter dicta of Lord Fox in the case of *Gomba Holdings UK Ltd and others v Minories Finance Ltd and others.*[577] In this case Lord Fox stated that:

> [T]he agency of a receiver is not an ordinary agency. It is primarily a device to protect the mortgagee or debenture holder. Thus a receiver acts as agent for the mortgagor in that he has the power to affect the mortgagors' position by acts which though done for the benefit of the debenture holder, are treated as if they were acts of the mortgagor………. The result is that the receiver in course of the receivership performs duties on behalf of the debenture holder, as well as the mortgagor.[578]

The Zambian judiciary has established that indeed this agency relationship created is complicated because no one can be expected to serve two masters at the same time. This is also attributed to the fact that the interests of both the company and the creditor are never the same as acknowledged in *Magnum Zambia Ltd v Basit Quadri and Grindlays Bank International Zambia Ltd*[579] where the court stated that the receiver is an agent of the company and the company cannot bring an action against him. This was later confirmed by the court in *Goodwell Siamutwa v Southern Province Co-operative Union and another*[580] where the court acknowledged that the receiver appointed other than by the court, is an agent of the company protecting the interests of the debenture holder is in an untidy position because of the conflicting interests. It is therefore asserted that receivership lacks effectiveness in principle and be amended to give clear guidelines as to the functions of the receiver and in whose interests, they are to be performed. A receiver perhaps must be an agent of

575 Section 113(1), Companies Act, 1994
576 [2010] ZR 499
577 [1989] 1 ALL ER 761
578 Ibid
579 [1981] ZR 14
580 [2002] SCZ Appeal No. 114

the debenture holder and to act in the interest of the principal for it is the foundation of his appointment.

3.5.2.1 Creditors and the reality of insolvency

Insolvency proceedings begin when a company is no longer able to service its debts.[581] Insolvency is split into two namely;- commercial insolvency and balance sheet insolvency.[582] This happens whether there is commercial or balance sheet insolvency with the former meaning there is no money to meet financial obligations as they fall due and the latter meaning liabilities are more than the assets of the company.[583] In addition to these insolvency definitions, Sealy and Worthington added the 'ultimate insolvency' which occurs after all the assets of the company have been sold and creditors are left with nothing.[584] Usually when the company is trading and seems solvent under both commercial and balance sheet insolvency, there is a possibility of ultimate insolvency which indicates the amount of risk creditors take. The law has permitted a company to continue trading when it is financially troubled and this is detrimental to creditors, and beneficial to shareholders because of the presence of limited liability.[585] Although Mwenda referred to this as an incentive for the company, it can be argued that this is a risk legally permitted and solely vesting on creditors because if the business fails, they bear the risk. During this time, directors are still involved in decision making and any wrong doing leading to loss for creditors attracts personal liability under fraudulent and wrongful trading provisions.[586] The offence of fraudulent trading in Zambia is argued to be difficulty to prove especially that directors are not made accountable for their actions.[587] It was argued by Mwenda that creditors usually lack information on how directors comply with the law hence being unaccountable for their actions.[588] This position was supported by Agyemang, Fantini and Frimpong who found that to ensure affective implementation and enforcement of law on compliance, there is need to have clear costs for non-compliance in form

[581] Section 272(c), Companies Act, 1994
[582] Andrew Keay and Peter Walton, Insolvency Law: Corporate and Personal (3rd ed. Jordan Publishing Ltd, 2012) 16
[583] Andrew Keay and Peter Walton, *Insolvency Law: Corporate and Personal* (3rd ed. Jordan Publishing Ltd, 2012) 16
[584] Len Sealy and Sarah Worthington, *Sealy and Worthington's Cases and Material in Company Law* (10th ed. Oxford University Press, 2013) 768
[585] Kenneth Kaoma Mwenda, 'Corporate Insolvency Law and the Liability of Company Directors for Wrongful Trading and Fraudulent Trading' (2008) ZLJ, 65, 65
[586] Ibid
[587] Kenneth K. Mwenda, 'Wrongful Trading and Fraudulent Trading in Corporate Insolvency Law: The Case Study of Zambia' (2008) OUCLJ, 8, 93
[588] Kenneth Kaoma Mwenda, 'Corporate Insolvency Law and the Liability of Company Directors for Wrongful Trading and Fraudulent Trading' (2008) ZLJ, 65, 65

of penalties such as legal costs or investigations cost or fines for damage to reputation.[589] Even though, the above mechanism have been provided for creditors, they are as good as non-existent due to their enforcement and implementation challenges. However, it is argued in this case that, although the legal framework is problematic, corporate governance could be used to improve the implementation of the law.

3.6 The regulatory framework for corporate governance in Zambia

It has been argued that corporate governance consists of the legal and regulatory frameworks that are concerned with the way in which power is exercised in corporations and the board must ensure that managers do manage the company on behalf of the shareholders as if it was their own.[590] In every country, the legal system is the cornerstone of good corporate governance practices because of the competition for investment and investors usually desire to conduct business where they can be assured of protection and understand the risk involved.[591] The problem is lack of transparency and accountability within companies when it comes to corporate governance practices coupled with ineffective corporate governance codes which are arguably ineffective as they are not comprehensive and not updated. The law relating to corporate governance is mainly established in the Securities Act which establishes the Securities and Exchange Commission (SEC),[592] the Lusaka Stock Exchange corporate governance Code (LuSE Code) which governs and regulates companies listed on the Stock Exchange, the Bank of Zambia corporate governance guidelines (BOZ) and the Institute of Directors Zambia (IODZ). All these statutes and Codes are aimed at regulating the way in which companies and businesses are run thereby attracting both foreign and local investors through sound corporate governance practices. The corporate sector needs to be strengthened through legal and regulatory mechanisms in order to protect all stakeholders with emphasis being on creditors as a focus of this research. At the centre of corporate activities lies the role and mandate of the board of directors. The proper control and direction of companies is important for commercial development and wealth creation. Although the LuSE Code does not provide a definition for corporate governance, it states that the Code is for purposes of providing

[589] Otuo Serebour Agyemang, Giulia Fantini and Joyce Frimpong, 'Does Country-level Governance Enhance Ethical Behaviour of Firms?' (2015) IJLM, 57, 582
[590] Musonda Simwayi, 'A Critical Analysis of the Financial Intelligence Centre Act of Zambia' (2012) JBR, 13, 114
[591] Peter Cornelius, 'Good Corporate Governance Practices in Poor Corporate Governance Systems' (2005) IJBS, 5, 12
[592] Securities Act, Chapter 354 of the Laws of Zambia 1993

clear guidelines and provisions aimed at enhancing good corporate governance practices and standards for both listed and quoted companies with the aim of achieving better and effective boards to govern and ultimately boost investor confidence.[593] In 2006 the Bank of Zambia in the guidelines on corporate governance defined corporate governance as 'the process and structure used to direct and manage the business and affairs of an institution with the objective of ensuring its safety and soundness' and enhancing shareholder value'.[594] From the above definition, shareholder value model is expressly highlighted and this is the concept of corporate governance in Zambia.

During 1990-2000, Zambia experienced the closure of nine banks as they were going through financial difficulties and there were no adequate measures to manage troubled banks which had a lot of unpaid loans due to lack of effective regulations.[595] It was argued that lack of transparency, mismanagement of accounts in the financial reports coupled with weaknesses of the supervisory and regulations were some of the reasons for the closure of the banks.[596] Despite the closure of these banks, issues of corporate governance were not considered, except the banking sector regulations by the Bank of Zambia. It has been reasoned that when legal rules are effective in protecting creditors, financial markets become more developed thereby leading to economy growth as investors have more confidence in corporate activities.[597] It can be argued that corporate governance aims to promote investor confidence by promoting competitiveness and in the process improving the way in which companies are directed by protecting shareholder rights, enhancing disclosure and promoting transparency and accountability to facilitate effective functioning of the board, as well as providing an effective enforcement framework for the protection of lenders or providers of finance which promotes the growth of the economy through enhanced and increased access to outside capital. However, there is less literature on corporate governance in Zambia the empirical question seeks to establish this assertion. In 2006, the World Bank report on country corporate governance performance indicated that the traditions of governance in Zambia are centred on shareholder rights and even though the process was still in the initial stages, it was

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[593] Lusaka Stock Exchange Corporate Governance Code, 2005)
[594] Para 1.0, Banking and Financial Services (Corporate Governance) Guidelines, 2006, http://www.boz.zm/Instruments/CorporateGovernanceGuidelines.pdf accessed 29/01/2016
[595] Samuel Munzele Maimbo, 'Explaining Bank Regulatory Failure in Zambia' (2002) JID, 14, 229
[596] Ibid
[597] Efraim Benmelech, and Nitta K. Bergman, 'Vintage Capital and Creditor Protection' (2011) JFE, 99, 308

proposed that laws and regulatory measures need to be reviewed and harmonised with minimum international standards required.[598] The Code is not comprehensive and not to the acceptable international standards despite having these institutions to foster corporate governance. The concept itself is not fully developed and Zambia adopted a unitary board structure and the LuSE code is based on the 'comply or explain' principle which is also used in the UK. The concept of corporate governance in Zambia is centred on shareholder value principle. However, directors are agents of the company and so they should serve the interests of the company and not of the members per se- a concept which is legally right but troubled by the authority of the shareholders. Even though this is the case, the shareholders have more authority in the affairs of the company. The shareholders do occupy a superior position as they have power to override decisions of the board.[599] This was stated in the case of *Zambia Consolidated Copper Mines v Kangwa & Others*[600] that: directors are only nominees who stand in a position of trust to the shareholders who are the beneficiaries and hold overriding authority over the affairs of the company. This has been fully discussed under directors' duties in the second part of this chapter. For Zambia to improve, lessons can be drawn from the UK which is argued to be one of the leading countries on corporate governance although it is short of the ideal model as well.

3.7 **A comparative analysis**

This part of the analysis answers the methodological question which is 'why compare the UK and Zambian framework for creditor protection?' While addressing the above question, the focus is to analyse the legal inadequacies for both jurisdictions relating to creditor protection. This is done by analysing the similarities and differences between the two jurisdictions while highlighting the shortfalls for creditor protection in UK and drawing legal insights that Zambia can learn from to improve creditor protection. This is because the purpose for this comparative analysis is knowledge which enables the comparatist to draw lessons from one jurisdiction as opposed to the concept of legal transplant.[601] This must be read with regard to the critical analysis in chapter two. Henceforth to void repetitions, only the main arguments are discussed. Although the UK framework lacks the

[598] World Bank (2006) http://documents.worldbank.org/curated/en/483401468350182244/Zambia-Report-on-the-Observance-of-Standards-and-Codes-ROSC-corporate-governance-country-assessment
[599] Section 216, Companies Act 1994, Chapter 388 of the laws of Zambia
[600] [2000] ZLR 109
[601] Konrad Zweigert and Hein Kotz, Introduction to Comparative Law (3rd ed. Oxford University Press, 1998) p.21

ideal framework for creditor protection, it is being used as a standard that can help to improve creditor protection in Zambia. This looks at the nature of the corporate entity itself, directors' duties focusing on safeguards or mechanisms for creditor protection such as fraudulent and wrongful trading, dividend policy, and safeguards provided by regulatory instruments such as corporate governance Codes.

The case of Salomon in company law illustrates the separation of the company from its members and the legal consequence is that creditors' claims are limited to company assets only. Although limited liability is an advantage of incorporation, it was backed for purposes of economic development in the corporate sector.[602] It is a burden for creditors who ensure that there is corporate finance for business activities. Credit has always existed and it facilitates the smooth running and expansion of business such that a world without it is hard to imagine as it cannot exist.[603] While the above is true, the law has failed to devise a mechanism for creditor protection both in UK and Zambia. Creditors rely on mechanisms such as debtor control, credit contracts and insolvency procedures for their protection. Debtor control involve restrictions that can be imposed on the company to protect creditors with the ultimate purpose of reducing risk.[604] These restrictions have the following in consideration; the amount of minimum capital required, restrictions on the payment of dividends, lifting of the corporate veil, directors duties during financial distress to consider creditors' interests and holding directors accountable for fraudulent and wrongful trading. Credit contracts are more centred on self-help methods for protection such as the use of collateral which can take different forms such as mortgages, floating charges, or retention of title clauses. This also involves the amount of interest rates to impose and the use of director guarantees. Insolvency procedures are focused on measures to be taken during corporate restructuring and liquidations including rules to follow to trigger such proceedings. These mechanisms are different according to legal systems, but it has been argued that jurisdictions with strong creditor rights have a better protection framework.[605]

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[602] Bob Tricker, 'Re-Invention the Limited Liability Company' (2011) CGIR, 19 384
[603] Roy Goode Principles of Corporate Insolvency Law (4th ed. Sweet & Maxwell,2011) 2
[604]Simon Deakin, Viviana Mollica, and Prabirjit Sarkar, 'Varieties of creditor protection: insolvency law reform and credit expansion in developed market economies' (2017) SER, 15, 359
[605]Ibid

3.7.1 Directors' duties

Directors' duties in both jurisdictions were founded on common law and principles of equity before the UK codified them into the Companies Act 2006 for purposes of accessibility, clarity, and certainty in order to remedy the defects that applied.[606] The precise duty is under section 172(3) of the UK Companies Act 2006 which requires directors to take into account the interests of creditors when a company is going through financial difficulties.[607] In the UK, uncertainties have been found and discussed in terms of the time of effect. Case law has established that the duty is triggered when the company is in doubtful insolvency as in *Re Horsley & Weight Ltd,*[608] in the vicinity or likelihood of insolvency as in *Facia Footwear Ltd (In Administration) v Hinchliffe,*[609] in actual insolvency as stated in *Wessely v White,*[610]and when directors know or should know that a company is or is likely to be insolvent as stated in *BTI 2014 LLC v Sequana SA.*[611] This demonstrates how late creditors are considered in terms of protection through directors duties. The other uncertainty is the fact that the law does not stipulate what it means for directors to consider creditors' interests as to what they should be doing. This study found that key issues in new contracts and every decision made during distressed times must be evaluated for creditors' interests such as negotiating of new contracts as argued by Keay.[612] This will take into consideration the nature of the contract under consideration, the size of the company, the risk involved, the likelihood of fruitfulness, and the setting up of a contingency plan in case the deal does not work. While this is proposed for UK, in Zambia this duty is non-existence in principle. As in practice, this is yet to be analysed in the empirical discussion in chapter 6. Interpretational challenges were found in the UK whereas in Zambia there is need for the duty to be codified with modification using the UK challenges as a model to avoid such difficulties. However, in countries like South Africa, when a company is financially distressed, the law requires that directors enter into business rescue plan or issue a written statement to all affected parties including creditors.[613] Mweenda argued that legislation needs to be introduced to regulate the conduct of directors as it has been seen that they are reckless

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606 Robert Goddard, 'Directors' Duties' (2008) ELR, 12, 468-472
607 Section 172(3), Companies Act, 2006
608 [1986] 4 ACLC 215
609 [1988] B.C.L.C 218
610 [2018] EWCA 1499 (Ch)
611 [2019] EWCA Civ 112
612 Andrew Keay, 'Directors Negotiating and Contracting in the Wake of their Companies' Financial Distress' (2015) JSCN, 1, 214
613 Section 129(7), Companies Act no 71 of 2008, South Africa

because there is no regulation.[614] Besides amending the law, it is submitted that the lesson for Zambia is founded on the possibility of eluding legal uncertainties and ensuring that the law is clear and capable of implementation as those seen in UK.

3.7.2 Legal provisions relating to creditors

The legal provisions surrounding the protection of creditors in the UK are found in the Insolvency Act 1986 alongside other statutes such the Enterprise Act of 2002, Companies Act 2006 and Insolvency (England and Wales) Rules 2016. In the quest to protect creditors from risk, the Insolvency Act introduced fraudulent and wrongful trading provisions in an attempt to hold directors responsible for their actions although this was met with a lot of debate from shareholders who were arguing that this was giving too much power to creditors.[615]

3.7.3 Fraudulent and wrongful trading

Fraudulent and wrongful trading is a measure to protect creditors from unscrupulous directors. However, these provisions have enforcement and implementational problems because challenges in proving 'intent' in the UK and lack of adequate information. However, whereas the law seems to have been tried more in the UK, in Zambia this is not common because directors are not held accountable and creditors find it almost impossible to prove fraud. The difficulties in fraudulent trading presented a lot of obstacles in the UK and so wrongful trading was introduced to curb erring directors under the provisions of fraudulent trading which are now found in section 213 of the insolvency Act.[616] Intent was very challenging to prove and so there was need to adopt the part of recklessness which was introduced as wrongful trading.[617] Problems have also been found with wrongful trading such as the date of wrongful trading, and what it means to take every step to reduce potential loss'[618]Problems of evidential burden and the discretion of the court are also problematic in enforcing these provision. The situation is even worse in Zambia because the provisions are rendered almost impractical. While the challenge is proving intent in the UK for fraudulent trading, in Zambia the challenge is the requirement of meeting the standard of proof for criminal liability coupled with the lack of quality information for creditors to bring an action under

[614] Kenneth K. Mweenda, Wrongful Trading and Fraudulent Trading in Corporate Insolvency Law: The Case of Zambia (2008) OUCLJ, 8, 93
[615] Kevin Keasey and Robert Watson, The 1986 UK Insolvency and Company Director's Disqualification Acts: An Evaluation of their Impacts upon Small Firm Financing Decisions 1994) JSBE, 6, 257
[616] Andrew Keay, Wrongful Trading and the Liability of Company Directors: a Theoretical Perspective (2005) JSLS, 25, 431
[617] Marcus P.L. Gustafsson, Beating a dead Horse? An Assessment of Wrongful Trading (2017) CL, 38(8), 239-247
[618] Andrew Keay, Wrongful Trading and the Liability of Company Directors: a Theoretical Perspective (2005) JSLS, 25, 431

civil liability? Wrongful trading provision can be said to be almost useless in Zambia because only after securing a conviction for criminal liability, can civil liability be imposed which is almost impossible for creditors because the burden of proof is high. While in both jurisdictions there are challenges with these provisions of the law, the nature of these problems is different although similar. In Zambia there is no law that disqualifies directors found guilty of fraudulent or wrongful trading. Whereas a shareholder has a right to bring a derivative claim, they are also entitled to bring a claim against a director or an officer of the company. There are interpretational challenges which has led to ineffectiveness of the law itself because there are no reported cases so far. In the case of *Bank of Zambia v Access Financial Services*[619] the respondents were officers of the company and alleged that the appellants mishandled insolvency proceedings and resources for the company were mismanaged. Although the Supreme Court quashed the appeal while upholding the decision of the High Court to hold the appellants responsible for the mismanagement of the insolvency process, erring directors were not held responsible for their actions. It is submitted that Zambia needs to consolidate its legal framework surrounding responsibilities of directors in order to stop a poor adherence culture to corporate governance.[620] Having noted from the challenges faced in the UK as to the enforcement of the fraudulent and wrongful trading, this ought to be a learning point.

3.7.4 Distribution of dividends

La Porta, Lopezi-de-Silanes, Shleifer and Vishny[621] Easterbrook,[622] Byrne and O'Connor,[623] have all argued that dividend has been highly influenced by corporate need to strengthen the protection of providers of external capital. Jensen and Meckling argue that the major shareholders prioritise their interests which in turn cause the agency problem and in trying to resolve the problem they end up bearing agency costs.[624] They further argue that preventing the conflict of interest between the managers and the shareholders, managers will be motivated to pursue strong incentives which will maximise value of the firm by allowing them to hold stakes in the firm. By so doing, the interests of the managers will be protected and aligned alongside the shareholders so managers

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[619] [2013] SCJ No 104/2013
[620] Kenneth K. Mweenda, 'Wrongful Trading and Fraudulent Trading in Corporate Insolvency Law: The Case of Zambia' (2008) OUCLJ, 8, 93
[621] Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert Vishny, Investor Protection and Corporate Governance (2000) JFE, 58, 3
[622] Frank H. Easterbrook and Daniel R. Fischel, 'Limited Liability and the Corporation' (1985) UCLR, 52, 89
[623] Julie Byrne & Thomas O'Connor, 'Creditor Rights and Outcome Model Dividends' (2012) QREF, 52, 227
[624] Michael C. Jensen & William H. Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs & Ownership Structure' (1976) JFE, 3, 305

will be concentrating on maximising firm value. On the contrast, Demsetz argue that ownership stake by managers only makes them to increase their interest and ignore those of the outside shareholders thereby decreasing the value of the firm. Literature has indicated that one of the ways in which shareholders can handle the agency problem is by way of dividends and debt.[625] Easterbrook argues that when there is dividend distribution and external capital, it reduces the amount of cash flow from managers and the reduction helps in preventing misuse.

However, Jensen argues that using the distribution of dividends as a mitigating factor is not effective but rather proposes that debt be used to substitute large dividends.[626] Jensen further argues that by so doing creditors have the right to take the firm to court if they do not pay back the principal amount and the interests promised by the managers. It can be argued that its unjust for creditors to offer finance to the firm and in return get the right to take the firm to court if it fails to pay because there is no guarantee that court process will result in full repayment of the debt. This is because sometimes creditors lose both the principal sum, the interest and end up spending more on legal costs. In order to prevent harm creditors are exposed to, it was established that weak creditor rights only enhances the possibility of managers to make dividends.[627] Creditors need to demand stronger control rights because with inadequate protection, they are not sure their claims in court will be met within reasonable time and so they continue to bear the risk of doing business with incorporated companies. In the UK the law provides that:

> A company may only make a distribution out of profits available for the purpose. A company's profits available for distribution are its accumulated, realised profits, so far as not previously utilised by distribution or capitalisation, less its accumulated, realised losses, so far as not previously written off in a reduction or reorganisation of capital duly made.[628]

Any distribution that is made contrary to the provisions of the law is unlawful dividend and the shareholder is to pay is back if at the time of the distribution, he had knowledge or reasonable grounds for knowing that it was made unlawful. Although it is the right of shareholders to receive a dividend, where external finance is involved, perhaps creditors could have rights to influence dividend pay-out policy. Such as requiring the firm to declare any dividend unless after conducting

[625] Julie Byrne & Thomas O'Connor, 'Creditor Rights and Outcome Model Dividends' (2012) QREF, 52, 227
[626] Michael C. Jensen, 'Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers' (1986) AER, 76, 323
[627] Paul Brockman and Emre Unle, 'Dividend Policy, Creditor Rights, and the Agency Costs of Debt' (2009) JFE, 92, 276
[628] Section 830, UK Companies Act, 2006

a solvency test and ensuring that the company is financially stable. A notable decision in *BTI 2014 LLC v Sequana S.A. & Others*.[629] The court indicated that a lawful dividend payment made after a careful examination can be found to be contrary to section 423 and be deemed to have been issued with intentions of putting company assets from the reach of creditors. The section of the law has a broad interpretation of what 'transactions could fall under it and the advantage is that it does not require any financial status as it could be effected even when a company is financially stable or troubled. This is notably to the protection of creditors when a company is trying to hide assets. The Companies Act in Zambia provides for the distribution of dividends to shareholders when directors declare it. The law provides that: No dividend shall be payable to the shareholders of a company except out of profits arising or accumulated from the business of the company.[630] The law in Zambia has adopted the position of the UK in terms of distribution of dividends. The distribution of dividends by directors to the shareholders is a measure by which shareholders position the performance of the firm. They believe more dividend is declared, the more a firm is performing well. Nevertheless, besides legislation, other regulatory measures can be implemented such as the inclusion of creditors interests in the corporate governance Codes. Even though the Codes have no legal effect, the purpose is to facilitate effective, entrepreneurial and prudent management for the company which in turn can deliver long term success.[631]

3.7.5 Corporate governance framework in UK and Zambia

In the UK, the framework surrounding corporate governance is regularly revised in terms of corporate governance codes. The 2018 corporate governance code has been improved to include the positive relationship of the company with stakeholders although the emphasis is on the workforce unlike creditors. It also requires that directors indicate how they implement the duty under section 172 of the Companies Act 2006 however, no strict rules or procedures have been set out which implies that a company can chose to do this in any way it deems fit. This code has also demonstrated how creditors have been neglected. Although there is always room for improvement to the UK corporate governance practices especially the fact that creditors' interests are arguably neglected in the Codes, the corporate governance culture in Zambia is very poor because the Code has not been amended. It has not been revised to bring its relevance to the current economic issues

[629] [2019] EWCA Civ 112,
[630] Companies Act 2017, Section 159, Chapter 388 of the Laws of Zambia
[631] UK Corporate Governance Code 2016

to ensure prudent reporting and management of companies. Despite having the institution such as the Institute of Directors Zambia, to foster corporate governance, the concept itself is not fully developed. Even though this is the case, the shareholders have more authority in the affairs of the company.

3.8 Zambia within the SADC countries

Despite the different theories in corporate governance, no single model has been internationally recognised as the best for corporate governance. However, the shareholder primacy model which is constructed on the agency theory has dominated the debate both in the UK and in the SADC countries. The post-colonial era has seen most of the laws being adopted from the UK and this did not isolate the model for corporate governance.[632] The General Agreements Tariffs and Trade (GATT) does not allow for World Trade Organisation (WTO) member states to discriminate amongst members but creates room for such through a regional integration for a common good.[633] It was on this premise of recognition that the southern region came together to form an alliance that would help to promote development and uplift the standards of living for its citizens through regional integration. Zambia is at the centre of the southern Africa and a member of the Southern African Development Community which has about 16 member countries namely; Angola, Malawi, Mozambique, Namibia, Botswana, South Africa, Swaziland, Tanzania, Lesotho Democratic Republic of Congo, Mauritius, Madagascar, Seychelles, Comoros, Eswatini, Zimbabwe and Zambia.[634] These are found in the southern part of Africa and the main purpose of coming together to form an alliance was to attain development and promote economic growth so as to alleviate poverty and improve the standard of living for the citizens in every member state.[635] The aim is to promote the coordination of developmental projects through regional integration and decrease economic reliance.[636] These countries have laws and regulations that govern their corporate sector within their member states and some of them are analysed as Zambia is used as a representative of these countries.

[632] Dan Haglund, Regulating FDI in Weak African States: A Case Study of Chinese Copper Mining in Zambia (2008) JMAS, 46(4), 547-575
[633] T. N. Srinivasan, Non-discrimination in GATT/WTO: Was there anything to Begin With and is There Anything Left? (2005) WTR, 4(1), 69-95
[634] https://www.sadc.int/member-states/accessedon08/05/2019
[635] Article 5, Treaty of SADC, 1992
[636] Sannassee Raja Vinesh; Seetanah Boopendra; Diksha Hemraze, Determinants of Foreign Direct Investment in SADC: An Empirical Analysis (2014) BMR, 4(4), 146-159

This region has not yet harmonised all the laws except where they have agreed to do so on investment schemes. FDI plays an important role in the inflow of foreign investment in developing countries especially the amount of natural resources available in a particular country.[637] In a study conducted on 12 SADC countries, it was found that the inflow of foreign investment was dependent on the extent of openness and size of the market, the available natural resources and the level of education.[638] Besides these, other factors that were found to be more important included the need to prevent abuse of power, political and macroeconomic stability, policy reforms for the economic environment and the quality of information needed for investment.[639] In the banking sector there is a question of what exactly determines development in this area. While countries have adopted certain regulatory models from developed countries, this ought to be done with attention to the environment of the receptive country. Many countries in the region have formulated investment policies in order to attract investment from Multinational Companies (MNCs) but very little has actually been gained from these policies due to lack of effective corporate governance policies and well-structured legal mechanisms for investor protection.[640] For instance, while Zambia is still struggling on the laws relating to director duties and creditors, in South Africa the common law duty to consider creditors has been practiced and its fraudulent trading provisions are more specific under the Companies Act. Once the company is financially distressed, they are to take some form of corporate rescue measures and if directors choose not to do so, they are to issue a written statement as to why they did not take the company into corporate rescue measures. South African law has provisions relating to business rescue. One can argue to the fact that South Africa is far more developed than Zambia in terms of its economy hence having a better legal framework for business rescue.

In terms of corporate governance too South Africa has a developed framework with a stronger institutional framework and has been revising its codes. The first report on corporate Governance was King I issued in 1994 and was revised in 2002 when King II was issued. In 2009 King III was

[637] Kunofiwa Tsaurai, An Empirical Study of the Determinants of Banking Sector Development in the SADC Countries (2018) JDA, 52(1) 71-85
[638] Sannassee Raja Vinesh; Seetanah Boopendra; Diksha Hemraze, Determinants of Foreign Direct Investment in SADC: An Empirical Analysis (2014) BMR, 4(4), 146-159
[639] Ibid
[640] Ngaundje Doris Leno, Development of a Uniform Insolvency Law in SADC: Lessons from OHADA (2013) JAL, 75(2), 259-282

issued and in 2016 King IV was issued. These reports have been issued for purposes of compliance with the Johannesburg Stock Exchange requirements for listed companies. The King IV has changed the approach of corporate governance in South Africa with a different approach to the rest of the SADC countries. It adopts the ‘apply and explain approach’ which requires that a company applies the principles required by the King IV and explain to substantiate the claim that good governance is practiced in accordance with the King Report. The Report defines corporate governance as exercise of ethical, and effective leadership by the governing body towards the achievement of the following outcomes: ethical culture, good performance, effective control and legitimacy.[641] The systems for internal control and institutional framework is detailed and comprehensive compared to other SADC members. The King IV report is in pursuit of reconciling the governance requirements with legislative minimum requirements placed on companies by encouraging a style whereby principles are adapted to ‘fit in’ with sectoral contexts and legislative regimes.

3.9 **Conclusion**

In conclusion, the chapter has analysed the framework relating to creditor protection in Zambia, this focused on the ineffectiveness of the formal procedures of insolvency as well as the governance of the firm by directors. The companies Act authorises directors to bind the company in contracts and one way in which this is done is by using debt finance for projects.[642] However, directors’ duties are not codified which is one of the problems because directors don’t seem to know what they are supposed to be doing. There is no clarity and certainty which leads to directors not understanding their responsibilities towards the company. It was also established that both fraudulent and wrongful provisions have impractical requirements which in return put directors in a position where they cannot be held accountable for their actions. Both fraudulent and wrongful trading does not disqualify directors even though they have been found guilty. Directors have authority that is almost unchecked. While this is evident, the duty to consider creditors’ interests in financial difficulties under common law lacks implementation in Zambia. The implication is that once a company is financially troubled, what seems to be the only option is insolvency leading to the collapsing of the company because corporate rescue measures are not developed either. Mechanisms such as schemes of arrangement, receivership and insolvency have been discussed

[641] Part 2, King IV Report on Corporate Governance, 2016
[642] Section 215, Companies Act,1994

and it has been established that they fall short of creditor protection. One of the problems associated with such arrangement is the requirement that all creditors must consent to the arrangement or exercise the right to become a shareholder thereby becoming unsecured. Also, the court process itself is expensive and time consuming which does not favour creditors in the end. Receivership on the hand seems to work better although the receiver is in a difficulty position of having to serve two masters at the same time which is almost impossible because; although appointed by the creditor, he/she is an agent of the company. Insolvency in Zambia has been associated with challenges such as possible wrongful trading which goes unpunished because directors are not held accountable for their decisions. By the time a company goes into insolvency, it is almost certain that it will not survive. Which is the reason why directors ought to have careful consideration on the impact of their decisions both during financial stability as well as when a company is financially troubled. Where the law is not sufficient such as directors' duties, corporate governance measures can help to improve this through good governance. This calls for transparency, adequate disclosure for creditors, accountability, ethical behaviour, and integrity in the way companies are managed. The problem in Zambia is that the concept of corporate governance is not developed hence the need to call for directors' duties to be codified and corporate governance to be strengthened. Due to the dearth of literature on the Zambian analysis, there was need to collect empirical data to understand how directors perform their duties in practice and how creditors deal with challenges they face. This process is analysed in the next chapter and empirical analysis in Chapter Six and Seven will substantiate this analysis for a better and conclusive understanding.

CHAPTER 4: **Methodology**

4.1 Introduction

This chapter contains the research strategy consisting of the method from the general research questions to analysis. The objective is to explain how the aim of the study has been achieved through adopted methods. Research strategy simply means the methodology adopted for the study[643] and it is the analysis of the direction and implications of the research.[644] Different disciplines have identified different methodologies for research such as the doctrinal approach for legal studies, and qualitative or quantitative for social sciences. The focus of methodology is centred on the suitability of the methods employed and this can involve more than one method.[645] This is called the mixed method approach tailored on social sciences because it combines quantitative and qualitative methods. The instigators of mixed methods restricted the approach to social sciences only.[646] Notably among them is Bryman and Bell, who defined mixed method as the integration of quantitative and qualitative research.[647] Likewise, Creswell defined mixed methods as the combination of qualitative and quantitative methods in a single study.[648] Teddlie and Tashakkori defined it as an approach in which both quantitative and qualitative methods have been employed to answer questions in a single study.[649] This brings about the methodological question of whether the combination of two different methodologies from different disciplines is qualified to be called a mixed method approach. Although literature does not address this question, it has been indicated that scholars who have used this kind of approach used the word interdisciplinary.[650] Research that combines legal methods and social sciences has been referred to as social legal.

4.2 Social-legal method

Most of the journal articles on social-legal argue that it lacks a comprehensive methodological framework to be used because of the challenges in integrating social sciences into legal methods.

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643 Alan Bryman and Emma Bell, *Business Research Methods* (4th ed. Oxford University Press, 2015) 37
644 Dawn Watkins & Mandy Burton, *Research Methods in Law* (Routledge, 2013) 2
645 Alan Bryman and Emma Bell, *Business Research Methods* (4th ed. Oxford University Press, 2015) 37
646 Donald T. Campbell and Donald W. Fiske, 'Convergent and Discriminant Validation by the Multitrait-Multimethod Matrixi' (1959) PB, 56, 81
647 Alan Bryman and Emma Bell, *Business Research Methods* (4th ed. Oxford University Press, 2015) 641
648 John W. Creswell, *Research Design: Qualitative & Quantitative Approaches* (SAGE Publications, 1994) 174
649 Charles Teddlie and Abbas Tashakkori, *Foundations of Mixed methods Research: Integrating Quantitative and Qualitative Approaches in the Social and Behavioural Sciences* (Sage Publications, 2009) 7
650 Terry Hutchinson, 'The Doctrinal Method: Incorporating Interdisciplinary Methods in Transforming the Law' (2015) ELR, 8, 1065

These authors include the following: Posner recognised that doctrinal research still dominates legal scholarship but there has been a call for interdisciplinary, although it is important to understand that it does not have the process so presciently.[651] Dawson argued that though it is important to study law in the social context, there are no sound methodological propositions yet in place for social-legal.[652] Hutchinson argues that at what point in the interdisciplinary do you synthesis the social data into the law?[653] Others such as Collier,[654] Priest,[655] Tyler,[656] and Kazmierski[657] have also stressed on the challenges of social-legal studies as a method. To offset all these weaknesses, this study is guided by the persuasive methodological approaches in qualitative research methods. As a result, the research intends to define a mixed method approach which is inclusive. To cover this ambiguity in definitions, this research defines mixed method approach as the integration of two different methodologies without any limitations in terms of discipline. However, this study adopts two different methods from different disciplines and this approach involves legal research and social science methods. Although it is a rare combination in terms of mixed methods research, different scholars call it social-legal which entails an integration of social science methods into legal research methods. The traditional method used as a form of an inquiry in legal research is called doctrinal.[658]

The departure from this method entails stepping into interdisciplinary intersection with the social sciences where two different methods could be employed.[659] However, this study does not depart from the traditional method of legal research but it does bring into perspective a social science method which is qualitative in nature hence the mixed method approach. Whether one calls it a mixed method or a social-legal study is entirely a matter of preference but there are weaknesses that have been associated with social-legal studies such as the lack of methodological framework

[651] Richard A. Posner, *Legal Scholarship Today* (2002) H.L.R, 115, 1314
[652] T. Brettel Dawson, *Legal Research Methods in a social science Setting: The Problem of Method* (1992), D.L.J, 13, 445
[653] Terry Hutchinson, 'The Doctrinal Method: Incorporating Interdisciplinary Methods in Reforming the Law' (2015) E.L.R, 8, 1065
[654] Charles W. Collier, 'Interdisciplinary Legal Scholarship in Search of Paradigm' (1993), D.L.J, 42, 840
[655] George L. Priest, 'The Growth of Interdisciplinary Research and the Industrial Structure of the Production of Legal Ideas: A reply to Judge Edwards' (1993) M.L.R, 91, 1929
[656]Tom R. Tyler, *Methodology in Legal Research* (2017) ULR, 13, 131
[657] Vincent Kazmierski, How Much Law Studies: Approaches to Teaching Legal Research and Doctrinal Analysis in a Legal Studies Program (2014) CJLS, 29, 297
[658] Terry Hutchinson & Nigel Duncan, Defining and describing what we do: doctrinal legal research (2012) Deakin Law Review**,** 17, 83: Dawn Watkins & Mandy Burton, *Research Methods in Law* (Routledge, 2013) 3
[659] Brettel T. Dawson, Legal Research in a Social Science Setting: The Problem of Methodology (1992) DLJ, 14,445

to be adopted as one carries out the integration of the two methods and to offset this problem, this study is adopting a purely doctrinal research on one hand and following a purely qualitative approach on the other hand.

4.2.1 Legal research methods

Conducting an inquiry in law is an entirely different approach in that it is examined in its own conceptual terms as it is a site or source of knowledge and authority.[660] Central to legal research is the classic cannons of interpretation, reasoning and analysis assimilated from the primary data which includes statutes, case law, and general principles of law, customary law, and authoritative writings of prominent authors among other sources.[661] This normative analysis of the law is known as 'doctrinal', and it has been at the heart of legal scholarship from the Roman times, and it dominates every legal research.[662] The word doctrinal originates from a Latin word 'doctrina' which translates into instructions or knowledge.[663] It is rooted in the critical examination of the legislation and case law in order to establish an arguably correct and complete statement of the law on a subject.[664] Doctrinal means a synthesis of rules, principles, norms, interpretive guidelines and values that are applied consistently and they evolve organically.[665] It must be noted that applying the methodological considerations to the theory of law requires looking into, and analysing the law in its most pure and practical form looking at the historical developments and transformation of the content of legal norms and principles.[666] Doctrinal involves the analysis of legal concepts, statutes, cases and rules because every legal research before proceeding with the critical analysis of the theory of law, or before the collection of empirical data can be conducted in order to analyse the effectiveness or ineffectiveness of the law, it is imperative that sound foundations of the authority and legal status of the law is substantiated or critically examined.[667] It is argued that the

[660] Terry Hutchinson and Nigel Duncan, 'Defining and Describing What We Do: Doctrinal Legal Research' (2012) DLR, 17, 83: T. Brettel Dawson, 'Legal research in a social setting' (1992) DLJ, 14, 445
[661] Mark Van Hoecke, *Methodologies of Legal Research: What Kind of Method for What Kind of Discipline?* (Hart Publishing, 2013) 11
[662] Tom R. Tyler, *Methodology in Legal Research* (2017) ULR, 13, 131
[663] Mark Van Hoecke, *Methodologies of Legal Research: What Kind of Method for What Kind of Discipline*? (Hart Publishing, 2011) 188
[664] Dawn Watkins & Mandy Burton, *Research Methods in Law (Routledge*, 2013) 2
[665] Terry Hutchinson & Nigel Duncan, 'Defining and describing what we do: doctrinal legal research' (2012) DLR**,** 17, 83
[666] Evgeny B. Pashukanis, *Law and Marxist: A General Theory* (Transaction Publishers, 1978) 65
[667] Dawn Watkins & Mandy Burton, *Research Methods in Law* (Routledge, 2013) 7

only method that can substantiate the legal status of the law in operation is through doctrinal research thereby being the method on which every legal project is built.[668]

'Doctrinal Research is concerned with a methodical elucidation of the rules governing a particular legal classification, analyses the relationship between rules, explains areas of difficulty and, perhaps, predicts future developments.'[669] It is usually characterized by the study of legal texts, formulations of the law in particular contexts and the legal doctrines.[670] These legal doctrines are found in statutes and cases and in common law principles and rules of equity if dealing with common law jurisdictions.[671] The procedure of the doctrinal approach to research is done in two stages where the first one involves the search for the law and the second part involves the analysis of the law through interpreting and critically analysing it.[672] This is because the law is usually not certain, hence, critical analysis to determine its effectiveness or inadequacies. Since the inception of the concept of limited liability, the risk that falls on creditors has increased such that doing business with a company incorporated is risky.

It is legally undisputed that directors' duties are owed to the company with a requirement that in times of financial difficulties, directors must take into consideration the interests of creditors.[673] In construing the law particularly section 172, when the company is in financial distress, section 172(1) is substituted by section 172(3) hence the focus is no longer for the benefit of the members but creditors. The suspension of section 172(1) during financial distress is the authority on which the legal standing for creditors is established even though less attention has been given to them in literature.[674] This duty is not provided from inception but qualified by circumstances of a company being insolvent, nearing insolvency, or doubtful insolvency.[675] However, the interpretation of this section has attracted a lot of controversy as the law is not clear on the actual aspects of application.

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668 Ibid

669 Murtala Ganiyn Murgan, 'A Critical Analysis of the Techniques for Data Gathering in Legal Research' (2015) JSSH, 1, 266

670 Ibid

671 Julius Stone, *Social Dimensions of Law and Justice* (Stevens and Sons Ltd, 1966) 28

672 Peter Cane and Herbert M. Keitzer, *The Oxford Handbook of Empirical Legal Research (Oxford University Press,* (2012) 930

673 Section 172(3), Companies Act, 2006

674 Christopher J. Cowton, 'Putting Creditors in their Rightful Place: Corporate Governance and Business Ethics in the Light of Limited Liability' (2011) JBE, 102, 21

675 Andrew Keay, 'Formulating a Framework for Directors' Duties to Creditors: An Entity Maximisation Approach' (2005) CLJ, 46, 614

It has been disputed that even though the duty flows from the traditional fiduciary duty to act in the best interest of the company, the courts have been tentative in stating when the duty arises or comes into effect.[676] Likewise the law does not provide for elements constituting what it means to consider creditors interests. The study addressed these gaps in the legal context the doctrinal approach.

4.2.2 Qualitative research methods

Research in the social sciences and humanities has identified three research strategies and these are qualitative, quantitative and mixed methods.[677] Qualitative research in social sciences involves the emphasis on words and it is inductive, constructionist and interpretive in nature its emphasis being on first hand data.[678] Authors such as Bryman and Bell,[679] and Creswell[680] describe qualitative research through the processes it involves such as field work in which the researcher finds meaning out of the lived experiences of the subjects or participants, and building of concepts and theories from the data. As a result, qualitative research has been associated with the definitions that are contrary to quantitative research. Creswell and Poth define qualitative research is an activity that locates the researcher or observer in the world.[681] They go further to state that qualitative research: begins with assumptions and the use of interpretive or theoretical frameworks that inform the study of research problems addressing the meaning individuals or groups ascribe to a social problem.[682] This definition is not based on contraries of quantitative research but has strong orientations to process of research in its own accord. Although there has been a number of approaches in qualitative research, Creswell provides the main five methods commonly used in social science research namely; narrative, grounded theory, ethnographic, case studies and phenomenology.[683] Narrative inquiry involves the telling of people's lives and events around them including accounts of episodes and the interconnections between them.[684] Proponents of this

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[676] Andrew Keay, 'The Duty to Promote the Success of the Company: Is it fit for Purpose?' (2010) University of Leeds School of Law, Working Paper, Accessed on 13/02/2017 from: SSRN: https://ssrn.com/abstract=1662411
[677] John W. Creswell, *Research Design: Qualitative, Quantitative and Mixed Methods Approaches* (3rd ed. SAGE Publications, 2009) 15
[678] Alan Bryman and Emma Bell, *Business research Methods* (4th ed. Oxford University Press, 2015) 392
[679] Ibid
[680] John W. Creswell, *Research Design: Qualitative, Quantitative and Mixed Methods Approaches* (SAGE Publications, 1994) 145
[681] John W. Creswell and Cheryl Poth, *Qualitative Inquiry and Research Design* (4th ed. SAGE Publications, 2018) 7
[682] Ibid 8
[683] Ibid, John W. Creswell, *Research Design: Qualitative, Quantitative and Mixed Methods Approaches* (4th ed. SAGE Publications, 2018) 177
[684] Alan Bryman and Emma Bell, *Business research Methods* (4th ed. Oxford University Press, 2015) 541

inquiry argue that continuity to life span is essential and the aim is to elicit the interviewees' interconnections between account of events and context.[685] Grounded theory is an inquiry which derives theory from the systematically analysed data through a research process.[686] The two major characteristics of grounded theory are the emerging of theory from data, and the interactive process of which data collection and analysis proceeds in tandem.[687] Ethnography involves the researcher joining a group for an extended time to observe and gather data and writing it up.[688] Case studies involve a detailed and intensive analysis of a single case and the distinguishing factor is that it restricts the research to the selected bounds.[689]

Phenomenology is an inquiry in which the researcher selects participants, and interviews them on a selected phenomenon to understand their lived experiences, and usually this involves a small number of participants but extensive engagement in order to establish patterns.[690] The researcher derives patterns and relationships of meaning that emerge from the engagement with the participants and at the same time the researcher covers his/her personal understanding to eliminate subjectivity.[691] This method of inquiry is adopted in this study as the researcher seeks to understand the lived experiences of directors, creditors and lawyers within the context of responsibilities, challenges, and the law respectively. This design adopts interviews as the method for data collection. An interview has been defined as a conversation between the researcher and the respondent for supposes of extracting knowledge or understanding descriptions of the interviewee as regards a particular phenomenon.[692] Kvale goes further to state that it is a structured conversation which has a purpose as it goes beyond the mere exchange of words to understand thoroughly tested knowledge.[693] (Detailed discussion on interviews is in the section for data collection). The research strategy can be clearly illustrated in the diagram below which indicates

[685] Ibid
[686] Barney G. Glaser and Anselm L. Strauss, *The Discovery of grounded Theory Strategies for Qualitative Research* (Aldine Transaction Publishers, 1967) 12
[687] Alan Bryman and Emma Bell, *Business research Methods* (4th ed. Oxford University Press, 2015) p.584
[688] John W. Creswell and Cheryl Poth, *Qualitative Inquiry and Research Design* (4th ed. SAGE Publications, 2018) 11
[689] Alan Bryman and Emma Bell, *Business research Methods* (4th ed. Oxford University Press, 2015) 69
[690] John W. Creswell, *Research Design: Qualitative, Quantitative and Mixed Methods Approaches* (3rd ed. SAGE Publications, 2009) 13
[691] Ibid
[692] Steiner Kvale, *Interviews: An Introduction to Qualitative Research Interviewing* (Sage Publications, 1996) 7
[693] Ibid

the methodologies, methods, and the research design adopted as well as the research questions to be addressed. This is illustrated in a diagram below.

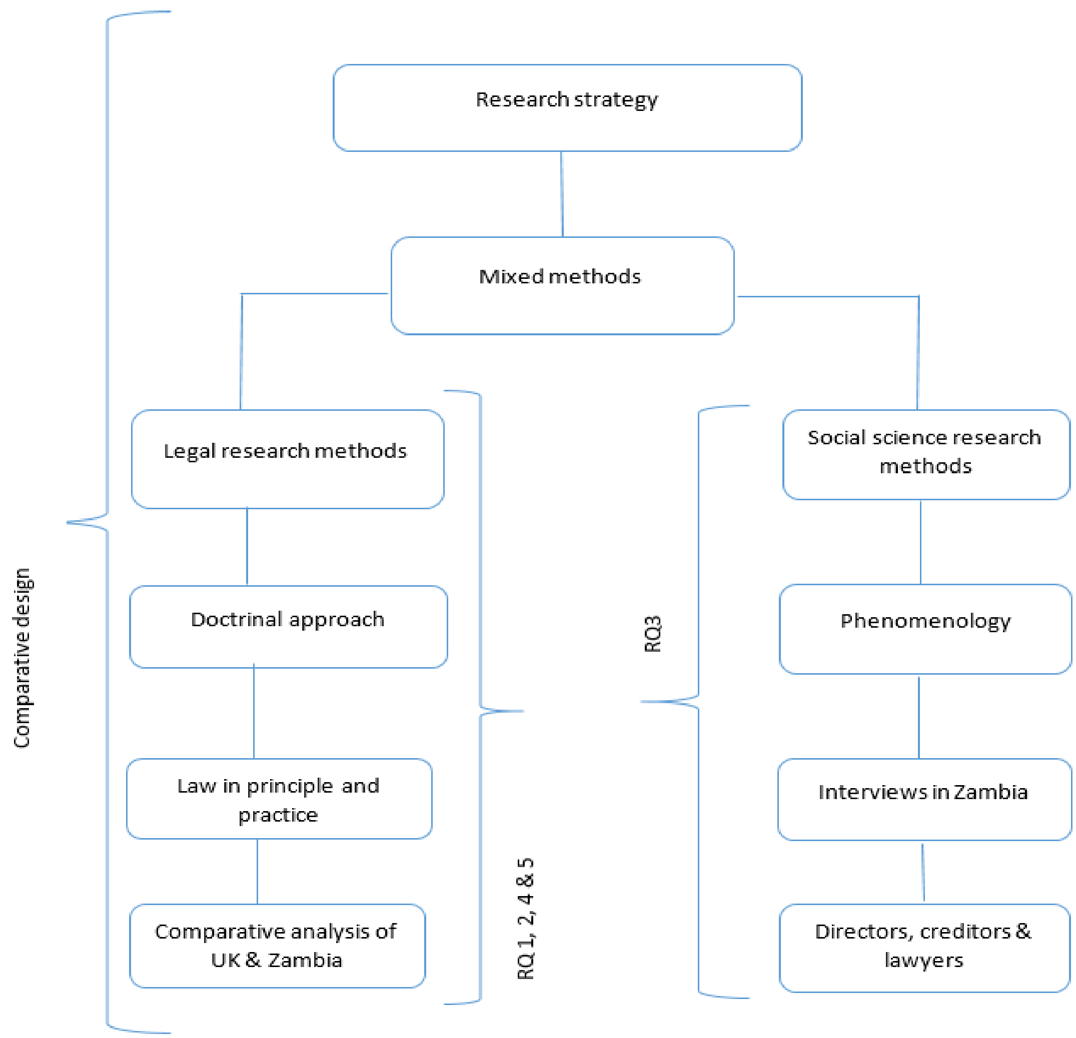

Figure 4:1 Figurative research strategy

The above strategy indicates the overall methodology which is the mixed method approach. Under legal research methods, the doctrinal approach is used to analyse the law and phenomenology is adopted for social science methods for purposes of understanding lived experiences of the respondents in Zambia. Comparative design is used while analysing the law and interviews are used for collecting data in Zambia from the respondents. The study design is comparative illustrated in the conceptual framework.

4.3 Justification for mixed methods

Doctrinal method is used alongside social science research methods; interviews to be precise. The doctrinal method answers the legal research questions while interviews address the empirical question. The first justification for this strategy on the aspect of the doctrinal approach is that it has been submitted that the doctrinal method is the foundation upon which all legal research is built.[694] In supporting the above statement, Watkins and Burton submitted that before proceeding with critical analysis of law or collection of empirical data, it is imperative that sound foundations of the authority, and legal status of the law is substantiated or critically examined.[695] Henceforth, it is acquiesced that the only method that can substantiate the legal status of the law is through doctrinal research thereby being the method on which this study is built. The second justification on the aspect of social sciences is that qualitative research is founded on the understanding derived from the interpretation of the world lived by the participants unlike quantitative method which is founded on natural scientific models.[696] It is submitted that by using this strategy, the aim and objectives of the study will be achieved.

4.4 Research approach

This is the process illustrating how the research has been conducted indicating the approach to the research questions, the approach used to answer the questions, and the objectives achieved through such an approach. This provides a clear understanding of how the research questions have been answered thereby indicating what objectives have been achieved. This is illustrated in a table below.

[694] Mark Van Hoecke, *Methodologies of Legal Research: What Kind of Method for What Kind of Discipline*? (Hart Publishing, 2011) 155
[695] Dawn Watkins & Mandy Burton, *Research Methods in Law* (Routledge, 2013) 7
[696] Alan Bryman and Emma Bell, *Business Research Methods* (3rd ed. Oxford University Press, 2011) 386

Table 4.1 Approach to research questions, methods and objectives achieved

Research question	Adopted approach	Objective achieved
RQ 1. What are the strengths and shortcomings of the legal mechanisms available for the protection of creditors in the UK?	Doctrinal	OB.1 To critically analyse the mechanism for creditor protection in UK
RQ 2. How adequate and successful are the legal and regulatory mechanisms available for the protection of creditors in the context of quality of law in Zambia?	Doctrinal	OB.2 To critically analyse the duties directors have towards creditors in Zambia.
RQ 3. What are the challenges faced by creditors in Zambia?	Legal empirical/interviews	OB.3 To assess the implementation of the legal framework for creditor protection in Zambia.
RQ 4. What are the similarities and differences regarding creditor protection and what are the nature of these differences between UK and Zambia?	Comparative	OB. 4 To systematically analyse the similarities and differences that exist between the UK and Zambia.
RQ 5. How can creditor protection in developing countries like Zambia be of better-quality?	Doctrinal	OB.5 To reflect on the challenges of ensuring creditor protection within the context of company law and corporate governance in a developing country like Zambia.

4.5 Theoretical assumptions

It has been argued that the nineteenth century saw a development of positive science into a system of model, mathematics and testing of hypothesis for purposes of general validity as a method for acquiring knowledge.[697] However, the study of law is not founded on mathematical theories or on construction of theories which calls for testing except to its confines of the legal system concerned as the law does not exist on its own but creations of man.[698] They are not Res (things) existing autonomously from the Intellectus (mind) but, creations of the mind.[699] Legal research is reasoned differently both in nature and substance because the general philosophical or theoretical reflections of law are embedded in the construction of reasoning through the study.[700] The distinctiveness from other disciplines is in substance especially with the approach and modes of validation.[701] The process of acquiring knowledge in legal research is dependent on how one views the law.[702] The philosophical undertones in legal research are more centred on the rules and norms of a legal system and these depend on the answer to the philosophical question 'what is law'.[703] To begin with, the study of legal knowledge is known as jurisprudence which is not only restricted to inquiries of the law but its application to the social world.[704] The word Jurisprudence originates from the Latin word 'juris prudential' which translates into the knowledge of law.[705] So many thinkers or scholars have tried to answer the question 'what is law,' a practice which is not common with other disciplines. Hart argues law is a social construction which is not devoid of human action in that it does not exist without man.[706] This is because laws are not objects of nature but artifice made possible by man.[707] Kelsen defined law as a primary norm which provides for sanctions[708] and Aquinas argued that surely law is not only about the rules and norms but law serves various purposes and he called it an ordinance of reason which is meant for the common good.[709] There are many schools of thought in legal philosophy but the major two to be discussed include legal positivism and the natural law theorists.

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[697] Mark Van Hoecke, *Methodologies of Legal Research: What Kind of Method for What Kind of Discipline?* (Hart Publishing, 2011) 1
[698] Ibid
[699] Ibid
[700] Charles Chatterjee, *Methods in Law* (Old Bailey Press, 2000) p.5
[701] Nigel E. Simmonds, *Central Issues in Jurisprudence: Justice, Law and Rights* (4th ed. Sweet & Maxwell, 2013) 1
[702] Bebhinn Donnelly, *A Natural Law Approach to Normativity* (Ashgate Publishing, 2007) 2
[703] Priel Dan, 'Towered Classical Legal Positivism' (2015) VLR, 101, 942
[704] Andrew Knight & Les Ruddock, *Advanced Research Methods in the Built Environment* (Blackwell Publishing, 2008) 3
[705] Nigel E. Simmonds, *Central Issues in Jurisprudence: Justice, Law and Rights* (4th ed. Sweet & Maxwell, 2013) 1
[706] H. L. A. Hart, *The Concept of Law* (3rd ed. Oxford University Press, 2012) 2
[707] Ibid
[708] Hans Kelsen, *General Theory of Law and the State* (Transaction Publishers, 2005) 3
[709] Thomas Aquinas cited in Herbert L. A. Hart, *The Concept of Law* (3rd ed. Oxford University Press, 2012) 2

4.5.1 Legal positivism

This school of thought is of hermeneutical jurisprudence developed by legal thinkers beginning from the 18th century such as Jeremy Bentham, John Austin and H. L. A Hart to name but a few who argued that laws are commands and there is not a relation between law and morality.[710] This school of thought argues that a legal system is a logical system in which correct decisions can be deduced from predetermined legal rules without reference to social considerations.[711] They contend that moral judgement cannot be defended by rational argument as can be done with statements of facts.[712] Laws are commands put in place by a sovereign or a socially recognised authority despite being a bad law as long as a legitimate authority put it in place because the validity of law is in the coherence of the system.[713] Philosophers in this school firmly argued that law is what it is and ought to be distinguished from morals.[714]

One of the most influential or recognised works of Hart was the 'rule of recognition' founded on normativity or validity of rules and norms. The rule of recognition had the primary aim of setting the criteria for validating law by defining membership in the structured set of norms that make up a legal system hence defining the boundaries and it anchors the authority of the rules.[715] This rule of recognition identifies the authoritative factor of a rule or norm as belonging to a particular legal system and it outlines the standards by which members are distinguished.[716] The former answers the ontological question as to how a rule can be identified, and the latter, answers the epistemological question of how to establish that a rule is a member through tests. Although it was not clear whether Hart had not clearly distinguished between the two approaches and he did not categorise whether rules are members of the legal system or not, but the test validating a rule as law was to be found in the judges' reasoning by holding the governed subjects to its terms.[717] Hart argued that different criteria could be used to validate law probably by the ranking of superiority,

[710] Mark Van Hoecke, *Methodologies of Legal Research: What Kind of Method for What Kind of Discipline?* (Hart Publishing, 2011) 188
[711] Ibid, David Plunkett, 'Negotiating the meaning of Law: The Metalinguistic Dimension of the Dispute over Legal Positivism' (2016) LT, 22, 205
[712] Ibid
[713] Danny Priel, 'Trouble for Legal Positivism?' (2006) LT, 12, 225
[714] Ibid
[715] Gerald J. Postema, 'A Treaties of Legal Philosophy and General Jurisprudence, Legal Philosophy in the Twentieth Century: The Common Law World,' (2011) JLS, 24, 1
[716] Ibid.
[717] H. L. A. Hart, *The Concept of Law* (3rd ed. Oxford University Press, 2012) 18

but he did not give support for empirical work for it.[718] In the positivist school, law is valid through the causal scheme in that it must be endorsed by a superior or higher legal norm which is the grand norm, but the problem was, what kind of process to use in recognising what the grand norm is. It is because of this challenge that Hart came up the rule of recognition as discussed above.[719] However, causality does not deduce the complexities of legal reasoning, rhetoric and the categorisation of the social facts and as a result, law can be viewed as an ordinance of reasoning made for the common good of people.[720] This school of thought is not entirely rejected because law is provided by the superior command which is the legislature. It is partially recognised in this study because, the law is supreme and ought to be put in place by a legitimate body. The validity of the law is not based on the scientific models that can be measured by instruments. However, the reasoning of the law is for the goodwill of the people because of the pursuit of justice for all people under the law. This includes creditors in this study who deserve justice by protection under the law when companies fail to pay back loans. This is the reason why the natural law theory is adopted.

4.5.2 The natural law theory

The natural law theory is to be differentiated from the natural law theory of morality because they are different as the former is focused on what is legal or illegal and justice, and the later on morality and justice as in what is right or wrong. The former is the subject of this study as it considers law as a social fact and legal systems ought to have functions in pursuit of achieving justice. Law as a socially recognised standard for conduct has institutions mandated to enact and enforce it, and only a norm that is recognised by these institutions can hold a valid legal status.[721] An example is the legislature, judiciary and so on. Law is rational for conduct and this has not gone without critics as questions to its validity arose whether anything that falls short of rational standard can be qualified as law. However, the strong view of natural law is that a rational defect in a legal norm renders it invalid and the weak view is that, such a law is rendered legally defective. Scholars like Moore defended the strong view which renders law that does not meet the rational standard invalid using the constitutional interpretation.[722] This study is much more aligned to the weak view as the law

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[718] Gerald J. Postema, 'A Treaties of Legal Philosophy and General Jurisprudence, Legal Philosophy in the Twentieth Century: The Common Law World' (2011) JLS, 24, 1
[719] Mark Van Hoecke, *Methodologies of Legal Research: What Kind of Method for What Kind of Discipline?* (Hart Publishing, 2011) 183
[720] Ibid
[721] Jonathan Crowe, 'Natural Law Theories' (2016) PC, 11, 91
[722] Michael Moore, 'Justifying the Natural Law Theory of Constitutional Interpretation' (2001) FLR, 69, 2087

relating to creditors is legally defective, but not invalid. Just like legal positivism, so many philosophers have written about natural law but the distinguishing work of Thomas Aquinas is worth discussing.[723] Aquinas distinguished four kinds of laws namely, human law, divine law, eternal law and natural law.[724] He claimed that human law as an ordinance of reason as it rules and measures conduct and rational beings conduct is ruled and measured by the dictates of where there is reason to conform.[725] He claimed that the plans God has for humanity or creation is eternal law whereas divine law is found in the scripture which is revealed unto man and he argued that if a law is contrary to natural law then it is contrary to divine law.[726] There is an obligatory force that comes with knowing the law because it does provide for regulation of human conduct hence the moral element is inherent in the law.[727] As many writers have different views, both the positivist and the natural law theorists are trying to state that law is a set of rules and regulations meant for governing a society by binding them to such a legal system.

This study being a mixed method approach is using two different philosophical approaches and these include the natural law theory and interpretivism from qualitative methods. The adoption of natural law theory is influenced by the fact that creditor protection laws are defective and interpretivism on the other side clearly helps to understand the lived experiences of the directors, creditors and lawyers on how they apply these defective laws in business. It was suggested by Creswell that two different philosophical beliefs can be used in a single study if the specifics are given especially in law related research[728] and this is exactly what has been done. Below is an illustration of the layers to this research in an adaptation of the research onion from Saunders et al.

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[723] Mark C. Murphy, *Natural Law in Jurisprudence and Politics* (Cambridge University Press, 2006) 2
[724] Sean Coyle, Natural Law in Aquinas and Suarez (2017) JJ, 28, 319
[725] Ibid
[726] George Duke, 'The Planning Theory and Natural Law' (2015) LP, 34, 173
[727] Mehmet Ruhi Demiray, 'Natural Law Theory, Legal Positivism, and the Normativity of Law' (2015) EL, 20, 807
[728] Mark Saunders, Philip Lewis and Adrian Thornhill, 'Research Methods for Business Students' (6th Ed. Pearson, Education, 2012) 129

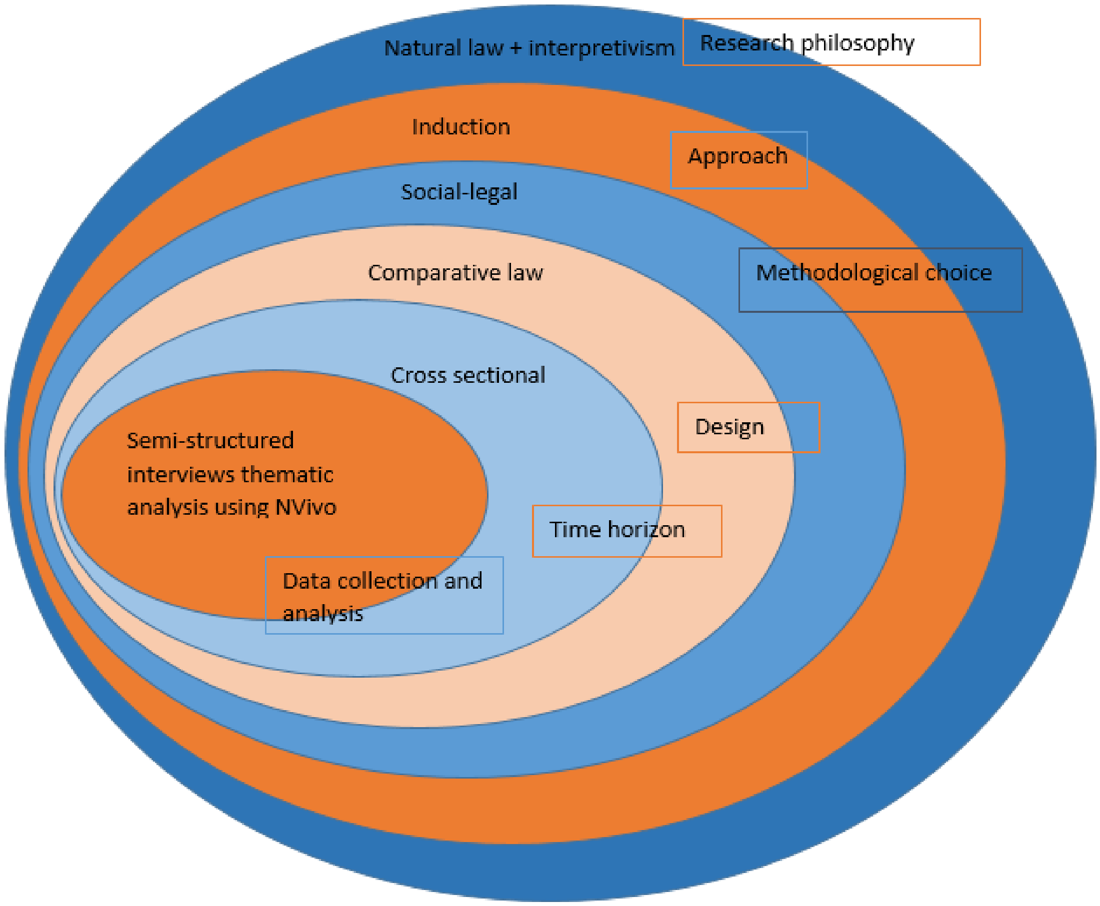

Figure 4:2 Research onion adapted

Source: Saunders et al., (2012)

4.5.3 Ontological assumptions

Ontological considerations in research refers to the nature of social entities and whether such entities can be considered objective as having a reality external to social actors or on the other hand whether they should be considered as social constructions built up from perceptions and actions of social actors.[729] This philosophical underpin involves two main paradigms namely objectivism and constructionism.[730] A paradigm is a cluster of beliefs and dictates which scientists in disciplines use to influence what is studied, how it's done and how results are to be interpreted.[731] Objectivism

[729] Ibid p. 33
[730] Ibid
[731] Ibid

is the ontological assumption which implies that the social phenomena confronts the researcher as an external factor of which the researcher has no influence whereas constructionism implies that the social phenomena is continually influenced and accomplished by the social actors and it's not independent of the researcher as they are in a state of continuous revision.[732] Objectivism has been rejected in this research because the nature of the study is not external to the researcher by virtue of the process adopted. The researcher has the power to select the methods of the research best way possible to ensure that research questions and objectives are achieved. It has been argued that the methodology selected hinges on what one is trying to do as opposed to a commitment to a specific paradigm. [733] Thus, the methodology employed needs to match the phenomenon of interest because diverse phenomena require the use of different methodologies.[734] It was stated that:

> 'The researcher's theoretical lens is recommended as playing a significant role in the choice of methods because the underlying belief system of the researcher (ontological assumptions) largely defines the choice of method (methodology).' [735]

Owing to the above proposition, objectivism is associated with the positivist's school of thought which adopts the quantitative method of study. Henceforth, it is not adopted for this study because the researcher is not independent from the social phenomena under examination. The ontological paradigm to be adopted in this research is constructionism because directors' duties and the protection of creditors cannot be viewed as an external factor since they can be accomplished by the social actors and they can be revised any time to enhance their effectiveness. Therefore, it can be argued that this ontological paradigm is helpful in achieving the aim and objectives of the study.

4.5.4 Epistemological assumptions

Epistemological considerations are concerned with what is to be considered as knowledge and how this knowledge can be obtained or whether the social world can be studied through the same principles, procedures and ethos of the natural sciences.[736] The epistemological perspectives are grounded in the positivist view of how knowledge can be acquired and this is through the use of mathematical models, instruments and causality.[737] The epistemological position supporting the

[732] Ibid
[733] Cavaye, A. L. M. 'Case study research: A multi-faceted research approach for IS' (1996). ISJ, 6, 227
[734] Ibid
[735] Steven Eric Krauss, 'Research Paradigms and Meaning Making: A Primer' (2005) TQR, 10,758
[736] Alan Bryman, '*The Debate about Quantitative, Qualitative and Mixed Methods or Epistemology*?' (1984) BJS, 35, 75
[737] Mathias M. Siems and Daithi M. Sithigh, 'Mapping Legal Research' (2012) CLJ, 71, 651

notion that the rigid measures of natural sciences should be used in acquiring knowledge is known as positivism whereas the position propounding that knowledge can be acquired through other means such as understanding human behaviour is known as interpretivism.[738] These two epistemological assumptions are discussed below.

4.5.5 Positivist's paradigm

Positivism is an epistemological position that advocates the application of methods of the natural sciences to the study of socio reality.[739] The social sciences in the nineteenth century were characterized on experimentation, objectionism and reductionism as the only methods that incited rigour and methodological innovation.[740] Auguste Comte influenced the development of sociology through his ideas of logical positivism in the early twentieth century.[741] Two major concepts existed namely empiricism and rationalism.[742] Empiricism is a concept which argued that knowledge can only be known through observations whereas the concept of rationalism argued that we get knowledge not from the means of observations but through other means too. [743] The proponents of legal positivism tried to combine these two concepts which were rooted in empirical and observable facts while highlighting the importance of verification of facts. They argued that "a proposition is cognitively meaningful only when there exists fixed means by which to determine conclusively its truth or falsity".[744] It has been argued that the positivists regard data as value-free and don't change because of observations but since science measures facts about reality independently.[745] It was further argued by Krauss that the positivists only regard knowledge as that which can be measured scientifically and can be observed hence the purpose of scientific knowledge is to understand the world well enough so as to predict and control it through the laws of cause and effect which are discerned if scientific methods are adopted.[746] However, opponents to this epistemological undertone have argued that knowledge can be acquired through other means

[738] Alan Bryman and Emma Bell, *Business Research Methods* (4th ed. Oxford University Press, 2015) 27
[739] Steven Eric Krauss, Research Paradigms and Meaning Making: A Premer (2005) QR, 10(4), 758-776
[740] Mark Van Hoecke, Methodologies of Legal Research: What Kind of Method for What Kind of Discipline? (Hart Publishing, 2011) p.188
[741] Ibid
[742] Ibid
[743] Raymond Wacks, Understanding Jurisprudence: An Introduction to Legal Theory (3rd ed. Oxford University Press, 2012) p.58
[744] Brooks Tom, 'Legal Positivism and Faith in Law' (2014) MLR, 77(1), 139-147
[745] Steven Eric Krauss, Research Paradigms and Meaning Making: A Premer (2005) QR, 10(4), 758-776
[746] Ibid

such as phenomenology, an understanding of how people interpret the world.[747] It is argued that critics to positivism intend to understand the world through human experience an element which cannot be achieved using natural scientific measurements or model[748] and because of the above critics, this research will not be adopting a positivist approach as it will not answer the research questions which are tailored to the understanding of lived experiences of directors and creditors. Therefore, this study adopts the interpretivism paradigm which allows for understanding of human experiences especially creditors challenges as the focus of this study.

4.5.6 Interpretivism

Interpretivism is a belief that the subject matter of social sciences and the institutions are distinct from the natural world and therefore the study of social world requires a different approach from the natural sciences.[749] Interpretivism is founded on understanding of human behaviour rather than the forces that act on it.[750] This is concerned with the way in which people make sense out of the world as well as how they can bracket their own preconceptions. Phenomenology is one of the traditions of this philosophical belief of which its history can be traced to Alfred Schultz's work in the 1960s influenced by Marx Webber's concept of 'Verstehen' which means 'understanding from the actor's perspective.'[751] Schultz contended that social reality has meaning to the social actor and this meaning is acted upon in a way that the researcher gains access to the participants and understands from their perspective.[752] The philosophical underpins of qualitative research is associated with phenomenology, Verstehen and symbolic interactionism.[753] Bryman said that phenomenological based research has always been questioned because of its empirical concerns such as the actor's perspective as the empirical departure. This approach which views people as an internal factor is strictly an approach that seeks to focus on lived experiences and this cannot be achieved if actors are perceived to be an external factor.[754] This study seeks to understand the experiences of the respondents hence adopting interpretivism as the philosophical undertone. The philosophical beliefs are illustrated in the table below and it is important to note that as earlier

[747] Alan Bryman & Emma Bell, Business Research Methods (4th ed. Oxford University Press, 2015) p.31
[748] Steven Eric Krauss, Research Paradigms and Meaning Making: A Premer (2005) QR, 10(4), 758-776
[749] Ibid
[750] Ibid
[751] Ibid 30
[752] Alan Bryman, 'The Debate about Quantitative and Qualitative Research: A Question of Method or Epistemology?' (1984) BJS, 35, 75
[753] Alan Bryman, 'The Debate about Quantitative, Qualitative and Mixed Methods or Epistemology?' (1984) BJS, 35,75
[754] Ibid

stated, these beliefs are applied differently in legal research which is why the table reflects three methodological approaches with a summarised outline of the beliefs. Secondly, even though this research is a mixed method approach, it does not adopt the pragmatic belief because beside the doctrinal aspect of the work, the phenomenological aspect is qualitative. There is no use of the quantitative approach in this work to warrant the adoption of pragmatic belief. The table below is indicative of the methodologies and philosophical beliefs.

Table 4.2 Methodologies and associated philosophical beliefs

Methodology	**Ontology assumptions**	**Epistemological assumptions**
Legal research methods	**Constructionism** Law does not exist on its own	**Interpretivism** Legal positivism and natural law. Law is what it is and what it ought to be respectively
Qualitative	**Constructionism** Multiple realities are constructed through lived experiences and interaction with others	**Interpretivism** Reality shaped between the researcher and the researched
Quantitative	Reality exits outside the researcher	Reality is approximated, known through research using statistics and validity is through peers not participants
Mixed methods (social sciences)	Reality is what is useful, practical and works	Known using many tools that reflect both deductive and inductive proof

4.6 **Conceptual framework**

It has been argued that the legal system is the theoretical and the conceptual framework in legal research because it is the main object of the study.[755] The conceptual framework is based on the law relating to creditor protection in UK and Zambia. It indicates the gaps identified in literature

[755] Mark Van Hoecke, *Methodologies of Legal Research: What Kind of Method for What Kind of Discipline*? (Hart Publishing, 2011) 155

and emphasising concepts and methods adopted. Therefore, after data analysis, another framework will be drawn to indicate the concepts covered and contributions to the gaps.

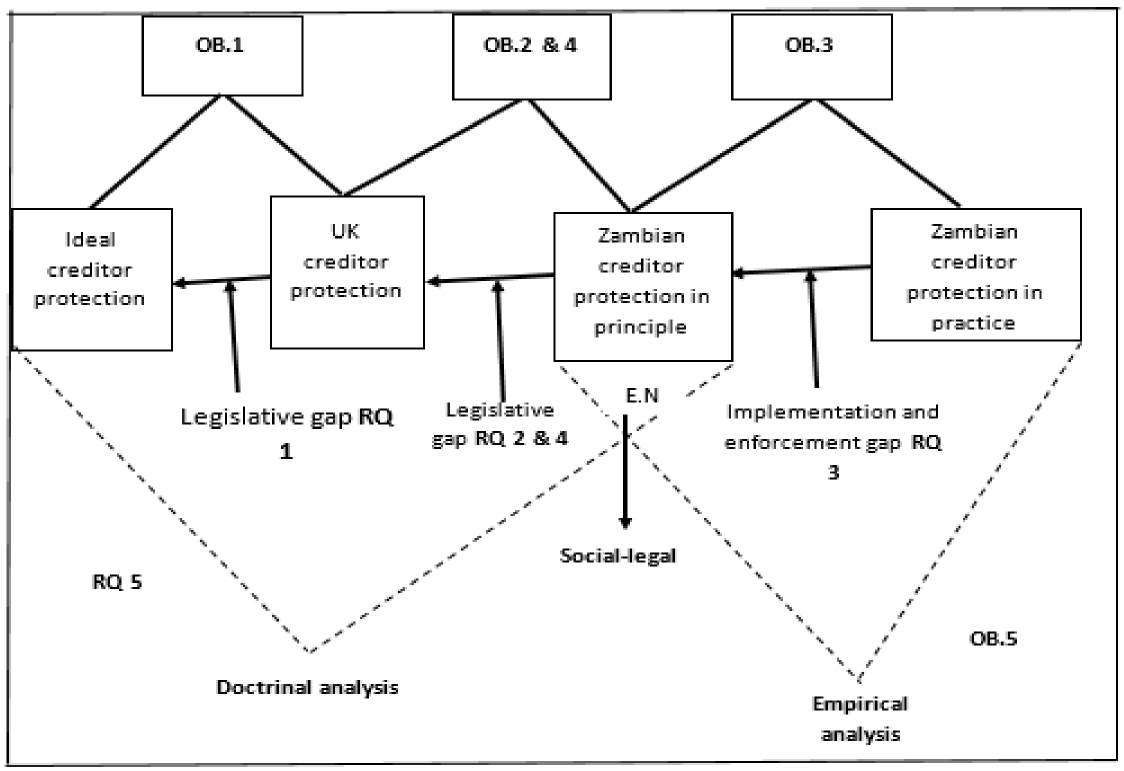

Figure 4:3 Conceptualised framework for an ideal creditor protection

The protection of creditors in the UK in context is insufficient from the ideal protection which is a legislative gap established in doctrinal analysis which answers the first research question and achieves the first objective. The second gap conceptualised is between UK creditor protection and Zambian creditor protection in principle which is also a legislative problem established through doctrinal analysis focusing on laws available for creditors in Zambia through a comparative approach. It addresses the second and fourth research questions and achieves the second and fourth objectives. The gap between creditor protection in principle and creditor protection in practice focuses on the actual experiences of the respondents. This gap is an implementation and enforcement problem answering the third research question and achieves the third objective. Research question five is addressed using the doctrinal analysis and it reflects on the nature of creditor protection within corporate governance company law in a developing country such as Zambia.

4.7 Methods adopted

Research methods denotes a special form of procedure employed systematically as a mode of inquiry.[756] Two methods have been used in this research; the first is doctrinal and the second is interviews. Doctrinal is used to analyse the law in both jurisdictions whereas interviews are used to understand the challenges creditors face when dealing with companies especially after defaults on loans. The doctrinal focused on analysing the legal mechanisms available for creditor protection in the UK and Zambia by evaluating its enforceability and implementation process. Interviews were conducted in Zambia. Although there is no generally accepted procedure for carrying out interviews, both Bryman and Bell[757] and Kvale[758] state that there are common guidelines or methodological conventions that need to be employed in a research interview. Below is the process taken in conducting the interviews and it is influenced by the guidelines of Bryman and Bell,[759] Braun and Clarke,[760] Kvale[761] and Saunders el.[762]

4.8 Data collection process

Kvale identified a concept of seven stages to help the interview with the interview investigation process beginning from the original ideas to the final report for purposes of providing structure and clarity throughout the process.[763] This includes thematising, designing, interview, transcribing, analysing, verifying and reporting.[764] The figure below has been created to illustrate the process.

[756] John W. Creswell, *Research Design: Qualitative, Quantitative and Mixed Methods Approaches* (3rd ed. SAGE Publications, 2009) 15
[757] Alan Bryman and Emma Bell, *Business Research Methods* (4th ed. Oxford University Press, 2015) 490
[758] Steinar Kvale, Interviews: *An Introduction to Qualitative Interviewing* (1st ed. Sage Publications, 1996) 13
[759] Alan Bryman and Emma Bell, *Business Research Methods* (4th ed. Oxford University Press, 2015)
[760] Virginia Braun & Victoria Clarke, '(Mis)conceptualising Themes, Thematic Analysis, and other Problems with Fugurd and Potts' (2016) IJSRM, 19, 739
[761] Steinar Kvale, Interviews: *An Introduction to Qualitative Interviewing* (1st ed. Sage Publications, 1996)
[762] Mark Saunders, and Othrs, *Research Methods for Business Students* (5th ed. Pearson Education, 2009)
[763] Steinar Kvale, *Interviews: An Introduction to Qualitative Interviewing* (1st ed. Sage Publications, 1996) 87
[764] Ibid

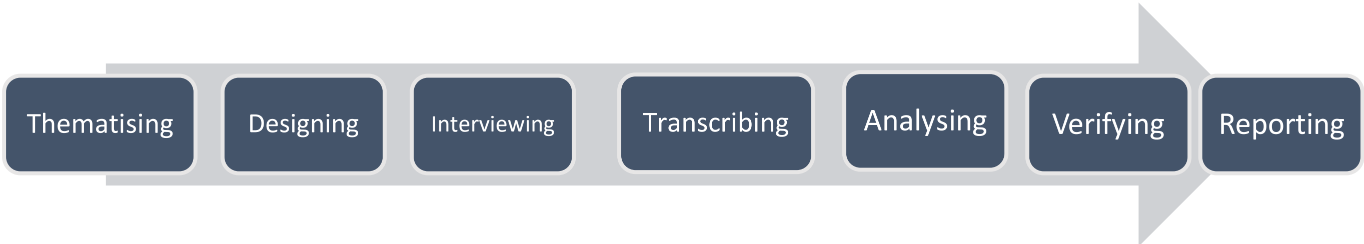

Figure 4:4 Seven stages of interviews

Source: Kvale 1996

4.8.1 Stage 1: Thematising

Thematising an interview is the first step taken by the researcher and it focuses on the exact purpose of the interview and the concept surrounding the topic to be investigated.[765] This has been established in the literature chapter where the gaps have been identified and the need for carrying out interviews. Although Zambian law is based on English Law, the framework for directors' duties, corporate governance and creditor protection is not developed both in principle and practice. If the law is inadequate, what kind of challenges do creditors face and how do they deal with them. Considering the dearth of research and the penumbral on directors' duties and responsibilities to the company and the need to improve creditor protection, the purpose of the interview is to understand the lived experiences of the respondents. To find the relevant information in line with the empirical research question, directors, creditors, and lawyers have been selected as respondents.

4.8.2 Stage 2: Designing

This involves planning procedures and techniques to be used.[766] This happens after thematising takes into consideration the type of the interview, how it should be carried out and the site.[767] This same procedure is proposed by Bryman and Bell by asserting that selection of relevant sites and subjects should be done after research questions have been developed.[768] It was established in the doctrinal approach that creditors are inadequately protected by law and this led to the decision of adopting interviews as a method. To understand from the creditor's position what kind of challenges they go through, there is need to gain access to them and interview them with the purpose of acquiring information on how they deal with their challenges. The study also looks at

[765] Steinar Kvale, *Interviews: An Introduction to Qualitative Interviewing (1st ed. Sage Publications*, 1996) 88
[766] Steinar Kvale, *Interviews: An Introduction to Qualitative Interviewing* (2nd ed. Sage Publications, 2009) 109
[767] Ibid
[768] Alan Bryman and Emma Bell, *Business Research Methods* (4th ed. Oxford University Press, 2015) 492

directors' responsibilities and legalities from lawyers. These have also been chosen as respondents each providing their own experiences. Considering the nature of the empirical question, three data sample sets namely directors, creditors and lawyers have been selected. The justification for this is that, each sample set brings a component relevant to the research aim and objectives. The directors provide their lived experiences on how they manage the company in relation to considering creditors' interests. Creditors provide information on the challenges they face in their everyday business and how they handle the risk they are exposed to, and lawyers provide information on law in practice. Figuratively this is illustrated below.

Directors	Creditors	Lawyers
• To provide practical experiences on directors' responsibilities	• To provide the challenges they face as providers of corporate finance	• To provide a practical legal perspective in relation to directors and creditors

Figure 4:5 Data sample sets

4.8.2.1 Sampling population

Located at the heart of Central Southern Africa, Zambia is a land locked country with a population of about sixteen million people as of the 2010 census.[769] In 2017, a Gross Domestic Product (GDP) of $25.81 billion dollars was estimated.[770] It is a unitary state with centralised powers and most corporate activities are finalised in Lusaka being the capital city. All banks have their head offices in Lusaka which is the reason why the data collection was done in Lusaka as the capital for economic activities. The corporate sector is relatively small with most large companies being subsidiaries of foreign companies. Although large indigenously owned companies exist like Zambeef plc, Chilanga Cement Plc, Zambia sugar Plc, most of them are Family Owned Enterprises (FOE). As a result, the financial market is relatively small with a total of twenty-four (24) listed

[769] http://www.zamstats.gov.zm/phocadownload/2010_Census/2010%20Census%20of%20Population%20National%20Analytical%20Report.pdf accessed on 02/08/2018

[770] http://www.zamstats.gov.zm/phocadownload/2010_Census/2010%20Census%20of%20Population%20National%20Analytical%20Report. Accessed 02/08/2018

companies on the Lusaka stock Exchange. Thirteen (13) of them are locally owned and the rest are subsidiaries of foreign companies. It is important to note that many large companies that are not listed, and directors serve on boards for both listed and unlisted companies. Bearing this in mind, the criterion for sampling population was neutral to the listing status. However, directors registered with the Institute of Directors qualified for interviews whether sitting on boards with unlisted or listed companies. There is no maximum or minimum number for interviews but it has been suggested that thirty to forty interviews are substantial.[771] In reconstructing subjective theories, Scheele and Groeben suggested a semi-structured interview which allows the interviewee to answer spontaneously because the questions are open.[772] The subjective theory is a term that refers to the fact that the interviewees already have a complex stock of knowledge on the subject and this includes assumptions and so it is important to ask open questions.[773] The important thing is to ensure that the sample size is adequate to provide the information required for the study in order to achieve the objectives of the study and make recommendations appropriately.[774] The use of qualitative data involves a smaller sample size because of the huge amount of information that emerge from in-depth interviews.[775]

4.8.2.2 Selection criteria

The criteria for selecting director respondents was based on the experience as board members. Even this was so, directors with vast experience were sought. The reason was to ensure that only respondents who have been vested with managing the affairs of the company are interviewed to understand exactly what is involved and how they do it. The experiences from the board is relevant to the research questions because, if a director has no board experience, the implication is that they do not have a record of experience. The creditors were selected on the criterion of being financial lenders to companies and not individuals. This does not imply that those who lend to individuals and companies could not participate but it was important that they give experiences of lending to companies because the research is limited to incorporated companies. The interview was limited to debt finance creditors only and these were identified as the banking sector. The lawyers were selected based on the field of profession and with experience of practise which means they must be licensed to practice. The legal profession is noble, and lawyers possess a vast amount of

[771] Bram Oppenheim, Questionnaire Design, *Interviewing and Attitude Measurement* (Printer Publishers 1992) 68
[772] Scheele and Groeben in Uwe Flick, *An Introduction to Qualitative Research* (3rd ed. Sage Publications, 2006) 155
[773] Uwe Flick, *An Introduction to Qualitative Research* (3rd ed. Sage Publications, 2006) 155
[774] Alan Bryman, *Social Research Methods*, (4th ed. Oxford University Press, 2012) 160
[775] Donald R. Cooper and Pamela S. Schindler, *Business Research Methods* (10th ed. McGraw-Hill Education, 2008) 165

knowledge coupled with their experience in the legal sector, they are better placed to provide information on creditor protection in the field. The criteria included both lawyers from the public and private sector.

4.8.2.3 Sampling technique

Purposive sampling is dependent on the notion of participants being essential to research questions as this identifies the units to be sampled.[776] Usually research questions inform the researcher on the subjects to be the unit of analysis for purposes of achieving research objectives.[777] Purposive sampling was used to sample participants because they are relevant to the research questions and in turn provide a variety in terms of results. There are arguably two types of purposive sampling in qualitative research which are: theoretical and snowball sampling.[778] Theoretical sampling refers to the process of collecting data with the aim of generating theory in order to develop theory from the data.[779] While the researcher is aware of this sampling technique, this research is not aimed at developing theory henceforth snowball sampling is adopted. Snowball sampling is defined as 'a sampling technique in which the researcher samples initially a small group of people relevant to the research questions and the sample participants propose other participants who may have had the experience or characteristics relevant to the research.'[780] As Saunders el states that a researcher need to select a sampling method that enables him or her to meet the objectives of the study, purposive sampling was nominated because directors, creditors and lawyers are able to answer the research questions in the study. Although the purpose of snowball sampling is to get contacts from respondents as opposed to theoretical sampling,[781] it also presents an opportunity to gain access to high profile subjects and makes it easy to create a rapport with them.

4.8.2.4 The sample sizes

Although there is no minimum or maximum number for qualitative interviews, it has been suggested that thirty to forty interviews are substantial for a research.[782] However, qualitative data involves a smaller sample size because of huge amount of information emerging from in-depth

[776] Alan Bryman and Emma Bell, *Business Research Methods* (4th ed. Oxford University Press, 2015) 428
[777] Mark Saunders, and Othrs, *Research Methods for Business Students* (6th ed. Pearson Education, 2009) 287
[778] Boris F. Blumberg and Othrs, *Business Research Methods* (4th ed. McGraw Hill Education, 2014) 193
[779] Alan Bryman and Emma Bell, *Business Research Methods* (4th ed. Oxford University Press, 2015) 431
[780] Ibid
[781] Ibid 434
[782] Bram Oppenheim, Questionnaire Design, *Interviewing and Attitude Measurement* (Printer Publishers 1992) 68

interviews.[783] Bryman and Bell[784] and Kvale[785] suggest that it is not appropriate to set the number of interviews on the onset however, the researcher could carry on interviewing until there is no much new data emerging. Theoretical saturation occurs when no new themes or concepts emerge from interviews and usually this is employed in grounded theory.

4.8.2.5 Contact with the participants

The professional bodies such as the Law Association of Zambia (LAZ) and the Institute of Directors Zambia (IODZ) were chosen points of contact more specifically the IODZ. The IODZ is mandated to promote the highest standard of ethics amongst directors, excellence in corporate governance, enhance the standard and effectiveness of directors on their legal, moral, financial and general rights and obligations in respect of their companies among other things.[786] The IODZ was the initial point of contact for ethical approval in Zambia and this was done before ethical approval was sought from the University Ethics Committee in Huddersfield. Contact through phone to the office of the President was made and the study was briefly discussed. A request for a proposal was made and it was emailed explaining the nature of the study and the purpose indicating the need for interviews and requesting access to members willing to participate in the research. An application for organisation approval was sent and it was granted. This was used for ethical approval in Huddersfield. Although the plan was to use the Institute for access to directors only, this was the initial contact to all the sample sets because some directors happened to be on boards of some banks, and others are lawyers hence the institute was the central point of contact. Through the IODZ, all respondents were contacted by phone after obtaining their contact information and appointments to their offices, homes and other meeting places were arranged for those who were willing to take part in the research. To illustrate this, the figure below indicates first point of contact and how access was gained.

[783] Donald R. Cooper and Pamela S. Schindler, *Business Research Methods* (10th ed. McGraw-Hill Education, 2008) 165
[784] Alan Bryman and Emma Bell, *Business Research Methods* (4th ed. Oxford University Press, 2015) 437
[785] Steinar Kvale, *Interviews: An Introduction to Qualitative Interviewing* (2nd ed. Sage Publications, 2009) 109
[786] http://www.iod.co.zm/about-iod/

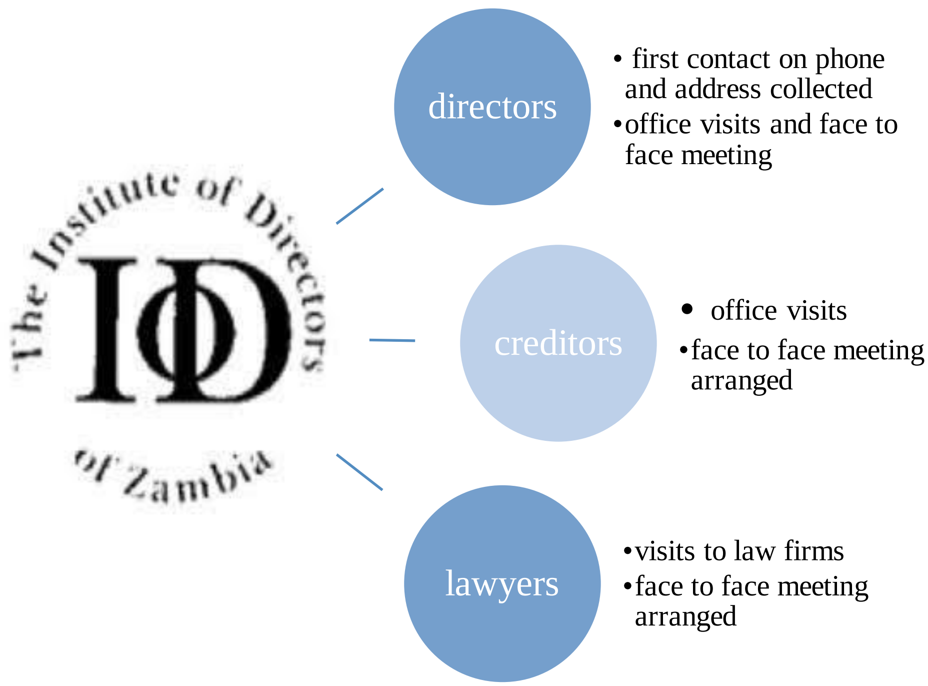

Figure 4:6 Initial point of contact with respondents

The figure above indicates the process taken in accessing contact with the participants. The starting point was the institute of directors and then from there, contacts to other participants were made.

4.8.2.6 Ethical considerations

Consent was sought from all the respondents before the interviews. All the respondents were informed of the objective of the study and why they were approached for the interviews. They were informed that participation was voluntary and at any time during the interview they were free to withdraw their consent. Respondents were informed of confidentiality of the interview, their anonymity and secure storage of data. The interview researcher has to possess the practical skills of understanding the powers and vulnerabilities that come into play when adopting interviews as a data collection technique.[787] Kvale stated that the knowledge obtained from interviews affects the way one understands human conditions and consequently interview research is saturated with ethical issues which seek to preserve privacy of the participants.[788] Interviews are confidential unless the participant wishes otherwise and consent is sought and granted.[789] The interviewer must

[787] Steinar Kvale and Svend Brinkmann, *Interviews: Learning the Craft of Qualitative Research Interviewing* (2nd ed. Sage Publications, 2009) 61

[788] Ibid

[789] Bram Oppenheim, *Questionnaire Design, Interviewing and Attitude Measurement* (Printer Publishers 1992) 71; Steinar Kvale and Svend Brinkmann, *Interviews: Learning the Craft of Qualitative Research Interviewing* (2nd ed. Sage Publications, 2009) 110

ensure that he or she seeks the consent of the participants and avail them with enough information concerning the interview and assure them of the confidentiality and their right to withdraw.[790] Owing to the ethical considerations, this study is guided by the ethical requirements under the standards and regulations of the University of Huddersfield Ethical Code. Ethical approval for the study was granted by the University of Huddersfield and the University of Zambia. While in the field, some of the creditors felt venerable to be recorded and requested that notes be taken instead. The researcher made them understand the confidentiality of the interview again and made them understand anonymity was guaranteed to make them comfortable even if notes were taken. The reason this was done was to create a rapport of trust to ensure they are comfortable and that they do not withhold information during the interview.

4.8.3 Stage 3: Interviewing

An interview has been defined as 'a face-to-face verbal exchange, in which one person, the interviewer, attempts to elicit information or expressions of opinion or belief from another person or persons'[791] Kvale created miner metaphor kind of interviews which means understanding one kind of thing from another while highlighting new aspects.[792] In the miner metaphor, knowledge is understood as buried metal and the interviewer is a miner who unearths the valuable metal from the interviewee's pure and unpolluted experiences.[793] Semi-structured interviews were conducted in Lusaka. An interview guide with themes guiding the interview questions was used as Saunders el suggested that in semi-structured interviews the researcher has themes and crucial questions to be covered, although their use may vary from interview to interview.[794] The purpose of the guide was to ensure that questions about the main concepts of the research question were asked during probes. The researcher detached her personal understanding to allow knowledge from the respondent's point of view and this was done by ensuring that the questions were clear, and the respondent understood them. A total of forty-four face to face interviews were conducted from the 15th October to 12th of December 2017. Twenty interviews with directors, seventeen creditors and

[790] Bram Oppenheim, *Questionnaire Design, Interviewing and Attitude Measurement* (Printer Publishers 1992) 71; Mark Saunders, and Othrs, *Research Methods for Business Students* (6th ed. Pearson Education, 2009) 287
[791] Norman K. Denzin and Yvonna S. Lincoln, *The Sage Handbook of Qualitative Research* (5th ed. Sage Publications, 2018) 1000
[792] Steinar Kvale, *Interviews: An Introduction to Qualitative Interviewing* (Sage Publications, 2009) 3
[793] Steinar Kvale and Svend Brinkmann, *Interviews: Learning the Craft of Qualitative Research Interviewing* (2nd ed. Sage Publications, 2009) 48
[794] Mark Saunders, and Othrs, *Research Methods for Business Students* (6th ed. Pearson Education, 2009) 287

seven with lawyers. An interview journal was kept, and reflections of the entire process was recorded by the researcher. The interviews lasted an average of one hour and ten minutes, and for the creditors about one to two hours. Most of the interviews were conducted from their offices and those who did not want to use the offices arranged to be interviewed from their homes and others chose different places such as a cafe. Below is the process for each of the data sample sets.

4.8.3.1 Interviews with directors

A list of 57 directors was given by the IODZ and contact was initiated which led the researcher from one respondent to another. Note that this number does not reflect the total number of registered directors, but the institute issued a list based on experienced directors who are cognisant to the issues of corporate governance in Zambia. Some had contact numbers and others had none, so the researcher embarked initiating contact through calls and visitations to their offices to create personal contact and create a rapport with them. This involved personal introduction and production of all relevant documents such as introductory letter and ethical approval from the university. During the first meetings, the researcher explained the nature of the research, the aim and objectives and other matters relating to research in Zambia generally. Thereafter those who were willing to participate provided their prospective free dates and those who were not willing instead of stating categorically that they were not interested, they rather gave appointments and rescheduled them and later cancelled them.

Although a list of names was issued from the Institute, being towards the fiscal year ending which is December 31st, it was very challenging to get appointments for the interviews as their schedules were full and others just didn't want to participate. However, perseverance played its part and interviews were conducted beginning 26th October 2017 to 12th December 2017. At the end of every interview, respondents were requested for contacts and sometimes they suggested other contacts before a request was made. Prominent names emerged from the process as these people are viewed as prominent players in issues of governance. To the advantage of the researcher, names of lawyers and creditors came up and this helped the researcher create contact with other participants.

4.8.3.2 Interviews with creditors

The providers of finance to companies in Zambia are mainly banks although there are a number of micro finance institutions that lend to companies with limited liability. Zambia has a total of nineteen registered banks with thirteen being subsidiaries of foreign banks and seven of them are locally owned. Only the headquarter offices were used for interviews because every bank approached, the researcher was sent to the head offices. Apart from the contacts given by the respondents from the category of directors, all the remaining banks were contacted for the interviews by personal visitations to their offices. Thirteen banks responded positively and two were financial institutions. The remaining six banks didn't want to participate. The reason for the refusal to participate was that bank policy did not allow them to have interviews although this was not stated immediately after being approached but it was communicated as a matter of feedback after promising to help. Perhaps it was fear of giving away the banks because two out of the six banks participated in the interviews through the help of a respondent director. Some of the respondents refused to be recorded as a matter of bank policy and so, notes were taken, and this dragged the interviews to last longer than expected with an average time of one to two hours.

4.8.3.3 Interviews with Lawyers

Access to the lawyers was easy as they were identified from director respondents and contacts were given. Contact was initiated and interviews were arranged and conducted. As the number was less, there were no challenges recorded with these respondents.

4.8.4 Stage 4: Transcribing

Transcribing is a process of transforming data from one form usually audio to a written format.[795] Kvale and Brinkmann stated that the process of transcribing although mostly done by secretaries or other people, it has no standard rules of how it should be done whether verbatim or selective transcription however, one basic rule is that it must be clearly stated how the researcher went about to do this process.[796] Despite the availability of transcribing software, the researcher embarked on transcribing the data personally in order to be familiar with the data. At the stage of transcribing data, several critical decisions were made by the researcher on the approach to take whether verbatim or selective transcription. In thematic analysis sampling procedure also include decisions

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[795] Steiner Kvale and Svend Brinkmann, *Interviews: learning the Craft of Qualitative Research Interviewing* (2nd ed. SAGE Publications, 2009) 203
[796] Ibid 180

on whether words such as emotional expressions such as laughter or sighing must be included in the transcripts and if so how much of this kind of texts should be included but this depends on the choices of the researcher.[797] The data was transcribed verbatim word for word even though not everything is useful for the study. however, in certain cases where the pauses or the sighing affected the meaning of what the respondent was saying, such words were deleted for better construction of the sentences. This is because the study addresses the challenges faced by creditors and so searching meaning in the text is important and unlike a linguistic approach. Literature has indicated arguments for verbatim and non-verbatim transcription highlighting the uncertainty with non-verbatim transcription in that the researcher would not know how to achieve selective transcription as this would impact on the reliability, validity and veracity of the data.[798] Some authors have suggested that on average the process of verbatim transcription requires at least a minimum of 6-7 hours of time for an hour interview,[799] it took the researcher approximately 10 to 11 hours to transcribe one interview bringing the transcripts to an average of 9 - 12 pages of transcribed text. 153 pages for creditors' transcripts, 180 for directors and 76 for lawyers. The recorded data was stored on a recording device and after field work it was transferred to the researcher's personal laptop secured with a password which only the researcher had access to and the field note diary was kept safely in the researchers' possession in a safe place to ensure confidentiality.

4.8.5 Stage 5: Analysing (data analysis)

The data collected was analysed using thematic analysis on NVivo software and later the analysis continued manually. Careful consideration on analysis tools was given to ensure they are correct.[800] This helped to manage, organise, query and report data.[801] This process enables segmentation of information in the transcript then developed into codes thereby generating patterns or themes.[802] The process of analysing adopts the use of the Computer Assisted Qualitative Data Analysis Software (CAQDAS) known as NVivo. It is best known for coding and retrieving of text and organises them segmentally on the computer by replacing the manual coding and photocopying of

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[797] Steiner Kvale and Svend Brinkmann, *Interviews: learning the Craft of Qualitative Research Interviewing* (2nd ed. SAGE Publications, 2009) 203
[798] Elizabeth J. Halcomb and Patricia M. Davidson, 'Is verbatim Transcription of Interview Data always Necessary?' (2006) JANR, 19, 38
[799] Ibid
[800] Alan Bryman and Emma Bell, *Business Research Methods* (4th ed. Oxford University Press, 2015) 430
[801] Pat Bazeley and Kristi Jackson, *Qualitative Data Analysis with NVivo* (2nd ed. SAGE Publications, 2013) 3
[802] Steinar Kvale and Svend Brinkmann, *Interviews: Learning the Craft of Qualitative Research Interviewing* (2nd ed. Sage Publications, 2009) 109

transcripts.[803] However, the process of coding on the computer is usually a complicated process and it has been advised that the first steps should be learnt on how to code manually on paper before the software can be used.[804] Firstly the researcher read through the transcripts for better understanding of the data before coding as suggested by Bryman and Bell.[805] This revealed the broader concepts that were emerging during the interviews in the field. This process was argued to be important as it gives an understanding and an awareness of the interesting and significant information embedded in the data.[806] Qualitative research has several different approaches in terms of data analysis. These include analytic induction, grounded theory, thematic analysis, narrative analysis, secondary analysis and synthesising qualitative studies.[807] After a review of all the above approaches, thematic analysis was adopted for this research because of the nature of the research questions and need to search for themes emerging from the data collected. Although Bryman argues that this type of analysis does not have a cluster of techniques as those in grounded theory, the research adopts the six step by step procedure that was designed by Flick.[808] Bryman defined a theme as a category identified by the analyst from the data and it relates to the research focus and questions that build on codes identified in transcripts, or field notes that provide the basis for theoretical understanding that can make a theoretical contribution to the literature of the research.[809] Flick emphasises on the importance of knowing what a theme is because it is vital to know what it represents in thematic analysis.[810] Themes are developed at an early stage of analysis and conceptualised through coding which is the evidence of process taken to identify them.[811] In order to have more clarity on the procedure taken for thematic analysis, Braun and Clarke laid down six steps and these have been adopted in this research. This process is represented figuratively below.

[803] Allan Bryman and Emma Bell, *Business Research Methods* (4th ed. Oxford University Press, 2015) 606
[804] Johnny Saldana, *The Coding Manual for Qualitative Researchers* (3rd ed. SAGE Publications, 2016) 2
[805] Allan Bryman and Emma Bell, *Business Research Methods* (4th ed. Oxford University Press, 2015) 609
[806] Ann Lewins and Christina Silver, *Using Software in Qualitative Research A Step-by-Step Guide* (SAGE Publications, 2007) 11
[807] Alan Bryman, *Social Research Methods* (5th ed. Oxford University Press, 2016) 569
[808] Uwe Flick, *An Introduction to Qualitative Research* (5th ed. SAGE Publications, 2014) 421
[809] Alan Bryman, *Social Research Methods* (5th ed. Oxford University Press, 2016) 584
[810] Virginia Braun & Victoria Clarke, '(Mis)conceptualising Themes, Thematic Analysis, and other Problems with Fugurd and Potts' (2016) IJSRM, 19, 739
[811] Ibid

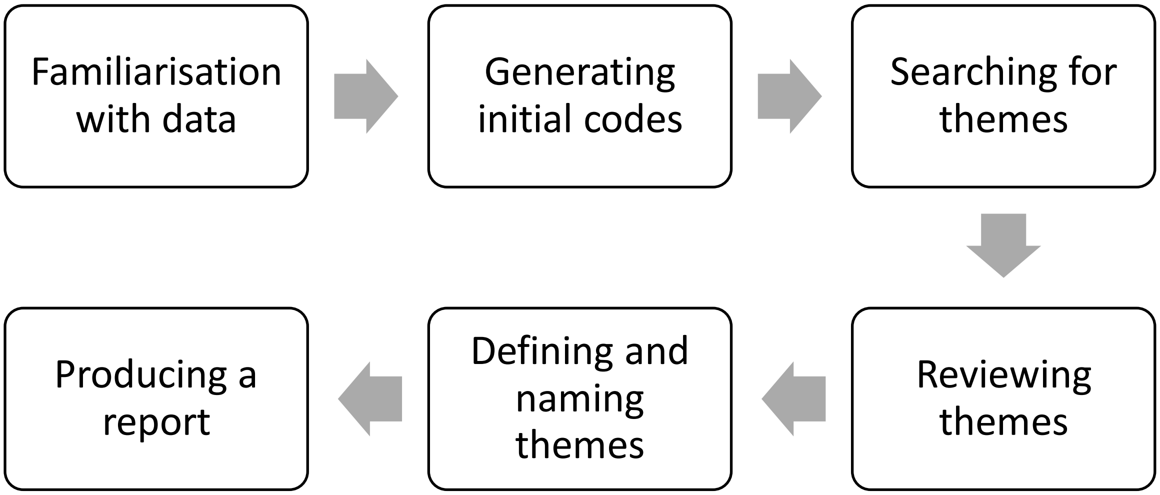

Figure 4:7 Cluster of techniques for thematic analysis

Source: Braun and Clarke 2006

This step involves the progression from the time of the interviews to the transcription process namely, the time data was recorded, stored, and later transcribed from an audio version to text. A copy of the recorded interviews was stored on the secure University K drive for a backup copy and it is password protected and only the researcher has the password. All the transcribed interviews were coded to remove any identifying information and ensure anonymity. An illustration of this process can be summed up below from the time of field work to return from field country. A figurative process is indicated below.

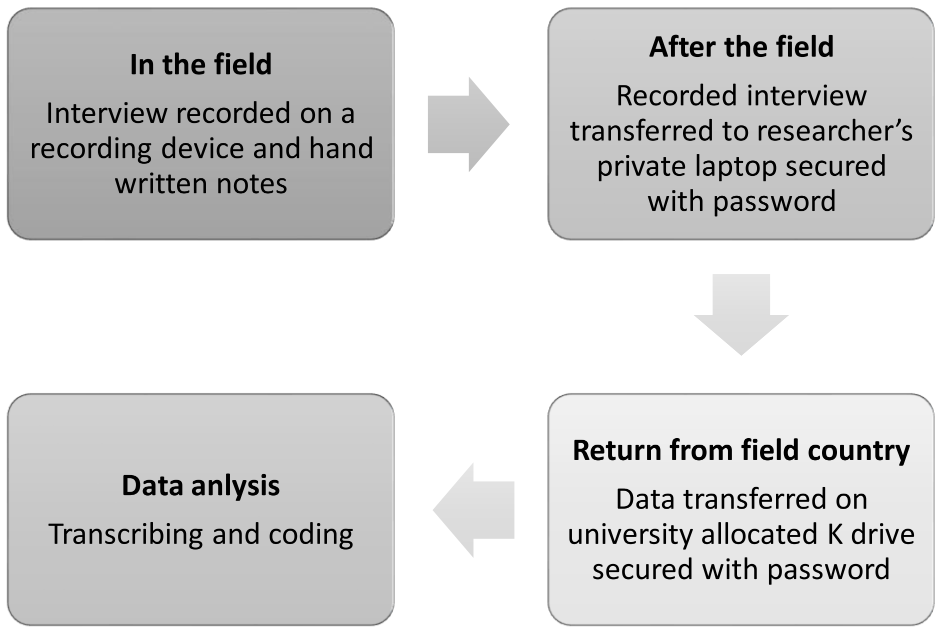

Figure 4:8 Process of data storage from field work to Coding

The entire process of transcribing made the researcher to familiarise herself more with the data while preparing for coding on NVivo. The interview transcripts were read at least twice against the audio to ensure accuracy and this was also validated by the supervisors to ensure reliability of transcripts. The transcripts were then imported on the NVivo software for coding. This led to the second stage of the analysis process which is the generation of initial codes. Coding has been defined as the key process in which nodes are created and this takes different forms depending on the type of analysis the researcher employs.[812] Kvale and Brinkmann described coding as the process of attaching words to a segment of text in order to allow identification of a statement.[813] Coding is a very important process of breaking down, examining, comparing, categorising and conceptualising data when using thematic analysis.[814] A code is an abstract representation of an object which helps in the organisation of the data.[815] Before the coding process started, the researcher read through the transcripts at least more than once to understand the data. NVivo is

[812] Allan Bryman and Emma Bell, *Business Research Methods* (4th ed. Oxford University Press, 2015) 609; Allan Bryman and Emma Bell, *Business Research Methods* (4th ed. Oxford University Press, 2015) 599
[813] Steiner Kvale and Svend Brinkmann, *Interviews: learning the Craft of Qualitative Research Interviewing* (2nd ed. SAGE Publications, 2009) 203
[814] Ibid
[815] Pat Bazeley & Kristi Jackson, Qualitative Data Analysis with NVivo (2nd ed. SAGE Publications, 2013

equipped with a tool for automatic coding but manual coding was used on the software to allow an understanding of the codes to know what kind of information is coded in each node. Unlike the approach taken in discourse, content, and grounded theory where initial coding starts with a detailed analysis, coding in thematic analysis starts with a general category. The nature of this study involved three different data sample sets namely creditors, directors and lawyers which meant that different NVivo projects had be opened for each data sample set because the software is not equipped to open different node files. So, to avoid mixing up data, every analysis was done on a different project starting with creditors, directors, and lawyers but all adopting the same techniques. The first broad coding was conducted with very general categories of nodes which then required the search for themes. Searching for themes requires 5 steps namely discovering the themes and sub themes, describing the core and peripheral elements of themes, building hierarchies of themes, applying themes to chunks of text and linking themes to theoretical models.[816] Russell et al identified two kinds of themes namely priori themes which comes from the phenomenon which is already known usually from literature, constructs or theoretical values or personal experiences whereas induced themes emerge from the data.[817] Induced themes was the focus of the search to see what was emerging from the transcripts. This process is referred to as open coding in grounded theory and qualitative analysis in content analysis or latent coding.[818] This involves several techniques and some of them were adopted in this study. These techniques include searching for repetitions, indigenous typologies or categories, metaphors, transitions, similarities, and differences.[819] The search for themes was done using three steps of coding. First degree coding was done, then followed by the second degree and finally the third degree which resulted into several broad themes. First degree coding was searching for repetitions and these are words or phrases that were used repeatedly by respondents during the interview. During this stage, the codes are broad and generic. It is just a process that gives an understanding of how the ideas look like in the data. The second-degree coding was done to find categories and make more sense or find understanding to the emerging themes. This process involves the extraction of nodes into categories and involves looking for familiar words that were used in an unfamiliar way. This

[816] H. Russell Bernard and Others, *Analysing Qualitative Data: Systematic Approaches* (2nd ed. SAGE Publications, 2017) 103
[817] Ibid 104
[818] Ibid
[819] Ibid 105

method of finding themes is known as in vivo coding in grounded theory.[820] (A copy exported nodes after first degree coding from NVivo is attached as appendix 1) For example one of the respondents said that: 'In Zambia you know (tatubwesha empiya shabene) - Speaks in vernacular that (we don't pay back other people's money). Anyways that is what we do here.' (C3) The above phrase is unfamiliar but has meaning in relation to the bad credit culture that exists in Zambia. This kind of theme searching happened during the second-degree coding and third, the last stage of coding involved searching for metaphors and analogies as was suggested by Russell et al[821] which involves participants using analogies or experiences to represent their thoughts. The other way of searching for themes is in the pauses in the speech and transitioning into a new topic. This was done as the last degree of coding and broader themes were coded. After the search for themes, a review of the identified themes was done. The process of reviewing themes involved breaking down the identified themes into subthemes and refining them. At this stage, the relevant themes were saved. The naming of subthemes was guided by the degrees of their strength in similar themes as was suggested by Flick.[822] After this process, the coded themes were then redefined and named. This led to the fifth stage of extracting data as well as focusing on the whole dataset by redefining the codes to thematic mapping and visual representation of the data.

This was more focused on combining the categories of codes into themes and dwelling on what they represent in the data before a final visual representation of the procedure is given. Bryman suggested that at this stage, the researcher must consider whether there are any links in the concepts and relation in sequence.[823]

4.8.6 Stage 6: Verifying

'In semi-structured and in-depth interviews a high level of validity may be achieved where these are conducted carefully due to the scope to clarify questions, to probe meanings and to be able to explore responses and themes from a variety of angles.'[824] While Bryman and Bell state that validity in qualitative research is made up of trustworthiness and consists of four criterion namely; credibility, transferability, dependability and confirmability,[825] Kvale provides for the same

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[820] Ibid 105
[821] Ibid 106
[822] Uwe Flick, *An Introduction to Qualitative Research* (5th ed. SAGE Publications, 2014) 421
[823] Alan Bryman, *Social Research Methods* (5th ed. Oxford University Press, 2016) 588
[824] Alan Bryman and Emma Bell, *Business Research Methods* (4th ed. Oxford University Press, 2015) 399
[825] Ibid. 400

concepts, and adds that to validate is to question the investigation if it does investigate what it seeks to investigate, and not only is it about the methodological approach but also to validate the theory.[826] Credibility involves submitting the findings of the research to the participants seeking confirmation that the researcher has understood the social world and it has been carried according to the cannons of good practice.[827] This research was undertaken with good practice and credibility was achieved by member validation, or respondent validation during the interview whereby the respondents were given an account or conversation of what the respondent said. Also, the pre-interview questionnaire (appendix 4) had an option for participants to indicate if they wished to know the general findings and a few that did so were notified.

Transferability entails the production of a thick detailed account or description of the details.[828] In this research this was provided by ensuring that analysis of findings is carried out separately according to the sample sets so as to understand what each set was talking about and then making judgements about conceivable transferability of the findings. Some matters that were raised by creditors such as the incompetency of directors were also raised by both directors and lawyers too. Dependability requires that the researcher keeps as an audit process all the relevant records relating to the process from the selection of participants to data analysis. This has been achieved by the researcher as all the relevant documents have been attached. The participant consent form (appendix 5), organisation consent form (appendix 6), interview questions for creditors (appendix 7), directors (appendix 8), and lawyers (appendix 9), sample transcripts from each category of the respondents (appendix 10), interview reference sheet (appendix 11) and some codebooks from NVivo. Confirmability entails the capabilities of the researcher not to overly allow personal values to sway or influence the conduct of the research and findings. Woods et al argued that reflexivity is not about totally avoiding self-bias because all qualitative research is situationally embedded and therefore the emphasis is on the researcher being aware of their personal views, and what they bring to the researcher but distancing themselves from such influencing the research.[829] If software such as NVivo is used, reflexivity includes an awareness of the impact of the software on

[826] Steinar Kvale and Svend Brinkmann, *Interviews: Learning the Craft of Qualitative Research Interviewing* (2nd ed. Sage Publications, 2009) 253
[827] Alan Bryman and Emma Bell, *Business Research Methods* (4th ed. Oxford University Press, 2015) 401
[828] Ibid p. 402
[829] Megan Woods, Rob Macklin & Gemma K. Lewis, 'Researcher Reflexivity: Exploring the Impacts of CAQDAS Use' (2016) IJSRM, 19, 384

judgments and actions, including the ways in which it structures qualitative research practice, and the phenomena their architecture might conceal, disclose or prefigure.[830] The researcher was aware and understands the dangers of self-bias. To supplement this awareness, several recordings and transcribed interviews were sent to the supervisory team for verification. Also, the documents retrieved from the software during coding have been attached in the list of appendices.

4.8.7 Step 7: Producing a report (Findings)

In the final stage is the results of the procedure presented as a write up to show a compelling narrative of the data and tying the themes to the research questions and literature. This includes a justification of why the themes are important and how they relate to the literature. This is a discussion of the findings, and what they represent in connection to research questions, and the objectives. This indicates how the empirical question has been answered and how it is linked to the doctrinal analysis. This part is represented in chapters six and seven containing discussion of empirical findings and conclusions.

4.9 Conclusion

In conclusion, this Chapter has achieved the objective of explaining the methods taken in conducting the research. This focused on how the research questions been answered including the steps taken in the process of data collection all through to data analysis. The overall methodology is social-legal which combines the doctrinal approach and qualitative empirical approach from the social sciences. The interdisciplinary method adopted offsets the weaknesses of using one approach thereby providing rigour to the analysis. This adopted a comparative research design which systematically integrated the components of the study in a coherent and logical manner in order to achieve the aim and objectives.[831] It is a suitable design as it has compared the law in both jurisdictions and analysed its implementation and enforcement measures using the doctrinal and empirical approaches respectively. While both the UK and Zambian frameworks have been analysed using the doctrinal approach, the empirical approach on the Zambian part adds further understanding into the practical challenges faced by creditors. The empirical analysis follows in the subsequent chapter.

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[830] Ibid

[831] Alan Bryman and Emma Bell, *Business research Methods* (4th ed. Oxford University Press, 2015) p.73

CHAPTER 5: **Empirical Findings**

5.1 **Introduction**

The purpose of this chapter is to analyse the findings from interviews. Where it is necessary, quotations are used for emphasis as suggested by Strauss.[832] The findings are presented categorically for clear illustration and understanding as suggested by Castleberrya and Nolenb.[833] The nodes or codes were put into sub-themes thereby generating patterns or themes.[834] This process is important in thematic analysis because it involves identifying, analysing and reporting themes emerging from data.[835] A theme is a category identified by the analyst from the data and it relates to the research focus and questions that build codes identified in the transcripts.[836] Themes are developed at an early stage of analysis and conceptualised through coding which is the evidence of process taken to identify them.[837] The main themes from each group are numbered starting with the initial from the data set. This mean that creditors' main themes are numbered as C1, directors as D1 and lawyers as L1 and subsequently their respective sub-themes follow suite.

5.2 **Creditors**

A total of four main themes emerged from sub-themes. The main themes are bad credit culture, pitfalls within the law, problems with management of the firm and the undue influence of politics.

5.2.1. Theme C1. Bad credit culture

The study found evidence of a bad credit culture or practice caused by irregularities when obtaining loans. Most of the respondents used the phrase bad credit culture which led to the naming of the theme. The economic sector in Zambia largely depends on the availability of liquidity from the financial institutions to sustain businesses.[838] While this is good for business activities, it was found that some shareholders want to sustain their lavish lifestyles by getting loans through the company because they have the influence to acquire loans using the company. They end up using

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832 Anselm L. Strauss, Qualitative Analysis for Social Scientists (Cambridge University Press, 1987) p. 217

833 Ashley Castleberrya and Amanda Nolenb, 'Thematic analysis of qualitative research data: Is it as easy as it sounds?' (2018) CPTL, 10, 807

834 Steinar Kvale and Svend Brinkmann, *Interviews: Learning the Craft of Qualitative Research Interviewing* (2nd ed. Sage Publications, 2009) 109

835 Virginia Braun & Victoria Clarke, 'Using Thematic Analysis in Psychology' (2006) QRP, 3, 77

836 Alan Bryman, *Social Research Methods* (5th ed. Oxford University Press, 2016) 584

837 Ibid

838 Samuel Munzele Maimbo, 'Explaining Bank Regulatory Failure in Zambia' (2002) JID, 14 (1), 229-248 Akalemwa wa Mubiana ni Munalula Ngenda, Registration and Ranking of Company Charges in Zambia (2009) JAL, 53(2), 276-288

the money on other things unlike implementation of business projects that brings a return on the investment in the company. This diversion of the loan usually under the control of directors then brings about consequences because the loan has to be paid back and sometimes there is no money to be used for loan repayments then the company defaults. Although the loan was obtained on the premise of business investment, evidence shows that in companies were shareholders have control on the board, there is a likelihood of mismanagement of finances. And because of the financial mismanagement, the company is likely to default on the loan. When the company defaults or is in financial stress and directors know that they will not be able to meet their obligations, they do not engage creditors on time. As a result, creditors rely on external information to know that the company is in financial distress and this sometimes takes away the time for any arrangements because usually it occurs after defaults have been registered. For instance, it was said that:

> '[T]he credit culture in the country is very bad… What I mean is that unless you are different if you lend people money, as an individual, even if its 3 thousand dollars and I make 4 thousand dollars, I am not going to give you the 3 thousand dollars. To remain with a one thousand dollars? No I won't.' (C1)

The first problem revealed is financial mismanagement and the second one is the lack of transparency and integrity on the part of directors. The former was exhibited through the effect of shareholders having so much control in the company such that, it leads them to making bad decisions for the company because of the dishonest behaviour. The diversion of money belonging to the company is unethical and directors ought to ensure that this does not happen because it is not in the best interest of the company. However, the authority of the shareholders in company affairs is endorsed by the court henceforth matters of dishonesty on shareholders are challenging. This illustrate how easy companies default because they do not feel obligated to repay. They would rather default and let the creditor sell the security but sometimes the security does not realise the principal amount including interest. Security only reduces the risk but does not take it away as creditors established that the reason, they collect it, is not to sell but to mitigate against risks of loss. To add to this is the loss of business growth over the extended period of the facility had there not been any default. The problem of transparency and lack of integrity on directors is evident in the obligation under common law to consider creditors interests when the company is financially troubled. However, it was found that even when directors are aware that company funds were diverted and mismanaged which then implicates the repaying of the loan, engaging creditors does not seem their first option. They wait until it is too late such that the company is going into insolvency and a liquidator needs to be brought in. This attitude problem on directors has become a norm because there is no accountability for their actions. They behave dishonestly because apart from losing security, they know that there will not be repercussions. This behaviour was linked to lack of ethics in the way business is conducted by C7 who insisted that this is where the honesty of people should come into play in the corporate sector especially when it comes to meeting obligations of a company.

While referring to dishonest behaviour in Zambia another respondent attributed this problem to local business failures compared to foreign businesses that have presence in Zambia and C3 appeared to support this view by mentioning that most people who are doing business are not trustworthy. This has been seen in the number of businesses doing well on the market, which are mostly subsidiaries of foreign companies. C3 said that almost 90% of the economy or the businesses that are doing well are not owned by Zambians. This business failure was attributed to lack of ethics which was discussed further off the record. This is because, after an interview during the data collection process, respondents would chat about the research. These conversations formed part of field notes as some went into discussing the trends such as the problem of local businesses, and why they fail to compete with the subsidiaries of foreign companies because of the irregularities, dishonesty, and selfishness of the owners. Most of them alluded to this problem to the tight shareholding of the company such that one person makes all decisions.

5.2.1.1 Sub-theme C1.1: Inadequate disclosure

Credit facilities involve a strict procedure in terms of application stages. This is policy followed by most creditors to assess applicants' capacity of paying back the loan. This included relationships with other creditors and the gearing position of the company. While financial performance of the company is put under scrutiny, banks want to see how applicants have serviced their debts with other financiers in the past. Some of them involve the services of the Credit Reference Bureau (CRB) where defaulters are occasionally registered as bad debtors for purposes of protecting other creditors. This is how they do the 'Know Your Customers' (KYCs) as recommended by the Central Bank. However, it was found that reliance on the CRB by banks has received controversial perceptions from both companies and the courts. Applicants opt to conceal vital information which could hinder them from obtaining the facility if otherwise rendered. Although it is dependent on the bank to either grant or deny the loan, perhaps the law could require more disclosures through accurate financial reporting regularly which can be easily accessed by creditors. The debate for more information is not for purposes of denying the applicant a loan but it guides creditors to make an informed decision. This could relate to the amount of the loan and how they can help such a customer on the payment methods because the risk is known to creditors. The amount of disclosure has an important role to play however, this inadequacy has affected creditors because up until default, a lot of information that affects foreclosure comes to light. This comes too late because the disposal of security is then affected, and creditors could be losing their money in the process.

5.2.1.2 Sub-theme C1.2: Collateral defects

There was evidence of challenges during foreclosure because of collateral defects. Creditors take collateral in form of equity, debentures, or property. However, only a few creditors were found to be taking equity as security while most of them take landed property and create debentures. Recently creditors have started collecting movables as collateral after the introduction of the Movable Property (Security Interest) Act in 2016 which was spearheaded by the Bank of Zambia (BOZ). The meaning of Movable property includes goods, intangibles, securities, money, negotiable instruments, and negotiable documents.[839] The use of movables is not yet common because many banks desire landed property even though it consumes time during disposal. Besides high timely costs in landed property collateral, dishonesty behaviour was exhibited in form of fake ownership, over valuation and registration of interests. Sometimes the property has more than one registered interest. In such cases, the second creditor is arguably unsecured to an extent, except the property fetches enough money to cover them both. Owing to this, creditors are not interested in selling the security but promote business sustainability by ensuring the company honours the facility. This is in the interest of both the creditor and the company because when the company honours its obligations, it strengthens the corporate relationship and supports future business activities. It was expressed that:

> '[….] usually we require that the principal be paid and interest because selling of the collateral is not the primary part of this business. The primary thing we need is the principal sum and interest to be paid back in that way the business will be healthy and running well.' (C6)

It is the obligation of creditors to ensure the collateral has no defects and in case of defaults, it can be disposed of within a reasonable time. While this is true, attention is to be given to the costs of

[839] Section 3, Movable Property (Security Interest) Act, 2016

ensuring that collateral is clean. This is because the amount of money the bank uses in ensuring that the appraisal is complete, is added to the facility. Sometimes the costs of ensuring that collateral is clean is added to the interest rate. The implication is that this increases the cost of lending. High cost lending is a risk because customers can leave in search of lower rates. These have contributed to the increasing number of nonperforming loans. In 2015 the Central bank removed the cap on the interest rates to allow commercial banks and other financial institutions to compete fairly and all service charges and interest rates to be fully explained to customers.[840] This is to allow full disclosure to the customer for an informed decision. While collateral has been associated with problems in relation to cleanliness, the other challenge is the dishonest valuations of property. This was illustrated in many examples where clients would put up property for security and on many occasions, the prices are exaggerated for purposes of the facility. This problem lacks regulation because there is no statute or policy concerning these valuations. It was said that:

> '[…] in most cases we ask for landed property both commercial and residential in which case we get a lot of problems with applicants giving a lot of fake property or maybe the property is overvalued.' (C2)

Although the onus is on the bank, these evaluations are carried out by qualified valuators except there is no law regulating how they are conducted. Respondents expressed concern in this regard because this adds to the service charges for the facility at the same time it leads to loss because during foreclosure, the property attracts less money than was valued, hence the need for regulation.

5.2.2 Theme C2. Pitfalls within the law

Respondents were dissatisfied with the measures of the law especially on the management of the company by directors. Five sub-themes emerged. The first problem is the late legal involvement which delays restructuring, the second problem is implications of changing the line of business, the third problem is reliance on court orders, the fourth is lack of regulation for government contractors and the fifth problem, is regulation of interest rates and forex.

5.2.2.1 Sub-theme C2.1: Late legal involvement

It was established that identifying the distressed period is challenging either because directors are not aware that the company is troubled financially but more often, they don't engage creditors on time. It was found that by the time creditors are aware of the financial distress, things are bad and recovery measures must start to salvage the loan. This is because directors have been said to be

[840] Circular No. 19/2015, Bank of Zambia

incompetent. The failure of management to notify directors of the financial situation has more to say on governance by directors than managers in the sense that directors ought to be aware of what is going on in the company. They are trustees and stewards of the company and it is their duty to manage the business in the best interest of the company. Creditors said that once a default occurs, then it is a bad debt and they lose out on the interests and this affects the business because in cases where litigation is involved then issues of legal costs and time come into play as well as uncertainties. It was stated that:

> […] they should be able to call for a meeting with us say guys look this is what is happening financially the company is struggling. What do we do or how can you help us? If there is still some decent finances or assets left, we enter into a moratorium and agree on what to do next when we all have a chance of surviving, but this is problematic because they don't come. You have to chase them up all the time. (C.7)

Respondents indicated that the legal department is the last resort and usually they only come in when the company has defaulted, and all manner of dialogue has been attempted usually demand letters are sent for the money to be paid. C12 said that usually the legal department is the last resort when they are fully secured, and the client has not been very cooperative. So, the legal department then comes in, to take the matter to court. Whereas it is the last resort for creditors, they also indicated that they try to avoid dragging clients to court because this has a possibility of damaging their reputation. As creditors reputational risk is one of the things that they want to keep clean for purposes of maintaining confidence from their customers.

5.2.2.2 Sub-theme C2.2: Implications of changing the line of business

The study found that one of the preconditions to a loan application is the purpose of the loan. This is a standard procedure or bank policy. This requirement appears simple yet a key requirement for creditors because of the risks involved in the industry and how these risks are set out to be managed by the company and most importantly by creditors in case of default. Examples are market risks, foreign exchange risk, industry risks and reputational risks. Once the creditor has assessed the risk regarding the loan application and it grants it, the problem comes in when the business of the company changes. Two aspects are involved in this theme legalities on the nature of business and management of risk associated with the line of business. The aspect of legalities is twofold: one deals with the lawfulness of the business to be funded and the second one deals with the fraud and misrepresentation that comes with changing the line of business. This is because creditors are legally prohibited from funding illegal projects and the company is also prohibited from any unlawful business.[841] This is simple yet becomes a problem after the company changes business because the law has no parameters of prohibiting a change of business. The company is by law allowed to change the line of business at any time without any requirement to inform existing creditors. The existing creditors did evaluate the risk at the time the debt was obtained. This means that the change of business without the knowledge of creditors can be argued to be tantamount to fraud and misrepresentation. Creditors were concerned that if companies are allowed to change businesses anytime, it poses a challenge on them because it is fraud on the basis that they approached the bank for a loan to support one line of business and yet they go into another business which might not be profitable and then a default occurs. This is the time at which they are informed that the business changed. It was stated that:

> '[…] as much as you want to challenge them on the grounds of fraud it becomes very difficult to challenge them because it is legal. Even though we try to ask for the purpose of the loan whenever the company wants to change business they can simply go ahead and change. So, I think we need to get our company law in order first.' (C7)

The second aspect involves the management of risk identified with the nature of the business. The company has to illustrate measures on how to manage risk in case of business contingencies. While this is for the company to put in place, the creditor as well identifies the risks involved in the nature of the business the company is doing. They assess the risk appetite so that they are not lending money to a company that is venturing into a project without potential of succeeding. It was said that:

> '[…] with industry risk we want to see what kind of industry you are in and the risks involved…..Management risk, exchange risk we also have account performance risk very funny because in most cases here in Zambia we have had a lot of clients applying for a loan to settle another loan with a different creditor…. So, in such cases you want to wonder how exactly this client will be able to pay back?' (C11)

A look at the directors, shareholders, and the management of the company before they can assess the financial capacity is usually done. The purpose is to know the characters of the individuals behind the corporate veil, and to establish their track record in terms of managing a firm and also to check if they are noble people of the society as well as checking if they are politically exposed individuals. It was stated that:

[841] Section 22, Companies Act, 1994

> '[O]ne of the first Cs is Character. You have to look at the character of the borrower. What does that entail? You have to obtain information about who are the directors of the company? Who are the shareholders of the company what is their conduct in that line of business that they are engaged in and what is their reputation on the market? Because the character of the promoters of any company, will basically tell you whether these are crooks they just want to defraud the bank or these are people of high integrity with proper business acumen.so character is very important okay.' (C12)

The purpose for this assessment is to enable judgement on the performance of the company if the people in charge are qualified people who can manage the organisation and manage the risks. The other reasons included the intrusion of shareholders in the affairs of the company. How much of control is exercised by the owners was a major concern for creditors. It was shown that some defaults are caused by the influence of the owners on the management as C8 stated that:

> '[…] You know we have a lot of spending problems in Zambia especially if the shareholders are involved in the running of the company and they go to the bank and ask for a loan because they know someone in higher positions or because they are well known public figures and so they have a certain kind of influence that will make them get away with certain standard procedures.' (C8)

This brings about the problem of minority shareholders and how they are treated in a company. The major shareholders are influential in decision making leaving out the minority shareholders. This behaviour was found rooted in the concentration of the shareholding system such as Family Owned Business (FOB). On the other hand, the interference in State Owned Enterprises (SOE) seemed to be based on the abuse of authority and political interference. To start with, the minister oversees selecting board members. The requirements after constituting a board do not include procedure for disbanding. The Minister can fire any board member at any time because such powers are vested in him.

5.2.2.3 Sub-theme C2.3: Reliance on court orders

The judiciary has a key role to play in the financial sector especially when it comes to restructuring and granting of orders in relation to corporate rescue. Creditors were concerned about the role of the judiciary once a default has been recorded and a company has not been cooperating. The debtor company can get injunctions against banks in a bid to stop them from selling security. The courts grant these injunctions even after default. The corporate rescue procedures are not adequate which is why there are a lot of discrepancies within the law. It was stated by C7 that:

> '[….] we have been dragged to court by debtor companies and they have managed to get injunctions against us to stop us from disposing the security. (C7)

The reliance on such orders from the court were not only unfair on creditors but they are time consuming in that if the matter has been taken to court, everything else is dependent on the orders from the court. Sometimes issues of interest come into play and how long it will take the company to pay back or the duration of an injunction. References were made to the case of *Savenda Management Service v Stanbic bank*[842] in which the defaulting bank was registered on the CRB as a bad debtor and in the process, it lost business. The company went to court seeking relief against the bank and the court sided with the defaulting company. With such, companies feel safe to default because they know that there will be no consequences, but the court will help them, and this has led to a lot of defaults. C12 was concerned with the levels of defaults in Zambia and said that:

> '[I]n this market I will tell you the levels of default are alarming. Maybe I think if you have been listening to the bank of Zambia governor every time they are announcing their quarterly monitory policy statements, they have been saying the non-performing loans in Zambia is worrying the Central Bank so people borrow but fail to pay back.' (C12)

This seems unfair on creditors because the court is used as a shelter for companies. This is because they feel secure to default, as the court will restructure the loan as a delaying technique. Sometimes this process leads to non-payment of interest. While defaulting companies prefer litigation, so, creditors avoid it because it is costly, has potential to create a bad reputation for the bank and takes time.

5.2.2.4 Sub-theme C2.4: Unregulated government contractors

It was found that suppliers doing business with the government are usually paid late and there is no regulation for these contracts. Creditors dealing with these companies face problems. In 2016, the banking industry survey indicated that the growth of the economy was slow because contractors were paid late by the government and this led to a high number of non-performing loans.[843] This lack of regulation was a concern for creditors as C9 stated that:

> '[Y]ou have heard about government owing suppliers and contractors the debt levels of government…so if this customer who came and got a facility from us was for the purposes of doing road constructions and then we are hearing stories that government is having challenges in paying contractors that trigger number one.' (C9)

[842] [2018] SCZ No. 47

[843] Zambia Banking Industry Survey: Adapt to Thrive https://www.pwc.com/zm/en/

There is need for transparency and acting swiftly when dealing with private companies doing business with the government. If these are regulated, then contracts with the government will follow a certain procedure which can help for purposes of risk assessment and planning.

5.2.2.4 Sub-theme C2.5: The regulation of interest rates and Foreign exchange

The increase in the interest rates for both assets and liabilities have remarkably increased in Zambia and this is dependent on the monetary policy.[844] The second basis for this increase has also been the increased government borrowing which then limits liquidity and banks borrow at higher rates.[845] The implication is on customers because borrowing becomes expensive. Another problem associated with the interest rates was found to be foreign exchange rates. The study found that instability for both interest rates and foreign exchange has been associated with increased inflation. When inflation is high, the cost of lending is evidently high. Creditors were worried that the Central Bank must ensure stability for purposes of financial and economic development. C16 expressed concern by saying that:

> '[…] when the dollar becomes expensive it means that business has also become expensive. This affects interest rates and then customers start leaving wanting to see who has lower interests.' (C16)

Concern was expressed over loss of business due to high interest rates as well as confidence in the service delivery on the part of creditors.

5.2.3 Theme C3. The management of the firm

It was found that creditors aim to attract and retain customers and so they do rely on the corporate relationships created between them and companies. This highly depends on the reliability and commitment the company must pay debt. The governance of the firm is very crucial to creditors because it is one of the risks that they must assess. This impacts on the behaviour of directors when dealing with creditors and if the company is not properly managed, it could suggest problems of loss to creditors. In the management of the firm, three main issues emerged from creditors and these include the control and influence of the owners, incompetency, nepotism, and unavailability of shareholders' property.

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[844] A Bank of Zambia Journal (2018) http://www.boz.zm/June-2018.pdfaccessedon29/01/2019

[845] Ibid

5.2.3.1 Sub-theme C3.1: Shareholder control and influence

Most companies in Zambia are controlled by shareholders through presence and influence in decision making. It was found that the wishes of the shareholders are passed through the directors on how the affairs of the company are to be managed. However, the worries expressed by creditors focus on the impact of influence which extend to the bank, because sometimes loans are issued without prudential guidelines being followed such as skipping the assessment of the applicant. This backfires on creditors because some of them usually do control the finances too through directors. This money could end up in luxury lifestyle and the company cannot afford to repay. As much as the fault was with the bank, if policies are put in place to avoid the presence of this influence and allow directors to do their duties, there is a possibility of avoiding such situations. Creditors worry about this control because shareholders make a company get a loan and they spend it on personal things instead of investing in the business, in the process they fail to pay back. Whereas this causes problems as the company defaults on the loan, the implication is poor management if such occurrences are permitted. The facade in theory is that directors manage the company because shareholders cannot do that by law. However, in practice it's the opposite. For instance, one respondent said that:

> '[….] in that case you are still talking about the influence of the shareholders…. This is because we do have shareholders making decisions in these companies.' (C13)

Although the issue of controlling shareholders is a common practice, it is more evident with the majority shareholders exerting influence by virtue of having more shares. The problem created by this influence is the treatment of the minority shareholders. Some respondents qualified this influence on the nature of the company especially FOBs and even the large companies traded on the stock exchange such as Zambeef, Zambia Sugar, and others have at least one major shareholder that is exerting control.

5.2.3.2 Sub-theme C3.2: Incompetency and nepotism

Creditors were concerned that directors in charge of these companies are prone to making poor financial decisions due to incompetence and nepotism. It was found that some of the people that hold these strategic positions are not qualified either directors or senior management positions. This problem was evident in the number of phone calls coming from back doors or top bosses. The respondents acknowledged that some of these calls make the banks forego banking procedures and deal with customers based on personal relationships. This is because they have been put in these positions by the connections of either the shareholders or influential people. C13 expressed this concern by saying that:

> '[We] do employ people based on who we know and what favours they have done for us or they are most likely to do for us maybe well-known people or so. You don't see the impact of these on the businesses, but it causes poor management like I mentioned earlier.' (C13)

Whereas these problems occur in these companies, the impact it causes affects creditors because sometimes defaults result from incompetence of management. They fail to make strategic financial decisions for the long term and divert money to evade obligations. The view was that, financial management be taught or be improved to manage risk. Although this could be done through financial workshops and trainings as well as ensuring that qualified people are put into strategic positions, it is very hard to eradicate this problem because this was one of the problems identified during the bank failures in the 1990s. In explaining bank failures, Maimbo found that the nature of relationships in the banks was one of the reasons which led to limits in taking proper decisions in closing insolvency banks and this led to more loss.[846]

1.2.3.3 Sub-theme C3.3: The unavailability of shareholders' property

Zambian company law adopted the principle in *Salomon v Salomon & Co. Ltd*[847] establishing a company as a juridical person.[848] The complication starts from the foundations of management and internal organisation from positions of directors as trustees, and as businessmen.[849] As trustees directors ought to manage the company for the beneficiary and as businessmen they have to ensure continuity of business for shareholders. Although the company is a legal person, within that individuality there are contractual rights and duties for shareholders, directors, and the employees or officials.[850] These rights and duties are in form of contracts and this brings contract law at the centre of company law. Each contract with the organisation has its own enforceable rights for instance, the relations between shareholders and the company, directors and shareholders, directors and the company, and the company and creditors or employees. The contractual rights of the

[846] Samuel Munzele Maimbo, Explaining Bank Regulatory Failure in Zambia (2002) JID, 14, 229
[847] [1897] AC 22
[848]Chomba J, in AItala Trust Lid v Registrar of Companies (1971) ZR
[849] Kabanda RK Mushota, 'The Legal Validity of the Ministerial Directive Purporting to Dissolve Limited Liability Companies in Zambia' (1979) CILJSA, 12, 140
[850] J.M. Mulwila & R.K. Mushota, 'Company Law and Some Doctrinal Problems concerning the Management of Parastatal Companies in Zambia' (1980) ClLJSA, 13, 265

shareholders and the firm places a limitation of liability on members to subscribed shares which means that creditors cannot claim against their personal property. This limitation of liability means that the business transactions with the company must end with the company and not extend to shareholders. The limitation of liability creates a corporate veil that covers shareholders from liability for company debt. This hinders creditors from recovering their money beyond company assets even in circumstances where the company was poorly managed under the control of shareholders. It was found that shareholders control the affairs of the company and the argument raised is that, to an extent, there must be a way of holding them responsible for such influence because at the point of lifting the veil, while this involvement in the affairs of the company was going on, creditors suffered loss as a result, and they must take responsibility for their actions. Creditors cannot make shareholders responsible for their involvement in the company. They are protected by the corporate veil which has proved to be problematic to pierce because the courts are reluctant to do so. The courts have not been proactive in lifting the corporate veil as a mechanism to protect creditors in Zambia. One respondent said that:

> '[Z]ambian courts at least we don't have such case law maybe you can check with the courts but us creditors find it very difficult to do business…..you cannot go after their personal property in order to get your money back the law does not allow and because it is companies we can't do anything but rely on the morality of the promoters.' (C1)

The findings showed that creditors have no recourse to law through piercing the corporate veil. This was attributed to the way in which the courts favour defaulting companies. In addition to due diligence, prudential loan policies and the collection of security, creditors have adopted the use of directors' guarantee in which the liability is shifted in case of defaults. This requires that directors sign an undertaking that they take responsibility of the debt in case of any default. This means that directors' personal property is put on the line for the debt of the company. The problem is that this is only a way of reducing risk because even if they show capacity today of repaying the loan, tomorrow they may not have that capacity any longer. C12 expressed it as:

> 'If the guarantee provides that if we fail to realise that landed property, we can go for any of the assets of the directors. Even if they have not been specified. Because they have guaranteed that they have got capacity to pay so if we can't realise that we go now individually on that.' (C12)

The study found one unique ideal creditor who has not experienced any default from the time the business was established in Zambia. After analysis, it was found that the 100% record is because of the nature of the creditor. This involved a foreign bank in which the government is also a shareholder and in charge of most of the mining activities. This is because the creditor only lends money to companies that are in the mining sector and have a proven record handling high level government projects. The respondent was uncertain as to the reasons for the clean record or mechanisms they have put in place to protect themselves. There was a lot of indecision as to whether the reason for this record could be revealed. C6 stated that:

> '[…] maybe it could be the customers we lend to that are honest enough and they are paying back, or I don't know whether to say that our due diligence is good. But well we are happy not to have any defaults that all I can say.' (C6)

Clearly the respondent could not establish why they have a 100% repayment record, and this was also demonstrated after a lot of probing it was stated that:

> '[W]ell the truth is that we have put policy in place for us to monitor the usage of the loans. This is because we lend to the sensitive industry and as we are a foreign bank…. the nature of the business they are undertaking is very important to us as we do not lend to every sector. The bank has a policy of lending only to certain sectors especially in the mining sector….' (C6)

This creditor does not lend to any company that applies except those involved in the mining and construction sector under close support and supervision of the government. Having a bank with a 100% repayment record which is associated with the government and the Chinese investors speaks for itself. However, in the assessment stages of the application, it was clearly stated that they do have a monitoring scheme for the facility in relation to the construction project in question.

5.2.4 Theme C4. Lack of corporate governance and undue influence of politics

Empirical findings show lack of good governance practices especially the internal organisation of the company between directors and management. There is no mechanism for monitoring compliance, especially with the filling of audited financials. Whereas other companies cannot meet the costs involved in the use of auditing accounts in accordance with the requirements of the Act, most companies do not comply because there is no penalty for noncompliance. This is one of the reasons companies when applying for loans, have little information that is supported financially. Financial disclosures are not comprehensive and adequate. What happens in these companies is that compliance with certain provisions such as the corporate governance Code is dependent on the size of the company and whether it is listed on the exchange. Corporate governance is very weak unlike the banking industry which is regulated by a revised Act which included some benchmarks for credibility of people who can manage financial institutions. Findings indicate lack of ethics in the way companies are managed especially for directors. Most of these irregularities have been associated with the influence of politics. These practices happen because of influence of political figures who are both in the public and private sector. The financial sector has been a victim of politics despite the mandate of the Anti-Corruption Commission because perpetrators of political financial crimes use the banks for their activities. Although these problems have been found, some creditors too showed that they are interested in the money and have no desire to report directors for wrongdoing.

1.2.3.4 Sub-theme C4.1: Corruption and political interference

Most respondents indicated that once a company is associated with political figures, the loan involved back door arrangements from bosses on top management. Several respondents referred to the case of Zambia Development Bank v Zambian Airways[851] in 2009 which involved a loan of over 12million dollars (over 60 Billion Kwacha). They used this as an example of how politics can infiltrate the financial sector and lead to unpaid loans. The government gets involved and everything becomes politically motived. C9 mentioned that:

> '[....] people are not paying you because they are having corrupt deals going on. They could be using the company to launder money and they can't make certain payments until something happens or they are authorised by someone they work for. Especially those companies that are involved with political figures.' (C9)

> '[A]nd similarly C. 4 said that so much political interference because even when it comes to the issuance of these loans, if you know someone in the bank like the some of us you know what am saying…. you will definitely be given the loan because of the figure involved.' (C4)

A recent example of how much politics has infiltrated the banks is the case of the Post Newspaper closure by the government based on political affiliation. Some of the respondents mentioned how the banks have fallen prey to political figures. However, one of the respondents was of the view that one needs to take advantage of the public figures and use it to attract business instead. This is a risk that can be taken just like any other risk involved in business. It was stated that:

> '[T]he very nature of business is risky and sometimes one has to be bold to create the kind of business one want… like to catch the big fish'. (C15)

[851] [2012] ZMHC 26

5.3 Directors

A total of four main themes emerged with the first being on problems from the oversight role of the board, the second on the difficulties of identifying financial distress, the third from the weak corporate governance structures and the fourth from the effects of socialism or having a centralised governance structure for the economy.

5.3.1 Theme D1. Problems with board oversight and the role of directors

This was based on the understanding of the central role played by directors in ensuring strategic direction of the organisation. The legal mandate of directors to manage the affairs of the company include powers such as attracting debts for the company and employing officers of the company such as the Chief Executive Officer (CEO) to manage the everyday affairs of the company.[852] The board has the responsibility to ensure sound business, sustainability, cooperation among stakeholders, and also a stable and sound financial status. Three sub-themes emerged from this namely, unprofessionalism, lack of awareness and understanding of directors' duties, the difficulties in balancing the needs of shareholders and stakeholders.

5.3.1.1 Sub-theme D1.1: Unprofessionalism

The findings established that most respondents were concerned with the presence of unqualified directors. While there is no qualification for directorship, there is a presence of unprofessionalism due to the quality of people in directorship positions which is below the expected standards. It was also found that there are no documented cases of directors taken to court for wrongful decisions made, and so, this made most of them complacent with the status quo. Most of the respondents across the data sets called for penalty measures for erring directors, as well as minimum qualifications not only reasonable skill as required under common law. This leads to what one of the respondents called an attitude problem found in the board room. It was expressed as:

> '[….] sometimes directors may be qualified, but it is the attitude that is wrong in the board room. Because we are many so you don't even bother about the deliberations, but you will cast a vote on issues you did not understand. (D1)

Without a restriction of qualification, it is difficult to establish that one is unqualified because there is no benchmark that can be used for qualification if education is not attributed. In expressing a similar problem, D20 said that:

[852] Section 215, Companies Act, Chapter 388 of the Laws of Zambia, 1994

> '[A] director must be educated to make strategic decisions in management or budgeting or legal issues or accounting… for good business practices that involve abstractions of risk?' (D20)

Besides qualifications, nepotism is a major problem in the corporate sector. Findings showed evidence of a disreputable culture of appointing directors unethically unlike on merit. This usually happens through people appointing their relatives and people they know to directorship positions. Respondents complained about the incompetence that is demonstrated on boards by some directors and this is because they do not hold the positions based on merit but on favours and contacts from mostly shareholders and recommendations of those who have the influence over the decisions of the company. They do not know what the position requires of them professionally because of the circumstances in which they were employed. For instance, D11 said that:

> '[…] a lot of people who get to be appointed CEOs and directors they have got no experience but less than what it takes for somebody to sit in that office. They are sitting in there because they know this one, they know that one and they have got some influence on who appoints who and then they find themselves in that position.' (D11)

It was shown that the first quality needed for a director is an education as one cannot have someone unqualified to run a company. This goes to question what kind of skill or decisions they would bring to the company. This incompetence leads to the 'tick the box' kind of governance and also the possibility of having one director dominating the board. D13 stated that:

> '[…] directors don't know how to make contributions, but they are on the board and this problem is very much present in the private sector and it is worse in the public sector especially with the State-Owned Enterprises. (D13)

The effect of this incompetency arguably leads to lack of expertise on boards, lack of checks and balances as well as lack of independent and objectivity in decision making. This then brings about the problem of power being vested in the few that are qualified and understand what is happening. In the process this establishes the need for effective presence of NEDs who can then ensure that they bring an independent voice and some checks to the decisions of other directors.

5.3.1.2 Sub-theme D1.2: Unawareness and lack of understanding of directors' duties

Empirical findings showed a lack of awareness and understanding for directors' duties. Ignorance, lack of ethics, and transparency was found to be some of the problems effecting the corporate sector. Lack of codification of directors' duties was found to be a major factor for lack of understanding. The respondents demonstrated that, if directors don't understand their duties, it makes implementation problematic in the process. While some of them did allude to the duties outlined in the contracts of employment, others did state that not having codified duties is not a problem because there is too much ignorance. However, it was established that to have them in the statutes will help them to ascertain exactly what they are meant to be doing. Most of them did state that knowing and understanding what they must be doing is much more important than just having the duties in the statute because executing the responsibilities is more important to the organisation. It was stated by D14 that:

> '[…] the problem is not having the duties spelt out but the willingness to do the right thing. Are directors ready to act in good faith as required by law and the profession itself? The role of a director is of trust and in good faith. (D14)

Others called for change as stated by D.3 that:

> '[…] there is so much urgent need for change…. urgent need for change… to redefine the full roles and responsibilities of directors and the systems under which institutions or organisations operate. (D3)

Whereas directors were concerned with the lack of duties, it was found that they act in unethical manner. The IODZ has not been very active in promoting ethical behaviour despite having some workshops to educate and sensitise directors about their duties. The quality of regulation by the IODZ is weak such that directors feel no need to act professionally or to comply with the code of conduct because there is no accountability for their behaviour. They have a toothless institution which does not have any mandate to regulate behaviour of directors. Erring directors are usually recycled even if they were involved in a bad liquidation.

5.3.1.3 Sub-theme D1.3: Difficulties balancing shareholders and stakeholders' interests

Respondents established that their responsibilities are aligned with the wishes of the shareholders. The Companies Act has prescribed provisions ensuring shareholders engagement to be during the Annual General Meeting (AGM) where they have the right to vote, and directors are required to notify them of the meetings.[853] Shareholders have the right to appoint directors and they reserve the right to remove them.[854] The purpose of these rights is to limit shareholders' participation. However, it was found that participation of shareholders in practice is more than what is legally required. This involvement of shareholders in the affairs of the company influences directors to

[853] Section 138, Companies Act, 1994
[854] Section 206, Companies Act, 1994

make decisions embraced by shareholders. This involvement interferes with the independent judgment of directors. Although others argue that they are the owners of the company, and their interests represent those of the firm, it is not all the time that shareholders' interests are aligned with the interest of the company. This is because there are competing interests in a company which includes stakeholders like employees, regulators, and creditors to mention but a few. It was demonstrated that shareholders can walk in any time and request for certain information. For instance, one of them stated that:

> '[…] normally we report to shareholders through the board but sometimes shareholders walk in and ask for certain information because they are not there day to day because if they did, then they are taking over the responsibility of the members of the board.' (D11)

This presents a conflict of interests as shareholders want them to run the company according to their desires whereas the law requires them to manage in the interest of the firm. This conflict is divided as some of the respondents view shareholders as owners and therefore, they manage the firm in their interest. In times of conflicting interests, most directors stated that unless otherwise what the shareholders want is against the law, otherwise the interests of shareholders are presumed to be the best interests of the company. However, three of them expressed a different view and were concerned with the interests of the firm unlike those of the shareholders and they gave instances in which they experienced a conflict of interest and two of them had to resign while the other one did not because the conflict was among themselves as directors and eventually the board had to come along to adopt the strategy that was under discussion. One of the respondents, D15 narrated an experience of a systematic scheme carried out by directors to acquire company assets like vehicles after a company uses them for five years. The respondent had to resign as this was stealing company assets and unethical and after making a formal complaint, by the time the matter got to court, all documents had already been changed to cover up the scheme. In a second instance D1 said that:

> '[…] now where I feel or where I have felt that am getting undue pressure or interference from the owner because he is the owner or what he is proposing goes against what I feel is not going to steer the company in a profitable manner I have known myself to step back. Where I feel that the pressure, the expectation of the influence is to take undue risk then am sorry I can't do that it goes against my seat.' (D1)

Directors must balance the interests of shareholders, the company, and stakeholders. However, within the law, the interests of the company must be a priority for directors, and this includes consideration of stakeholders. This involves a balance in managing company affairs by considering stakeholders and making decisions that do not expose the company to risk and also not contrary to the law. It was found that creditors as a stakeholder group are neglected both during financial solvency and distressed times. It is not disputed that creditors as a stakeholder group are very essential as providers of corporate finance especially in developing countries.[855] Directors did allude to the use of financial debt as a major source of corporate activities emphasising that no business can subsist without debt. D13 mentioned that all companies have debt because they borrow to run companies but despite this acknowledgement, creditors are not adequately protected. The study found that directors only think about creditors during insolvency. Insolvency automatically brings in creditors but in Zambia almost all companies that go into liquidation leave huge debts behind. To stress this point D2 insisted that creditors come into consideration when a company is going into insolvency. This means that until insolvency occurs, creditors have been neglected and because the company has gone into insolvency, this means that they are not safe either.

5.3.2 Theme D2. Decisions in the vicinity of insolvency

When a company is struggling financially, directors have an incentive to continue trading. Under common law, they are to consider creditors' interests while they try to bring the company back to financial stability. Directors demonstrated that they do not know when the company goes into financial difficulties. Once they become aware their priority is shareholders' wishes. While this time requires directors to decide what happens, they are not concerned with creditors' interests but what the shareholders would decide for them to trigger or put the company in official insolvency. It is important that directors demonstrate alertness and quick considerable actions that could save the firm if not, it triggers the demise of the company. Two sub-themes emerged first being the complications of recognising financial troubles and the inability to engage creditors during this time.

5.3.2.1 Sub-theme D2.1: Complications of recognising financial trouble

For the company to survive financial distress, directors ought to act early. It was found that directors are not sure when the company has gone into a distressed mode. Others cited the incompetence of management and some said they lack adequate information to realise that the

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[855] Mathew Tsamenyi, Elsie Enninful-Adu and Joseph Onumah, Disclosure and Corporate Governance in Developing Countries: Evidence from Ghana (2007) JMA, 22, 319

company is becoming financially troubled. Once they establish that the company has no money or is struggling to meet its obligations, they have to run to the shareholders and tell them that the company has no money or they go to the bank for more loans. These loans obtained around this time create a fresh risk on creditors if by any chance the company fails to come out of the distressed mode, it might be argued that it creates preferential treatment among creditors. It was understood that identifying an issue of financial distress is almost impossible rather the issue of insolvency is triggered immediately. This is because when the company is financially troubled, it continues to trade and by the time these financial issues are brought forward for proper attention, the company is almost gone. Empirical findings established that the period of financial distress in practice is not identified quickly hence, most of the times directors end up trading when the company is insolvent. This takes away the opportunity for early intervention such as a business rescue plan. It was said by D2 that:

> '[….] it is the responsibility of the board to identify at that particular point that an issue of insolvency has arisen and what rescue measures or what plans are going to put in place by the board to come out of that insolvency so that you can get back to being solvent. (D2)

Whereas D2 stated above that identifying the point of financial distress is vital in order to decide, most directors do not differentiate between a company in financial distress, and a company in insolvency. They talked about liability that comes with trading when a company is insolvent yet the time when the company is struggling is not taken into consideration as they want to apportion blame. Trading when a company is insolvent is against the law whereas trading when a company is in financial difficulties is not illegal except directors need to trade with caution having the interests of creditors as a priority. It was established that directors misunderstand how this liability comes about and the first thing they said was elimination of blame from themselves and question the management. Although some respondents were happy to take responsibility, they did state that usually directors are liable, yet it is not their fault but that of the management because they are not made aware in time. D14 stressed that during financial difficulties there is always someone responsible for taking the company into such a position but the question must go to directors whether they did their risk assessments, and strategically evaluated the vital financial information from auditors, and whether they did what they are supposed to do as stewards of the company.

5.3.2.2 Sub-theme D2.2: Late creditor engagement

While directors find it challenging to identify the period of financial distress and try to avoid liability for their actions, creditors are not brought in on time for engagement on how to proceed and negotiate repayment of the facility or to have meetings for restructuring of the business. It was shown that creditors are brought in when the mess has already been made and the issue is distribution of the assets if any and how creditors are going to be paid. Usually companies misappropriate funds, and when they go into liquidation, whatever remains is the risk creditors must face and it comes with the nature of the business.

5.3.3 Theme D3. Weak corporate governance institutions

Corporate governance is not fully developed for implementation despite the efforts by the IODZ in promoting awareness through the media, workshops, trainings, and conference speeches. Although SEC, LuSE, and the IODZ have been pushing for compliance for listed companies, a large number of companies in Zambia are not listed but good corporate governance practices attract foreign and local investment through transparency, accountability and ethical management of companies is needed. The results indicate that in Zambia the framework for corporate governance is undeveloped and directors demonstrated that at the moment the adherence is poor although there are steps to ensure adherence such as the introduction of a corporate governance code for listed companies by LuSE. Although a poor corporate governance culture was established, some of the contributing factors included ignorance because most directors are complacent with the system that lacks accountability measures. Others attributed the factors to the type of companies. The majority included listed companies, and State-Owned Enterprises (SOEs). Concern was shown for private companies and subsidiaries of foreign companies. For instance, one respondent said that:

> ‘[T]hen you look at the working culture that we have in Zambia generally you can say that it’s very poor. But we actually are doing something about it especially the listed companies on the exchange they are guided by the listings requirements and so they are more aware of best practice than other companies.’ (D8)

Results indicate that there is a probability of justification for this underdeveloped framework which tends to sit well with directors. They see no need for change. For instance, one respondent said that:

> ‘[W]e are getting there …reason why I said it’s very poor is this there are very few formal corporates in our economy. So, you have the parastatals then you have the big guys like the Zambeef and the mines. But the majority of the people are employed in the

> small scale you know sub sector and a lot of those institutions are not fully incorporated they operate at an informal level so that is why presidents and CEOs are the chairmen.' (D11)

Arguably reasons include lack of systems for internal control that hinge on corporate governance and there is no separation of powers between shareholders and directors and so decisions are merely made by those in positions of influence. This is unethical and this is one of the many problems the corporate sector is facing. The need for ethics to be integrated into the affairs of the company by providing ethical regulation through codes of conduct and these must be enforceable and capable of implementation. Three sub-themes emerged categorised according to the type of the company. The first is governance of SOEs, the second is governance within listed companies and the third is governance in private companies.

5.3.3.1 Sub-theme D3.1: Governance of State-Owned Enterprises (SOEs)

Corporate governance in SOEs is very weak as evidenced from the findings. SOEs are companies where the government is a major shareholder and rooted in politics. The word Parastal is used interchangeably with SOEs in this study. The SOEs play a major role in the Zambian economy as it is one of the largest formal employers with controlling important sectors such as the mining, energy, transportations, communications and the media.[856] Generally poor political institutions perform poorly because of the nature of governance and the way in which strategic policies are formulated to fit the political needs of the government.[857] The study found two major problems in the governance of SOEs. The first problem is that there is no law or regulation in place to address the specific conduct of business within the SOEs. The second problem identified is the interference of politics and the unchecked authority of ministers in charge. These are not oriented to the tenets of good governance because the government has direct influence over management and at any time, they can get rid of the board and replace it within a short period of time. There is no separation of the positions such as the CEO and the chairman can be vested in the same minister. And the minister decides who sits on the board and when to fire them. The challenge in these companies is that some of them are listed on the stock exchange and compliance then becomes political. So, the rules are usually put aside, and politics take over. D16 stated that:

[856] Jotham C Momba, 'The Intersection Between Politics and Corruption in Zambia' (2007) SAJIA, 14, 115
[857] Stuart J Barton, 'Why Zambia Failed' (2015) JIE, 11, 803

> '[….] power politics determine the compliance of the company…. A number of parastatals seem to receive a lot of favour, there is so much lenience on them than there is on non-parastatals.' (D16)

The dangers included confusion on who to report to and so accountability becomes complicated and the tenure of these boards either is too long or too short that there is no progressive or effective handover. There is no systematic exist of board members to preserve certain practices or customs for posterity.

5.3.3.2 Sub-theme D3.2: Governance within Listed companies

Corporate governance institutions in Zambia continue to exist despite its weaknesses in terms of enforcement. The listed and quoted companies are under the regulation of SEC and LuSE governed by the corporate governance code which was enacted in 2005. The enactment of the code was in a bid to improve accountability and attract investment.[858] The exchange in conjunction with SEC and IODZ has been in charge of promoting corporate governance tenets and despite their efforts into increasing awareness, and promoting good practice, the study found that compliance is dependent on how invested the company is with politics and affiliation to shareholders. Also, owing to lack of repercussions for noncompliance, for example financial consequences for noncompliance is lacking. For example, D6 asserted that it does not matter what kind of explanation is given because some companies are left off the hook. It was found that compliance is by influence in the sense that the same rules apply to one company but will not apply to the other. Although there are benchmarks by LuSE, there is no compliance.

5.3.3.4 Sub-theme D3.3: Private companies and Subsidiaries of foreign companies

The private companies are not regulated in terms of corporate governance and the same applies for the subsidiaries of the foreign companies except for those that are listed. Now there are a number of large companies that are not listed. They are not regulated by any code except the legal regulation under the Companies Act. Even though they are encouraged to comply with the code, this does not apply to them. Two major reasons for lack of corporate governance in private companies were found. The first is the lack of a framework and secondly the ownership structures of the companies. Most of these companies are FOBs and they are more informal and have no

[858] Shikaputo Chanda, Bruce Burton, Theresa Dunne, 'The Nature and Potential of Corporate Governance in Developing Countries: Zambian Perceptions' (2017) AAAJ, 30, 1257

obligation to comply with the code. They have a closed shareholding and in most cases the owner of the business is the ED, CEO and Chairman. D5 stated that:

> '[….] in privately owned and especially Zambian indigenous most of them are family owned kind of business. The tendency in Zambia is that companies are not set up in a way that other shareholders are accommodated.' (D5)

The concern with subsidiaries of foreign companies that are not listed is compliance and regulation. It is not clear who regulates these kinds of companies, which is why most of these are very poor at corporate social responsibility. They are not answerable to any organisation in practice even though they are set up within the Act. Concern was raised especially with the increase of Chinese and Lebanese businesses in Lusaka. It was established that corporate governance initiatives such as awareness and sensitization are not implemented in the private sector and for the subsidiaries of foreign companies. D2 stated that: 'now corporate governance doesn't apply to a company like Airtel or like MTN… in as much as those are big companies, the regulation doesn't go that far.' There is no corporate governance that can improve the way things are run in Zambia which is why legal enforcement is necessary to stiffen up the standards.

5.3.4 Theme D4. The effects of socialism

The political standing of government interference or influence is still alive as it was during the one-party state. When the government used to run and control everything including the conduct of business. Today even though a lot of changes have occurred especially after the liberalisation of the economy, the state still controls everything. There is politics in every sector of the economy with government now authorising ministers to appoint and remove boards. The financial industry has not been left out as the influence of the government is still present in the Central bank as politicians are put in charge. This has led to the increase in corruption which was found to be one of the major problems that politics has brought. Directors were concerned that without fighting corruption, it is difficult to have good ethics and accountability on boards. Although the Anti-Corruption Commission (ACC) has been trying to fight corruption, these have been selected cases as to who can be prosecuted as those in the government are sacred until they fall out of good books. There has been no accountability for board members in charge of key public companies such as ZESCO, ZAMTEL, and ZIMCO. Boards are constituted without any accountability, yet the government intrude and make policy that affects the private sector. For instance, it was stated that:

> '[…] from the time of nationalism to now, you can say that the government is pretty much in control when you look at the regulatory structure…. there is this transition under which the private sector is driven by businesses after liberation of the economy and what that means is that understanding corporate governance since 1999-2000 is still a new thing.' (D8)

> '[….] we need to remember that our country is still somehow run by the state. We are independent yes, we have the private sector but we do find the government everywhere in the private sector. What kind of influence is coming from the state… is it positive or negative in that it helps to build the economic activities? But business in Zambia is at the centre of politics.' (D7)

The political standing or influence is still alive as it was during the one-party state. When the government used to run and control everything including the conduct of business and how much a company could make.

5.4 Lawyers

A total of four main themes emerged the first from provisions of the law regarding creditors, second from legal duties of directors, the third from the control and influence of shareholders and the fourth from the role of the judiciary in the corporate sector.

5.4.1. Theme L1. Lack of law for corporate rescue measures

The findings established that laws relating to corporate rescue are impracticable however, the provisions under the Companies Act have proved to be inadequate as they only relate to insolvency procedures. Respondents demonstrated some of the challenges relating to implementation complications under the Act. These have been categorised into sub-themes. The first problem is the provision regarding the authority of a company. The second relates to provisions for fraudulent and wrongful trading. The third problem relates to the period when the company is nearing insolvency.

5.4.1.1 Sub-theme L1.1: The problems with the law on authority of a company

The study found some ambiguities within the laws especially with the authority of the company and the line of business. The risk from these ambiguities fall exclusively on creditors who might not have recourse to loss arising from any change of business. To start with upon incorporation, the pre-requirement is that the nature of business be revealed in the articles of association[859] yet section 22 gives the company authority to do any lawful business without limitation to the one prescribed at the time of incorporation.[860] The authority given under section 22, entail that the company can do anything and not even the enabling Act can veto such actions. It can do anything and that cannot be invalidated by virtue of being contrary to its articles of association or the very statute that gave birth to it. Now the implication of this authority is that a company can get away with anything it does whether it is against the Companies Act which could mean that companies in Zambia are not regulated. Both provisions look sound however, the consequences of these sections are on creditors, when the company decides to change the line of business from one on which a loan facility was taken. When a company applies for a loan, the assessments include the nature of business because creditors want to lend to sectors of appetite as they do not lend to every sector. L1 stated that:

> ‘[C]ompanies have misrepresented themselves to creditors and as well as customers that this is what we are dealing with and yet not…. You get money in the pretext that you

[859] Section 12, Companies Act 1994
[860] Section 22, Companies Act 1994

> will invest in a company and you don't …. you will in such circumstances attribute fraud to them because they came and deceived you that the money will be used for timber processing when in fact not.' (L1)

As established in the analysis from creditors, the assessment will be approved based on how the business has been performing and also future projections are included. This becomes a challenge when a company changes the line of business to a sector that is not supported by the bank. Legally this amounts to a misrepresentation, and if intent to change business before the loan can be established, it amounts to fraud under section 360 although this is only applicable when a company has gone into liquidation. The problem is that this fraud or misrepresentation of the change of business as much as it hurts creditors, it is permissible under section 22 which is very ambiguous in terms of application because it goes against the enabling Act itself. This challenge has no recourse for creditors unless otherwise the law is changed to limit the authority of the company to its articles or otherwise to notify existing creditors of the intended proposal to change the line of business to allow creditors re-evaluate the risks involved. It was for instance stated that:

> '[I]f you look at the number of companies collapsing these days you will find that sometimes the companies can be redeemed from that terrible situation but these are not regulated I mean look at the companies Act and you find a provision that is impractically impossible to enforce because the company can get away with it. A company is capable of creating a situation today and escape liability tomorrow.' (L5)

Once a company has been incorporated, any action it takes cannot be invalidated because it is inconsistent with its articles or the statute itself. The second provision is centred on the conduct of company officers both when a company is solvent and in liquidation. These are provisions surrounding fraudulent and wrongful trading.

5.4.1.2 Sub-theme L1.2: Challenges of fraudulent and wrongful trading provisions

The empirical findings established problems in terms of application of fraudulent and wrongful trading provisions in the Companies Act. It was established that finding fraud by creditors is almost impossible because they are not privy to the affairs of the company especially with the distribution of the borrowed money on implementing the projects. As such, in practice it was found to be almost impossible to use fraudulent trading provisions for creditors. Respondents referred to the case of *Ethiopian Airlines Ltd v Sunbird Safaris Ltd & Others*[861] where the Supreme Court lifted the corporate veil to hold the managing director liable for company debts. It was demonstrated by

[861] [2007] SCJ NO. 26

respondents that this mechanism is not as practical in Zambia for creditors' protection. In order to protect themselves, creditors have come up with what is known as directors' guarantee. This is an undertaking by directors of a company guaranteeing that if the company defaults or fails to pay the loan, the creditors are legally allowed to hold the directors liable for the debts. These are contracts that are legally binding between the company and the creditor. Although this is for the protection of the creditor, legally this is also done for the continued protection of the members from liability. It is because of lack of legal protection for creditors that this mechanism has recently surfaced on the Zambian market and its effectiveness cannot be ascertained yet. It was stated that:

> '[…] directors' guarantee ensures that directors are made liable for the debt of the company in the event of failure to pay by the company. So certain institutions have become smarter because they possibly maybe they realise that the company is not bound to go in this kind of business they can change at any time…. That way it also helps them to stay on course with that line of business that they initially proposed because if they fail, or if the company fails to pay back…it's on them.' (L6)

However, this has been a recent development in Zambia, it is not yet proven whether it has been a successful mechanism for creditors to realise their money from defaulting companies. It was not established by respondents as to its effectiveness. This is one area for future research to find out if it is effective and whether directors do have the kind of assets that can cover the debt for creditors.

5.4.1.3 Sub-theme L1.3: Doubtful insolvency

This period can be identified on paper in terms of books but in practice is has been demonstrated that most of the time they do not know when the company is financially distressed. As one of the respondents indicated that alertness to doubtful insolvency is important. The importance of identifying the time is because directors' priorities need to shift to creditors and every decision made during this time can attract personal liability in case of liquidation. It was found that directors' decisions during this time are made without certainty of the financials and any attempts to rescue the company usually comes very late when the damage has already been done. This was stressed by L7 who said that:

> '[…] directors are negligent that they go into insolvency in final stages when there is no redemption for the company.' (L7)

L6 used a patient scenario to demonstrate how a company will transit from financial stability to a distressed mode to emphasise the importance of the change and how critical it is.

> '[I]f it is a human life situation you will say that a patient has gone into coma. What I mean is that the financial situation for the company has become very critical so anything

> can happen that means it can die and this is going into liquidation. (L6)

This was also mentioned by L3 who indicated that making a judgment call at the right time is very important whether the company must go to the banks for a loan, or there is need to wind-up the company. The findings establish that during this time, as there are no reliable corporate rescue measures in the Companies Act. However, it was established that this is ineffective as by the time creditors are brought in, things are bad and secured creditors bring in the receiver to recover their money and once this is done then the receiver gives back the management of the company to directors. Whereas this is simple, this is problematic in terms of the agency nature of the position of the receiver. L1 said that:

> '[W]hen you have a pure receivership, his focus is just secured creditors that's all. Once he goes in the company … problems usually arise with the receiver in terms of what he must or must not do…. This is in relation to the position that he or she is put in under the law. This is a position of conflict as to whose interest the receiver acts.' L1

The mandate of the receiver is different in nature from that of the liquidator. The receiver is appointed by creditors upon an order from court for the purposes of enforcing the debentures on behalf of secured creditors and he is an agent of the company. There is a conflict which is very difficult to handle because he must protect the interests of the company and at the same time of the creditors. How does one do such? This is difficult to attain in practice.

5.4.2 Theme L2. Lack of codified duties for directors

Whereas directors' duties are not codified in the Companies Act, they apply under common law. Lack of codification was found to be one of the factors for lack of accountability and also unethical behaviour as it is not clear in detail what directors should be doing. It was found that having codified duties would enable a certain level of understanding for directors as to what is required of them legally, and, they will have certain benchmarks to follow. Two sub-themes emerged the first being lack of duties in relation to creditors and secondly lack of accountability and ethics.

5.4.2.1 Sub-theme L2.1: Lack of duties towards creditors

It was established that directors have no legal duties towards creditors even when the company is in financial distress. Although under common law they are required to consider the interests of creditors when a company is struggling, this is non-existent in Zambia. Creditors are only considered when a company is in liquidation and a liquidator has been appointed. For instance, it was said that:

> '[T]he legislation in Zambia relating to insolvency and creditor protection is nonexistence in fact this is where there is need for substantial legislative reform in fact it is not so un common whereby once a company starts experiencing difficulties the owners of the business start syphoning and taking out money with the view to defeat claims of the creditors.' (L5)

It was found that there is need for reform of the law to protect creditors from fraudulent directors and officers of the company. L1 said while making a comparison that:

> 'You do realise that our Companies Act or company law is built on the bulk of what was practiced in the UK or is obtained from the UK company law but our friends have left those bad practices and have moved on. They have laws regarding directors' duties I mean they have codified these after noticing problems but us we find refuge in complicated things.' (L1)

While others called for the introduction of directors' duties in the Act, one respondent was concerned on the application of this law, and how it will be understood. L3 was of the view that clarity in law especially, directors' duties is needed. However, this should not be misunderstood with implementation procedures. Is it a matter of directors not knowing what to do or just not doing what they are required to do in law? This was the concern expressed by this respondent. However, the call for duties to be codified emerged from the lack of clarity under common law hence the need for change.

5.4.2.2 Sub-theme L2.2: Lack of accountability and unethical behaviour

In Zambia there has not been evidence of accountability especially on the part of directors. This is both in the private and public sector. There is a recycling of people in leadership positions from one company to another without any sort of disciplinary measures against those that take companies into insolvency fraudulently. For instance, L7 said that:

> '[T]here is no accountability for their behaviour and conduct on boards. Sometimes you just have directors doing what they want to do because the law will not hold them responsible. They can pursue their interests at the detriment of the company without facing any consequences at the end of it. For instance, there are companies in which directors are shareholders which already implies a conflict of interest. There won't be any accountability because such an individual report to himself or herself.' (L7)

Because one must be accountable, and a director is accountable to shareholders, but this is a shareholder and at the same time a director. He is accountable to no one. Even if he errs no one questions him because such people, are usually surrounded by people they have simply put on the board for the sake of the formalities under the Act, but they oversee everything. Empirical findings also established that there is lack of ethical behaviour on the part of creditors. The problem is that when creditors are trying to get their money back, they do not report wrongdoing by directors if they get their money back. One could argue that this is because they have taken what they wanted and have nothing to do with directors, and on the other hand one would argue that creditors ought to report wrong doing even if the company is able to pay them back. This is a matter of ethics and it must be a mandatory requirement that if creditors find wrongdoing, they must report it in order to promote good practice.

5.4.3 Theme L3. Shareholder control and legal personality

It was found that in practice there is no separation between the members and the company itself. The study found evidence of interference from the shareholders into the affairs of the company. This established first, the lack of separation between the shareholders and the company and the second problem is the presence of the agency argument. This is because shareholders consider the company as their own and not as an independent entity in law.

5.4.3.1 Sub-theme L3.1: Problems with the interference

The concept of legal personality does not apply in practice in terms of management of the company. Even though lawyers demonstrated that the company ought to be a separate entity in law, they did recognise that in practice this has been impossible for shareholders to maintain, as they want to know what is going on in the company from time to time. L4 stated that:

> '[I]t is an artificial entity that is separate from its members and in the eyes of the law cannot be run by the shareholders too… am afraid to say this does not happen because when anything on the board goes bad in Zambia I have known that shareholders were involved. Now how can you effectively enforce the law?' (L4)

This interference is owing to many reasons but evidently, to drive their interests such that some of them would rather put unqualified people on boards for hidden agendas owing to either personal interests or not having confidence in the directors. In supporting this view, L7 said that some of the directors are puppets as they have been sitting on boards because they have been planted by untrusting owners who want to pass wishes through such a director. This interference could imply the possibility of the courts to pierce the corporate veil if it is found that the control of the company was done fraudulently. The challenge is that, when the company goes into liquidation, the shareholders are still protected by the veil.

5.4.3.2 Sub-theme L3.2: The agency argument

Shareholders interfere with the affairs of the company and this is allowed not only by directors but also by the judiciary in their rulings. The shareholders have a superior position that supersede directors, and this is against the divide that must exist between shareholders and the company. This interference is in contradiction with the law because directors oversee managing and directing the company therefore shareholders appoint them. Two competing views have been forwarded regarding this interference. The first view is that directors as evidenced from the study, most of them consider shareholders as the principal and so they perform their duties for the benefit of the principal. Because they are the appointing authority and so as the principal under the agency theory in law, they control how the agent performs the duties. The second reason is that the shareholders consider themselves owners of the business, and so they can demand for any information they want any time. This has been the trend in Zambia. It was stated that:

> '[…] the interaction is only…the interaction is supposed to be at the annual general meeting or extraordinary meeting but you normally tend to have more interaction with the shareholders the shareholders want to know what is happening in the company.' (L5)

While shareholders are involved in company business, when the company goes into insolvency, the same shareholders claim that the company is different from them. They seek the protection of the corporate veil, yet they had control and influence over the decisions made that drove the company into liquidation.

5.4.4 Theme L4. A compromised judiciary

Banks have the right to take a company in default to court to enforce either the security or demand for payment of interest accrued on the facility. However, it has been indicated that while creditors want to enforce the legal right emanating from the contractual agreement with a company, the client on the other hand goes to court for protection. The debtor companies use the court system as a shelter from creditors. Two sub-themes emerged the first being litigation as shield and the second is state interference and politics.

5.4.4.1 Sub-theme L4.1: Litigation as a shield

It has been established that debtor companies use litigation as a means of delaying to pay their debts, or as a refuge from the immediate payment when it falls due. The company requests lawyers to take the matter for litigation as a way of finding relief from the financial obligation. This does not mean that the company is denying responsibility except they buy time by taking the matter to court. The company has the right to drag a creditor to court and they use injunctions against the banks. So, they want a mechanism to delay things and mostly they use the court process. It was said that a client would approach the lawyer and request for a delay mechanism as stated by L5 that: put in place a plan to rescue the company, you normally get such instructions where by the owners of the company say you know what, we are in trouble we can't pay these debts and we are instructing you to see if you can put a strategy to hold off our creditors. The implication is that while they are finding strategies to hold off creditors, this strategy means risk for creditors even though they can still dispose collateral, the issue of accumulative interests becomes a challenge. A company defaulting and seeking shelter from court is acting on fraudulent grounds than a company in default that engages creditors in a dialogue to have the loan restructured. However, in Zambia companies default and create so many excuses and run to court for protection. It was established that many of the debtor companies find refuge in the court process meanwhile it is bad for creditors. L6 confirmed that:

> '[…] they find a shield…. They use the court process as a shield in a way because they know that when they go to court, they will plead with the trial judge and ask that they pay a lesser amount…. normally happens or they will try and use the court process to try and see if the creditor can waive off a certain component on interest because you realise that the bulk of the money is in the interest and not the principal.' (L6)

It has been demonstrated that the courts have leniency on defaulting companies. While creditors are supposed to be relying on the judiciary to enforce their contractual rights, the court favours the company and therefore the only place were creditors would feel safe is taken away which implies lack of protection. This was illustrated in the Stanbic bank decision[862] in which the court decided against the creditor for listing a company as a bad debtor. They must depend on the goodwill of the company when they decide to honour the debts. This leaves creditors exposed legally and must find other mechanisms for their protection.

5.4.4.2 Sub-theme L4.2: State interference and politics

Empirical findings show interference from the government especially in companies associated with the opposition parties. The illustration can be seen from respondent C6 who recorded a 100% repayment record due to dealings with the mining sector using the government. Therefore, they want to make trade deals with foreign investors such as the Chinese on projects that can be done

[862] Savenda Management Services v Stanbic [2018] ZMSC 11

by local contractors. They use this as a platform for exploitation of government resources and the selling of companies such as the Lap green Scandal in which the president was implicated. Bribery has evidently gone up and this is seen as a way of getting things done which was also used by the Chiluba regime. Local authorities have been the platforms used as they get into standard contracts with other private companies and the Auditor General's reports have year in year out revealed financial irregularities, yet the government has not prosecuted those cases. The ACC has been only used for targeted people in opposition to the government. The government come in and disturb company until they shut them down. Most lawyers interviewed do represent the opposition some of them do represent the government they did indicate that the corporate sector is under the leadership of the ruling party and any economic policies implemented are aligned with the will of the politicians in charge. This is the role that politics plays in the corporate sector. This has brought about a lot of corruption and political financial crimes. The interference of political figures in the business sector is associated with corrupt practices and bribery. The extent is worrying as it has infiltrated the judiciary as well such that even prosecuting these cases based on the affiliation of political parties. L3 was concerned with discussing on going cases but noted that, the sector is rooted with the government in such a way that it feels like it is still under one-party rule. And L4 said that:

> '[…..] a lot of powerful cases in our courts have been influenced by politics which is the reason why even the judiciary is infested with corruption, bribery, all sorts it is disappointing that we do not have an independent judiciary. (L4)

The interception of politics in the corporate sector is rooted from way back due to power struggle for control of natural resources such as the mining industry. Whereas it is difficult to separate politics from the corporate sector completely, the starting point would be to ensure that people have confidence in the law, and the judiciary is independent. There is need to regulate government contracts and at the same time stiffen the fight against corruption and enforce the AG's reports to deter political financial crimes. The independence of the ACC is very crucial as it will allow the prosecution of the perpetrator without fear or favour of who is involved. It is important to have certain benchmarks to regulate the contracts between the private sector and government institutions.

5.5 Conclusion

In conclusion this chapter analysed the findings from the interviews. While some of them are similar, they were arranged categorically for clear illustration of what emerged from each data set. The main findings from creditors showed evidence of a bad credit culture. This is because of the dishonest behaviour of the shareholders as well as irregularities shown by the banks when issuing loans. This is where the bank decides to forego bank prudential policies and treat a company purely on corporate relationship in pursuit of business. This culture is based on dishonest behaviour of the directors and shareholders after acquiring a loan. This behaviour is because of inadequate disclosure measures under the Companies Act and the challenges associated with collateral. It was found that companies with shareholders who are influential use their positions to obtain loans through the company and sometimes these loans are used for personal things unlike business investment. Once a default has been recorded, there is an option of restructuring the loan or creditors will choose to dispose the security. The challenges arise when the dishonest was also on the security because if the security is unclean, it is loss for creditors. This is because the security does not take away the risk but reduces it. Creditors must find other means of protection such as the signing of directors' guarantee and also requesting for higher interests, which poses a danger of loss of customers because borrowing will become expensive. This finding is consistency with the problem that was identified in the literature on interference of shareholders which is endorsed by the courts.

The findings indicate that there are shortfalls in the law relating to creditor protection. There is no legal framework for business that is financially distressed. There is no effective framework for corporate rescue and as a result, a company that is financially troubled more than likely ends up in liquidation. In Zambia it has been established that by the time the company goes into insolvency, there is nothing left for the business to survive. This is owing to how a company is managed by directors who find it difficult to tell when a company is financially troubled. One of the reasons include lack of codified duties for directors which can enable certainty as to what directors must be doing. The implication for this is that creditors risk losing their money because the company has been mismanaged. And once the company goes into insolvency, it was found that directors responsible not held accountable because the law renders accountability almost impossible in practice. Certain provisions of the law that were enacted to help creditors such as fraudulent and wrongful trading are not helpful in practice. Literature identified the problem of difficulties in applicability of fraudulent and wrongful provisions and this has been substantiated in empirical findings. This means that the mechanisms provided by law for creditor protection are ineffective. The role of the board is characterised by many problems such an appointment of unqualified directors, incompetency, and unawareness of directors' duties and the lack of accountability were all established in the findings. The implication is, while there is possible fraud going on, directors are complacent because they take no responsibility for their decisions. Even though corporate governance has been suggested as a means that can help implementation of the law, the findings show a poor corporate governance culture due to weak regulatory framework. There are no strong controls for corporate governance practices especially in the SOEs. The publicly traded companies are required to comply with the code, but this is challenging in that, compliance is selective because of corruption and also state interference. This has achieved the third research question of the study which was to find out the challenges faced by creditors in Zambia. The next chapter discusses the implication of these findings on creditor protection in more detail.

CHAPTER 6: Discussion of empirical findings

6.1 Introduction

The previous chapter answered the third research question which was to find the problems creditors face in Zambia. The purpose of this chapter is to address the third objective which is to assess the implementation of the legal framework for creditor protection in Zambia. This will highlight the areas of contribution especially, what can be done to enhance creditor protection and to improve the quality of law in relation to directors' duties. The structure is broken down into five sections headed by the central themes. The first section covers common theme 1 which is the bad working ethics, the second section covers common theme 2 which is ambiguities in the legislation and its implications on creditors, the third section is common theme 3 which is incompetency exhibited by directors, section four is common theme 4 which is the weak corporate governance structure, and institutional challenges, and section five is common theme 5 which is the state interference and a compromised judiciary. These common themes emerged from the sub-themes in the analysis of findings. The diagram below illustrates how the sub-themes moulded the common themes.

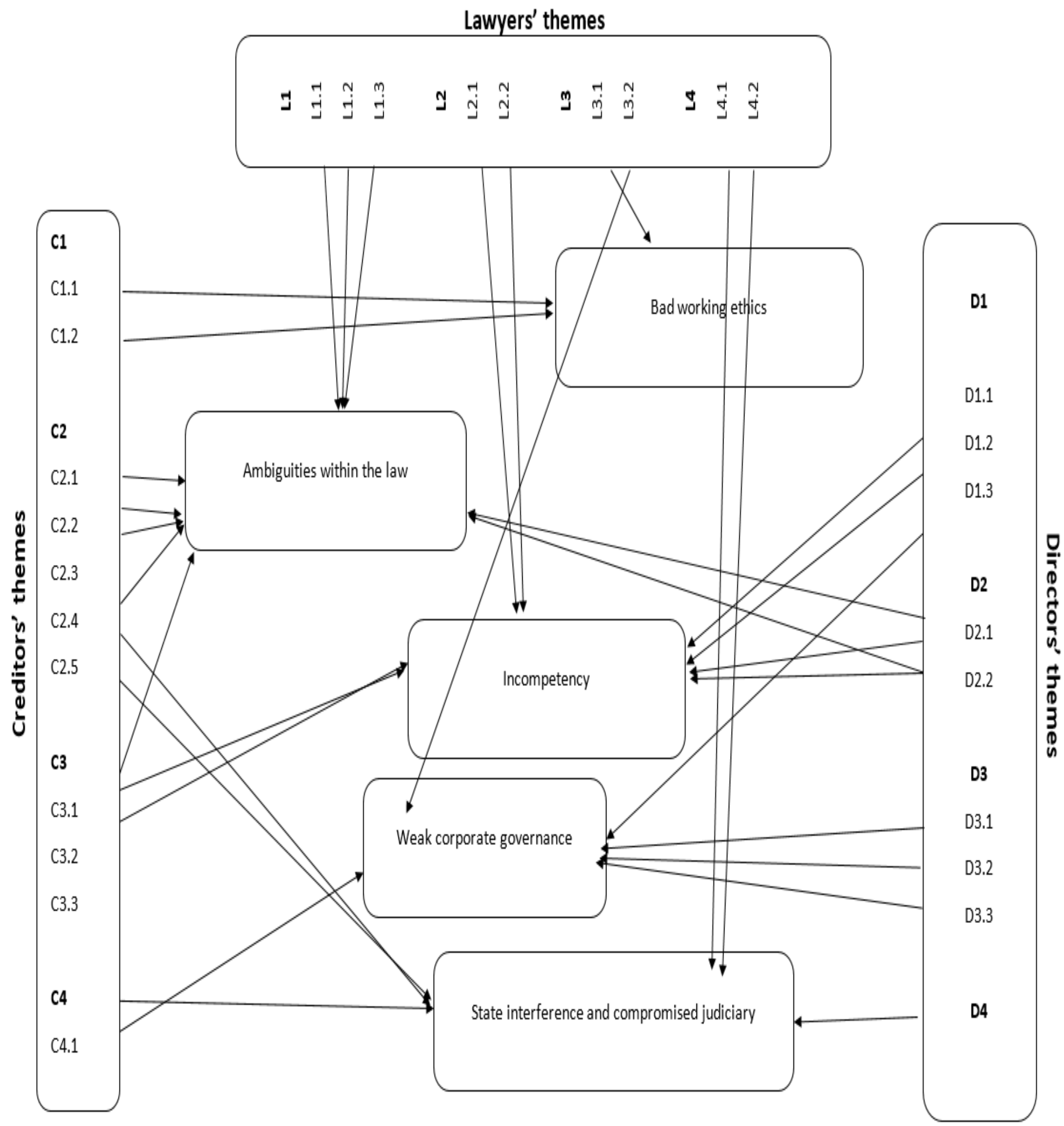

Figure 6:1 Model of emerging themes

6.2 Common theme 1: Bad working ethics

Empirical findings show irregularities both from companies and creditors. These start with the company when applying for a loan because sometimes inaccurate information is tendered. The bank in their due diligence do require a management letter for them to see if the financial accounts can be supported. The management letter usually indicates if the audited accounts were unqualified or not by auditors. However, it was established that the amount of due diligence even though properly done, there is a tendency of companies not disclosing important information and the bank cannot compel them otherwise. One can argue that, this is where the bank can decline lending, and on the hand, a compromise to proceed could be made. While it is easier not to proceed, creditors' business is risky in nature and because of this fact, it is important that they are given adequate protection within the law. The challenge comes after a default has been registered by the bank because this is when information emerges about inaccurate disclosure.

Companies are willing to withhold vital information in pursuit of acquiring a loan and this is unethical. Not only is it dishonourable but borderline fraud which is almost impossible for creditors to prove. This is the same behaviour exhibited by companies when tendering collateral. Creditors were concerned that in most cases collateral is unclean and it was suggested that in order to improve recovery of debt, there is need for security to be clean.[863] This is because if it is not, it becomes expensive for creditors and in the process, increases the risk. The recovery procedures of a loan through disposal of the security has been said to be very difficult[864] and this was confirmed by creditors that most of the times collateral is unclean and upon default, issues such as ownership of security emerge and this becomes costly for creditors to fight in court and it takes a lot of time. In the process, they end up realising less than. It has been argued that the sole purpose of collateral is not repossession but an incentive to reduce risk, and this does not eliminate it completely.[865] In fact, Keay suggested that even though collateral has been the most used mechanism for creditor protection, it is insufficient because it only reduces the risk not a viable options for all creditors.[866] Another problem for creditors is the fake valuations of property for collateral because there is no

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[863] Reinier Kraakman, 'Concluding Remarks on Creditor Protection' (2006) EBOLR, 7, 465
[864] Richard S. Bradstreet, 'Should Creditors Rely on the Insolvency and Liquidity Threshold for Protection? A South African Case Study' (2015) JAL, 59, 121
[865] Michael J. Mumford and Alan J. Katz, 'Making Creditor Protection Effective' (2010) JCI, 3, 1756
[866] Andrew Keay, 'Directors' Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors' (2003) MLR, 66, 665

regulation. The law does not provide for accountability for misleading valuations given by companies. This needs urgent intervention because there is no recourse against such unprofessional conduct. On the other hand, when creditors are dealing with companies having shareholders who are influential, the bad working ethics are exhibited by creditors themselves. It was found that lack of separation between shareholders and the company has affected creditors to an extent where unprincipled lending is exercised because the bank wants to maintain corporate relationships. This happen in form of back door calls from shareholders because of the influence they have on the board, the bank lends in pursuit of business. However, this is dishonourable, and it was one of the problems that led to bank failures in 1990s as reliance on lending to big corporations, in sider lending and ignorance of responsible lending were practiced.[867]

Problems such as reckless lending, bad ethics huge unrecoverable loans are still apparent despite the amendments to the BFSA. This theme seems to endorse the findings of Ramachandran and Shah[868] on the growth of indigenous businesses in the Sub-Sahara Africa. They found that foreign companies took the top spot because of certain incentives such as credit arrangements that are favourable and mechanisms for spreading managerial responsibilities which can be delegated and quality of information to lowering of transactional costs. They had an effective mechanism that governed the agency relations which removed the need for embezzling funds. However, in this study it was found that the agency relation between shareholders and directors did not focus more on the embezzlement of funds however, to an extent, shareholders used this relationship to acquire loans and divert company funds through their agents. This study establishes a different kind of agency problem through which shareholders use to exploit company assets. The challenge is that the interference of shareholders is endorsed by the judiciary as established in the literature which makes it difficult to question their involvement. In contrast with the UK practice where the agency problem is centred on abuse of discretion by directors.[869] It was noted that in the nineteenth century when there was multiplicity in the number of shareholders and directors, the authority shifted from

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[867] Sheilla Nyasha and N.M. Odhiambo, 'Economic Growth and Market-based Financial Systems: A Review' (2015) SEF, 32, 235

[868] Vijaya Ramachandran and Manju Kedia Shah, 'Minority Entrepreneurs and Firm Performance in Sub-Saharan Africa' (1999) JDS, 36, 71

[869] Michael C. Jensen & William H. Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs & Ownership Structure' (1976) JFE, 3, 305

the principal to the agent thereby bringing about abuse of authority by the agent.[870] It has been shown that in Zambia the agency problem is founded on the abuse by shareholders and in return this exposes creditors to risk. It leaves them vulnerable at the mercy of the few directors who insist on ethical behaviour on boards and have the courage to stand firm against the wishes of the shareholders if unsound. This problem can possibly be changed if the courts in the dispensation of their duties can state that there should be a separation of shareholders from the management of affairs in the company because this is the purpose to which directors were appointed. Their interference needs to be limited to the times prescribed in the Act.

6.3 **Common theme 2: Ambiguities within the law**

The provisions of the law are essential, but, implementation and enforceability are very important.[871] This argument was also evidenced in the works of La Porta et al,[872] and Maimbo.[873] La Porta et al found that most common law jurisdiction had a stronger legal protection for corporate investors because of the quality of enforcement and legal protection and the ease of shareholder protection from exploitation by management.[874] However, in Zambia the legal framework is weak and also the shareholders are the ones that are more into exploitation as opposed to management. Maimbo found that, there is need to remove administrative weaknesses and strengthen regulatory measures.[875] Even though He focused on the banking sector, this study established the need for legal provisions to be strengthened in order to yield enhancement for creditor protection. Having the law is not enough if it cannot be enforced. Finch suggested that credit arrangements are complex rendering the mapping of legal procedures significant for companies seeking credit.[876] Section 12 of the Companies Act requires that on application for incorporation, nature of business be disclosed[877] and under section 22 a company is permitted to carry out any lawful business

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[870] Adolf A. Berle and Gardiner C. Means cited in Bob Tricker, *Corporate Governance: Principles, Policies and Practices* (2nd ed. Oxford University Press, 2012) 59

[871] Kenneth K. Mwenda, Wrongful Trading and Fraudulent Trading in Corporate Insolvency Law: The Case Study of Zambia (2008) OUCLJ, 8(1), 93-116

[872] Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer and Robert W. Vishny, Law and Finance (1998) JPE, 106(6), 1113-1155

[873] Samuel Munzele Maimbo, Explaining Bank Regulatory Failure in Zambia (2002) JID, 14, 229-248

[874] Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer and Robert W. Vishny, Law and Finance (1998) JPE, 106(6), 1113-1155

[875] Samuel Munzele Maimbo, Explaining Bank Regulatory Failure in Zambia (2002) JID, 14, 229-248

[876] Vanessa Finch, Corporate Insolvency Law: Perspectives and Principles (2nd ed. Cambridge University Press, 2009) p.74

[877] Section 12(4), Companies Act, 1994, Chapter 388 of the Laws of Zambia

whether specified in the pre-incorporation form or not.[878] The challenge arising from the authority under section 22 is the permissible fraud and misrepresentation that comes with changing the line of business because at the time the facility was agreed, the line of business was different and risk was evaluated against such. This problem is borderline fraud and misrepresentation even though allowed by the statute. Creditors were concerned that if companies change businesses anytime, it poses a challenge on them because it is fraud and therefore directors need to be held liable for the debt of the company pursuant to fraudulent provisions. Mwenda found that the provisions for fraudulent trading are almost impossible to use effectively because of the heavy standard of proving beyond reasonable doubt.[879] It is argued in this study that this change of business in itself constitutes fraud and perhaps creditors could sue on this basis. This however entails that the law needs to be amended so that it can be subject notification by the company to creditors.

The only time directors can be made answerable is under the provisions of fraudulent and wrongful trading.[880] The law gives an incentive of trading during financial difficulties, however there is a likelihood of personal liability on directors for wrong doing.[881] It was revealed that without adequate information, creditors find it difficult to prove directors are liable for fraudulent trading. Although it is an offence to conceal information to creditors, it is argued that establishing fraud is very difficult because creditors are not privy to transactions directors make. Creditors lack information on how directors comply with the law hence, it is difficult to hold them accountable for their actions.[882] This is why in Zambia directors are not accountable for their decisions because the law has not made it viable. As much as the law requires fraud be established in theory, in practice it was found to be impossible and this is the basis on which the corporate veil can be lifted. It is important to note that while the findings established that creditors find it difficult to hold directors accountable owing to their fraudulent decisions, their reasons for this challenge was not only the lack of information but also the reluctance of the court to lift the corporate veil and impose liability on members and directors. There seems to be a misunderstanding on how the law in principle and in practice is applied. The reason for this argument is that lifting the veil under

[878] Section 22, Companies Act, 1994 Chapter 388 of the Laws of Zambia
[879] Kenneth Kaoma Mwenda, 'Corporate Insolvency Law and the Liability of Company Directors for Wrongful Trading and Fraudulent Trading' (2008) Zam LJ, 65
[880] Section 383, Companies Act 1994, Chapter 388 of the Laws of Zambia
[881] Kenneth Kaoma Mwenda, 'Corporate Insolvency Law and the Liability of Company Directors for Wrongful Trading and Fraudulent Trading' (2008) Zam LJ, 65
[882] Ibid

fraudulent trading is for purposes of holding directors personally liable for their decisions. Where fraud by directors has been known by the shareholders, the veil can be lifted in order to impose liability on the shareholders too. However, it is thought that directors too are protected by the corporate veil. What is imposed under this section is personal liability on directors for fraudulent trading. In practice the cases of wrongful trading are not even brought to book because the provision of the law is almost useless. It requires that a conviction be secured under section 357 and an officer of the company has been found guilty of criminal charges. Only then can civil liability be imposed by the court. This requirement renders that law impossible to implement which leaves creditors unprotected against any wrongful trading by directors. This can be cured if the quality of information is made available to creditors on the implementation of the projects for which the money is borrowed. Such monitoring mechanism could perhaps improve dissemination of information to creditors. The permissible fraud under section 12 and 22, the challenges in fraudulent and wrongful trading provisions and the impractical mechanism of lifting the corporate veil have been found to be problematic in terms of enforcement and implementation in practice. This finding confirms the problems identified in the literature and establishes how law has neglected creditors.

6.4 Common theme 3: Incompetency

While directors affirmed their role of oversight, and as trustees of the company for the benefit of the shareholders, evidence showed a lack of understanding of their duties. Lawyers highlighted the challenges of not having codified duties for purposes of certainty. This concern was similar as expressed by creditors who felt that some directors lacked the understanding and skill needed for governance. Directors amongst themselves did allude to the lack of awareness and understanding of their duties citing lack of law and some of them citing mere ignorance, corruption, lack of ethics, and transparency, lack of education, others citing lack of mechanisms for accountability. Whereas it is right to assume that no shareholder would want to appoint a director without a qualification, it is also right to state that some people in the society are not educated however, they have influence obtained from exposure especially those in the category of 'some of us' because of social affiliations, and privileges such as wealth. People falling into the above category have been found to command a certain level of influence such that shareholders are happy to have them on boards or being associated with their companies. It was argued that foreign companies have an advantage surpassing those of African origin because of professionalism which included qualifications and work experiences among other factors.[883] It was further argued that there was need to invest in the education sector for better competent workforce. It was established that the level of education leads to better managerial skills including the ability to employ qualified staff.[884] This is especially true in developing countries where political careers and appointments require loyalty and connections as posed by Nkomo.[885] This study calls for qualification in terms of education to be considered as one of the minimum requirements for directorship positions. This is resulting from high level incompetency that was found in the empirical analysis. There was also high-level culture of nepotism found in Zambia. This affects both creditors and the company itself as ethical and effective decisions are lacking.

Shareholders might view it as a positive thing because they can control the board through such appointments. This is because such directors are likely to serve the interests of the shareholder as opposed to the company and they bring no independent judgement to the team. Secondly, they have no skills to contribute on deliberations of the board meetings if they sit and take a vote. The board as a vehicle of the company, in order to drive the company to sustainable business and profit, need skilled, knowledgeable, professional, and qualified personnel, who understand strategic decision making, risk management and the need for ethics in organisations. Creditors were of the view that financial training could at least be given to directors as well as management teams for purposes of adequately combating risk, and, lawyers suggested that directorship positions should have at least a minimum qualification of a degree. The study found lack of understanding of directors' duties and this needs change to have competent directors who understand what their duties are and are they can perform them. This argument is supported by the premise given by Keay that understanding or knowing what exactly directors ought to be doing enables them to avoid personal liability because, their duties to the company involve other stakeholders such as creditors.[886] While under common law directors are required to consider creditors' interests when a company is going through financial difficulties,[887] it was found that in Zambia this requirement

[883] Vijaya Ramachandran and Manju Kedia Shah, 'Minority Entrepreneurs and Firm Performance in Sub-Saharan Africa' (1999) JDS, 36, 71
[884] Ibid
[885] Mokubung O. Nkomo, 'A Comparative Study of Zambia and Mozambique: Africanization, Professionalization, and Bureaucracy in the African Postcolonial State' (1986), JBS, 16, 319
[886] Andrew Keay, 'Formulating a Framework for Directors' Duties to Creditors: An Entity Maximisation Approach' (2005) CLJ, 64, 614
[887] Andrew Keay, 'Shifting of Directors' Duties in the Vicinity of Insolvency' (2015) IIR 24, 140

is not applicable in practice even though directors' duties are founded on common law. This finding is in support of Mwenda who called for laws to be enacted regulating the corporate sector because lack of regulation has led to self-enrichment by stealing assets of the company under their control.[888] While Mwendas' study emphasised the need for disqualification of directors, this study adds to this call by suggesting that education be added to directors' qualifications because, this will enable them to understand their duties and improve the quality of decisions on boards. This will also add to the merits of understanding why ethics is important in governance.

Directors need to consider interests of creditors when the company is financially struggling.[889] Keay argued that this is because the money involved at this time in many cases belong to creditors.[890] Kraakman also argued that shareholders and directors are motivated to take up more risky projects in the vicinity of insolvency because they do not have to take the risks for any failures.[891] This duty has come under scrutiny especially from the contractarian views whose arguments are founded on the works of authors such as Coase,[892] Jensen and Meckling, [893]and Easterbrook and Fischel.[894] The basis for the argument is that placing on directors additional duties towards creditors increases the cost of management and reduces efficiency because there are other ways in which creditors can protect themselves such as through freedom of contract and the free market.[895] Even though Posner argued that the above argument does little in creditor protection, he does not support the addition of fiduciary duties to directors because resources might be put to the use of monitoring especially the financial affairs of the company instead of maximising profits for shareholders.[896] To the contrary, Keay urged that directors undertaking more attention to monitoring is more of a normal practice for their duties to ensure that they are well informed about the state of financials for purposes of compliance with regulation as well as ensuring that the

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[888] Kenneth Kaoma Mwenda, 'Corporate Insolvency Law and the Liability of Company Directors for Wrongful Trading and Fraudulent Trading' (2008) Zam LJ, 65
[889] Section 172(3), Companies Act, 2006
[890] Andrew Keay, 'Shifting of Directors' Duties in the Vicinity of Insolvency' (2015) IIR 24, 140
[891] Reinier Kraakman, 'Concluding Remarks on Creditor Protection' (2006) EBOLR, 7, 465
[892] Ronald Coase, 'The Problem of Social Cost' (1960) JLE, 35, 75
[893] Michael C. Jensen & William H. Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs & Ownership Structure' (1976) JFE, 3, 305
[894] Frank Easterbrook and Fischel Daniel, *The Economic Structure of Corporate Law* (Harvard University Press, 1991) 188
[895] Harry J. Glasbeek, 'More Direct Director Responsibility: Much Ado About ... What?' (1995) CBLJ, 25, 416
[896] Richard Posner, 'The Rights of Affiliated Corporations' (1975) UCLR, 43, 499

company is not involved in wrongful trading.[897] Empirical findings indicate that this duty is nonexistence in practice as creditors only get involved when the company is in receivership and liquidation. Directors are usually not sure when the company has gone into distressed mode others cited the incompetence of management and others said they lack adequate information to realise that they are running out of money. While creditors were of the view that directors lack financial training to manage such risks on a daily basis, lawyers said that there is no law regulating the conduct of directors when a company is financially distressed and the duty under common law does not apply in the Zambian context. Henceforth, once they establish that the company has no money, liquidation is the only option. There is no place for corporate rescue, and this is problematic because there is no regulation for struggling companies. The implication of this finding is that even when a company is capable of being rescued, there is no mechanism for such rescue and in the process, it ends up in liquidation which means potential loss for creditors. This also contributes to the lack of protection for creditors because directors have no obligation to consider creditors' interests when a company is struggling due to lack of understanding of their duties under common law. This study calls for the introduction of this duty in Zambia with special attention given to the challenges faced in the UK so that uncertainties in enforcement and implementation can be avoided.

6.5 **Common theme 4: Weak corporate governance**

Despite the different theories in corporate governance, no single model has been internationally recognised as the best. However, shareholder primacy model constructed on the agency theory has dominated both the UK and developing countries.[898] The findings showed a corporate sector built on shareholder primacy model of governance. The post-colonial era has seen laws being adopted from UK and this did not isolate the model for corporate governance.[899] This confirms the arguments of Chanda et al, who found that corporate governance in most developing countries seem to favour and lean towards promoting the interests of shareholders and their desire for

[897] Andrew Keay, 'Directors' Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors' (2003) MLR, 66, 665
[898] Mathew Tsamenyi, Elsie Enninful-Adu & Joseph Onumah, 'Disclosure and Corporate Governance in Developing Countries: Evidence from Ghana' (2007) JMA, 22, 319
[899] Racheal Ntongho, 'Self-regulation of Corporate Governance in Africa: Following the Band Wagon?' (2009) ICCLR, 20, 427

profits.[900] Lack of accountability has been one of the biggest challenges causing poor economic performance in developing countries without Zambia being exception.[901] Although Zambia has experienced political stability unlike its neighbouring countries in the southern region of Africa, the challenges and economic failures have been attributed to the failures in governance structures, policies and benchmarks just like its counterparts in the region.[902] Owing to the above, it can be argued that this is the reason why corporate governance deserves utmost attention in order to improve corporate behaviour in the economy. Tricker stated that corporate governance is important for regulating companies, preventing irregularities, abuse of power without inhibiting flexibility, innovation and entrepreneurial risk taking.[903] However, these have been exhibited and Zambia has not been left out on corporate failures as the country saw one of the leading newspaper companies closed down with a huge debt behind and the recent liquidation of the largest mining company and employer Konkola Copper Mines KCM.

The findings established problems faced governance institutions mandated to promote good practices. The regulatory regime and efforts to spearhead the development of corporate governance in Zambia is vested in the IODZ, LuSE, SEC, and BOZ as the main institutions. Despite the efforts of the IODZ in promoting awareness through workshops, trainings, and conferences, it was found that the institute itself is not well equipped with authority as it is not regulated by an Act of Parliament. In a jurisdiction with a well-structured corporate governance regime, reliance on the law is minimal.[904] However, La Porta et al submitted that in countries with weak legal systems, the governance culture is weak.[905] Further, they argued that even though it is possible for firms to improve the corporate governance culture through a properly structured system, this mechanism cannot substitute the need for legal infrastructure.[906] This is similar to the submissions by Shleifer

[900] Shikaputo Chanda, Bruce Burton and Theresa Dunne, 'The Nature and Potential of Corporate Governance in Developing Countries: Zambian Perceptions' (2017) AAAJ, 30, 1257
[901] Ibid
[902] Ngozi Okoye and Juliana Siwale, 'Microfinance Regulation and Effective Corporate Governance in Nigeria and Zambia' (2017) 59,102
[903] R.I. Tricker, *Corporate Governance: Practices and Powers in British Companies and Their Board of Directors* (Gower Publishing, 1984) 98
[904] Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer and Robert Vishny, 'Investor Protection and Corporate Governance' (2000) JFE, 58, 3
[905] Ibid
[906] Leora F. Klapper, and Inessa Love, 'Corporate Governance, Investor protection, and Performance in Emerging Markets' (2004) JCF, 10, 703

and Vishny, who posed that legal protection is the effective mechanism by which investors such as shareholders and creditors can be protected.[907] It is therefore argued that without an effective legal framework, although the IODZ can independently try to improve its efforts on corporate governance, this cannot be successful because the legal system is weak in Zambia. The poor performances in some sectors of the economy is because of lacking strong corporate governance systems in place.

SEC and LuSE are mandated with the authority to regulate the conduct of listed companies in Zambia and this is done through the Listing rules and the corporate governance Code 2005. The enactment of the Code was in a bid to improve accountability, transparency and to attract investment.[908] For listed companies, complying with the Code is not mandatory because of the approach of ‘comply or explain’ adopted from the UK. However, owing to the lack of repercussions for non-compliance, companies are not bothered. What they do is just to put up a statement as they want because there is no accountability as to why they have not complied. There is no study showing statistics of how many companies do comply and those that do not comply, what kind of explanations they give for non-compliance. It has been argued that lack of effective enforcement mechanisms has created a ceiling for corporate governance standards such that even the minimum rules such as complying without any legal consequences is a struggle. It was contended that legal rules and corporate governance codes of a country infused together is a vital key to effective enforcement.[909] It is therefore proposed that corporate governance rules and principles be integrated into the Companies Act for better adherence.

The Central Bank formulates legal benchmarks and financial policy for the markets and works in partnership with key stakeholders such as the National Pension Scheme Authority, and the Zambia Revenue Authority (ZRA).[910] Major financial institutions like Zambia Information and Communications Technology Authority (ZICTA), Financial Intelligence Centre (FIC) and the Competition and Consumer Protection Commission (CCPC) have also been part of the financial

[907]Andrei Shleifer and Robert W. Vishny, ‘A Survey of Corporate Governance’ (1997) JF, 72, 737
[908]Shikaputo Chanda, Bruce Burton, Theresa Dunne, ‘The Nature and Potential of Corporate Governance in Developing Countries: Zambian Perceptions, (2017) AAAJ, 30, 1257
[909] Simeon Wanyama, Bruce Burton and Christine Helliar, ‘Frameworks Underpinning Corporate Governance: Evidence on Ugandan Perceptions’ (2009) CGIR, 17, 159
[910] Nicholas M. Odhiambo, ‘Financial deepening and poverty reduction in Zambia: an empirical investigation’ (2009) IJSE, 37, 41

sector as it is important to have fair, effective and sound coordination of the institutions. The Central Bank has made positive steps into improving corporate governance within the financial sector through the Bank of Zambia guidelines on corporate governance requirement of the 'fit for purpose test.'[911] This is a positive mechanism into appointing qualified and skilled people who are able to perform their duties with competence. It is argued therefore that the same could be imposed for other directors not only in the financial sector as this would promote harmonisation of the laws on governance. Whereas directors were upfront about the lack of developed framework for corporate governance, creditors demonstrated a slight awareness because of the BFSA.

It was demonstrated that the perceptions of corporate governance in Zambia are very weak and in its early stages even though the pace is arguably slow since the implementation of the corporate governance Code 2005. Respondents seemed to have ideas that corporate governance can secure a steady growth of the economy by enhancing standards on transparency and accountability and disclosure but there was no indication of the zeal to appreciate these. The concept itself is not self-sufficient or developed to promote its advantages such as transparency and good ethics within the corporate sector. These can only be improved if there are strong and enforceable systems of governance which lead to high investor confidence.[912] However, there was no evidence of monitoring and oversight in terms of corporate governance practices hence lack of appreciation. This opens potential loopholes for corruption as respondents were concerned that the development of corporate governance cannot be independent from the fight against corruption. An effective appreciation of corporate governance has been argued to have potential to secure a steady growth of the economy essential for vital inward investment.[913] While corporate governance structures in developed countries are much more advanced and effective, the Zambian perceptions have been associated with factors such as ownership structures, cultural influence, legal benchmarks and political environment which was found to be very weak. This finding is consistent with the conclusions by Chanda et al when they said that the concept in Zambia is still young with a lot of

[911] Section 31, Banking and Financial Services Act, 2017
[912] Shikaputo Chanda, Bruce Burton, Theresa Dunne, 'The Nature and Potential of Corporate Governance in Developing Countries: Zambian Perceptions' (2017) AAAJ, 30, 1257
[913] Ngozi Okoye and Juliana Siwale, 'Microfinance Regulation and Effective Corporate Governance in Nigeria and Zambia' (2017) 59,102

challenges on how to improve it.[914] One of the challenges has been lack of accountability, transparency and ethics. Lack of accountability both in the private and public sector was found. Instead of disqualification of erring directors there seems to be a tendency for recycling the same people in leadership positions from one company to another without any sort of disciplinary measures. It has been argued that in Zambia it is unheard of to hold directors accountable for taking companies into insolvency fraudulently.[915]

Empirical findings also established lack of ethical behaviour on the part of directors and creditors. The problem is that when creditors are trying to get their money back, they do not report any wrongdoing by directors if they get their money. One could argue that this is because they have taken what they wanted and they have nothing to do with directors, and on the other hand one would argue that creditors need to be obligated to report wrong doing even if the company is able to pay them back. This could promote good practice and ethical behaviour. In 2017, the credit risk in the banking industry was the second most highly rated issue because of the rise in percentage from the allowed prudential limit of 10% to 11.6% due to the high number of non-performing loans.[916] The Bank of Zambia found that the non-performing loans threshold went up to 12.4% above the prudential 10.0% allowed thereby mounting financial stress on the banking industry.[917] The percentage of nonperforming loans indicate the profile system of the financial sector with a high percentage implying the challenges banks face in recovering their money.[918] While others have called for corporate governance to be developed for purposes of attracting investment for growth of the economy, this study goes further to argue that corporate governance can also enhance the implementation of the law because the law takes time to change in order to catch up with new developments.

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[914] Shikaputo Chanda, Bruce Burton, Theresa Dunne, 'The Nature and Potential of Corporate Governance in Developing Countries: Zambian Perceptions' (2017) AAAJ, 30 1257

[915] Kenneth K. Mwenda, 'Wrongful Trading and Fraudulent Trading in Corporate Insolvency Law: The Case Study of Zambia' (2008) OUCLJ, 8, 93

[916] PWC, 2017 Zambia Banking Industry Survey: Cautiously Optimistic (2018) https://www.pwc.com/zm/en/assets/pdf/2017-banking-industry-survey-report.pdf accessed29/01/2019

[917] A bank of Zambia Journal (2018) http://www.boz.zm/June-2018.pdfaccessedon29/01/2019

[918] http://www.boz.zm/Zambanker-June-2018.pdfaccessedon11/05/2019

6.6 Common theme 5: State interference and a compromised judiciary

Findings show interference from the government especially in companies associated with opposition parties. Creditors alluded to this interference through politics and exposed shareholders and directors who, sometimes get loans using this influence and paying back turns into politics. Director respondents alluded to politics in the corporate sector due to effects of socialism and lawyers indicated political interference through the judiciary. The case of JCN Holdings Ltd v Zambia Development Bank[919] which involved a debt over 12million dollars (over 60 Billion Kwacha) as discussed in chapter three. The owners of the company are influential public figures exposed to politics, yet the bank continues to make losses as a result. This causes corruption, unprofessionalism and eventually engaging in fraudulent practices and creditors believe shareholders do this to sustain lavish lifestyles to maintain their status.

A study carried out by Okeahalam found that fraud and corruption in Africa has affected the development of businesses as politics exposed them to risk.[920] Political leadership and the commitment of the government for corporate sustainability in the bid for growth of the economy has been a driving feature in the control of managerial behaviour in Zambia.[921] It has been argued that interference of political figures in the business sector is associated with corrupt practices and bribery. [922] Corruption is rooted in the need to maintain control of the corporate sector for natural resources such as the mining industry.[923] This is evident from trade deals with foreign investors such as the Chinese on projects that can be done by local contractors. Instead of using these projects as a mechanism to promote local contractors, they allegedly use it as a platform for stealing public funds because of weaknesses in enforcement framework.[924] Bribery has evidently gone up and this is seen as a way of getting things done which was also used by the Chiluba regime.[925]

Directors seemed concerned that the presence of corruption is because of socialism since the government oversees everything. Coupled with the lack of accountability, and weak enforcement

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919 [2012] ZMHC 26
920 Charles C. Okeahalam, 'Corporate Governance and Disclosure in Africa: Issues and Challenges' (2004) JFRC, 12, 359
921 Jotham C. Momba, 'The Intersection between Politics and Corruption in Zambia' (2007) SAJIA, 14, 115
922 Ngozi Okoye and Juliana Siwale, 'Microfinance Regulation and Effective Corporate Governance in Nigeria and Zambia' (2017) 59,102
923 Mwaka Nakazwe, 'Life Beyond the Glitz and Glamour of Mining: Strengthening the Mine Closure Regime in Zambia' (2017) JENRL, 35, 325
924 Desmond Tutu Ayentimi, John Burgess and Kerry Brown, 'Developing effective local content regulations in sub-Sahara Africa: The Need for More Effective Policy Alignment' (2006) MBR, 24, 354
925 Jotham C. Momba, 'The Intersection between Politics and Corruption in Zambia' (2007) SAJIA, 14, 115

mechanisms for both law and corporate governance, the boards are full of corrupt people. From the Kaunda era in 1964, corruption, lack of accountability, and political crimes have been at the centre of the corporate sector.[926] Generally institutions perform poorly because of the nature of governance and the way in which strategic policies are formulated to fit the political needs of the few. Although the Anti-Corruption Commission (ACC) has been trying to fight corruption, the government has so much influence on what cases can be pursued. Whereas it is difficult to separate politics from the corporate sector completely, the starting point would be to stiffen the fight against corruption. It has been argued by Chanda et al,[927] Wanyama et al,[928] Momba,[929] Burton, Okeye and Siwale,[930] and Okeahalam[931] that the fight against corruption is a feature that can help advance corporate governance in developing countries. The findings confirm the above argument and it is further proposed that perhaps in a country like Zambia where soft law for corporate governance has failed to develop after a long time since the concept emerged, it is possibly time to consider legal effect. From the time of independence in Zambia, the judiciary has been a compromised institution against the concept of separation of powers.[932] The political structure has shifted power from institutional inclusiveness to a centre pivotal where the executive power of the president is a source of policy at which power is centrally controlled.[933] This has been illustrated in a number of cases such as the sentencing of the director for Southern African Network against Corruption (SANAC) to six years imprisonment for a contempt charge because he opposed the outcome of an appeal in a high-profile commercial case. This was surrounded by corruption allegations as some LAZ officials welcomed the verdict, but these were allegedly corrupt ones within the association. The Judiciary was involved in this huge corruption scandal when the Chief Justice was alleged to have received huge amounts of money to secure a judgment but it could not refute these allegations but LAZ issued a statement defending the judicial system. The director called the Chief Justice as

[926] Stuart J Barton, 'Why Zambia Failed' (2015) JIE, 11, 803
[927] Shikaputo Chanda, Bruce Burton, Theresa Dunne, 'The Nature and Potential of Corporate Governance in Developing Countries: Zambian Perceptions' (2017) AAAJ, 30, 1257
[928] Simeon Wanyama, Bruce Burton and Christine Helliar, 'Frameworks Underpinning Corporate Governance: Evidence on Ugandan Perceptions' (2009) CGIR, 17, 159
[929] Jotham C. Momba, 'The Intersection between Politics and Corruption in Zambia' (2007) SAJIA, 14, 115
[930] Ngozi Okoye and Juliana Siwale, 'Microfinance Regulation and Effective Corporate Governance in Nigeria and Zambia' (2017) 59,102
[931] Charles C. Okeahalam, 'Corporate Governance and Disclosure in Africa: Issues and Challenges' (2004) JFRC, 12, 359
[932] Stuart John Barton, 'Why Zambia failed' (2015) JIE, 11, 803
[933] Ibid

the most corrupt judge and he was put under investigation and charged for contempt. It was said in the business report on corruption that:

> Corruption risks are high in Zambia's judiciary bribes and irregular payments in return for favourable judicial decisions are common and most Zambians believe that most or all judges are corrupt because the judiciary lacks independence and companies have insufficient confidence in the efficiency of the legal framework to settle disputes and challenge government regulations.[934]

The judiciary hardly operates independent from the interference of the state and this has become more apparent in the current regime. A report in Times Newspaper said that the judiciary is the weakest link in the country's economy as it not independent, fair or just as judges are corrupt and receive bribes.[935] It has also used by debtor companies as a shield from meeting obligations through litigation.

6.7 **Conclusion**

In conclusion, the Zambian Companies Act must be amended to remove ambiguities because its application and consequences fall on creditors, and legal redress is a challenge because it is permitted by law. The nature of business can be limited to the one prescribed under section 12 with an exception to written notice for creditors. This could allow creditors to re-evaluate the risk and engage in a dialog on how effectively the facility can be restructured if there is need. This is to promote disclosure and transparency in the affairs of the company. Section 383 also begs clarity on the parties that can be held liable under fraudulent trading. This will remove the misunderstanding that directors are also protected by the corporate veil. It was demonstrated that there is need for directors' duties to be codified and the need to include creditors' interests when a company is still solvent because this will help directors to ensure that they are not putting the company under the threat of wrongful trading and any financial distress can be noticed in ample time. This will help to protect both directors from personal liability and create room for business rescue. It is submitted that even though the financial sector in Zambia has experienced challenges such as high inflation, which led to the high credit costs and high default rates in the past years, there is need to develop a cost effective structure which is sustainable and can be enforced legally

[934] GAN Integrity: Business Anti-Corruption Portal: https://www.business-anti-corruption.com/country-profiles/zambia/accessedon13/06/2019
[935] Andrew Kapya, Times newspaper dated 18the June 2019 : https://www.lusakatimes.com/2017/04/10/judiciary-weakest-link-zambias-democracy/accesedon 18/06.2019

with due process within reasonable times. This includes the enactment of law to regulate valuations of property and the quality of information. This will contribute to creditor protection against unclean collateral and fake property valuations. There is need for awareness and sensitisation workshops and trainings for every company for boards through the IODZ. One of the ways to improving this awareness, understanding, and acknowledgment that a director ought to perform his/her duties with skill and care and perhaps it is time to consider education for a minimum qualification for directors. Although this study confirms some problems found by previous studies such as corruption,[936] lack of accountability,[937] lack of disqualification of directors found guilty of fraudulent trading,[938] and slow growth of corporate governance,[939] the findings in this study confirm the above arguments and goes further to add firstly, the exposure of creditors to risk through the agency problem in which shareholders exploit company assets. This problem is in contrast to the UK practice where the agency problem is centred on abuse of discretion by directors.[940] Further this research is different in that it brings to light the incompetency exhibited by directors because of lack of education as qualification. It is also different in that it calls for the introduction of directors' duties towards creditors an aspect which has been neglected both in principle and practice. The study also calls for strengthening of corporate governance practices for purposes of complimenting enforcement and implementation of directors' duties. This chapter demonstrated the implications of the findings on creditor protection. The next chapter contains conclusions and recommendations.

[936] Simeon Wanyama, Bruce Burton and Christine Helliar, 'Frameworks Underpinning Corporate Governance: Evidence on Ugandan Perceptions' (2009) CGIR, 17, 159
[937] Shikaputo Chanda, Bruce Burton, Theresa Dunne, 'The Nature and Potential of Corporate Governance in Developing Countries: Zambian Perceptions' (2017) AAAJ, 30, 1257
[938] Kenneth K. Mwenda, 'Wrongful Trading and Fraudulent Trading in Corporate Insolvency Law: The Case Study of Zambia' (2008) OUCLJ, 8, 93
[939] Ibid
[940] Michael C. Jensen & William H. Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs & Ownership Structure' (1976) JFE, 3, 305

CHAPTER 7: **Conclusion**

7.1 **Introduction**

The subject of this research raised several issues which brought together an analysis consisting of numerous concepts in company law and corporate governance. The interdisciplinary nature has allowed a broader approach to creditor protection in relation to directors' duties. Chapter one set a platform for boundaries of the arguments focusing on creditor protection by analysing the effects of the attributes of incorporation, directors' duties when a company is nearing insolvency, fraudulent and wrongful trading, and the shareholder primacy model of corporate governance. The purpose of this chapter is to draw conclusions from both doctrinal and empirical analysis. The doctrinal analysis brought out the shortfalls of creditor protection in the UK and the empirical analysis brought out the nature of challenges faced by creditors and quality of enforcement and implementation of law in relation to creditors in Zambia. This chapter starts with conclusions from doctrinal analysis, then it shows how the aim and objectives were achieved. This is followed by effects of the new legislation in Zambia. Research contributions, and policy implications then follow, and the chapter concludes with recommendations, and limitations.

7.2 **Conclusions from doctrinal analysis**

Four major conclusions have been drawn in this study and these are summarised below.

The first conclusion is drawn from the nature of a company having limited liability and legal personality which is the foundation of exposure to risk for creditors. Credit has always existed and it facilitates the smooth running and expansion of business such that a world without it is hard to imagine as it cannot exist.[941] While the above is true, the law has not been successful in devising an ideal mechanism for protecting creditors despite their contractual rights. Though the sanctity of company law holds that a company is a different legal entity separate from its members,[942] in cases where fraud and evasion of legal duty has been established,[943] the court can lift the veil. Although it has been argued that this mechanism can protect creditors, it is submitted that it is inadequate

[941] Roy Goode, *Principles of Corporate Insolvency Law* (4th ed. Sweet & Maxwell,2011) 2
[942] Section 16(2), UK Companies Act, 2006
[943] Alan Digman and John Lowry, *Company Law* (8th ed. Oxford University Press, 2014) 33

because of difficulties in establishing the requirements for fraud which is almost impossible and also the reluctance of the courts in doing so both in UK and Zambia.

In the UK, the study found that lifting the veil has been ineffective due to difficulties owing to lack of definitive methods as supported by many authors such as Digman,[944] Sealy,[945] and Griffin.[946] Others have advocated for its abolition.[947] Scholars such as Easterbrook and Fischel observed that lifting the veil is severe and unprincipled.[948] Supporting this view Bainbridge describes it as unjustifiable and arbitrary because it is vague and only creates uncertainty as it leaves judges with great discretion instead of achieving its purpose which is an effective policy outcome which can protect businesses.[949] This leaves creditors unprotected because the courts have not been willing to distance themselves from the legal personality of the company. To protect themselves, creditors enter covenants with directors by signing the undertaking to settle the debt of the company against their personal property in case of default. This method has been argued to be effective for some creditors but not all especially where a company is borrowing a second facility.[950] However, this method of protection also protects shareholders by shifting the obligation to directors. It is submitted that perhaps shareholders can waive the protection of the veil voluntarily against debt where a company need external finance. The undertaking should stipulate that if the company fails to meet its obligations under the facility, creditors can seek repayment from shareholders' personal property. This means that while the court can lift the veil, another mechanism of removing it would be by voluntary waiver by shareholders. Although it can be argued that no shareholder would want to remove this protection, it can as well be contended that creditors need protection from dishonest shareholders who hide behind the veil. The honest ones would honour their obligations with nothing to fear but waive the protection of the veil in pursuit of business sustainability. This does not abolish the protection of the veil like others have called

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944 Alan Digman and John Lowry, Company Law (8th ed. Oxford University Press, 2014) 33
945 Len Sealy & Sarah Worthington, Cases and Materials in Company Law (10th ed. Oxford University Press, 2013) 33
946 Stephen Griffin, Company Law: Fundamental Principles (4th ed. Pearson Education, 2006) 15
947 Edwin C. Mujih, 'piercing the Corporate Veil as a Remedy of Last Resort after Prest v Petrodel Resources Ltd: Inching Towards Abolition: Limited Liability' (3016) CL, 37(2), 39
948 Frank Easterbrook and Fischel Daniel, The Economic Structure of Corporate Law (Harvard University Press, 1991) p.187
949 Stephen M. Bainbridge, Abolishing Veil Piercing (2000) JCL, 26, 479
950 Andrew Keay, Directors' Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors (2003) MLR, 66, 665

for, but it mitigates on behalf of creditors who as much as shareholders, need justice as well as protection.

Following the pattern in the UK, Zambian courts have followed suit on the principle of legal personality except with little reported cases on the matter. It was found that in Zambia creditors are far from using this mechanism for protection because it is nearly impossible for the courts to pierce the veil. Drawing on the decisions of the courts in *VTB Capital Plc v Nutritek International Corp & Others,*[951] and *Prest v Petrodel Resources Ltd and Others,*[952] the Zambian legal system has followed suit with strict adherence to the cornerstone of company law set in the case of Salomon v Salomon and Co Ltd.[953] The Zambian Supreme Court in *Madison Investment, Property & Advisory Company Ltd v Peter Kanyinji,*[954] emphasised the doctrine as it operates in the UK citing *Prest v Petrodel* categorically stated that the veil is not to be pierced as held in Prest except in exceptional circumstances. In both jurisdictions the courts have been reluctant to lift the veil although case law is more evident in the UK compared to Zambia, this implies that creditors cannot rely on this mechanism for protection in its current state.

The second conclusion is premised on uncertainties under section 172(3) which require directors to consider creditors' interests when a company is financially troubled.[955] The uncertainties concern the trigger point[956] which was held to arise when directors know or should know that a company is or is likely to be insolvent in *BTI 2014 LLC v Sequana*.[957] The second problem is the uncertainty of the meaning of the duty itself in terms of what directors are to be doing. The courts did not decide what it means to consider creditors interests in the above case but did state that this is an issue the legislature should solve. While the study acknowledges previous studies on these uncertainties, it is proposed that perhaps the implementation of the Keay framework could be the starting point in establishing that directors did consider creditors interests. This means that before

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[951] [2013] UKSC 5
[952] [2013] UKSC 34
[953] [1897] AC 22 Case
[954] [2018] SCZ 48
[955] Section 172(3), Companies Act, 2006
[956] Andrew Keay, 'Formulating a Framework for Directors' Duties to Creditors: An Entity Maximisation Approach' (2005) CLJ, 46, 614; 'The Duty to Promote the Success of the Company: Is it Fit for Purpose?' (2010) University of Leeds School of Law, Working Paper, Accessed on 13/02/2017 from: https://ssrn.com/abstract1662411
; 'Directors Negotiating and Contracting in the Wake of their Companies' Financial Distress' (2015) JSCN, 1, 214; 'The Shifting of Directors' Duties in the Vicinity of Insolvency' (2015) IIR, 24, 140
[957] [2019] EWCA Civ. 112

going into new contracts, they have to weigh the size of the company they are considering to contract against the outstanding debt and decide whether it is worth entering into, they have to assess the nature of the business the company is involved in, the nature of the deal, the levels of risk involved in the deal, the probability of fruitfulness, and a contingency plan in case it fails. These constructs need to be evaluated to the benefit of creditors because during this time, creditors' interests supersede those of shareholders, and it is creditors' money that is used as external finance for any new deals or risky projects. This is because directors may have to bear in mind the impact of their decisions on the ability of creditors' claims being met.[958] Keay concluded that normative investigation for future research could help in finding out from directors exactly what they do in considering creditors interests.[959]

The third conclusion relates to the challenges of fraudulent and wrongful trading provisions. It is submitted that the provision has interpretational, enforcement and implementation challenges. The requirement of proving intent to defraud is problematic for the liquidator due to the evidential burden which is very high yet there is unavailability of quality information. Some problems with wrongful trading were exposed in *Re Continental Assurance of London Plc*[960]and *Grant and Another v Ralls and Others*[961] were wrongful trading was committed and no order for contribution was given by the courts even though creditors suffered huge losses. Case law has shown that directors can get away with reckless conduct that is likely to attract personal liability especially when the company is financially struggling.[962] There is also a problem of establishing the date on which the alleged wrongful trading started, and the meaning of 'taking every step' to reduce risk of loss. *Grant v Ralls*[963] exposed some problems such as acquiring fresh debt to settle another debt. Would this amount to a step that reduces risk of loss if the same action creates an equivalent risk on a different creditor? It is submitted that whilst the provision of the law is drafted to protect creditors, this law is not clear on the enforcement mechanisms to the detriment of creditors

[958] Rosemary Teele Langford and Ian Ramsay, 'The Creditors' Interests duty: When Does it Arise and What Does it Require?' (2019) LQR, 135, 385
[959] Andrew Keay, 'Directors Negotiating and Contracting in the Wake of their Companies' Financial Distress' (2015) JSCN, 1, 214
[960] [2001] 4 WLUK 505
[961] [2016] EWHC 243
[962] Thomas Bachner, 'Wrongful Trading before the English High Court Re Continental Assurance Company of London plc (Singer v. Beckett)' (2004) EBOR, 5, 195
[963] (2016) EWHC 243 (Ch)

considering that in most cases liquidators come in when a lot of things have gone wrong. It can be said that while the section requires directors to prove that they took reasonable steps to minimise the risk of loss, it seems at the same time preferential treatment of creditors is permitted. It has been established that the law permits wrongful trading provided it does not influence an increase of indebtedness of the company. It can be argued that the burden of proof placed on the liquidator goes beyond establishing that the company is in insolvent liquidation, that the directors ought to have known that there was no reasonable ground to avoid insolvency, but adds that reckless behaviour be proven by the liquidator even though this is not required by section 214 of the Insolvency Act 1986. Proving reckless conduct is difficult for liquidators especially that when a company is in the twilight zone, directors are known for taking on risky projects to gain huge profits.[964] While this is the case in UK, in Zambia wrongful trading provisions are unusable because they have not been used due to the enforcement impracticalities which puts the law beyond creditors. This is because they require a high standard of proof which is almost impossible for creditors to establish as well as the lack of quality information relating to company transactions. The implication is that directors are therefore not accountable for any possible wrongful trading which happens more often because directors are not aware that a company is in financial difficulties hence trading while in doubt. The study submits that without amendments to these provisions, creditor protection is far from being improved.

The fourth conclusion is that whereas the code has maintained its long standing principle of comply or explain approach, it has significantly included that directors do set out on reporting how they have considered section 172 into their implementation report.[965] The code further requires that a company must establish procedures on how they are to manage risk, oversee the internal control measures, the nature and extent of principal risk a company is willing to take for purposes of achieving its long term objective.[966] Although the code has provided guidance notes, they are only indicative of how boards can actually explain however, the question still remains as to what good is soft law if while corporate governance codes are revised there are still corporate disasters due to governance failures. Which means there is need for strengthening corporate governance practices. The failures such as seen in BHS and Carillion revealed the need to improve the role of NEDs to

[964] Rainer Werdnik, 'Wrongful Trading Provision - is it Efficient?' (2012) JII, 25, 81
[965] P.5, Corporate Governance Code, 2018
[966] P.25, Corporate Governance Code, 2018

challenge and scrutinise decisions of the board in a constructive way. There was possible wrongful trading exposed in the fall of Carillion and questions have not yet been answered as to whether directors will be held responsible on that ground. Additional equity was rejected yet more external finance was brought in from creditors. There was evidence for lack of transparency, accountability and integrity which attributed to the lack of legal sanctions by the FRC which only has regulatory powers. It could be argued that the exposures of corporate governance rise from the aspect of flexibility in the approach. Which only requires an explanation for non-compliance without defined parameters of what constitutes a satisfactory explanation and the lack of legal consequences. Perhaps it is time to consider legal effect to corporate governance.

In Zambia, the framework for corporate governance is not yet developed starting from the code itself which is not up to international minimum standards. The weaknesses in the regulatory framework have been revealed in the empirical analysis highlighting problems such as lack of transparency, accountability, awareness and understanding. The corporate sector needs to be strengthened through legal and regulatory mechanisms to protect stakeholders with emphasis being creditors as a focus of this research. While others like Mwenda emphasised that the disqualification of directors found guilty of fraudulent and wrongful trading could improve the corporate insolvency culture and enhance compliance in terms of best practice,[967] this study further argues that poor culture deprives creditors of valuable information which could be available for them. The mechanisms of fraudulent and wrongful trading are ineffective, therefore a call to disqualify directors found guilty is a good proposal, but the basis on which they can be disqualified is flawed. This translates into lack of accountability continuing unless amendments to the law are made. However, this study submits that strong compliance and legal rules capable of effective enforcement and implementation could mitigate against such shortcomings for creditors.

7.3 How the aim and objectives were achieved

The first objective was to analyse the mechanisms for creditor protection in the UK. This objective has been achieved through doctrinal analysis on mechanisms that can improve creditor protection such as the lifting of the corporate veil, improving the laws surrounding directors' duties under section 172(3) of the Act, the need to improve the laws on fraudulent and wrongful trading, and

[967] Kenneth K. Mwenda, 'Wrongful Trading and Fraudulent Trading in Corporate Insolvency Law: The Case Study of Zambia' (2008) OUCLJ, 8, 93

the need to enhance corporate governance which can develop implementation of the law. The study found that the uncertainties surrounding the duty in the UK as found by Keay[968] and others[969] still exist today. Hence it has been submitted that this law be amended to allow effective implementation. It was established that uncertainties in the law impede creditor protection and therefore creditors' interests could be applicable to directors for consideration when the company is still solvent. Also analysed is fraudulent[970] and wrongful trading[971] provisions for purposes of establishing personal liability on the part of directors especially when their decisions are made in bad faith during financial distress. It was found that these provisions are ineffective.

The second objective was to critically analyse the duties directors have towards creditors in Zambia. This was achieved through doctrinal analysis under common law duties and it was found that directors have no duty to creditors during financial distress in principle. The practice in Zambia is that directors perform their duties to the satisfaction of the shareholders as evidenced in case law. Arguably this is inconsistent with the classical sanctity of company law because directors are to perform their duties in the best interest of the company. It was found that there is need to introduce directors' duties when a company is financially troubled. This is proposed to take effect in ample time to enhance creditor protection. This should be done with careful consideration to the UK Act to eliminate possible uncertainties in terms of interpretation. There is need to improve professionalism and to introduce procedures and consequences for erring directors such as disqualification for a period. It was also found that strengthening disclosure measures and the fight against corruption can help in developing corporate governance and implementation of the law. Independence of the judiciary is very important for an effective legal framework to be achieved. Clearly creditors are neglected in Zambia.

The third objective was to assess the implementation of the legal framework for creditor protection in Zambia. This was achieved through the analysis of empirical data and it has been demonstrated that creditors are not adequately protected. Empirical evidence found a bad working culture lacking

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[968]Andrew Keay, 'Shifting of Directors' Duties in the Vicinity of Insolvency' (2015) IIR 24, 140
[969] Ross Grantham, 'The Judicial Extension of Directors' Duties to Creditors' (1991) JBL, 1; [969] Brenda Hannigan, *Company Law* (4th ed. Oxford University Press, 2016) 121; Elaine Lynch, 'Section 172: A Ground-breaking Reform of Director's Duties, or the Emperor's New Clothes?' (2012) CL, 33, 196
[970] Section 213, Insolvency Act 1986
[971] Section 214, Insolvency Act 1986

ethics, incompetence of directors, a weak corporate governance framework and an immature perception of corporate governance. There is no framework for creditor protection when a company is financially troubled both within the law and in practice. This has led most companies to exploit creditors by taking companies into insolvency with huge debts because there is no accountability.

The fourth objective was to systematically analyse the similarities and differences that exist between the UK and Zambia. The first notable similarity is the law. This is because the Zambian legal system is based on the English legal system by virtue of being its former colony. Among other similarities, the Zambian Companies Act was adopted based on the UK Companies Act. Both jurisdictions have challenges on directors' duties. The corporate governance codes do not attract legal sanctions as they are based on the flexible approach where companies are required to comply or explain. However, the differences include the economic status of the jurisdictions, the levels of development socially and the judicial systems. Interestingly, different approaches to directors' duties have been shown. The first is the agency theory that exist between directors and the company in the UK as required by law even though in practice the agency relationship is between directors and the shareholders. While in the UK the agency problem is on directors abusing their discretion, in Zambia it is the shareholders who abuse their positions to exploit creditors. The second difference is the nature of the challenges regarding provisions of law on fraudulent and wrongful trading. The third difference is the quality of statute law itself which is more comprehensive in the UK although falling short of ideal creditor protection unlike in Zambia were the quality is poor. This is the same in terms of enforcement and implementation of the law.

The fifth objective reflected on the challenges of ensuring creditor protection within company law and corporate governance in a developing country like Zambia. This demonstrated that Zambia being a developing country is not the only legal system struggling with protection of creditors. Besides South Africa with an economy better developed than Zambia, almost all the economies in the SADC region experience weaknesses in the legal and regulatory framework as a result, this impede on the pace for sustainable development. The economic policies are usually affected to a higher degree by the political structures in government and as a result the private sector does not operate effectively and independent from government pressure.[972] Many countries in the region have formulated investment policies in order to attract investment from Multinational Companies (MNCs) but little has been actually gained from these policies due to lack of effective governance policies, and well-structured legal mechanisms for investor protection.[973]The integration of a harmonised framework for both corporate governance and measures that can appropriately strengthen corporations in solving economic problems has also been a challenge for the region.[974] The study established that the problems surrounding the protection of creditors in the region are rooted in the sustainable and long term established weaknesses in accountability and the high level presence of corruption with less enforcement of legal parameters. This is presented in the conceptual framework below.

[972] Desmond Tutu Ayentimi, John Burgess, Kerry Brown, 'Developing Effective Local Content Regulations in Sub-Sahara Africa: The Need for More Effective Policy Alignment' (2016) MBR, 24(4) 354-374

[973] Ngaundje Doris Leno, Development of a Uniform Insolvency Law in SADC: Lessons from OHADA (2013) JAL, 75(2), 259-282

[974] Malebakeng Forere, Is Discussion of the "United States of Africa" Premature? Analysis of ECOWAS and SADC Integration Efforts (2012) JAL, 56(1), 29-54

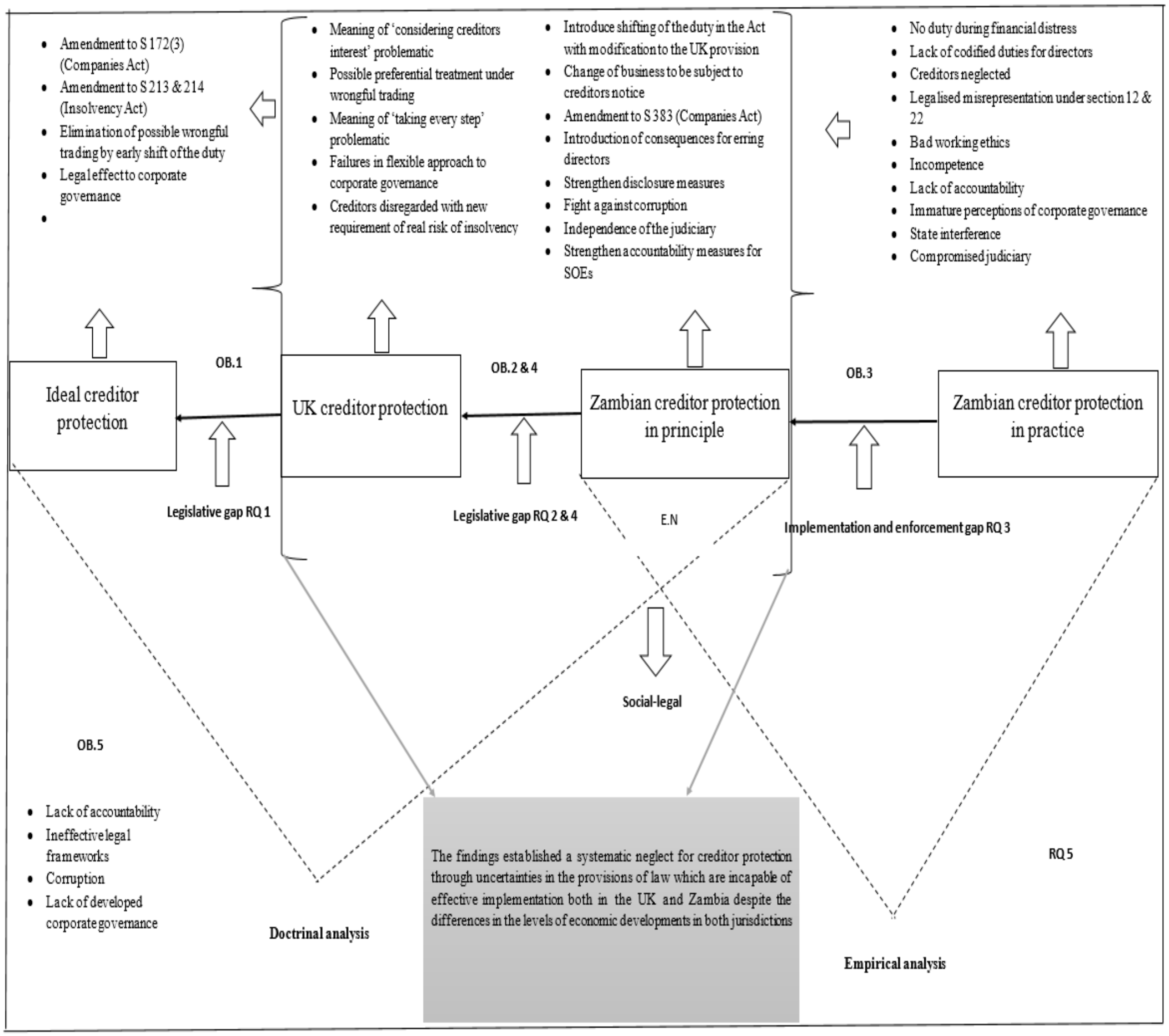

Figure 7:1 Conceptual framework after analysis

After the analysis of both doctrinal analysis and empirical findings, the conceptual framework indicates how the above objectives and research questions were answered. This figuratively shows the legislative gaps and the empirical gap and how the intersection between doctrinal and qualitative research achieved the aim of the research. It shows the problems found in the objectives and proposed recommendations.

7.4 **Postscript: The effect of new legislation on the study**

Part of the study called for codification of directors' duties for certainty and clarity. The duties have been codified however, with its own interpretational challenges different from the UK but which also impede effective implementation. For instance, sections of problematic interpretations are analysed below.

Section 105 arguably permits risk of loss to creditors provided it is not of a serious nature. The Act defines substantial risk of serious loss as 'risk of a nature or degree that if disregarded will constitute a gross deviation from the standard of care that a reasonable person would exercise.'[975] Whereas the Act defines the standard of care to be taken as that of a reasonable person, it does not state whether the reasonable person has to be in the same position as the director. The other implication is that were standard of care has been shown but loss occurs, there is no liability. The satisfaction of the duty is dependent on the discretion of the court in deciding what steps amount to standard of care. The requirement allows risk of loss but not of a serious nature the question is what amounts to a serious loss or harm to creditors and who is to determine that? This means implementation of this provision is to the detriment of creditors because, even if the standard of care has been taken or not and harm occurs, there is no liability. However, the Act does not state whether the standard of care must be of such a nature that in all honesty and circumstances was the right thing to do for any reasonable person in the circumstances of a director at that particular time, and whether it was done in good faith considering the interests of creditors. This provision has some implementation problems and calls for clarity. As far as this provision to consider running the company in a way that does not cause loss to shareholders or creditors, this does not affect research findings because to an extent, creditors are still neglected by this provision which permits loss provided directors can show mere consideration.

The other problem associated with this provision is that it is simply a general responsibility and has no requirement of good faith from directors. However, section 106 requires that directors act in good faith to promote the success of the company.[976] The implication is that while performing the duty under section 105, there is no requirement for directors to act with utmost faith as long as they are able to show the smallest standard of care, it exonerates them from liability. This is argued

[975] Section 105, Companies Act, 2017, Chapter 388 of the Laws of Zambia
[976] Section 106, Companies Act, 2017, Chapter 388 of the Laws of Zambia

to be harmful to creditors. The findings in this study already established how creditors are neglected and the lack of penalties for erring directors. The Act is arguably legalising the loss or harm suffered by creditors at the hands of directors to an extent. The findings in this study have a legal implication on the attainability of effective implementation of section 105 and 106 of the Companies Act on both directors and the judiciary. Under section 335,[977] the law states that; a member or former member of a company may bring an action against a director for breach of a duty owed to the member or former member.[978] This provision threatens the duty to exercise independent judgement under section 106(b).[979] If a director can be sued for breaching a duty owed to a Member, then it becomes difficult to exercise independent judgement because directors will be in fear of being sued by shareholders. The enforcement of section 106(b) attracts liability however, the law does not state whether this action is for personal liability or the director will be sued as an employee of the company.

While it is a positive step to have directors' duties codified, it is submitted that implementation of these duties is likely to be surrounded by difficulties hence the law be amended while its early enough so that injustice is avoided. These uncertainties are differentiated from those experienced in the UK even though it is safe to state that both jurisdictions fall short of the ideal creditor protection legally. However, the law has introduced new requirement on the distribution of dividend which requires that directors must declare a distribution of dividend when they are satisfied that the company will pass the solvency test right after the distribution.[980] Whereas this is a good requirement to protect creditors in Zambia, it could have been ideal to declare the distribution of dividend after the company has passed the solvency test.

The enactment of new legislation does not invalidate this research because besides calling for directors' duties to be codified, it goes further to suggest how the duty towards creditors should be implemented. The research goes beyond codified duties to elaborate how governance has been problematic because directors are not held accountable and they don't understand their duties. Having codified duties has been illustrated not to be the ultimate solution but implementation and enforcement is the key. This was illustrated in the UK analysis were duties are codified yet

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977 Section 335(1), Companies Act, 2017, Chapter 388 of the Laws of Zambia
978 Section 335(1), Companies Act, 2017, Chapter 388 of the Laws of Zambia
979 Section 106(b), Companies Act, 2017, Chapter 388 of the Laws of Zambia
980 Section 158, Companies Act, 2017

uncertainties exist that impede creditor protection. This has been illustrated by the few provisions analysed above which seem to have interpretation problems in the new legislation. These problems impede creditor protection. The provisions on fraudulent and wrongful trading remain unchanged which means that this problem is still present. The same goes for the problem under section 12 and 22 of the new Act which seem to permit fraud and misrepresentation to occur to the detriment of creditors.

7.5 Research contributions

The overall contribution to knowledge is the need to improve creditor protection within company law in the UK, especially in Zambia.

- Firstly, directors in Zambia do not seem to understand what they are doing under common law in terms of implementation and enforcement. Problems such as unawareness, lack of understanding and incompetence were found. Likewise, even though duties are legislated in the UK, they are surrounded by uncertainties specifically section 172(3) of the Companies Act 2006. These uncertainties relate to the effective time when directors are supposed to start considering creditors' interests and what it means to consider creditors interests.
- Secondly the study argues that creditors have been neglected until the company's safety is endangered thereby increasing their risk. The shifting of the duty can feasibly take effect when the company is financially stable thus increasing regular financial monitoring by directors, in the process eliminating uncertainties, and reducing potential wrongful trading thereby enhancing creditor protection.
- Thirdly, the study makes specific proposals for reform of law on directors' duties, fraudulent and wrongful trading provisions to eliminate interpretation and implementation challenges both in the UK and Zambia (new legislation).
- Fourthly, corporate governance needs to be strengthened particularly accountability, transparency, disclosure, compliance, and ethics which will complement and enhance implementation of law.

7.6 Policy implications

The study has policy implications on the legislature and the judiciary in the UK to consider changing and amending the law on directors' duties by removing uncertainties, and also by amending the provisions on wrongful trading to remove the possible creation of preferential treatment of creditors and what amounts to taking reasonable steps by directors in minimising the risk on creditors.

The other policy implication is on the legislature and the judiciary in Zambia to consider introducing laws for directors' duties towards creditors when the company is both financially stable and in financial distress. This will also remove the misunderstanding on piercing the veil in an unprincipled manner. This study has policy implications on lawyers who seek to defend their clients to do so legally and with ethical values both in fact and law when dealing with fraudulent trading to the benefit of their clients. The study has implications to institutions and policy makers to understand the need for ethics in companies whether members of the IODZ or not.

7.7 Recommendations

The study has a total of ten proposed recommendations arising from the established problems found both in the doctrinal and empirical work. The first four proposed amendments are in the context of UK and the other six are for the Zambian context.

7.7.1 Amendment to fraudulent trading under section 213 of the Insolvency Act 1986

Fraudulent trading under section 213 and wrongful trading under section 214 of the Insolvency Act 1986 yield the same remedy. However, enforcement problems hinder the efficacy of these mechanisms particularly considering they are the only benchmarks on which directors can be held accountable. Fraudulent trading requires the liquidator to prove intent to defraud in both criminal and civil proceedings.[981] This has led to conclusions about section 213 not being fully utilised due to the difficulties in proving this important element.[982] While others argued for widening the scope to section 213 because it will help in halting fraudulent transactions,[983] this study submits that; the requirement for 'intent' be removed from the law because it impedes the efficacy of protection that could otherwise be attained. The need for proving intent makes the provision difficult henceforth, the study submits that it be removed from the requirements because its' evidential burden defeats the purpose of the law. It is proposed that the provision of the law should read as follows:

[981] Ian F. Fletcher, *The Law of Insolvency* (4th ed. Sweet & Maxwell, 2009) 851

[982] Henry Skudra, 'Fraudulent Trading as a Creditor's Remedy - Time for a Rethink?' (2015) AC, 94, 11

[983] Ibid

(1) While winding up of a company if it appears that any business of the company has been carried on, to the detriment of creditors of the company or creditors of any other person, or for any fraudulent purpose.
(2) The court, on the application of the liquidator may declare that any persons who were knowingly parties to the carrying on of the business in the manner above-mentioned are to be liable to make such contributions (if any) to the company's assets proportionate to the loss, including loss suffered for purposes of bringing such a claim.

The liquidator will need to establish that fraud has occurred to succeed because this will permit efficacy and promote creditor protection. This will reduce the discretion of the court in awarding the contribution order in such a way that, the director responsible will be paying for the loss caused on creditors as well as the costs of the litigation process and loss suffered by the company in the process. It can promote responsible governance of the company by directors and improved accountability in a bid to avoid personal liability.

7.7.2 Amendment to wrongful trading under section 214 of the Insolvency Act 1986

The study recommends amending wrongful trading provisions because of the enforcement and implementation problems found. It is proposed that reforming the law is desirable to enhance creditor protection. The amendments could include (i) imposing liability were reckless behaviour by directors has been established. This is where wrongful trading has been found although no contribution has been created on the debt because the company will be affected in terms of legal fees. The liquidator should not be in a position where he or she must prove that directors were reckless before the court can award the order for contribution. The director responsible ought to contribute where wrongful trading has been established. This is because in the current state, if wrongful trading is established without injury on creditors, there is no liability. The reason for this proposed amendment is because reckless behaviour affects the assets of the company thereby, invariably creditors. (ii) The discretion of the court affects the protection of creditors because case law has shown that even where creditors suffered loss due to wrongful trading, they can choose not to award an order for contribution. This discretion impedes creditor protection because directors found guilty, can be ordered to contribute less than the injury suffered by creditors. There is a limitation of relief to the suffered damage only and even though the provision has this limitation, the courts have discretion to reduce the relief even further which is unfair for creditors. The provision could perhaps restrict the discretion of the court by stating that once wrongful trading has been established, the award of the contribution order should not be according to what the court deems fit but proportional to the loss suffered including loss of business. (iii) The study suggests that the law removes the requirement of the actual time to be pinpointed and liquidators can only show that at a certain time before the company went into insolvency, directors were involved in wrongful trading. The emphasis being on directors engaging in wrongful trading and not dependent on the date. It is just and reasonable that rigidity to the liquidator pinpointing a date for wrongful trading should not be adhered to as long as directors were involved in wrongful trading before the commencement of winding up. It is possible for the liquidator to miss the actual date at which directors started the wrongful trading but to remove liability due to this possibility is unjust for creditors. (iv) It is proposed that the defence directors have on showing that they took steps to minimise potential loss for creditors should exclude preferential treatment of creditors and should not include creating a similar risk with another creditor except, they reveal all the information to the new creditor regarding the financial position of the company. Creating a similar risk should only happen subject to full disclosure of the financial position of the company. This will safeguard the potential new creditor in that, they will be making a well-informed decision knowing the risk they are getting into. The court in Grant v Ralls acknowledged that the judgement could possibly reveal statutory problems which only the legislators can solve by reforming the law.[984] Although wrongful trading provision can deter directors from acting recklessly, they have nothing to fear because its' enforcement has several hindrances. Therefore, there should be reform of law to improve effectiveness and reduce the effect of judges' discretion on the efficacy of wrongful trading provision. The study also proposed a Keay framework which directors could use while governing the firm which could help in restraining them from decisions which put creditors at risk. This can possibly reduce the risk of wrongful trading because directors would be self-aware of the financial status of the company on a regular basis, and they will always have creditors' interests especially when the company is nearing insolvency. This can potentially promote and enhance responsible behaviour and well-thought decisions by directors before entering new contracts.

7.7.3 Amendment to directors' duties (section 172 Companies Act 2006) UK

This proposed amendment is arising from the conclusion submitted under 7.2 above. It is proposed that the law should be amended to state clearly when the duty is to arise because case law has not

[984] Marcus P.L. Gustafsson, 'Beating a Dead Horse? An Assessment of Wrongful Trading' (2017) CL, 38, 239

been helpful. The current state of the provision comes into effect late and by the time the duty comes into effect, things such as wrongful trading would have occurred to cause loss for creditors. It is proposed that the duty should come into effect while the company is financially stable as this would improve creditor protection. It is proposed that if the Keay framework is implemented, the duty could arise before the company even goes into a distressed mode. This would allow directors to be regularly aware of the financial status of the company and creditors' interest would apply even during financial stability. The second amendment proposed is on the problem of interpretation as to the meaning of the duty itself in terms of what directors are to be doing. While the study acknowledges previous studies on the uncertainties, it is proposed that perhaps the implementation of the Keay framework could be the starting point in establishing that directors did consider creditors interests. The five steps in the Keay framework would be the minimum benchmarks for the directors to implement to establish that they acted in the interests of creditors. The law ought to ensure that creditors' interests are protected even before the company goes into financial distress. Although others could argue that this would be contrary to policy on permitting directors to continue trading in the twilight zone, there is need to weigh between having ineffective and inadequate laws on one hand, and policy on the other which can easily be changed and has to be in conformity with the law.

7.7.4 Amendment calling for legal sanctions for noncompliance with the code (UK)

Due to the corporate scandals, which continue to expose the weaknesses of corporate governance especially after the fall of Carillion in which wrongful trading was committed, the study suggests that legal enforcement be attached to the provisions of the code upon non-compliance. This is by providing all relevant information as to the process of what led to non-compliance and if found wanting, legal sanctions be imposed. This creates a 'comply or face potential legal sanctions' approach. The noncompliance statement could be investigated by the FRC and if established that the company could have complied but chose not to, it can make recommendations for legal action by anyone affected by the failure of the company to comply. This calls for reformation to legislate the FRC and equip it with legal mandate. Corporate governance in its current state has neglected creditors. However, the problem is that even if creditors are included in the corporate governance code, due to its' flexibility nature, creditors will still be neglected, hence the need for legal recourse. Since the law takes time to be amended, corporate governance could be used to improve the enforcement and implementation of the law. This can be achieved by implementing the changes proposed above and by adopting the use of the Keay framework. The use of the Keay framework would ensure that the company is run effectively and creditors' interests as a stakeholder group are considered in ample time. Corporate governance can help in implementation of the law before amendments are done. This way, companies would comply more with the code and those that do not, will open themselves up to legal investigation.

7.7.5 Amendment of the laws relating to directors (Zambia)

It is recommended that the law be amended in order to rectify the wording of section 12, 22, 105, and 106, of the Companies Act 2017 for purposes of removing ambiguities which impede implementation because of inconsistencies and also to clarify the duty to promote independent judgement and how it is to be applied in practice. Although the Act has codified the duties, it is a good time to amend the sections to ensure that implementation will be without loopholes that hinder creditor protection. It is proposed that the law can indicate that lawful business needs to be in conformity with the nature of business registered at incorporation stage. If any change of business is needed, notification in ample time like within 90 days of the intended change must be given to existing creditors. The reform does not take away the autonomy of the company but adds the requirement which make directors to exercise the autonomy in a responsible and just manner. This will promote disclosure to creditors and enhance the quality of law. This is arguably to take away the interpretational and implementation challenges currently experienced.

The implication of section 105 on creditors is that it allows directors to simply indicate that they tried to take steps to avoid substantial risk from occurring to creditors. Although the first focus are the members before creditors, this shows how much shareholders are prioritised. However, these steps are not required to be the best available for a reasonable person put in the position of the director with the same circumstances. The study is proposing that this section be amended to require first, utmost trust, and that the steps taken, must be the best available for creditors even though they are against the wishes of the shareholders. The law ought to remove the interpretational problems which allow risk to occur to creditors provided it has been shown that steps had been taken, until proven that those steps taken were in all honesty, and circumstances in the best interest of creditors, and taken in good faith. Perhaps this could employ the steps in the Keay framework to be established as the minimum standards of reducing risk of loss for creditors. Empirical findings established that shareholders are always a priority for directors even when the company is financially struggling. It is proposed that a stakeholder inclusion is necessary for purposes of accountability and awareness. The law is silent on the behaviour of directors during financial difficulties in Zambia. Even though section 105 provides for directors to govern the company in a way that is not detrimental to creditors, there is need to establish duties for directors during this time. The findings indicate that this phenomenon is not provided for and in practice it is not available hence the rise in corporate failures as most companies go into liquidation leaving huge debts behind. There is a near vacuum on what directors are to be doing when the company is financially struggling both in principle and practice and this impede creditor protection.

7.7.6 Introduction of directors' duties during financial distress in Zambia

The study recommends that the new Companies Act be amended so that it can include duties for directors to consider creditors' interest when a company is going through financial difficulties. While this duty is applicable under common law, it was not practiced hence, creditors are neglected until the company has gone into liquidation. Directors demonstrated that they do not know when exactly the company goes into insolvency. Empirical findings established that directors are not aware of their duties, they are incompetent and unqualified directors on boards, and, they lack ethics in governance. Directors amongst themselves did allude to the lack of awareness and understanding of their duties citing lack of law and some of them citing mere ignorance, corruption, lack of transparency, lack of education, others citing lack of mechanisms for accountability. The study recommends that directors should have duties to consider creditors' interests' when the company is financially troubled, but attention must be given to the interpretational challenges in the UK so that these can be avoided in the Zambian statute. Clear and concise language to be used to avoid problems of enforcement and implementation. Further the study recommends that directorship positions must be given educational requirement such as a degree. This is to promote people who understand the skill a director must possess. It was established that the level of education leads to better managerial skills including the ability to employ qualified staff.[985] This is especially true in developing countries where nepotism is rampant as posed by Nkomo.[986] This study calls for qualification in terms of education to be considered as one of the minimum

[985] Vijaya Ramachandran and Manju Kedia Shah, 'Minority Entrepreneurs and Firm Performance in Sub-Saharan Africa' (1999) JDS, 36, 71

[986] Mokubung O. Nkomo, 'A Comparative Study of Zambia and Mozambique: Africanization, Professionalization, and Bureaucracy in the African Postcolonial State' (1986), JBS, 16, 319

requirements for directorship positions. This is resulting from high level incompetency that was found in the empirical analysis.

7.7.7 Proposed amendments to fraudulent and wrongful trading provisions in Zambia

It is proposed that due to the inefficiencies found in the provisions for both fraudulent and wrongful trading in Zambia, the law should be amended to remove the requirement of proving intent because it puts that law beyond the reach of creditors. It is proposed that the law be amended to remove the requirement of intent because it acts as a hindrance to creditor protection. On the other hand, wrongful trading has its own problems too for example, it attracts both criminal and civil liability. Mwenda argued that this provision of law is not useful because of the high standard of proof required for a criminal conviction.[987] It is proposed that the law be amended to remove the requirement of first securing a conviction under criminal charges before a civil case can be brought forward. The law should also state that this provision attracts personal liability not only for officers of the company, but directors. This will reduce the argument as whether this provision is expressly for directors or other officers as it does not mention the word ‘director’ as it is clearly stated in the UK statute. This will improve accountability, and, in the process, creditor protection will be enhanced. Although the law needs to be changed, this must be supported by corporate governance which is a steppingstone to improve the enforcement and implementation of the law provided directors act in a responsible, and ethical manner while governing the firm. This means that there is need to strengthen the institutions of governance and ensure certain benchmarks that could provide accountability and good stewardship.

7.7.8 Strengthening regulatory institutions for good corporate governance (Zambia)

The institutional framework for corporate governance needs to be strengthened to promote good governance practices. At the centre of good corporate governance practices lies concepts such as responsibilities of the board, disclosure, fair treatment for shareholders and financial providers, ethical behaviour, transparency and accountability.[988] Empirical findings demonstrated that there is lack of transparency, accountability and lack of ethics in Zambia. The failure of corporate governance in Zambia has been characterised by lack of understanding of the nature of the concept itself and also the lack of accountability structures, the disorganised institutional framework and

[987] Kenneth K. Mweenda, ‘Wrongful Trading and Fraudulent Trading in Corporate Insolvency Law: The Case of Zambia’ (2008) OUCLJ, 8, 93
[988] Mathew Tsamenyi, Elsie Enninful-Adu & Joseph Onumah, ‘Disclosure and Corporate Governance in Developing Countries: Evidence from Ghana’ (2007) JMA, 22, 319

the weaknesses of both the government and the private sector in implementing measures that will ensure adherence to corporate governance practices. This gap can only be addressed if the institutions embark on a national agenda to strengthen the corporate sector. It is recommended that the IODZ be legislated to have the mandate to investigate allegations against directors for unethical behaviour. The effects for lack of ethics in Zambia is rampant and there is no institution that is vested with authority to impose measures of accountability on erring directors. The companies Act has now provided for erring directors found guilty of an offence to be barred for a period of five years. Notwithstanding this development in the law, it has been established that directors are usually not taken to court. To assist accountability, it is proposed that there be established a body corporate to investigate and inculcate penalties for erring directors. This will provide some level of accountability even if they are not taken to court, they will be held answerable for their actions through such an authority. Suspensions can be part of the penalties as well as fines and disqualification. This will promote ethical behaviour among directors. It is also recommended that directors be registered with the IODZ and companies especially those listed on the stock exchange could endeavour to pick their directors from that pool. This will not only improve accountability but also promote credibility and integrity of directors having to be regulated under the IODZ. It is also submitted that the Corporate governance code be amended to harmonise with new legislation and be brought up to speed with international standards required. Empirical data established how problematic compliance with the code has been. Due to the influence of the shareholders, some companies are required to comply with the code while others are not. Although the flexible approach was adopted from the UK, it has demonstrated problems too in the UK because of the recent corporate failures such as the fall Carillion and other high stores. The concept of comply and explain has been tested in the UK and now it is time that legal effect was attached to it so that compliance becomes a legal requirement with penalties for breach. It is proposed in this study that the 'comply or explain' approach be dropped and enforce legal effect to corporate governance. This will adopt the 'comply or face legal sanctions approach.'

7.7.9 Recommendation to stiffen the fight against corruption in Zambia

The judiciary can be used as an instrument to spearhead the fight against corruption. This can be achieved through the fight to restore confidence of the people and the market in the judiciary by fighting against corruption and establishing its independence including distancing itself from politics. To start with, there is need to get the laws straight and tightened on the fight against corruption by investigating with due process allegations made against the judiciary and while such investigations are going on, the concerned judges be put under suspension by the Judicial Service Commission. This is possible if the executive can remove itself from the judiciary. There is urgent need for separation of powers in Zambia. It is proposed that the rule of law be adhered to and the judiciary separate itself from the daily politics and embark on ensuring that corruption is eradicated starting from its institutions. The fight against corruption is spearheaded by the government through the Anti-Corruption Commission (ACC). There is need to solidify the investigation process at the ACC for purposes of eliminating a witch-hunt by the government. Most of the culprits are sacred because of their political affiliation. The choice of cases to be investigated and prosecuted should not depend on the wishes of the government. This corruption has also led to companies finding refuge in the judiciary when they default on their loans. The empirical findings showed evidence of the judiciary being used as a shelter for defaulting companies. A study carried out by Okeahalam found that fraud and corruption in Africa has affected the development of businesses as politics exposed them to risk.[989] Political leadership and the commitment of the government for corporate sustainability in the bid for growth of the economy has been a driving feature in the control of managerial behaviour in Zambia.[990] Corruption is rooted in the need to maintain control of the corporate sector for natural resources such as the mining industry.[991] It has been argued by Chanda et al,[992] Wanyama et al,[993] Momba,[994] Burton, Okeye and Siwale,[995] and Okeahalam[996] that the fight against corruption is a feature that can help economic development in Africa. The political structure has shifted power from institutional inclusiveness to a centre pivotal where the executive power of the president is a source of policy at which power is centrally controlled.[997] In order to understand the extent of political influence on regulation, the study of

[989] Charles C. Okeahalam, 'Corporate Governance and Disclosure in Africa: Issues and Challenges' (2004) JFRC, 12, 359
[990]Jotham C. Momba, 'The Intersection between Politics and Corruption in Zambia' (2007) SAJIA, 14, 115
[991] Mwaka Nakazwe, 'Life Beyond the Glitz and Glamour of Mining: Strengthening the Mine Closure Regime in Zambia' (2017) JENRL, 35, 325
[992] Shikaputo Chanda, Bruce Burton, Theresa Dunne, 'The Nature and Potential of Corporate Governance in Developing Countries: Zambian Perceptions' (2017) AAAJ, 30, 1257
[993] Simeon Wanyama, Bruce Burton and Christine Helliar, 'Frameworks Underpinning Corporate Governance: Evidence on Ugandan Perceptions' (2009) CGIR, 17, 159
[994] Jotham C. Momba, 'The Intersection between Politics and Corruption in Zambia' (2007) SAJIA, 14, 115
[995] Ngozi Okoye and Juliana Siwale, 'Microfinance Regulation and Effective Corporate Governance in Nigeria and Zambia' (2017) 59,102
[996] Charles C. Okeahalam, 'Corporate Governance and Disclosure in Africa: Issues and Challenges' (2004) JFRC, 12, 359
[997] Ibid

power needs to be carried out which is a very difficult phenomenon. This can be done as part of future research on the impact of political power on the corporate sector.

7.7.10 The problems of state interference in the corporate sector

The effectiveness of the economic reforms from the time of nationalisation back in 1964, have been dependent on the government in power starting from the Kaunda era in 1964-1991,[998] to the current Lungu era today. Each era had its own impact on economic development in terms of policies and strategies for the corporate sector. Nationalisation of industries was for purposes of promoting local businesses as well as putting local people in management positions and to encourage shareholding participation.[999] Right after change of government in 1991, privatisation took place which promoted the private sector to own businesses.[1000] Since then, all the subsequent governments have controlled the corporate sector in the way that benefits their own personal interests rather than putting the interests of the nation as a priority. Policies for economic growth and investment including the fight against corruption, were made during the Mwanawasa era but this was thwarted by the change of government. After the global financial crisis in 2008, the focus on financial regulation emerged but it was characterised by lack of accountability and governance policies which are still evident today as established in the empirical findings. Today while one can argue that there is some form of progress on legal and regulation of the economic sector, their effectiveness has been hampered by inadequacies and government interference such that we have more financial crimes and corruption.[1001] Generally political institutions perform poorly because of the nature of governance and the way in which strategic policies are formulated to fit the political needs of the government.[1002] The ministers who are authorised to appoint and remove boards, do so based on their personal agendas aligned with the government.[1003] There is need to reflect on the problem of having no laws to regulate the specific conduct of businesses within the SOEs. The interference of politics and the unchecked authority of the ministers in charge of key sector industries like the Mining sector, the Agricultural sector, and the telecommunications which are

[998] Jotham C. Momba, 'The Intersection between Politics and Corruption in Zambia' (2007) SAJIA, 14, 115
[999] Jotham C. Momba, 'The Intersection between Politics and Corruption in Zambia' (2007) SAJIA, 14, 115
[1000] Samuel Munzele Maimbo, 'Banking Regulation and Supervision in Tanzania, Uganda and Zambia: A Review of Banking Sector Reforms' (2000) JFRC, 8, 289
[1001] Themba G. Chirwa and N.M. Odhiambo, 'The Dynamics of the Real Sector Growth in Zambia: Key Macroeconomic Drivers and Challenges' (2015) GJEME, 217
[1002] Stuart J Barton, 'Why Zambia Failed' (2015) JIE, 11, 803
[1003] Shikaputo Chanda, Bruce Burton, Theresa Dunne, 'The Nature and Potential of Corporate Governance in Developing Countries: Zambian Perceptions' (2017) AAAJ, 30, 1257

not oriented with tenets of good governance because the government has direct influence over the management of the boards. The challenge is that some of these companies are not regulated and those that are listed, on the stock exchange, compliance becomes political. The interception of politics in the corporate sector is rooted corruption and pursuit for personal gain. Although it is difficult to separate the government from the corporate sector, there is need to regulate government contracts, corporate governance within the SOEs, and to ensure that the executive arm of the government is impartial and free from corruption. This will promote introduction of regulation and formulation of policies in favour of corporate growth without state interference thereby contributing to the growth of the economy. This is why there is need to introduce corporate governance benchmarks for SOEs because they are run differently due to the presence of the government and they must be harmonised with the Companies Act, The BFSA, Securities Act as well as other enabling statutes to avoid inconsistencies.

7.8 Research limitations

The first limitation is that the contributions of the study are particularly for UK and Zambia. However, this does not limit its usefulness to the two countries because other jurisdictions with similar laws could adopt the mechanism of enhancing creditor protection through directors' duties. The second limitation is that empirical findings are based on the Zambian context although used as representative country for the SADC region. Further research could be carried out extending the population sample area with a larger sample size. Further research could be carried out with empirical data from UK. This research is limited to single entities and does not cover the position of group companies so that could be an area for future research as well. The research is also limited to debt creditors. A similar research could be carried out soon to assess the impact of the new legislation in Zambia as well as to assess the impact of corruption on the economy.

7.9 Conclusion

In conclusion, the study has illustrated how the laws relating to the mechanisms available for creditor protection are surrounded by problems in terms of enforcement and implementation, and how their protection is inadequate. The study has analysed the effects of limited liability and how lifting of the veil does not protect creditors because of the courts' reluctance. The study also analysed duties directors have towards creditors in the UK and in Zambia. It has shown areas of concern that can be amended to clear the uncertainties surrounding directors' duties. The practice in Zambia both within the law and in practice is that directors perform their duties to the satisfaction of the shareholders as evidenced in the Act, in the decisions of the courts, and as established in the empirical findings. Arguably this is in contradiction of the classical sanctity of company law because directors perform their duties in the interest of the company. Clearly creditors are neglected in this regard. There is clear evidence for lack of enforcement and implementation framework due to insufficient laws, impracticable laws, and lack of accountability, lack of awareness and understanding of directors' duties and lack of ethics among other factors. The mechanisms of fraudulent and wrongful trading under which directors are held accountable are surrounded by enforcement challenges which impede creditor protection for both jurisdictions. There is evidently no framework for creditors when a company is financially troubled both within the law and in practice in Zambia. This has led to most companies exploiting creditors by taking companies into insolvency with huge debts. In the UK directors are required to consider creditors' interests when a company is in financial distress whereas in Zambia this duty is nonexistence. This does not automatically mean that Zambia has the same problems as the UK owing to the differences in the economic development levels, Zambia could not experience the same problems experienced in the UK. Both jurisdictions have neglected creditors due to the challenges in the laws provided for their protection.

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Appendices

Appendix 1

Nodes Data analysis second degree coding for Creditors

Name	Description	Files	References
Bad credit Culture or practice	People are not honest	12	24
Credit reference	To check for black listed companies	7	12
Financial and Risk assessments	To assess the stability of a company financially	16	60
Problems with collateral	Adequate and clean security is vital	11	44
Governance of the firm	Governance structure is vital as it will show you the owners of the firm	9	16
Corporate Social Responsibility	Helping the community by trading responsibly	7	21
Individual characters of the Members and Directors	To assess the career records	10	24
Need for Ethics	Lack of ethics in the corporate sector	5	6
Poor financial management	Unqualified people in management positions	9	19
Shareholder influence and control	No separation of the shareholders from the company in reality	11	28
Ideal creditor protection	This bank had no record of any default	1	6

Name	Description	Files	References
Attributes for the good record	Policies to improve repayment records	1	9
Monitoring	Lack of monitoring mechanism for the facility	10	12
Legal and regulatory policies	Laws relating to financial sector	11	24
Director Guarantees	Directors personal property pledged for the debt	5	7
Foreign Exchange rate	Forex has to be stable as fluctuation causes losses	5	10
Late legal involvement and Court process	The legal involvement comes in very late and takes long	15	41
Valuations for property	Lack of legal regulation which is negative on creditors	4	6
Political interference	Impact of politics on creditors	10	18
Corruption	Corrupt practices affect the banks	6	8

Appendix 2

Nodes Directors Analysis second degree coding

Name	Description	Files	References
Adherence to best practice		7	15
Effects of the Corporate governance Code		5	8
Financial institutions		2	8
Privately owned companies		7	10
Public institution		7	11
Quasi government owned		7	14
Subsidiaries of foreign companies		3	5
competing interests of the stakeholders		6	8
Creditors		5	9
Customers		1	1
Employees		4	7
Regulators		5	7
The organisation		1	2
Decisions in the vicinity of insolvency		13	36

Name	Description	Files	References
Collective responsibility		5	7
Ethical behaviour		11	27
Influence on boards		9	14
Political influence and corruption		5	16
Lack of accountability		8	23
Mitigations for protection of directors		2	3
Need for reform		8	14
Regulators codes in relation to fiduciary responsibilities		9	11
Stewards		7	9
Agency relationship		9	21
Executive directors-duties		6	8
NED		2	3
Risk management		7	15
Returns for shareholders		9	13
Sustainability of the company		4	5
Corporate Social Responsibilities		4	6

Name	Description	Files	References
Socialist effects		4	5
Unqualified directors on the board		8	15
Lack of awareness on directors duties		6	9

Appendix 3

Nodes lawyers' analysis after first coding

Name	Description	Files	References
Governance policies and ethics		5	38
Inadequacy of legal provisions in the companies Act		6	43
Creditors		6	12
Secured		3	7
Unsecured		2	4
Registration of interest		2	2
Need for change		6	24
Shareholder control and legal personality		6	18
Agency problems		5	13
Director's guarantee		3	3
Scarcity of veil piercing		6	13
State interference		4	16
the role of the judiciary		1	2
Litigation as a shield for debt companies		3	7
Trading during insolvency		1	2
Doubtful insolvency		7	39
Fraudulent behaviour on Directors		7	40
Lack of accountability		4	10

Appendix 4

Pre-interview questionnaire

Pre-interview questionnnaire

Dear Participant,

I am a law PhD student from the Business school at the University of Huddersfield. This short fact-sheet is conducted to record the demographic characteristics of the participants before the interview. Your participation is highly appreciated.

For any other enquiries please contact the researcher on:

Mobile: +260961127301 or +447867217853

Email: Eneless.Nyoni@hud.ac.uk

Instruction: Please write the name of your company in question 1 below, and complete the next set of questions by ticking the appropriate box

Section A: General Information

1. Name of company____

2. Type of Directorship held

a) Exec ☐ b) Non Executive ☐

3. Gender

a) Male b) Female

4. Age Bracket

a) 50 years or b) 51 and

5. How long have you held this position?

a) 5 years b) 6 - 10

c) 11 - 15 d) 16 year ore

6. Highest qualification

a) School Certificate

b) Higher National Diploma

c) Bachelor's Degree

d) Master's Degree and higher

NOTE: If you want a copy of the results please provide contact details.

Phone:

Email:

Thank you for your time. I look forward to meeting you and I am happy to collect this copy before the interview.

Please send completed questionnaire to: Eneless.Nyoni@hud.ac.uk

Appendix 5

Participants consent form

University of HUDDERSFIELD
Inspiring tomorrow's professionals

PARTICIPANT CONSENT FORM

Title: A Critical Analysis of Directors' Duties: Creditor Protection in Developing Countries Using a Comparative Study of the United Kingdom (UK) and Zambia

It is important that you read, understand and sign the consent form. Your contribution to this research is entirely voluntary and you are not obliged in any way to participate, if you require any further details please contact your researcher.

I have been fully informed of the nature and aims of this study as outlined in the information sheet version X, dated 00:00:00	☐
I consent to taking part in this the study	☐
I understand that I have the right to withdraw from the research (Participation on this study is entirely voluntary, so please do not feel obliged to take part. You may withdraw from the interview at any stage before the end. You are not obliged to give reasons for your withdrawal of consent. Withdrawal of consent after the interview will not be possible as there will be no identifying information to trace your interview.	☐
I understand that the information collected will be kept in secure conditions for a period of ___ years at the University of Huddersfield	☐
I understand that no person other than the researcher/s and facilitator/s will have access to the information provided	☐
I understand that my identity will be protected and that no written information that could lead to my being identified will be included in any report	☐

If you are satisfied that you understand the information and are happy to take part in this project please put a tick in the box aligned to each sentence and print and sign below.

Signature of Participant:	Signature of Researcher:
____________________	____________________
Print:	Print:
____________________	____________________
Date:	Date:
____________________	____________________

(One copy to be retained by Participant / one copy to be retained by Researcher)

Appendix 6

Organisation consent form

Business School Research Ethics Committee
Organisation consent form

Directors' duties in relation to creditor protection in developing countries using a comparative study of the UK and Zambia

Name of Researcher:

i) To critically analyse the duties directors have towards creditors in the UK
ii) To critically analyse the duties directors have towards creditors in Zambia
iii) To assess the implementation of the legal framework for creditor protection in Zambia.
iv) To systematically analyse the similarities and differences that exist between the UK and Zambia
v) To reflect on the challenges of ensuring creditor protection within the context of company law and corporate governance in developing countries

☐ I confirm that I give permission for this research to be carried out and that permission from all participants will be gained in line within my organisation's policy.

Name and position of senior manager:

…………………………………………………………………………………………

Signature of senior manager:….…………………………………………………

Date: …………………………

Name of Researcher: ……………………………………………………………

Signature of Researcher: …………………………………………………………

Date: …………………….

Appendix 7

QUESTIONS FOR CREDITORS

1. Please describe your business and professional background.
Probe:

2. Before granting credit, how do you establish that a company will be able to pay? Probe:

3. What do you do when you think a company might default?
Probe:

4. What do you do when a company defaults?
Probe:

5. What are the challenges creditors like you face in Zambia?
Probe:

Thank you very much for your participation

Appendix 8

QUESTIONS FOR DIRECTORS

1. Please describe your business and professional background.
Probe:

2. What do you consider to be a director's role in Zambia?
Probe:

3. Kindly tell me about your relationship as a director with shareholders?
Probe:

4. How is the role of a director affected when his or her company seems to be financially troubled?
Probe:

6. Is there scope for change on directors' duties in Zambia?
Probe:

7. What is your view of corporate governance practices in Zambia?
Probe:

Thank you very much for your participation

Appendix 9

QUESTIONS FOR LAWYERS

1. Please describe your business and professional background
   Probe:

2. What is the position of creditors when a company seems to be in financial difficulties in Zambia?
   Probe:

3. At what stage do you get involved?
   Probe:

4. How is the role of a director affected when a company is trading during financial distress in Zambia?
   Probe:

5. Is there scope for change on directors' duties in relation to creditors in Zambia?
   Probe:

6. How practical is the concept of lifting the veil in Zambia?

   Probe:

7. What is your view of corporate governance practices in Zambia?
   Probe:

Appendix 10

Sample transcripts

C12

Interviewer: thank you so much for your time, maybe just to start the interview I would like to you to describe the business and your professional background.

Interviewee: yeah. Basically the business is a financial institution a locally owned bank it's been in existence for twenty years on the Zambian market providing commercial and retail banking services and leasing services. My professional background aaaam am a chartered accountant I graduated from Copperbelt University, I graduated in 1997 completed my ACCA in 1999, completed my MBA in aaaam 2007 am currently am pursuing CFA level 2. I have been with Investrust the last 13 years. I have served in 2 capacities….as chief financial officer when I joined in 2012 I served as corporate and investment banking until last year when again I was reappointed to be chief financial officer.

Interviewer: thank you that was quite rich. Emm just before granting credit, what do your require from the company or how do your establish that a company will be able to pay back?

Interviewee: okay amm I will tell you that in credit there amm some basic things that we look at in fact some scholars have written about the C s of credit.

Interviewer: the Cs as in C?

Interviewee: Yes the Cs of credit are many but others are have (condested) congested. Soo I will touch on the few Cs. One of the first Cs is Character. You have to look at the character of the borrower. What does that entail? You have to obtain information about who are the directors of the company/ who are the shareholders of the company what is their conduct in that line of business that they are engaged in and what is there reputation on the market. Because the character of the promoters of any company, will basically tell you whether these are crooks they just want to defraud the bank or these are people of high integrity with proper business acumen.so character is very important okay …. Aaaa the second one that we look at is capacity. Now by capacity here we look at the company that is borrowing. Or even at an individual level we look at capacity but at individual level then we will be looking at the sources of income to repay the loan. So for a company capacity is analysed by looking at their historical performance so we say have you doing such a project before? Give us your financial statements if it is your balance sheet your income statement and your cash flow.

If someone for instance wants a loan of 5 million kwacha but when we look at their turnover, their turn over is only a 100 thousand kwacha per annum. Then we say hmmm this money you have never handled it in your books or in your company how….can you justify that we should be able to give you 5 million kwacha when your business only turns over a 100 thousand kwacha. So there are some analytics that we do aa when we look at the financial statements we… in that analytics we look at aaa the purpose of the borrowing okay.. And what are the returns expected if we give them the money for example there. The purposes differ if someone wants to construct a school but says I will pay back the loan in 12 months the quick answer is that that is a dream because construction projects it's a aaa a long term and what they need is project finance. Project finance goes very a long period of time repayment period is much longer so you cannot construct a school and be able to pay back within 12 months that's impossible cause that's capital expenditure. So we do those aa aa analytics. The other one that we look at apart from looking at the directors and the shareholders is the management because companies normally fail because of poor managers.

The owners of the business put in capital but the managers mismanage the entity. So we look at the experience of the management team. Who is leading the organisation, who is managing the human resource aspect, who is managing the marketing aspect who is managing the finance aspect who is managing the sales aspect we look at their credentials when we are satisfied then we say okay at least they have got quite a strong management and strong track record aa the other thing we look at is account conducts. Do they have any bank banking relationship elsewhere okay if the answer is yes, we ask them to bring the bank statements from that financial institution cause the account transactions is going to tell us the volume of business that passes through their accounts how active it is. So if we find someone speaks big or presents I ll give you an example if they prepare financial statements and they show that their turnover is one million kwacha per annum or per month we expect that money to pass through the bank or the bank accounts so if we print a statement we find what only goes through there is only 200 thousand then this difference of 200 where does it go?

So the financial statements then became questionable then already if they submit such discrepancy information which they cannot clarify they begin to have shivers to say mmm does the character okay you want to get a loan but you are submitting falsified information am sure you have heard of certain businesses who have different sets of books for the taxman certain business aaa another set of books for the auditors another set of books for the shareholders because people try to avoid tax they want to paint a good picture to the owners they want to paint a good picture to the bankers so you find a company is maintaining different types of books but any that's not the discussion hhahhaha so we do such level of analytics in the financials.

Interviewer: okay just a quick question so are there instances where you ask aammm a potential debtor for any relationships with other banks and they don't divulge such information?

Interviewee; aaaahh if they fail to divulge that it means they are not in business cause we got two we got classes of borrowers. Existing client customers it means we have information on them within the bank. Then there are those who want to come and establish a relationship. Any new person who wants to establish a relationship the first question we ask them to say who are your bankers if they say they do not have bankers then it means there are a green field it means the level of analysis it will be like a start-up they have got no experience so it means the project is all speculative they have got no background. But immediately they say oh I have got a banking relationship with bank X will say okay how long have you banked with bank X? Why is bank X not giving you what you have come to ask for and you come here where we have no relationship? And they have to give us convincing answers no I don't like their service I don't like this so no I just want to move the business here then will listen then will say okay show us your bank statements then the bank statements will start marrying putting all the pieces together after we do that analysis it will show us their capacity, the level of business activity and what their constraints are. Then we go further to say okay.

You have passed all these things I have talked about earlier now in case you default because in this market I will tell you the levels of default are alarming. Maybe I think if you have been listening to the bank of Zambia governor every time they are announcing their quarterly monitory policy statements, they have been saying the non-performing loans in Zambia is worrying the central bank so people borrow but fail to pay back so in order to protect the bank because when we lend out we are basically lending out depositors fund cause we are just an intermediary put your money here then someone who has need, we lend so protect we ask for collateral that's the other C am talking about. So collateral for us aam we have got aaa some ratios that we use to determine how much collateral that aa we need for a facility aamm our loan to value ratio is 120%. What does that mean? If you want a loan of 100 kwacha, will ask you to give us collateral of minimum value of 120 kwacha. Okay and the basic collateral that we accept is a developed property commercial or residential that is what is common but government has now introduced moveable property things like cars anything that is movable but that has to be registered with Paccra .

but a few banks are moving towards accepting that but some of us are still lagging behind but since its now an Act there's even an Act Movable Property Act I think eventually all of us will start accepting moveable assets but predominantly landed property there are certain transactions were we accept stock okay and for stock financing aa where we re-in fence the stock is different it means the bank owns the stock. We take a lien over the stock. The company wants to use it we have to put a collateral manager there to make sure that the release is only authorised by the bank. While on the other side if its property they have to bring a title deed we have to register our interest at ministry of lands and they have to sign mortgage documents to say that aai have gotten a facility from the bank and I have pledged my property and I have assigned all my rights if I fail to pay then the bank has the right to sell this property.

And then aaa of course before that what we do is aaa before we accept the property we have to physically inspect it that it exists. I will tell you that you will be very shocked to learn that in this market there have been frauds with property. Some customers go to the bank with the intention to defraud. You say it goes through this assessment when it comes to the collateral because they know that aa banks want collateral show me the property…..he goes and shows you something else but the documents that you are getting the title deed is a different property. Only now when the loan becomes bad and then you foreclose.

When you want to go and realise now and you send bailiffs they say no this property you have is not what where you are sending us. We have found out that this property is actually somewhere else and when you go to that somewhere else you find that its their piece of land and the person is has gone away so there is that fraud so banks are encouraged to do a bit of due diligence in terms of search at lands. Just to make sure that that title deed that has been brought to the bank the person has not gotten multiple loans cause its possible you can go to bank what borrow on the same title, go to bank whatever borrow on the same title so depending on which bank registers there interest first, then they are the ones who will be secured.

So it has to be an incumbent so once all that due diligence is performed and the bank is happy then aaa the relationship is ready to start. If there will be any conditions that are required for example if we tell someone we don't know you so much but so far what you have presented looks genuine, but for us to get comforts can we see you to bank with us for a minimum of 6 months we see the flows so that we see the motivation that you want to move your business to us. Aa we do that so in a nutshell I think aaa I have touched on that. there are other things that we look at for example we look at the sector in which they are economic sector because we wouldn’t find find we wouldn’t find like financing sectors that are risky or sectors that are prohibited.

Interviewer: what kind of sectors are risky?

Interviewee: for example if you recall 2 years ago when the mining sector was having trouble with the copper prices, copper prices plummeted the mining sector was shaky so if a mining came and wanted a facility the key issue is look the mines are not doing well so it means the risk that you will get your payment on time is very uncertain. Yeah another risky areas are agriculture I think this year if you have followed the events of maize in Zambia farmers are crying soo these are sectors that are cyclical where the the the future cannot be predicted you find you finance someone then there is a flood the crop is destroyed and maybe you had aaa the way you structured the facility is that you are going to get all the proceeds from what you financed now the crop is not there so aa it’s a loss. That kind of thing yeah prohibited sectors are of course to do with narcotics aaa illegal trading in arms and all that kind of things those we don’t even do so we also look at what sector they are in so that we make sure that it is a sector that is vibrant, the returns are good it’s not a sector that is basically declining.

Interviewer: thank you and what do you get to do when you think the company is financially troubled but they haven’t defaulted yet. You just thick things are not okay financially?

Interviewee: aaaa. ……there are trigger signs that would make us begin to think that way firstly, we monitor what is happening in the economy and I give you an example

Interviewer: okay

Interviewee: you have heard about government owing suppliers and contractors the debt levels of government so if this person who came and got a facility from us was for the purposes of doing road contractors and then we are hearing stories that government is having challenges in paying contractors that trigger number one. So external information will trical (trigger) the next thing that will see is aa is a basic one where will just see it from within without even going outside is failure to pay the instalments on their due dates. Then immediately they miss that due date the loan is due on the 27th November the account there is no ngwee no kwacha then we call ah ah what’s happening? Noo I have not been paid by government so when is government paying you because we are in touch government is with clients no they said they will pay next week. Two months arears its even worse then you know this is a sign of trouble. Other triggers is if you get a hint off that this company the owner has died then immediately we move in to find out then this company has got this facilities how are we going to recover the owner has died. If we just pick up anything negative that is affecting that company industrial unrest, employees striking the factory gets gutted then we know that trouble is basically coming. Now coming to your specific question the question is what do we do? What we do is that aaah we have aaa we have a way that that we monitor all facilities we have reports within the bank that show us arears in days and immediately we see that a company has arears we send our teams the relationship managers who manage these accounts to engage the customers and get information as to why are they in arears.

Interviewer: okay

Interviewee: yeah and then now we get feedback sometimes we might find that the business is seasonal and I will give you an example of schools..aaa schools only get their income termly so you are going to have January for a school the account activities is very high cause they are collecting school fees. You not expect a lot of deposits afterwards after the school opens it will now they will be spending all that money and depending on the school activities by the time the school closes the account is been depleted. And if they have a loan it is always wise for such ana entity to structure that their loan repayments should be in line with their cash flow.

In fact cash flow is one of the things we look at its one of the Cs if you go back to the first yeah when you want to borrow we say show us your cash flow paten how you will manage the coming in yeah so what we do first of all is engage the customer to understand why they are behind in terms of arears you get their story and then aaa if it is something we can live or it is something that is genuine we live by it. Yeah if we are not satisfied we put them on what is called the watch list. A watch list means that they have to be visited every week to ensure that there is business continuity and they are not diverting the sales and the revenues.

Okay so we monitor them if they are like in the construction and they are saying government is not paying we have to make sure that every week someone calls them when is government paying you what is government say when show us the documentation and communication you are having with the relevant government department. What they are basically telling you because you are going to lose your property you have pledged. So that kind of thing then when it reaches aaa in fact the first call as I have mentioned is that we engage them verbally by making visitations when it reaches second month third month we basically write.

Interviewer: okay so third month it's written?

Interviewee: we basically write to them. We write to them fourth month the responses are not are not coming forth we internally here what we do is that we move the matter to a department called recoveries... recoveries people are different from the relationship people. The relationship people are very nice guys they nature the customer they use very nice good language recoveries people them they just go there to collect money. There is no diplomacy. Hahha your account is in arears sir we have written you 2 demand letters you have not responded we have come to collect money no this that no we are giving you 7 days. After 7 days it will be another story aaa will call you back after 7 days.

That's the recovery unit. And the recoveries people will come back and say no we visited this customer we threatened them and we wait for the 7 days to happen if it does not happen the case is moved to the legal department. The legal department is the last resort and we only take cases to the legal department where we are fully secured the capital the client has not been very corporative during these preceding stages. Them they will just tell you. In fact it's not bank that will even write. The bank just hands over the case over to the lawyer the lawyer now will write to the customer we have received instructions you owe so much and our client has told us to do the following actions. Then the matter now is a different case. So it means a customer has not been corporative for all during this process of engagement yeah.

So during this process of engagement others would come to say look I have had serious problems my employees store so much my aaa it has affected my cash flows which I gave you I thought things would work out like this as a business we understand then we say okay how can we help you? Okay no you suspend interests for now until when I do this or you give me more money so that I can get back on my feet because again we don't we are not in the business of killing businesses we are in business of supporting businesses.

Yeah so that's the process that we basically go through so at that point if the teams are convinced that this customer is genuine and needs further support they come and put in proposals to restructure the facility so that we make everything look like its current if a customer needs aaa more funding cause certain projects you can underestimate what you went to ask for so if you are underfunded and you find that yes the money was insufficient you can say okay will give you a top up so that you finish since the business case is still solid and the opportunities are still there so we can either restructure the facility yeah.

Interviewer: so what are the main challenges you face as creditors?

Interviewee: the biggest challenge I'll tell you is realisation of aaa the collateral. That's number 1. (Long sigh)

Interviewer: how is that?

Interviewee: especially the ones that you take to court. You get a court judgement and then you go and reposes someone's property but to sell certain properties it's been very it's a long process. Why it's taken long is the economic environment you just find that there is just no one to buy it. For example we've had aaa we have one facility which we have advertised for 3 years offers are there but the offers are far much lower than the amount of debt we are sitting with and we are not ready to take a loss. But meanwhile the customer grabbed it's you holding it so realisation of collateral has been a problem because of aaaaa liquidity in the market.

But on the flip side there are certain cases that take forever in court and you cannot push the court. And the problem with that is that as long as the matter is in court you have to leave that facility on your books interests will be accruing on interest and on interests so you find a situation where someone borrowed 1 ,million kwacha by the time the court process finishes the debt is seven million kwacha. And you can't push the judges they are the ones who allocate when these cases will be heard. So I think the legal system has not really helped banks a lot. And that's one of the biggest biggest challenges. Interviewer: maybe just to go back a bit in connection with what you have just said now in terms of realising the money from the security, eeen you earlier mentioned that you only get landed property right? Commercially developed or residential?

Interviewee: not only there are other securities we get for example I dint touch on director's guarantee.

Interviewer: okay….

Interviewee: you can find that aaa like in the case where someone gave us a property that losing aa loses value we would also ask them to sign what is called a directors guarantee. The guarantee provides that if we fail to realise that landed property we can go for any of the assets of the directors. Even if they haven't been specified. Because they have guaranteed that they have got capacity to pay so if we can't realise that we go now individually on that.

Interviewer: does that happen often?

Interviewee: yes it does happen it does happen it does happen

Interviewer: but do you ever create charges or debentures at pacra?

Interviewee: yes we do we do

Interviewer: how bad is realising from company assets when the company defaults?

Interviewee: aaaa debentures are normally there are fixed and floating. They are few that are specific. Specific would be on assets that are not movable but when you do a debenture you are basically doing it on stocks debtors but these positions change so you find a debtors books can be a different figure in this month a debtors book can be a different figure but once you register it and you aaa have a court judgement it will be at a point in time then you say all these debtors should be assigned to us and there the best course of action the bank will have to take is to put the company in receivership. Because how do you realise an asset that is floating? It means you have to freeze it. It will have to crystallise at one point and the way to crystallise it is to force it into receivership. Now if you force it into receivership it means now you start running the entity so that you are in control of the stocks you are in control of the debtors but we do register charges over stocks and we do register debentures over stocks and debtors.

Interviewer: okay any other challenges apart from the legal system and the realisation of collateral?

Interviewee: I think these are the major challenges but generally speaking I would say the credit culture is very poor in Zambia and there aa this question has been thrown back to say okay you are saying the credit culture is poor maybe the problem is banks underwriting process is weak. So it is still a debate but bankers don't want to accept that maybe internally at the credit assessment stage we were a bit loose hence the customer found a loop hole to default. Yeah so it's a two tyre situation. Yeah but if people were honest you need to pay back on your err borrow. Whether the banks systems are weak and some customers they just to be called you don't call them they will not deposit money on the due date that's just the poor Zambian culture. They know that they have got an obligation but they wait to be called others just wait to be threatened and we have seen situations where only when you serve a summon then someone comes you even start receiving phone calls from all sorts of all over the world in big offices no you cannot repossess their house and what we can't know you should have mercy. you say you should have mercy but this person we were engaging them sending them reminders they were not responding, uncooperative now when we sent bailiffs they are saying np they have the money they 'll pay we should withdraw the court action meanwhile the lawyers are waiting to be paid. Yeah so it's just kind of attitude that needs aaa and you know the funny thing which you'll be shocked is that credit is not criminal offence. No one will be taken to jail for failing to pay a bank loan. It’s a civil matter. So it depends on how people value their integrity there are certain people who don’t get scared to borrow from this institution from that institution that institution because they know. They can’t go to jail but when you squeeze them that they are going to lose their valuable property then it becomes a moral issue and psychological issue you watch your family being thrown away and then an integrity issue so those who have such thinking they try to make sure that they pay. Yeah

Interviewer: thank you so much that brings us to the end of the interview. Am very grateful for your feedback.

Respondent 3

Interviewer: Kindly describe your business and your professional background

Interviewee: I am a lawyer by profession mmmm having been admitted to the bar in 1985 which is mmm almost 32 years now. Eennh I have been practicing law eeenhh initially in the private sector for about 2 years and thereafter I went into the public service as an in house lawyer mmmm for one parastatal company for about 7 years or so and thereafter I went into another public sector institution involved into revenue collection. I was in charge of the legal department and then after that came back into private practice to set up my own practice which I have been running for about 20 years now with my colleagues.

Interviewer: What do you consider to be the role of a director in Zambia?

Interviewee: Aaammm I think that the starting point is eeen is to look at the governance structure of the company aaa at the apex you have the shareholders or the members in General meeting of the company and then after that you have the directors who are appointed by the shareholders who are the owners of the company. Now according to the law the management of the company is exclusively in the hands of the shareholders except for those very few specific items that are reserved for the shareholders in the Companies Act okay. So in other words the directors do everything except for those very few items reserved to the shareholders in the general meeting for instance the reduction of share capital or to seize doing business okay so the directors virtually run the company but of course as it happens you have independent what should I say you have non-executive directors and executive directors so you have directors appointed by the shareholders who are not there on a day to day basis okay the law says theoretically they are responsible for managing the company but they are not there every day okay it's the managers and the executives who run the company so because of that I think their key role is to have oversight. They have specific responsibility and oversight of the management and the key executive directors who run the company on a day to day basis and this is why because as far as the law is concerned they are the ones who run the company as far as the law is concerned but in reality they are not there on a day to day basis it's the managers and this is why they have to make sure that they appoint the right people. For instance the CEO, the Chief Finance Officer, the Chief Operations Officer they have a responsibility that aaa that they appoint the right people and they provide the correct oversight and they also have the responsibility of forming and formulating the right policies because ultimately as far as the law is concerned, should anything go wrong, they are the ones who are answerable

Interviewer: so that's both both legally and in practice?

Interviewee: Both legally and in practice aaaaaaammmm though with private smaller companies you probably don't see much of that put in practice but with listed companies you see that being fully implemented.

Interviewer: okay. Aaa the fact that we don't have codified duties in Zambia, does that affect the directors when implementing their roles?

Interviewee: no not at all. What you must remember is that in particular especially well informed directors this is why it goes back to the shareholders themselves I think the shareholders who are responsible for appointing the directors. They must ensure that they appoint the directors with the right skills okay. The right skills the right qualifications who are able to understand the business aaa who are able to ask the right information demand aaaa for certain document information so that they know exactly what is happening in the company and give proper directives and then you can only give proper directives and guidance if you understand the business and if you know what your management team is doing okay and this comes from the basis that you are a director who is well informed so I think it's incumbent upon the shareholders themselves that they put on the board people who have the qualifications and the right skills to be able to understand the business ask the right questions, ask for the relevant formation and make the management team accountable

Interviewer: What is the position of creditors when a company seems to be in financial difficulties in Zambia?

Interviewee: ennnh when a company is financially distressed, it's not able to meet its obligations the only thing that a creditor has to do is to rely on those powers for recovery and enforcement under the law but that said: the legislation in Zambia relating to insolvency and creditor protection is nonexistence in fact this is where there is need for eeennnh for substantial legislative reform in fact eenh it is not so un common whereby once a company starts experiencing difficulties ennh the owners owners of the business start syphoning and taking out money with the vie to defeat claims of the creditors. But again I will say this for those companies that are not listed. For banks even even if eennh let me say I shouldn't say not listed for banks whether listed or not listed there is more more protection because of the banking and financial services act. Okey.,.. because other than the companies act itself you have the banking and financial services act because the bank of Zambia has the means and mechanism of monitoring the prudential requirements of banks so they are able right from an early stage to determine whether a bank is troubled and can put in place measures to deposit stakeholders for that particular bank. Take MTN or Airtel for instance there is no law equivalent to the BFSA which will protect the creditors of those institutions. You will rely purely on on the provisions of the companies act and that just depends on how vigilant the lawyers of the creditor are to swiftly move in and secure the interests of their client.

Interviewer: At what stage do you get involved?

Interviewee: mmm repeat that question again.

Interviewer: At what stage do you get involved as lawyers when are you called in to the pic whether for the company or for the creditor?

Interviewee: normally is say for instance I am acting for a creditor, een the chances are the client will say you know what, I can see that this company is not doing very well I would like you to quickly take some form of legal action to protect my interest so normally the lawyer will come in at a point where there is some managing and this where normally clients see that there is a problem. If there is an amount due let's say it's due on the 30th November you pay. Then the creditor is being fed off with excuse one after the other normally that point in time the creditor will say you know what? I have not been paid and the excuses am being given are not making sense and ,maybe I also picked up on the market that X is not also being paid or the cheque which was issued bounced. I think this is the time for you to move in. that's how normally that happens.

Interviewer; okay and when do you come in when you are acting for the company?

Interviewee: when you are acting for the company normally the directors and owners of the compay would say you what either we are going through a difficult patch but we think we will come come of the woods in the next 6 months, some will say you know what you engage with the creditors have a discussion with them and see if you can work a plan on eehh the amount we pay if it can be paid and staggered over a period of time so that within that period we would have put in place ennn a plan to rescue the company you normally get such instructions where by the owners of the company you say you know what we are in trouble we can't pay these debts and we are instructing you see if you can put a strategy to hold off our creditors drag this delay so much that either there is money we are expecting somewhere , there sis cash we are expecting from shareholders once that cash comes we will be able to turn around the business and be able to meet our obligations or they will say you know what? Whichever way we look, wherever we look whether 6 months down the line, one month down the line, there is nothing we can do. Just start the process that we put this company in liquidation.

How is the role of a director affected when a company is trading during financial distress in Zambia? May I bring your attention to wrongful fraudulent and wrongful trading?

Interviewee: eehh I must say that I haven't found myself in such a situation I have not found myself in a situation where eennh a company where I sit on the board the company is insolvent or almost insolvent but from a legal perspective first and foremost what you must remember is that under the law eeehhh its an offence for a director to allow a company to continue operating even when you know that it is insolvent and its not able to meet its obligations eeennn when a situation like that occurs, I think it's a responsibility of the board to identify at that particular point that that's an issue of insolvency has arisen and what rescue measures or what plans are you going to put in place as a board to come out of that insolvency so that you can back to being solvent. Its up to the board to come up with a rescue or a plan to ensure that the company to get back to being solvent if the board thinks that the situation is beyond redemption I think it's the board responsibility to make a recommendation to management and to the shareholders the owners of the business cause its only the owners of the business who can decide whether the company should be liquidated but since it's the board which runs the business, it will be the board which will be able to identify this situation either its possible to turn this business around with the injection of more capital from the shareholders or if if it is so desperate just go to the shareholder to say look this is your business our recommendation is that we wound down the business that's the responsibility of the board.

Interviewer: is there scope for change in terms of directors' duties in Zambia?

Interviewee: eennnh there always scope for change. Situations are never static. Things are always moving eeenh my view is that about time we started having codification of directors duties and responsibilities cause what we do have in Zambia is that this is only generally outlined in the provisions of the companies act which doesn't go to details its just general and what is understood as at common law but I think its about time we started the level of eeennnh where companies have reached ennnehh the demands that are placed on directors in accordance with the law I think its about time where we started eennh a move towards codification for instance membership to the institute of directors is not compulsory I think its about time it was made compulsory so that eennn in particular for listed companies eennh big private companies that are regulated they should be drawing directors from the pool of membership from the institute of directors which will be compulsory if the IOD enn leading the process towards codification so that een through the IOD they are exposed to interaction with best practice. When a company is insolvent and as a director when you realise that a company is insolvent remember I said you have to make a judgement call either to tell the shareholders is there going to be a rescue plan to turn the business around or if none, close the business. And if you don't do any of these things and then you continue the business that's an offence under the business Act because you are allowing a company to continue trading.

Interviewer: who makes the decision for a rescue plan?

Interviewee: it's the directors who make the recommendation because remember the directors don't own the business maybe the reason why the business is financially distressed is because its undercapitalised so it's up to shareholders to bring new capital so it's up to the board to say look……the problem the company has its because there is not capital so it's either you bring in the capital or we close.

Interviewer: Is there scope for change on directors' duties in relation to creditors in Zambia?

Interviewee: eennnh there always scope for change. Situations are never static. Things are always moving eeenh my view is that about time we started having codification of directors duties and responsibilities cause what we do have in Zambia is that this is only generally outlined in the provisions of the companies act which doesn't go to details its just general and what is understood as at common law but I think its about time we started the level of eeennnh where companies have reached ennnehh the demands that are placed on directors in accordance with the law I think its about time where we started eennh a move towards codification for instance membership to the institute of directors is not compulsory I think its about time it was made compulsory so that eennn in particular for listed companies eennh big private companies that are regulated they should be drawing directors from the pool of membership from the institute of directors which will be compulsory if the IOD enn leading the process towards codification so that een through the IOD they are exposed to interaction with best practice.

Interviewer: How practical is the concept of lifting the veil in Zambia?

Interviewee: the lifting the corporate veil has been on the statutes books for as long as I can remember even before before I became a lawyer and I have only come across one reported case this is followed this is never used and this is my 32nd year at the bar I have only come across one fully reported case in the supreme court where they resorted to that and this this is why there is so much frau especially with the smaller private companies though the law is there regrettably this is an avenue where which is rarely followed

Interviewer: what case is that you are referring to?

Interviewee: I will have to check and get back to you on the parties of the case. In fact I came across it eennhh a couple of weeks ago again. I will check and email unto you.

Interviewer: case was checked and emailed. Below is the extract from the email. *"During our interview yesterday, you asked about a decided case on lifting the corporate veil. Please see the following-* ***Ethiopian Airlines Limited V Sunbird Safaris Limited Sharma's Investment Holding Limited Vijay Babulal Sharma (2007) ZR 235. 2,*** *were the Supreme Court held that; "The 3rd respondent fraudulently allowed the 1st respondent to continue to trade and therefore was personally liable for the debt to the 1st respondent."*

In case you need any clarification call me. I seem not to have saved your number.

Interviewer: generally what is your view concerning corporate governance in Zambia now?

Interviewee: mmmm again if you look at those companies that fall under the sphere of regulation, corporate governance is stronger than the companies that don't don't face regulation. Look at banks for instance which are regulated by bank of Zambia under the Banking and Financial Services Act, the corporate governance there is stronger because of the requirements of the BFSA where for instance there is a demand that before you can be a member of a board, you must satisfy the fit and proper test. Now that doesn't apply to a company like Airtel that doesn't apply to a company like MTN. in as much as those are big companies, the regulation of those companies don't go that far. Insurance companies for instance have the same requirement of fit and proper test … I suppose its because of the appreciation that these are companies that are in the fiduciary position whereby they are entrust with the funds belonging to the public for banks depositors, for for insurance companies policy holders funds so you find that the regulation there is stronger. So my answer would be it depends on the sector. Some sectors the governance is very poor because there is no regulation and insistence that this is what you should do. Eeeehh for banks now there is even a requirement you cannot stay on the board for more than 6 years eeeh you could be a member of the board on MTN for 40 years if you so wish there is nothing that stops you. It is a concept that is rarely used.

Interviewer: Thank you very much for your participation that brings us to the end of the interview you can make any clarifications or add anything you think you left out or you want to talk about.

Interviewee: no nothing at all thank you was actually just looking through your questions again.

Appendix 11

Reference sheet for interviews

Interview No.	Themes			
Creditors	C1	C2	C3	C4
1	**X**	**X**		
2	**X**			
3	**X**	**X**		
4				**X**
5				
6	**X**		**X**	
7	**X**	**X**		
8		**X**		
9				**X**
10				
11		**X**		
12		**X**	**X**	
13			**X**	
14				
15				**X**
16		**X**		
17				
Directors	D1	D2	D3	D4
D1	**X**			
D2	**X**	**X**	**X**	

D3	**X**			
D4	**X**			
D5			**X**	
D6			**X**	
D7				
D8	**X**		**X**	**X**
D9				**X**
D10				
D11	**X**		**X**	
D12				
D13	**X**			
D14	**X**	**X**		
D15	**X**			
D16			**X**	
D17				
D18				
D19				
D20				
Lawyers	L1	L2	L3	L4
L1	**X**	**X**		
L2				
L3		**X**		**X**

L4			**X**	**X**
L5	**X**	**X**	**X**	**X**
L6	**X**			**X**
L7	**X**	**X**		