Zimbabwe Economic Policy Analysis and Research Unit

Enhancing Zimbabwe's Regime for Resolving Corporate Financial Distress

Current Challenges and Possible Solutions

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TABLE OF CONTENTS

ACKNOWLEDGEMENTS i

TABLE OF CONTENTS ii

FOREWORD iv

EXECUTIVE SUMMARY v

1.0 INTRODUCTION 1

2.0 INSOLVENCY AND THE METHODS OF RESOLVING IT 8
- 2.1 The Difference between Economic and Financial Distress 8
- 2.2 The Essence and Benefits of an Insolvency Resolution Regime 8
- 2.3 The Connection between a Well Functioning Insolvency Resolution Regime and a Competitive and Efficient Economy 10
- 2.4 Limits to an Insolvency Resolution Regime 12

3.0 CORPORATE FINANCIAL DISTRESS IN ZIMBABWE 13

4.0 THE RESPONSES OF THE LEGAL AND REGULATORY SYSTEM TO FINANCIAL DISTRESS OF COMPANIES 14
- 4.1 Standard Debt Collection Practices 14
- 4.2 Informal Methods to Resolve Substantial Indebtedness 15
- 4.3 Entry and/or Formation of Financial Distress Funds 15

5.0 THE ZIMBABWE'S INSOLVENCY RESOLUTION REGIME AND ITS PERFORMANCE IN THE CURRENT ECONOMIC CRISIS 17
- 5.1 The Institutional Framework for Insolvency Resolution 17
- 5.2 Legal Framework 19
- 5.3 The Recent Performance of the Insolvency Resolution Regime 21

6.0 SIX APPROACHES TO ENHANCING THE INSOLVENCY RESOLUTION REGIME 25
- 6.1 Actions Requiring No Legislative or Regulatory Reform 25
- 6.2 Clarify Procedures, Rights and Obligations through Issuance of Rules and Regulations 26
- 6.3 Develop and Enact a Limited Number of Legislative Changes 27
- 6.4 Replace Judicial Management with a Business Rescue Regime Similar to that Recently Adopted in South Africa 29

6.5 Develop a Comprehensive Unified Law on Insolvency Based on Models Developed in Other Commonwealth Countries 29
6.6 Develop a Comprehensive Unified Law on Insolvency Based on Models Developed Outside of Other Commonwealth Countries 30
6.7 Develop a Legislatively-Defined Approach that Accelerates the Restructuring of Debt and Ownership of Insolvent Companies through Market Mechanisms 30

7.0 A MENU OF POTENTIAL REFORMS THAT COULD IMPROVE THE COUNTRY'S INSOLVENCY RESOLUTION REGIME 33
7.1 Improving the Insolvency Resolution Infrastructure 33
7.2 Encouraging Earlier Use of Insolvency Resolution Regimes 34
7.3 Encouraging Quicker Resolution of Insolvency Resolution Cases 36
7.4 Addressing Pre-Established Rights during the Course of a Business Rescue 37
7.5 Encouraging Arrangements that Increase the Likelihood of a Successful Business Rescue 38

8.0 ADDITIONAL AND/OR ALTERNATIVE OPTIONS TO RESOLVING WIDESPREAD COMPANY DISTRESS 41
8.1 Improving the Management of Tax Claims in Insolvency Cases 41
8.2 Encouraging Parastatals to Sell their Receivables 41
8.3 Establishing Free Trade Zones for Particularly Hard Hit Economic Areas 42
8.4 Establishing a Multi-Pronged, Integrated, and Pro-Active Approach to Corporate Financial Distress 42

9.0 CONCLUSIONS 43

END NOTES 44

FOREWORD

It is an acknowledged fact that many companies in Zimbabwe, in both the industrial and commercial sectors of the economy, as well as households, are saddled with debts since the adoption of multi-currency system in 2009. Some companies have closed down and others have been placed under judicial management. Many are operating at sub-optimal levels, amid being also laden with debts. These debts are mainly in respect of utilities, statutory obligations and labour.

Whilst focus has been on capacity utilization by business firms, there has not been sufficient attention on Balance Sheet strength, which is key to expanding capacity utilization, attracting new capital and accessing credit facilities from financial institutions. Concern should be given to the health of existing firms as measured by their Balance Sheet strength as this projects their ability to continue as going concerns. Also, little has been done to protect the employees and other key stakeholders of such companies that have collapsed. Further, the economy's manufacturing sector has been significantly weakened to the extent that the economy is importing the bulk of its goods and services thereby bearing pressure on the scarce foreign currency.

Company closures are a cause of great competition concern since they result in the removal of competitors and increase in concentrations in the relevant markets, and this facilitates and promotes monopolization and cartelization, which are prohibited restrictive business practices under the Competition Act [Chapter 14:28].

It was against the above background that the Competition and Tariff Commission (CTC) collaborated with the Zimbabwe Economic Policy Analysis and Research Unit (ZEPARU) in the undertaking of a study on the setting up of a policy framework on bankruptcy prevention in Zimbabwe, with financial assistance from the USAID- Strategic Economic Research and Analysis (SERA) programme and the African Capacity Building Foundation (ACBF).

This research study on Enhancing Zimbabwe's Regime for Resolving Corporate Financial Distress: Current Challenges and Possible Solutions would not have come at a better time. The report and its recommendations are pertinent to the current enterprise problems in Zimbabwe and relevant to the effective implementation of not only the country's Industrial Development Policy (2012-2016) and National Trade Policy (2012-2016), but also the Zimbabwe Agenda for Sustainable Socio-Economic Transformation (ZIMASSET). It should therefore provide a basis for review of various laws and statutes governing insolvency, debt recovery and legal framework for resuscitation of struggling companies.

Dumisani Sibanda
Chairman of the Competition and Tariff Commission

EXECUTIVE SUMMARY

Economic indicators point to greater financial challenges for Zimbabwean businesses over the coming months and perhaps years. These challenges will add to the number of companies that cannot pay their debts, or attract the financing necessary to maintain operations. One way of dealing with such conditions is through use of an insolvency resolution regime: formalized procedures that allow a debtor to adjust the ownership and creditor claims against it. Most countries, including Zimbabwe, have such regimes. They normally consist of specialized judicial procedures, specialized judges and court personnel, and private professionals, who serve as liquidators or administrators (in Zimbabwe referred to as judicial managers) of such companies.

An insolvency resolution regime can give a debtor breathing room to negotiate a broadly effective adjustment of the claims creditors might have against it. It does so by imposing a temporary moratorium on creditors' claims against the debtor. During this period, the debtor's management is either displaced or closely watched by an experienced insolvency resolution professional. Various rules encourage creditors to offer the debtor working capital during these proceedings. Any debts incurred to workers and other suppliers of the company after the commencement of the case are given favoured treatment.

The appointed insolvency resolution professional usually has the authority to reverse transactions that have unfairly benefited particular creditors or shareholders at the expense of the creditors in general. He or she can also break unfavourable contracts of the debtor with little downside risk. Creditors or the debtor can present a rescue plan, which, if supported by the majority of the creditors and approved by the court, would bind the minority creditors who refused to go along. Their claims would be adjusted by the ruling of the court and the contents of the plan.

Liquidation would result if the plan is rejected. This gives all parties an incentive to reach a compromise. A progressive and effectively enforced insolvency resolution regime can have benefits beyond the companies and creditors affected. Such regimes reduce financial risk, giving creditors greater confidence, thereby enticing them to lend on more generous terms. They also increase opportunities for companies to reorganize themselves so that they remain viable competitors in the market place. When this is not possible, liquidation under a progressive insolvency resolution regime can help recycle assets into the hands of new owners with the incentives to use them more effectively.

Zimbabwe has many of the elements necessary to support an effective insolvency resolution regime of this calibre. The legal system is generally sound, with both substantive rules and enforcement techniques giving creditors the opportunity to put pressure on non-paying debtors. The larger creditors appear to be aware that well-regarded debt restructuring techniques and investment funds focusing on financially distressed enterprises have been formed.

The country's insolvency resolution regime consists of the High Courts of Harare and Bulawayo, the Master's Offices associated with each, the administrators and judicial managers registered with the Council of Estate Administrators, and the Official Gazette. Together, these institutions and individuals implement the Insolvency Act and the Companies Act. The main types of insolvency actions available under these two laws are judicial management and wind-up (liquidation). Judicial management is designed to give creditors a temporary respite from enforcement of claims of creditors while wind up allows for the orderly gathering and sale of the debtor's assets in order to pay the claims of creditors.

In each action it is possible for the debtor to enter into a scheme of arrangement. Under this procedure, creditors can vote on a plan that would adjust their claims against the debtor if approved by a majority of creditors holding seventy-five per cent of the debt. The current financial challenges facing the country have placed many companies under judicial management or wind up due to their inability to pay their debts. The number of filings for judicial management has increased substantially in recent years and is likely to continue to increase in the near future. In a number of instances, it appears that judicial management has been used by debtors to stem the efforts of creditors to initiate a wind up.

Judicial management proceedings have been criticized as continuing for too long a period and for failure to put companies back on solid financial footing once the proceedings are over. Judicial managers have found it difficult to reshape the work force of debtors they are working with and to obtain new capital from banks to restart operations. Further complicating these efforts is the lack of an efficient mechanism for restructuring the ownership of a company under judicial management, to dilute current shareholders and allow new shares to be issued to creditors in lieu of payment. While schemes of arrangement can be used to restructure the rights of both shareholders and creditors, these tools have been underused in recent years.

Wind up proceedings have been subject to some criticism as well, primarily their tendency to result in a piecemeal asset sale rather than the sale of a company as a going concern. In general though, there is a perception that these proceedings are underused—too many companies are sitting in judicial management that should instead be wound up. While there is some controversy over whether judicial management and wind up proceedings in Zimbabwe can generally be considered successful or not, a broad consensus appears to acknowledge considerable room for improvement with regard to the country's insolvency resolution regime, especially given the mounting financial challenges that Zimbabwe faces.

Broadly speaking the country has a range of reform options to pursue, all of which would likely improve the insolvency resolution regime to a certain degree. On one end of the spectrum, they include focusing solely on improved implementation and transparency of current procedures. On the other end, they involve drafting a new unified insolvency law based on international best practices or abandoning structured negotiations in favour of market-oriented mechanisms for adjusting ownership and creditor claims.

In terms of producing the greatest impact over the shortest period of time, one promising option involves a combination of regulatory issuances under current law supplemented by a few key legislative amendments to the Companies Act and Insolvency Act where it is clear that a key reform requires a change of law. Another promising option would be to substitute current judicial management proceedings with those similar to the business rescue proceedings recently adopted in South Africa. While not without shortcomings, the business rescue proceedings in South Africa have been praised as a substantial leap forward in improving that country's insolvency resolution regime. That, plus the similarity of the two country's legal systems makes this a choice worth considering in the coming months.

In terms of particular substantive reforms, the following should be considered high priority:

- Establishing more consistent and transparent standards for regulating insolvency resolution professionals and enhancing mechanisms that sanctions individuals from deviating from these standards.
- Increasing transparency with respect to implementing the regime, both within particular cases and in the performance of the system in its entirety.
- Encouraging the earlier use of schemes of arrangement or other rescue mechanisms that would adjust creditor and shareholder claims to a level that would allow troubled companies the room to resume or increase operations.
- Giving insolvency resolution professionals or new owners of troubled companies more legal flexibility to streamline operations in order to return to profitability and to repay adjusted claims.
- Simplifying both rescues and liquidations by consolidating and reducing the number of statutorily recognized classes of creditors.
- Adjusting downward the current 75 per cent approval rule to increase the possibility that reasonable schemes of arrangement or other rescue plans gain approval.

Finally, in addition to reforming the insolvency resolution mechanism itself, consideration should be given to more systemic reforms that

- Encourage greater investment and make it easier for businesses (both healthy and troubled) to compete for customers, both in the country and abroad.
- Create more flexibility with respect to claims of the tax authorities and parastatals against troubled companies.
- Create an integrated approach that would address bank non-performing loans, bank recapitalizations and out-of-court restructurings in line with international best practices.

1.0 INTRODUCTION

Nearly five years after the height of its financial crisis, the country's economy once again faces substantial challenges. This is particularly true in the corporate and financial sectors, where loans to companies are going unpaid and companies are looking to formal and informal arrangements to address mounting financial distress. Among the companies trying to stay afloat, at least some are already too far-gone to be saved. Distinguishing between the hopeless corporate cases and the ones worth saving is crucial at a time when financial resources and the technical expertise necessary to turn companies around are growing excessively thin.

At least one of the ways of addressing these issues is through resort to laws and institutions that help corporate debtors and creditors to resolve their claims in a structured setting. In Zimbabwe, the Companies Act and the Insolvency Act, as implemented by the High Court, the Master's Office, and the various appointed liquidators and judicial managers, make up what could be referred to as the country's insolvency resolution regime.

In the face of these considerable, and likely increasing economic challenges, there is a growing sense that the country's insolvency resolution regime needs upgrading. The Competition and Tariff Commission (CTC), observing the deleterious effect of corporate financial distress on competition and employee welfare, invited the Zimbabwe Economic and Policy Analysis Research Unit (ZEPARU) to collaborate on a study. The goal was a research report that could serve as both a catalyst, and basis, for formulating and implementing an enhanced policy framework for addressing corporate insolvency.[1]

The CTC and ZEPARU formed a joint research team that was assisted by an insolvency reform expert mobilized by the USAID-funded Strategic Economic Research and Analysis (SERA) Project. The team reviewed available literature concerning best practices regarding insolvency, and consulted with various private sector and government experts familiar with these issues and possible solutions. Focus group discussions were held in Bulawayo and Harare in early September 2013. ZEPARU organized a larger workshop in early December in Harare, at which the findings and recommendations were presented and discussed with approximately fifty experts and stakeholders. At the December seminar, a noted expert on insolvency issues, Doctor Cecil Madondo, offered his views on an earlier version of this report that was shared with him.

The result is this research report. Section 2 begins with the concept of corporate insolvency, how it might be addressed, and the benefits of doing so effectively. Section 3 briefly surveys the current and likely future challenges the country faces with regard to financially distressed companies and unpaid loans. Section 4 reviews the various ways in which unpaid debts are being addressed, short of resorting to insolvency proceedings.

Sections 5-7 provide an assessment of the current insolvency resolution regime and offer a range of options policy makers might consider should they decide to pursue reforms in this area. Given

a perceived need to find practical and timely solutions that can make a difference sooner than later, the policy options lie along a continuum from "keeping the legislation as is" (focusing instead on enhanced implementation) to a complete overhaul of the system—essentially replacing the current amalgamation of overlapping laws on corporate insolvency with a unified insolvency law compliant with international best practices tailored to the country's particular needs.

Turning to broader perspectives, Section 8 offers a set of policy suggestions that, though going beyond the reform of the country's insolvency resolution regime, could nevertheless address company indebtedness in a constructive manner. And finally, Section 9 offers conclusions that policy makers might wish to focus on.

Tables summarizing the recommendations in Sections 6-8 of this report are provided below.

Table 1.1: Various Options for Addressing Corporate Insolvency (by Degree of Extensiveness of Legal and Regulatory Reform)

Possible Options	Particulars	Relation to Other Approaches
1. Actions Requiring No Legislative or Regulatory Reform	• Voluntary guidelines for insolvency resolution professionals—developed by the professionals or by creditors. • Education and guidance for creditors. • Use of Internet and social media to facilitate creditor engagement.	Much of the thinking and discussion regarding insolvency resolution professionals and creditors contemplated here could be incorporated into more formalized reforms. The possibility of more formalized reforms in the near future, however, might encourage individuals to wait rather than act.
2. Clarify Procedures, Rights and Obligations through Issuance of Rules and Regulations	Both the Companies Act and the Insolvency Act allow for the establishment of more detailed rules governing procedures. Both acts are sufficiently broad in areas so as to allow for rules and regulations that could clarify issues and streamline procedures.	This option would likely be quicker to implement than options 3-7, but would be limited to reforms that conform to current law. It could be used, however, in tandem with option 3.
3. Develop and Enact a Limited Number of Legislative Changes	The amendments could be used where the effort to develop regulations meets a legislative roadblock. Optimally they should be short and very specific. Examples include • reducing approval levels for schemes of arrangement • imposing a 180-day cap on the duration of judicial management.	The group developing the proposals under option 2 could develop the proposals for option 3 as well.

Possible Options	Particulars	Relation to Other Approaches
4. Replace Judicial Management with a Business Rescue Regime Similar to that Recently Adopted in South Africa	In 2011 South Africa replaced a judicial management scheme that was very similar to Zimbabwe's. The new, generally well regarded approach: • can be initiated outside of court; • allows management to remain in place "supervised" by an insolvency professional; • requires 25 days to publish a rescue plan; • allows creditors vote as a group (75% approval required). Geography, common tradition, and quality of the reform make this a very strong option.	Clearly a different path than that contemplated under options 2,3, 6 or 7.
5. Develop a Comprehensive Unified Law on Insolvency Based on Models Developed in Other Commonwealth Countries	The current legal framework is quite complex with both gaps and redundancies. A new, unified law would be easier for non-experts to master and would more comprehensively address issues necessary to resolve corporate financial distress. Very few Commonwealth countries have enacted insolvency legislation that could be said to be unified.	Efforts with regard to this option could be pursued as follow-on work after adopting a rescue regime similar to South Africa's (option 4).
6. Develop a Comprehensive Unified Law on Insolvency Based on Models Developed Outside of Other Commonwealth Countries	This approach would address the same problems discussed under option 5 but would not constrain itself to models developed by other Commonwealth countries. This could provide more flexibility and produce a more efficient set of procedures. There is the risk, however, that such legislation would fail to fit within the established legal framework, or at the very least might be perceived as failing to properly fit.	A different direction than that offered by options 2 and 3, options 4 and 5, or option 7. Achieving success under this option would likely take longer than most of the other options.

Possible Options	Particulars	Relation to Other Approaches
7. Develop a Legislatively-Defined Approach that Accelerates the Restructuring of Debt and Ownership of Insolvent Companies through Market Mechanisms	This approach would establish resolution system for substantially adjusting ownership and debt of financially distressed companies on an accelerated basis, most likely through the sale of the shares of a spin-off company holding the assets of the distressed company. Difficult operational decisions would be left to the new owners of the spun-off company, which would have a substantially reduced debt burden. The previous owners and creditors of the company would still need to resolve their competing claims, but the assets that they would be fighting over would be the funds generated by the sale of the spun-off company.	Adoption of this approach essentially amounts to acknowledgment that traditional, structured debt resolution mechanisms (reflected in options 2-6) are difficult to effectively implement in practice. There are far fewer precedents, however, for this option than there are for options 2-6.

Table 1.2: A Menu of Potential Reforms that Could Improve the Country's Insolvency Resolution

General Area	Particulars	Basis and/or Ramifications
1. Improving the Insolvency Resolution Infrastructure	1. Deepen judicial expertise through either (a) the creation of specialized courts for insolvency resolution cases or (b) allocation of insolvency resolution cases to particular judges in addition to their regular docket responsibilities.	Both the technical nature of these cases and the increasing number of such cases support the argument for allowing a limited number of judges to specialize in this area.
	2. Formalize and further clarify responsibilities of personnel at the Master's Office. 3. Clarify the standards under which insolvency resolution professionals operate (high priority).	The Master's Office currently handles a wide variety of cases. It would make sense to consider various ways in which it could be reoriented and supported to increase its ability to respond to the rising tide of insolvency resolution cases. The level of regulation for these individuals is light in comparison to international best practices.

General Area	Particulars	Basis and/or Ramifications
	4. Increase transparency and facilitate communications in insolvency resolution proceedings (high priority).	The Internet and other technical advances allow for far greater transparency than even imagined ten years ago. The public interest in the progress and outcome of these cases support greater transparency in this area.
	5. Facilitate the role creditors play in insolvency cases.	Allowing and supporting the formation of creditors' committees, for instance, should be considered.
2. Encouraging Earlier Use of Insolvency Resolution Regimes	1. Clarify the risks that managers face in continuing to do business when insolvent.	Greater specificity on when company officials might be considered liable for wrongful trading might increase incentives for such persons to start insolvency cases sooner.
	2. Allow current managers to participate more actively in the effort to rescue the business.	This would increase incentives for such managers to bring cases voluntarily.
	3. Incentivize unsecured creditors to initiate cases.	An individual, unsecured creditor is essentially performing a public service in moving a financially distressed company into formal insolvency proceedings. Consideration should be given to rewarding them for doing so.
3. Encouraging Quicker Resolution of Insolvency Resolution Cases	1. Establish time limits on insolvency resolution procedures (high priority).	Explicit deadlines may accelerate case development and resolution.
	2. Make schemes of arrangement proposals an early requirement in judicial management cases (high priority).	A scheme of arrangement should be an early priority for nearly every judicial management case. Such proposals should be required within specified deadlines.
	3. Allowing creditors to cast an early veto over rescue procedures where there is little likelihood of success.	This could preclude judicial management efforts that are being used as a means of delaying liquidation.

General Area	Particulars	Basis and/or Ramifications
	4. Facilitate the conversion of failed judicial management attempts into company wind-ups.	Judicial management efforts that continue without realistic hope of a turnaround reduce the value of the debtor's assets and harm the interests of most of the stakeholders.
	5. Establish quick-resolution procedures for existing judicial management cases that have not adequately progressed.	This would free up judicial and other resources to address cases where judicial management may have a greater degree of effectiveness.
4. Addressing Pre-Established Rights during the Course of a Business Rescue	1. Protect the rights of secured creditors while their claims are suspended.	If the rights of foreclosure are suspended during the proceedings, special provisions should be made to ensure that secured creditors' claims do not erode in value over the course of the proceedings.
	2. Clarify the rights of suppliers and other contractual counterparties.	Reducing uncertainty here would result in mutually beneficial arrangements and reduce the likelihood that suppliers of crucial inputs would abandon the debtor during the proceedings.
	3. Balance the rights of workers to continued employment with the need to rescue companies (high priority).	Several observers have noted the substantial costs and delays entailed in resizing a debtor's labour force during insolvency proceedings.
5. Increasing the Likelihood of a Successful Business Rescue	1. Reduce the number of classes of creditors in a liquidation and in a scheme of arrangement (high priority).	Fewer classes mean simpler voting procedures and lesser likelihood that a particular class of creditors may try to block the approval of a rescue plan or scheme of arrangement.
	2. Reduce the approval requirements for approving a binding compromise with creditors (high priority).	The current levels for approving a scheme of arrangement are relatively high in relation to

General Area	Particulars	Basis and/or Ramifications
		international best practices. Lowering the standard might increase the likelihood of approval with little downside risk.
	3. Clarify the roles and rights of shareholders in restructuring the debtor and approving the business rescue plan.	Proper incentives and rules for shareholders are crucial to having cases brought at the optimal time and having them brought to a satisfactory conclusion.
	4. Encourage pre-packaged insolvency resolution petitions.	Cases where stakeholders make binding arrangements prior to filing a petition tend to be processed far faster than those that do not.

Table 1.3 Additional and/or Alternative Options to Resolving Widespread Company Distress

Possible Options	Particulars
Improving the Management of Tax Claims in Insolvency Cases	Consideration should be given to transferring such claims to private parties once a company has gone into insolvency proceedings; or at least establishing a specific unit under the tax authorities staffed with individuals trained and authorized to compromise tax claims.
Encouraging Parastatals to Sell their Receivables	The reasons are similar to those supporting the argument for transferring tax claims to third persons.
Establishing Free Trade Zones for Particularly Hard Hit Economic Areas	Replacing regulations that are perceived as unfriendly to businesses with the most liberal of international best standards would likely increase the amount of capital available for turning around financially distressed companies. At the very least, this could be done on a regional basis in areas that are in particular need of new capital.
Establishing a Multi-Pronged, Integrated, and Pro-Active Approach to Corporate Financial Distress	This would involve recapitalizing banks, moving non-performing loans to a special purpose vehicle, and facilitating out-of-court debt restructurings.

2.0 INSOLVENCY AND THE METHODS OF RESOLVING IT

Nearly everyone familiar with the challenges facing Zimbabwe understands that many of its companies are suffering financially. The term corporate insolvency is often used to describe these conditions. Insolvency however, can mean different things to different people. Early elaboration on this and related terms will likely help keep issues clear throughout the course of this paper.

2.1 The Difference between Economic and Financial Distress

An important aspect of insolvency is the difference between companies that are suffering from economic distress and those that are suffering from financial distress. A leading theorist on insolvency described this distinction:

A firm may be troubled because it cannot succeed in the marketplace, since competitors produce a better product at a lower cost. On the other hand, a firm may be distressed because it cannot generate sufficient revenue to pay its debts. This first kind of adversity is called "economic" distress. It exists regardless of a firm's capital structure. The sole owner of a business that attracts no customers will shut it down, even if there are no banks or other creditors in the picture.

The second kind of trouble is "financial" distress, meaning the firm's income is not enough to pay back what it has borrowed. For example, a toy manufacturer borrowed a large amount of money to develop and market a toy tied to a movie that later flopped. The people responsible for this debacle have left the firm. The current managers are now the best in the business. Nevertheless, this huge loan and the firm's other obligations exceed the value of the firm itself. The firm is in fine shape with respect to everything it now does, but it cannot pay its debts. This firm is in financial distress. Financial distress exists only if a firm has creditors. If the creditors disappeared, the problem would disappear and the firm would thrive. Not so for a firm in economic distress: Its assets fail to bring in sufficient revenue, relative to the costs of operating the firm and the alternative ways in which they could be used. Eliminating creditors would not change the fundamental problem the firm faces.[2]

The economic challenges currently facing the country have thrown many companies into financial distress. Longer-term structural challenges, for instance adjusting to a more globalized economy, have produced perhaps many companies that are in economic distress as well.

Both types of companies could be described as "insolvent". But the ones suffering from financial distress are far less difficult to fix than those suffering from economic distress. The challenge involves distinguishing between the two conditions, especially when shareholders, owners, and workers of a troubled company tend see their problems as financial rather than economic.

2.2 The Essence and Benefits of an Insolvency Resolution Regime

Most countries, including Zimbabwe, have established formal systems (i.e., insolvency resolution regimes) to address the challenges described above. They normally consist of specialized judicial

procedures, specialized judges and court personnel, and private professionals, who serve as liquidators or administrators (in Zimbabwe referred to as judicial managers) of such companies.

One possible way of understanding what an insolvency resolution regime should do is to imagine a set of circumstances where it might not be used, for instance when a company negotiates an out-of-court restructuring of its debt with its creditors.

These types of negotiations usually involve a debtor and several large, relatively sophisticated creditors, usually banks. A debtor who finds itself in economic trouble goes to its main creditors and tries to negotiate a collective solution. In several jurisdictions, notably the U.K. and Singapore, creditors establish arrangements amongst themselves to ensure that such negotiations are done cooperatively. When an agreement is reached, it usually involves virtually all the main creditors signing on to one or more agreements that provide the debtor with relief in the form of payment extensions or even forgiveness of amounts due. All is done through contract with no court involvement.

Unfortunately, such circumstances in many jurisdictions are the exception rather than the rule. There are several challenges that make such out-of-court negotiations difficult to finalize:

- The fear that one or more creditors might act unilaterally to either seize assets or obtain a court judgment when others are negotiating. This could put the whole restructuring effort at risk.
- The lack of trust in the debtors' management. These individuals are often times seen by the creditors as incompetent or corrupt. But their knowledge of the company and support by shareholders can keep them in power.
- The absence of new financing to keep the debtor's company going through the crisis.
- The possibility that assets might disappear, or that the debtor will favour particular creditors.
- The legacy of unfavourable contracts that continue to cost the company money.
- The tendency of parties to put off difficult decisions, such as agreeing to a reduction of claims.
- The possibility that a few creditors would refuse to compromise in a plan agreed to by the majority. The majority creditors might resent this unfairness and refuse to finalize the plan.
- The lack of a clear threat of liquidation to give the creditors and shareholders a real incentive to make meaningful compromises.

An effective insolvency resolution regime addresses each of these challenges. Once a case is filed under an effective regime, several things usually happen:

- Creditors face a temporary moratorium on their claims. No one can move unilaterally against the debtor for a limited period of time.
- The debtor's management is either displaced or closely watched by an experienced insolvency resolution professional, usually chosen by the creditors.
- With court approval, the debtor can grant a creditor a "super priority" with respect to credit

extended after the case is filed. This will usually entice a creditor, or a group of them, to lend additional funds that the debtor can use to keep the company operating during the negotiation. Further, any debts incurred to workers and other suppliers of the company after the commencement of the case are considered to have priority-payment status.
- If the insolvency resolution professional finds unfair treatment of particular creditors or shareholders of the company (such as an accelerated loan payment or a transfer of an asset at below-market value), he or she can apply to the court to have these transactions reversed.
- The insolvency resolution professional and management can decide to break certain contracts that are burdensome to the debtor. The counterparty will have the right to compensation, but usually as an unsecured creditor (whose claim is likely to be substantially discounted).
- The procedures are subject to clear and well-enforced deadlines with liquidation as the penalty for delay. This forces parties to come to decisions.
- Creditors or the debtor can present a rescue plan, which, if supported by the majority of the creditors and approved by the court, would bind the minority creditors who refused to go along. Their claims would be adjusted by the ruling of the court and the contents of the plan.
- A liquidation would result if the plan is rejected. This gives all parties an incentive to reach a compromise.

While these are only some of the elements in a modern, effective insolvency resolution regime, they are the fundamental elements that help facilitate collective resolution of financial distress amongst a debtor and its creditors.

2.3 The Connection between a Well Functioning Insolvency Resolution Regime and a Competitive and Efficient Economy

In helping to resolve financial distress in an expedited and relatively predictable manner, an effective insolvency resolution regime can contribute substantially to a country's economic competitiveness and performance. In particular, a well functioning regime (1) enhances financial stability and reduces the risk of creditors and investors, (2) reinvigorates viable companies and recycles assets so that they contribute to growth and competitiveness, (3) fosters risk-taking and entrepreneurship by clarifying the risks of business start-up, and (4) offers an alternative to state-funded bailouts.

2.3.1 Enhancing Financial Stability and Reducing Risks Facing Creditors

The link between an effective insolvency resolution regime and financial stability and risk reduction is well documented. The World Bank's Doing Business Report for 2013 notes how insolvency law reform in Brazil "strengthened the rights of secured creditors, [which] led to a significant reduction in the cost of debt and an increase in both short- and long-term debt."[3] The same report notes how reforms in Italy several years ago had the opposite effect: excessive use of reorganization proceedings increased interest rates on loan financing because it reduced "the incentives for entrepreneurs to act prudently."[4]

These findings make intuitive sense. Small and medium sized enterprises often times lack access to credit at interest rates and durations that make investment projects feasible. In countries where enforcement mechanisms in the event of default are slow, uncertain, and/or expensive, creditors build such assumptions into loan evaluation processes. This usually means loans that are shorter in duration at higher interest rates.[5]

The Doing Business Report recognizes and charts methods for collecting on a debt in the event of default: enforcing a contract under normal circumstances and collecting when the debtor has come under insolvency proceedings. Both are most certainly important. A reliable contract enforcement mechanism frames both contract negotiation and dispute resolution on a regular basis. An efficient insolvency regime addresses less frequent but potentially more disruptive circumstances. Lenders consider both in determining the risks in offering credit.[6] And when these mechanisms fail to provide reliable results in the event of default, lenders respond by raising interest rates and shortening loan durations in order to manage this risk.[7]

This constraint ultimately serves as a barrier to entry to new competitors in a given market. This is especially critical with respect to small to medium sized firms that cannot rely on internal funding.[8] Further, such constraints not only hamper new entry. They retard the growth of firms, thereby constraining their ability to compete in the markets in which they operate.

2.3.2 Reinvigorating Distressed Companies and Recycling Assets

For reasons not related to an otherwise sound business plan, a company may find itself in financial distress. The causes are numerous: currency fluctuations, unfriendly government policies, or an unexpected loss of buying power amongst customers are just a few. While these constraints might eventually ease, they often leave a legacy of debts caused by the firm's inability to meet all its obligations during the crisis. In other words, looking forward, the company might be sound and profit making on an operating basis. But legacy debts and the costs of servicing them may leave it unable to make a profit or even meet all its obligations as they come due.

An effective insolvency resolution regime can facilitate a restructuring of a company's balance sheet by either rescheduling or reducing debts, or converting some of them to shares in the company, so that loan obligations are more realistic. By avoiding a disruptive and disorderly seizure of a company's assets or a piecemeal liquidation, an effective insolvency resolution regime helps to ensure that going concern value in a company is preserved, allowing it to compete for customers in the market in which it operates.

But it is also possible that economically, the business plan of the company no longer makes sense, due to changing economic landscapes or obsolescence of key assets. Managers and shareholders are sometimes the last to recognize this, continuing to insist that problems were merely temporary and prosperity is around the corner. In such cases, the company's assets are under utilized, representing less of a competitive pressure on others in their sector. An effective insolvency resolution regime, by transferring the assets to new owners, puts them in

hands of people who can use them more effectively. In such cases such assets may once again put competitive pressures on other firms.[9]

2.3.3 Fostering Risk Taking and Entrepreneurship

The third benefit of an effective insolvency resolution regime is that it can foster greater risk-taking in an economy by clarifying the consequences of business failure. If the downside of a particular venture is well known, entrepreneurs and companies can better assess the overall risk and reward equation. In this sense, an effective insolvency resolution regime complements the role that limited liability plays in encouraging risk taking.[10]

2.3.4 Offering an Alternative to State Funded Bailouts and More Onerous Interventions

During widespread financial crisis, government officials are often tempted to consider direct economic intervention such as state investment in troubled companies, subsidized credits, deferred tax collections, etc.[11] Perhaps even more onerous, however, are policies that shift the cost of addressing economic distress to the private or financial sector, such as a moratorium or other restraints on debt collection. It has been well recognized that policies such as these discourage companies from addressing operating inefficiencies and lead to more costly or frequent crises in the future. They also cost taxpayers money (when funded by the state) or discourage private sector lending (for example, when moratoria on debt collection are imposed on creditors).

An effective insolvency resolution regime offers companies a map for resolution of financial distress. It does so by allocating losses amongst the parties involved according to pre-existing rules that normally coincide with their risk preferences (i.e., shareholders should suffer losses before creditors). The existence of such procedures can help de-politicize financial crises, reducing incentives for fiscally costly, and often times ineffective, state interventions.

2.4 Limits to an Insolvency Resolution Regime

At the same time, though, it is important to realize that even the most effective insolvency resolution regimes have their limits in resolving company distress, especially when the cause of such distress is exogenous to the companies themselves or is widespread in an economy. For instance, an insolvency resolution regime can have little direct affect on the level of liquidity in a country. Political pressure can also play a factor. For instance, an insolvency law might be ignored with respect to companies, for political reasons, that are too big to fail.[12] It should also be noted that insolvency cases, even in the best scenarios, tie up substantial amounts of human capital (judges, lawyers, administrators) and take substantial amounts of time. These restrictions serve as a reminder that an effective insolvency resolution regime is only part of the solution to countries facing substantial economic dislocation.

3.0 CORPORATE FINANCIAL DISTRESS IN ZIMBABWE

The ills affecting the corporate sector in Zimbabwe are well documented and need not be repeated at length here. The introduction of the multi-currency regime tamed inflation and created a relatively more stable environment, which saw the growth of businesses from 2009-2011. Since then, though, there has been a creeping perception that this growth is stalling and that it may turn sharply negative in the coming years. Several factors point in this direction. Observers refer to the recent increase of companies being delisted from the Zimbabwe Stock Exchange due to financial distress. Other anecdotal accounts describe skyrocketing numbers of lawsuits as banks attempt to collect from defaulting borrowers.[15]

A perhaps fairly indicative measure of this stress is the increase in non-performing loans (NPLs). According to the government's recent Mid-Year Fiscal Policy Report, NPLs stood at the end of 2009 at less than two per cent of outstanding loans. At the end of 2012, it stood at over 13%. Anecdotal information indicates that this trend has yet to peak. Several banks at the end of the third quarter have reported increases of NPLs to over 20%.[16]

Discussions with business sector representatives and reports from the government indicate that many of the firms generating these NPLs suffer from economic, rather than financial, distress.[17] Saving these firms in their current form will be very difficult and, for many, impossible. In order to be effective, an insolvency resolution regime needs to be able to distinguish between these two types of distress, channelling those with merely financial distress into relatively quick rescue procedures, and channelling those facing hopeless economic distress into liquidation or reorganization procedures that contemplate fundamental reorientation of the company's profile and mission.

But, regardless of the choices that may emerge from a review of the country's insolvency resolution regime, one thing will not change. If there are very few investors (private or public, foreign or domestic) seeking to inject capital into financially distressed companies or if there are very few bidders with funds sufficient to buy industrial assets in liquidations, essentially only one of two things will likely occur. The first is that the price of assets might fall substantially. This will allow the few investors willing to inject capital to obtain disproportionately favourable deals in distressed companies, or buyers of assets to obtain substantial discounts in their purchases. This will mean losses for creditors and shareholders, but at least new owners and investors will have a chance to utilize these assets, hopefully more successfully than their predecessors.[18]

Or, perhaps more likely, and more painfully in the longer run, the prices will be considered too unfair and extortionate, in other words both socially and politically unacceptable. There will be extreme pressure to reject these offers either before or after the fact. But if the prices of these assets fail to reach their market-clearing price, they will not be sold. Investors will remain at a distance, and asset values will deteriorate further.

It is thus crucial that any reforms of the country's insolvency resolution regime be coupled with policies that attract potential investors in distressed companies and buyers of capital assets.

4.0 THE RESPONSES OF THE LEGAL AND REGULATORY SYSTEM TO FINANCIAL DISTRESS OF COMPANIES

In a broad sense, many of the policies and activities implemented by either the government or the financial/business sector have been shaped by a need to address the problems facing companies. This section will focus on three mechanisms that likely have the greatest impact on the current, and any future, insolvency resolution regime: standard debt collection practices, informal methods of resolving substantial indebtedness, and the formation and funding of financial distress funds.

4.1 Standard Debt Collection Practices

An action to enforce a debt is one of the primary catalysts behind the initiation of proceedings under an insolvency resolution regime. A debtor, fearing or reacting to seizure or freezing of its assets through standard collection practices, might initiate an insolvency case as a defensive measure.

In countries with relatively effective debt collection methods, voluntarily initiated insolvency cases are far more common. By contrast, in countries where debt collection methods are inadequate, there is a tendency to see insolvency procedures serving as an alternative debt collection device.

Cases that are voluntarily initiated, even under duress, are procedurally simpler and more likely than an involuntary case to move towards full resolution.[19] A fair assessment of Zimbabwe's insolvency resolution regime thus requires at least some consideration of its mechanisms for enforcing obligations through standard procedures.

In general, the combination of procedures and institutions in Zimbabwe appears to adequately pressure debtors to either pay debts or initiate insolvency proceedings. In arranging contracts or loans, businessmen have a broad array of devices to resort to as insurance (or as leverage in negotiations) should a counterparty refuse to meet obligations. Counterparties can take mortgages over immovable property or take a form of security over some types of movable property through the use of a notarial bond.[20] They can also obtain promissory notes from their counterparties as well as personal guarantees from third parties (which in turn could be supported by real security instruments such as mortgages or notarial bonds).[21]

Should a dispute arise that requires court action, the procedures and institutions in Zimbabwe appear adequate to pressure the debtor. Claimants can resort to a well-established legal profession as well as a steadily growing number of debt collection agencies, and a court system that remains relatively well trusted and reasonably efficient.

This state of affairs is generally reflected in the 2013 Doing Business Report. Under the "enforcing contract" indicator, the number of days necessary to enforce such a claim through the courts in Zimbabwe is substantially less than the average for countries in either Sub-Saharan Africa or those within the "OECD high income group."[22]

A full evaluation of Zimbabwe's standard debt collection mechanisms is beyond the scope of this paper. Nonetheless, it does appear adequate to put pressure on corporate debtors sufficient to make them at least consider Zimbabwe's insolvency resolution regime. This is corroborated through discussions with various attorneys and insolvency resolution professionals, who indicate that the majority of insolvency cases in Zimbabwe are initiated voluntarily.

Nevertheless, it should be noted that whatever the effectiveness of standard debt collection mechanisms, there remains a growing risk that banks with increasing NPLs on their books will become less willing to aggressively enforce claims non-paying borrowers. The fear here is that filing and winning a suit, and thereafter realizing proceeds from the sale of the debtor's property (be it collateral or otherwise) would cause the bank to recognize losses, which could impair its capital and bring it under regulatory scrutiny. The alternative is "evergreening", a practice of banks in some countries to continuously roll over loans of non-paying debtors in order to avoid this result.[23]

4.2 Informal Methods to Resolve Substantial Indebtedness

In many countries, banks and other creditors engage in "workouts"--informal, but well-established practices for resolving financial distress without resort to formal legal proceedings. Rather than filing a case under a particular insolvency law, creditors will collectively enter into an arrangement with a distressed debtor to reschedule debts, trade equity for debt forgiveness, etc. These arrangements are finalized through resort to contractual and corporate finance instruments without the need for judicial approval.

The benefits and shortcomings of this approach have been discussed in Section 2, which explained how a formal insolvency resolution regime could supplement or improve on informal methods.

Recent reported efforts to conduct workouts indicate that banks, large debtors, and their various advisors are well aware of this approach and are attempting to strike deals to resolve indebtedness. Still, successes are more the exception than the rule. A recent example of a successful workout involves Lobel's Holdings, where large bread company negotiated an arrangement with several of its large creditor banks. The Lobel's example, though, cannot be characterized as a pure workout, as the parties utilized a "scheme of arrangement" that was approved by the court. See Section 5.2.3 for a discussion of this instrument.

4.3 Entry and/or Formation of Financial Distress Funds

Investment funds specializing in distressed companies can provide a useful source of liquidity and expertise in restructuring efforts. Somewhat unfairly referred to as "vulture funds" these vehicles will either buy debt and or equity from existing holders at a substantial discount or offer new equity or loan capital at terms designed to cover the fund for any downside risk. Formed on the basis of private, public or donor-funded capital (or combinations thereof), these funds have assisted the recovery of companies in many countries following systemic crises.

Possibly the only, and certainly the most high profile, example of such a vehicle is the Distressed Industries and Marginalized Areas Fund, better known as DIMAF. The fund was formed as a joint venture between the government and a local private bank. It has provided funding to approximately a dozen distressed companies, primarily in the Bulawayo region. Discussions with an official at DIMAF indicate that its lending efforts, while perhaps not moving as quickly as some observers would like, are proving a catalyst for restructuring efforts. Still, perhaps because the fund has been in operation only since 2012 and funds were only fully disbursed in 2013, few clear success stories have emerged. The government has recently expressed interest in expanding the funds available to DIMAF.

5.0 THE ZIMBABWE'S INSOLVENCY RESOLUTION REGIME AND ITS PERFORMANCE IN THE CURRENT ECONOMIC CRISIS

Zimbabwe's corporate insolvency resolution regime could be said to consist of the laws and regulations addressing insolvency (primarily the Insolvency Act and the Companies Act) and the private and public institutions and persons that implement them. The institutions are addressed first.

5.1 The Institutional Framework for Insolvency Resolution

The three primary institutions/persons charged with implementing the insolvency system are the High Courts of Harare and Bulawayo, the Master's Office and various insolvency practitioners. The Official Gazette plays an important supporting role in providing notice to parties.

5.1.1 The Courts

The High Courts of Harare and Bulawayo have original jurisdiction over corporate insolvency cases.[24] They are staffed by judges enjoying security of tenure who, according to discussions with various practitioners, enjoy general respect among the business and legal community. Nevertheless, there appears to be a growing sense that corruption is undermining their reputation. The Chief Justice of the Supreme Court himself has brought attention to this fact.[25] Several practitioners noted that they are most concerned about judicial impartiality with respect to cases that have high political profiles and ramifications.

Court operations are relatively transparent. The Judicial Service Commission (JSC) operates a website that publicizes the court's dockets on a weekly basis. Court proceedings are conducted in public and there appears to be little restriction on who may observe them. Many of the decisions of the High Court are published on the JSC's website.

5.1.2 The Master's Office

The Master's Office both supervises the progress of insolvency cases and actively plays a role within them. Among other roles, the master appoints liquidators and judicial managers, convenes and runs creditor meetings, reports on the debtor's condition, reviews the accounts of appointed insolvency practitioners, and publishes a weekly docket of insolvency case events occurring at the court. These tasks are in addition to various other responsibilities of the Master's Office, for instance the supervision of individual estates of deceased persons.

Personnel at the Master's Office have yet to be extensively interviewed by the research team. Discussions with various practitioners, however, reveal a sense that the personnel at the Master's Office are overstretched. It appears to be caught between a very broad mandate and the pressures that most government institutions are facing in a time of diminishing resources.[26]

5.1.3 Insolvency Practitioners

The country has a cadre of individuals, most of them accountants by training, who serve as judicial managers and/or liquidators. Their reputation with business and finance sector representatives, in terms of competence and integrity, appears to be mixed.[27]

A person is eligible for appointment as a judicial manager or liquidator if he or she is registered with the Council of Estate Administrators ("CEA"),[28] a legal entity constituted under the Estate Administrators Act. Currently, the CEA consists of 10 members appointed from a cross section of interest groups, skills and professions. Its main functions are as follows:

- to register estate administrators countrywide;
- to conduct examinations to qualified persons for registration;
- to enforce ethical practice and discipline among registered estate administrators;
- to issue practise certificates to registered persons and to cancel or suspend such certificates; and
- to administer a compensation fund.

Under the legislation that established the CEA, a person is eligible for registration if he or she is either a licensed attorney or accountant/auditor, and has not been adjudicated bankrupt, convicted of a crime, etc.

The CEA appears to be a low profile organization. Application materials do not appear to be available on the Internet, nor is there online guidance on procedures by which individuals aggrieved by the acts or omissions of a liquidator or judicial manager may complain to the CEA. Although it is authorized to prescribe "rules of conduct to be observed by registered persons"[29] it has not done so with respect to any guidelines or code of ethics for liquidators or judicial managers.

The CEA appears to have the power to sanction a registered person for "improper or disgraceful conduct" or "negligence in his practice as an estate administrator." [30]

The research team, however, is not aware of instances where a liquidator or judicial manager has been sanctioned under this authority.

Nevertheless some recourse in the event of misconduct of insolvency practitioners is available through the courts and through the Master's Office. For instance, the Master may reduce a liquidator's payment on account of any failure or delay in the discharge of his duties[31] or dismiss him outright for a similar violation.[32] It is unclear as to how many disciplinary actions have occurred in recent years.

5.1.4 The Official Gazette

The Official Gazette is used to publish many of the notices regarding the initiation and progress

of insolvency proceedings. It is issued on a regular basis by the government printing office in Harare. It is generally considered a regular and reliable source of official news.

5.2 Legal Framework

Zimbabwe's corporate insolvency resolution regime is governed by several different laws, many of which have remained essentially unchanged over the past several decades, despite the fundamental transformations the country has experienced during that time.[33] Much of it remains very similar to insolvency legislation in South Africa. It is not unusual for judges to cite to South African treatises and cases in interpreting Zimbabwean law on these matters.[34]

The Companies Act provides for most of the substantive and procedural aspects for resolving insolvency of companies in Zimbabwe.[35] The provisions allow for an in-court administration and restructuring scheme (referred to as judicial management), a liquidation process (referred to as wind-up), and a set of procedures by which a company can have its creditors vote on a restructuring of debt (generally known as a scheme of arrangement). This latter instrument can be used during wind-up proceedings, judicial management, and with out-of-court negotiations.

The Insolvency Act governs the process for resolving the insolvency of individuals and partnerships. Nevertheless, the Companies Act incorporates many provisions of the Insolvency Act by reference and a court may apply the Insolvency Act to any matter not specifically covered by the Companies Act.[36] Finally, the Companies Act authorizes the Chief Justice of the Supreme Court to issue procedural rules regarding insolvency proceedings and the Minister of Justice to issue other rules to implement the act.[37]

A complete description of the procedures for implementing judicial management, wind-ups, and schemes of arrangement are beyond the scope of this paper. The following description highlights the main requirements, milestones, and characteristics of such procedures.

5.2.1 Judicial Management

Judicial management is a court-supervised procedure designed to give the debtor a temporary respite from the claims of creditors, during which time a court-appointed manager investigates the debtor's affairs, clarifies its debt, and attempts restructure the company and the claims against it so that it can become a successful concern.

Judicial management may be initiated via several routes. The most common appears to be through voluntary means, when a company submits an application to the court either as the result of pressure from creditors enforcing their claims or in response to the filing of an application by another party for wind-up.[38] If the court determines that there is a "reasonable probability" that the debtor is (a) unable to pay its debts, and (b) if brought under judicial management it would eventually be able to do so, it may grant a provisional judicial management order.[39]

The provisional judicial management order starts the process for the appointment of a judicial manager by the court's Master. The order normally contains provisions that prohibit creditors from enforcing their claims against the debtor. The Master thereafter appoints the judicial manager, who takes custody of the debtor's property and begins investigating the state of the company's affairs in order to determine whether it can be restored to financial health.[40] He also organizes a meeting of creditors to review the report and to nominate a final judicial manager should a final judicial management order be issued.

Within sixty days of the provisional order, the court must decide on whether to issue a final judicial management order. The court, taking into account various reports developed during the provisional period of judicial management, as well as the opinions of the creditors and members of the company, determines whether "the company concerned, if placed under judicial management, will be enabled to become a successful concern and that it is just and equitable to grant such an order." Otherwise, the court "may discharge the provisional management order or make any order that it thinks just."[41]

An order placing the company under final judicial management allows the provisional judicial manager, or his replacement, to effectively displace the management of the company, if that has not occurred already. The judicial manager thereafter operates the company. He normally cannot sell assets outside the ordinary course of business but may do so if given specific permission by the court. He is further required to investigate the affairs of the company to determine if any officers of the company may be liable to it on the basis violation of the Companies Act or other violations.

Notably absent from these statutorily defined duties is the requirement to negotiate a scheme of arrangement with the company's creditors under Section 191 of the Companies Act. See Section 5.2.3. The legislation also appears to provide little relief to a secured creditor threatened by erosion of its secured status by reason of either depreciation, damage or disappearance of collateral in the hands of the debtor company.

If over the course of his term, the judicial manager determines that the company will not "become a successful concern" he is required to apply to the court "for the cancellation of the judicial management order and the issue of an order for the wind-up of the company."[42] Any person "having an interest in [the] company" may make a similar application.[43]

Alternatively, if the judicial management proves successful, the judicial manager may apply to the court for the cancellation of the final judicial management order and the transfer of authority over to the company's management and shareholders.[44]

5.2.2 Wind-Up

Winding up procedures involve the appointment of a liquidator, who gathers and sells the assets of the company, using the resulting funds to pay creditors and, if possible, shareholders in accordance with statutorily based priorities.

A company may be wound up for a myriad of reasons, several of them under circumstances when the debtor is not insolvent, indeed, not under any financial distress, and able to pay all its creditors in full.[45] For purposes of this paper, wind-up will be considered in the context of a creditors' petition alleging that the debtor "is unable to pay its debts"[46] or where creditors are attempting to convert a voluntary wind-up controlled by the company to one controlled by the court, and where a judicial manager or other interested party has applied to the court to convert the proceedings to a wind-up.[48]

Upon receipt of a petition by creditors alleging an inability of the debtor to pay its debts, the court must determine whether, the debtor is truly in such a state. The Companies Act provides relatively clear guidance on this question. Essentially if a creditor shows that a debtor has been unable to pay a claim submitted to it within three weeks, or where a sheriff in enforcing a judgment cannot find sufficient assets to do so, the debtor is considered unable to pay his debts.[49] In the absence of such proof, the Companies Act also allows the court to come to such a conclusion by taking "into account the contingent and prospective liabilities of the company."

If the court determines that the debtor cannot pay its debts, it issues an order to wind-up the company. Such an order is deemed to be effective as of the time the petition was presented to the court.[50] It has the effect of transferring all property of the debtor company to the custody of the Master until he appoints a liquidator[51] and imposes a moratorium on all actions against the debtor.[52]

Upon the issuance of a wind-up order, the Master is required to appoint any fit person that the court has ordered to be appointed as a provisional liquidator or appoint his own choice if the court has not provided direction.[53] The Master is also required to publish notice of the order in the Official Gazette[54] and summon the creditors to a meeting to ascertain claims and determine who should serve as the permanent liquidator.[55]

The liquidator eventually appointed has the responsibility of gathering the assets of the company and selling them "by public auction or otherwise."[56] The liquidator should also evaluate various on-going contracts and leases of the debtor and determine which ones to adopt or abandon.[57] He is also required to comply with any duly passed resolution of creditors to undertake any action for which he is not required to obtain leave of court.[58]

As soon as practicable, and in no case later than three months after appointment, a liquidator is required to report to the creditors on the causes of the company's failure, the current status of the debtor, and the "progress and prospects of the liquidation."[59] Within six months he must present to the Master an account of his or her receipts and payments and a plan of distribution.[60] The distribution of proceeds to creditors should be in line as "nearly as possible as they would be applied in payments of costs of sequestration and the claims of creditors under the law of insolvent estates,"[61] i.e., the Insolvency Act.

In applying the provisions of the Insolvency Act in the context of a company wind-up, it should be noted that preferential and general creditors are only entitled to the "free residue" of the estate. Free residue is that "portion of the estate which is not subject to any right of preference by reason of any special mortgage, landlord's legal hypothec, pledge or right of retention."[62] Proceeds from the sale of encumbered property of the debtor will thus be distributed to the appropriate secured creditor in accordance with its claim.

Surplus proceeds and proceeds from the sale of unencumbered property will likely be distributed in accordance with the following order of preferred classes, with no class being paid unless the class above is paid in full.[63]

- the costs of liquidation, including the costs of the court application, the liquidator's and master's costs; and the sheriff's costs;
- the taxed costs of the Sheriff, deputy sheriff or messenger with respect of any execution of the property of the company that was under attachment or the proceeds of which were in the hands of the Sheriff, deputy sheriff or messenger at the date of the sequestration;
- contributions to any pension, provident, sick, medical aid, unemployment, holiday, insurance or workmen's compensation fund which have been or should have been deducted by the employer from the salary or wages of his employees up to the time of the initiation of the wind-up;
- employee claims for salary arrears (incurred during the month of the case commenced and the two months before that) plus any termination payments owed to the employees;
- income tax owed up to the time the case was commenced;
- capital gains tax owed up to the time the case was commenced;
- value added tax owed up to the time the case was commenced;
- claims secured by a general notarial bond or a special notarial bond over movable property.

Any funds remaining after the payment of these claims are distributed amongst general creditors.

5.2.3 Schemes of Arrangement

Section 191 of the Companies Act allows a company to enter into a formal, court- sanctioned arrangement with its creditors (hereinafter referred to as a scheme of arrangement). Section 191 specifically refers to such arrangements arising in the context of a wind-up proceeding or a negotiation outside the court, but it has been also used in Zimbabwe in the context of a judicial management proceeding.

A vote on a scheme of arrangement needs to occur in a formal meeting called by the court, in response to a request by the company, the judicial manager, or the liquidator. Voting may be done by classes of creditors, most likely secured creditors, preferred creditors, and general creditors in different classes. The scheme must be agreed to by a majority in number representing three-quarters in value of creditors' claim or a class of thereof. If such a vote is successful, the organizer of the meeting applies to the court to have it approved. The Companies Act fails to

state the criteria on which such approval would be granted. Presumably the court would do so unless it determines that the creditors have voted for an arrangement that would provide them substantially less than what they would receive in a liquidation.

If approved, the arrangement is sanctioned by the court. It is binding on all creditors or classes of creditors whether they voted for the scheme or not.

In addition to creditors, schemes of arrangement may also be used to modify the rights of members of a company. Applied in such a context, a scheme of arrangement can be used to substantially increase the number of shares in the company, which can then be used to compensate creditors who have compromised on their claims. As with creditors, the "three quarters rule" governs whether such a proposal would be approved.

5.3 The Recent Performance of the Insolvency Resolution Regime

In preparing this report the team was able to review statistics provided by the High Court of Harare. This information, combined with observations gleaned from news accounts, the Doing Business Report for Zimbabwe, and discussions with business and financial sector representatives, provides at least an initial sense of the performance of the country's insolvency resolution regime.

5.3.1 Accounts and Statistics with respect to Judicial Management

Among the three main instruments of country's insolvency resolution regime, judicial management attracts the most attention. Various observations include the following:

- The number of filings for judicial management has increased substantially in recent years. Nevertheless, there is a perception that companies in financial distress are waiting longer than they should be to file, resulting in their being in worse shape financially than if they had resorted to the procedure earlier.
- Banks are reluctant to lend to companies in judicial management,[64] despite possibilities for them to be accorded a limited preferred status as a creditor.
- Companies have been able to use judicial management as a means of stopping a wind-up proceeding. From 2010 through 2012, the High Court of Harare accepted 117 petitions for company wind-up. Of these, 38 were converted to judicial management. Although more analysis would be necessary, it is quite possible that many of these conversions were done primarily as a defensive measure (to stop the wind-up) rather than to proactively attempt to resolve the company's indebtedness.
- Judicial managers are not able to suspend labour contracts as readily as preferred.[65]
- In many cases, the information accompanying plans for rescuing a company is less consistent and not as guiding as it could otherwise be.
- The lack of clear and binding deadlines for resolving cases allow for judicial management efforts to continue longer than they otherwise should.[66]
- It is in only in rare circumstances that both ownership and debt are restructured through a scheme of arrangement. Instead, observers note that shareholders (referred to as

"members" under the Companies Act) often refuse to cooperate in such proceedings leaving the company's ownership unadjusted and discouraging creditors from compromising on their claims.

- Companies have emerged from judicial management only to return to it again several years later. Alternatively, they have moved from judicial management to wind-up.[67]
- For some companies where the political fallout from a liquidation or shutdown is expected to be high, judicial management is being used as a means of preventing such political costs.
- The Doing Business Report on resolving insolvency (which is influenced substantially by the ability of a theoretical enterprise to survive an insolvency as a going concern) estimates recovery rates of less than 1% and proceedings that last well over three years on average.
- Judicial management is not being applied to parastatal organizations despite the fact that many are incapable of paying their debts.
- The scheme of arrangement mechanism under Section 191 of the Companies Act (which could be used to reduce claims held by all creditors) is underused.

Discussions with various individuals familiar with judicial management as to the effectiveness of these procedures produced some controversy. On one hand, there are numerous examples of companies that went into judicial management and thereafter emerged, having avoided immediate liquidation.[68] On the other hand, commentary accompanying the statistics from the High Court in Harare indicated that most judicial management cases eventually convert to wind-up rather than go on to operate successfully. Others have also expressed concerns about the effectiveness of the procedures.[69]

5.3.2 Accounts and Statistics with Respect to Wind-Up Proceedings

The number of petitions filed with the Harare High Court for corporate wind-up on the basis of non-payment of debt increased by nearly three-fold between 2010 and 2012.[70] All indications are that this trend is continuing in 2013. Nevertheless, the most common observation with respect to wind-up proceedings was that they are underused. Companies that should be in wind-up proceedings remain stuck in judicial management.[71]

Even if the number of wind-up petitions is less than what should be, the system is having trouble keeping up with the recent increases. While petitions have grown substantially, the number of cases being accepted has only partially kept up with this increase, and the number of cases fully resolved has actually trended downward.[72]

Where liquidations push through, they tend to involve sales of assets rather than companies as going concerns. This usually means fewer proceeds than would be otherwise.

While the statistics obtained from the High Court of Harare are helpful and appreciated, they, like most statistics, prompt as many questions as they supply answers. Nonetheless, this much is clear: the country's insolvency resolution regime is being overwhelmed by a tsunami of cases caused by growing economic troubles. These numbers are likely to continue growing before they begin to recede.

6.0 SIX APPROACHES TO ENHANCING THE INSOLVENCY RESOLUTION REGIME

As will be discussed below, perhaps the ideal legislative solution to the problems afflicting the country's insolvency resolution regime would be the enactment of a new unified insolvency law, in line with international best practices and tailored to the country's particular needs. But insolvency laws are quite complex and controversial. Such an effort would likely take more than several years with the outcome uncertain[73] perhaps with the legislation eventually developed being less effective than its predecessor.

Taking into account the time, uncertainty and risk often associated with insolvency law reform, the proposals below are categorized by degree of regulatory or legislative action required, from solutions that require no legislative or regulatory reform to ones requiring a complete legislative overhaul of the current framework.

6.1 Actions Requiring No Legislative or Regulatory Reform

This approach to enhancing the insolvency resolution regime requires no government action. They are discussed below:

6.1.1 More Specific Standards for Insolvency Resolution Professionals

An association of estate administrators and executors was recently formed. The country, however, has yet to see the formation of an association of professionals dedicated to establishing, improving and maintaining standards of practice, specifically with respect to insolvency resolution proceedings. Establishing such an organization (either separate from or as a subset of the newly formed association) would apparently not be difficult. Upon organization, such a group could adopt a code of ethics and guidelines on how to conduct a liquidation or undertake a judicial management. More than several examples can be found online that could be used as templates.[74] If explicitly adopted by enough professionals, the guidelines would become the de facto standard for measuring performance.

Alternatively, efforts could be taken to establish a set of workable standards from the demand side of the equation. Various industries associations whose members are often times creditors could establish (with or without the cooperation of insolvency professionals) a statement of expected good practices that it could ask insolvency practitioners to agree to. Only those that do should get the support of creditors.

6.1.2 Education and Guidance for Creditors

Despite its existence on the books for decades, understanding of the legislative framework for insolvency resolution does not extend very far beyond the relatively small group of lawyers and insolvency resolution professionals who work with it on a nearly daily basis. Experts from the World Bank described South Africa's legislation as "extraordinarily complex"[75] and would likely describe the Zimbabwe's legislative framework in a similar manner. The insolvency expert who assisted in the drafting of this research report would likewise agree.

The complexity of the legal framework and the relative infrequency in which creditors find themselves trying to collect from creditors in insolvency means that most are likely under-informed with respect to their rights during a proceeding. One possible solution could involve the development and publication of guidelines for creditors. Industry associations could develop them in cooperation with insolvency resolution professionals and/or international technical assistance. One such example is a manual on creditor rights in insolvency proceedings published by USAID in Serbia in 2008.[76] The Australian Securities and Investment Commission has published shorter handbooks on the rights of various types of creditors during liquidation or a "voluntary administration" in cooperation with that country's insolvency practitioners association.[77]

As creditors are usually the primary stakeholders in an insolvency proceeding, they usually have the greatest incentives to ensure that it is conducted properly. Such manuals give them the tools to do so more effectively.

6.1.3 Use of Internet and Social Media to Facilitate Creditor Engagement

The various notices and publications required in an insolvency proceeding can be slow, uncertain and costly. Recognizing this, the United Kingdom recently amended its insolvency rules to allow liquidators and administrators to communicate with creditors via websites. An official site, "Insolvency Notices," has been set up to facilitate this.[78] In the meantime, companies and groups are increasingly using social media, such as Facebook and LinkedIn, to communicate with shareholders.

Replicating a noticing site like that in the United Kingdom might not occur for several years, if ever. In the meantime, liquidators and business managers are free to replicate a noticing site using free resources like Facebook groups or Google+, or an inexpensive web or blog site. Absent legal or regulatory changes, such sites cannot replace the Official Gazette, newspapers or the mail as means of officially noticing creditors. But they could make communications quicker and less expensive while offering an alternative channel to ensure that notices are in fact getting through to their intended recipients.

6.2 Clarify Procedures, Rights and Obligations through Issuance of Rules and Regulations

It appears that both the Chief Justice of the Supreme Court and the Minister of Justice and Legal Affairs have the power to issue regulations that could clarify various issues in insolvency proceedings. Under the Companies Act, the Chief Justice may, "in consultation with the Minister [of Justice and Legal Affairs], make rules concerning the procedure to be followed with respect to any matter in connection with the wind-up of companies . . . and generally as to all matters in which the court is empowered under this Act to exercise jurisdiction . . ." [79]

The Companies Act likewise authorizes the Minister of Justice and Legal Affairs to make "regulations providing for anything required by this Act to be prescribed by regulations" as well as "such other regulations as he may deem expedient or necessary for the carrying out of the purposes of this Act."[80]

Under the Insolvency Act, the Minister of Justice and Legal Affairs may

(1) . . . Make regulations providing for any matter which by this Act is required or permitted to be prescribed or which in his opinion is necessary or convenient to be provided for in order to carry out or give effect to this Act.

(2) Regulations made in terms of subsection (1) may provide for—
   (a) the procedure to be observed in any Master's Office in connection with insolvent or assigned estates;
   (b) the form and manner of conducting proceedings under this Act . . .

These are broad powers. Under them, the Chief Justice and the Minister could fashion detailed rules that address the "complexity" problem with the current legislative framework, by setting out procedural rules that more closely parallel the actual flow of a wind-up or judicial management. They could also address the lack of deadlines for judicial management, not by necessarily imposing time limits (as this might contradict the Companies Act) but by establishing checkpoints where the Master could be required to call a meeting on the continuation of the judicial management. The authority under the Insolvency Act could also be used to reorient the Master's Office so that it is better positioned to take on increased number of insolvency cases to be filed in the months ahead. A code of conduct for insolvency professionals apparently could be made binding under rules issued under the Minister's authority as well.

6.3 Develop and Enact a Limited Number of Legislative Changes

No doubt, various positive practice objectives pursued under the rulemaking exercise described in Section 6.2 would eventually clash with at least some of the provisions in the Insolvency Act and Companies Act. For instance, it has been noted that the 75% creditor approval requirement under Section 191 of the Insolvency Act is probably too high. But that probably could not be changed through the issuance of a regulation. A legislative amendment would be needed.

Other targeted changes would also be needed. Any working group formed to develop rules and regulations should have a secondary mandate to draft a limited number of legislative amendments that it determines to be necessary. It might be possible to get a small number of crucial amendments passed relatively quickly.

An ideal goal with respect to insolvency law reform might be a new unified, relatively user-friendly insolvency law. But that could take years of drafting and debate. The approach described in this section and the previous one could achieve perhaps 70-80% of what a new, unified law could accomplish while taking only twenty per cent of the time.

6.4 Replace Judicial Management with a Business Rescue Regime Similar to that Recently Adopted in South Africa

In 2011 legislation came into effect in South Africa that replaced judicial management with a new business rescue procedure. The legislation has been hailed as a "fundamental change

of approach" from a practice that (prior to passage of the legislation) had generally favoured liquidation and replaces a business rescue system (i.e., judicial management) that was considered to be a general failure.[82]

The procedure allows a debtor to initiate a business rescue and obtain an immediately- effective moratorium simply by filing a resolution at the Companies Office. Any creditor unhappy with this would have to file a court application to object.

Unlike judicial management, the board of directors stays in office throughout the business rescue period, albeit under the supervision of an insolvency resolution professional appointed by the master.[83] This individual, labelled a "supervisor", has the power to remove directors or remove or appoint any manager of the company. Essentially, the supervisor acts as a safeguard in the management of the debtor while tending to his or her main tasks of addressing burdensome contracts and developing a business rescue plan.

The debtor company must publish a proposed rescue plan within 25 days of the supervisor's appointment. Creditors with recognized claims vote on the plan as a group. Essentially, if creditors representing 75% of the claims against the company vote for the plan, and no objections are filed with the court, the plan goes into effect. Creditors are thereafter only entitled to enforce claims against the debtor in accordance with the plan.

Analysis of the new rescue approach, aside from the brief description here, is beyond the scope of this paper. Suffice it to say that experts from the World Bank, who recently undertook a detailed review of South Africa's creditor and insolvency law system, had the following opinion about it:

[T]he new business rescue procedure represents a fundamental change of approach, and the reform must be commended for the change that it tries to introduce in a practice dominated by liquidation . . .

The new business rescue procedure aims to promote quick and easy access to the proceeding, especially since it can also be initiated with a board resolution and without going to court. The system is designed to allow employees, trade union representatives, shareholders as well as the board to take the initiative in petitioning to place a company in business rescue, and in engaging with the process for the final approval of the plan. In addition to various company interests, the new process also entails considerable court oversight, for example, in scrutinizing the grounds on which the petition has been brought, for hearing appeals to cancel the terms of contracts, as well as in instances for review of the actual plan itself . . . It therefore represents a thoroughgoing reform of the insolvency system, and one that may be seen as very positive in seeking to restore greater balance to the current corporate insolvency framework and therefore in seeking to better preserve economic enterprise value.

It should be noted that the World Bank expressed concerns about a number of aspects of this reform, for instance, the power of the supervisor to negate specific provisions of unfavourable contracts and the possibility that secured creditors rights may be undermined by the voting procedures (i.e., creditors vote as a whole rather than by classes formulated by reference to their common rights in the event of a liquidation). The new reform is drawing substantial attention in the press and there are observers who are less sanguine about the reform than the experts from World Bank.[84] The coming months should reveal much about how this reform is working in practice.

Zimbabwe and South Africa have a shared legal tradition, and their insolvency rescue regimes, prior to the recent reforms, were nearly identical. To be sure, Zimbabwe faces challenges with respect to corporate insolvency substantially greater than its southern neighbour. Nonetheless, there is no denying that close review of this legislation and possible adoption of a set of reforms modelled closely on it stands as one of the more compelling options for Zimbabwe discussed in this paper.

6.5 Develop a Comprehensive Unified Law on Insolvency Based on Models Developed in Other Commonwealth Countries

While expressing general satisfaction with the new business rescue provisions enacted by South Africa, the World Bank recommended that unified insolvency legislation is the preferred longer-term solution.[85] This is consistent with the World Bank's general discussion of this issue. Some of the well-regarded examples of insolvency legislation, e.g. that of Germany and China, reflect a unified approach.

In South Africa, this idea goes as far back as the late 1990's with work led by faculty at the University of Pretoria.[86] Deliberations on this reform continue.

One of the challenges is that a true, unified insolvency act has yet to emerge out of a country with a Commonwealth legal tradition. Australia continues to have its rules in multiple laws, as does Canada, though to a lesser extent. The United Kingdom formally has a single act, but it is divided into separate parts with few necessarily in common.

The second challenge stems from a combination of limited time, limited resources, and competing priorities. The country faces a crisis-level challenges in its corporate sector. A concerted effort in drafting a new unified law would likely distract expertise from quickly upgrading the country's insolvency resolution regime to a level sufficient to meet these challenges.[87]

6.6 Develop a Comprehensive Unified Law on Insolvency Based on Models Developed Outside of Other Commonwealth Countries

As noted above, there are several good examples of unified insolvency acts that could serve as models for a drafting effort in Zimbabwe should it decide that it need not wed itself to a Commonwealth-based approach. Indeed, such a Greenfield approach to drafting is in many ways the easiest and most direct way to adopt international best practices and even tailor them to local circumstances.

Nevertheless, even if well drafted, there is substantial risk that such legislation could be labelled an ill-suited transplant and be rejected by policy makers and practitioners. This makes this option less attractive than others.

6.7 Develop a Legislatively-Defined Approach that Accelerates the Restructuring of Debt and Ownership of Insolvent Companies through Market Mechanisms

Much of the discussion in this paper assumes that company rescue is the result of negotiations between the creditors and the debtor, and the creditors amongst themselves, facilitated by the insolvency rules, the judge, a master, and an administrator. The oft-cited paradigm for this approach is Chapter 11 of the bankruptcy code of the United States, though few nations have adopted anything even closely related to the structure and wording of that chapter.

There are sceptics to this approach.[88] They point to several potential weaknesses. For instance, they point to rescue cases that seem to never end, but at the same time serve to frustrate the efforts of creditors, especially secured creditors, to enforce their claims. They also point to a tendency of such systems to provide false solutions through ill- defined rescue plans that result in the debtor coming back to the judicial rescue proceedings several years later. Indeed this has happened enough in the United States to the point where such repeat proceeding are informally referred to as Chapter 22 (for the second time through the system) or even Chapter 33 (when companies are forced to go back for a third time).

Another concern is expense. Critics point to the fees generated by complex rescue proceedings, noting that in many cases the lawyers, experts, and accountants are the only ones seeming to prosper.

It might be easy to point to the problems with judicial management, as this is what observers concluded in South Africa on the way to its replacement as the result of recent reforms. But even if judicial management were perfectly adjusted, challenges would remain.

The problem stems from the nature of a rescue proceeding itself. The process requires various interest groups (workers, secured creditors, trade creditors and shareholders) with very different preferences to negotiate a plan and then approve it. The plan will usually offer

reasoned speculation on the future cash flows of the company. It will then compare these to the proceeds of a hypothetical liquidation. Inevitably, secured creditors will be sceptical (despite their favourable treatment), workers will be focusing on jobs preservation (not necessarily the best strategy for a turnaround plan) and the trade creditors will be upset with the small amounts they are getting. Shareholders in the meantime will be trying to leverage their inside information and sometimes their role as managers to protect themselves from lawsuits and to preserve their ownership interest in the company.

Running a business is difficult. Turning around a distressed business is harder. Turning around a distressed business while keeping all the interest groups affected by a rescue plan reasonably satisfied is even more difficult, and for many companies probably impossible.

Defenders of business rescue point out that despite these concerns, the alternative of liquidation is far worse. The critics of rescue, however, argue that liquidation has been unfairly stigmatized. They challenge the widely held assumptions that business rescues save jobs or provide creditors with greater returns in comparison to liquidation. They also challenge the notion that liquidation necessarily leads to the shut down of the debtor company and the piecemeal sale of its assets. And even if a piecemeal sale does occur, they challenge whether this is necessarily worse than the sale of the company as a going concern in all cases.

Various attempts have been made to find a third way between the fleeting hopes of rescue and the steely consequences of liquidation. Most have involved the use of market mechanisms, essentially allowing various creditors to use a combination of cash and their claims to bid on and participate in a new, debt-free version of the company that is supposed to emerge from the process relatively quickly.

The greatest merit of this approach (perhaps to be called "claim and ownership restructuring") is that, in a relatively short period of time, it puts the company into the hands of new owners who are focusing on the future — i.e., how to use the assets of the company going forward in the most efficient manner possible. At this point the question of economic versus financial distress is answered. If the company was in financial distress, then it has been cured by claim and ownership restructuring. If the company was in economic distress (i.e., it has trouble operating regardless of debt) then the new owners will have a bigger challenge on their hands. But at least it is a challenge they can focus on with business-oriented incentives to solve.

Questions about the past (i.e., the value and extent of individual claims) are left with the old company. If this takes a substantial amount of time to sort out, the risk to the old version of the company are fewer as its only asset is the money in the bank account that was generated from the sale of its debt-free twin.

Such an approach could be particularly useful in countries facing widespread company distress with limited time and expertise to tackle each struggling company on an individual basis.

To date, no country has hard-wired such procedures into an insolvency law.[89] A decision to do so here should acknowledge this and the possible risks it would entail. It should be considered only after taking a hard look at traditional business rescue approaches and how they might or might not work effectively in Zimbabwe. In the meantime, though, this approach could be tried out on a company-level basis. For instance, such restructuring could be called for in a liquidation or business rescue plan, especially if it is connected to the possibility of an injection of new capital via a fund similar to DIMAF once the new debt-free twin of a distressed company emerged from "claim and ownership restructuring."

7.0 A MENU OF POTENTIAL REFORMS THAT COULD IMPROVE THE COUNTRY'S INSOLVENCY RESOLUTION REGIME

The previous section focused on broader reform choices and the extent to which they depend on the cooperation of various political institutions to make them a reality. This section goes through an initial, and by no means exhaustive, list of particular suggestions.

These suggestions are particularly apt should decision makers decide to amend the regulatory or legal framework to improve generally accepted approaches to liquidating or rescuing a financially distressed company. In other words, they are less useful should decision makers choose to forego legislative or regulatory reform entirely (see Section 6.1), adopt South Africa's rescue regime (see Section 6.4), or develop an accelerated method for adjusting a company's ownership and indebtedness (Section 6.7).

7.1 Improving the Insolvency Resolution Infrastructure

The infrastructure of an insolvency resolution regime could be said to encompass the institutions and personnel that implement the legal framework, be the latter in the form of laws or secondary legislation, such as procedural rules, etc.

7.1.1 Deepening Judicial Expertise

The judge overseeing the insolvency resolution proceedings is perhaps the single greatest factor in determining whether the outcome best reflects the goals intended by the governing legislation. Although the master and the liquidator/judicial manager carry the case forward, it is the judge that they look to ultimately for guidance.

In order to become expert in matters relating to insolvency resolution, a judge, in addition to undertaking training on a regular basis, will need to hear insolvency cases regularly. Many jurisdictions have encouraged repeat work on insolvency for judges by creating commercial courts with authority to hear insolvency cases (among other complex commercial matters). A few have even gone so far as to create courts entirely dedicated to insolvency resolution.

Currently special courts exist for labour, and for income tax appeals, among others. Each was created by an act of Parliament. It is thus likely that the creation of a commercial court would need to be authorized by Parliament as well.

7.1.2 Formalizing and Further Clarifying Responsibilities of Personnel at the Master's Office

The master and his office are charged with a dual roles in insolvency cases: appointing and regulating insolvency resolution professionals on one hand (a regulatory function) and issuing various orders in the course of an insolvency proceeding on the other (a judicial function). These roles are often undertaken by separate agencies in other countries. Detailed recommendations regarding the

Master's Office are premature at this time. Suffice it to say here that it worth considering the creation of a formal division within the Master's Office focusing on insolvency cases and staffed with more than several individuals who have been exposed to formalized insolvency law training either in Zimbabwe or abroad. This might be further divided into a division dealing with the master's judicial tasks and its regulatory functions with respect to insolvency professionals.

7.1.3 Clarifying the Standards under which Insolvency Resolution Professionals Operate (High Priority)

This recommendation was discussed earlier in Section 6. It was one of the reforms that could be instituted through rules issued by the Minister of Justice and Legal Affairs.

7.1.4 Increasing Transparency and Facilitating Communications in Insolvency Resolution Proceedings (High Priority)

Insolvency cases are unique in that they affect, and require participation by, dozens and sometimes hundreds of people. Further, given the state of the corporate sector, the performance of the country's insolvency resolution regime is one of great public concern.

As discussed earlier, consideration should be given to use of electronic methods to either replace or supplement the current paper and postal method of providing notices and otherwise transmitting information among participants in an insolvency case. This could be one of the tasks of the proposed sub-division of the Master's Office that regulates insolvency resolution professionals.

Consideration should also be given to establishing an insolvency case registry that would provide to the public with key information about the status and progress of insolvency cases. It would also create incentives for the personnel at the courts and offices in Harare and Bulawayo to perform effectively.

7.1.5 Facilitating the Role Creditors Play in Insolvency Cases

Creditors are the real stakeholders in most insolvency cases. It has been discussed earlier how they might be empowered through education and guidance on these matters. Although current insolvency laws allow for creditor meetings, there are no provisions that establish the rights and responsibilities of a creditors' committee. In other countries such committees play an important role in monitoring the proceedings and facilitating communications with the creditors as a whole. The provisions in South Africa's new rescue proceedings are worth considering as a starting point.[90]

7.2 Encouraging Earlier Use of Insolvency Resolution Regimes

A general consensus exists that companies are often times broken beyond repair by the time they get to liquidation or judicial management. This is unfortunate in that earlier intervention could have possibly led to a more effective result in at least some of cases.

This might change over time if such proceedings lose the stigma that is currently associated with them. In the meantime, several reforms should be considered.

7.2.1 Clarifying the Risks that Managers Face in Continuing to Do Business when Insolvent

Many countries' insolvency laws punish directors and managers for insolvent trading, that is, continuing to operate a company when it cannot pay its debts. Such provisions, when properly enforced, can encourage companies to access an insolvency resolution regime sooner rather than later.

The Companies Act contains provisions that could be used to punish managers and directors for insolvent trading.[91] Under these provisions, they can be held liable if found to have managed the company in a fraudulent or reckless manner. Few if any cases have apparently been brought under these provisions, however, and fewer cases have found directors and managers liable.

Any effort to amend legislation should consider changes that might tighten up the standards for finding such persons liable.[92]

7.2.2 Allowing Current Managers to Participate More Actively in the Effort to Rescue the Business

It has been postulated that one of the reasons managers and directors do not readily resort to insolvency procedures is that they fear the loss of their jobs. For this and for other reasons, various countries allow the debtor's management to remain in their positions during the course of an insolvency case, especially one that is attempting a rescue.[93] Such approaches have been controversial, especially in jurisdictions marked by low levels of trust in enforcing provisions that could adequately ensure that such managers and directors are focusing on the interests of the creditors during such proceedings.

A potential compromise is to allow the directors and managers to remain in place under the supervision of an insolvency resolution professional. This was the approach taken in South Africa in establishing its new business rescue procedures.

7.2.3 Incentivizing Unsecured Creditors to Initiate Cases

Currently unsecured creditors have little reason to start an insolvency case, as they may very well get little in terms of debt recovery due to their low payment priority should the debtor be liquidated. Further, a petition to start an insolvency case is more complex than a normal creditor collection claim.

Nevertheless, should a creditor start such a case, he or she is performing a public service if the case eventually moves forward to a successful conclusion. It is thus worth considering a provision that would allow at least a portion of an unsecured creditors' claim to be considered payable at a higher priority (perhaps as an administrative expense) if that creditor was the one to initiate the action.

7.3 Encouraging Quicker Resolution of Insolvency Resolution Cases

One of the biggest obstacles to a successful resolution of an insolvency case is time. In general, the longer the participants delay the hard choices required in an insolvency case, the less likely a successful outcome. There is also the problem of the (seemingly) never-ending judicial management or liquidation effort, which serves mainly to put off the effects of a company failure while frustrating the rights of creditors in the meantime. The suggestions below address these problems.

7.3.1 Establishing Time Limits on Insolvency Resolution Procedures (High Priority)

This suggestion has already been raised. Establishing deadlines for various milestones in a business judicial management proceeding (with the consequence being a liquidation if the deadlines are not met) will focus the attention of participants and force them to make the difficult decisions that are necessary.

7.3.2 Making Schemes of Arrangement Proposals an Early Requirement in Judicial Management Cases (High Priority)

As discussed earlier, a scheme of arrangement proposal, if approved by creditors and the court, can be very effective in improving the debtor's balance sheet and establishing a more realistic debt burden going forward. Such proposals are currently not required in judicial management cases. These should be made mandatory.

7.3.3 Allowing Creditors to Cast an Early Veto over Rescue Procedures where there is Little Likelihood of Success

Often times in various countries, managers and shareholders of companies in substantial financial trouble have used rescue proceedings as a means of delaying liquidation. As a result, various countries' insolvency resolution regimes have established provisions for an early veto by creditors of an attempt to rescue a company where the chances of success are very slim. This is most compelling under circumstances where the debtor is attempting to convert a wind-up proceeding into a rescue proceeding. These types of procedures can be effective, though it is crucial that they be simple and summary enough so that they in themselves do not become a source of delay.

7.3.4 Facilitating the Conversion of Failed Judicial Management Attempts into Company Wind-Ups

The Companies Act allows for the conversion of a judicial management case into a wind-up proceeding.[94] This however, is dependent on the affirmative act of the judicial manager, the judge, or a creditor. It is quite possible that various social and political pressures could be discouraging these parties from taking such action. A more effective approach would be one where legislation called for the automatic conversion of judicial management proceedings into wind-ups upon the violation of a deadline by which a rescue plan had to be approved. In order to prevent such an automatic conversion, the creditors would have to explicitly vote in favour of an extension of the deadline.

7.3.5 Establishing Quick-Resolution Procedures for Existing Judicial Management Cases that have not Adequately Progressed

With the growing number of judicial management cases on the courts' dockets, the existence of a backlog of hopeless judicial management cases can tie up resources and clog the system. They also represent circumstances where decision-making for one reason or another has broken down with respect to obtaining a final outcome. This in itself may represent a waste of resources.

Consideration should be given to application of well-tested docket clearing techniques that could bring stagnating cases to a quicker, ultimate decision. An order could be issued calling for all judicial management cases be subject to a vote on a scheme of arrangement within six months, with failure to do so being an order of conversion to wind-up proceedings.

7.4 Addressing Pre-Established Rights during the Course of a Business Rescue

In general, an insolvency resolution regime should not fundamentally alter pre-established contractual rights against the debtor. Such rights should yield only to the extent necessary to rescue a company or maximize the value of proceeds from the sale of the debtor's assets.[95] Several areas where this tension exists are discussed below.

7.4.1 Protecting the Rights of Secured Creditors while their Claims are Suspended

It is well recognized that a reliable regime for enforcing the rights of creditors with claims secured by collateral is crucial to the provision of credit to businesses at reasonable terms. Zimbabwe appears to have a reasonably strong framework for creating and enforcing these rights, both through standard foreclosure procedures and during a wind-up proceeding.

This stands in contrast to judicial management, where such rights are apparently not recognized. While the debtor benefits from having all claims against it stayed, secured creditors are vulnerable to having their claims eroded by the depreciation, damage, or disappearance of the property securing their claims.

Any future reform should attempt to strike a balance between the rights of secured creditors and the rights of the debtor in the course of a business rescue. Various approaches from other jurisdictions require the court, upon application of the creditor, to determine if the security interest is "adequately protected." This means looking at the value of the collateral in relation to the secured creditor's claim. If the value of the collateral is not substantially above the value of the claim, then many jurisdictions require the debtor (or the professional administering the debtor) to take various actions to ensure that the secured creditor's claim reflects its rights at the commencement of the proceedings. Such measures could mean something as simple as requiring the purchase of insurance against the theft or damage of the collateral. It could also mean something as complex as establishing a series of cash payments to the secured creditor to ensure that its claim, which is likely accruing interest, does not eclipse the value of the collateral.

Finally, it could also mean something as dramatic as allowing the creditor to enforce its claim against the debtor, even if allowing such would jeopardize the feasibility of a rescue plan.

7.4.2 Clarifying the Rights of Suppliers and other Contractual Counterparties

At the commencement of an insolvency case, a debtor may have several on-going contracts with suppliers, lessors, etc. It is not necessarily clear, especially in a judicial management, whether they terminate upon commencement of proceedings and how they should be treated. The goal here should be to establish a procedure that informs counterparties of the debtor whether the contract will continue or not and provides for the consequences of a decision to adopt an on-going contract or breach it. Without such a system, contractual counterparties will abandon the debtor, undermining opportunities to undertake a successful rescue of the business.

7.4.3 Balancing the Rights of Workers to Continued Employment with the Need to Rescue Companies (High Priority)

At the commencement of insolvency proceedings, the debtor may have hundreds of on-going arrangements with its workers. The insolvency legislation (as it relates to labour legislation) fails to make sufficiently clear the right of a judicial manager or a liquidator to terminate contracts with such employees. To the extent flexibility is restricted here, the opportunities to streamline the debtor's operations in order to rescue it are substantially hampered.

Consideration should be given to giving either the judicial manager or liquidator as much authority as possible in streamlining the operations of the company to the point where it might be substantially easier to dismiss workers after an insolvency case has begun. While this might violate the norm of equal treatment in and out of insolvency proceedings, it is an example of where the needs of saving the company outweigh the claims of the counterparty.[96]

7.5 Encouraging Arrangements that Increase the Likelihood of a Successful Business Rescue

A key aspect of any insolvency resolution regime is to distinguish between proposals for business rescue that have a likelihood of success and those that do not. Consideration should be given to adjustments that could remove several barriers that might block meritorious proposals from being approved.

7.5.1 Reducing the Number of Classes of Creditors in a Liquidation and in a Scheme of Arrangement (High Priority)

A proposal to creditors to accept a scheme of arrangement should come down to a decision as to whether to allow a rescue plan to go forward (and hope for promised payments under the plan), or settle for the proceeds from a liquidation that would likely result from a rejection of the proposal. The best way to ascertain this is to make sure that the classes of creditors in a scheme of arrangement mirror the classes that would receive proceeds from a liquidation.

While this makes sense in theory, it is rare to see such a correspondence. Liquidation classes are often too numerous and complex to recreate in a practical manner in a rescue proposal. But deviations between the two create confusion and a sense of unfairness as creditors come to realize that the classes to which they have been assigned fail to reflect their entitlement to a liquidation pay-out.

Several jurisdictions have been addressing this problem by reducing substantially the number of classes recognized in liquidation. By reducing the number of preferred classes, the class of unsecured creditors grows in number while receiving a larger share of the proceeds. This gives more creditors a more meaningful stake in the proceedings and increases the sense creditors are being treated fairly.

But most importantly, it reduces the number of classes that would need to approve a rescue plan before it could be accepted. Consolidating creditor classes should be a high priority with respect to any legislative reform.

7.5.2 Reducing the Approval Requirements for Approving a Binding Compromise with Creditors (High Priority)

In addition to consolidating the classes that would vote for a business rescue, consideration should be given to decreasing the required level of support needed for a plan approval. If the goal is to ensure that plans are in the interests of the creditors, the current seventy-five per cent rule achieves that, but at the possible cost of preventing meritorious plans from being approved.

It would seem possible that approval rates could be adjusted downwards to as low as a fifty-fifty rule for each defined class: fifty per cent of the creditors in number holding fifty per cent value of the outstanding debt of the particular class.

7.5.3 Clarifying the Roles and Rights of Shareholders in Restructuring the Debtor and Approving the Business Rescue Plan

Many successful business rescues require some sort of restructuring of the ownership of the company. Such restructuring often involves the issuance of additional shares that can be given to creditors as partial compensation for compromising their claims. As noted in Section 5.3.1, this likely occurs less than it should. It is possible that due to gamesmanship or simply lack of full understanding of the proceedings, shareholders are not participating in restructurings as much as they should.

Jurisdictions differ in their treatment of shareholders in business rescue efforts. Some treat them as simply another class of claimant against the debtor's assets and cash flows. Others give them special privileges, for instance the exclusive right for a limited period of time to develop and propose a rescue plan.

From a theoretical view, this makes some sense. As the residual owners, the shareholders do

have a substantial stake in the company, even if their equity might be substantially or entirely reduced (as when debt exceeds assets). This, plus the need to encourage voluntary rescue attempts, might justify giving them the right to shape the company's future.

The problem lies in their risk preferences at this point. During a financially distressed situation, many shareholders recognize that if the company is liquidated, they will likely get nothing. As a result they often start advocating for rescue plans that are overly optimistic. In their eyes, if the plan succeeds, they will emerge as owners of a more healthy company. If it fails, they are in no worse shape than if the company were liquidated.

If the only two outcomes of a vote on a shareholders' plan is approval or liquidation, it is possible that the shareholders can bluff or bully the creditors into approving a plan that gives the shareholders more rights than they would otherwise deserve. To remedy this, some jurisdictions require the shareholders to invest new funds into the company in order to enjoy this privilege. Others allow the creditors, upon disapproving a shareholders' plan, to propose their own plan within a short period of time. Usually such creditor plans substantially reduce the equity participation of the current shareholders in the company.

Thus, if creditors are to have an option of forming a meaningful plan on their own, legislative reforms need to allow these plans to modify the ownership interests in the debtor, even without shareholder approval. Other jurisdictions allow this so long as creditors that are senior to the shareholders, such as unsecured creditors, are seeing their claims being compromised (i.e., reduced and extended) as part of the plan.[97]

7.5.4 Encouraging Pre-Packaged Insolvency Resolution Cases

A somewhat recent innovation in rescue efforts in other jurisdictions is the greater use of pre-packaged proposals for a judicially approved rescue plan. In such instances a debtor in financial distress negotiates an arrangement with creditors out of court that is fully compatible with the requirements necessary to receive approval in court. The reason for obtaining the in-court approval is to bind dissenting minority creditors (recall the discussion of out-of-court workouts in Section 2.2).

With all the paperwork, negotiating and voting completed, it is then possible to have companies file for insolvency resolution and emerge with an approved plan in a very short period of time. In jurisdictions where this practice is well developed, a turnaround time of approximately a month is not uncommon.

The practice for pre-packaged insolvency resolutions emerged in the United States under a time when such an approach was not even recognized in applicable law. Not wanting to wait for this to happen in a similar spontaneous fashion, several jurisdictions have established procedures for fast-track approval of plans that have been negotiated ahead of time. This has the double benefit of both educating parties as to this opportunity and to making the requirements more transparent, thereby reducing the likelihood of a rejection or slow-down by the court.

8.0 ADDITIONAL AND/OR ALTERNATIVE OPTIONS TO RESOLVING WIDESPREAD COMPANY DISTRESS

As mentioned earlier, even the most progressive of insolvency resolution regimes will not in itself solve the problem of widespread company insolvency. This is especially true if potential investors are hesitant to commit for one reason or another.

In addition to policies that encourage investment in general, the following are initial suggestions that, if adopted, might be able to facilitate resolution of financial distress. They are raised here for the sake of completeness and for stimulating further discussion.

8.1 Improving the Management of Tax Claims in Insolvency Cases

A substantial portion of claims against many insolvent companies consists of those for unpaid taxes. In most countries, the tax authorities are somewhat slower to react and less flexible in willingness to compromise arrangements when acting as creditors in insolvency proceedings. The result may be fewer successful rescues than would otherwise be possible.

One extreme position would be to allow the tax authorities to auction off claims against an insolvent company once it has entered into formal insolvency proceedings. The tax authorities would have partial recoveries with relatively low administrative effort. Buyers of such claims (presumably at a discount) could then have the proper incentives to participate in the case and would have greater flexibility to compromise their claims.[98]

Less extreme, but administratively more complex would be establishment of a special purpose vehicle (SPV), operated by a private investment company. The private investment company would be chosen on the basis of its skills in insolvency collection matters and the compensation it would require.

Once a company goes into insolvency proceedings, the tax authorities would transfer tax claims to the SPV. The SPV would participate in the proceeding and collect what it could from the debtor, splitting the proceedings with the tax authority at an agreed-upon rate.

The least extreme of these proposals would be to establish a workout unit within the tax authorities, and provide the personnel in it with sufficient training, flexibility, goals, and oversight to sufficiently empower and motivate them to make optimal decisions as creditors in insolvency cases.

8.2 Encouraging Parastatals to Sell their Receivables

The claims of parastatals (state owned companies) are somewhat similar to tax claims in that the incentives and flexibility to participate in insolvency cases may be lacking. The same range of options could be applied here, with a bit of a bias toward auctioning off receivables, as that is administratively simpler.

8.3 Establishing Free Trade Zones for Particularly Hard Hit Economic Areas

As noted earlier, a shortage of investment capital will likely hamper efforts to effectively resolve company distress until policies emerge that increase these amounts substantially. One possible incremental solution would be to encourage the flow of capital to hard-hit economic areas by establishing very liberal trade zones therein. Such zones should attempt to replicate or improve upon the offerings and incentives found in jurisdictions that are well regarded for investor friendliness. Alternatively, investors could be polled for the range of policies that discourage them the most, with the results informing the establishment of a zone freed from such constraints.

8.4 Establishing a Multi-Pronged, Integrated, and Pro-Active Approach to Corporate Financial Distress

In 1997, a handful of countries in Asia, in particular Southeast Asia, suffered from a loss of financial confidence, currency devaluation, and widespread corporate insolvency. A detailed, comparative analysis of the various approaches to the crisis is beyond the scope of this research report. Suffice it to say that the approach taken by one of those countries, Malaysia, was particularly active and government driven. As discussed by Doctor Madondo at the December workshop on the preliminary version of the research report, the government established an agency to take over non-performing loans from banks (Danaharta), an agency to recapitalize banks (Danamodal) and convened a Corporate Debt Restructuring Committee under the sponsorship of the central bank.

The approach taken by Malaysia has been characterized as addressing corporate indebtedness on a case-by-case basis relying primarily on market oriented principles and voluntary agreements to reduce debt. The government's role in the debt restructuring efforts was seen more as a facilitator of private negotiations more than anything else.

Needless to say, such an effort would require substantial amounts of financial and political capital in order to succeed. Various integrated approaches such as those undertaken in Malaysia and elsewhere are discussed in a recent IMF publication available online.[99]

9.0 CONCLUSIONS

The goal of this research report was to offer options more so than specific recommendations. Nevertheless, several points emerge from this study for policy makers to consider in the near future:

- The current economic challenges facing the country are leaving many companies heavily in debt with few avenues for new capital as a result.
- While the underlying legal and judicial framework appears to be reasonably sound, there is both a need and an opportunity to upgrade the country's insolvency resolution regime.
- An effective insolvency resolution regime, combined with other business and investor friendly policies, can substantially accelerate and improve the effectiveness of efforts of a financially troubled company to resolve and adjust competing claims again it. Such a regime will add to creditor confidence and encourage lenders to offer finance on less onerous terms.
- There are several options to pursue in upgrading the insolvency resolution regime. It seems, however, that either (a) new regulations under existing law combined with a handful of legislative amendments (See Sections 7.2 and 7.3) or (b) adoption of a rescue regime similar to South Africa's (See Section 7.4) offer the biggest potential for improvement in the shortest period of time.
- In term of particular substantive reforms, the following should be considered high priority:
    - Establishing more consistent and transparent standards for regulating insolvency resolution professionals and enhancing mechanisms that sanctions individuals from deviating from these standards.
    - Increasing transparency with respect to implementing the regime, both within particular cases and in the performance of the system in its entirety.
    - Encouraging the earlier use of schemes of arrangement or other rescue mechanisms that would adjust creditor and shareholder claims to a level that would allow troubled companies the room to resume or increase operations.
    - Giving insolvency resolution professionals or new owners of troubled companies more legal flexibility to streamline operations in order to return to profitability and to repay adjusted claims.
    - Simplifying both rescues and liquidations by consolidating and reducing the number of statutorily recognized classes of creditors.
    - Adjusting downward the current 75 per cent approval rule to increase the possibility that reasonable schemes of arrangement or other rescue plans gain approval.
- Finally, in addition to reforming the insolvency resolution mechanism itself, consideration should be given to more systemic reforms that
    - Encourage greater investment and make it easier for businesses (both healthy and troubled) to compete for customers, both in the country and abroad.
    - Create more flexibility with respect to claims of the tax authorities and parastatals against troubled companies.
    - Create an integrated approach that would address bank NPLs, bank recapitalizations and out-of-court restructurings in line with international best practices.

END NOTES

[1]Procedures for resolving personal insolvency are outside the scope of this research report.
[2]Douglas Baird, *Bankruptcy's Uncontested Axioms,* YALE LAW JOURNAL, Volume 108, p. 573 (1998).
[3]DOING BUSINESS 2013: SMARTER REGULATIONS FOR SMALL AND MEDIUM SIZED BUSINESSES, at p. 94 (citing to A. P. de Araujo, R. De Vasconcelos, X. Ferreira and B. Funchal, The Brazilian Bankruptcy Law Experiment, Working Paper. Available at http://ssrn.com/abstract=1853984).
[4]Id. (citing to Giacomo Rodano, Nicolas Andre Benigno Serrano-Velarde and Emanuele Tarantino, *The Causal Effect of Bankruptcy Law on the Cost of Finance*). Available at http://ssrn.com/abstract=1967485.
[5]See also Elena Cermizi, Leora Klapper, and Mahesh Uttamchandani, The Challenges of Bankruptcy Reform, WORLD BANK RESEARCH OBSERVER, Volume 27, Issue 2, August 2012. Available at http://wbro.oxfordjournals.org/content/27/2/185.full.pdf+html (it is "widely recognized that sound insolvency systems constitute one of the main areas integral for sound financial systems and financial stability").
[6]This was recognized by the World Bank in its statement of principles and guidelines on insolvency systems:

> A modern, credit-based economy requires predictable, transparent and affordable enforcement of both unsecured and secured credit claims by efficient mechanisms outside of insolvency, as well as a sound insolvency system. These systems must be designed to work in harmony. Commerce is a system of commercial relationships predicated on express or implied contractual agreements between an enterprise and a wide range of creditors and constituencies. Although commercial transactions have become increasingly complex as more sophisticated techniques are developed for pricing and managing risks, the basic rights governing these relationships and the procedures for enforcing these rights have not changed much. These rights enable parties to rely on contractual agreements, fostering confidence that fuels investment, lending and commerce. Conversely, uncertainty about the enforceability of contractual rights increases the cost of credit to compensate for the increased risk of non-performance or, in severe cases, leads to credit tightening.

Principles and Guidelines for Effective Insolvency and Creditor Rights Systems, at p. 5 (revised version 2005).
[7]Empirical research generally supports this intuitive result. See Jun Qian and Phil Strahan, *How Laws and Institutions Shape Financial Contracts: The Case of Bank Loans:*

> Specifically, we find that in countries with strong creditor protection, bank loans are associated with more concentrated ownership, longer maturities, and lower interest rates. In countries with weak creditor protection, our findings suggest that maturity, a non-price term, substitutes for interest rate (the pricing term) and controls borrower risk. Thus, consistent with the law and finance view, strong creditor rights seem to enhance loan availability as lenders are more willing to provide credit on favourable terms." JOURNAL OF FINANCE Vol. LXII, No. 6 DECEMBER 2007 (citations omitted).

[8]See Philippe Aghion, Thibault Fally, Stefano Scarpetta, *Credit Constraints as a Barrier to the Entry and Post-Entry Growth of Firms,* ECONOMIC POLICY, Vol. 22, No. 52, pp. 731-779, October 2007. Earlier draft available at http://siteresources.worldbank.org/INTFR/Resources/CreditConstraintsasaBarriertotheEntry.pdf.

[9]It should be acknowledged that an effective insolvency resolution regime, by facilitating exit of a company and its assets from a given market, could have the effect of temporarily reducing competition. In the long run though it very well might be better for consumers to have three healthy companies competing for customers rather than four, with one of them being so financially desperate as to offer cut-rate prices in order to sell inferior goods or services. While the "three healthy plus one sick" scenario may keep prices lower, it might also reduce profits, which could discourage healthier companies from further investment in the market. Such firms can also bid up costs for inputs, thereby making the sector less competitive overall. See generally, *The Challenges of Bankruptcy Reform*, supra note 5, at p. 5 (discussing the importance of firm exit in a market economy).

[10]Limited liability, though, offers no protection if the owner of a company has issued a personal guarantee for its debts. In such instances, failure of the company could mean a lifetime of outstanding debt for the owners and prevent them from returning to entrepreneurial activity. This issue is best addressed through addressing rules and institutions that would govern individual insolvency.

[11]*See The Challenge of Bankruptcy Reform,* supra note 5, at p. 14.

[12]Almost every society has private companies that are perceived as too big to fail (whether such is truly the case might be debatable). In cases when such companies come under financial or economic distress, the better policy would be a transparent subsidy in the form of an injection of state funds into the company (with a dilution of current ownership) rather than imposing a de facto suspension of the rights of creditors to enforce their claims.

[13]See Section 8.

[14]E.g., KennedyMaposa, *Zimbabwe Stock Exchange Exposes Distressed Industry,* MAIL AND GUARDIAN (June 21, 2013).

[15]Taurai Mangudhla, Bank Lawsuits Clog the Courts, ZIMBABWE INDEPENDENT (June 21, 2013).

[16]For more detail on trends with NPLs in Zimbabwe and their comparison to other countries in the region, see Cornelius Dube, Sanderson Abel and Everista Mugocha, *Access to Bank Credit as a Strategy to Re-Industrialisation in Zimbabwe: The Issues*, ZEPARU Discussion Paper (July 2013) at 17-18.

[17]As the Ministry of Finance noted in 2012:

> [s]ince 2000, productivity in the manufacturing sector has been undermined by lack of new investments, macroeconomic instability, leaving companies to operate with old and obsolete equipment, some of which was commissioned as far back as 1950s. Such a situation could only promote un-competitiveness on both the domestic and export markets . . . Inefficiencies in the manufacturing sector are evidenced by unsustainable wage demands, inflexible labour laws, use of obsolete equipment, high rentals, unreliable supply of utilities such as electricity and water, lagging ICT, input shortages and poor quality as well as loss of skills.

2012 Mid-Year Fiscal Policy Review, p. 48 (July 18, 2012). Available at http://www.zimtreasury.gov.zw/mid-year-fiscal-policy-review.

[18]Eventually, if there are few barriers to entry, the profits these investors make will attract emulators, who, in competing for bargains, will cause prices to rise.

[19]As noted by the World Bank:

> If the debtor is unable to pay, the existence of an efficient debt enforcement system will encourage the debtor to file an insolvency proceeding. In turn, an efficient insolvency system will protect the assets for the benefit of all concerned. From the creditor's perspective, an efficient enforcement system is often a more attractive remedy than the initiation of an involuntary insolvency proceeding, which may result in delayed recovery if the debtor contests the filing and because individual creditor interests are often subordinated to the larger goals and objectives of the collective proceeding. In short, an efficient judgment enforcement system interacts with an efficient insolvency system to force a debtor—the party with the most information about its financial condition—to pay or to file an insolvency proceeding.

Principles and Guidelines, supra note 6, at p. 17.

[20]According to a legal rights index that measures the extent to which a party may create and enforce a security interest in movable property, Zimbabwe meets 7 of the 10 specified criteria. Notably lacking, however, is a unified electronic registry by which parties may check and register their rights to movable property. Doing Business Report for Zimbabwe 2013, supra note 3 at p. 57. For a discussion of the economic benefits of upgrading a regime for registering and enforcing rights in movable property see Heywood Fleisig, Mehnaz Safavian, and Nuria de le Pena, REFORMING COLLATERAL LAWS TO EXPAND ACCESS TO FINANCE (World Bank 2006). Available at https://www.wbginvestmentclimate.org/uploads/BookReformingCollateral.pdf

[21]See generally, Augustine Chizikani, COMMERCIAL LAW IN ZIMBABWE at pp. 261-282 (2010).

[22]In Zimbabwe the reported number of days was 410. This compares to an average of 649 days amongst the Sub-Saharan countries and 510 days on average for countries in the OECD high-income group. Zimbabwe's ranking in this area (currently 111 out of 185) would be substantially higher if the reported costs of attorney's fees in relation to the claim were not so high (several times that of the average of the two comparison groups).

[23]For a discussion of this phenomenon in other countries, see Wako Watanabe, *Does a Large Loss of Bank Capital Cause Evergreening? Evidence from Japan,* JOURNAL OF THE JAPANESE AND INTERNATIONAL ECONOMIES, Volume 24, Issue 1, (March 2010) at pp. 116–136. Earlier version available at http://www.bis.org/bcbs/events/rtf06watanabe.pdf.

[24]Unlike many countries, Zimbabwe does not have a specialized insolvency or commercial court. Specialized courts exist for labour, tax appeals, etc.

[25]*Chief Justice Admits Judiciary Corrupt,* NEW ZIMBABWE (April 4, 2012).

[26]The institution recently came under an administrator focused on its activities alone. The previous Master of the Harare High Court also oversaw the registrar's office and the sheriff's office.

[27]Most business representatives expressed the opinion that the judicial managers and liquidators were relatively competent and honest. Some businessmen, though, had the opinion that judicial managers seemed to be the only ones prospering from judicial management cases.
[28]Companies Act, Section 272 (requiring registration to serve as a liquidator) and Section 313 (applying Section 272 to judicial management). The application for registration as an estate administrator does not require proof of any knowledge or experience with respect to matters pertaining to resolution of insolvency.
[29]Estate Administrator's Act, Section 66(i).
[30]Id., Section 55.
[31]Companies Act, Section 226.
[32]Insolvency Act, Section 79.
[33]Tapiwa Chizana, *Business Rescue and the Companies Act,* ZIMBABWE INDEPENDENT (October 25, 2013) ("The Zimbabwe legislation for judicial management enshrined in the Companies Act was last updated in 1959").
[34]E.g., *N.M.B. Bank Limited, v. Selemani,* November 10, 2012 (referencing Hockley's INSOLVENCY LAW).
[35]The Companies Act applies to private and public companies. The Private Business Corporations Act allows for the formation of small business enterprises consisting of no more than 20 members, all of whom must be natural persons. With a few exceptions, the provisions of the Companies Act apply in the case of the insolvency of a private business corporation.
[36]See Companies Act, Section 270 (applying "the law relating to insolvent estates" to "every winding up of a company unable to pay its debts"). See also Section 313 (applying Section 270 to judicial management where "the court so orders").
[37]Companies Act, Sections 359 and 360.
[38]Id., Section 299.
[39]Id., Section 300.
[40]Id., Section 303.
[41]Id., Section 305(1). Presumably, a discharge of the provisional judicial management order would either lift the stay against the creditors or return the debtor to judicial wind-up procedures if the petition for judicial management had been submitted during the course of such a proceeding.
[42]Id., Section 306(m).
[43]Id., Section 314.
[44]Id., Section 314.
[45]Id., Section 206.
[46]Id., Section 206(f).
[47]Id., Section 207(2).
[48]See Section 5.2.1 of this report.
[49]Companies Act, Section 205(a) and (b).
[50]Id., Section 210(2).
[51]Id., Section 218(2)(a).
[52]Id., Section 213.

[53]Id., Section 218(2)(b).
[54]Id., Section 214(5). In most instances, the attorney representing the petitioner initiates this publication. Comments submitted by Dr. Cecil Madondo (available from ZEPARU).
[55]Id., Section 219(a). Meetings are usually convened by the liquidator in close consultation with the office of the Master of High Court. Comments submitted by Dr. Cecil Madondo (available from ZEPARU).
[56]Companies Act, Section 221(h).
[57]Id., Section 221(f) and (g).
[58]Id., Section 221(4).
[59]Id., Section 277.
[60]Id., Section 279.
[61]Id., Section 291(1).
[62]Insolvency Act, Section 2(1), definition of "free residue."
[63]Id., Sections 100-109.
[64]Chizana, supra note 33.
[65]Chizana, supra note 33.
[66]Chizana, supra note 33. See also comments submitted by Dr. Cecil Madondo ("While it is possible for a judicial management process to be concluded within a year, it should not take more than two years based on international standards").
[67]Comments from the Harare High Court alluded to this trend but did not provide specific numbers.
[68]Comments of Dr. Cecil Madondo (citing to a success rate of nearly 80 per cent based on such criteria).
[69]Chizana, supra note 33.
[70]Fifty petitions were filed in 2010, 73 in 2011, and 149 in 2012.
[71]It is also possible that judicial management procedures have been used to forestall wind-up. See discussion in Section 5.3.1.
[72]Fifteen companies were fully wound up in 2010, 24 in 2011, and 18 in 2012. Of course, any bulge in the number of resolutions is likely to lag the increase in petitions.
[73]Recent experiences in other countries indicate that drafting insolvency laws (or merely amendments to them) and then achieving the level of support necessary to pass such legislation is a lengthy and uncertain process. Jurisdictions as diverse as Germany and the Philippines took more than ten years to pass new insolvency laws in recent years. South Africa began discussing a unified insolvency law to replace its current system over ten years ago.
[74]For an example from United Kingdom see http://corporatelawandgovernance.blogspot.de/2008/11/uk-insolvency-practitioners-association.html. For an example from Ukraine, see http://www.insolvency-practitioners.org.uk/regulation-and-guidance/ethics-code. Closer to Zimbabwe, the South African Restructuring and Insolvency Professionals Association is rewriting its code of ethics and professional conduct. http://www.saripa.co.za/pages/aboutconduct.html.
[75]World Bank, Report on the Observance of Standards and Codes: Insolvency and Creditor Rights: South Africa (June 2012), at p. 3.

[76]USAID, PROTECTING CREDITOR INTERESTS IN BANKRUPTCY (2008). English version available at http://www.academia.edu/2256685/ProtectingCreditorInterestsinBankruptcy ACompaniontotheBankruptcyPracticeManualDesignedforCreditors. The expert assisting the drafting of this research report was the author of this manual.
[77]See http://www.asic.gov.au/asic/ASIC.NSF/byHeadline/Creditors%20and%20insolvency.
[78]http://www.info.insolvencynotices.co.uk/
[79]Companies Act, Section 359.
[80]Id., Section 360.
[81]Report on Standards and Codes: South Africa, supra note 75, at p. 120.
[82]The opinion that judicial management was a failure in South Africa is neither new nor confined to the World Bank. *See Le Roux Hotel Management (Pty) Ltd v E Rand (Pty) Ltd* [2001] 1 All SA 223 (C) at 238, where the court described it as "a system which has barely worked since its initiation in 1926."
[83]This dual appointment (the board and the bankruptcy supervisor) is somewhat unique. In most insolvency resolution regimes, the insolvency resolution professional replaces the management. In a few regimes, the management is left in office to run the 'debtor in possession', subject to court supervision. Even fewer call for a co-habitation arrangement.
[84]Anneli Loubser, *Tilting at Windmills? The Quest for an Effective Corporate Rescue Procedure in South African Law,* Inaugural lecture presented at the Department of Mercantile Law, University of South Africa (September 7, 2011), available at http://uir.unisa.ac.za/bitstream/handle/10500/5218/Inaugural%20lectureAnneli%20Loubser.pdf.
[85]Report on Standards and Codes: South Africa, supra note 75 at p. 24 ("There is a need for coordination of the different pieces of legislation that compose the South African system, and there is considerable opportunity in the initiative of drafting a unified insolvency act, which could provide a broad solution to the rationalizing the insolvency framework for businesses, regardless of legal form").
[86]Centre for Advanced Corporate and Insolvency law, Final Report Containing Proposals on a Unified Insolvency Act (January 2000), available at http://www.justice.gov.za/master/mdocs/insolve-unified-insolvency-report-up.pdf
[87]Should a Commonwealth country develop a well-regarded model within the next year or so, such a development might increase the relative attractiveness of this option.
[88]They include the former dean of the University of Chicago Law School and a professor of corporate law in South Africa. Douglas Baird, *The Uneasy Case for Corporate Reorganizations,* THE JOURNAL OF LEGAL STUDIES, Vol. 15, No. 1 (January 1986) available at http://www.jstor.org/discover/10.2307/724364?uid=3737864&uid=2&uid=4&sid=21102773225601 and Anneli Loubser, *Tilting at Windmills,* supra note 84.
[89]Perhaps the closest attempt was legislation filed in the Philippines congress that discouraged traditional rescue approaches (unless agreed to first in out-of-court negotiations) and attempted to channel most distressed companies into something called "fast-track rehabilitation." The proposal did not attract the support of the insolvency professionals and the law that emerged ten years later had a more traditional approach.
[90]South African Companies Act 71 of 2008, Sections 148 and 149.

[91]Companies Act, Section 318.

[92]South Africa's recent reforms have attempted to address this issue. Eric Levenstien, South Africa: The New Companies Act, No. 71 of 2008 – Reckless Trading And The Personal Liability Of Directors (July 29, 2001), available at http://www.mondaq.com/x/140688/Corporate+Company+Law/The+New+Companies+Act+No+71+Of+2008+Reckless+Trading+And+The+Personal+Liability+Of+Directors

[93]Chapter 11 reorganization in the United States is the most widely cited example of this.

[94]Companies Act, Section 306(m).

[95]As noted by the World Bank:

> The rights of creditors and priorities of claims established prior to insolvency proceeding under commercial or other applicable laws should be upheld in an insolvency proceeding to preserve the legitimate expectations of creditors and encourage greater predictability in commercial relationships. Deviations from this general rule should occur only where necessary to promote other compelling policies, such as the policy supporting reorganization or to maximize the insolvency estate's value.

Principles and Guidelines, supra note 6, at p. 18

[96]Note that this report is not suggesting that workers' entitlement to unpaid wages be adjusted due to their employers' insolvency, rather that workers' entitlement to security of tenure be adjusted under such circumstances.

[97]Care, however, should be taken as to make the rules so harsh towards shareholders as to undermine their incentives to bring cases voluntarily. Striking the proper balance here is a rather delicate undertaking that many advanced jurisdictions are still attempting to perfect. Further review and discussion of this question is necessary should reforms in this area move forward.

[98]For instance, a creditor buying a claim for 40 cents to the dollar might be willing to support a plan where it receives 70 cents to the dollar.

[99]Thomas Laryea, *Approaches to Corporate Debt Restructuring in the Wake of Financial Crises* (International Monetary Fund, January 26, 2010). Available at http://www.imf.org/external/pubs/ft/spn/2010/spn1002.pdf.

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