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TOPIC: CORPORATE INSOLVENCY: PROTECTION OF EMPLOYEE RIGHTS IN KENYA

Declaration

I, **Calystus Juma Kisaka,** do hereby declare that this Project Paper is my original work. It has not been submitted for award of a degree or any other academic credit in any other University or learning institution. I also declare that any references made to texts, articles, journal articles, papers, websites and journals, and any other pertinent materials have been duly acknowledged.

Calystus Juma Kisaka

G62/34441/2019

Signed: _____ Date: **February 14, 2022.**

This project paper has been submitted for examination with my knowledge and approval as the University Supervisor.

Signed:_____ **Date: February 14, 2022.**

DR. ELIZABETH MULI.

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ACRONYMS AND ABBREVIATIONS

CAK	The Competition Authority of Kenya
COVID-19	Coronavirus Disease of 2019
CBK	Central Bank of Kenya
CMW	Creditor Wealth Maximisation
CWM/CB	Creditor Wealth Maximization or Creditor Bargain
CV	Communitarian Vision
c. 173 of 1992	The Protection of Workers' Claims (Employer's Insolvency) Convention 173
DIP	Debtor In Possession
EBO	Employee Buyout
EESS	The Employee Entitlements Support Scheme
FEG	Fair Entitlements Guarantee Act, 2012
GEERS	The General Employee Entitlements and Redundancy Scheme
HMRC	HM Revenue and Customs
ILO	International Labour Organization
ICRS	Insolvency and Creditor Rights Standard
KCB	Kenya Commercial Bank Limited
KBC	Kenya Broadcasting Corporation
KRA	Kenya Revenue Authority
M & A	Mergers and Acquisitions
MV	Multiple Values
NHS	The National Health Service
NIF	The National Insurance Fund
NSSF	National Social Security Fund
OHADA	Organization for the Harmonization of Business Law in Africa
POWIF	The Protection of Wages on Insolvency

PwC	PricewaterhouseCoopers
UIF	The Unemployment Insurance Fund
UNCITRAL	United Nations Commission on International Trade Law
SDSP	State Department for Social Protection
UK	United Kingdom
US	United States

Table of Laws and Statutes

Constitution of Kenya, 2010

Employment Act, 2007.

Insolvency Act, 2015

Kenya Deposit Insurance Corporation Act, 2012

The Competition Act, 2010

South Africa Labour Relations Act, 1995

South African Companies Act, 2008

Uganda Employment Act, 2006

The Singapore Companies Act

Canada Business Corporations Act, 1985

Retirement Benefits (Minimum Funding Level and Winding-Up of Schemes) Regulations 2000

Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015

The UK Employment Rights Act 1996

UK Transfer of Undertakings (Protection of Employment) Regulations, 2006 and Transfer of Undertakings (Protection of Employment) (Amendment) Regulations, 2014

Table of International Instruments

International Labour Organization (ILO) 1949 Protection of Wages Convention;

International Labour Organization (ILO) 1982 Termination of Employment Convention;

International Labour Organization (ILO) 1992 Protection of Workers' Claims (Employers' Insolvency) (Convention 173);

UNCITRAL Model Law on Cross-Border Insolvency; and

UNCITRAL Model Law on Recognition and Enforcement of Insolvency Related Judgments.

Principle C12 of the World Bank's Principles for Effective Insolvency and Creditor/Debtor Regimes, 2015.

International Labour Organization (ILO) Conference in June 2009 Global Jobs Pact.

Table of Case law

DEDICATION

To my dear mum who planted in me the seed of academic excellence, I dedicate this research. Though departed, your ideals continue to live in me. I am because you were. Rest In Peace mum.

To my brother Geoffrey who has incessantly reminded me to complete this research, I dedicate this thesis to you.

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Erick Masafu was reliably available to supply that book or article that was required for this research.

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For those who through their tacit efforts, provided an enabling environment for me to complete this research, though not specifically mentioned here, I profusely thank you.

I do, here and now, acknowledge your tremendous contribution to the existence of this body of knowledge on protecting employee rights in Kenya in corporate insolvency.

ABSTRACT

Employees are an integral part and the lifeblood of any corporate entity. They play a crucial function in the existence of a corporate entity. They have immense stake in its continued existence and its sound financial health for purposes of keeping their jobs. Their jobs are a source of livelihood to them. The financial ill-health or insolvency of their employer poses a risk to their jobs. COVID-19 exacerbated the risk of losing jobs. Insolvency of the corporate employer, causes employees to lose their jobs and entitlements and to be condemned to abject poverty. This is largely because developing countries like Kenya have weak social welfare programmes to support the unemployed.

Over the years, insolvency law has developed with the aim of addressing the interests of stakeholders in insolvency. The development of the law has been informed by the proceduralist and traditionalist theories discussed in chapter 2. The traditionalist theory informed the development of the law to take care of interests of all stakeholders in corporate insolvency including employees.

The laws of Kenya, discussed in chapter three, have structures whose intention is to protect employees in the wake of insolvency of their corporate employer. These include preferential treatment of a portion of their entitlement, providing a guarantee payment under the National Social Security Fund and corporate rescue through administration. Despite the legal regime providing some measure of protection to employees, the mechanisms are not sufficient to protect employee entitlements which exist prior to insolvency. These laws can be improved to effectively and adequately protect employee rights in corporate insolvency.

In chapter four, this research discusses lessons from other jurisdictions on effectively and meaningfully protecting the interests of employees in corporate insolvency. In chapter five, this research recommends lessons from other jurisdictions to be adopted in Kenya, together with some amendments to the laws of Kenya to further buttress the protection of employees in corporate insolvency.

CHAPTER ONE

1.0 INTRODUCTION TO THE STUDY

1.1 Background

A corporate entity is insolvent where it is unable to settle its debts upon any creditor presenting to the entity the demand for payment.[1] The directors or creditors of the insolvent company may then apply to a commercial court for a liquidation order, an administration order or for making of an arrangement with all creditors. Employees are part of the unsecured creditors.

Employees are an integral part and the lifeblood of any corporate entity. They play a crucial function in the existence of a corporate entity. They have immense stake in its continued existence and its sound financial health for purposes of keeping their jobs. Their jobs are a source of livelihood to them. The financial ill-health or insolvency of their employer poses a risk to their jobs. Their right to work, fair labour practices[2], earning and a decent life, which is in tandem with their right to dignity, is jeopardised whenever their employer becomes insolvent.

An employer may face financial distress from economic, legal, political and human causes. Human causes include poor personal relationships, disagreement over strategy, rivalry and underperformance.[3] When an employer becomes insolvent, appropriate legal process will ensue to dispose of its assets in a process known as liquidation, with a view of settling the debts owed to its creditors. This process practically kills the company and causes the employees to lose their jobs. Some employees may have skills and training specific for the insolvent employer and there may not be any other suitable demand for their skills.[4]

[1] Insolvency Act, 2015, s 384.
[2] The Constitution of Kenya, 2010, Art 41.
[3] Brian Finch, *Insolvency and Financial Distress: How to Avoid It and Survive It* (Bloomsbury Publishing Plc 2012) Chapter 2 p 2-3.
[4] John Kong Shan Ho & Rohan Price, 'Moral Hazard, Insolvency and Employees as Creditors: What Governance Lessons can be Learned from the Hong Kong Model?' (2011) Journal of Corporate Law Studies p.2.

Creditors of the company are spooked when a company goes under. The many creditors, in the absence any legal procedure, will then engage in a chaotic race to protect their interests and ensure their debts are settled. To prevent chaos, insolvency law puts in place procedures to be adopted to ensure that creditors' interests are taken care of in a systematic manner.[5] Employees as creditors of the insolvent company are often overshadowed by the trade and loan creditors. There is need to balance the rights of employees and those of other creditors.[6] Employees are creditors in terms of unpaid salary, salary in lieu of notice[7], leave allowances, severance pay, service pay benefits and pension which form a significant portion of their wealth.[8]

Insolvency of companies has undesirable results on employees because it engenders redundancy. The loss of jobs results in the deterioration of the social fabric, decline in living standards, urban poverty, decline of consumer goods businesses and increase in crime rates.[9] This is largely because developing countries like Kenya have weak social welfare programmes to support the unemployed.[10]

In recognition of this conundrum, the law has put in place mechanisms to secure the rights of employees and ameliorate their plight arising from corporate insolvency. Other creditors unlike employees, may diversify their risk and may be aware that the company may soon be collapsing from the financial and economic information they obtain and accordingly factor the risk in their pricing and lending rates.[11] The law should ensure that employees' wages, other benefits and pension earned are guaranteed and paid in a timely manner. Further, it should be a social function of law to protect the employees' rights to retain their jobs even in the face of their employer's financial ill-health. In addition, employees should

[5] Ibid.
[6] The World Bank, 'Principles for Effective Insolvency and Creditor/Debtor Regimes' (2015) Principle C12.4.
[7] 1982 International Labour Organization Termination of Employment Convention, Article 11.
[8] Gordon W. Johnson, 'Insolvency and Social Protection: Employee entitlement in the event of employer insolvency' (2006) available at <https://www.oecd.org/daf/ca/corporategovernanceprinciples/38184691.pdf> accessed on 2nd January, 2020.
[9] Ibid.
[10] Ibid.
[11] Ibid.

be adequately compensated, in accordance with the existing law, to prevent a drastic shift from their former standards of living.

Kenya like many other countries such as Brazil, Australia, Argentina, Belgium, Canada, China, Czech Republic, Denmark, France, India, Ireland, Italy, Japan, Malaysia, The Netherlands, New Zealand, South Africa, Sweden, the UK and the US elevate the employee claims to rank above other unsecured creditors during insolvency of employers.[12] The employee entitlements are indeed unsecured interest-free loans to the insolvent companies. The preferential treatment of employee entitlements is an exception to the *pari passu* principle which serves to cater for interests of employees in insolvency.[13]

The law further protects employees by a guaranteed payment of a capped amount shortly after the employer becoming insolvent.[14] The law also provides for corporate rescue in a process called administration where an officer the court appoints runs the insolvent company as a going concern aiming to save the company and jobs.[15] The law further requires directors to make decision which consider employees' interests.[16] However, despite the foregoing provisions, the existing law does not adequately protect the employees' interests in corporate insolvency as discussed in the statement of the problem below.

1.2 Statement of the problem

Many corporate entities in Kenya have, in the recent past, faced financial distress and subsequently taken action which has been prejudicial to the interests of their employees. Panpaper Mills- Webuye collapsed causing over 2,000 employees to lose their jobs and livelihoods in February, 2009.[17] Only

[12] 1949 International Labour Organization Protection of Wages Convention, Art 11.1 and the Insolvency Act, 2015, Second Schedule.
[13] John Kong Shan Ho & Rohan Price, 'Moral Hazard, Insolvency and Employees as Creditors: What Governance Lessons can be Learned from the Hong Kong Model?' (2011) Journal of Corporate Law Studies, p 535.
[14] Employment Act, 2007, s 68-69.
[15] Insolvency Act, 2015, Part VIII.
[16] Companies Act, 2015, s 143.
[17] Stephen Makabila, 'Webuye Panpaper factory goes down with livelihoods in entire town' (Standard Digital, 23rd February, 2009)
<https://www.standardmedia.co.ke/article/1144007297/webuye-paper-factory-goes-down-with-livelihoods-in-entire-town> accessed on 25th December, 2019.

four hundred (400) of the Pan Paper Mills employees received their dues in June 2017, eight years after the collapse of the company.[18] Kenya Airways rendered redundant four hundred and forty seven (447) of its employees which decision was affirmed by the Court of Appeal.[19] Mumias Sugar Company Limited failed to pay its employees for thirty (30) months and the employees were paid a paltry twenty thousand Kenya Shillings (Kshs. 20,000/=) as terminal pay in December, 2019.[20] The East African Portland Cement Company Limited had to undertake a restructuring including failing to renew contracts of employees[21] and sending managers home.[22] Eveready Kenya also closed its offices in Nakuru thereby affecting about one hundred (100) employees.[23]

The employees of an insolvent company are among its creditors who hope to be paid some day as the realization of the insolvent company's assets progresses. However, the question to be determined, taking into account the unique circumstances of each insolvency, is whether the assets of the ailing company are sufficient to settle the employee claim in full and how long does it take to settle those claims.

The Insolvency Act, 2015 and employment law provide the means of settlement of debts of an insolvent company. The Act places employee claims at the second preferential rank.[24] The Act also provides for administration of an insolvent company as a choice in the place of liquidation.[25] The Companies Act, 2015[26] and the Code of Corporate Governance, 2015 requires directors to act in the best interest of all

[18] Raphael Wanjala, 'Former Pan Paper workers receive 74 million dues' (Standard Digital, 10th June, 2017) <https://www.standardmedia.co.ke/article/2001242928/former-pan-paper-workers-receive-sh74-million-dues> accessed on 25th December, 2019.

[19] Kenya Airways Limited v Aviation & Allied Workers Union Kenya & 3 others [2014] eKLR.

[20] Benson Amadala, 'Sacked Mumias Staff get Shs 20,000 termination pay'(Business Daily, 23rd December, 2019) <https://www.businessdailyafrica.com/economy/Sacked-Mumias-staff-get-Sh20-000-termination-pay/3946234-5395236-tj8e5j/index.html> accessed 25th December, 2019.

[2121] Lynet Igadwah, 'Portland Cement sends home 520 employees' (Business Daily, 14th August, 2019) <https://www.businessdailyafrica.com/corporate/companies/Portland-Cement-sends--home-520-employees/4003102-4712726-94ruxo/index.html> accessed 25th December, 2019.

[22] Stanley Ngotho, 'Portland Cement sacks all managers in cost cutting plan'(Business Daily, 23rd September, 2019) <https://www.businessdailyafrica.com/economy/Portland-Cement-sacks-all-managers-in-cost-cutting-plan/3946234-5283750-ufjj0k/index.html> accessed 25th December, 2019.

[23] Francis Mureithi, 'Battery Maker Eveready shuts down Nakuru Branch'(Daily Nation, 29th September, 2014)<https://www.nation.co.ke/business/996-2468972-12o4n6tz/index.html> accessed 25th December, 2019.

[24] Insolvency Act, 2015, Second Schedule Para. 3.

[25] Ibid Part VIII s 520-623.

[26] Companies Act, 2015, s 143.

stakeholders including employees and not just the shareholders in what is now known as the "enlightened shareholder value".[27]

Despite the existing laws which protect the interests of employees in the event of an insolvent employer, the employees' rights are not adequately protected. As indicated above, the employees of Pan Paper Mills waited for eight years for their pay and when the pay came in 2017, only a few of them received the pay. The Mumias sugar staff had not been paid for 30 months and the KCB receiver manager paid them a paltry Kshs. 20,000 in December, 2019. The existing law, therefore, does not adequately advance the rights of employees of financially distressed companies.

1.3 Justification of the study

This research paper seeks to establish how the law protects the rights of employees of financially distressed companies and how it can be improved to this end. Though the insolvency and employment law in Kenya attempt to protect the rights of employees of an insolvent entity, they do not sufficiently protect employee entitlements and rights in the event of an insolvent employer. This is especially the case where the insolvent company's assets do not suffice to settle the secured creditor claims let alone the employee claims. Further, in cases where the liquidation of the company takes so long a time that the extended wait for payment of the salaries and benefits due becomes a patently gross violation of the employee rights. This research paper aims to unearth the ways in which the existing law in Kenya can be improved to protect the rights of employees of an insolvent corporate entity.

Further, this research aims to contribute to the available Kenyan literature on the issue of protection of employee rights in the event of corporate insolvency. The available Kenyan literature tends to focus on the entitlements of the employee in the event of unfair termination. Further, the available literature on insolvency the world over tends to focus on the protection of the secured, unsecured creditors and trade creditors. Protection of employee rights in insolvency in most literature comes out as peripheral and

[27] Neshat Safari & Martin Gelter, 'British Home Stores collapse: the case for an employee derivative claim' (2019) Journal of Corporate Law Studies.

collateral discussion. The fabric of this research seeks to place protection of employee rights at its pith and marrow.

In addition, this research ventures to establish the best practices around the world relating to protection of employee rights in the wake of insolvency of their employer. The best practices are intended to be availed to policy and law makers for consideration. The best practices will then inform the policy and law makers on what laws and policies to put in place in the interest of employees. This is very important considering that insolvencies have become prevalent in the Kenyan economy and will certainly persist.

1.4 Statement of Objectives

1. To discuss the history and theoretical foundation of insolvency law in protecting employee rights in corporate insolvency.
2. To establish how the Kenyan law protects the rights of employees during liquidation of insolvent companies
3. To find out lessons from other jurisdictions in protecting employee rights in corporate insolvency.
4. To make recommendations on reforming Kenyan law for meaningfully and effectively protecting employee rights in corporate insolvency.

1.5 Research Questions

1. What is the history and theoretical foundation of insolvency in protecting employee rights in corporate insolvency?
2. How does the Kenyan law protect the rights of employees during corporate insolvency?
3. What are the lessons from other jurisdictions on protecting employee rights in corporate insolvency?

4. What reforms can be made to the Kenyan law to meaningfully and effectively protect employee rights in corporate insolvency?

1.6 Hypotheses

1. The law of Kenya inadequately protects the rights of employees of insolvent companies.
2. The protection the law of Kenya provides to employees in corporate insolvency is not meaningful and effective.
3. The law of Kenya can be reformed to meaningfully and effectively protect employees in corporate insolvency.

1.7 Theoretical Framework

The legal theories underpinning this research project are the proceduralist theory and the traditionalist theory. These two theories explain the existence of insolvency law. The proceduralist theory holds that insolvency law should be employed as a procedure of debt collection for the economic benefit of creditors.[28] Traditionalist theory holds that insolvency law should consider all the interests that are impacted by the insolvency of a company.[29] These theories are discussed under the broader public interest theory which postulates that the purpose of regulation is to enhance public interest.[30]

This is research will also discuss the opposing offshoot theories of the proceduralist theory and the traditionalist theory being the Creditor Wealth Maximisation ("CMW") or Creditor Bargain Theory and the Maximisation of Social Welfare Theory or Communitarian Vision which underpin insolvency law.[31] The CMW theory holds that the purpose of insolvency law is to ensure that the creditors get as much as they can from the estate of the insolvent company in satisfaction of their debts. The CMW theory

[28] Note 12 p.38.
[29] Douglas G. Baird, 'Bankruptcy's Uncontested Axioms' (1998) 108 Yale L. J. p 579.
[30] Levine, Michael E., and Jennifer L. Forrence. "Regulatory Capture, Public Interest, and the Public Agenda: Toward a Synthesis." (Oxford University Press, 1990) Journal of Law, Economics, & Organization, vol. 6., pp. 167, http://www.jstor.org/stable/764987.
[31] Ruzita Azmi & Adilah Razak, *The Theories Underpinning Corporate Insolvency Law: An Analysis* (Mcgraw Hill Kuala Lumpur, 2012) p 5-7 available at <https://www.researchgate.net/publication/312091906_THE_THEORIES_UNDERPINNING_CORPORATE_INSOLVENCY_LAW_AN_ANALYSIS> accessed 7th February,2020.

does not support consideration of external interests which may lead to policies such rehabilitation of companies.[32] The Maximisation of Social Welfare theory holds that the realm of insolvency law should take into account the larger interests including employees, the government, suppliers, consumers and the community. It holds that insolvency law should venture beyond concerning itself with the interests of creditors.[33]

1.8 Research Methodology

This research project was based on the doctrinal research methodology. This entailed reading books, Journals and articles from the University of Nairobi, School of Law Library and reading books, Journals and articles from the internet and the University of Nairobi online library.

The introduction to the study was based on reading books, articles, journals and newspaper reports about the number of employees affected by corporate insolvency. Chapter two was also based on reading books, articles, journals on the history and theoretical framework of insolvency law.

Chapter three was based on reading and analysing the Kenyan Acts of Parliament, case law and international conventions. Chapter three was based on reading books, articles, journals on the lessons from other jurisdictions. The UK, Australia and Hong Kong were picked as jurisdictions to borrow the idea of the guarantee fund because the idea is well developed in these jurisdictions. Canada, Singapore and Australia were chosen as jurisdictions with the idea of employee derivative action because they are the only jurisdictions who have employee derivative action in their statutes.

Chapter five is derived from chapters one to five. Chapter five is based on the review of the preceding chapters one to five. The recommendations were derived from the inadequacies identified in chapter three and the lessons from other jurisdictions in chapter four.

[32] Ibid,
[33] Ibid.

This research was intended to be based on questionnaires and interviews with the Insolvency Practitioners who are accountants in audit firms[34] to provide data on the extend of how employees were affected by corporate insolvencies. However, as indicated in the limitations of this research, they declined to provide this information.

1.9 Literature Review

The literature review analyses the various works written on the research questions. Therefore, this section will consider the literature review under the headings of the research questions namely history and theoretical foundation of insolvency law in protecting employee rights in corporate insolvency, Kenyan legal protection of employee rights in corporate insolvency and lessons from other jurisdictions on protecting employee rights in corporate insolvency.

1.9.1 History and theoretical foundation of insolvency law in protecting employee rights in corporate insolvency

Karl Gratzer provides the historical treatment of bankrupts in different jurisdictions and the development of insolvency law over time.[35] The author traces the evolution of insolvency law relating to individuals as dishonest persons who are later viewed as unfortunate persons who deserve the sympathy. The bankruptcy law applicable to sole traders extends and applies to corporate entities with the emergence of joint stock companies. This discussion is important to this research because it brings the initial discussions in the 1990s that informed the social considerations and purposes of insolvency law such as having regard to employee rights. The author, however, fails to provide the historical development of company law but suddenly brings on the stage the joint stock companies. This author does not discuss the theoretical foundation of insolvency law.

[34] Peter Kahi of PKF was appointed administrator of Nakumatt Limited, Muniu Thoiti and George Weru of PwC were appointed administrators of ARM Cement Limited and Ponangipalli Venkata Ramana Rao was appointed as the administrator of Mumias Sugar Company Limited.

[35] Karl Gratzer, 'Introduction' in Karl Gratzer & Dieter Stiefel (eds), 'History of Insolvency and Bankruptcy from an International Perspective'(Soderton hogskola, 2008)

J.H. Farrar & B.M. Hannigan provide the missing link in Karl Gratzer's work by providing the flesh to the historical development of the instrument of the company in doing business.[36] The discussion of history of development of the modern is important because corporate insolvency is inextricably linked to company law. The author discusses the initial form of business being sole trader, merchant ventures, medieval *commendas* and *societas*, the South Sea Company, Deed of Settlement Companies, Joint Stock Companies, Railway Companies and the 1855 limited liability Companies. This exposition is important to this research because it provides the light into the past that led to the current corporate entities with similarities to the present insolvencies exemplified in the collapse of the South Sea Company in 1720. Such early bankruptcies informed the legislative efforts to protect the rights of stakeholders including employees. This is history is restricted to the English company law and aptly so because the company and insolvency law in Kenya is derived from the English law, Kenya having been a colony of Great Britain. These authors do not discuss the theoretical foundations of insolvency law.

Hamiisi Juniour Nsubuga discusses the UK insolvency law. The author discusses the reforms introduced by the UK Insolvency Act, 1986 and subsequently revised by the Entreprise Act, 2002.[37] This discussion is important because Kenya's law largely, more often than not, borrows from the UK law. The consolidation insolvency law and bankruptcy law in Kenya and separation of insolvency law from company law followed the UK lessons. The 2015 Insolvency Act of Kenya is based on the UK insolvency law. This author discusses an entire chapter of theoretical foundation of insolvency law being proceduralist theory and traditionalist theory and their subsets.

Fancy Chepkemoi Too provides a brief discussion of the insolvency law in Kenya. The author commences with the 1948 Companies Act which encapsulated the winding up provisions to the then Bill which is now the 2015 Kenya Insolvency Act.[38] The author focuses on the broad purposes of

[36] J.H. Farrar & B.M. Hannigan, '*Farrar's Company Law'* (Butterworths, 4th Edn) p.15-25
[37] Hamiisi Juniour Nsubuga, 'The Rights of Employees on Corporate Insolvency: A UK & US Perspective', A Thesis Submitted in Partial Fulfilment of the Requirements of Nottingham Trent University for the Degree of Doctor of Philosophy, 2018) p. 5.
[38] Fancy Chepkemoi Too, 'A Comparative Analysis of Corporate Insolvency Laws: Which is the Best Option for Kenya?', (A Thesis Submitted in Partial Fulfillment of the Requirements of Nottingham Trent University for the Degree of Doctor

insolvency law and how the law could be reformed in the best interest of stakeholders and not specifically employees. This discussion in referring to the broad purposes, though not expressly, instinctively captures employee interests. This author discusses an entire chapter of theoretical foundation of insolvency law being proceduralist theory and traditionalist theory and their subsets.

Vanessa Finch comprehensively discusses history of insolvency in the United Kingdom. The author traces the early attitude towards bankrupts as criminals and the forms of punishment meted out on them. The author then traces the shift from former attitude to the enlightened attitude and the reforms that were made. The author discusses the report made by the Mr. Kenneth Cork to reform insolvency law.[39] The author provides a comprehensive discussion which covers the development of company law and insolvency law. The author makes special mention of the Cork Report which made recommendation in 1982 which forms the basis of modern insolvency law including the principle of rehabilitation. The principle of rehabilitation is crucial to protection of employee rights in corporate insolvency. This work is of particular importance to this research because it traces the development of insolvency up to the point where the plight of employees was addressed. This author discusses the visions of corporate insolvency law being the creditor wealth maximization vision and the communitarian vision. The author also proposes the novel Explicit Value approach

Ruzita Azmi & Adilah Razak are vehemently opposed to the proceduralist theory. [40] They argue that focusing on maximizing the returns of creditors should not be the only aim of insolvency law. These authors demonstrate little concern for legitimate interests of employees in corporate insolvency. Their work runs afoul to the aims of this research. They are diametrically opposed to the thesis of this research that the law of Kenya can be amended to adequately and meaningfully protect employee rights.

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of Philosophy, September, 2015) p.87 and Fancy Chepkemoi Too, 'Drivers of Insolvency Reforms in Kenya' (Nottingham Insolvency and Business e-Journal, 2016) para. 7 & 13.

[39] Vanessa Finch, *Corporate Insolvency Law: Perspectives and Principles*, (Cambridge University Press, 2009) p.10-19.

[40] Ruzita Azmi & Adilah Razak, *The Theories Underpinning Corporate Insolvency Law: An Analysis* (Mcgraw Hill Kuala Lumpur, 2012) p.12 available at <https://www.researchgate.net/publication/312091906_THE_THEORIES_UNDERPINNING_CORPORATE_INSOLVENCY_LAW_AN_ANALYSIS> accessed 20th January,2020.

Charles W. Mooney in support of the traditionalist theory which forms the gravamen of this research, argues that insolvency law should rehabilitate companies where possible for the greater interest of the community such as taxes for the government, wealth creation for the community resulting from increased economic activity, new jobs and higher wages for employees[41], preservation of jobs even if it is at the expense of others.

1.9.2 Kenyan legal protection of employee rights in corporate insolvency

There is little literature on the Kenyan legal protection of employee rights in corporate insolvency. The existing literature is mainly blogs by law firms in Kenya. Even so, none of them focuses on the protection of employee in corporate insolvency. Such discussion can only be implied in their discussion.

Daly & Inamdar discuss the issue of administration which is very instrumental in preserving employment if successful.[42] This discussion is relevant to this research because administration is one important means of protecting employee rights in corporate insolvency. This blog does not expressly state how employees can be legally protected in corporate insolvency.

Jackline Wakuthii Warui argues for a case of establishing a pension guarantee fund in Kenya.[43] This is a good idea which when harmonised with our recommendations herein can protect employee rights in corporate insolvency. When a company is insolvent, some of the benefits under threat are benefit contributions withheld by the employer. The challenge with this work is that it focuses on pension and generally a pensioner is different from an employee and pension benefits are paid when the person is no longer an employee. This work, therefore, bears little relevance to this research.

Jacob Ochieng, Sandra Kavagi and Sheila Nyakundi discuss the protection of employee rights in mergers and acquisitions. They discuss the implication of the employment amendment bill which seeks

[41] Charles W. Mooney, Jr., 'A Normative Theory of Bankruptcy Law: Bankruptcy As (Is) Civil Procedure' (2004) p.950 Washington and Lee Law Review, Volume 61 Issue 63 Article 2.
[42] Daly & Inamdar, 'Overview of Kenyan Insolvency Law' (2019) available at <http://www.dalyinamdar.com/overview-of-kenyan-insolvency-law/> accessed on 13th March, 2020.
[43] JacKline Wakuthii Warui, 'Regulation of Pension Benefits in Kenya: A Case for Pension Guarantee Fund' (University Master of Law Thesis, 2018) p.46.

to require acquiring entities to take over employees. They conclude by saying that the Bill may not be good because businesses merge to save on costs and that the bill could discourage mergers. Their conclusion does not show concern for the legitimate interests of employees in corporate insolvency.[44]

Brian Finch considers the specific alternatives to insolvency involved in administration or corporate rescue.[45] He argues that behind the façade of challenging financial circumstances, there may be a viable business whose heart is beating. In that case, it is prudent to explore the alternatives to insolvency and if otherwise the business will be liquidated. Alternatives to insolvency save jobs. Alternatives to insolvency includes business restructuring, selling the business, compounding or making arrangement or agreement with creditors informally or through a company voluntary arrangement and administration. Company finance restructuring occurs where loans are converted into preference shares to save the company from paying back the loan and interest and, therefore, enrich its balance sheet. Cash injection can be through asset refinancing, mortgage or re-mortgage, invoice financing including factoring and invoice discounting, trade finance, outright sale of the assets or sale and leaseback, selling part of the business that is not core and credit card financing.

Saleh Al-Barashd & Horace Yeung recognise the plight of employees in corporate as does this research. They opine that creditors would receive better returns than they would have were the company to be liquidated.[46] They, therefore advocate for corporate rescue.

Jennifer L.L. Gant examines the UK and US insolvency systems and outlines the reforms made by the continental Europe following the Global Financial Crisis.[47] The UK model is paternalistic and based

[44] Jacob Ochieng, Sandra Kavagi, Sheila Nyakundi, 'A Dicey Matter: The Fate of Employees in Mergers and Acquisitions'(January, 2020) available at <https://www.oraro.co.ke/tag/mergers-acquisitions/> last accessed on 5th July, 2021.
[45] Brian Finch, *Insolvency and Financial Distress : How to Avoid It and Survive It* (Bloomsbury Publishing Plc, 2012).
[46] Saleh Al-Barashd & Horace Yeung, 'An Assessment of Various Theoretical Approaches to Bankruptcy Law' (2016) p. 27 Sultan Qaboos University, Journal of Arts and Social Sciences.
[47] Jennifer L. L. Gant, 'Constitutions and Crisis: Balancing Insolvency and Social Policy through the Lens of Comparative Legal History (2017)' available at <http://irep.ntu.ac.uk/id/eprint/31292/1/PubSub8841_Gant.pdf> accessed on 3rd January, 2020.

on social-welfare state while the US model like the DIP and at-will employment[48] are based on the philosophy of independence and freedom of the person.

Hon. Samuel L. Barford takes a rather radical approach which contrary to the aims and aspirations of this research.[49] He is of the view that employment protection plays a secondary role in insolvency law. He states that employment can only be protected if the company is a going concern and if the insolvent entity is sold to another entity which will be expected to retain the employees of the insolvent company. He further states that the insolvent entity should be allowed to render employees redundant where necessary to enhance economic efficiencies. This is indeed allowed by the Employment law of Kenya which allows for the employer to terminate the employment contract of the employee on account of operational requirements.[50] Further, an employer who renders an employee redundant as a result of insolvency is not required to follow the procedure laid down in law.[51] He opines that protection of employment should not be a concern of the insolvency law but that of the government through taxes paid by businesses. This is a view championed by the creditor wealth maximisation theory discussed above. His view is radical to the extent that he has little concern for employees.

Jay Lawrence Westbrook discusses the employee rights in insolvency under chapter 6 of their book.[52] The authors state that an employee is a creditor to a company in insolvency who may be owed claims in the form of unpaid salary, salary in lieu of notice, leave allowances, severance pay, service pay benefits and pension. This is a view championed by the communitarian vision theory discussed above.

The author illuminates the prevailing position of the law in Kenya that employee claims should rank preferentially because employees would ordinarily work for one employer. The collapse of their employer means the loss of their source of salary and pension. The other creditors would more likely

[48] The doctrine under which an employee may be dismissed without a just cause as long as the reason is not illegal.
[49] Hon. Samuel L. Barford, 'Coordination of Insolvency Cases for International Enterprise Groups: A Proposal' available at <https://www.iiiglobal.org/sites/default/files/cordination_of_insolvency_cases.pdf> accessed on 2nd January, 2020.
[50] Employment Act, 2007, s 45(2)(b)(ii).
[51] Employment Act, 2007, s 40(2).
[52] Jay Lawrence Westbrook, *A Global View of Business Insolvency Systems* (BRILL, 2009).

than not have diversified their investments. The author also discusses the unique American instrument of Debtor In Possession (DIP) which is absent in the Kenyan legal system. Under the DIP system, the directors of the insolvent continue to run the company. The DIP system may not be attractive in Kenya because in most cases, the directors will have run down the company.

The author recognises a rival argument to the effect that the employee claims should rank after the secured creditors because their rights exist even before the insolvency of the company sets in. The existing law in Kenya complies with this position. The secured creditors have a legitimate expectation that where the company is unable to settle its debts, they shall then deal with the assets provided as security in the manner they deem fit to realize the secured amount or the balance of it. This ensures certainty in commercial transactions. The employee claims should be afforded other settlement mechanisms.

The protection of employee rights in Kenya is based on the review of the relevant statutory law, case law, similar provisions in other jurisdictions and international instruments. There is a paucity of literature on this subject in Kenya. Most of the literature is about unfair termination of employees during normal disciplinary processes.

1.9.3 Lessons from other jurisdictions on protecting employee rights in corporate insolvency

This subsection will analyse the literature on lessons from other jurisdictions under the following sub-topics: the Guarantee or Insurance Fund, Retraining of Employees and Job Referrals, Corporate Rescue, Employee Participation in Decision-Making, Maintaining Employment in Mergers and Acquisitions and employee derivative action.

1.9.3.1 The Guarantee or Insurance Fund

Jay Lawrence Westbrook discusses the mechanisms that this research seeks to establish as necessary to sufficiently protect employee rights. He expounds on the Guarantee Fund that will facilitate the

payment of employment and pension claims and business rescue which ensures that the business of the insolvent company is carried out as a going concern for the welfare of every creditor and stakeholder.

The author further argues that establishing a guarantee fund and corporate rescue are means of ensuring that employees are treated fairly and every creditor is happy in line with the theory of utilitarianism and prioritarian theory which focuses on giving attention or emphasis to the welfare of those who are worse off.[53]

John Kong Shan Ho & Rohan Price provide an important insight to this research as to the model of guarantee fund to be adopted. Their argument is sound and has formed the basis of the recommendation in chapter five. They argue that a guarantee fund based on private contributions should be preferred over a state funded guarantee fund.

In arguing against the state funded guarantee fund they opine, and we agree, that the government guarantee or insurance of employee claims may cause directors to fail to take ingenious actions to save the company in what they call the moral hazard.[54] They further argue that an individual will behave more responsibly if they are made to bear the consequences of their risk-taking action. They argue that the best employee claims insurance should be modest and based less on funding by general tax-payers for purposes of reducing the moral hazard.

The authors discuss the Australian and UK models of the guarantee funds. Both are funded from state resources. They also examined the Hong Kong Model made up by private annual levy on business registration certificates. They thought the Hong Kong Model as the best. In Kenya, it may not be viable to base the contribution on business registration certificates because of the small and informal economy and heavily taxed employers.

[53] Stanford Encyclopedia of Philosophy, 'Rights' (2005) available at < https://plato.stanford.edu/entries/rights/> accessed 4th January, 2020.
[54] John Kong Shan Ho & Rohan Price, 'Moral Hazard, Insolvency and Employees as Creditors: What Governance Lessons can be Learned from the Hong Kong Model?' (2011) Journal of Corporate Law Studies.

However, despite the model guarantee fund adopted, the moral hazard cannot be completely dismantled. A guarantee fund of whatever form will still encourage the moral hazard. Therefore, a guarantee fund has to be curbed with penal laws aimed at the directors and complicit employees.

Gordorn W. Johnson examines the insurance or guarantee fund in place world over for protection of employees in insolvency.[55] The author brings forth the exact model that this research recommends to be adopted in Kenya. The author highlights the striking example of the Chinese and Austrian models which are radically pro-employee. There is an insurance fund made up by the employer and employee contributions. The employee of an insolvent company is paid 80% of the minimum wage for two years after the collapse of the employer. He concludes that the insurance or guarantee fund requires to be supplemented with retraining, assistance in job search and public works programmes.

1.9.3.2 Maintaining Employment in Mergers and Acquisitions

John McMullen discusses the rights of employees in transfer of business undertakings.[56] It is likely that the insolvent company could eventually be sold off to another entity. The employees of the insolvent company may be transferred to the purchaser. The author brings out the evolving law from the aspect of the purchaser engaging the employees on the existing terms and on no less favourable terms to renegotiation of terms. The renegotiation of terms should first proceed from the premise that the terms should be no less favourable than the existing terms.

Brian Finch discusses tax incentives may be used to woo investors. These incentives will invite potential buyers to acquire the insolvent company and thereby preserve employment. Such incentives would include personal income tax allowance, tax-free capital gains and offsetting losses against the personal income tax. Such favourable or neutral tax measures are discussed by the World Bank.[57]

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[55] Gordon W. Johnson, 'Insolvency and Social Protection: Employee entitlement in the event of employer insolvency' (2006) available at <https://www.oecd.org/daf/ca/corporategovernanceprinciples/38184691.pdf> accessed on 2nd January, 2020.

[56] John Mcmullen, 'Employment: The golden goose?' (2011) 161 NLJ 1008.

[57] World Bank, 'Principles for Effective Insolvency and Creditor/Debtor Regimes' (2015) available at <http://pubdocs.worldbank.org/en/919511468425523509/ICR-Principles-Insolvency-Creditor-Debtor-Regimes-2016.pdf> accessed on 3rd January, 2020.

The European Union discusses the applicability of directives relating to protection of employee rights to seafarers.[58] The directives include Employer Insolvency, Works in Council, Information and Consultation, Collective Redundancies and Transfer of undertakings directives. The conclusion is that the directives are applicable to seafarers.

1.9.3.3 Retraining of Employees and Job Referrals

Gordorn W. Johnson highlights the striking example of the Chinese and Austria models which facilitate retraining and job referrals. He concludes that the insurance or guarantee fund requires to be supplemented with retraining, assistance in job search and public works programmes.

1.9.3.4 Employee Participation in Decision-Making

Moritz Kunz and Lingscheid Anja discuss the insolvency law in Germany.[59] The striking aspect of the German model is, unlike the South African model, insolvency does not terminate the employment contract. And like the South African model, the employees, through the work's council, participate in decision making relating to restructuring of their employer.

Brandusa Bartolemei examines the insolvency law in Romania.[60] The author mentions the Global Jobs Pact which arose out of the ILO Conference of June 2009 which provides guidelines to nations for stimulating economic recovery, creating jobs and protecting employees and their families.

Moiz Rahman calls out the decision in ***Ontario (Ministry of Labour, Employment Standards) v. Rizzo & Rizzo Shoes Ltd. (Trustee of)***[61] which exacerbated employees' plight. The Court of Appeal of Ontario held that employees are not entitled to terminal or severance pay where an employer is declared

[58] European Union, 'EU Proposal to Extend the Employee's Rights to Information and Consultation and Other Associated Social Rights to Seafarers' (2015) JIML 21(2015) 3, 227- 230.

[59] Moritz Kunz and Lingscheid Anja, *Restructuring and M and A : German Employment Law Guide*(Otto Schmidt KG, Verlag 2011) pp 105-114.

[60] Brandusa Bartolomei, 'Employee Claims in the Event of Employer Insolvency in Romania: A Comparative Review of National and International Regulations' in Cristina Mihes and Verena Schmidt (eds) (2011) available at <http://ilo.org/wcmsp5/groups/public/---europe/---ro-geneva/---sro-budapest/documents/publication/wcms_169023.pdf> accessed 3rd January, 2020.

[61] (1995), 22 O.R.(3d) 385 (C.A.).

insolvent and a receiving order is made against it. This was a very bad decision which amounted to violation of the employees' right to property.

Andrew Ellul and **Marco Pagano** acknowledge that the employee claims form a substantial part of the insolvent company's creditors.[62]

1.9.3.5 The Employee Derivative action

Neshat Safari & Martin Gelter discuss a crucial point to this research, employee derivative action, which forms the basis of the recommendations in chapter five.[63] They bring out the collapse of the British Home Stores, a family-owned business, which led to loss of eleven thousand (11,000) jobs and loss of five hundred and seventy-one million pounds (£571,000,000) in pension benefits.[64] They argue that the employees would better protect their rights to forestall corporate insolvency, misuse of company funds and misuse of pension funds if they had a right to commence court action against the directors of the company. They, therefore, advocate for a derivative action right for employees to help prevent directors from wasting the assets of the company which has the eventual effect of killing the company and causing employees to lose their jobs. They recommend, and we agree, that this derivative action should repose in the trade unions to prevent abuse of the right. This research shall recommend that a leave mechanism be inbuilt in the law so as to prevent frivolous suits.

They bring to the fore the fact that the law in most jurisdictions with the exception of South Africa, Canada and Singapore only recognise the right of shareholders to institute a derivative action on behalf of the company to protect the interests of the company. However, there may be actions of the directors which the shareholders may not be keen to prevent because they would bring more profits and

[62] Andrew Ellul and Marco Pagano, 'Corporate Leverage and Employee Rights in Bankruptcy' (2017) Centre for Economics and Finance, Italy available at< http://www.csef.it/WP/wp472.pdf> accessed on 3rd January, 2020.
[63] Refer to part 5.1.4 herein.
[64] Neshat Safari & Martin Gelter, 'British Home Stores collapse: the case for an employee derivative claim' (2019) Journal of Corporate Law Studies.

dividends. It is only employees who would be motivated to bring action that would guarantee the long-term existence of the company and they should, therefore, have the derivative action right.

1.9.3.6 Critique of the literature review on lessons from other jurisdictions

The literature review has revealed that the authors have examined the various mechanisms set by the world legal systems to protect employees' rights during the insolvency of the corporate employer. The mechanisms include establishing a guarantee or insurance fund to settle employee claims, retraining the employees who are rendered redundant and job referrals, allowing employees to participate in making decisions relating to their employer to ensure continued existence of their employer and ensuring that whenever the insolvent employer is sold off, the purchaser maintains the employment under no less favourable employment terms than the existing terms.

Other authors have argued for enhancement of employee rights by legally granting the employees the right to a derivative action. This would enable employees to sue the directors to prevent them from taking actions that are detrimental to the company. The authors argue that the existing law only bestows the derivative action right on shareholders who are unlikely to sue the directors to protect the rights of employees.

1.10Limitations

This being doctrinal research, first-hand information relating to the challenges affecting the employees of insolvent companies such as Nakumatt Limited, ARM Cement and Mumias Sugar Company Ltd could not be obtained. The Insolvency Practitioners, who are mainly Accountants in audit firms such as PKF[65] and PwC[66] declined to provide any information on the number of employees affected citing internal policies that preclude them from giving out client information or simply failed to respond.[67] We

[65] Peter Kahi of PKF in Westlands Kenya.
[66] Muniu Thoiti and George Weru of PwC Westlands Kenya.
[67] Ponangipalli Venkata Ramano Rao appointed as the administrator of Mumias Sugar Company Limited vide an order made by Justice Alfred Mabeya on 19th November, 2021 in Insolvency Petition No. E004 of 2021 Kimeto & Associates Advocates v KCB Bank Kenya Limited & 2 Others.

mitigated this limitation by obtaining information as reported by mainstream media to get a glimpse of the extent to which employees were affected.

1.11Chapter Breakdown

1. Chapter One: Introduction

   Chapter One briefly discusses and introduces what this research is about. This chapter indicates the research hypothesis that the law of Kenya does not sufficiently protect the interests of employees of insolvent corporate employers. The chapter lays out the statement of the problem and outlines the research topic and objectives. Further, the chapter reviews the relevant literature on various mechanisms of protection of employee rights.

2. Chapter Two: The theoretical Framework Relating Protection of Employee Rights in Corporate Insolvency.

   Chapter Two discusses the theories underpinning this this research namely proceduralist theory and traditionalist theory. The two theories are discussed under the auspices of the wider public interest theory that postulates that law is enacted in the interest of the public. The proceduralist theory stipulates that insolvency law should aim at collecting the assets of the company for redistribution to creditors and no more. However, the traditionalist theory stipulates that insolvency law should address the varied interests affected by the insolvency of the company among them employee interests and should not be confined to the sole economic interests of creditors. This Chapter further discusses the offshoots of the proceduralist theory including the Creditor wealth maximisation theory and the offshoot of traditionalist theory which is the communitarian vision theory.

3. Chapter Three: Legal Protection of the Rights of Employees of Insolvent Companies.

   Chapter Three examines how the existing laws of Kenya protect employee rights in corporate insolvencies. The chapter discusses administration, preferential treatment of employee claims and

guarantee fund under the existing Kenyan law as mechanisms to protect employee rights in corporate insolvency. The chapter indicates that these mechanisms have been informed by the traditionalist theory. The Chapter also sheds the light on the shortcomings and inadequacies of the existing law in so far as protection of employee rights in corporate insolvency is concerned.

4. Chapter Four: The best practices across the world in protecting the rights of employees of financially-ill companies.

   Chapter Four examines the best practices for protection of employee rights in corporate insolvency in different jurisdictions world over. The Chapter discusses the guarantee fund in Australia, the UK and Hong Kong. The chapter discusses the phenomenon of phoenixing related to guarantee funds and is predominant in Australia. Phoenixing is the phenomenon where a company folds up with the sole aim of avoiding paying employees and subsequently reemerging under a different name to carry out the same business. This chapter also examines other mechanisms of employee protection such as, employee director, employee derivative action in South Africa, Singapore and Canada, employee buyout and pre-pack.

5. Chapter Five: Recommendations and conclusion.

   Chapter Five makes recommendations on how to improve the existing laws of Kenya as discussed in Chapter 3 in light of the best practices discussed in chapter 4 towards meaningful protection of employee rights in corporate insolvency. This chapter recommends the setting up of a guarantee fund based on employer and employee contributions. The Chapter recommends that the Companies Act, 2015 be amended to provide for employee derivative action, require directors report in Annual Reports on how they have taken into account employee interests, require all boards of directors to have an employee director and incorporate pre-packs in the Kenyan legal system. The chapter then concludes the research by highlighting the summary of the five chapters.

CHAPTER TWO

2. THE HISTORY AND THEORETICAL FRAMEWORK OF INSOLVENCY LAW

2.1.Introduction

Chapter One discussed the plight of employees in corporate insolvency. Corporate insolvency has negative consequences including liquidation or killing the company, creditors losing the funds advanced, destruction of opportunities for the local community and loss of employment. The loss of employment leaves employees destitute as discussed in chapter one.[68] The development of insolvency law over time was and is intended to ameliorate the negative consequences of corporate insolvency.[69] There is debate as to the interests that insolvency law should address. This debate is evident in the theories that academics and practitioners have advanced as underpinning insolvency law. This chapter, therefore, discusses the history of insolvency law and the theories underpinning the substance of the law of insolvency being the proceduralist and traditionalist schools of thought both discussed under the public interest theory.

2.2.History of Insolvency Law and its Purposes

Corporate insolvency arises from failure to repay credit advanced to the company: when a company is unable to pay its debtors.[70] Before the advent of insolvency law, a bankrupt was considered a swindler and would be killed, tortured, enslaved[71], put in prison or subjected to corporal punishment in a bid to get him reveal hidden assets.[72] The debtor was blamed for his bankruptcy which was attributed to his pride, vanity and exaggerated market speculation.[73]

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[68] See 1.2 of Chapter 1.

[69] John Kong Shan Ho & Rohan Price, 'Moral Hazard, Insolvency and Employees as Creditors: What Governance Lessons can be Learned from the Hong Kong Model?' (2011) Journal of Corporate Law Studies p. 526.

70 Karl Gratzer, 'Default and Imprisonment for Debt in Sweden: From the Lost Chances of a Ruined Life to the Lost Capital of a Bankrupt Company' in Karl Gratzer & Dieter Stiefel (eds), 'History of Insolvency and Bankruptcy from an International Perspective'(Soderton hogskola, 2008) P. 15.

71 Ibid p.16.

72Karl Gratzer, 'Introduction' in Karl Gratzer & Dieter Stiefel (eds), 'History of Insolvency and Bankruptcy from an International Perspective'(Soderton hogskola, 2008) P. 6.

73 Ibid.

The emergence of free market economy, liberalism[74] and joint stock companies brought to the fore the existence of business cycle and changed the perspective of bankruptcy from moral failure to economic failure.[75] The present-day corporate entity developed from the sole trader and medieval associations or guilds.[76] The development of registered companies can be traced to the simple associations in the medieval times termed as *commenda* and *societas*.[77] *Commenda* involved an individual providing money to a trader so that he may share in the profits of the business depending on profits made.[78] *Commenda* offered the foundation for the present day companies. In 1711, John Blunt formed the South Sea Company which purchased state debt owed to individuals and generated much goodwill in the business leading to a bubble of investments which burst in 1720.[79] This led to stagnation in the growth of companies. However, the modern limited liability companies find their match in the companies formed pursuant to the Limited Liability Act, 1855 and the Joint Stock Companies Act, 1856.[80] The latter Act encapsulated detailed provisions on winding up. There were many registered companies in England after 1856.[81]

Business cycle involves companies going through stages of rising, optimal and declining performance. With the knowledge of business cycle, countries established insolvency law in the mid-nineteenth century with the aim of achieving fairness and equality among creditors and preventing tousled competition among creditors to execute their claims against the assets of the bankrupt.[82] Insolvency law was aimed at removing inefficient firms from the economy by selling off their assets and distributing the proceeds amongst creditors.[83]

In the UK, Mr. Kenneth Cork was appointed in 1973 to lead a committee which developed sweeping recommendations in its report published in 1973. The Report formed the basis of the modern insolvency law in the UK including the 2015 Kenya Insolvency Act.[84]

74 Supra note 63 p.17.
75 Supra note 65 p.6.
[76] J.H. Farrar & B.M. Hannigan, '*Farrar's Company Law'* (Butterworths, 4th Edn) p.15.
[77]Max Rheinstein (ed) '*Max Weber on Law in Economy and Society* (1954)' p. 148.
[78] J.H. Farrar p. 16.
[79] J.H. Farrar p.17-18.
[80] J.H. Farrar p. 20.
[81] Ibid.
82Supra note 65 p.6.
83 Ibid.
[84] Vanessa Finch, *Corporate Insolvency Law: Perspectives and Principles*, (Cambridge University Press, 2009) p.10-19.

In the 1990s, the debate about reforming insolvency law revolved around according the debtor a "fresh start" which was inspired by the 1978 American Bankruptcy Code model which advocated for rehabilitation of insolvent companies.[85] Rehabilitation was essential for incorporation of social objectives in insolvency law such as government tax, entrepreneurship and employment interests.[86]

2.2.1. History of Corporate Insolvency Law in Kenya

In Kenya corporate insolvency was governed by the Companies Act, 1962. This law was based on the English Companies Act, 1948 because Kenya was a British colony.[87] The United Kingdom reformed its insolvency law when it enacted the Insolvency Act, 1986 and revised by the Enterprise Act, 2002.[88] However, the Kenyan Companies Act, 1962 continued to constitute the law on insolvency until 2015. The Companies Act, 1962 provided for receivership and winding up or liquidation.[89]

In Kenya, insolvency law reform efforts began in the 1990s including in 1999.[90] In 2009, a taskforce was set up which developed a draft Bill that was presented in Parliament without being passed in 2010, 2012 and 2014.[91] Finally, in 2015, Kenya enacted the Insolvency Act, 2015 which introduced reforms including administration[92] and company voluntary arrangements.[93]

2.3.Theories Underpinning Insolvency Law

Employment law exists to protect the employees' rights while the purpose of insolvency law is to secure stakeholders' interests including the insolvent company, creditors, shareholders, customers, suppliers,

85 Ibid. p.7.
86 Ibid.
87 Fancy Chepkemoi Too, 'A Comparative Analysis of Corporate Insolvency Laws: Which is the Best Option for Kenya?', (A Thesis Submitted in Partial Fulfillment of the Requirements of Nottingham Trent University for the Degree of Doctor of Philosophy, September, 2015) p.87.
88 Hamiisi Juniour Nsubuga, 'The Rights of Employees on Corporate Insolvency: A UK & US Perspective', A Thesis Submitted in Partial Fulfilment of the Requirements of Nottingham Trent University for the Degree of Doctor of Philosophy, 2018) p. 5.
89 Companies Act, 1962 Part VI and VII (Repealed).
90 Fancy Chepkemoi Too, 'Drivers of Insolvency Reforms in Kenya' (Nottingham Insolvency and Business e-Journal, 2016) para. 7 & 13.
91 Note 11 p. 90.
92 Insolvency Act, 2015, Part VIII.
93 Insolvency Act, 2015, Part IX.

the community and the government.[94] Employees too are stakeholders during insolvency of a company. They are unsecured creditors. They are responsible for creation of value during the solvency of the company by offering their labour in exchange for benefits such as salaries, pension and other allowances.[95] When the company is insolvent or in financial distress, these benefits to employees are threatened or disappear and job security becomes non-existent.[96]

Employees need to be protected because salaries and wages are their only income.[97] Loss of this income jeopardizes their families which will invariably render them destitute. In any event, the employees are the engine which runs the company to generate revenue. It is this revenue which then settles other creditors' claims.

2.3.1. The Public Interest Theory

Arthur Cecil Pigou, an economist, propounded the public interest theory. The theory postulates that the purpose of the law is to enhance public interest.[98] The driving force behind most legal enactment is to ensure the general good and protect the interest of the public. It follows that the purpose of insolvency law is to protect the good of all stakeholders. In particular law is supplied to govern and protect employee rights in the interest of the public.

The question then arises: how should employees be treated in the face of the financial ill-health of the corporate employer? What action should be taken to ensure employees are not left destitute following the insolvency of a corporate employer? Divergent schools of thought and theoretical foundations exist to guide policy formulations in an attempt to address the plight of employees during the insolvency of a corporate employer. Insolvency like all law exists to protect the interest of the public. There are two

[94] Hamiisi Juniour Nsubuga, 'The Rights of Employees on Corporate Insolvency: A UK & US Perspective', A Thesis Submitted in Partial Fulfilment of the Requirements of Nottingham Trent University for the Degree of Doctor of Philosophy, 2018. Pg xx.
[95] Ibid p.1.
[96] Ibid.
[97] Roy Goode, Principles of Corporate Insolvency Law (3rd ed., 2005), p.198.
[98] Levine, Michael E., and Jennifer L. Forrence. "Regulatory Capture, Public Interest, and the Public Agenda: Toward a Synthesis." (Oxford University Press, 1990) Journal of Law, Economics, & Organization, vol. 6., pp. 167, http://www.jstor.org/stable/764987.

schools of thought which explain the purpose of the law of insolvency and thereby apply the public interest theory. These are the proceduralist or economic theory[99] and traditionalist or social theory.[100]

2.3.2. The Proceduralist School of Thought

The proceduralist school of thought opines that insolvency law should be employed as a procedure of collecting debt for the economic welfare of creditors.[101] Proceduralists opine that employment law should take care of the rights of employees and not insolvency law. This school of thought holds that the insolvency law should be concerned with collection of creditors' debt and not special treatment of some creditors like employees or other peripheral interests. The theory further holds that rehabilitation of businesses should not be main goal of insolvency law, the impact of insolvency law on investment decisions should be considered and judges should allow parties involved in the insolvency and the free-market dynamics to determine the fate of the insolvent company.[102]

2.3.2.1.Definition of Financial Health and Economic Health

For proceduralists, a firm's financial health and economic health are different concepts. The financial health refers to the ability to pay debts while economic health refers to ability to provide goods and services and generate revenues.[103] There may be much economic viability in a company which is financially distressed and there may not be need to dismember it.[104] A company is in economic distress if it is unable to generate enough revenue to cater for its costs while a company is in financial distress if it would have reported positive earnings were it not for the debt the company has.[105] A business in

[99] Fancy Chepkemoi Too, 'A Comparative Analysis of Corporate Insolvency Laws: Which is the Best Option for Kenya?', (A Thesis Submitted in Partial Fulfillment of the Requirements of Nottingham Trent University for the Degree of Doctor of Philosophy, September, 2015) p.38.
[100] Douglas G. Baird, 'Bankruptcy's Uncontested Axioms' (1998) 108 Yale L. J. pp 576-577.
[101] Note 12 p.38.
[102] Ibid pp 579-580.
[103]Douglas G. Baird, 'Bankruptcy's Uncontested Axioms' (1998) 108 Yale L. J. p 581.
[104] Barry Adler, 'A theory of Corporate Insolvency' (1997) New York University Law Review Vol. 72: 343 available at <https://www.nyulawreview.org/wp-content/uploads/2018/08/NYULawReview-72-2-Adler.pdf> accessed 20th January,2020.
[105] Adegbemi Babatunde Onakoya & Ayooluwa Eunice Olotum, 'Bankruptcy and Insolvency: An Exploration of Relevant Theories' (2017) p.708 International Journal of Economics and Financial Issues, 2017, 7(3), 706-712.

economic distress should be allowed to fail and that in financial distress may be given a second chance if the parties so wish based on and as determined by the free market economy.[106]

2.3.3. The traditionalist school of thought

The traditionalist school of thought is to the effect that insolvency law should consider and reflect all the interests impacted by the insolvency of a company. This school of thought considers bankruptcy law as a means of addressing social challenges created by business failure. The traditionalists contend that preservation of businesses should form part of the agenda of insolvency law and judges should have wide discretion to enable address the various interests represented in insolvency.[107] Liquidating and closing the business would lead to loss of jobs, loss of a customer for the suppliers and jeopardizing the economy of the local town or community.[108]

The traditional theory is in sync with the idea Ronald Coase raised that the sum effect of social arrangement in every sphere of life should be considered in resolving economic problems.[109] It is not in doubt that in choosing a system of considering interests will lead to improvement of some interests and worsening of others, however, we choose a system of action that results in more gains than losses.[110]

[106] Douglas G. Baird, 'Bankruptcy's Uncontested Axioms' (1998) 108 Yale L. J. p 582.
[107] Ibid p.579.
[108] Ibid.
[109] Ronald H. Coase, 'The Problem of Social Cost' (1960) p.43 Journal of Law and Economics, Vol. 3 (Oct., 1960), pp. 1-44
[110] Ibid p. 44.

The main proponents of procedural theory include Douglas G. Baird[111], Thomas H. Jackson[112], Alan Schwartz[113], Barry E. Adler.[114] The traditionalists include Karen Gross[115], Donald Korobkin[116], Elizabeth Warren[117], Samuel L. Bufford[118] and Harvey R. Miller.[119]

There are as many off-shoot theories of the proceduralist and traditionalist theories as there are writers, though the common thread running through the theories is what insolvency law should recognize and protect.[120] Such off-shoot theories underpinning the law of corporate insolvency include the Creditor Wealth Maximization or Creditor Bargain (CWM/CB), contractarian approach, Communitarian Vision (CV), Multiple Values (MV), Explicit Value Approach and the Risk-sharing Approach.[121]

The question, therefore, arises whether an insolvent company should be liquidated or should be preserved to protect the interest of employees, the government, suppliers, the community and creditors.[122] The theories referred to above seek to answer this question and are discussed below.

2.3.3.1.Creditor Wealth Maximization and Creditor Bargain (CWM/CB) or Procedure Theory or Contractarian Theory

[111] Douglas G. Baird, 'Bankruptcy's Uncontested Axioms' (1998) 108 Yale L. J. p 575.
[112] Thomas H. Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements and the Creditors' Bargain, (1982) 91 Yale Law Journal 857, 860; Thomas H. Jackson, 'Avoiding Powers in Bankruptcy' (1984) 36 Stan. L. Rev. 725; D. Baird & T. H. Jackson, 'Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy' (1984) 51 U Chi. L. Rev. 97.
[113] Alan Schwartz, 'A Contract Theory Approach to Business Bankruptcy' (1998) 107 Yale L. J. 1807, 1851.
[114] Barry E. Adler, 'Financial and Political Theories of American Corporate Bankruptcy' (1993) 45 Stan. L. Rev. 311; Barry E. Adler, 'Finance's Theoretical Divide and the Proper Role of Insolvency Rules' (1994) 67 S. Cal. L. Rev. 1107.
[115] Karen Gross, *Failure and Forgiveness: Rebalancing the Bankruptcy System*, (New Haven: Yale University Press, 1997).
[116] D. R Korobkin, 'Contractarianism and the Normative Foundations of Bankruptcy Law' (1993) 71 Tex. L. Rev. 554.
[117] Elizabeth Warren, 'Bankruptcy Policy' (1987) 54 U. Chi. L. Rev. 775; E Warren, 'Bankruptcy Policymaking in an Imperfect World' (1993) 92 Mich. L. Rev. 336, 387.
[118] Samuel L. Bufford, 'What Is Right About Bankruptcy Law and Wrong About Its Critics' (1994) 72 Wash. U. L. Q. 829.
[119] Harvey R. Miller, 'The Changing Face of Chapter 11: A Re-emergence of the Bankruptcy Judge as the Producer, Director, and Sometimes Star of the Reorganization Passion Play' (1995) 69 Am. Bankr. L. J. 431.
[120] Saleh Al-Barashd & Horace Yeung, 'An Assessment of Various Theoretical Approaches to Bankruptcy Law' (2016) p. 25 Sultan Qaboos University, Journal of Arts and Social Sciences
[121] Ruzita Azmi & Adilah Razak, *The Theories Underpinning Corporate Insolvency Law: An Analysis* (Mcgraw Hill Kuala Lumpur, 2012) p.6 available at <https://www.researchgate.net/publication/312091906_THE_THEORIES_UNDERPINNING_CORPORATE_INSOLVENCY_LAW_AN_ANALYSIS> accessed 20th January,2020.
[122] Saleh Al-Barashd & Horace Yeung, 'An Assessment of Various Theoretical Approaches to Bankruptcy Law' (2016) p. 25 Sultan Qaboos University, Journal of Arts and Social Sciences.

This is the earliest theory which underpins insolvency law.[123] Professor Thomas H. Jackson, a law professor at Stanford University propounded this theory in his 1982 article '*Bankruptcy, Non-bankruptcy Entitlements, Creditors' Bargain*'.[124] Douglas Baird supported this theory[125] in his article *Bankruptcy's Uncontested Axioms* (1998).[126]

This theory recognizes that the law of insolvency should seek to protect both creditors' interests of the and debtor's interests.[127] However, if the debtor is a corporate entity, its interests are not to be considered because its shareholders are entitled to share in the assets of the insolvent company in the event of liquidation.[128] However, the law protects the interests of the individual business debtor.[129]

This theory borrows from John Rawl's theory of justice.[130] It postulates that if creditors came together, before they advanced credit to the company (*ex ante*), to bargain,[131] "in the original position" or "under a veil of ignorance" as to what should be their cause of action in the course of insolvency of the company: they would have a hypothetical agreement[132] on the collective system of debt recovery and not each individual employing their might and resources to cart away as much from the estate of the insolvent company as possible. To prevent the chaos which would certainly ensue, they agree to come together, collect and realize the assets of the company for distribution of the proceeds among themselves

[123] Ruzita Azmi & Adilah Razak, *The Theories Underpinning Corporate Insolvency Law: An Analysis* (Mcgraw Hill Kuala Lumpur, 2012) p.6 available at <https://www.researchgate.net/publication/312091906_THE_THEORIES_UNDERPINNING_CORPORATE_INSOLVENCY_LAW_AN_ANALYSIS> accessed 20th January,2020.
[124] Charles W. Mooney, Jr., 'A Normative Theory of Bankruptcy Law: Bankruptcy As (Is) Civil Procedure' (2004) p.948 Washington and Lee Law Review, Volume 61 Issue 63 Article 2.
[125] Ibid.
[126] Charles W. Mooney, Jr., 'A Normative Theory of Bankruptcy Law: Bankruptcy As (Is) Civil Procedure' (2004) p.944-945 Washington and Lee Law Review, Volume 61 Issue 63 Article 2.
[127] Charles W. Mooney, Jr., 'A Normative Theory of Bankruptcy Law: Bankruptcy As (Is) Civil Procedure' (2004) p.943 Washington and Lee Law Review, Volume 61 Issue 63 Article 2.
[128] Ibid.
[129] Ibid p. 944.
[130] Brian Bix, *Jurisprudence Theory and Context* (6th edn, Sweet & Maxwell 2012) pp 112-113.
[131] Thomas H. Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements and the Creditors' Bargain, (1982) p.860-867 91 Yale Law Journal 857-907
[132] Saleh Al-Barashd & Horace Yeung, 'An Assessment of Various Theoretical Approaches to Bankruptcy Law' (2016) p. 26 Sultan Qaboos University, Journal of Arts and Social Sciences

pari passu and *pro rata*.[133] The creditors are therefore bound to act altruistically under this contractarian approach.

This theory postulates that the purpose of insolvency law is to maximize the payments to creditors as a group and alleviate the problem of the "common pool" of assets.[134] The "common pool problem" is resolved through staying the legal action of execution by the creditors. The Kenyan law provides for stay of commencing or continuing legal action against the company once an insolvency petition has been filed.[135]

It further, asserts that the insolvency law should not be concerned with rehabilitation, restructuring or reorganization of an insolvent company unless such action would maximize the payments to creditors.[136] The law should leave the decision to liquidate or reorganize with the creditors.[137] This is because they stand to lose or gain. The law should resort to a market solution and neither a judicial solution nor should it be left to the company's or directors' decision because they have nothing to lose.[138]

According to this theory, insolvency law should respect the rights of creditors which exist before the insolvency of the company.[139] The theory vehemently opposes the prioritisation of any creditors or the consideration of the interests of other persons except the creditors. Insolvency law should not redistribute the assets of the company to employees or serve other social goals such as sustaining government taxes, wealth maximization in the community and preservation of jobs to the detriment of creditors.[140] The enforcement of social goals should be achieved through other laws such as employment law. Redistribution of the insolvent's assets amounts to stealing from one creditor and giving another

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[133] Charles W. Mooney, Jr., 'A Normative Theory of Bankruptcy Law: Bankruptcy As (Is) Civil Procedure' (2004) p.937 Washington and Lee Law Review, Volume 61 Issue 63 Article 2.
[134] Ruzita Azmi & Adilah Razak, *The Theories Underpinning Corporate Insolvency Law: An Analysis* (Mcgraw Hill Kuala Lumpur, 2012) p.6 available at <https://www.researchgate.net/publication/312091906_THE_THEORIES_UNDERPINNING_CORPORATE_INSOLVENCY_LAW_AN_ANALYSIS> accessed 20th January,2020.
[135] Insolvency Act, 2015, s. 428.
[136] Ibid.
[137] Charles W. Mooney, Jr., 'A Normative Theory of Bankruptcy Law: Bankruptcy As (Is) Civil Procedure' (2004) p.947 Washington and Lee Law Review, Volume 61 Issue 63 Article 2.
[138] Ibid
[139] Ibid.
[140] Ibid p50-951.

and rendering their pre-insolvency rights ineffective.[141] Reorganizing businesses would force creditors to keep their moneys in the insolvent company instead of investing elsewhere.

2.3.3.1.1. Strength of the Theory

This theory considers the law of insolvency as a compulsory debt collection subset of civil procedure[142] which facilitates orderly collection, realization of the insolvent company's assets for distribution to the creditors.[143] The compulsory debt recovery system of debt reduces the cost of debt collection and eliminates the "first-in-time, first-in-priority" rule and the "race-to-collect" or "race-to-the-court-house" by the creditors.[144]

The collective system increases the creditors' return. This is because the assets sold together as a bunch are more valuable than when sold singularly by the individual creditors.[145] Further, the individual creditors will not expend resources overseeing the estate of the debtors with the aim of being the first to collect the assets in the event of insolvency.[146]

2.3.3.1.2. Criticisms of the theory

The concept of creditors entering into a contract for collective system of debt recovery is far-fetched. [147] The creditors in the real world have diverse powers. Creditors differ in their leverage, knowledge, skills and tact of obtaining judgment and execution against debtor's assets. Powerful creditors are unlikely to agree to the collective system of enforcement of their rights. The powerful creditors are unlikely to give up their rights to weak creditors unless they are properly compensated.[148]

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[141] Hamiisi Junior Nsubuga, Corporate Insolvency and Employment Protection: A Theoretical Perspective (2016) p. 22 available at <https://www4.ntu.ac.uk/nls/document_uploads/191390.pdf>accessed on 15th March, 2020.

[142] Charles W. Mooney, Jr., 'A Normative Theory of Bankruptcy Law: Bankruptcy As (Is) Civil Procedure' (2004) p.948 Washington and Lee Law Review, Volume 61 Issue 63 Article 2.
[143] Ibid.
[144] Ibid.
[145] Saleh Al-Barashd & Horace Yeung, 'An Assessment of Various Theoretical Approaches to Bankruptcy Law' (2016) p. 27 Sultan Qaboos University, Journal of Arts and Social Sciences.
[146] Ibid p.27.
[147] Ibid p. 27-28.
[148] Ibid.

The argument that costs of executions would cause creditors to agree to a collective system of debt recovery has little weight. Creditors understand that any benefit must come at a cost. They would, therefore, not fear the costs of racing to obtain a gain from the insolvent company's assets.[149]

The emphasis on the interest of creditors misses the point. Focusing on maximizing the returns of creditors should not be the only aim of insolvency law. Creditors can be protected in other ways such as rehabilitation of the company which will also protect other stakeholders. The effort to rescue a company could turn around the fortunes of the company after turning it into a going concern.[150] The worth of a company as a going concern is more than it would have been during liquidation. The creditors would receive better returns than they would have, were the company to be liquidated.[151] They could even receive the full repayment of their debt.

The interests of other stakeholders should be considered. This theory has no regard for the effects that corporate collapse has on persons who are not creditors. Employees will lose jobs and the community will suffer as a result of corporate failure. Employees will lose their jobs or salaries for no other reason than insolvency. The protection of the wider interests affected by the insolvency of a corporate entity falls within the ambit of the law of insolvency. The priority rule makes no sense except in insolvency.[152]

This theory does not address our concern for the plight of employees in corporate insolvency. This theory disdains the idea that insolvency should be concerned with protecting employee rights in corporate insolvency. It emphasizes on maximizing the creditors wealth to the exclusion of employees. This runs afoul of the purpose of this research which seeks to recommend ways in which the insolvency law can be reformed to better protects the rights of employees in corporate insolvency. Nevertheless, the law already has provisions aimed at protecting employees in insolvency.

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[149] Ibid.

[150] Ruzita Azmi & Adilah Razak, *The Theories Underpinning Corporate Insolvency Law: An Analysis* (Mcgraw Hill Kuala Lumpur, 2012) p.12 available at <https://www.researchgate.net/publication/312091906_THE_THEORIES_UNDERPINNING_CORPORATE_INSOLVENCY_LAW_AN_ANALYSIS> accessed 20th January,2020.

[151] Saleh Al-Barashd & Horace Yeung, 'An Assessment of Various Theoretical Approaches to Bankruptcy Law' (2016) p. 27 Sultan Qaboos University, Journal of Arts and Social Sciences.

[152] Ibid.

The Kenyan law provides for preferential treatment of some creditors.[153] The liquidator in respect of costs incurred in liquidation, the employees in respect of their claims and the Kenya Revenue Authority which collects taxes are preferential creditors. The law also provides for corporate rescue in the form of administration and voluntary arrangements.

2.3.3.2.Communitarian Theory

This theory seeks to balance the wider variety of constituent welfare of the stakeholders of the insolvent company and not just the concerns of creditors.[154] Unlike the creditor's bargain theory, this theory postulates that insolvency law should consider all interests impacted by the insolvency of the company. The insolvency law should address the welfare of employees, suppliers, customers, the interests of the government and the community within which the insolvent company carries on its business.[155] Insolvency law should consider the public interest which are interests the society regards as important and which transcend the interests of the direct parties involved in the insolvency.[156]

This theory advocates for an insolvency law which considers the interest of the community at large and, therefore, favours corporate survival or rescue, reorganization, rehabilitation or restructuring of an insolvent company. It also favours the liquidation of failed companies which are irredeemable and economically unviable.[157]

The Kenyan law provides for administration[158] and voluntary arrangements[159] as a means of corporate rescue. Liquidation is also available for companies which are not economically viable.[160]

[153] Insolvency Act, 2015, Second Schedule.
[154] Ibid p. 28
[155] Ibid.
[156] Ibid.
[157] Ibid.
[158] Insolvency Act, 2015, Part VIII.
[159] Insolvency Act, 2015, Part IX.
[160] Insolvency Act, 2015, Part VI.

This theory considers individuals in a society as interdependent who should act in the best interest of their communities regardless that doing so would jeopardise their individual rights.[161] The insolvency law should rehabilitate companies where possible for the greater interest of the community such as taxes for the government, wealth creation for the community resulting from increased economic activity, new jobs and higher wages for employees[162], preservation of jobs even if it is at the expense of others.[163] This theory advocates for change of pre-insolvency rights.[164]

2.3.3.2.1. Criticisms

There are many interests to be protected and choosing among them for protection by the law can generate a lot of disagreement.[165] The theory cannot demarcate the clear boundaries of the interests to be protected some of which are very remote.[166] It is difficult to define the community affected by the insolvency of the company, thereby making the law inconclusive.[167] Within any geographical area, there may be many persons affected by the insolvency of the corporate entity ranging from the employees to a distant supplier claiming a remote loss due to the failure of the company.[168]

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[161] Ruzita Azmi & Adilah Razak, *The Theories Underpinning Corporate Insolvency Law: An Analysis* (Mcgraw Hill Kuala Lumpur, 2012) p.8 available at <https://www.researchgate.net/publication/312091906_THE_THEORIES_UNDERPINNING_CORPORATE_INSOLVENCY_LAW_AN_ANALYSIS> accessed 20th January,2020.

[162] Charles W. Mooney, Jr., 'A Normative Theory of Bankruptcy Law: Bankruptcy As (Is) Civil Procedure' (2004) p.950 Washington and Lee Law Review, Volume 61 Issue 63 Article 2.

[163] Ruzita Azmi & Adilah Razak, *The Theories Underpinning Corporate Insolvency Law: An Analysis* (Mcgraw Hill Kuala Lumpur, 2012) p.8 available at <https://www.researchgate.net/publication/312091906_THE_THEORIES_UNDERPINNING_CORPORATE_INSOLVENCY_LAW_AN_ANALYSIS> accessed 20th January,2020.

[164] Ibid.

[165] Saleh Al-Barashd & Horace Yeung, 'An Assessment of Various Theoretical Approaches to Bankruptcy Law' (2016) p. 29 Sultan Qaboos University, Journal of Arts and Social Sciences.

[166] Ruzita Azmi & Adilah Razak, *The Theories Underpinning Corporate Insolvency Law: An Analysis* (Mcgraw Hill Kuala Lumpur, 2012) p.12 available at <https://www.researchgate.net/publication/312091906_THE_THEORIES_UNDERPINNING_CORPORATE_INSOLVENCY_LAW_AN_ANALYSIS> accessed 20th January,2020.

[166] Saleh Al-Barashd & Horace Yeung, 'An Assessment of Various Theoretical Approaches to Bankruptcy Law' (2016) p. 29 Sultan Qaboos University, Journal of Arts and Social Sciences.

[167] Ruzita Azmi & Adilah Razak, *The Theories Underpinning Corporate Insolvency Law: An Analysis* (Mcgraw Hill Kuala Lumpur, 2012) p.12 available at <https://www.researchgate.net/publication/312091906_THE_THEORIES_UNDERPINNING_CORPORATE_INSOLVENCY_LAW_AN_ANALYSIS> accessed 20th January,2020.

[168] Saleh Al-Barashd & Horace Yeung, 'An Assessment of Various Theoretical Approaches to Bankruptcy Law' (2016) p. 29 Sultan Qaboos University, Journal of Arts and Social Sciences.

Further, there are so many community interests which then results in conflict of the interests to be protected.[169] It has been argued that the courts could balance between the interests and determine that which is to be protected. The Critics further argue that the insolvency court is not best placed to determine what is community interest. The communitarians, in response, argue that the courts, in all situations, decide on matters public interest and insolvency law is no exception.[170]

Despite the criticisms, this is the theory that is in line with the purposes of this research. This theory supports our concern for the plight of employees in corporate insolvency. We agree with the postulations of this theory that insolvency law should address the interest of other stakeholders in corporate insolvency including employees beyond the interests of creditors.

2.3.3.3.Multiple Values Theory

This theory was propounded by Warren and Korobkin in their articles of 1987 and 1991 respectively.[171] They are American Scholars. The theory states that insolvency raises various observable, practical, empirical, normative and standard concerns or challenges in the society which cannot be reduced to theoretical consideration of the interests of a single group or theoretical construct or concept.[172] The theory postulates that insolvency law should address the insolvency of a company in such a way that all the affected persons obtain optimum value.[173] The law should address the social, political, moral and personal dimensions of the insolvency which the economic consideration of creditor wealth maximization fails to.[174] The insolvency law should seek to address the multiple and complex web of values and affected interests.[175] Warren argued that insolvency law should redistribute wealth of the

[169] Ibid.
[170] Ibid.
[171] Ruzita Azmi & Adilah Razak, *The Theories Underpinning Corporate Insolvency Law: An Analysis* (Mcgraw Hill Kuala Lumpur, 2012) p.8 available at <https://www.researchgate.net/publication/312091906_THE_THEORIES_UNDERPINNING_CORPORATE_INSOLVENCY_LAW_AN_ANALYSIS> accessed 20th January,2020
[172] Ibid.
[173] Adegbemi Babatunde Onakoya & Ayooluwa Eunice Olotum, 'Bankruptcy and Insolvency: An Exploration of Relevant Theories' (2017) p.709 International Journal of Economics and Financial Issues, 2017, 7(3), 706-712.
[174] Ibid.
[175] Saleh Al-Barashd & Horace Yeung, 'An Assessment of Various Theoretical Approaches to Bankruptcy Law' (2016) p. 29 Sultan Qaboos University, Journal of Arts and Social Sciences.

insolvent company in such a way that the class that is least able to bear the cost of the corporate failure is favoured.[176]

This theory suffers the same criticisms as the communitarian theory.

This theory too serves the purposes of this research and shares our concern for the challenges employees face in corporate insolvency. The view that the law should consider various values including social dimensions of insolvency is attractive to us. One of the social dimensions is the impact of insolvency on employee interests. Once the design of the law considers the welfare of employees in corporate in insolvency, then our concern is addressed.

2.3.3.4.Explicit Value Approach

This theory was advanced by Finch. The theory makes reference to values enjoying broad acceptance as legitimating insolvency law.[177] Insolvency law should be a legitimate law which takes into account public and private interests. Insolvency affects public rights because the decision to liquidate or reorganize an insolvent company will have an impact on revenues which affects the public.[178] The stay on taking legal action against an insolvent company has an impact on private rights.[179] She argued that the legitimacy of the insolvency law and process is based on four specific values or benchmarks of efficiency, expertise, accountability and fairness.[180] These are discussed below.

"Efficiency" aims to achieve the democratic purposes at the least cost. "Expertise" involves entrusting decision and policy making power to persons with the requisite competence. "Accountability" refers to subjecting all those participating in the insolvency to the control of courts or conducting the process in

[176] Ibid, p.30.
[177] Ibid, p.31.
[178] Ruzita Azmi & Adilah Razak, *The Theories Underpinning Corporate Insolvency Law: An Analysis* (Mcgraw Hill Kuala Lumpur, 2012) p.8 available at <https://www.researchgate.net/publication/312091906_THE_THEORIES_UNDERPINNING_CORPORATE_INSOLVENCY_LAW_AN_ANALYSIS> accessed 20th January,2020.
[179] Ibid.
[180] Saleh Al-Barashd & Horace Yeung, 'An Assessment of Various Theoretical Approaches to Bankruptcy Law' (2016) p. 31 Sultan Qaboos University, Journal of Arts and Social Sciences.

an open manner. “Fairness” refers to dispensing justice and respecting the interests of the participants in the insolvency process.[181]

She further argues that decision makers and judges should consider the four benchmarks and not rely on just a single theory of insolvency.[182] She incorporates both the creditor bargain theory and communitarian theory. She argues that choice between different values or interests can be resolved by reference to the substantive vision of a just society and just distribution of rights.

Unlike the communitarian theory and multiple values theory, her theory is circumscribed and indicates the demarcations. This is because it provides four benchmarks which are to be considered, that is, efficiency, expertise, accountability and fairness. Communitarian theory and multiple values do not provide the limits of the interests and values do not be considered.[183]

2.3.3.4.1. Criticisms

This theory has been criticized because it fails to differentiate the varied nature of the benchmarks. There are no principles governing these benchmarks nor are there factors which distinguishing them.

Mokal states that the theory fails to bring out the substantive aims of insolvency by dwelling on the procedural aims. The theory fails to distinguish between the aims of the law and the methods employed in achieving those aims.

Further, it is not easy to balance between the objectives of insolvency and the various conflicting interests. Different societies will value different things. One society will place more value on rehabilitating a company while another one will place more value on repaying creditors.[184]

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[181] Ibid.
[182] Ibid.
[183] Ibid.
[184] Ruzita Azmi & Adilah Razak, *The Theories Underpinning Corporate Insolvency Law: An Analysis* (Mcgraw Hill Kuala Lumpur, 2012) p.13 available at <https://www.researchgate.net/publication/312091906_THE_THEORIES_UNDERPINNING_CORPORATE_INSOLVENCY_LAW_AN_ANALYSIS> accessed 20th January,2020.

The explicit values approach has one of the approaches as fairness. Fairness ensures that justice is done to all the interest groups in insolvency. This means that the interests of employees will be considered thus addressing the concerns of this research.

2.4.Conclusion

Insolvency law, like any other law is based on a theoretical foundations or schools of legal thought. The question is whether in insolvency, should the law be concerned with maximizing the creditors wealth from the sale of the insolvent's assets only or should the interests of other stakeholders including employees of the insolvent company be considered in reaching the decision concerning the fate of the insolvent? The proceduralist school of thought and the traditionalist school of thought have informed the design of the of insolvency law world over in answer to the foregoing questions. The procedural theory is responsible for the collective recovery of debts on behalf of the creditors. This theory advocates for maximization of creditor wealth and shows no concern for other stakeholders including the destitute employees of an insolvent corporate employer. The traditional theory forms the foundation of designing the law in such a way that the challenges of employees of an insolvent corporate employer are addressed by insolvency law. The law reforms that introduced corporate rescue, voluntary arrangements, priority treatment of employee entitlements discussed in chapter 3 are credited to the traditional theory.

CHAPTER THREE

3. LEGAL PROTECTION OF EMPLOYEE RIGHTS IN CORPORATE INSOLVENCY.

3.1. Introduction

Kenya has made legal strides towards protecting employee rights in the face of insolvency of a corporate employer. The legal framework extant in Kenya is informed by the theories discussed in chapter two. This chapter seeks to discuss the means by which the extant legal framework protects rights of employees of insolvent companies and establish whether such employees are adequately protected. By way of example, the right to social security is a constitutional edict.[185] Further strides manifest themselves through the Insolvency Act, 2015, the Employment Act, 2007 and the Companies Act, 2015. Whether these strides are sufficient in achieving the desired objective, is the question that this paper seeks to unravel. It would suffice to state, at this point, that significant effort has gone into protecting employee entitlement in corporate insolvency, but there is more that can be done.

There are myriad ways in which the law protects the interests of employees including prioritising employee claims, payment of a guaranteed part of their entitlements upon liquidation and encouragement of corporate reorganisation through administration and lifting the corporate veil to make directors personally liable.[186] It cannot be lost that prioritizing employee claims is not a sufficient protection because the assets ordinarily fall short of the employee entitlements and debts due to secured creditors.[187] The existing Kenyan law is informed by the international law, whether soft or hard, on employment and insolvency. We will consider the Kenyan substantive law, then consider the international law which Kenya has not ratified.

3.2. The National Legal Regime

[185] The Constitution of Kenya, 2010, Art. 43(1).
[186] Helen Anderson, 'Theory and Insolvency Law: Some Contradictions in Australia' (2009) Company and Securities Law Journal, 27(8), 506 – 523 available at <http://www.clta.edu.au/professional/papers/conference2009/AndersonCLTA09.pdf> accessed on 1st March, 2009.
[187] Mohammed Al Bhadily & Peter Hosie, 'Australian Employee Entitlements in the Event of Insolvency: Is an Insurance Scheme an effective Protective Measure?' (2016) pg. 1-2

3.2.2. The Constitution of Kenya, 2010

The right of employees to fair labour practices is a constitutional right.[188] The right of employees to fair practices provides the basis for treating employees as special creditors entitled to preferential treatment and attention in corporate insolvency.[189] The right to dignity[190] is crucial to ensure that employees do not live desperate lives by having a means of livelihood. Further the right to information[191] may be crucial for them to exercise their rights under labour law. The right to social security[192] is important to ensure that their pension and employment benefits are safeguarded. The constitution, through the robust bill of rights, is, therefore, the basis of all laws in Kenya which seek to protect employee rights in corporate insolvency.

3.2.3. Director Consideration of the Best Interests of Employees

Traditionally, the common law required directors to consider the best interest of shareholders in their actions.[193] This ignored other stakeholder interests. A director would only be expected to consider economic, social and environmental impact of their decisions if such consideration were best interest of the shareholders in the long-term.[194] In ***Hutton v West Cork Railway***[195] the directors of a company being dissolved chose to pay gratuities to employees, the court pronounced itself that the gratuities were not for the benefit of the shareholders. Bowen LJ further observed that for any conferred benefits to be legal, they have to benefit the company as well.

[188] The Constitution of Kenya, 2010, Art. 41(1).
[189] Tapiwa Givemore Kasuso & Kudakwashe Sithole, 'Protection of the Rights of Employees in Insolvency Law: A Zimbabwean Perspective' (SOAS University of London, 2020) Journal of African Law, 65, 1(2021) pp 54-55.
[190] The Constitution of Kenya, 2010, Art. 28.
[191] The Constitution of Kenya, 2010, Art. 35(1).
[192] The Constitution of Kenya, 2010, Art. 43(1)(e).
[193] Minal Ramnath & Vincent Nmehielle, 'Interpreting Directors' Fiduciary Duty to Act in the Company's Best Interest through the Prism of the Bill of Rights: Taking other Stakeholders into Consideration. ' (Dentons) p.98.
[194] Ibid.
[195] Hutton v West Cork Railway supra note 4 at 673

Recently, the "pluralist theory" and the "enlightened shareholder value theory" have emerged to spearhead the consideration of stakeholder interests.[196] The pluralist theory advocates for the balancing of the many groups of interests without giving special preference to shareholders. The enlightened shareholder value theory opines that the welfare of various stakeholders should be considered in decision making with the long-term benefit to shareholders in mind.[197]

In ***Teck Corp Ltd v Millar***[198] Berger J stated that directors of a company would be acting in the best interest of the company if they considered the welfare of employees.

The law of Kenya requires directors to have regard to the best interest of all stakeholders including employees and not just the shareholders.[199] This is referred to as the "enlightened shareholder value".[200] The Companies Act requires a director to act in ways which in their considered view would bring about the success of the company thus promoting the interest of shareholders and at the same time considering the welfare of employees.[201] In ***Re Welfab Engineers Ltd***[202] the directors of a financially distressed company sold it to allow the company continue in business and save jobs. The court observed that the directors' consideration of employees' interests was proper.

This requirement of taking into account employee interests can be traced to Margaret Thatcher Labour Government which enacted section 46 the UK Companies Act, 1982.[203] It is now part of the UK law.[204]

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[196] Supra Note 3 p. 106.
[197] Bakhulule Nomadwayi, 'The Directors Fiduciary Duty to Act in the Best Interests of the Company: The Possible Development of Common Law by Statute and How they Affect Human Rights' (Thesis Submitted in Fulfilment of the Requirements for Master of Laws Degree, University of Kwazulu-Natal, 2018) p. 24. Available at <https://researchspace.ukzn.ac.za/bitstream/handle/10413/16140/Nomadwayi_Bakhulule_2018.pdf?sequence=1&isAllowed=y> accessed on 25th June, 2021.
[198] Teck Corp Ltd v Millar (1972) 33 DLR (3d) 288 (BCSC) at 313-4
[199] The Companies Act, 2015 s 143(b) and the Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015 para 1.1.4.
[200] Neshat Safari & Martin Gelter, 'British Home Stores collapse: the case for an employee derivative claim' (2019) Journal of Corporate Law Studies.
[201] Companies Act, 2015, s 143(b).
[202] [1990] BCC 600.
[203] Neshat Safari & Martin Gelter, 'British Home Stores collapse: the case for an employee derivative claim' (2019) Journal of Corporate Law Studies p. 50.
[204] UK Companies Act, 2006, s 176.

The requirement to consider the interests of employees is a normative concept requiring directors not to take action that will cause insolvency of the company and subsequent loss of employment. However, the section does not have clear words to specifically prescribe for directors how and when to consider employee interests.[205] The UK government now requires large private and public companies to explain how their directors have had regard to the interests of employees.[206]This can be done by designating a non-executive director, employee representative on the board and appointing employee advisory council to promote the interests of employees.[207]

Despite section 143 of the Companies Act and paragraph 1.1.4 of the Corporate Governance Code requiring directors to consider employees' interests in their decisions, it does not go further to state how the directors are to consider employees' interests in their decisions. In chapter five, we have recommended, how the Companies Act should ensure that the employee rights are meaningfully and effectively protected.[208]

3.2.4. Kenya Deposit Insurance Corporation Act, 2012

This Act provides the legal framework for the management of insolvent banks and microfinance institutions. Banks and microfinance institutions are governed by a special regime of insolvency because banks depend on public confidence without which customers will run the bank leading to withdrawal of deposits.[209] The banks are crucial in maintaining financial stability and preventing systemic risk in an economy. Further, banks' solvency is determined by the financial services supervisor who will then take rapid action to safeguard customer deposits.[210] The Insolvency Act, 2015 does not govern the management of insolvent banks and microfinance institutions.

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[205] Ibid p. 52.
[206] Ibid p. 54.
[207] Ibid 54-58.
[208] Refer to part 5.1.5 herein.
[209] Eva Hupkes, 'Insolvency-Why a Special Regime for Banks?'(International Monetary Fund, 2003) p 9-10 available at <https://www.imf.org/external/np/leg/sem/2002/cdmfl/eng/hupkes.pdf> last accessed 6th July, 2021.
[210] Ibid p. 12.

The Act provides for priority payment of employee entitlement including claims arising from injuries at the work place.[211] In addition, in exclusion and transfer, staff wages rank after insured deposits.[212]

This Act does not sufficiently protect the interests of employees who work for banking institution. In times of acquisition of an ailing bank, there is no obligation on the Competition Authority of Kenya (CAK) or Central Bank of Kenya (CBK) to require retention of its employees by the acquiring entity. Further, in most cases, the deposits would be large sums of money rendering the employees' second preferential status otiose.

3.2.5. The Insolvency Act, 2015

This Act came into full operation vide Legal Notice No. 119/2016 dated 27th June, 2015. The Act provides for a number of mechanisms aimed at protecting employees' rights in the event of a corporate employer's insolvency. The scheme of the Act aimed at achieving this objective is corporate reorganization and preferential treatment of employee rights.

3.2.5.1. Corporate Reorganisation

Corporate reorganization involves readjusting the debts and assets of the business with a view of continuing with business operations.[213] Corporate reorganization entails administration[214] or company voluntary arrangements.[215] It serves the purpose of rescuing a company that is poised for failure thus giving it a new lease of life. Professor Douglas G. Baird argues that corporate rescue should not be the aim of insolvency law. He argues that if a restaurant collapses, workers will find jobs elsewhere and the restaurant would be replaced by a better performing restaurant. Maintaining the ailing restaurant delays

[211] Kenya Deposit Insurance Corporation Act, 2012 s.57.
[212] Ibid s.50(9).
[213] Linda J Rusch, 'Bankruptcy Reorganisation Jurisprudence: Matters of Belief, Faith and Hope- Stepping into the Fourth Dimension' (1994) Montana Law Review Volume 55 Issue 1 P.13.
[214] Insolvency Act, 2015 s. 521.
[215] Insolvency Act, 2015, Part IX.

the movement of employees to excellent restaurants.[216] Corporate reorganization deprives holders of floating charges from realizing their security.[217] Professor Elizabeth Warren opines that corporate reorganization enhances the insolvent companies value[218] and saves jobs.[219]

3.2.5.2. Administration

In Kenya, corporate insolvency has been commonplace due to poor corporate governance and financial embezzlement. In the early 1990s, a Receiver Manager was appointed in respect of Kisumu Cotton Mills and Karuturi Limited, one of Kenya's largest flower farms, and Kenya National Assurance Company Limited are some of the companies which were liquidated whose aftermath was a bitter taste in the nation's mouth. A host of employees lost their jobs and livelihoods, business opportunities in the cotton and flower industries died leaving a big blow to the economy.[220]

Liquidation or winding up, compromise with creditors and mergers or amalgamations[221] were the only available option under the prevailing law before 2015 which is now repealed.[222] Any company which was unable to settle its debts would automatically be set for winding up or put under receivership for the purpose of collecting its assets and realizing them for distribution to creditors. The situation has since changed with the enactment of the Insolvency Act, 2015. There is a departure from the past Kenyan legal position where financially distressed companies would only be wound up.[223] Insolvent companies now have the option of administration.

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[216] Douglas G. Baird, 'Bankruptcy's Uncontested Axioms' (1998) 108 Yale L. J. pp 576-577.
[217] James W. Bowers, Rehabilitation, Redistribution or Dissipation: The Evidence for Choosing Among Bankruptcy Hypotheses, 72 Wash. U. L. Q. 955 (1994),p. 962
[218] E Warren, 'Bankruptcy Policymaking in an Imperfect World' (1993) 92 Mich. L. Rev. 350.
[219] Ibid, p. 357, 367.
[220] '9 Companies Put Under Management as Economy Struggles' (*Soko Directory*, 28 November 2018) <https://sokodirectory.com/2018/11/9-companies-put-under-management-as-economy-struggles/> accessed 24 March 2019.
[221] In re Nakumatt Holding Limited [2017] eKLR para 31.
[222] Companies Act, Cap 486 of the Laws of Kenya, Part VI (Repealed).
[223] Daly & Inamdar, 'Overview of Kenyan Insolvency Law' (2019) available at <http://www.dalyinamdar.com/overview-of-kenyan-insolvency-law/> accessed on 13th March, 2020.
[223] Insolvency Act, 2015 s 6 & 7.

Administration refers to a process of running a financially distressed, but viable, corporate entity with the aim of steering it to profitability, maintaining it as a going concern, achieving a better result for the creditors and selling the company's property and sharing the proceeds among secured or preferential creditors.[224] Administration aims at giving the corporate employer a second chance. It seeks to achieve the economic and social objective of rescuing employees to save their jobs.[225]

The 2015 Insolvency Act, unlike the repealed Companies Act, seeks to resuscitate viable insolvent corporate entities by way of administration instead of liquidating such a company. The idea of corporate rescue, or corporate reorganization through administration is a positive development providing an alternative to the immediate liquidation of the corporate entity, with the salutary consequence of preventing the demise of a company.[226] Corporate rescue the restores a company in financial difficulty to enable it continue operations after reorganization.

In Kenya, administration was attempted when Justice Fred Ochieng made an order for administration of Nakumatt Holdings Limited ("Nakumatt") and appointed Peter Obondo Kahi of PKF Kenya as its administrator on 22nd January, 2018.[227] The administration of Nakumatt did not, however, succeed because 141 out 169 creditors voted to liquidate the company.[228] Justice J.L. Onguto had on 16th November, 2017 declined to make an order for administration because the company did not provide information to creditors to enable them respond to the application.[229]

In ***In re Hi-Plast Ltd***[230] Muigai J allowed the appointment of the administrator following the company's application for an order of administration. The Company was unable to settle its debts following the

[224] See the objectives of administration. Insolvency Act, 2015 s. 522.
[225] In re Nakumatt Holdings Limited [2017] eKLR Para 58.
[226] Bo Xie, *Corporate Rescue – the New Orientation of Insolvency Law* (Edward Elgar Publishing 2016) <https://www.elgaronline.com/view/9781781007372/09_chapter1.xhtml> accessed 24 March 2021.
[227] Primrose Management Limited & 3 others v Nakumatt Holdings Limited & another [2018] eKLR, Insolvency Cause No. 10 of 2017.
[228] Lewis Njoka, 'End of Era for Nakumatt as creditors dissolve giant retailer' (PD Online, 8th January, 2020) available at <https://www.pd.co.ke/business/economy-and-policy/end-of-an-era-for-nakumatt-as-creditors-dissolve-giant-retailer-19144/> accessed on 13th March, 2020.
[229] In re Nakumat Holdings Limited [2017] eKLR, Insolvency Cause No. 10 & 13 of 2017 (Consolidated). The Judge at paragraph 72 recommends that there should be bare minimum information to be given by a company seeking administration like the Statement of Insolvency practice in the UK.
[230] In re Hi-Plast Ltd (2019) eKLR Insolvency Petition E009 of 2019 & Insolvency Petition No. 19 of 2017.

Government of Kenya's ban on plastics. The Judge was convinced that the proposal to use environmentally friendly raw materials would maintain the company in business and protect every party's rights including employees.

Once appointed, the management of the affairs and property of the insolvent entity vests in the administrator.[231] Under the Act, an administrator could be appointed by the court, the holder of a floating charge relating to the whole or part of a company's property. The company or its directors may also appoint an administrator.

In determining whether to issue an administration order the court will be guided by several factors. First, the Court will consider whether the company is unable to settle its debts.[232] Secondly, the court considers whether the administration order will meet the objectives of administration and thus whether the entity is likely to carry on with its business.[233] Thirdly, the impact of the administration order on the society.[234] Fourthly, the court will consider the information disclosed relating to the entity including the turnaround time and the plans to maintain the organisation in business.[235]

An order of administration imposes a moratorium on commencement or continuance of legal actions without the leave of court.[236] This gives the company a chance to focus on the rescue[237] as opposed to having aggressive creditors institute legal process by dismemberment of the company's assets.[238]

The administrator owes a fiduciary duty to the body of creditors as a whole and his decisions must receive creditors' consent. For this reason, administration is designed to be a short process (12 months)

[231] Insolvency Act, 2015 s. 580.
[232] Insolvency Act, 2015 s. 531 (a). Section 384 of the Insolvency Act, 2015 sets out the conditions to be satisfied before a company is considered unable to pay its debts including where a demand has been made and not heeded or persistent requests and consistent promises to pay have not been honoured.
[233] Ibid s. 531(b).
[234] Re Nakumatt Holdings Ltd [2017]eKLR.
[235] Ibid.
[236] Insolvency Act, 2015 s. 560.
[237] Hoggers Limited (In Administration) v John Lee Halamanders & 11 Others [2021]eKLR Insolvency Notice No. E013 of 2020.
[238] Midland Enerrgy Limited v George Mururi t/a Leakey Auctioneers & Another (2019)eKLR Insolvency Notice No. E014 of 2018 para 13.

and if it must go beyond that, he can apply to extend time upon sound grounds and with the consent of creditors.[239]

Administration is an anathema to the otherwise powerful position held by secured creditors. Administration demands that the assets of the insolvent company be dealt in a way to ensure continuity of the business.[240] The secured creditor is deprived of the benefit of crystallization of the charge and the right of sale. This renders the market of secured creditor otiose.

The traditionalist theory discussed in the previous chapter underlies the idea of administration. Administration serves to protect the interests beyond those of trade creditors. Unlike that the proceduralist theory which advocates the maximization of creditors' wealth, administration will ensure that the company continues in business, saving jobs and securing employee entitlements. Professor Elizabeth Warren states that the law of insolvency law should transcend the rights existing before insolvency by considering the employees' interests who may not have any contractual protection designed with insolvency in mind like the secured creditors.[241]

The Cork Report recommended administration intended to reorganize and restore a corporate entity to profitability and maintain jobs; ascertain the chances of restoring a corporate of doubtful solvency of returning to profitability; identify mechanisms of realizing assets for creditors and shareholders and running the business in the public interest where the management of the business cannot continue under the current directors.[242] The architecture of the 2015 Insolvency Act is inspired by the Cork Report recommendations and is geared towards running insolvent companies in a bid to bring them back to profitability and sound financial health.

Administration under the new regime is yet to demonstrate success. Various Companies have been placed under administration since its enactment, including ARM Cement which went under

[239] Insolvency Act, 2015 s. 593.
[240] Jay Lawrence Westbrook, *A Global View of Business Insolvency Systems* (BRILL, 2009) p. 186.
[241] E Warren, 'Bankruptcy Policy Making in an Imperfect World' (1993) 92 Michigan Law Review 336, 356.
[242] Cork Report, para. 498

administration in August 2018, Deacons East Africa and Nakumatt without success. Mumias Sugar Company Limited was recently placed under administration.[243] The fate of Mumias Sugar Company Limited is yet to be determined but at least the 2015 Insolvency Act allows companies to continue in business with a chance of saving jobs.

3.2.5.3. Preferential Treatment of Employee Claims

The elevation of employees to preferential creditor status developed as a result of the lack of the welfare state.[244] This was intended to cushion the poor employees, as members of the society, against the financial shock resulting from insolvency of their corporate employer. The treatment of employees as privileged creditors is recognized in the Protection of Wages Convention, 1949.[245]

In Kenya, **the Second Schedule of the Insolvency Act, 2015** provides for preferential treatment to employee claims and places those claims as the second in priority. The first priority is given to expenses of bankruptcy including the fees of the liquidator, court costs for the person who instituted the insolvency petition and employing an advocate, payment to a creditor who took initiative to preserve the worth of the assets of the insolvent entity for the benefit of creditors including his costs and his unsecured debt.[246] The third priority is reserved for government taxes owed by the insolvent company.[247]

Employee entitlements due and payable before the insolvency of the corporate employer are ranked second in line of priority. These benefits include four months' wages or salaries, any holiday pay due to the employee, compensation for redundancy which also arises as result of the insolvency, usual

[243] Ponangipalli Venkata Ramano Rao was appointed as the administrator of Mumias Sugar Company Limited vide an order made by Justice Alfred Mabeya on 19th November, 2021 in Insolvency Petition No. E004 of 2021 Kimeto & Associates Advocates v KCB Bank Kenya Limited & 2 Others.
[244] The Cork Report, p. 324.
[245] Protection of Wages Convention, 1949, Art. 11.
[246] Insolvency Act, 2015, Second Schedule Para. 2(1).
[247] Ibid para.4.

deductions from the employee's salary. [248] The usual deductions must be interpreted to mean NHIF deductions, NSSF or pension deductions[249], HELB, PAYE and other loan repayments.

The amount payable is a maximum of two hundred thousand shillings (Kshs. 200,000.00).[250] The Cabinet Secretary has the power to increase the maximum amount by a Gazette Notice which amount can be reviewed and adjusted within three months after the lapse of every three years.[251] In making the adjustment, the Cabinet Secretary takes into account the increase in average weekly earnings derived from the Employment Survey by the Kenya Bureau of Statistics or other similar survey certified by a Government Statistician for the relevant adjustment period.[252] The Cabinet Secretary cannot make any adjustment if there has been a decrease or no change in the average weekly earnings.[253]

One critical and striking point of concern is that the Act places employee entitlements in competition with the trade creditors and Kenya Revenue Authority (KRA). The debt owed to suppliers of goods[254] and the amount owed to KRA by virtue of agency notices it has issued against the insolvent company[255] are also ranked second in priority. Given that these debts are lumped up together in the second priority with employee entitlements, they rank equally and compete for equal payment.[256] When the assets of the insolvent corporate entity are not sufficient to settle them in full, they abate equally. This jeopardizes employee benefits and risks leaving employees destitute especially where the claims by trade creditors and KRA under agency notices are huge. This may render the priority afforded to the employee superfluous and otiose in certain instances.

The plight of employees arising from competition with trade creditors and KRA is compounded by the fact secured creditors rank way ahead of employees. The World Bank too recommends that the secured

[248] Insolvency Act, 2015, Second Schedule Para. 3(1).
[249] JacKline Wakuthii Warui, 'Regulation of Pension Benefits in Kenya: A Case for Pension Guarantee Fund' (University Master of Law Thesis, 2018) p.46.
[250] Insolvency Act, 2015, Second Schedule Para. 3(2).
[251] Ibid para 3(a) & (b).
[252] Ibid para 3(c).
[253] Ibid para 3(d).
[254] Ibid para 3(1)(g).
[255] Ibid para 3(1)(h).
[256] Ibid para 5.

creditors' legitimate expectations to realizing the security should be respected and no other creditor should have prior interests in the collateral.[257] This effectively reduces the available assets of the insolvent employer which could be realized to settle employee entitlements. This competition among trade creditors, KRA and employees of an insolvent company will be the subject of our recommendations in chapter 4.

3.2.6. The Guarantee Fund

Employee entitlements are invariably threatened and diminished when the corporate employer becomes insolvent. The Employment Act, 2007 provides that these entitlements include wages earned and not paid, amount payable in lieu of notice under the contract of employment, amount payable in lieu of leave days earned and not taken, compensation for unfair dismissal and service charge.[258] In the year 2015, Parliament amended the Employment Act, 2007, vide Act No. 9 of 2015 to provide for the guaranteed payment of these entitlements in the event of the insolvency of the corporate employer in Part VII of the Act.[259]

It is noteworthy that severance pay which is paid upon declaration of redundancy is not payable upon insolvency of the employer.[260] This position is contrary to Zimbabwean approach where severance pay is paid to employees of an insolvent company.[261] However, it cannot be lost that redundancy may be related to insolvency because it may be undertaken as a measure to stave off insolvency.[262] In ***Kenya Chemical & Allied workers Union v Ernst & Young Liquidators for Coates Brothers EA Limited***[263], Sun Chemical Group Cooperatiff filed a winding up Petition against Coates Brothers EA Limited in November, 2011 for failure to pay a debt. A winding up order was issued and Ernst & Young appointed

[257] The World Bank, 'Principles for Effective Insolvency and Creditor/Debtor Regimes' (2021) Principle C12.2.
[258] Employment Act, 2007, s. 36 & s.49(1).
[259] Employment Act, 2007, s. 68.
[260] Kenya Chemical & Allied workers Union v Ernst & Young Liquidators for Coates Brothers EA Limited[2015] eKLR ELRC Cause No. 1078 of 2014.
[261] Tapiwa Givemore Kasuso & Kudakwashe Sithole, 'Protection of the Rights of Employees in Insolvency Law: A Zimbabwean Perspective' (SOAS University of London, 2020) Journal of African Law, 65, 1(2021) p 48 61.
[262] Jay Lawrence Westbrook, *A Global View of Business Insolvency Systems* (BRILL, 2009) p. 198.
[263] Ibid

as the Liquidator in Winding Up Cause No. 32 of 2011. A dispute arose as to whether employees were entitled to redundancy benefits. The dispute was referred to a conciliator who found that the termination was a redundancy and the employees were entitled to severance pay of thirty-nine million shillings (Kshs. 39,000,000.00). The issue before the court was whether the termination was on account of redundancy or insolvency. The Court stated that the termination was on account insolvency and the employees were not entitled to redundancy benefits provided for under the Employment Act.[264] Indeed, payment of severance pay is expressly excluded where the termination is on account of insolvency.[265]

Pension benefits may also be at risk of dissipation when a corporate employer becomes insolvent. This is the case especially where the employer has not remitted the deductions to the employee's scheme even after deducting.[266] This was evident in the case of the **Board of Trustees, *Kenya Broadcasting Corporation (KBC) Staff Retirement Benefits Scheme v Kenya Broadcasting Corporation (KBC)***[267] where it was averred that KBC had been deducting the scheme members' pension dues from their salaries without remitting them to the scheme for nearly ten years. The amount due to the scheme was then KShs. 2.8 billion. This threatened winding up of the Scheme under Regulation 4 of the relevant Regulations.[268] As earlier indicated in this paper, unremitted pension benefits are payable under second priority out of the assets of the insolvent corporate employer.[269]

A corporate employer is deemed insolvent where the court makes a liquidation or administration order against the company or where shareholders voluntarily resolve to wind up the company.[270] In addition, the corporate employer is insolvent where creditors holding a floating charge or a debenture over the

[264] Employment Act, 2007, s. 40.
[265] Ibid s. 40(2).
[266] Jay Lawrence Westbrook, *A Global View of Business Insolvency Systems* (BRILL, 2009) p. 194.
[267] Kenya Broadcasting Corporation (KBC) Staff Retirement Benefits Scheme v Kenya Broadcasting Corporation (KBC)[2020] eKLR Cause No. 1352 of 2018.
[268] Retirement Benefits (Minimum Funding Level and Winding-Up of Schemes) Regulations 2000 regulation 4.
[269] Insolvency Act, 2015 Second Schedule para 3(1)(d).
[270] Employment Act, 2007, s. 67b(i).

assets of the company appoint a receiver or manager over the company or the creditors take control of any property comprised in a fixed charge.[271]

3.2.6.1. Limitation of the compensation to be paid

The Act authorizes the Cabinet Secretary for labour[272] to pay employees of an insolvent employer their entitlements from the National Social Security Fund ("**NSSF**").[273] The Cabinet Secretary is empowered to pay the employees in accordance with the statement of the relevant officer in charge of the corporate insolvent employer.[274] The relevant officer may be a liquidator, administrator, official receiver or supervisor or provisional supervisor. [275]

The Cabinet Secretary is subrogated in respect of the claims of the employee once it has made the payment. The rights of the employee are transferred to the Cabinet Secretary including priority treatment, if any.[276] The insolvent employer is required to first reimburse the Cabinet Secretary the part already paid to the employee before making any payment to the same employee. After receiving the money, the Cabinet Secretary pays the money back to NSSF.[277]

The Cabinet Secretary empowered to limit the amount paid to employees of an insolvent corporate employer. The amount payable to an employee is the greater of ten thousand shillings or one half of the monthly remuneration.[278] The method of computing any benefit due to an employee for a part of the month is the greater of ten thousand shillings or one half of the remuneration for the part of the month worked. If there are any arrears in remuneration, the insolvent employer owes the employee, the cabinet secretary shall settle such arrears up to a maximum of six months.[279]

[271] Employment Act, 2007, s. 67b(ii).
[272] Employment Act, 2007, s. 2.
[273] Employment Act, 2007, s. 66
[274] Employment Act, 2007, s. 70(1)(a).
[275] Employment Act, 2007, s. 70(1)(b).
[276] Employment Act, 2007, s. 72.
[277] Ibid.
[278] Employment Act, 2007, s. 69(1).
[279] Employment Act, 2007, s. 68(a).

An employee of insolvent employer can lodge a suit in the Employment and Labour Relations Court where the Cabinet Secretary has declined to make the payment as aforestated or the amount paid is less than what is stipulated above.[280] The employee has the duty to lodge the complaint in court within three months or a longer period where the court he/she persuades the court that it was not reasonably possible to lodge the suit within three months.[281] The Court has the power to make appropriate orders depending on its findings.[282]

3.2.6.2. Critique of the Provisions of the Insolvency Act and Employment Act Discussed Above

There is conflict between Employment Act and Insolvency Act as to the length of period of payment of salaries and the least amount payable and whether redundancy pay is due in insolvency. The Employment Act provides for the monthly payment of Kenya Shillings ten thousand (KShs. 10,000/=) or half the monthly salary. The Act further provides for a maximum period of six months. The Insolvency Act provides for a maximum of lumpsum of Kenya Shillings two hundred thousand (KShs. 200,000). The said Act provides that the amount payable shall not exceed four months of the employee entitlements.

It is not clear whether the amount paid under the Employment Act is over and above the amount paid under the Insolvency Act. Does the current law envisage that once the Cabinet Secretary has paid the Employee under the Employment Act, he/she shall be entitled to the amount under Insolvency Act? If so, this is likely to lead to inconsistencies in the amounts recovered because of the different provisions under the two laws.

For instance, under the Insolvency Act, if an employee has not been paid salaries for 6 months and his salary is ten thousand shillings per month, the employee will be entitled to forty thousand shillings. The

[280] Employment Act, 2007, s. 71(1).
[281] Employment Act, 2007, s. 71(2).
[282] Employment Act, 2007, s. 71(3).

Cabinet secretary, under the Employment Act, will pay sixty thousand shillings to the employee. He will then only recover the forty thousand and will then have a shortfall of twenty thousand shillings. The shortfall will be greater where the employee concerned had higher salaries or wages.

The situation is worse were the law's position to be presumed to be that the amount paid under the Employment Act is over and above the amount paid under the Insolvency Act. This would mean that the employee will collect the moneys payable under the preferential scheme leaving the Cabinet Secretary to await the employee to be paid as other creditors. The Cabinet Secretary will not have any reimbursements where the insolvent has no sufficient assets to pay creditors. The former position is persuasive.

In addition, the enactment to draw funds from the Pension and Provident Funds set up under the NSSF Act, 2013 is a rather curious phenomenon. This is a position which can be challenged in court. The suggested mechanism amounts to taking property belonging to somebody else. Even though it is provided that the Cabinet Secretary becomes subrogated in respect of the rights of the employees and the funds reimbursed to him shall be paid back into the Fund, it cannot be lost that at times, there may not be funds sufficient to pay beyond the first priority claims. This means that, in that case, the money drawn out of the Fund will be lost. This would then amount to depriving the Pensioners of their property contrary to Article 40.[283]

3.2.7. Protection of Employee Rights in Mergers and Acquisitions

In some instances, one company may offer to acquire or merge with an insolvent company. This will invariably lead to continuity of the business of the insolvent company. A case in point is SBM Bank (Kenya) Limited which acquired part of the assets and liabilities of the insolvent Chase Bank (Kenya)

[283] Constitution of Kenya, 2010, Art. 40.

Limited (In Receivership).[284] It is apparent that SBM Bank acquired 'a significant majority of staff'[285], even though the CAK approved the acquisition unconditionally.[286] The question then arises whether the acquiring company has the legal obligation to maintain in employment the employees of the insolvent company.

Mergers and Acquisitions (M & A) lead to restructuring and change in character and identity of companies involved. Employees are declared redundant[287], lose employment and have to wait for jobs to be advertised before applying. Employment contracts cannot be assigned to the new entity under the extant Kenya law. Employees will be rendered redundant to be compensated under the law.

The Competition Authority of Kenya (CAK) has the mandate of considering and approving M & A. In determining whether or not to approve the M & A, the CAK considers the extent to which the proposed merger is likely to affect employment.[288] The CAK would thus consider a situation where the M & A may have profound impact on employees. It will only approve the M & A on conditions such as that the Companies retain 90% of the employees or 100% of the employees for at least one year. This happened in the merger between National Bank of Kenya Limited by KCB Bank PLC[289] and NIC Group PLC and Commercial Bank of Africa Limited[290] respectively. In the proposed merger between Telkom and Airtel, the CAK approved the merger on condition that a certain number of employees be retained for two (2) years. This retention period was upheld by the Competition Tribunal on the grounds that the telecommunication industry is unique in the sense that there would be only two players: Safaricom and

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284 Central Bank of Kenya, Press Release (2018) available at https://www.centralbank.go.ke/uploads/press_releases/1236253842_Press%20Release%20-%20Chase%20Bank%20(Kenya)%20Limited%20(In%20Receivership)%20and%20SBM%20Bank%20(Kenya)%20Limited.pdf <last accessed on 5th July, 2021>.

285 Ibid.

286 Competition Authority, 'Annual Report 2017-18' p. 80 available at <https://www.cak.go.ke/sites/default/files/annual-reports/FY%202017-2018%20CAK%20Annual%20Report.pdf> last accessed on 5th July, 2021.

287 Subject to conditions under section 40 of the Employment Act, 2007.

288 The Competition Act, 2010 S. 46(2).

289 https://cak.go.ke/sites/default/files/2019-09/CAK%20Decision%20on%20Proposed%20Acquisition%20of%20100%25%20of%20the%20Ordinary%20Shares%20of%20National%20Bank%20of%20Kenya%20Limited%20by%20KCB%20Group%20PLC.pdf

290 https://cak.go.ke/sites/default/files/2019-06/CAK_Decision_on_Proposed_Merger_between_Commercial_Bank_of_Africa_Limited_and_NIC_Group_Plc%20%281%29.pdf

itself and the employability of employees would be greatly affected and that the merged entity would take 2 years to break even.[291]

It is apparent that there is no clear legal obligation on the merging entities to retain employees. The number of employees retained from the target entity would depend on the whim of the CAK. There is no obligation on the CAK to compel merging entities to retain a particular number of employees. There are no policy guidelines to aid the CAK to determine the employee question in M & A.

A Bill in draft form (**the Bill**)[292] proposes to introduce section 15A which is to the effect employment contracts and terms will be maintained in M & A transactions. This proposed section is akin to Zimbabwean law which stipulates that whenever there is transfer of business, the employment contracts will be transferred to the new company without changer of terms.[293] The section requires the company to be acquired to consult its employees or their representatives about the impending transfer, the impact of the transfer and the steps to be taken to attenuate such implications. The Bill seeks to make it law that any dismissal premised on M & A shall amount to summary dismissal. South Africa[294], Uganda[295] and the UK[296] have similar provisions in their law. The Bill seeks to offer relief and protect the interests of employees who lose out in M & A. However, this is only a Bill and it has received much criticism in so far as it seeks to restrict companies which may want to cut on costs or expenses. It inhibits sale of businesses and frustrates business rescue much to the detriment of the employees themselves.[297]

[291] Telcom Kenya Limited & another v Competition Authority of Kenya [2020] eKLR, paragraphs 167 and 173.
[292] https://www.klrc.go.ke/images/Draft-Employment-Amendment-Bill-April-2019.pdf
[293] Tapiwa Givemore Kasuso & Kudakwashe Sithole, 'Protection of the Rights of Employees in Insolvency Law: A Zimbabwean Perspective' (SOAS University of London, 2020) Journal of African Law, 65, 1(2021) pp 64-66.; section 16 of Zimbabwean Labour Act.
[294] South Africa Labour Relations Act, 1995, s.197A & 197B. In South Africa, when an insolvent employer is transferred to another entity, the previous employer's obligations will not be transferred to a new employer.
[295] Uganda Employment Act, 2006, s.28 & Employment Regulations, Regulation 29 and William Kasozi, 'Africa Guide-Employment Consequences of Business Transfers' (Bowmans) p.36.
[296] Transfer of Undertakings (Protection of Employment) Regulations, 2006 and Transfer of Undertakings (Protection of Employment) (Amendment) Regulations, 2014.
[297] Jay Lawrence Westbrook, *A Global View of Business Insolvency Systems* (BRILL, 2009) p. 200.

The Bill burdens the companies involved. The Bill implies that the transferee is expected to pay employee entitlements from the start of the employment contract before acquiring the transferor.[298] It subjects companies involved to unnecessary costs and restrictions. The requirement to retain employees runs afoul of the purpose of M & A which is to reduce operational costs. It offers indiscriminate protection to employees without regard to the reasons for termination if any. The law should allow the transferee to negotiate with employees so as to agree on mutually beneficial terms.

3.3. International Legal Regime

3.3.2. The Protection of Workers' Claims (Employer's Insolvency) Convention 173 of 1992

It recognizes employee entitlements in insolvency as privileged[299]and to establish a limit on the privileged amounts.[300] It also enjoins governments to create a guarantee fund or insurance scheme.[301] Further, it encourages member countries to allow insurance companies with sufficient guarantees to provide guarantee of payment.[302] CPF Financial Services Ltd has pioneered a product called Daraja Benefit (Unemployment Benefit) to guarantee payment on loss of employment.[303]

The Convention has good prescriptions for the plight that face employees of insolvent companies. The requirement of the guarantee fund would assist in alleviating the plight of employees in insolvency. Unfortunately, Kenya is not a party.[304] However, Kenya appears to have adopted the prescription of the guarantee fund by establishing a guarantee fund under the NSSF as discussed later in this chapter.[305]

3.3.3. UNCITRAL Model Law on Cross-Border Insolvency 1997

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[298]Jacob Ochieng, Sandra Kavagi, Sheila Nyakundi, 'A Dicey Matter: The Fate of Employees in Mergers and Acquisitions'(January, 2020) available at <https://www.oraro.co.ke/tag/mergers-acquisitions/> last accessed on 5th July, 2021.
[299] The Convention, art. 5 & 6.
[300] Ibid art. 7
[301] Ibid art. 9.
[302] Ibid art. 11.
[303] See https://cpf.or.ke/defined-contribution-scheme/ accessed on 31st August, 2021.
[304] International Labour Organisation, 'Ratification of C173-Protection of Workers Claims (Employer's Insolvency) Convention, 1992 (No. 173).' Available at http://www.ilo.org/dyn/normlex/en/f?p=1000:11300:0::NO:11300:P11300_INSTRUMENT_ID:312318 accessed on 31st August, 2021.
[305] See part 3.10 herein.

Globalisation has led to cross-border trade, business transactions and the existence of multinational companies. The model law addresses issues arising from insolvencies beyond the borders of any one jurisdiction. The model law has no meaningful protection of employee rights[306] and has therefore had no impact to the legal regime in Kenya relating to protection of the welfare of employees of insolvent companies. The UNCITRAL, the World Bank and the and the International Monetary Fund developed the standard for assessing the strength of insolvency and creditor systems of different jurisdiction.[307] The standard reflects both the model law and the World Bank Principles on insolvency[308]. Kenya adopted the Model Law prescriptions on cross-border insolvency.

The World Bank Principles on insolvency have influenced the development of insolvency law in Kenya. Secured creditors are allowed to sell the specific assets in realization of the debts as recommended by the World Bank. Further, employees are significantly protected in insolvency as prescribed by the World principles.

3.3.4. The OHADA Insolvency Act 1999

The treaty on harmonization of business law in Africa[309] "birthed" the corresponding organisation (OHADA)[310] leading to the organisation's Insolvent Act, 1999.[311] The Act advocates for prioritisation of employee claims in insolvency which position has been adopted in the Kenyan law. The Act provides for corporate rescue procedures which saves companies from failure. Corporate rescue plays a critical role in preserving jobs. Corporate rescue in form of administration has been adopted in the Kenyan

[306] Tapiwa Givemore Kasuso & Kudakwashe Sithole, 'Protection of the Rights of Employees in Insolvency Law: A Zimbabwean Perspective' (SOAS University of London, 2020) Journal of African Law, 65, 1(2021) p 51.
[307] Insolvency and Creditor Rights Standard (the ICRS).
[308] World Bank, 'Principles for Effective Insolvency and Creditor/Debtor Regimes'(2021) available at https://openknowledge.worldbank.org/handle/10986/35506 accessed on 31st August, 2021.
[309] The Port Louis Treaty on the Harmonization of Business Law in Africa, October 1993.
[310] Organization for the Harmonization of Business Law in Africa (OHADA).
[311] Paul J. Omar, 'Out of Africa: The OHADA Uniform Insolvency Law' (International Insolvency Institute, 1999) p. 1.

insolvency law.[312] We believe that the OHADA Act informed the enactment of the Kenyan Act which is quite positive.

3.4. Conclusion

The Kenyan law on protection of employee entitlements is predicated upon the theoretical schools of thought discussed in chapter two. The traditional theory informs the provisions of the Insolvency Act on Administration. Administration seeks to save the insolvent company for the greater interest of stakeholders beyond the creditors. Such stakeholders include the employees. A company rescued means jobs saved. The traditionalists argue that the Insolvency law should serve interests of employees and that is what administration seeks to achieve.

The proceduralist theory provides the foundation for the provisions of the Employment Act. The proceduralists propound the idea that employees' rights protection should be the concern of the employment law. This view informs the provision of the Insolvency Act which imposes a moratorium on execution against the assets of the insolvent company. Further, the Employment Act, 2007 conforms to this argument by specifically providing for settlement of the employee entitlements from the National Social Security Fund. However, this approach yields to the view held by traditionalists by acknowledging that employees may be entitled to preferential treatment. This is because the law provides that the Cabinet Secretary is entitled to rights and privileges of the employee in the process of insolvency after he/she has settled the employee entitlements.

Kenya's legal terrains has structures focused on protecting employees in corporate insolvency of their employer. These include, preferential treatment of a portion of their entitlement, providing a guarantee payment under the National Social Security Fund and corporate rescue through administration. Despite the legal regime providing some measure of protection to the employees, the mechanisms are not sufficient to protect employee entitlements which exist prior to insolvency. There is need to infuse better

[312] Insolvency Act, 2015 Part VIII.

schemes into the Kenyan law to provide adequate and real protection to employee rights. Jurisdictions world over, have established mechanisms to insulate employees from shocks caused by the insolvency of their corporate employer. These mechanisms are discussed in chapter Four.

CHAPTER FOUR

4. LESSONS FROM OTHER JURISDICTIONS

4.1. Introduction

Insolvency law has evolved over the years, as discussed in Chapter two to cater for the interests of the debtor and other stakeholders. The law has developed on the rival legal thoughts of proceduralists on one divide and the traditionalists on the other. As earlier discussed, the development of insolvency law which protects the interests of employees of insolvent corporate employers is informed by the traditionalist approach.[313]

Kenya has developed law, as discussed in chapter 3[314], which to a significant extent, protects employee rights. The Insolvency Act, 2015 has mechanisms such as administration which seeks to rescue the insolvent corporate employer whose end game is to save jobs. Further, the Act has preferential treatment of employee entitlements which are to be paid way before majority of the debts. In addition, the Employment Act, 2007 provides for a guarantee of payment of a particular amount from the National Social Security Fund.

The question, arises whether these mechanisms are effective and adequate methods of protecting employee entitlements. The answer is no. Administration may not always work. This is evident in the Nakumatt Supermarkets case where an attempt at administration was made and failed. Further, even if employees are granted preferential creditor status, there are instances when the assets of the company may not be sufficient to pay off the first priority claims leave alone the employee entitlement which are second in the order of priority.[315]

[313] See to the second paragraph of part 3.12 herein.
[314] See parts 3.3 to 3.10 herein.
[315] Mohammed Al Bhadily & Peter Hosie, 'Australian Employee Entitlements in the Event of Insolvency: Is an Insurance Scheme an effective Protective Measure?' (2016) pg. 1-2

Developed countries noted that the elevated status of employee claims is not sufficient to assure their settlement.[316] They have further noted that it is good policy not to subordinate the interests of secured creditors to any other interest as recommended by the World Bank.[317] Developed countries have noted that invariably employees of insolvent employers, will in the circumstances be left destitute. Most of these countries have, therefore, created a state-administered guarantee fund, among other mechanisms, to alleviate the plight of employees in insolvency of a corporate employer.[318]

There are better methods and policy options of protecting employee entitlements across the world which this chapter now sets out to discuss.

4.2. The Guarantee/Insurance Fund

As indicated above, some jurisdictions add the icing on the cake over and above bestowing upon employees preferential creditor status by segregating a public fund to settle employee entitlements.[319] This fund comes in handy when the assets of the insolvent employer are depleted to nada. More often than not the funds will not be sufficient for the unsecured creditors after the secured creditors have exercised their power of sale of the insolvent's assets.[320] The fund provides assurance of the reasonably timely payment of part of the employee entitlements.

The guarantee fund in most cases settles a portion of the employee rights as recommended by the Insolvency Convention, c. 173.[321] If the guarantee fund were to provide a comprehensive insurance of the employee entitlements in insolvency, a moral hazard would be created.[322]

[316] Jay Lawrence Westbrook, *A Global View of Business Insolvency Systems* (BRILL, 2009) p. 184.
[317] The World Bank, 'Principles for Effective Insolvency and Creditor/Debtor Regimes' (2021) Principle C12.1 and C12.2.
[318] Jay Lawrence Westbrook, *A Global View of Business Insolvency Systems* (BRILL, 2009) p. 194.
[319] Jay Lawrence Westbrook, *A Global View of Business Insolvency Systems* (BRILL, 2009) p. 184.
[320] Mohammed Al Bhadily and Peter Hosie, 'Australian Employee Entititlements in the Event of Insolvency: Is an Insurance Scheme an Effective Protective Measure' (2016) 37 Adelaide Law Review p. 247-248
[321] The Protection of Workers' Claims (Employer's Insolvency) Convention 173 of 1992, art.7.
[322] John Kong Shan Ho & Rohan Price, 'Moral Hazard, Insolvency and Employees as Creditors: What Governance Lessons can be Learned from the Hong Kong Model?' (2011) Journal of Corporate Law Studies p. 528.

The challenge with the guarantee fund is that, the employer will have the incentive to take greater risks and cause the company to go into insolvency knowing fully well that the guarantee fund will settle the employee entitlements. The profligate employer will not take corrective measures to avert insolvency because they know the responsibility for the consequences lies with the guarantee fund. The solution to the challenge lies in making employers carry the responsibility of their actions, reducing government funding and limiting access to the fund.[323] The best insurance fund is modest and is less funded by the taxpayer.

4.2.2. Guarantee Fund in Australia

In **Australia**, the Howard administration established the Employee Entitlements Support Scheme ("**EESS**') in 2000.[324] The General Employee Entitlements and Redundancy Scheme ('**GEERS**'), an administrative rather than legal mechanism, replaced the EESS in 2001.The GEERS could not withstand criticism on account of being taxpayers' money funding insolvent companies, having limited protection to employee benefits and encouraging companies to abuse the system by evading to pay their employees.[325] The Gillard government introduced the Fair Entitlements Guarantee Act, 2012 ('**FEG**') to replace GEERS.[326] The FEG is anchored on statute and provides more protection to employee entitlements but it derives its funds from the government coffers. The taxpayer still bears the burden of corporate failure.[327]

The employees are entitled to claim from the FEG. The claims consist of a maximum 13 weeks' unpaid wages, unpaid annual leave, unpaid long service leave, maximum five weeks' notice, maximum four weeks redundancy entitlement per year. This money is drawn from the commonwealth which is

[323] Ibid, p. 529.
[324] Mohammed Al Bhadily and Peter Hosie, p. 248.
[325] Ibid p. 253
[326] Ibid.
[327] Ibid. p. 249.

government funds.[328] The Australian government is then subrogated to employee benefits from the insolvent company. However, the recovery of paid out amounts is as low as 13.8%.[329]

4.2.2.1. Definition of phoenix activity

The funding from the government coffers has occasioned a **moral hazard**[330]; **phoenix activity** as is known in Australia. Phoenix activity is the abuse of the corporate form which entails the resurrection of the collapsed corporate entity as a new entity with the same directors and carrying out the same economic activity.[331] The aim of the phoenix activity is to deny unsecured creditors including employees their entitlements.[332] The responsibility and accountability of employers to pay employee entitlements is shifted from the directors of the company to taxpayers.[333] Further, the existence of the fund encourages employers to engage in risky business activities fully aware that the government will settle employee claims in the event of insolvency.[334] The profligate employer is rewarded for giving up rather than fighting on through the challenges.

4.2.3. Guarantee Fund in the United Kingdom

In the **United Kingdom**, there exists the National Insurance Fund ("**NIF**"). The fund is made up of contributions by employees, employers and the self-employed.[335] With the creation of the Welfare State in 1948, the contributions were merged. The contributions insure a range of claims set out under the UK Social Security Administartion Act, 1992.[336] The NIF is managed by HM Revenue and Customs

[328] Ibid. p.251.
[329] Ibid. 254.
[330] John Kong Shan Ho & Rohan Price, 'Moral Hazard, Insolvency and Employees as Creditors: What Governance Lessons can be Learned from the Hong Kong Model?' (2011) Journal of Corporate Law Studies p. 537.
[331] Helen Anderson, Ann O'Connell, Ian Ramsay, Michelle Welsh & Hannah Withers, 'Defining and Profiling Phoenix Activity' (Melbourne Law School & Monash Business School, 2014).
[332] Helen Anderson, 'Understanding the Phoenix Landscape for Employees' (2016) 29 Australian Journal of Labour Law 257 p. 1.
[333] Mohammed Al Bhadily and Peter Hosie p. 253.
[334] Ibid 254.
[335] HM Revenue & Customs, 'Great Britain National Insurance Fund Account For the year ended 31st March, 2020' p. 4.
[336] Such benefits include widowhood, industrial injuries benefits and disability working allowance, child benefit, housing benefit, Christmas bonus, job seekers benefit, Guardian's Allowance, state pension, bereavement benefits, etc.

("**HMRC**"). The HMRC collects contributions, deducts a portion of them for the National Health Service (**NHS**) and deposits the rest to the NIF.[337] The NIF is used to pay unemployment benefits[338], pensions, sickness or disability benefit. When it is not sufficient to pay the claims or when it is below a set threshold, the government tops up through a Treasury Grant.[339]

The UK NIF is made up of consolidated contributions and caters for virtually all the social security claims. This situation of a common fund for diversified and myriad claims can create confusion and competition. Some claims may be too rampant causing depletion of the fund at the expense of other claims. This depletion necessitates government intervention by injecting more funds. A good fund for developing resource-deprived country like Kenya should be self-sustaining and funded by the private contributions.

4.2.4. Guarantee Fund in Hong Kong

In **Hong Kong**, the guarantee fund is privately funded. John and Rohan tout the Hong Kong model as the best because the fund is derived from the contributions of employers with strict limits on payable benefits thus minimizing the moral hazard.[340] However, the Hong Kong Model also guarantees payment of employee entitlements without lifting the corporate veil to hold directors liable. The Protection of Wages on Insolvency (POWIF) in Hong Kong is an *ex gratia* payment to employees of insolvent companies. It is derived from mandatory annual levy of HK$450 on business registration certificates.[341]

[337] Ibid p. 16.
[338] The UK Employment Rights Act 1996, s. 182.
[339] Thomas Henderson, 'UK National Insurance Explained' (2017) available at <UK National Insurance explained - The role and organisation of N.I. (familymoney.co.uk)> accesed on 18th Sept, 2021.
[340] John Kong Shan Ho & Rohan Price, 'Moral Hazard, Insolvency and Employees as Creditors: What Governance Lessons can be Learned from the Hong Kong Model?' (2011) Journal of Corporate Law Studies p. 526.
[341] Ibid, p. 541.

POWIF payment is limited to 4 months for services rendered prior to insolvency, any form of leave not taken, one month's wages in lieu of notice and severance pay. The maximum amount payable for all these claims is HK$ 278,500.00.[342]

Despite the Hong Kong Model being touted as the best, it still faces the challenge of phoenixing.[343] The hospitality industry in Hong Kong is the most affected. The owners of supposedly collapsed restaurants register and carry-on similar business in the same premises shortly after the old business is wound up. Employees, in most cases, work in cahoots with the owners of the restaurants so that they are rehired in the new businesses at higher salaries.

4.2.5. Critique of the Guarantee Fund

It is evident that there is no perfect model of establishing the guarantee fund. Whether the guarantee fund is based on private contributions or the taxpayers, it still encourages phoenixing. However, a guarantee fund made up of private funds is better because it would save taxpayer resources especially in developing countries like Kenya. Nevertheless, a guarantee fund is a necessary evil for protection of employee rights in corporate insolvency. The guarantee fund should be encouraged with special focus on punishing those engaged in phoenixing activity to stem the practice. In Kenya, we would propose a guarantee fund based on the private contributions from employers and employees to reduce the burden on the taxpayer.

4.3. Director from the Workforce

Employees are the 'lost souls' in the insolvency process because despite being the lifeblood of companies, they are usually not involved in the process.[344] The United Kingdom proposed the

[342] Ibid, p. 542.
[343] Ibid, p. 543.
[344] Vanessa Finch, *Corporate Insolvency Law: Perspectives and Principles*, (Cambridge University Press, 2009) p.570 & 778.

introduction of a director from the employees after the collapse of the British Home Stores that led to loss of 11,000 jobs.[345]

The introduction of the employee director on the Board of directors is an *ex ante* mechanism to ensure protection of employee rights, ensure pension contributions are remitted, forestall insolvency and save jobs. The employee director will ensure that the discussions in the meetings of directors take into account the rights of employees including in impending insolvency filings.

4.4. Derivative action by employee representative in South Africa, Singapore and Canada

When a company is incorporated, it becomes a legal personality which can sue and be sued in its name.[346] It follows, therefore, the company as person is the proper plaintiff to sue in its name through the directors under common law.[347] In Kenya, shareholders or members of the company have the right to bring a derivative claim on behalf of the company.[348] However, a number of jurisdictions have bestowed the privilege of derivative action upon any person including employees or their representative.

Section 165(2) of the **South African Companies Act, 2008** provides for derivative action by a registered trade union.[349] When a requirement is made that the employee derivative action be limited to the **employee representative**, floodgate of frivolous suits will be averted. [350] Further, section 238 of the **Canada Business Corporations Act, 1985** empowers any person to bring a derivative action as long

[345] Neshat Safari & Martin Gelter, 'British Home Stores collapse: the case for an employee derivative claim' (2019) Journal of Corporate Law Studies p. 44.
[346] Salomon v Salomon & Co (1897) AC 22 (HL).
[347] Foss v Harbottle (1843) Hare 461, 67 ER 189 at para 490-491.
[348] Companies Act, 2015 s. 231(1).
[349] Section 165(2)(c) & (d) of the South African Companies Act, 2008 provides as follows:

> *2) A person may serve a demand upon a company to commence or continue legal proceedings, or take related steps, to protect the legal interests of the company if the person*
>
> > *c) is a registered trade union that represents employees of the company, or another representative of employees of the company; or*
> > *d) has been granted leave of the court to do so, which may be granted only if the court is satisfied that it is necessary or expedient to do so to protect a legal right of that other person.*

[350] Neshat Safari & Martin Gelter, p. 64.

as the court considers the person as a proper person entitled to the action. **Singapore** too has similar provision in section 216A(1)(c).[351]

Under the Singapore Companies Act, leave of the Court is required before employees or their representatives can bring a derivative action. The applicant should satisfy the Court that they served the company with a fourteen (14) days' notice stating the intention to institute the suit if the directors do not bring the action. Further, the applicant must demonstrate to the court that the action is brought in good faith and in the interest of the company. [352] The Canadian Business Corporations Act, 1985 is *pari materia* to the Singaporean Companies Act.[353]

The South African Companies Act does more. It empowers the employee representative to restrain the company from contravening the Act, issue a declaration that the director is delinquent or to be placed on probation.[354] As a separate and independent entity, the employee representative could also apply to put breaks on unreasonable abuse of the company.[355] The company is enjoined to provide the union with access to financial statements to initiate business rescue.[356] The union must also be notified where a director is to be given financial accommodation.

A derivative action in the hands of employees is a powerful instrument. Employees are insiders and they could be privy to helpful information that would help save the company. Therefore, if employees have information relating to detrimental actions by directors they can pass it to their representatives.

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[351] Section 216A(1)(c) of the Singapore Companies Act provides as follows:

1) *In this section and section 216B "complainant" means —*
    a. *any member of a company;*
    b. *the Minister, in the case of a declared company under Part IX; or*
    c. *any other person who, in the discretion of the Court, is a proper person to make an application under this section.*
2) *Subject to subsection (3), a complainant may apply to the Court for leave to bring an action or arbitration in the name and on behalf of the company or intervene in an action or arbitration to which the company is a party for the purpose of prosecuting, defending or discontinuing the action or arbitration on behalf of the company.*

[352] Singapore Companies Act section 161A(2) & (3).
[353] Canada Business Corporations Act, 1985 s. 238 & 239.
[354] South African Companies Act, 2008, s.20(4).
[355] Ibid s. 20(9).
[356] Ibid s. 131.

The representatives will then institute a suit to arrest and forestall directors' actions intended to collapse their employer. This will be possible if the employee representative is empowered by law to institute court proceedings in the name of the company as is the case in South Africa, Canada and Singapore.

However, the challenge with employee derivative action is that they may not always be aware of what is going on in the company. This is because most discussions take place at the level of the board of directors. Employees in most jurisdictions including Kenya are not represented on the board of directors. This challenge may be resolved by having an employee representative on the board of directors as previously discussed.

4.5. Employee Buyout

Employee Buyout (EBO) is a process in which employees take over the ownership of their insolvent employer. EBO as a strategy was employed by workers in the 1970s and 1980s in Europe to save their jobs when employers risked collapse due then existing economic crisis and industrial restructuring.[357] Employees have the company-specific knowledge that would help in the rescue process. This EBO phenomenon worked, companies were rescued and many jobs were saved in Europe at the time.

For EBO to work, employees will have to have had substantial salaries and savings. Employees with big salaries can pool their savings and inject into the ailing business to ensure its continuity. However, in most cases, employees have meagre salaries that can only enable them to live from hand to mouth. In such cases, EBO will not be a realistic option. This is not to say that EBO should not be attempted even when the employees have the financial muscle to buy the distressed company. Employees capable of buying the troubled employer should be allowed to do so.

4.6. Pre-pack

[357] Anthony Jensen, Ithaca Consultancy, 'Insolvency, Employee Rights & Employee Buyouts: A Strategy for Restructuring' (A Report Commissioned by the Common Cause Foundation and Co-funded by Cooperative Action) p.11..

A pre-pack is now a common arrangement practiced in the US and the UK. A pre-pack is a pre-insolvency approach to corporate troubles.[358] A pre-pack is the sale of the company arising from an agreement between creditors and the company followed by out of court appointment of a prospective administrator who will conclude the process after court approval.[359] It may involve a troubled company negotiating with its creditors to exchange debt with equity with the end goal of reducing the burden of interest payment.[360] Once the creditors and the company have agreed, the company files an insolvency Petition, a plan and disclosure statement to facilitate the appointment of an administrator in the UK and Chapter 11 filing in the case of the US (Debtor-In-Possession).[361] The administrator will then oversee the restructuring of the company. This arrangement will lead to speedy recovery, keep legal and other professional costs low, preserve jobs and pay trade creditors in full.[362] Further, it will lead to a seamless transition without losing crucial employees, licences, franchises and reputation.[363] A pre-pack is a kind of corporate rescue.

The Court in *DKLL Solicitors v. HM Revenue & Customs*[364]sanctioned a pre-pack in the greater interest of employees. In this case, a firm of lawyers was heavily indebted to the revenue authorities. The partners of the law firm, on the advice of Insolvency Practitioners, applied to court for an order of administration to effect a pre-pack sale of the firm. The revenue authorities opposed the application on the ground that the proposed amount was too low. The Court, however, allowed the application for pre-pack sale based on the expert advice of Insolvency Practitioners.

Some creditors may be a stumbling block to a pre-pack. They could refuse to approve a pre-pack arrangement. Vulture Funds, who are investors who scout for troubled companies and invest in them with the aim of making maximum returns, are a case in point. The US law has a way to deal with such

[358] Vanessa Finch, *Corporate Insolvency Law: Perspectives and Principles*, (Cambridge University Press, 2009) p.455.
[359] Matthijs Van Schadewijk, 'Pushing the Boundaries between Competition and Insolvency Law: Pre-packing in the UK' (2017) 5 NIBLeJ2.
[360] Vanessa Finch p.454-455.
[361] Ibid. p. 454.
[362] Ibid. p. 456.
[363] Ibid. p. 457.
[364] DKLL Solicitors v. HM Revenue & Customs [2007] BCC 908 at 913, para. 10.

dissentient creditors. The US law provides that the pre-pack arrangement stands approved as long as creditors claiming two-thirds of the debt or more than half of the creditors voting have approved the pre-pack.[365]

The pre-pack arrangement may turn out to be lengthy especially where the court rejects the proposed plan or where some creditors attempt to frustrate the process.[366] Where the court rejects the plan, the company will have to go back to the drawing board and engage creditors again. Further, pre-pack arrangement may encourage phoenix trading among company directors.[367] In addition, pre-packs favour secured creditors over unsecured creditors.[368]

The pre-pack commonly referred to as the London Approach[369] is a commendable development. It seeks to preserve the business as a going concern. Maintaining the business as a going concern has the effect of enabling employees to keep their jobs. The pre-pack is a fundamental weapon in the quiver of protecting employee rights in corporate insolvency. The pre-pack is a good practice which we suggest should be encouraged in Kenya.

4.7. Conclusion

Jurisdictions across the world have adopted legal mechanisms to protect the rights of employees in corporate insolvency. They have recognized that the preferential treatment of employee claims in insolvency is not sufficient as assets may not be enough and the insolvency procedures often take inordinately long. They have established a guarantee fund to settle a portion of the employee claims in a reasonable time. Other mechanisms include availing derivative action to employees to sue directors to forestall the collapse of a company, requiring that one of the directors represents the employees, encouraging pre-pack arrangement to salvage the company at an early stage and enabling employees to

[365] US Bankruptcy Code, s.1126.
[366] Vanessa Finch, p. 459.
[367] Ibid, 460.
[368] Ibid, p. 463.
[369] John Armour & Simon Deakin, 'Norms in Private Insolvency: The "London Approach" to the Resolution of Financial Distress'(2001) Journal of Corporate Law Studies pp 34-37.

buy their distressed employer. All these mechanisms protect the rights of employees in insolvency. In the next chapter five, we recommend that the foregoing mechanisms together with legal amendments to be adopted in Kenya to further buttress the protection of employees in insolvency.

CHAPTER FIVE

5.0. CONCLUSIONS AND RECOMMENDATIONS

Chapter 4 discussed the lessons from other jurisdictions on how to effectively and meaningfully protect the rights of employees in corporate insolvency. This chapter will provide the conclusions of this research. This chapter supplies the conclusions of the preceding chapters one to four. This chapter will then proceed to make recommendations on how to improve the Kenyan law with the aim of effectively and meaningfully protecting the rights of employees in corporate insolvency.

1.1. CONCLUSIONS

As discussed in Chapter One Employees are an integral part and the lifeblood of any corporate entity. They play a crucial function in the existence of a corporate entity. They have immense stake in its continued existence and its sound financial health for purposes of keeping their jobs. Their jobs are a source of livelihood to them. The financial ill-health or insolvency of their employer poses a risk to their jobs. COVID-19 exacerbated the risk of losing jobs. Insolvency of the corporate employer, causes employees to lose their jobs and entitlements and to be condemned to abject poverty. This is largely because developing countries like Kenya have weak social welfare programmes to support the unemployed.

The plight of employees has led to a raging debate about the interests that insolvency law should serve. The question is whether in insolvency, the law should be concerned with maximizing the creditors wealth out of the sale of the insolvent company's assets or the interests of other stakeholders including employees of the insolvent company should be considered in reaching the decision concerning the fate of the insolvent. The proceduralist school of thought and the traditionalist school of thought, discussed in chapter two under the auspices of the public interest theory, inform the design of the of insolvency law world over in answer to the foregoing questions. The procedural theory emphasizes the collective recovery of debts on behalf of the creditors. This theory advocates for maximization of creditor wealth and shows no concern for other stakeholders including the destitute employees of an insolvent corporate

employer. The traditional theory forms the foundation of designing the law in such a way that the challenges of employees of an insolvent corporate employer are addressed by insolvency law. The law reforms that introduced corporate rescue, voluntary arrangements, priority treatment of employee entitlements are credited to the traditional theory.

The laws of Kenya, discussed in chapter three, inspired by the traditional theory, have structures whose intention is to protect employees in the wake of insolvency of their corporate employer. These include, preferential treatment of a portion of their entitlement, providing a guarantee payment under the National Social Security Fund and corporate rescue through administration. Despite the legal regime providing some measure of protection to employees, the mechanisms are not sufficient to protect employee entitlements which exist prior to insolvency. This research, in chapter four discusses better schemes adopted in the world over to provide adequate and real protection to employee rights in corporate insolvency.

Jurisdictions world over, have recognized that the preferential treatment of employee entitlements in corporate insolvency is not sufficient as assets may not be enough and the insolvency procedures often take inordinately long. As discussed in chapter four, a number of jurisdictions have established a guarantee fund to settle a portion of the employee claims within a reasonable time. Other mechanisms include availing derivative action to employees to sue directors to forestall the collapse of the company, requiring that one of the directors of the company represents employees, encouraging pre-pack arrangement to salvage the company at an early stage and enabling employees to buy their distressed employer.

The foregoing mechanisms protect the rights of employees in corporate insolvency which, in this chapter five, this research recommends that they be adopted in Kenya, together with some amendments to the laws of Kenya to further buttress the protection of employees in corporate insolvency. If the recommendations in this research, discussed below, are adopted by the Kenyan Government, then employees will be effectively protected.

1.2. RECOMMENDATIONS

The laws of Kenya make commendable attempts to protect employee rights in corporate insolvency. However, as earlier stated, there is room for improvement of Kenyan law towards protecting employee rights in corporate insolvency. The law can be reformed to protect the employee rights in a more meaningful and effective way. The law of Kenya can be improved in accordance with the lessons from other jurisdictions identified in Chapter Four.[370] In this chapter, we now venture to recommend the ways the law can be reformed and amended to protect employee rights whose corporate employers are insolvent in a more meaningful and effective way.

1.2.2. Establish a Guarantee Fund

We recommend that the National Social Security Fund Act, 2013 be amended to establish a Guarantee Fund. Such fund exists in Australia, UK and Hong Kong as discussed in chapter four.[371] The proposed guarantee fund should be based on the employer and employee contributions to insure payments to employees who lose jobs on account of corporate insolvency. This recommendation of the fund being based on employer and employee is a departure from the UK and Australian models because, it will not be based on public funds. It is also a departure from the Hong Kong model which is based on annual renewal of registration certificates which is not the case in Kenya.

The fund should be managed by the current National Social Security Fund (NSSF) Board established under section 3 of the Act to manage all funds established under the Act. Employers and employees already make contributions towards the Pension Fund[372], each being six (6) per centum of the employee salary, to the NSSF in respect retirement benefits. The voluntary contributions are channelled into the Provident Fund.[373] The guarantee fund should be established by enhancing the contributions made by

[370] See parts 4.2 to 4.6 herein.
[371] See parts 4.2.1 to 4.2.3 herein.
[372] National Social Security Fund Act, 2013, s. 20.
[373] National Social Security Fund Act, 2013, s. 18(5).

the employee and the employer. Section 18 of the Act should be amended to include the Guarantee Fund over and above the Pension and Provident Funds.

As discussed in chapter three, the Employment Act, 2007 authorizes the Cabinet Secretary for labour to pay employees of an insolvent employer their entitlements out of the National Social Security Fund.[374] This is an improper move in law and amounts to deprivation of the NSSF members of their property. It is also a violation of the NSSF members' right to social security.

Firstly, the National Social Security Fund Act, 2013 establishes the Pension and Provident Funds whose purposes is to pay benefits related to retirement or inability to work.[375] The aim of the present structure of the NSSF is to provide social security in old age or in situations where the member is physically incapacitated from working.

Secondly, the contributions are made by employees and their employers with the full knowledge that those contributions insure retirement benefits. Therefore, the fund is currently composed of the private property of the employees. The NSSF board holds the fund in trust for the employees. It would be a breach of the trust if the NSSF were to pay a section of employees on account of their employer's insolvency. Such payment would have the effect of reducing the available assets for payment of retirement benefits.

Thirdly, even though the Employment Act, 2007 requires the Cabinet Secretary for labour or the NSSF to be subrogated to the benefits of the employee in insolvency, sometimes the insolvent company's assets might not be enough to settle employee entitlement or refund the NSSF. In that case, the payments out of the NSSF would have been lost. The NSSF members' entitlement at retirement would be effectively reduced. This undermines the NSSF members' right to property and social security under Articles 40 and 43, respectively, of the Constitution.

[374] Employment Act, 2007, s. 66
[375] National Social Security Fund Act, 2013 ss. 33 and 41.

It suffices to state from the foregoing, that the 2015 amendment of the Employment Act, 2007, vide Act No. 9 of 2015 to provide for the payment of employee entitlements in insolvency out of the NSSF is baseless and unconstitutional. The provision runs the risk of being declared unconstitutional. It, therefore, does not offer meaningful, effective and solid protection of employee rights in corporate insolvency.

The effective solution lies in establishing a Guarantee Fund with timelines within which the Cabinet Secretary shall pay the employees. The Government has already noted the ineffectiveness and unconstitutionality of the above impugned position of the law. Plans are underway to establish the Unemployment Insurance Fund ("**UIF**") to compensate employees who lost jobs due to Covid-19 or who are unable to work as a result of illness.[376] The UIF will be made up of contributions by the employee and the employer each contributing one percent of the employee's salary. In a departure from our proposal, it is suggested that the UIF will be managed by the State Department for Social Protection (SDSP).[377]

It is thus evident that the establishment of a Guarantee Fund, separate from the Pension and Provident Fund, will provide an effective way of protecting employee rights in corporate insolvency. The Guarantee Fund will also not be under any risk of being challenged as unconstitutional unlike the prevailing position under section 68 of the Employment Act, 2007. This will assist in settling employee entitlements in a timely manner to avoid the long delays occasioned by protracted insolvency process. The Fund will also come in handy where the assets of the employer are not sufficient to pay the elevated employee creditors.

The creation of the Guarantee Fund is likely to engender the phoenix activity in Kenya. Companies may be incentivized to fold up and thereafter resurrect and carry on the same business. This is a challenge

[376] Republic of Kenya: The National Treasury and Planning: State Department for Planning, 'Post Covid-19 Economic Recovery Strategy 2020-2022' (2020) p.39.
[377] Ibid, p.8.

that we will have to live with. To contain the vice, we recommend sanctions on the directors or owners such companies who are found culpable following a forensic audit of the insolvent company's activities. We recommend lifting of the corporate veil. There should be criminal sanctions against the directors or owners and conniving employees. The guilty directors, owners and employees should be ordered to refund moneys paid out of the Guarantee Fund. This will ensure that the Guarantee Fund is self-sustaining.

1.2.3. Strengthening the Preferential Treatment of Employee Entitlements

In Chapter three, this research indicated our concern to the effect that the Insolvency Act, 2015 places employee entitlements in competition with the trade creditors and Kenya Revenue Authority (KRA).[378] The debt owed to suppliers of goods[379] and the amount owed to KRA by virtue of agency notices it has issued against the insolvent company[380] are ranked second in priority like employee entitlements.

Accordingly, we recommend that paragraph 3 of the Second Schedule of the Insolvency Act, 2015 be amended to delete the claims by suppliers and KRA agency notice claims to remove them from the second priority claims. These deleted items may be placed in a separate rank immediately after the second priority claims. This will serve to remove competition with employee entitlements and sufficiently protect the employee entitlements and give meaning to the second priority claims by the employee entitlements.

The suppliers may have different buyers and thus diversify their investments and reduce their risk. The employees cannot diversify their sources of income. The Government is undoubtedly a monolith of an institution and should not be placed in the same rank and be allowed to compete with the wretched employees. Therefore, the employees should not be placed in any competition with any persons in the second rank.

[378] See part 3.9 herein.
[379] Insolvency Act, 2015, Second Schedule para 3(1)(g).
[380] Ibid para 3(1)(h).

1.2.4. Employment Contracts on Transfer of Undertakings

Mergers and Acquisitions (M & A) help breathe life into distressed companies. The acquiring entity injects capital and or new methods of doing business thus bringing back to life a struggling company. This leads to continuity of business of the financially distressed or insolvent company and thus preserves jobs. However, it is not in all cases that the merging entities will preserve jobs. The merging entities are likely to render some employees redundant due to merging of some functions and thus duplication of roles. There is need for a law which compels the merging entities to retain employees.

In M & A, the Competition Authority of Kenya (CAK) has the mandate of considering and approving M & A as discussed in Chapter three.[381] However, there is no clear legal obligation on the merging entities to retain employees. The number of employees retained from the target entity depends on the whim of the CAK. There is no legal obligation on the CAK to compel merging entities to retain a particular number of employees. There are no policy guidelines to aid the CAK to determine the employee question in M & A.

This research thus recommends that the draft Employment (Amendment) Bill, 2019 seeking to preserve employment in M & A be enacted. Under the Bill, the acquiring entity is obligated to retain employees of the acquired entity under same previous terms. This will help in protecting employee rights in corporate insolvency.

It is understood that such a bill is likely to have a negative impact on the economy. It is likely to discourage mergers. Companies merge to save on costs and cut expenses. If they are forced to retain employees, then they are likely to refrain from engaging in mergers and acquisitions. This can be ameliorated by requiring the CAK to assess the situation on a case by case and allowing some acquirers to retain the employees but be free to enter into reasonable contracts with the employees. In those

[381] See part 3.11 herein.

situations, the CAK will desist from insisting that the acquiring entity takes over the employees of the acquired entity under the same terms.

1.2.5. Derivative action by employee representative

The 2015 Companies Act should be amended to empower the employee representative to sue directors who are hell bent on running the company down. The derivative action right should be subject to leave of the court to weed out frivolous suits. This will enable employees to sue on behalf of the company to prevent the misappropriation of company resources.[382] Employee derivative right also serves as a stop-gap measure which should exist to warn directors of potential legal action if they enrich themselves and plunder the employer's assets. This will prevent the directors from engaging in risky and negligent activities detrimental to the interests of employees.[383] Employee derivative action is an enforcement mechanism in the event of director misconduct.[384]

At the moment only shareholders have derivative action under company law. Shareholders are unlikely to institute costly and time-consuming litigation to protect the interests of employees and they may not care whether the employees suffer because of the misconduct of directors.[385] Further, shareholders will not utilize the instrument of derivative action where the directors' action is beneficial to shareholders but detrimental to employees.

Employees should have the derivative action right to sue directors who double up as the owners of the company. Employees are in a better position to obtain information about the misconduct of directors which will then serve as the fodder for the necessary information to sue the errant directors. Shareholders of a privately-owned company have every incentive to siphon money from the business through excessive dividends much to the detriment of employees. In privately-owned companies, there

[382] Neshat Safari & Martin Gelter, 'British Home Stores collapse: the case for an employee derivative claim' (2019) Journal of Corporate Law Studies p.44.
[383] Ibid p. 61.
[384] Ibid p. 53.
[385] Ibid.

are no external shareholders to check the actions of directors. Further, in publicly owned companies, shareholders may not be concerned if directors embezzle employees' pension funds.

1.2.6. Amending the Code of Corporate Governance and Companies Act, 2015

In making decisions, directors are required to consider the interests of employees. However, there is no clear manner on how the directors are to consider the interests of employees.

Therefore, this research recommends that the Code of Corporate Governance and 2015 Companies Act be amended to require large public and private companies to explain how their directors have had regard to the interests of employees in accordance with section 143 of the 2015 Companies Act. This should be done at the end of each year in the Annual Reports.

1.2.7. Provide for Non-Executive Employee Director

Employees have a right to assert their rights and influence decisions of directors of a company. Employees need to be involved in decisions impacting on the fortunes and continuity of the company. They need someone who will champion their rights in the meeting of the board of directors. This will ensure that employee rights in insolvency are protected. This position provides flesh to the employee right to derivative action.

To this end this research recommends that the 2015 Companies Act be amended to require all companies to designate a non-executive director to champion the welfare of employees. The challenge is that if the non-executive director represents divergent stakeholder interests, he might fail to reconcile the interests and thereby be conflicted. In addition, the non-executive director may be isolated on the board and rendered ineffective.[386] Further, they may lack the incentive to carry out their duties and may be beholden to the executive directors who have proposed them. To solve these challenges, the employee

[386] Ibid p. 55.

director should be elected by employees and should only represent employee interests and no other interests.

1.2.8. Trade Unions: Participation of Employees in Insolvency

We recommend that the Employment Act, 2007 and Insolvency Act, 2015 be amended to require consultation of trade unions before the company is liquidated. The trade unions should be consulted before the company is condemned to liquidation. Employees need not be 'lost souls' in insolvency.[387] The trade unions should be afforded opportunity to suggest alternatives to liquidation of the company. This will ensure that the employees are involved in the insolvency process. There exist such provisions in the Zimbabwean[388] and South African[389] law.

1.2.9. Suspension of Termination of employment

At common law, the occurrence of insolvency leads to termination of employment contracts.[390] The 2015 Insolvency Act does not provide specifically for this. The 2015 Insolvency Act should be amended to provide for suspension of termination of employment contract for a period of 60 days pending the Insolvency Practitioner's decision on whether to rescue the company or liquidate it. This is the approach adopted in South Africa.[391]

We recommend that this approach of suspending the termination be infused into the insolvency law of Kenya. This goes a long way of protecting employee rights. This will keep employee jobs if in the end, the Insolvency Practitioner decides to rescue the company.

1.2.10. Encourage the use of pre-packs to facilitate business rescue

[387] Vanessa Finch, *Corporate Insolvency: Perspectives and Principles* (Cambridge University Press, 2017, 3rd ed) p778.
[388] Tapiwa Givemore Kasuso & Kudakwashe Sithole, 'Protection of the Rights of Employees in Insolvency Law: A Zimbabwean Perspective' (SOAS University of London, 2020) Journal of African Law, 65, 1(2021) p 62.: section 25A(5) of the Zimbabwean Labour Act.
[389] South African Labour Relations Act s 189(1) & 197B.
[390] Tapiwa Givemore Kasuso & Kudakwashe Sithole, 'Protection of the Rights of Employees in Insolvency Law: A Zimbabwean Perspective' (SOAS University of London, 2020) Journal of African Law, 65, 1(2021) p. 48.
[391] Insolvency Act of South Africa, s 38(1).

Pre-packs are arrangements where companies with financial difficulties are restructured or sold to another company to maintain them as going concern. This is done before the company is insolvent. To identify companies which are about to enter insolvency, there is need to put in robust risk-assessment measures.

The Insolvency Act, 2015 should be amended to require company auditors to conduct a risk assessment on companies. The auditors should then inform shareholders and directors on when it is right to employ the tool of pre-pack to save the company. If it is necessary to sell or restructure the company, then investment banks will be hired to advise on the process. The law should provide the threshold of shareholders for approval of the pre-pack arrangement to avoid some shareholders from sabotaging the process.

A pre-pack arrangement has the effect of maintaining a financially distressed company as a going concern. It is one of the means of corporate rescue. This serves to preserve jobs. It is thus an effective way of protecting employee rights in insolvency.

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