

## **BANKRUPTCY**

Bankruptcy is defined as a compulsory administration of the estate of an insolvent person by the court for the benefit of the creditors.

Bankruptcy may also be defined as the legal status, imposed by a court, of a person or other entity that cannot repay the debts it owes to its creditors.

A bankrupt is therefore a debtor (excluding a corporate body) against whom a court has made a bankruptcy order. The order signifies that the debtor is unable to pay his debt, and deprives the bankrupt of his property, which then is realised and distributed among the creditors, subject to the following exceptions:

- a. Assets held by him in trust
- b. Tools of his trade
- c. Basic necessities, such as bedding and wearing apparels.

The intention is that the distribution of the proceeds (of the realised property) will discharge the bankrupt from further liability. All types of persons including infants may be adjudged bankrupt. However, bankruptcy proceedings cannot be taken against an insolvent corporate body. An insolvent company can only be liquidated/wound-up (not declared bankrupt).

### **Insolvency**

Insolvency is a temporary inability to pay debt as and when they fall due, because of lack of sufficient liquid assets. Balance sheet insolvency arises where the liabilities of an entity exceeds the assets of the entity. Both individuals and corporate entities can be insolvent.

Insolvency unlike bankruptcy is a temporary inability to pay, does not have to be by a court order, and is not limited to individuals alone.

### **Purposes of Bankruptcy Law**

- i. To inquire into the reasons for bankruptcy/insolvency;
- ii. To secure a fair distribution of the properties of the bankrupt among his creditors;
- iii. To free the bankrupt from his debts.

A bankrupt is not a criminal, although he may commit criminal offence in the course of bankruptcy. In spite of a bankrupt not being a criminal, an undischarged bankrupt suffers the following disabilities: he cannot

- a. vote or be voted for;
- b. be appointed a trustee;
- c. join in the formation of a company or partnership;
- d. act as a director of a registered company or take part in the management of such a company; and
- e. be a chairman or a member of any government parastatal.

### **Who can be declared Bankrupt? (Classes of Debtors)**

Every person (excluding corporate bodies) who has the capacity to contract may be declared bankrupt. Such persons include:

- a. Aliens: an alien may be declared bankrupt if he is domiciled in Nigeria; he has carried on business in Nigeria; and he has a place of business in Nigeria.
- b. Imprisoned criminals: there are no special treatments, they will be treated normally.
- c. Minors: they can be made bankrupt only in respect of legally enforceable debts, such as contract of necessities and unsatisfied judgement in tort, such as libel or negligence.
- d. Persons of unsound mind: they can be bankrupt for debts incurred whilst of a sound mind.
- e. Deceased persons: a dead person cannot be made bankrupt, but if his liabilities exceed his asset as at the time of death, then his estate can be administered in bankruptcy. An order of the court to this effect will override a grant of probate or letter of administration.

### **Causes of Bankruptcies**

- i. Lack of adequate and proper planning
- ii. Poor Credit management: lack of control over credit use

**ASSIGNMENT 1: List and explain 10 possible causes of bankruptcy and insolvency, apart from those listed above)**

### **BANKRUPTCY PROCEEDINGS**

For a debtor to be declared bankrupt, the following proceedings must be taken in law:

#### **a. Bankruptcy Petition**

A bankruptcy proceeding is started by the filing of a bankruptcy petition before a Federal high Court. Before a Bankruptcy petition can be filed, the debtor must have committed an act of bankruptcy. According to the Bankruptcy Act the three types of act of bankruptcy are:

- i. Where a judgement creditor has obtained a final judgement for a certain sum and has served a notice of bankruptcy on the judgement debtor, but the judgement debtor failed within 14 days of the service to pay the judgement debt or could not prove that he has to demand a sum equal to the judgement debt from the judgement creditor;
- ii. Where the goods or property of the judgement debtor have been seized upon the order of a court and such goods or property had been in the possession of the bailiff for 21 days or had been sold;
- iii. Where the debtor presents a bankruptcy petition against himself by filing in the court a declaration of his inability to pay his debts.

**b. Receiving Order**

This is an order of the court in bankruptcy proceedings whereby the debtor's estate is placed under the custody and control of the court. The officer of the court who exercises the power of court custody and control over the debtor's estate on behalf of the court is known as the Official Receiver.

This order does not strip the debtor of his title to the estate. It merely deprives him of possession and control over the property. The receiving order must be published in the gazette. The court shall only make a receiving order if the creditors satisfy the following requirements:

- i. The debt due to the debtor must not be less than ₦2,000;
- ii. The debt must be a liquidated sum (that is, a sum of money already ascertained or known before the presentation of the bankruptcy petition);
- iii. The act of bankruptcy on which the petition is presented must have been committed within three months before the presentation of the bankruptcy petition; and
- iv. The debtor should either be a Nigerian citizen resident in Nigeria or a foreigner who has a dwelling house or place of business in Nigeria.

**c. Filing of Statement of Affairs**

Statement of Affairs is a statement giving an account of the assets and liabilities of the debtor. It provides the details of creditors, and securities, if any, held by the creditors and names of the other persons holding property on behalf of the debtor (trustees). The statement of affairs, unless the court grants an extension of time, should be submitted within 7 days where the debtor files the bankruptcy petition; or 14 days where the creditor files the petition. The statement of affairs should be supported with a sworn affidavit by the debtor. Where the debtor is unable to file a statement, the official receiver may, at the expense of the estate, employ another person to prepare the statement.

**d. First Meeting of Creditors**

As soon as practicable after the grant of a receiving order, the official receiver should summon the first meeting of creditors. The purpose of this meeting is to consider any proposal for a composition or scheme of arrangement put forward by the debtor so as to avoid adjudication. If the meeting accepts a composition or scheme of arrangement, the bankruptcy proceedings shall terminate; but where it is decided that the debtor should be adjudged bankrupt, the meeting can also appoint the trustee in bankruptcy or a committee of inspection.

**e. Public Examination**

When a receiving order is made, the Official Receiver is entitled to apply to the court for the appointment of a time and place for the public examination of the debtor. The public examination of the debtor is a forum to ascertain the affairs, conduct, dealings, property and causes of the debtor's failing. The debtor shall be questioned on oath, but he is not allowed to be represented by a legal practitioner. A debtor shall be excused from public examination in the following instances:

- i. Where the debtor suffers from mental disability;
- ii. Where the debtor suffers from physical liability; and
- iii. Where the debtor is absent from Nigeria.

**f. Adjudication Order**

This is the order of the court declaring the debtor bankrupt. On adjudication, the property of the bankrupt becomes divisible among his creditors and the title in the property becomes vested in the trustee in bankruptcy for the purpose.

Where a debtor is an adjudicated bankrupt, he must in citing his name add the phrase “a bankrupt” (after his name).

According to the Bankruptcy Act, an adjudication order may be made in the following instances:

- i. If the creditors, at the first meeting or any adjournment, by ordinary resolution, resolved that the debtor be adjudged bankrupt;
- ii. If the creditors do not meet; and
- iii. If a composition or scheme of arrangement is not approved within fourteen (14) days after the conclusion of the public examination of the debtor.

**g. Discharge Order**

According to the Act, a bankrupt may at any time after being adjudged bankrupt, apply to the court for an order of discharge. As a matter of general rule, the application must be heard in an open court. Where the bankrupt does not apply for an order of discharge, he may be called upon to come for his discharge at the instance or request of the following:

- i. The court;
- ii. The official receiver;
- iii. The trustee in bankruptcy;
- iv. Any creditor who has proved his debt.

The court may or may not make an order of discharge. Specifically, the court shall refuse to make an order of discharge in the following instances:

- i. Where the bankrupt has committed a bankruptcy offence;
- ii. Where the bankrupt has continued to trade after knowing himself to be insolvent;
- iii. Where the bankrupt has previously been adjudged bankrupt; and
- iv. Where the bankrupt has been guilty of any fraud or fraudulent breach of trust.

However, a bankrupt shall be discharged after 5 years from the date a receiving order was made against him. An order of discharge shall release the bankrupt from all debts provable in bankruptcy except:

- i. Any debt incurred by means of any fraud or fraudulent breach of trust; and
- ii. Any debt due from the bankrupt to the government.

Furthermore, an order of discharge shall be a conclusive evidence of the bankruptcy and of the validity of the bankruptcy proceedings.

Finally, an order of discharge does not relieve a guarantor of a bankrupt or the bankrupt's partner or co-trustee from liabilities, which they are both jointly answerable to.

### **Priority of Costs and Charges**

In the distribution of the property of the bankrupt, payment shall be made in the following order of priority:

- a. Costs incurred in realising the assets of the debtor.
- b. Costs incurred by the official receiver in protecting the property of the bankrupt.
- c. Fees, percentages or charges due to official receiver or trustee.
- d. Remuneration of special manager, if any.
- e. The taxed cost of the petitioners as approved by the court.

### **Priority of Debts**

In the distribution of the property of the bankrupt the following shall be paid in priority to all other debts:

- a. All debts due from the bankrupt to the State at the date of the receiving order and having become due and payable within twelve months before the date of the receiving order;
- b. Wages and salaries (including commissions) of any employee over a period of four months to the date of the receiving order.

### **Landlord's power of Distrain**

The landlord is entitled to retain the assets of the debtor for any rent due to him for the following:

- a. All arrears of rent, if he seizes the property of the debtor prior to the commencement of the bankruptcy;
- b. For only six months' rent priority, if he seizes the debtor's property after the commencement of the bankruptcy. Any balance of rent due after the date of the receiving order will have to be proved as an unsecured creditor.

### **PARTNERSHIP BANKRUPTCY**

In a partnership bankruptcy, the assets and liabilities of the firm are separated from the personal assets and liabilities of the partners.

The partnership assets and liabilities are dealt with under a joint estate, while partners' personal assets are dealt with under the separate estate of each partner.

The liabilities of the partnership are settled from the assets of the business; when the assets are insufficient to meet the liabilities, then the personal assets and liabilities of the partners shall be used to make up for the liabilities.

After settling all liabilities, if there is an excess, this shall be distributed to the partners in the ratio of the balances of their capital accounts at that point in time. If there is deficit, any of the partner(s) with a surplus in his separate estate must transfer the surplus or part of it, to the joint estate to offset the deficit.

### **PROPERTIES AVAILABLE FOR DISTRIBUTION**

The properties of the bankrupt available for distribution among creditors include:

- a. All such property as may belong to or may be vested in the bankrupt at the commencement of the bankruptcy or may be acquired by or devolve on him before his discharge;
- b. All goods being at the commencement of the bankruptcy in the possession, order or disposition of the bankrupt, in his trade or business, by the consent and permission of the true owner, under such circumstances that he is the reputed owner thereof

The property of the bankrupt divisible amongst his creditors shall not include the following:

- a. property held by him in trust for any other person;
- b. Tools of his trade; and necessary wearing apparel and bedding of himself and his family dependent on and residing with him, to a value , inclusive of tool and apparel and bedding, not exceeding ₦1,000 in the whole.

### **ACCOUNTING PROCEDURES**

Having considered the basics of the bankruptcy law, it is important to learn how to prepare the accounts necessary to wind up the affairs of the bankrupt. The required accounts are:

- a. Statement of Affairs
- b. Deficiency Account.

#### **Statement of Affairs**

Statement of Affairs is a statement giving an account of the assets and liabilities of the debtor. It provides details of his assets; creditors, and securities, if any, held by the creditors and names of the other persons holding property on behalf of the debtor (trustees). It contains the details of how much will be realised in respect of each asset of the individual (including private assets). Also it will show the analysis of liabilities as follows:

- i. Unsecured Creditors
- ii. Secured Creditors (differentiating between those that are fully secured and those partly secured); and

iii. Preferential Creditors: those

It is prepared as follows

- a. A rough statement should be prepared with assets on the right hand side and liabilities on the left.
- b. Any item not in the (rough) Statement of Financial Position must appear both in the Statement of Affairs and in the Deficiency Account (double entry).
- c. The Capital must be accounted for in the deficiency account, on the same side as it appears in the Statement of Financial Position. Certain adjustments are required in connection with the capital account.
- d. The balance of the Statement of Affairs and Deficiency Account will be equal and closed by a cross transfer.

### **Deficiency Account**

The Deficiency (or Surplus) account must be attached to the statement of Affairs to explain how the deficiency or surplus in the Statement of Affairs has been arrived at. It generally contains the following:

- a. Losses or gains on disposal of assets (losses on the right side, profits on the left);
- b. Capital and profit or loss account balances;
- c. The double entry aspect of items not appearing in the debtor's Statement of Financial Position.