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Lubricating the Application of Preventive Measures Available to a Company in Difficulty

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Abstract. Companies are a convenient way of doing business, but the life of a company is never uneventful. It may go through some difficult periods, which if not redressed may result to insolvency. With the demise of Arthur Andersen, Enron and WorldCom, companies and countries alike have become increasingly sensitive to signs of corporate demise and insolvency. As a consequence, many countries including the Organisation for the Harmonisation of Business Law (OHADA)'s legislator have designed different measures or solutions to help companies in difficulty (les enterprises en difficultiés) weather any storm they may encounter. It is worth mentioning that the measures designed by the OHADA's Legislator are not confined only to traders, but in general apply broadly to artisans and moral persons of all kinds. One thing is the provision of the measures; while the other is implementation. It is against this backdrop that the paper argues that in spite of the availability of the preventive measures, companies in the OHADA circumference have run afoul of the Law for one reason to the next. With this, the paper seeks to distinguish between financial difficulty, insolvency and bankruptcy; to explore the various preventive measures available to a company in difficulty and the reasons why companies have run afoul of the law with the aim of educating investors, entrepreneurs and the society on what it takes to address any difficulty a company may face and to lubricate the application of the preventive measures.

Keywords: Preventive Measures, Company in Difficulty, OHADA-Uniform Act on Companies, Insolvency

Introduction

Operating a company is a convenient way of doing business, but the life of a company is never uneventful. It may go through some difficult periods when it cannot pay its bills and other obligations by their due date, thus giving him the status of a debtor (Swan, 1948, 376). Issue of difficulties faced by companies has been a great challenge to global economies and companies operating within the Organisation for the Harmonisation of Business Law (OHADA) circumference in particular. As a result, the OHADA legislator has designed different measures or solutions to help companies in difficulty (*les enterprises en difficultiés*) weather any storm they may encounter so as to minimise losses to creditors. It is worth mentioning that the measures designed by the OHADA's Legislator are not confined only to traders, but in general apply broadly to artisanal or agricultural activity, any legal person, including public entities having the form of a private legal person and private legal entities conducting a regulated activity (for instance, credit institutions, micro-finance companies, actors in the financial markets, and insurance and reinsurance companies) OHADA Insolvency Act (OIA) (2015).

One thing is the provision of the measures; while the other is implementation. It is in this light that the paper argues that in spite of the measures, companies in the OHADA circumference have run afoul of the Law for one reason to the next. The author attributes this to lack of awareness of the measures and willful refusal on the part of some companies to apply the measures. Against this backdrop, the paper uses the exploratory and qualitative approaches to distinguish between financial difficulty, insolvency and bankruptcy; to explore the various measures available to a company in difficulty and the reasons why companies have run afoul of the law with the aim of educating investors, entrepreneurs and the society on what it takes to address any difficulty a company may face and to lubricate the application of the preventive measures for better accessibility, comprehension and application by economic operators. The result of this paper reveals the lack of implementation of preventive measures in place for companies in financial difficulty.

Financial Difficulty/Distress, Insolvency and Bankruptcy Distinguished

One may be tempted to say that financial distress, insolvency and bankruptcy are synonymous. Though it is hard to draw a fine line between the three concepts, it is but critical for the author to clear the clouds in order to avoid confusion in the minds of the readers. The term financial distress comes up a lot, but one of the major concerns is the lack of consensus as to the definition of financial distress. This therefore means that there is no strict technical or legal definition for the term financial distress. However, according to DePamphilis (2012), the term financial distress applies "to a firm that is unable to meets its obligations or a specific security on which the issuer has defaulted." This definition is not exhaustive, and is therefore associated with that of Kenton (2019) according to who, financial distress can be seen as a "condition in which a company or individual cannot generate revenue or income because it is unable to meet or cannot pay its financial obligations". For him, this is generally due to high fixed costs, illiquid assets, expensive financing, and opportunity costs of projects, and employees who are not productive (DePamphilis, 2012).

For Corporate finance institute, financial distress is the situation where an individual or company's financial condition leaves them struggling to pay their loan payment CFI (2015). Beaver who modeled, classified and predicted corporate bankruptcy defined financial distress as "bankruptcy, insolvency, liquidation for the benefit of a creditor who have, firm which defaulted on loan obligations or firms that missed preferred dividend payments" and concluded that cash flow is the single best indicator of bankruptcy (Muller, 2012). It follows from this definition that financial distress, bankruptcy and insolvency are synonymous meaning they are one and the same thing. He went further to conclude that that cash flow insolvency is the best indicator of bankruptcy meaning that the lack of cash is the major ground on which a company can be adjudged bankrupt. Although this definition is all embracing of the concepts of financial distress and bankruptcy, it does not in clear terms distinguish the concepts. Financial distress is equally defined as "the "situation in which an organisation or individual is not capable enough to honour its financial obligations as a result of insufficient revenue".

The author in her own position thinks that the understanding provided by the various writers and authors above are limited and inexhaustible. Thus, the author believes that, there is a cut-off point between financial distress, insolvency and bankruptcy. For the author, financial distress is the financial condition of a company in which it cannot generate income or the period when a company is facing actual and feasible difficulties but it is not yet balance sheet insolvent. This is in fact saying that the company is at the verge of insolvency. Insolvency otherwise called *cessation de payment* is "the status of the debtor who is unable to pay its due debts out of its available assets, excluding situations where reserves of credit or payment moratoria granted by creditors enable the debtor to settle due debts" OIA (2015). Put differently, insolvency is when a company's liabilities are more than its assets or when a company has assets tied up in stock but lacks liquidity to pay of its creditors. OHADA adopts the balance sheet approach of insolvency which remains the single best indicator of bankruptcy within the OHADA region.

On the other end of the continuum, bankruptcy is the legal process in which an insolvent company is adjudged bankrupt by a competent court. Thus, when insolvency sets in, the debtor is required to make a declaration no later than thirty (30) days following the occurrence of the insolvency to the registry of the competent court against a receipt for the opening of bankruptcy proceedings: reorganisation or liquidation proceedings (OIA, 2015). This is accompanied by some relevant documents such as certification of incorporation and summary of financial statements just to name a few (OIA, 2015). Regardless of the dividing lines between financial distress and bankruptcy, insolvency is not a taboo or stigma but an inevitable aspect of life which can happen to just anyone even if well managed or capitalized and can result from many things, the events of which are endless. It may result from expensive financing, bad debts, less productive employees just to name a few.

Since we cannot predict insolvency, we can at least prepare for its occurrence. In so doing, the OHADA legislator has put in place several measures that a company can apply to navigate through insolvency. It ranges from conciliation, arbitrator to the appointment of a temporal administrator. With this, it is otiose to proffer a detail understanding of the preventive measures adopted by OHADA.

Understanding the Measures Available to a Company in Financial Difficulty

As mentioned above, the OHADA legislator has designed several measures that a company can apply to navigate through difficulty. It ranges from a warning procedure (*procedure d'alerte*), corporate transformation to the appointment of a temporal administrator.

The Warning Procedure (*procedure d'alerte*)

When in difficulty, persons with capacity such as the members or auditor may question the chairman of the board of directors or managing director as the case may be on any matter likely to jeopardize the continued operation of the company (Revised Companies Act, 2014), a process known as a warning procedure (*procedure d'alerte*) (Martor, 2003). This procedure is an innovation in the UA on Commercial Companies and Economic Interest Group (otherwise called the Revised Companies Act) and it guarantees and reassures investors of their investments. Like in France, the purpose of a warning procedure is to inform those in charge of the business that there are problems and to compel them to address them (Bell, 1998). Bell reveals that it is the responsibility of the company to address the problems it faces by describing the comptemplated means to address its problems. In describing the comptemplated means, the company may decide to do nothing about it, develop a head in the sand attitude, that is, pretending that all is well with the company or address the situation by transforming the company, referring the situation to a competent court for the appointment of a temporal administrator, commencement arbitration proceedings or the grant of preventive measures such as the preventive conciliation proceeding (règlement amiable) and preventive settlement proceedings. These measures are designed to help a company in difficulty negotiate its way out of problems and minimise losses to creditors.

Comptemplated Means to Address Financial Difficulty

Concerning the means, they include but not limited to corporate transformation and referral to court for the appointment of a temporal administrator, commencement arbitration proceedings or the grant of preventive measures.

The way to corporate transformation: Merger and partial transfer of assets (divestiture)

Corporate transformation otherwise called corporate restructuring is an operation whereby the company changes its legal form by decision of its members. When firms are transformed, the resulting transaction is known by many names: merger, division, partial transfer of assets, acquisition, consolidation, or takeovers. Building on article 189 of the Uniform Act on Commercial Companies and Economic Interest Group (Revised Companies Act, 2014), a merger is an operation whereby two firms combine to form either a new company or one acquiring the other. The case of Grant Thornton (2017) is an example of a merger. In contrast, a divestiture is the transfer of a part of a business through sale to another existing or newly created company or its product line to another for cash or securities (Revised Companies Act, 2014).

Unlike a merger where there is dissolution of the absorbing company without liquidation, the transferring company does not cease to exist in the event of a partial transfer. Moreover, in all instances, there is the transfer of contracts of employments with possible exchange of shares by shareholders in the target companies for those of the acquiring company or new company or accept cash for their shares which must not exceed 10% of the exchange value of the shares or stock allocated (DePamphilis, 2012). As for the debts and liabilities of the target company, they are assumed by the acquiring company. Also, the procedure for a merger is in tandem with those of partial transfer (Revised Companies Act, 2014).

Depamphilis advanced visible reasons why a company may engage in corporate transformation. For him, it is for a reduction of their average cost of capital by combining with a firm with excess cash flow or insufficient funds (DePamphilis, 2012). When this is done, the firm with insufficient funds is saved and cost of borrowing is reduced. Consider the merger of A and B. If A has a plant that is producing at only one half its capacity while B is producing the same product at a much higher capacity, the merger of both would enable A to shut down firm B and move production to its own underutilized facility. Undoubtedly, it is always cheaper to combine multiple product lines in one firm than to produce them in separate firms. Apart from reducing the cost of borrowing, the merger would increase the cost of capital for the surviving firm or newly created company. Connected to this is the desire to achieve greater returns for the shareholders. In so doing, firms may diversify by buying firms which are outside its line of business, shifts its core product line or market in a market with higher growth (DePamphilis, 2012).

The firm may equally acquire related investments as was the case with Retailer JC Penney's 3.3 billion pounds acquisition of Eckend Drugstore Chain in 1997 or Johnson and Johnson's 16 billion acquisition of Pfizer's consumer health care. Though the acquiring firm will acquire additional cost and risk but it would be less than with unrelated diversification. Researchers have found that the most successful mergers in developed countries are those that focus on deals that promote the acquirer's core business (related diversification) because of their familiarity and ability to optimize investment decisions and its overlapping functions and product lines (DePamphilis, 2012).

Although the Companies Act encourages merger between companies, article 3 of the law on Competition (1998) prohibits "practices that would effectively prevent, distort or restrict significantly the performance of competition in the market ...." likewise, any merger or acquisition that will restrict competition in the market. In this case, unfair competition between enterprises in the same line of business is being discouraged in all its facets by the legal instrument (Mbonteh, 2017) except it is to give a dying company a boost or promote competition which must be proven by the companies involved in the merger or acquisition. Thus, MTN Cameroon cannot acquire Nextel or other communication companies for reasons other than to boost a dying company and promote competition in the market. Suffice it to say that if satisfactory responses are not forthcoming from the management of the business after employing the above measures, the company can resort to court for the appointment of a third party: arbitrators, temporal administrator, conciliator and preventive settlement expert. As PricewaterhouseCoopers (PWC) so succinctly puts it "these are exceptional measures requiring the involvement of a third party in the running of the company (PWC, 2014).

Exceptional measures and the role of a third party in the management of a company in difficulty

Here a third party plays an active role in the management and resuscitation of the company in difficulty. The third party so appointed by the court at the behest of the company is an expert with knowledge and experience in the field of corporate restructuring. Upon appointment either as an arbitrator or administrator, he is required to ensure the smooth running of the company by resolving disputes or misunderstanding that may arise between the company and its shareholders or between shareholders which paralyses the normal functioning of the company.

Appointment of an Arbitrator (s)

In difficulty, a shareholder may refer the matter to a competent court for arbitration (Companies Act, 2014). OHADA framework on arbitration makes no distinction between domestic and international arbitration (Fouchard, 1999). This is to create a unitary arbitral system. Instead, OHADA provides for institutional arbitration under the auspices of the Common Court of Justice and Arbitration (CCJA) in accordance with the CCJA's Rules of Arbitration and ad hoc arbitration in accordance with the UA on Arbitration, both of which complement each other in matters not sufficiently dealt with or regulated by the law. In arbitration, parties are at liberty to appoint arbitrators. The UA on Arbitration and the CCJA Rules of Arbitration recognise the principle of equality between the parties in the formation of the tribunal, the appointment and dismissal of arbitrators. The principle of equality, as confirmed by Article 9 of the UA on Arbitration, states that "the parties shall be considered as equals and each party should have the possibility to assert its rights". This principle ensures that no party has greater influence over the other.

Under both rules, the arbitral tribunal is composed of either a single arbitrator, or a panel of three arbitrators appointed by the parties themselves (Arbitration Act, 1999). In case of a unique arbitrator, a joint appointment is made by the parties, and in the case of three, parties each appoint an arbitrator and jointly appoint the third within 30 days from the date of notification to the other party. A likely problem that may be encountered in the appointment of the third arbitrator is the possibility of dissenting and separate opinions between the parties. Upon appointment, the arbitrator is expected to resolve the dispute between the parties in accordance with the law designated by the parties, failing such designation, the arbitrator shall apply the law most appropriate taking into account international trade customs and usages applicable to the transaction. Arbitration proceedings are held in camera, but it does not mean they are not subject to review. Third parties are allowed to attend hearings for the consideration of their views. After the parties have been heard, the arbitrators make the necessary award.

Article 25 of the OHADA Treaty recognises the *res judicata* nature of arbitral awards of the CCJA, and its enforcement in accordance with the ordinary rules of civil procedures of the member states. It must however be noted that an arbitral award granted contrary to public international order is null and void as was the case in *Société Planor Afrique (SA) v Société Atlantique Telecom (SA)* (Judgment, 2011). For Yacoob (2007), arbitral awards are only enforceable in the state in which it is issued. However, for an enforcement of an award in a state other than the one in which it is issued, the requesting state must apply for an enforcement order (*exequatur*) and only the CCJA is competent to issue an exequatur *for* the enforcement of an award issued by the Court in the rest of the member states. An *exequatur* may be denied in the following cases: firstly, if the arbitrator failed to rule in accordance with the arbitration agreement; secondly, if there is lack of due process; and thirdly, if the award is contrary to a country's international public policy (OHADA Treaty, 2008).

Appointment of an Expert/Temporal Administrator

The appointment of a temporal administrator for the operation of a deadlocked company is an innovation open to all companies regardless of the form of company (Revised Companies Act, 2014). Unfortunately, the Act does not define the term expert. However, it may be defined as a temporal administrator, business management expert or an individual with knowledge and experience in the field of corporate restructuring. As Yves Chassagnon (1954) puts it, "The person appointed by the courts must manage the company temporarily and resolve the issues that led to his appointment". This therefore means that he must ensure the running of the company experiencing difficulties, present to court a report after every three months spelling out his operations carried out and progress made. As a court appointed agent, he derives his powers from the court and not from the general meeting of shareholders (Bakreo, 2017). With full powers, the administrator must draw up the annual summary financial statement based on the inventory of assets and liabilities.

The duration of the temporal administration is limited to six months with a possible six months extension at the request of the expert outlining reasons why he is unable to complete his tasks, steps he plans to take and length of time required to complete his task. The expert's amount of remuneration fixed by the court is born by the company. It is not clear on what basis the expert's remuneration will be calculated. With reference to the International Association of Insolvency Regulators document on The Regulatory Regime for Insolvency Practitioners, that is, the IAIR Principles, the expert's remuneration should be remunerated out of the debtor's assets with reference to the complexity of the task and amount of work in hours undertaken by the expert and its staff (IAIR (Principles).

The appointment of a temporal administrator is possible in three instances, that is, when the normal functioning of the company is no longer possible, if the company is threatened with bankruptcy or when management is clearly hampered by serious disputes between the shareholders as was the case in *Sieur Noubicier Léon C v. Sieur Ngamako Michel* (Bafang Court, 2007). In *casu*, a temporal administrator was appointed due to disagreements that led to deterioration in the relationship of two partners. For a company threatened with insolvency, the applicant is required to prove that the situation is urgent; that his interest is at risk and that only the appointment will remedy the situation. Upon receipt of the application, the court appoints the administrator taking into consideration the company's interests over the personal interests of certain partners, even if they are in the majority (PWC, 2014). Aside the above instances, an administrator is appointed when major shareholders refuse to give access to information about the company's financial and accounting position during the annual general meeting or refuse to amend the meeting's agenda.

Again, he is appointed when there is a fraudulent purchase of a partner's shares by the managing partner as was the case in *Peughoua Emmanuel et Kamkeng François v. Tene Job case* (Bonanjo Court, 2004) or when there is abuse of minority and majority powers or equality rights. There shall be abuse of majority powers when the majority shareholders vote in favour of a decision which serves solely their interests at the detriment of the minority shareholders; its creditors and the company itself (Fruehauf Summary judgment, 1973). On the other hand, there is abuse of minority powers where, in voting, minority shareholders object to decisions which are necessary for the company's interests and cannot show any legitimate interest

Preventive Measures: Conciliation and Preventive Settlement Procedures

The common features of conciliation and preventive settlement procedures is that they are designated to promote private negotiation between the debtor and its creditors so as to safeguard companies facing difficulties and improve the recovery rate of both secured and unsecured creditors. Secondly, they are available to companies which are not yet insolvent but are in dire economic and financial problems (Diarrah, 2015). Quiet apart, conciliator is appointed to help parties reach a compromise in the settlement of claims while the preventive settlement expert, known as the bankruptcy trustee is appointed to supervise the execution of the preventive composition agreement and to report any violations to the administrative judge (OIA, 2015).

Preventive Conciliation Procedure

A preventive conciliation procedure is a consensual and confidential procedure. As a court driven process, it is opened at the request of the company in difficulty, that is the debtor company or at the joint request of the debtor and its principal creditors describing the difficulties the company face and contemplated means of addressing the difficulties. Upon receipt of the request, the president of the competent court may or may not grant the procedure. If he so decides to open the procedure, he then appoints a conciliator whose role is to help the company and its main creditors reach an amicable settlement. This procedure is limited to three months with a possible one month extension at the request of the company in difficulty. It should be mentioned that the negotiation of an amicable settlement does not bar the commencement of legal actions against the company. However, once an amicable settlement is reached, legal actions against the company are suspended or prohibited for as long as the amicable settlement agreement is not terminated. Conciliation is important because it is confidential, in that it does not give rise to publicity; it is possible even in the event of insolvency and that it gives the conciliator the opportunity to organise for a partial transfer of assets. This of course is at the debtor's request with the consent of his creditors (Nouri, 2015).

Preventive Settlement Proceedings

Like a conciliator procedure, it is opened at the request of the company in difficulty or at the joint request of the company and its principal creditors. It is pertinent to note that preventive settlement proceedings may only be instituted by a debtor once every five years (OIA, 2015). Although the Insolvency Act does not state the rationale for this limitation, it would seem that it is aimed at preventing abuse by unscrupulous debtors, and protecting creditors. In Batoula (Pty Ltd) Company of Cameroon (Batoula, 1974), the company at the time of application had debts in the sum of 1,068,095,834CFA franc (approximately US$ 2,200,000). Upon receipt of the application and investigation by the appointed expert Yimgnia Crispin, the company was subjected to a preventive settlement proceeding (Wouri High Court, 2008). The granting of a preventive settlement order suspends all pending lawsuits (OIA, 2015) except those relating to "employees due wages" or acknowledgements of rights or disputed debts. It also prohibits the debtor from making any payment or redeeming any securities except with the authorisation of the president of the competent court.

The case of *SACAM SARL v. SDV Cameroun SA* (Bonanjo Court, 2007) accentuated on the effects of a preventive settlement procedure on the debtor and its creditors. As per the court, the grant of the order suspends all actions against the company and makes preventive composition agreement compulsory for creditors whether secured or unsecured. Notwithstanding the provisions of articles 9 and 18 (3) of the Insolvency Act, creditors have the rights to bring an action against the co-obligator of their debts. In view of the above, one may conclude that the above-mentioned measures are intended for companies facing actual and foreseeable difficulties. If, despite the measures, a business becomes insolvent, then judicial proceedings: reorganisation and liquidation may be brought to provide a definitive solution that is binding on all parties. But, instead of applying for the grant of any of the preventive measures, companies in difficulty have run afoul of the law by filing for the commencement of insolvency proceedings and the question is why. The author attributes this to the confusion existing between financial distress and insolvency, willful refusal to apply the laws and lack of awareness of the existing measures.

Reasons for the Culture of Under Filing for the Above Measures and Prospects

As for the author, there are two visible reasons behind the culture of under filing of the above measures: confusion existing between financial distress and insolvency, willful refusal to apply the laws and lack of awareness of the existing measures. To start with, the confusion has been to draw the line between the three concepts, thanks to this paper which now provides a clear understanding of the concepts. The truth is more people especially Anglophone Cameroonians are not aware of OHADA laws and hence the preventive measures. The lack of awareness due to either by language and OHADA's ability to disseminate the laws has many difficult for business operators to apply the measures. In an interview in kumba, one magistrate attached to the High court said "he did not really know the measures or the law, the reasons being that the law is in French, it is relatively new and many judicial personnel in the anglophone regions are not informed of the law" (Leno, 2019). Leno (2019) believes that the fact that the laws are in French and are relatively new constitute barriers to the effectiveness of the law; because people are not yet familiar with the law. Some lazy lawyers and economic operators will never read the official gazette or listen to the news. A lawyer attached to the court of first instance of kumba said "they are hardly faced with companies in difficulties, but when it arises, we quickly check the part of the law which is related to the facts and advice the client". From the above, we deduced that there are lawyers and judges who are not aware of the law and the measures and as such cannot apply laws or measures they do not know. If they do apply, it will unavoidably lead to misinterpretation and misapplication of the law.

The willful refusal to apply the laws provides yet another reason why companies are not filing for the grant of preventive measures. Some lawyers and judges are well informed of the laws and the measures but refused to apply it for one reason or the other. Justice Aya Paul in the case of *Akiangan Fombin Sebastian v. Fotso Joseph and others* (Unreported) (Kumba High, 2000) dismissed the application of the OHADA laws because they are basically French (Akiangan, 2000). The cost and lengthiness of the procedures provides yet another reason. For Mr. Daniel, manager of Tchanricam Enterprises, he cannot involve his enterprise in those procedures because it is waste of time and money for nothing (Leno, 2019). The problem of cost of proceedings is real and starts from the moment the debtor files for any of the above measures. The cost incurred ranges from certification of documents and remuneration of experts which make heavier the financial expenses of the debtor. This scared debtors' especially small businesses.

With the reasons discussed above, we may just conclude that in lubricating the application of the preventive measures, much is needed in terms of training of judges, corporate managers and other judicial personnel on the measures available for the treatment of businesses in difficulty. Most importantly, awareness campaigns should be organized across the country for better understanding of the laws and the available measures. Because the government cannot do it on its own, it should partner with other companies in and other of the country for a better organisation of the trainings and campaigns. OHADA on its part must continue to translate the laws, this time involving Anglophones experts for effective translations.

Conclusion

In a nutshell, in any difficulty, the company may employ a number of measures with the aim of preventing insolvency and negotiating its way out of problems. In spite of the measures, many businesses have run afoul of the measures by resorting to the opening of insolvency proceedings; a problem which can be attributed to the confusion between insolvency, bankruptcy and financial distress; refusal on the part of some people to apply the laws or the measures and lack of awareness of the existing measures. Much is needed and in so doing, the author recommends for trainings and sensitization campaigns across the country. The application of the preventive measures leaves much to be desired, but if Cameroon rises up to the challenge by implementing the above recommendations, then a conducive business environment will be a created for investors.

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