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The objectives of corporate insolvency law: lessons for Uganda

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Abstract

Purpose – This paper aims to provide guidance to law reformers in Uganda on the best approach to insolvency law reform and the objectives that should be furthered.

Design/methodology/approach – This paper provides a literature review.

Findings – A balance of various objectives serves the purpose of a modern insolvency law system.

Originality/value – These findings would enable future reforms in Uganda to be streamlined towards a particular objective rather than a general approach to insolvency regulation.

Keywords Uganda, Companies Act 2012, Insolvency Act 2011

Paper type Conceptual paper

1. Introduction

The first ever Insolvency Act in Uganda was passed by Parliament in 2011. Prior to that, corporate insolvency laws were found in the Companies Act 1961, the Bankruptcy Act 1931 and the Deed of Arrangements Act 1931. These were laws enacted by the Protectorate Government when Uganda was still under British colonial rule. At the turn of the twenty-first century, Uganda was still dependant on colonial laws that simply did not serve the needs of the commercial sector. In 2000, the Uganda Law Reform Commission (ULRC) took on the difficult task of reforming insolvency law in Uganda[1]. This culminated in the Insolvency Bill 2009, titled:

> An Act to provide for receivership, administration, liquidation, arrangements, bankruptcy, the regulation of insolvency practitioners and cross border insolvency; to amend and consolidate the law related to receiverships, administration, liquidation, arrangement and bankruptcy; and to provide for other related matters.

The Bill provided an overhaul of insolvency law in Uganda by amalgamating the various insolvency laws and introducing new insolvency procedures such as administration, strengthening the rights and duties of insolvency practitioners and introducing provisions in areas such as cross-border insolvency.

Insolvency law aims to serve the interests of all company constituents because corporate failure impacts a range of company constituents such as creditors, employees Nyombi (2013), shareholders and the economy. However, the challenge is how to balance a range of interests at a time when the company does not have enough resources to meet the demands of every constituent. It is vitally important that insolvency law serves the correct insolvency objectives. For scholars and practitioners, without clarity over the aims and objections that ought to be furthered, it is only possible to describe legal states of affairs and make prescriptions based on insolvency ideas. Thus, the aims and objectives of insolvency law have to first be established to evaluate the insolvency law reforms in Uganda. It is also not feasible to set out a single rationale for corporate insolvency law; thus, a number of

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objectives may have to be balanced against each other. This paper reviews research literature on the competing approaches to insolvency regulation. It provides suggestions on an approach that allows a balance of objectives.

To determine the objectives of the Insolvency Act 2011, the statement of aims contained in the 1982 Cork Committee Report, which is the main source of modern English insolvency law, must be examined[2]. The Cork Committee drew up a number of aims and objectives of a modern insolvency system. The statement of aims was considered by the ULRC when making insolvency law reforms. However, the aims were scattered all over the report; thus, they must be brought together to produce a concrete statement of aims[3]. The aims are as follows (in no particular order of preference):

- to enable the preservation of viable commercial enterprises[4];
- to provide a strong insolvency law framework; which is simple and easily understood, and free from anomalies and inconsistencies, but one which is also flexible enough to cope social and economic changes;
- to fairly and equitably distribute proceeds of realisation amongst creditors and return the surplus to the debtor;
- to prevent conflict between different creditor groups;
- to experience minimum delay and expense in the course of realising the assets of the insolvent;
- to diagnose and treat an imminent insolvency at the earliest stage;
- to safeguard to interests of the insolvent and their creditors, as well as society groups such as employees, suppliers and communities who are affected by insolvency[5];
- to warrant honesty and competency in the realisation and distribution of the insolvent's assets;
- to produce practical solutions to financial problems and to underpin the credit system;
- to investigate the causes of insolvency and decide on measures to be taken if the conduct warrants criticism or punishment;
- to fully and sufficiently investigate the cause of insolvency and to discourage unscrupulous or undesirable actions by the board of directors, members, creditors or any other stakeholder[6]; and
- to ensure respect and recognition abroad (cross-border insolvency).

The Insolvency Act 2011 did not provide a formal statement on purposes or objectives of insolvency but largely endorsed Cork's statement of aims. However, the ULRC expanded on Cork by stressing the need to provide a statutory approach that would oblige companies to pay attention to their finances to diagnose difficulties at the earliest stage and thus escape the decline into insolvency[7].

Cork's statement of aims was subject to criticism in the Justice Report of 1994[8]. It was stated that Cork failed to produce a coherent body of core principles, rather he left behind a collection of principles that offered no sense of direction[9]. The criticism raises an important question: are they sustainable and useful objectives for a modern insolvency law system? Judging from the transformation in English insolvency law (such as "rescue culture")[10] since the passing of the Insolvency Act 1986, they are useful objectives, but their sustainability remains doubtful, especially when transplanted into a third-world country

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like Uganda. In literature, however, some attempts have been made to formulate a single objective for corporate insolvency.

1.1 Creditor wealth maximisation approach

Inspired by law and economics research (Bhandari and Weiss, 1996), largely stemming from the USA (Baird, 1986; Jackson and Scott, 1989), a number of scholars have argued that insolvency law processes can only be carried out through one objective, which is to serve creditors interests by maximising their return (Baird and Jackson, 1984; Jackson, 1986). One of the leading defenders of this approach is Jackson, who argues that insolvency law is merely a tool for debt collection in response to the problem of diverse owners enforcing their rights against the remaining pool of assets (Jackson, 1986, chs. 1 & 2; Finch, 2009a, 2009b). Using "creditors' bargain theory", he suggested that if creditors were allowed to choose their position during insolvency, behind a "veil of ignorance", they would choose collectivism rather than individual actions[11]. The veil of ignorance would make creditors unaware of their legal status, position in the company and any other factors that may influence them to advance personal interests. However, they would be allowed to foresee that insolvency would affect a number of stakeholder groups. On the other hand, he argued that other stakeholders such shareholders would prefer partial collectivism to the detriment of company creditors. He believed that collectivism would be attractive to creditors because it increases the aggregate pool of assets, is administratively efficient and lowers strategic costs as compared to an individualist approach. On that basis, as a collective compulsory insolvency regime is at the heart of insolvency law, the objective can be reached by serving creditors interests.

However, the creditor wealth maximisation argument does not support the protection of non-creditor interests such as employees and communities as one of the objectives of insolvency law (Jackson, 1986, p. 25, Finch, 2009a, 2009b, pp. 32-40). Keeping the company trading during insolvency is not supported as one of the goals of insolvency law, as the interests of employees are overlooked to maximise creditors' returns. It protects pre-insolvency rights and does not support the creation of new rights during insolvency. Thus, insolvency law is concerned with maximising the value in the pool of assets and not entitlements to the pool.

Creditor wealth maximisation has been given legislative effect in many jurisdictions around the world. For example, the German Bankruptcy Code of 1999 aims to create a bankruptcy system that would rationalise debt collection (Schiller and Braun, 1999; Balz, 1997). However, treating insolvency as a debt collection system for the benefit of creditors has received extensive criticism (Carlson, 1987; Finch, 2009a, 2009b; Countryman, 1985; Sullivan *et al.*, 1989). It fails to recognise the legitimate claims of other contract creditors such as employees, communities and suppliers (Korobkin, 1993; Warren, 1987; Gross, 1994). Treating insolvency as a mere sale of assets for the benefit of creditors undermines the view that insolvency is a problem of business failure, which must be used to assist companies to continue to avoid liquidation. It also undermines policy reasons because insolvency law gives a moratorium or allows a company to reorganise itself through schemes of arrangement to preserve jobs; thus, non-economic values such as moral, social and political considerations form part of insolvency (Korobkin, 1991; Posner, 1979; Dworkin, 1980).

The idea that a troubled company is a mere collection of assets for distribution to creditors is questionable. Creditors' wealth maximisation theory treats the company as mere property rather than an organic enterprise. A corporation, as an enterprise, can change its personality and plays not only an economic role but also a social role in the country. This is why in many countries around the world, such as the UK, rehabilitation of the firm and the

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concept of corporate rescue have been widely established as legitimate approaches to dealing with insolvency[12]. This supports the view that a company is an organic enterprise with the potential to escape liquidation and not merely a collection of distributable assets.

Furthermore, there is no pool of assets that creditors can have a claim against before insolvency. This undermines the view advanced by creditor wealth maximisation supporters that a pool of assets should be awaiting them during insolvency. Creditors extend credit on the basis of repayments made from income and not from sale of fixed assets, unless the credit is secured normally through a fixed or floating charge. That said, income is not generated from assets alone but also depends on input from organisational actors such as employees, suppliers and customers. Thus, creating a pool of assets for creditors during insolvency is not supported by contractual and commercial jurisprudence. It undermines the view that insolvency law should maximise the value of pre-insolvency assets, in which case creditors would have none, and not to disturb any pre-insolvency entitlements.

The creditor bargaining model, which is advanced as support for the creditor wealth maximisation ideals, has been subject to criticism. It restricts participation only to contract creditors and assumes that contract creditors would know their status during insolvency.[13] If given a chance to choose a position during insolvency, such creditors are more likely to agree to maximise the pool of assets for distribution to themselves (Korobkin, 1993, p. 555). Thus, the choice of collective administration of insolvency is not necessarily reached through fairness and rational consensus but individualism and irrational greed.

Furthermore, the bargaining model assumes that creditors are all equal as they set out to protect and prove their entitlements over the pool of assets (Carlson, 1987, pp. 1,348-9; Korobkin, 1991, pp. 736-7). However, creditors differ in their knowledge, skill and wealth, which are essential elements during the bargaining process. Powerful creditors such as security holders are unlikely to agree to collectivism alongside their unsecured counterparts. Given the disparities, it is likely that creditors will agree to an entitlement that mirrors their bargaining position (Korobkin, 1993, p. 552). This means that unsecured creditors would choose a collective insolvency regime, whereas their secured counterparts would choose a more individualist regime.

Creditor wealth maximisation also assumes that all creditors have a purely economic interest during insolvency. However, this is questionable because creditors such as employees face displacement costs, which are separate from their economic wages (Ogus, 1994; Breyer, 1982). With that background, employees may not agree to a collective insolvency process because they may consider displacement costs to be of a higher priority than wages. However, inequalities of the employer/employee bargaining positions make such expectations very unrealistic. Alternatively, they may deem their claims to morally rank ahead of secured creditors and insist on higher priority for wages. Thus, it is not clear-cut that creditors share a purely economic interest during insolvency (Van Wezel Stone, 1993).

Furthermore, by supporting the enforcement of pre-insolvency rights, creditor wealth maximisation accepts the state determined insolvency collection and distribution process without question (Warren, 1987, p. 790, 802, 808). State pre-insolvency entitlements are designed in line with contractual agreements. However, one of the aims of an insolvency system is to be flexible to apportion assets in new and different situations that may arise. The state insolvency approach must look beyond pre-insolvency rights and find a fair balance to creditors' bargain when new situations arise. New and different situations would cover parties without formal legal rights, whose interests are overlooked under creditor wealth maximisation (Warren, 1993). Such a balance is normally achieved by adopting a base-line rule on equality (*pari passu*) and allowing a number of exceptions to that rule.

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Thus, the argument that insolvency law should only give effect to pre-insolvency rights goes against the proper function of insolvency law, which is to pursue different distributional objectives in given situations to preserve fairness. With that background, Jackson's approach omits from consideration those without formal legal rights who may suffer hardship because of corporate failure[14].

1.2 The contractarian approach

In an attempt to overcome the shortfalls in creditor wealth maximisation, Donald Korobkin formulated a broader contractarian approach as the main objective of insolvency (Korobkin, 1993; Finch, 2009a, 2009b, pp. 38-40; Mokal, 2001, 2005). Jackson justified creditor wealth maximisation by referring to pre-insolvency rights that contract creditors would agree to if they were placed behind the veil of ignorance. As a result, he argued that they would choose a collective insolvency process. In light of the abovementioned limitation of credit wealth maximisation, Korobkin went a step further by placing not only contract creditors but also every stakeholder who may potentially be affected by the company's failure behind a veil of ignorance, including tort claimants and the community.

According to Korobkin, the groups standing behind the veil of ignorance would select two principles to govern the insolvency process (Korobkin, 1993, pp. 575-89). First, a principle of inclusion was selected, which supports all parties impacted on by the distressed company to bring their demands. Second, a rational planning principle would be used to determine whether and the extent to which a party can enforce their legal rights and exert influence over the insolvency process. Guided by these two principles, Korobkin argued that the insolvency system would maximise the most important aims and allow the formulation of rational and long-term plans. It would also allow groups in worst positions to be able to protect and promote their aims rather than being stepped on by those in stronger positions. He believed that his contractarian approach will allow development of insolvency laws similar to those in America (Bebchuk, 1988). However, the contractarian approach differs markedly from other proposed "contractualist" insolvency regimes in America, which suggest that if businesses are allowed to choose an insolvency system, they would choose one in which they are free to bargain in advance for rules (which would also override any federal insolvency rules) to govern their rights during insolvency (Adler, 1993; Rasmussen, 1992; Warren and Westbrook, 2005).

However, his approach, like that of Jackson, is questionable (Finch, 2009a, 2009b, pp. 38-40). First and foremost, the choices made by individuals behind the veil of ignorance largely depend on the nature of the person, for instance, in terms of experience. Thus, it is not possible to completely cast a veil over an individual, yet Korobkin concludes that they would choose the two principles. This is simply "a theoretical attempt to isolate what cannot be isolated"[15]. Furthermore, risk neutral and risk-averse groups of individuals may also choose differing principles. There is no clear explanation advanced on why an individual behind the veil of ignorance may select a system of high protection for weak groups instead of low protection, especially as different categories of individuals would be standing behind the veil.

Second, supporters of creditor wealth maximisation might doubt the contractarian approach because insolvency law principles designed by veiled and inclusive groups are likely to protect a wide range of interests, thus making the insolvency process very uncertain and increasing the cost of credit. However, Korobkin believes that those behind the veil would anticipate such effects and remain alert to the "difficulty of actual decision-making" and factor them in their choice of insolvency objective (Korobkin, 1993, pp. 583-4; Mokal, 2005, p. 424; Finch, 2009a, 2009b, pp. 38-40).

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Last but not least, the veil does not explain distributional issues such as the choice between fairness and wealth creation or greed. These issues are largely determined by human nature rather than a veil. Even if a trade-off between fairness and wealth creation is selected, the protection offered by such a rule is of limited value if the individuals lack the necessary resources to take advantage of the rule. Furthermore, the contractarian approach does not explain how the agreement is reached on the most vulnerable group and one deserving of greater protection over other more secure groups during insolvency (Craig, 1990). Korobkin recognises the challenges faced in comparing positions during insolvency in terms of vulnerability and suggests that it should be measured in terms of potential loss to the individual and degree of influence (Korobkin, 1993; p. 584 and his n. 198.). However, there is no guarantee that Korobkin's suggestions would be accepted by all individuals standing behind the veil of ignorance. Thus, contractarianism is inherently flawed but inadvertently supports a system of insolvency law premised on two objectives.

1.3 The communitarian approach

By using a similar approach to contractarian, communitarian sees insolvency as balancing the interests of many company constituents. It thus makes it markedly different from creditor wealth maximisation, which is premised on private rights. It calls for a redistribution of values during insolvency with high priority creditors such as fixed and floating charge holders sharing the value of the insolvent with low priority claimants such as the community[16]. A key feature of communitarianism is the emphasis on fair distribution and redistribution during insolvency (Warren and Westbrook, 1986). Although redistribution goes against the concept of private rights, it serves the core values of insolvency law (Warren, 1987, p. 790). An insolvency approach that is concerned with protecting low-priority claimants such as communities is in line with one of the objectives of insolvency law, which is to compel companies and creditors to bear the costs of corporate failure, such as environmental cleaning, rather than shifting them onto third-party groups (Heidt, 1993; Manolopoulos, 1990). Thus, communitarianism challenges the orthodox economic model, which promotes selfishness and rational greed.

Communitarianism supports the view that insolvency law should first aim to secure the survival of the company, and when that fails, it should provide an orderly liquidation process. This is in line with Cork's statement of aims and communitarianism formed as part of the Cord Committee's recommendations[17]. The Cork Committee stressed that insolvency affects interests in society beyond the insolvent company, and that viable commercial enterprises should be rescued rather than left to die[18]. However, advocates of creditor wealth maximisation are critical of communitarianism because it departs from the traditional approach of dealing with creditors rights enforcement and ventures into the protection of groups such as communities and employees, which can be dealt with by allocating them pre-insolvency rights such as redundancy payment and employment security (Adler, 1994; Baird, 1987; Finch, 2009a, 2009b, pp. 38-40). In turn, it can be argued that rules and agreements devised without regard to insolvency should not be used to govern the insolvency process. Furthermore, there is no reason why communitarian issues should not form a part of pre-insolvency and insolvency processes. Thus, in some circumstances, insolvency law may turn to communitarian issues, but not necessarily to make it central to the insolvency process, by adjusting laws to that effect (Mokal, 2005, pp. 419-20).

Furthermore, as communitarianism refers to a range of interests, there is a lack of focus. There is a large number of community interests at stake during insolvency, which make it difficult to define the boundaries of community (Schermer, 1994). However, identification of

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community interests is not the problem but the availability of many potential interests during insolvency. Anyone in a community can claim some remote loss from a local school to a local business. This makes it difficult to select an interest worthy of legal protection, and any choice made would bring insurmountable challenges.

An important question remains, however, how can different community interests be weighed to determine which one to extend legal protection? (Bowers, 1994) For instance, it could be a choice between environmental pollution and preservation of employment. Furthermore, redistributing funds to community groups during insolvency may force lenders to alter their contractual agreements before insolvency. Redistribution dilutes the legal rights of secured creditors by redistributing some of their wealth to other groups. This could lead to future secured lenders increasing tariffs and making terms more onerous to reflect this and contract around the redistributive effect[19]. Thus, communitarianism promotes the principle of fairness, but it is difficult to determine its limits.

1.4 The forum approach

The forum approach aims to establish a forum within which all stakeholder interests affected, whether monetary or not, can be voiced before insolvency (Finch, 2009a, 2009b, pp. 43-44). This procedural approach to the insolvency process differs from the substantive objective view under communitarian, contractarian and creditor wealth maximisation approaches (Flessner, 1994). The forum approach takes the company as a collection of physical assets and emotional and social attachments. Thus, by creating a forum, members are able to choose an outcome that underpins all their interests and concerns. In the forum, insolvency law helps to create conditions that are conducive to the ongoing debate. This allows conflicting values to be discussed, and participants work towards redefining the aims of the enterprise, and those aims would be reflected in the multi-dimensional approach taken by the company during insolvency (Korobkin, 1991, p. 772). Furthermore, the forum allows other parties without a direct interest in the distressed company to engage in the discourse. Thus, legal expertise can come into play to guide the choice of interested parties by ensuring that a much fairer approach is taken. Similarly, accountants can play an important role in advising on financial responses to insolvency (Miller and Power,1995).

The forum approach is likely to shed light on the role and function of insolvency law but does not provide guidance on important issues such as distributions and priorities during insolvency. Furthermore, there is no guidance on the amount of representation different parties would be entitled to. The forum carries the assumption that both weak and strong creditors would receive the same representation. In reality, however, this is very unlikely given the differences in skills and expertise, as well as wealth (Stewart, 1975; Pateman, 1970). Finding the right balance between approaches for representation and the efficient administration of the insolvency process could also be problematic. It is likely that the priority afforded to those in a top category, such as fixed charge holders, would be reflected by strong representation on the forum. Thus, it is difficult to guarantee that the approaches that govern representation will not influence those in the insolvency administration process. Because the forum comes into play prior to insolvency, it means that matters of representation are not only an issue for insolvency law but for company law as well because it would fall within the internal conduct of the company. This could mean that new approaches would be taken on by company law to facilitate representation rights. However, the extent to which representation should be protected by legal rights is also unexplained. Thus, the forum approach fails to provide legitimate solutions with regards to the practicability and function of the forum; however, it sheds light on the role of insolvency law.

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1.5 The ethical approach

The ethical approach is premised on the view that insolvency laws fail to accommodate issues of moral concern (Finch, 2009a, 2009b, pp. 44-45). Thus, it calls for formal rules of insolvency to be based upon an adequate philosophical foundation. The leading advocate of this approach is Philip Schuchman, who argues that factors such as the intentions of the creditors and debtors, the moral worthiness of debt and the situation both creditors and debtors find themselves during insolvency should be taken into consideration when devising insolvency laws (Shuchman, 1973; Kilpi, 1998). Judgements in such cases would be based on utilitarian principles. According to Schuchman, a distinction should be drawn between debts flowing from contracts that personally benefit the creditor and those from involuntary loans between friends. The moral and philanthropic worth of the transaction and the present and prospective needs would guide the judgement (Shuchman, 1973, p. 447). The administrators, liquidators or even judges would base their decisions on ethically relevant realities and resist blind acceptance of creditors as being equal.

However, whether it is realistic to have ethical principles underpinning every aspect of insolvency law is questionable (Carlson, 1987, p. 1389). Imagine the impact it would have on the credit market if community interests are given higher priority over floating charge or fixed charge security during insolvency. This would have a detrimental effect on the cost and availability of credit because the creditors would be less willing to provide credit given the legal uncertainties brought about by a system based on morality. Thus, the boundaries between ethical principles and economic rationale need to be clearly drawn. Similarly, it is questionable that judges and creditors would agree with the substance of ethical principles (Hart, 1963; Devlin, 1965). To rely on a judge to evaluate the moral needs of creditors and moral worthiness of debt places a large degree of faith in their moral judgement (Dworkin, 1977). It difficult to see how the judiciary will be able to incorporate their evaluations into insolvency law and consistently develop a coherent body of law based on ethical principles. Although the ethical approach gives insolvency law a social and moral role, it neglects issues of economics which businesses depend on for their survival or revival. It raises an important question, however, as most areas of law including company law and property law fail to accommodate the motives of those involved in legal transactions, why would insolvency law choose otherwise? Clearly, the ethical approach pushes the bar too far.

1.6 The multiple values approach

While the aforementioned approaches such as creditor wealth maximisation support a single principle or objective, the multiple values approach, in contrast, carries the view that insolvency law should serve a range of values which cannot be organised into selected principles or priorities (Warren, 1987, p. 811, Finch, 2009a, 2009b, pp. 45-8). While the communitarian approach takes insolvency law as a social tool, the creditor wealth maximisation approach takes it as a device to maximise creditor wealth and the ethical approach takes it as a tool for judging moral worthiness. Advocates of the multiple values approach argue that not all outcomes of insolvency can be predicted or policy decisions can be fully articulated; thus, insolvency law should leave the door open to all potential eventualities through a wide range of inter-connected objectives. It takes into account economic and non-economic factors, as well as principles of fairness, ranging from personal to political to social values (Korobkin, 1991, p. 781).

The multiple values approach takes insolvency processes as a means of achieving ends such as sharing the consequences of corporate failure amongst a wide range of stakeholders; serving the interests of those without a direct financial loss such as neighbouring property owners, redundant employees and customers; determining priorities amongst creditors;

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providing means of rescue and reorganisation; providing means of disciplining those responsible for the financial failure; protecting investors and public interests; and providing a moratorium to enable rehabilitation. This approach unites elements of all other approaches and focuses substantially on distribution matters such as respect for pre-insolvency security agreements, placing value on ability to bear costs and treating similar creditors in the same way.

The Cork Committee's statement of aims is a clear example of the multiple value approach[20]. The Cork Committee saw insolvency law as a means of securing commercial morality and encouraging debt settlement (Triantis, 1992). It was also intended to act as a deterrent to unscrupulous actions and enable punishment where necessary. Warren argues that the multiple values approach is ideal because it would assist policymakers to have a policy that is focussed on the values that should be protected in an insolvency distribution and the effective implementation of those values (Warren, 1987, p. 796). Furthermore, it brings to light a range of important questions such as who are the casualties of business failure; to what degree are they affected; how to avoid the impact and to what cost; who may be better off because of the failure; who contributed to the failure; who standards in better position to bear the costs of the failure; who will bear the costs and is it fair; and how might the risk of failure be averted next time. Thus, the multiple values approach highlights both the normative and empirical assumptions surrounding insolvency, which leads to tough but specific questions which can be used to understand the underlying concerns. The answers gained from this approach are incomplete but fully reasoned than under a single objective approach observed under creditor wealth maximisation.

However, the multiple values approach has a number of shortfalls. It gives little guidance to decisionmakers on management of tensions and inconsistency or contradictions between different values or trade-offs between values. There are no core principles to guide decisions on such trade-offs or determine weight that should be afforded to certain values[21]. The approach seems to provoke more questions than answers and provides little guidance on most relevant values (Frug, 1984). Because of a lack of precision, decisions can be made based on uncertain purposes, and it is difficult to determine which of the values or aims are relevant. It runs the risk of having all arguments as valid and creating insolvency rules which are confusing and somewhat dysfunctional (Rasmussen, 1992, 1994). Thus, if clearly defining the objectives of insolvency law is essential in providing a legal framework under which judges can base their decisions, then a multiple values approach falls short of that. It gives discretion to judges and legislators to choose from and combine, as they see fit, a long list of vaguely stated aims.

1.7 Lessons from company law

The issue of justification lies at the heart of the debate over insolvency law objectives. How can the choice of insolvency approach be justified? To answer this question, it is possible to learn and borrow from justification in company law for managerial discretion. The fundamental rules of company law are all premised on the question of how managerial power is legitimised[22]. The argument is as follows; if economic power is to be accepted within a liberal society, then there has to be restraints preventing it from challenging state power and threatening liberty. There are two strands of arguments that challenge this view: first, economic power is already subject to constraints by competitive markets and second, economic power is not sufficiently concentrated to represent a threat. However, both arguments are flawed because the rapid growth in corporate enterprises, in terms of their size, influence and reach, has enabled a concentration of economic power and the separation

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between ownership and control has created managerial powers that are not impacted on by markets.

As a response to the challenges posed by managerial power, company law responded by giving discretionary powers to company managers. Management were given discretionary powers over the company based on the natural entity view of the firm (Parkinson, 1993; Bratton, 1989, p. 408; Jensen and Meckling, 1976; Butler, 1989). They recognised that when a company is young, owners might contract with managers as their agents to carry out its functions. However, when a company grows, it becomes more difficult to impose these contractual agreements. Furthermore, legitimising managerial power on a contractual basis conflicted with case law that a company was a separate entity from its shareholders. To overcome the contractual limitations, company law took the company as a living organism and shareholders as passive providers of capital and managers as the brains of the company[23]. The natural entity approach justified the vesting of discretionary power in managers because of their expertise and competences.

The checks and controls imposed on managers were another justification for the discretionary powers. The traditional legal model is premised on internal company controls and director duties as means of guaranteeing accountability to shareholders and the company. However, both internal control and director duties proved ineffective in imposing control and checks on managerial discretionary powers. The dispersal of shareholding in large public companies made it difficult for shareholders to control managers (Finch, 1992). The information asymmetry and lack of incentives to enforce directors' duties were the main obstacles to shareholder intervention. As a result, managers had absolute control over the company without shareholder constraints, and courts lacked the managerial expertise to question the decisions of managers. In light of this failure, Stokes advocated a new approach to company law based on market control[24]. Within this approach, the law could be developed to ensure that management operates in the interests of shareholders or made responsible to the markets. This approach takes the company's interests as not only based on shareholders' interests but also those of the public. Directors are seen as public servants with a need to serve the interests of various stakeholder groups with reference to public policy, and the company is seen as a collection of various stakeholder interests. Under this approach, managerial power is legitimised as serving the purposes of company constituents such as shareholders, employees and the community[25]. Thus, given the impact of corporate power on the public, company law objectives not only reflect the private values attached to shareholders interests but also community and democratic measures.

1.8 The values approach (Finch, 2009a, 2009b, pp. 52-63)

Although company law is said to be about legitimising corporate managerial powers held by directors, insolvency law is much more complex because it takes power out of the hands of management and hands it to various insolvency actors such floating charge holders, insolvency practitioners and the courts. Thus, all the actors and the broad insolvency process require legitimisation. Furthermore, insolvency processes impact on both private and public interests. Decisions made about corporate rescue and reorganisation affect communities and people's livelihoods. In regards to private rights, pre-insolvency rights or efforts to enforce legal rights can be constrained. The powers and objectives pursued during insolvency call for firm justification given the impact on both public and private interests. Thus, justifications which support democratically secured rights (public rights) and respect for individual rights (private interests) are favoured. Insolvency actors can carry out functions that serve both private and public interests; for example, liquidators may collect and realise assets but, at the same time, investigate any cases of company mismanagement

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for the purposes of disqualifying unfit directors (Wheeler, 1995; Armour, 2011). Such a view unites communitarian and creditor wealth maximisation approaches. However, the question of trade-off or how a conflict between private and public interests can be resolved remains unresolved.

Furthermore, if legitimisation is seen in terms of public or private rationales, the extent to which a particular rational must be pursued needs to be clarified because of differences in political persuasion. Policymakers or those involved in the insolvency process are likely to have dissimilar political persuasions. Korobkin argues that there are no "clear winners" in arguments based on competing values[26]. Thus, a disagreement on aspects of the insolvency process that requires legitimisation (democratically secured or private rights based) is likely to create a stalemate. For instance, people with opposing political views must differ radically on the treatment of ailing companies. One may choose immediate closure and reinvestment to create jobs, and other may choose rescue and reorganisation as means of securing jobs (Rusch, 1994). However, such political views result in a discussion over the legitimacy of particular decisions. To debate legitimacy, it requires reference to the accepted values underpinning democratic liberalism. These values are efficiency (a democratically achieved end at the lowest cost), expertise (decisions made by competent individuals), accountability (openness of insolvency process and control of insolvency participants) and fairness (justice and respect for all interested parties)[27]. These are the values the parties with conflicting political persuasions, given that they endorse democratic liberalism, would rely on. This "values" approach assumes that certain values are more widely accepted; thus, an insolvency system should be operated to serve them[28]. However, the values approach does not offer the authority that normally flows from a single approach, although it is a much safer approach as it is likely to meet a range of insolvency objectives. It is also unlikely that everyone would share the single vision, but it is likely that everyone would accept certain values. For example, individuals might agree that the insolvency process should be fair but disagree on details such as the priorities during asset distribution.

It still begs the question, however, whether particular trade-offs, for instance, between employees and security holders, are desirable or not. To answer this question, it would require giving weight to protection of different values. Such weighing creates visions of a just society, and in reality, different political persuasions are likely to disagree on the balance of values or interests in insolvency. To demand such answers also require a move away from the values approach to ethical and political approaches. Thus, the issue of trade-off remains unresolved under the values approach.

Another issue relates to transparency, which can only be achieved by persuading all the concerned parties to agree to a single just approach, which is in line with the vision of a just society[29]. The chosen approach would determine factors such as the level of expertise appropriate, the boundaries to community interests that must be served during insolvency and acceptable standards of behaviour for creditors during distribution. In reality, however, such a just approach is less likely to be encountered. The values approach is by far more realistic than other approaches, although less clear as compared to the just approach. The values approach accepts that individuals have differences in their conception of a just society; thus, it does not offer a one-off ideal value but offers a range of value to reflect the differences.

Furthermore, determining the legitimacy of the insolvency process depends on formal legitimacy of insolvency law. One of the benchmarks for determining the legitimacy of an insolvency process, such as distribution of assets, is the extent to which a statutory right is efficiently implemented. The existence of clear statutory provisions makes it easier to measure an insolvency process. For example, the liquidator has a statutory duty to

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distribute on a *pari passu* basis. If clear statutory laws are lacking, it is not easy to stipulate the factors that should be taken into consideration. Thus, because of a lack of clear laws, justification based on accountability, fairness and expertise become important. Does this mean that insolvency law is worthy of support provided that it has proper statutory form? Not necessarily, but it does provide a high level of democratic legitimacy to an insolvency provision. However, it is rare to lay down a statutory provision that clearly dictates a particular outcome. This is why values such as expertise and fairness come into play to help in evaluating statutory provisions and their effect. The reality is, however, different, because if parliament approves something, then it is law. Although it is not possible to deny parliament's decree, an evaluation of insolvency law objectives is possible.

2. Evaluation

A critical examination of insolvency law approaches has shown that measuring insolvency objectives goes beyond stipulating a number of outcomes such as enabling corporate rescue or serving the interests of a powerful company constituent, but looking at the whole insolvency process guided by appropriate values such as expertise, accountability and fairness. First, creditor wealth maximisation is wholly concerned with pre-insolvency rights and creditors' interests, and it views the insolvency process as a medium through which the company's pool of assets can be distributed to creditors. However, insolvency does not impact only on creditors interests; other company stakeholders are affected by corporate failure, and the approach also ignores the significance of corporate rescue. Second, the contractarian approach places all concerned parties behind the veil ignorance but fails to explain how the differing interests can be protected and, at the same time, ensure efficiency and fairness. Third, the communitarian approach fails to explain the limits of community, which means that every affected party, no matter how insignificant it is, has a claim on the pool of assets. Fourth, the forum approach raises a number of procedural concerns but is able to shed light on the various objectives that can be pursued under insolvency law. Fifth, the ethical approach fails to establish the boundaries of the ethical concerns but highlights the need to take into consideration moral worthiness when making policy decisions on insolvency distributions. Finally, the multiple values approach advocates a range of insolvency objectives and values but fails to establish how all the objectives can be achieved interchangeably.

The above mentioned approaches to insolvency law have all failed to provide a complete view of the appropriate measures that underpin insolvency law and to provide guidance over the objectives of the Insolvency Act 2011. However, the multiple values approach, which is premised on efficiency, expertise, accountability and fairness as core values of insolvency law, should be implemented in Uganda. This approach encompasses public and private interests, procedural and substantive and democratic liberalism and contractarian dimensions of insolvency. For both private and public dimension to be accepted as legitimate elements of insolvency law, legitimacy must also be obtained from communitarian and pre-insolvency rights, because they underpin public and private interests. The multiple values approach approves the use of a list of justifications to assess the legitimacy of an insolvency process. Thus, the multiple values approach sheds light on the legitimate values that are contained in Cork's statement of aims. However, unlike other approaches such as communitarian and the multiple value approach, this approach limits the list of justifications by organising them under four headings (efficiency, expertise, fairness and accountability). Thus, any arguments not falling under any of the four headings are deemed irrelevant. The four values provide a benchmark with which to evaluate current and proposed insolvency arrangements in Uganda and act as the objectives

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of a modern insolvency law system. These objectives will not only be applied to substantive and informal rules but also insolvency processes, institutional structures and other rules relevant to insolvency found in statutes such as the Companies Act 2012.

3. Conclusion

Having examined the various approaches to insolvency law, a number of objectives were encountered. Approaches such as creditor wealth maximisation narrowly focussed on the interests of one constituent while overlooking the interests of others. Approaches such as communitarian were too broadly defined in that it became difficult to determine who had a right to share in the remaining pool of assets during insolvency. Thus, all the approaches were flawed but contained a number of legitimate insolvency rationales. The approach selected as ideal for advancing the goals of a modern insolvency system in Uganda is the multiple values approach. The values of efficiency, accountability, fairness and expertise bring together the needs of all the important constituents in the company. The multiple values approach relies on these four values to serve the interests of every constituent in the company, with factors such as fairness ensuring that every constituent is given consideration within the insolvency process and their interests are part of the final outcome. Armed with a clear understanding of the objectives of a modern insolvency system, legal reformers in Uganda should ensure that future reforms are focussed on the four values under the multiple values approach rather than using a blurred approach to insolvency regulation.

Notes

1. Uganda Law Reform Commission: A Study Report on Insolvency Law, Law Com Pub No. 13 of 2004.
2. *Report of the Review Committee on Insolvency Law and Practice* (1982), Cmnd 8558 (The Cork Report), Para 198; Fletcher (1989); Farrar, (1983); Finch (2009a, 2009b).
3. See paras. 191-8, 203-4, 232, 235, 238-9.
4. See para. 198(j) para. 204.
5. See para. 198(i) paras. 203-4.
6. See para. 198(h) paras. 235 and 238.
7. Uganda Law Reform Commission (2004): A Study Report on Insolvency Law, Law Com Pub No. 13 of 2004; Para.1.1.1(a) of the Report at p.2.
8. Justice, *Insolvency Law: An Agenda for Reform* (London, 1994).
9. Justice, *Insolvency Law: An Agenda for Reform* (London, 1994), paras. 3.7-3.8.
10. A Review of Company Rescue and Business Reconstruction Mechanisms, Department of Trade and Industry and HM Treasury May 2000 p. 53.
11. (Jackson, 1986, chs. 1 & 2; Finch, 2009a, 2009b), p. 17; Duggan (2005).
12. Korobkin (1991, p. 749 and 751). On the UK, see Hill (1990); Cork Report, paras. 29-33 (re administration); Rajak (1993); Insolvency Service, *Company Voluntary Arrangements and Administration Orders: A Consultative Document* (DTI, 1993).
13. See Flessner (1994). See Carlson (1987, p. 1355): "even less than a hollow tautology".
14. Warren (1993, pp. 353-4); Cork Report, chs. 32, 33; Cantlie (1994, p. 413).

المنارة للاستشارات
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15. In F.H. Bradley's words quoted in 1992; Loughlin (1992). See also Sandel (1982).
16. See Warren (1987, 1993); Gross, "Community Interests".
17. Cork Report, paras. 191-8, 203-4, 232, 235, 238-9; Keay and Walton, (2008).
18. Cork Report, paras. 191-8, 203-4, 232, 235, 238-9; Keay and Walton, (2008), para. 198(i)and (j).
19. Bowers (1994, p. 959).
20. See Cork Report, para. 198. see Flaschen and DeSieno (1992).
21. *Insolvency Law: An Agenda for Reform* (Justice, London, 1994) paras. 3.7-3.8.
22. Stokes, "Company Law and Legal Theory", p. 155.
23. See Stokes, "Company Law and Legal Theory", p. 164. See also further discussion in Mayson *et al.* (2007).
24. Stokes, "Company Law and Legal Theory", pp. 173-7.
25. Stokes, "Company Law and Legal Theory", pp. 173-7, p. 174.
26. See Korobkin, "Role of Normative Theory", pp. 108-9.
27. The question of who constitutes an "interested party" raises substantive issues.
28. Korobkin, "Role of Normative Theory" pp. 104-11.
29. LoPucki (1994); Mokal's "Authentic Consent Model" (in Corporate Insolvency Law ch. 3); Duggan, "Contractarianism and the Law of Corporate Insolvency", pp. 463-81; Goode, Principles of Corporate Insolvency Law, p. 48.

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