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STATUTORY PREFERENT CLAIMS OF CREDITORS UNDER UGANDAN INSOLVENCY LAW – A COMPARATIVE ANALYSIS

By

JAVIER GILBERT MUGOMBESHA

18309462

submitted in partial fulfilment of the requirements for the degree

LLM in MERCANTILE LAW

in the

FACULTY OF LAW

UNIVERSITY OF PRETORIA

SUPERVISOR: PROFESSOR MELANIE ROESTOFF

Pretoria

October 2019

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ACKNOWLEDGEMENTS

I thank the Almighty God for being with me from the start, to this day and forever. Without such special blessing, I would not have gone this far with this academic journey.

I am indebted to the following persons:

1. My wonderful supervisor Professor Melanie Roestoff. Thank you for your unwavering support and patience. I was sure that I would do this with your encouragement and wise counsel.
2. Doctor Jani van Wyk for going against her busy schedule to read through this research and giving me all the necessary guidance.
3. Professors André Boraine, Corlia van Heerden and Counsel Silver Kayondo for making what seemed an impossible dream possible.
4. Ms Moipone Williams and Ms Kate Tabane for your overwhelming assistance.
5. Mr Sam Mbibo, Mr Julius Mark Kato Muniina and Charles Nsubuga for the ever-open space at Sandton Technical College Pretoria where I always sat to do my work.
6. Mr Godfrey Ibanda Kitabula, Mr Henry Wandera, Mr Jacob Ssali and Mr Denis Mafabi for the encouragement and support.
7. My family for believing in me and praying for me every time.

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SUMMARY

The ranking of creditors' claims is a salient aspect that affects the distribution of the proceeds realised out of the assets of the insolvent estate. Ugandan insolvency law divides creditors into secured and unsecured creditors. Therefore, when it comes to the order in which debts are paid from the proceeds of the insolvent estate, sections 11 to 14 of the Insolvency Act 2011 of Uganda provides for an order of distribution alongside the statutory preferent claims of creditors. This order is similar to insolvency laws in other jurisdictions.

This study will briefly describe the insolvency procedures and recognised creditors in Uganda, specifically the provisions of sections 11 to 14 of the Insolvency Act. It will further undertake a comparative study of the rules pertaining to the settlement of secured and unsecured debts in selected jurisdictions. This study will determine which debts are prioritised for payment in Uganda and the selected jurisdictions, and whether the ranking of creditors is fair. It will further ascertain whether there are any new classes or priority claims in other jurisdictions which should be introduced into the Ugandan system.

An analysis of policy considerations, principles and guidelines set forth by the World Bank Reports on the manner that insolvency systems should operate will be undertaken. This analysis will enable the identification of specific recommendations made in the Reports that relate to the manner in which insolvency systems should approach distributions, especially regarding priority claims and their ranking.

Therefore, against the background of the findings of the comparative study and the recommendations by the World Bank Reports, the study will ascertain whether the Ugandan order of distribution, particularly the statutory preferent claims of creditors, are aligned with international standards. The study will be concluded by determining whether there are any new classes or types of debt to be included or excluded from the Insolvency Act 2011.

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Student number: **18309462**

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CHAPTER 1: INTRODUCTION

SUMMARY

1.1 Background information and topic introduction

1.2 Problem statement and research objectives

1.3 Methodology

1.4 Delineations and limitations

1.5 Proposed structure

1.1 Background information and topic introduction

The ranking of creditor claims is one of the salient aspects pertaining to the distributions of the proceeds realised out of the insolvent estate in Uganda. Ugandan insolvency law divides creditors of the insolvent estate into secured[1] and unsecured creditors.[2] Therefore, when it comes to which creditor's claim shall be paid out of the proceeds of the insolvent estate first, the insolvency laws of every jurisdiction provide for an order of distribution. The secured creditors are paid first – from their secured asset proceeds[3] – and thereafter the unsecured creditors (consisting of statutory preferent and concurrent creditors) are paid from the free residue.[4]

Insolvency in Uganda is principally governed by the Insolvency Act and the Insolvency Regulations of 2013. Its purpose is as follows:

> "To provide for receivership, administration, liquidation, arrangements, bankruptcy, the regulation of insolvency practitioners and cross border insolvency, amend and consolidate the law relating to receiverships, administration, liquidation, arrangements and bankruptcy, and to provide for other related matters".[5]

The Insolvency Act repealed the old insolvency regime – which was characterised by multiple laws such as the Bankruptcy Act, Deeds of Arrangement Act and some parts of the Companies Act – and it consolidated the provisions of insolvency law embodied in the previous Acts into one Act.[6]

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[1] S 11 of the Insolvency Act 2011 hereafter "the Insolvency Act".
[2] S 10 of the Insolvency Act.
[3] See n 1.
[4] S 12 of the Insolvency Act.
[5] Long title to the Insolvency Act.
[6] S 262 of the Insolvency Act.

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Ugandan insolvency legislation emulates the modern trend in insolvency law to unify natural person and corporate insolvency into a single body of law. Notably at present, the Insolvency Act defines the notion of insolvency as including bankruptcy.[7] This is because some jurisdictions, like Australia, have separate legislation for insolvency and bankruptcy.[8] Companies become insolvent whilst natural persons become bankrupt, and this distinction is furthered by separate acts for each of the procedures.[9]

The Insolvency Act defines insolvency as the inability of a person to pay his or her debts. The person must be a natural person (individual) or a juristic person (company) to pay their debts.[10] South Africa has a similar position and insolvency refers to the situation where a person is unable to pay his debts: The test for insolvency is whether a debtor's estimated liabilities exceed the debtor's assets after a fair valuation.[11] Notably at present, Australian authors define insolvency as a situation where a legal person is unable to pay his debts. These authors point out that a natural person who is insolvent goes into bankruptcy, whereas a juristic person or corporate body goes into winding-up or liquidation.[12]

Nyombi, Kibandama and Bakibinga,[13] observe that the struggle to enforce individual creditor rights and to protect their interests, is likely to spur unfairness and inefficiency because creditors with weak bargaining power are likely to be overlooked in favour of powerful creditors.[14] Pursuing claims individually is more difficult than a unified process where creditors join forces to form a general body of creditors (*concursus creditorum*).[15] The Insolvency Act provides for rules of distribution of the proceeds realised from the insolvent estate that apply to secured creditors[16] and unsecured creditors (statutory preferent creditors and concurrent or non-preferential creditors).[17]

Through a thorough study of sections 11 (secured creditor claims), 12 (unsecured creditor claims, specifically statutory preferent creditors), 13 (concurrent or non-preferential creditors) and 14 of the Insolvency Act 2011, and the rules pertaining to settlement of secured and

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[7] S 2 of the Insolvency Act.
[8] Symes *Statutory Priorities in Corporate Insolvency Law an Analysis of Preferred Creditor Status* (2008) 1.
[9] The Corporations Act 2001 (Cth) and the Bankruptcy Act 1966 (Cth).
[10] S 2 of the Insolvency Act 24 of 1936.
[11] *Ibid.3*
[12] Symes 1.
[13] Nyombi *et al* "The Motivations Behind the Insolvency Act 2011" *JBL* 2014 652 hereafter "Nyombi *et al*".
[14] *Ibid*.
[15] *Ibid*.
[16] S 11 of the Insolvency Act.
[17] S 12(4), (5) and (6), and 13 of the Insolvency Act.

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unsecured creditor claims in the selected jurisdictions, the question as to which creditor's claim shall be settled first will be answered.

The insolvency procedures in Uganda will be discussed briefly, because the rationale of the study is to ascertain whether the Ugandan order of distribution, particularly the statutory preferent claims of creditors, align with international insolvency law standards. The study will conclude with suggestions for law reform.

1.2 Problem statement and research objectives

One of the aims of insolvency law is to replace the individualist approach with insolvency processes conducted in an orderly way and assets distributed to creditors in a fair manner.[18] The notion "fair manner" requires a thorough investigation into what *acting in a fair manner while distributing assets in times of insolvency*, entails. Fair manner is relative, and this study will therefore look at the rules of distribution, particularly the statutory preferent claims of creditors from other jurisdictions, in order to make sense of the notion and to finally ascertain whether the Ugandan insolvency law position pertaining to distributions and the statutory preferent claims of creditors, adheres to international insolvency law best practice standards.

The objectives of the study are to:

a) Provide an overview of the insolvency procedures in terms of the Ugandan Insolvency Act;
b) Discuss the types of creditor claims and subsequent ranking as regards the distribution of the proceeds of the assets of the insolvent estate;
c) Discuss the statutory preferent claims of creditors in terms of the Ugandan Insolvency Act;
d) Compare the Ugandan statutory preferent claims of creditors against those in the selected jurisdictions;
e) Study the international insolvency law policy considerations, in order to identify any shortcomings in Uganda's insolvency law pertaining to distributions and the statutory preferent claims of creditors; and
f) Suggest any amendments in the form of new classes of debt or debts which should be added to or excluded from the Insolvency Act.

[18] Nyombi *et al* 653.

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1.3 Methodology

The proposed research comprises a literature study of books, journal articles, thesis, reports, legislation and case law. The study involves a critical study of Uganda's rules of distribution, particularly statutory preferent claims of creditors, and benchmarked against selected jurisdictions. The comparative study will be undertaken in relation to South Africa, England, the United States of America, and Australia.[19]

Uganda is an English common law systemised country. This inspired the choice of the countries for the comparative study, since they are also British Colonies. The jurisdictions chosen are rich in literature pertaining to the topic of study and since those jurisdictions comply with international best practices, a thorough study of the statutory preferent claims of creditors in those jurisdictions is invaluable to determine whether Uganda aligns with the international insolvency law best practices.[20]

1.4 Delineations and limitations

The focus of this research is the Ugandan law pertaining to the rules of distribution, particularly the statutory preferent claims of creditors. First, a brief discussion of the Ugandan insolvency law procedures and their effects in relation to the different types of legal persons (natural and juristic) will be effected.[21] The word "insolvent" will be used interchangeably to refer to a natural and juristic person, even though the natural person might be referred to as "bankrupt" on a few instances because the natural person procedure is termed "bankruptcy".[22]

A distinction will be made between the rights of secured creditors and unsecured creditors (made up of statutory preferent creditors and concurrent creditors). Concurrent or non-preferential creditors sometimes include secured creditors whose claims cannot be fully covered by the proceeds from the secured assets. Secured creditors may then claim the balance as concurrent creditors. The distinction will be of value when determining which creditors' claims are prioritized for first payment from the proceeds of the insolvent estate, and whether such order of priority is reasonable.

A comparative study will be conducted to compare Uganda with some selected jurisdictions insofar as the statutory preferent claims of creditors are concerned. The purpose is to ascertain

[19] See ch 3.
[20] See ch 4.
[21] See ch 2.
[22] S 20(5) of the Insolvency Act.

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whether Uganda's position is fair and whether it complies with the international insolvency law standards.

1.5 Proposed structure

The dissertation is divided into five chapters. This chapter deals with the introduction, and is followed by chapter two which deals with Ugandan insolvency, recognised creditors and statutory preferent claims of creditors in terms of the Insolvency Act 2011. Chapter three contains the comparative analysis of the statutory preferent claims of creditors in selected jurisdictions namely, South Africa, England, the United States, and Australia. Chapter four deals with policy considerations, principles and guidelines in terms of international insolvency law best practices. Chapter five is the conclusion in which the deficiencies within the Ugandan system is be identified, and proposals for reform, based on the research findings, suggested.

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CHAPTER 2: INSOLVENCY, RECOGNISED CREDITORS AND STATUTORY PREFERENT CLAIMS IN THE INSOLVENCY ACT 2011

2.1 Introduction

This chapter explains the notion of insolvency in the Ugandan legal system, considers the available procedures regarding individual and corporate insolvency, and the effects of invoking such procedures on the insolvent and the creditors. The chapter also describes the creditors that are recognised within the Ugandan insolvency field, and how their claims rank at the time of distribution of the proceeds realised out of the insolvent's estate.

The Ugandan insolvency system's efforts to operate in line with the current modern insolvency trends are underway, and therefore adherence to modern insolvency principles is still in its initial stage. This is evident because the content of this chapter shows that some pertinent features, for example the express mentioning of some statutory preferent creditors such as municipalities (pertaining to fees levied and owing from, or before, the sale of immovables) is omitted in the Insolvency Act, and only identified as a matter of practice.

The legislation governing insolvency is a recent 2011 enactment and the few commentators who have written on this field have occasionally referred to English authors since Uganda follows the English common law system.[23] The 2011 Act[24] deals with natural and juristic persons, supplemented by the Insolvency Regulations of 2013.[25]

In Uganda, insolvency procedures are at personal (individual) and corporate level, and the two procedures will be discussed next.

2.2 Individual insolvency

In terms of the Ugandan Constitution, debtors have the right to carry on business – this is provided for by the economic rights provision.[26] Prior to insolvency or bankruptcy, the debtor has the right to borrow and create security rights over any of his assets, and he may create a floating or fixed charge.[27] Furthermore, the debtor has the right to own property and to deal

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[23] Makubuya *Introduction to Law*: The Ugandan Case (1983) 1. Uganda is a British colony and all the laws enacted were inspired by English common law. Therefore, whenever Ugandan legislation is silent on a given legal issue, recourse is sought from the position of English common law, and writings by English jurisprudential authors.
[24] The Insolvency Act of 2011, hereafter "the Insolvency Act".
[25] Statutory Instrument 36 of 2013, hereafter "the IR".
[26] Article 40(2) of the Constitution of the Republic of Uganda, 1995 hereafter "the Constitution".
[27] Part IV of the Companies Act of 2012, hereafter the "Companies Act".

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with same, that is, sell, pledge, mortgage or give as a gift, as he deems fit. This is a constitutional right and is protected from any arbitrary deprivation. This study will not investigate the constitutional aspects further since they only play a small part in respect of the manner in which debtors' rights arise.[28]

In terms of Ugandan insolvency law, bankruptcy is the procedure by which an over-indebted person is adjudged bankrupt, and his assets are seized for the benefit of his creditors.[29] Accordingly, a bankrupt is an individual who has been declared bankrupt by a court, and whose properties are administered by a trustee in bankruptcy for the benefit of his creditors.[30]

Individual insolvency is referred to as bankruptcy and the process commences when a bankruptcy order is made.[31] Such bankruptcy is the result of the inability of a natural person to pay debts as they fall due, and the latter is subsequently declared insolvent. The inability to pay debts is sometimes due to business misfortune or lack of financial discipline by the individual, which renders the latter incapable of managing his finances.[32]

Where a statutory demand[33] has been served under the Act[34] and the Insolvency Regulations,[35] the debtor has the right to apply to set the statutory demand aside[36] and has the right to dispute the debt claimed by the creditor. Therefore, the court may grant an application to set a statutory demand aside if it is satisfied that there is a substantial dispute regarding whether the debt is owing or is due.[37]

Given the few insolvency cases in Uganda, particularly regarding bankruptcy, research still has it that debtors usually settle their debts even before any court orders are made.[38] In *Re Joash Mayanja Nkanji*,[39] the debtor paid a substantial deposit on the due date immediately after he was served with a bankruptcy notice. Furthermore, in *Re Teddy Seezi Cheeyi*,[40] the debtor

[28] Article 26 of the Constitution. This provision corresponds with Section 25 of the Constitution of the Republic of South Africa, 1996. For a South African perspective, see Brits "Section 21 of the Insolvency Act and the Final Constitution's Property Clause: Revisiting *Harksen v Lane NO"* in: Transformative Property Law (2018) 74.
[29] S 2(b) of the Insolvency Act.
[30] S 2 of the Insolvency Act.
[31] See s 20(5) of the Insolvency Act.
[32] See s 2 of the Insolvency Act on the definition of Insolvency.
[33] A statutory demand is a formal written request that a debt must be paid.
[34] S 4 of the Insolvency Act.
[35] See IR 4 and 5.
[36] S 5 of the Insolvency Act read together with IR 6.
[37] S 5(4)(a) of the Insolvency Act.
[38] Uganda Law Reform Commission: *A Study Report on Insolvency Law* (2004) para 3.3.2.
[39] *Bankruptcy Cause* 1 of 2001.
[40] *Bankruptcy Cause* 1 of 1997.

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entered into a settlement agreement with his creditors immediately after a receiving order was made against him.

From this attitude, one would deduct that the debtors would rather avoid being subjected to insolvency proceedings by agreeing to settlements with creditors. This may be among the reasons why there are so few precedents in respect of insolvencies. However, due to the economic growth rate and endless participation in the credit market, bankruptcy and the insolvency of companies is inevitable.

2.2.1 Procedure

The bankruptcy procedure commences with a petition for bankruptcy.[41] A debtor may commence the proceedings for bankruptcy through a petition to the court alleging that he is incapable to pay his debts. The court may then order a public investigation into the affairs, dealings and property of the debtor, and may make a bankruptcy order in respect of the debtor.[42] On the other hand, the creditor may commence the proceedings if the debtor fails to comply with the statutory demand made under section 4.[43] Therefore, the petition for bankruptcy may be presented by a debtor or a creditor, and the court may make a bankruptcy order in respect of the debtor.[44]

The court must require a debtor, in respect of whom a petition has been presented under section 20, to file a statement of his or her affairs verified by an affidavit.[45] The statement must include particulars of the debtor's creditors, debts and assets, and such other information as may be prescribed. A debtor who defaults in respect of the above requirements commits an offence, and is liable on conviction to a fine or imprisonment not exceeding one year or both.[46]

The court must direct that a public examination be held on a day determined by the court and the debtor must be present on that day in order to be publicly examined on his or her affairs, dealings and property.[47] The examination must be held as soon as is conveniently practicable after the expiration of the time given by the court for the submission of the debtor's statement

[41] S 20 of the Insolvency Act.
[42] S 20(1) of the Insolvency Act.
[43] S 2 of the Insolvency Act. A demand by a creditor in respect of a debt incurred.
[44] S 20(2) of the Insolvency Act.
[45] S 20 of the Insolvency Act deals with the commencement of bankruptcy. This can be through a voluntary application by the debtor alleging that he or she is unable to pay his or her debts, or by the creditor upon failure by the debtor to satisfy a statutory demand.
[46] S 21 of the Insolvency Act.
[47] Ss 20 and 21 of the Insolvency Act.

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of affairs. A creditor who tendered a proof of claim may question the debtor concerning his or her affairs and the causes of his or her failure to pay his or her debts. The official receiver and trustee, if appointed before the conclusion of the examination, must take part in the examination.[48] The court may also question the debtor as it deems fit.[49] The public examination-process is a valuable tool to obtain all the relevant information relating to the insolvent, especially in respect of the property of the debtor, which is consequently beneficial to the general body of creditors.

The court may further inquire as to the debtor's dealings and property. It does so by requiring those persons whom it deems to have any property believed to be part of the debtor's estate, and any other persons with relevant information, to appear before the court and inform it about the debtor's dealings. These persons must furnish affidavits to that effect, in which they undertake to tell only the truth to the court.[50]

The bankruptcy order declares the debtor bankrupt, and this leads to the appointment of an official receiver as interim receiver for the preservation of the estate of the bankrupt. The official receiver has the power to sell any perishable and other goods whose value is likely to diminish if not disposed of, unless the court limits these powers. The bankruptcy of the debtor commences on the date on which the bankruptcy order is made.[51]

Thereafter, the official receiver issues a notice of commencement of the debtors' bankruptcy and of the creditors' first meeting. Within fourteen days after the commencement of the bankruptcy, he or she must give public notice of the date of commencement of the bankruptcy, and call the creditors' first meeting.[52] It is during the creditors' first meeting that the trustee is appointed, and the bankrupt's estate then vests in the trustee.[53] The trustee must, within five working days after his or her appointment, give public notice of his or her full name, physical office address, daytime telephone number, electronic mailing address and the date of commencement of the bankruptcy.[54]

[48] S 22 of the Insolvency Act.
[49] *Ibid.*
[50] S 23 of the Insolvency Act.
[51] S 20(3), (4) and (5) of the Insolvency Act.
[52] S 24 of the Insolvency Act.
[53] S 25 of the Insolvency Act.
[54] S 26 of the Insolvency Act.

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2.2.2 Consequences of the bankruptcy order

When the court makes the bankruptcy order, the bankrupt's estate vests in the official receiver first, and then in the trustee.[55] This occurs without any conveyance, assignment or transfer.[56] Except with the trustee's written consent or with the leave of the court, and in accordance with such terms imposed by court, no proceedings, execution or other legal process may be commenced or continued, and no distress may be levied against the bankrupt or the bankrupt's estate.[57]

The effect of the bankruptcy order on the insolvent individual is that the latter is disqualified from being appointed or acting as a judge of any court in Uganda; or being elected to hold office of the President, a member of Parliament, Minister, a member of a local government, council, board, authority or any other government body. Where a person holding the office of the Justice of the Peace or any other public office is adjudged bankrupt, the office immediately becomes vacant.[58]

The disqualifications to which a bankrupt is subject does not apply where:

a) The judgement of bankruptcy against the individual is annulled;

b) A period of five years elapsed from the date of discharge of the bankrupt; or

c) The individual gets his discharge from the court – with a certificate confirming that the bankruptcy was due to a misfortune and without any misconduct on his part.[59]

The court may grant or withhold the above-mentioned certificate as it deems fit, but any refusal to grant the certificate is subject to appeal.[60] A bankrupt is discharged from bankruptcy when the court, on an application by the bankrupt, makes an order discharging the bankrupt. The court, while considering a bankrupt's application for discharge, must consider the official receiver's report on the bankruptcy, the conduct of the bankrupt during the bankruptcy

[55] S 27 of the Insolvency Act.
[56] *Ibid.*
[57] *Ibid*.
[58] S 45 of the Insolvency Act.
[59] S 20 of the Insolvency Act.
[60] *Ibid*.

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proceedings, and any other matters the court may consider pertinent.[61] The discharge if granted sets the bankrupt free from all bankruptcy debts.[62]

2.3 Corporate insolvency

A juristic person, like a company, becomes insolvent if it does not have enough assets to cover its debts, or it cannot pay its debts on the due dates.[63] It is the directors' responsibility to know whether or not the company is trading while insolvent to avoid a legal responsibility for continuing to engage in wrongful trading.[64] The decision to appoint receivers, liquidators and administrators is the responsibility of participants like banks and lending institutions, creditors, the courts, the directors or the company itself.[65]

2.3.1 Procedures and consequences

The Insolvency Act primarily provides for three corporate insolvency procedures namely administration, company voluntary arrangements (CVA) and liquidation.[66]

2.3.1.1 Administration

Administration is a two-stage procedure, and the provisional route is always taken to see whether enough assets are available to instigate insolvency proceedings. Thereafter, formal administration is entered into mainly to administer the deed agreed on by the creditors.[67] Provisional administration lasts for a maximum period of thirty days, during which an administration deed must be agreed upon before entering formal administration.[68] A provisional administrator of a company is appointed out of court by a special resolution of the board.[69]

In the notice appointing a provisional administrator, the appointer must certify that the company is, or is likely to be, unable to pay its debts.[70] The provisional administrator has the power to manage the affairs, business and property of the company on behalf of the company.[71]

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[61] S 42 of the Insolvency Act.
[62] S 43 of the Insolvency Act.
[63] Nyombi *et al* 664.
[64] *Ibid*.
[65] S 24 of the Insolvency Act.
[66] Part IV of the Insolvency Act.
[67] S 162 of the Insolvency Act. The deed spoken about takes the form of a plan agreed upon by the creditors, and deals with the manner in which the assets of the estate will be administered.
[68] S 145(1)(a) of the Insolvency Act.
[69] S 139(1) of the Insolvency Act.
[70] S 139(2) of the Insolvency Act.
[71] S 153 of the Insolvency Act.

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Administration imposes a freeze (moratorium) on all creditor actions and legal proceedings against the company.[72]

A provisional administrator has the power to sell property that is not secured under a floating or fixed charge, and free of any third-party rights under any other security agreements.[73] Furthermore, on the date of appointment, the provisional administrator has a maximum of ten working days, or such longer period as the court allows, to produce a statement of proposals aimed at achieving the objectives of administration.[74] He or she must call a creditors' meeting to consider the proposals by way of a public notice issued within five working days of the meeting, and a written notice sent to all known creditors.[75]

If an administration deed is approved, the company will enter formal administration and the administrator must manage the company in accordance with the requirements of the administration deed unless he or any interested party applies to the court for variation or discharge of the administration order.[76] Provisional administration is a temporary measure, and a provisional administrator will automatically vacate this office twenty-one days after the meeting of creditors unless this period is extended by the court.[77] The administration will end or terminate upon completion of the administration deed or through a court order.[78]

2.3.1.2 Company voluntary arrangement

Company voluntary arrangement (CVA) is a manner in which an ailing company can negotiate settlements on various terms. Such agreements may be recognized under statute, or be informally and contractually agreed upon between the company and its creditors.[79] Companies may find a CVA useful because it is generally less complex, less time-consuming and less costly when compared to alternative insolvency procedures such as administration and liquidation. It allows a company to reach an arrangement with its creditors under the supervision of an insolvency practitioner.[80]

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[72] Ss 143(f)(i)(ii), 164(2)(a)(b)(i)(ii) of the Insolvency Act.
[73] S 157 of the Insolvency Act.
[74] S 145(2) of the Insolvency Act.
[75] S 147(2) of the Insolvency Act.
[76] S 167 of the Insolvency Act.
[77] S 150(2) of the Insolvency Act.
[78] S 169 of the Insolvency Act.
[79] S 234 of the Companies Act. See also Goode *Principles of Corporate Insolvency Law* (2005) paras 10-106–135.
[80] Nyombi *et al* 663.

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It is important to note that CVAs cannot be undertaken when a company is being wound up, but the company does not have to be solvent for it to be initiated.[81] Thus, a CVA can be instituted as an administration deed, since it is a form of settlement agreed upon between the debtor and the creditors. A formal agreement must be approved by the requisite majority of more than 50 per cent by value at shareholders' meetings and at least 75 per cent by value at creditors' meetings. It does not bind creditors who did not receive notice of the meetings, creditors with unascertained claims, or secured creditors who did not consent to the agreement. Thus, a CVA aimed at satisfaction of a company's debts largely depends on the attitude of the company's creditors.[82]

There is no moratorium under the CVA procedure to offer the company protection against petitions for winding up, appointment of receivers, enforcement of security, repossession of goods, or even administration orders. Regarding the latter, a moratorium can be obtained if a CVA is adopted as the administration deed by agreement between the creditors and the company. In other cases, a company would find it difficult to reach an agreement with creditors if it does not get breathing space by way of a moratorium.[83]

2.3.1.3 Liquidation

Liquidation is usually the procedure of last resort. A liquidator will be appointed to take control of the company and to collect, realise, and distribute the assets of the company in accordance with the creditors' statutory priority. He or she has no power to continue the company's business except for the purposes of winding up, and the company will be dissolved once the distribution process is completed.[84]

Liquidation takes two forms namely, compulsory liquidation and voluntary liquidation.[85] Voluntary liquidation involves a special resolution taken at a general meeting where the shareholders agree to put the company into voluntary liquidation.[86] This takes the form of a member's voluntary liquidation (MVL) and a creditor's voluntary liquidation (CVL). If a

[81] S 145(2) of the Insolvency Act.
[82] S 167 of the Insolvency Act.
[83] Nyombi *et al* 663.
[84] *Ibid*.
[85] S 57 of the Insolvency Act.
[86] S 58(1) of the Insolvency Act.

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liquidation resolution is passed, the company ceases to carry on business unless the continuation thereof will effect a better outcome for the creditors.[87]

Following a voluntary liquidation resolution, a creditors' meeting is initiated in order to appoint a liquidator, and establish a committee of inspection – whose members would be appointed principally as the creditors' representatives.[88] The inspection committee will supervise the liquidator and ensure that he collects and realises the company's assets, and that he thoroughly investigates the causes of the company's failure.[89]

Compulsory liquidation is instituted by an order of the court via a petition. A petition for winding-up the company can be presented by the company, a director, a shareholder, a creditor, or an official receiver.[90] Compulsory liquidation is the only method in terms of which a creditor can initiate the winding-up of a company. Such a petition must be based on one or more of the specific grounds stated under the Insolvency Act,[91] including the inability to pay company debts as they fall due.

The official receiver becomes a liquidator if a winding-up order is made, and until (and unless) an insolvency practitioner is appointed at the creditors' meeting.[92] It is important to note that, under compulsory and voluntary liquidation, the concerned parties can apply to court to challenge or nullify the liquidator's decisions.[93]

2.4 Recognised creditors and statutory preferent claims under the Insolvency Act 2011

2.4.1 Introduction

Many international authors have written about the concept "claim". Ferriel and Janger[94] define a claim as a right to payment held by a creditor. According to them, this right is either based on a debt owed by the debtor or a right to exercise an equitable remedy against the debtor.[95]

[87] S 60 (1) of the Insolvency Act.
[88] S 71 of the Insolvency Act.
[89] Nyombi *et al* 663-664.
[90] S 92 of the Insolvency Act.
[91] S 3 of the Insolvency Act.
[92] S 70 of the Insolvency Act.
[93] S 177 of the Insolvency Act.
[94] Ferriel and Janger *Understanding Bankruptcy* (2013) 309.
[95] *Ibid*.

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The universal rule which applies when it comes to distributing assets during insolvency is founded in the *pari passu* principle,[96] in terms of which there should be an equal distribution among creditors of the proceeds from the assets. According to this principle, "equality is equity", and all persons similarly situated are entitled to equal treatment during the distribution of the assets of the bankrupt estate.[97]

Goode argues that, no matter how important the *pari passu* principle is, it is not absolute and that policy considerations (which do not form part of this study) allow for certain deviations.[98] The most significant deviation is found in legislation that requires insolvency administrators to pay out certain unsecured creditors, who are given a special priority to payment while having no priority under the general law. Historically, virtually all insolvent systems across the world have provided for such priorities.[99]

According to Keay, Boraine and Burdette,[100] individual countries have debated and reassessed whether, and if so to what extent, priorities should be granted to specific creditors. There are three groups into which countries can be classified: those that adhere to a more traditional approach and retain wide preferential rights for certain creditors, for example France, Spain, Ireland, Italy and South Africa; those that have a reduced level of priority, for example the United Kingdom, New Zealand and the United States of America; and those that have abolished preferential claims, for example Austria and Germany.[101]

The Insolvency Acts of a variety of jurisdictions rank the various claims against the insolvent estate by laying down the order in which they must be paid, and to what extent each must be paid.[102] Claims are divided into several broad categories, based on the legal rights associated with the claim. Claims might be secured claims, unsecured general claims, or unsecured priority claims.[103] A secured claim is secured by collateral: a claim that is accompanied by an interest in specific property.[104] The most common type of secured claims is debts secured by a

[96] Keay *et al* "Preferential Debts in Corporate Insolvency" A Comparative Study 2001 *Int Insolv R* 167.
[97] Seligson "Preferences under the Bankruptcy Act" 1961 *Vanderbilt Law Review* 115.
[98] Goode paras 10-106–10-135.
[99] Garido "The Distributional Question in Insolvency: Comparative Aspects" 1995 *Int Insolv R* 50.
[100] Keay *et al* 2001 *Int Insolv R* 167.
[101] *Ibid*.
[102] Sharrock *et al Hockly's Insolvency Law* (2012) 186.
[103] Ferriel and Janger 309.
[104] *Ibid*.

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real estate mortgage or security interest in personal property, but secured claims also include debts secured by judicial or statutory liens.[105]

An unsecured claim is simply a debt. The creditor has no interest in any particular property of the debtor that it may foreclose on if the debt is not paid. Unsecured claims are sometimes simply referred to as general claims.[106] Priority claims are unsecured claims that are entitled to priority under statute. It is important to note that creditors may rank differently when it comes to statutory priorities, with some having seniority over others.[107] Sometimes these unsecured claims are subordinated in that their priority is lowered. This means that the claim is not paid until other unsecured claims have been satisfied. This usually occurs when a creditor agrees to the subordination of his or her claim or when some wrongdoing of the creditor leads the court to subordinate his or her claim on statutory or equitable grounds.[108]

Uganda follows the traditional approach which is characterised by the retention of a wide range of preferential rights for certain creditors. Before a court makes an insolvency order, the judge takes note of the rights that accrue to different parties (creditors). These rights can be categorised into the rights of secured creditors,[109] the rights of unsecured creditors,[110] and the rights of preferential creditors such as employees,[111] the government in the form of taxes[112] and the social security fund.[113] These three categories will be discussed in the upcoming paragraphs.

2.4.2 Secured creditors

Under corporate insolvency, for example, secured creditors have some rights prior to insolvency. A secured creditor – being a holder of a fixed charge – has the right to realise the security at any time after the time frame of the debenture has expired and without recourse to insolvency procedures.[114] Where the creditor holds a floating charge – and because it hovers over all or any class of assets of the estate without specifically attaching to any asset – the

[105] *Ibid*.
[106] Ferriel and Janger 310.
[107] *Ibid*.
[108] *Ibid*.
[109] S 11 of the Insolvency Act.
[110] S 10 of the Insolvency Act.
[111] S 12(5)(b) of the Insolvency Act.
[112] S 12(6)(a) of the Insolvency Act.
[113] S 12(6)(b) of the Insolvency Act.
[114] S 11(2) (a) of the Insolvency Act.

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creditor may not attach or realise his security, but he has the right to petition for insolvency in cases where the debtor commits an act of insolvency or fails to pay his debts as they fall due.[115]

The creditors also have the general right to appoint a liquidator or trustee before an order of insolvency is made. This occurs when there are clear indicators that the debtor is unable to pay his or her debts as they fall due, and all demands for payment have been made in vain.[116] A secured creditor must deliver written notice of any debt secured by a charge over any asset – together with particulars of the asset subject to the charge – and the amount secured, to the liquidator or trustee as soon as public notice has been given of the liquidation or bankruptcy.[117]

A claim by a secured creditor must be verified by way of a statutory declaration and must set out in full the particulars of the claim, the particulars of the charge including the date on which it was given, and any documents that substantiate the claim and the charge.[118] The liquidator or trustee must meet the claim in full and redeem the charge. Upon realising the asset subject to the charge, the liquidator or trustee will pay the secured creditor the amount of the claim, less consideration for the liquidator or trustee's reasonable remuneration. The liquidator or trustee may also reject the claim in whole or in part given the circumstances surrounding the case.[119]

2.4.3 Unsecured creditors

Unsecured creditors consist of statutory preferent creditors and concurrent or non-preferential creditors.[120] Except as required by the liquidator or trustee, an unsecured creditor may lodge a dated claim informally in writing.[121] Where the liquidator or trustee wants a claim to be lodged formally, the claimant must submit a claim verified by a statutory declaration describing in full the particulars of the claim and identifying documents, if any, that verify the claim.[122] The liquidator or trustee may acknowledge or reject any claim partially or entirely, and if he

[115]Kaweesi "Understanding the Impact of Insolvency on Pre-Insolvency Rights" http://www.academia.edu/kaweesi.html (accessed 13-06-2018).
[116] Ss 70 and 25 of the Insolvency Act. The trustee is elected at the first creditors meeting, and the liquidator is appointed by the creditors and the company during their respective meetings.
[117] S 11 of the Insolvency Act.
[118] S 60(1) of the Insolvency Act.
[119] *Ibid*.
[120] S 13 of the Insolvency Act.
[121] S 10 of the Insolvency Act.
[122] *Ibid*.

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subsequently considers a claim as erroneously admitted or rejected entirely or partially, he may revoke or amend the decision.[123]

It is important to note that there exist special creditor rights that are created by legislation, such as municipal debts and fees owing to municipalities. In Uganda, special rights to municipal fees exist because of insolvency law practices that are endorsed by the Constitution and the Local Government Act.[124]

Preferential creditor claims may also include claimants' rights to damages based on tort or breach of contract, but the creditor must have obtained judgment against the debtor.[125] It is important to note that these preferential claims are recognised at common law and the Insolvency Act expressly provides for both.[126]

The statutory preferent claims of creditor are paid from the proceeds of the unencumbered assets. The order of payment of statutory preferent claims of creditors as provided for by section 12 (4), (5) and (6) of the Insolvency Act, is as follows:

a) Remuneration and expenses duly incurred by the liquidator or trustee.[127]

b) Any receiver's or provisional administrator' s indemnity under section 159[128] or section 187,[129] and any remuneration and expenses duly incurred by any receiver, liquidator, provisional liquidator administrator, proposed supervisor or supervisor.[130]

c) The reasonable costs of any person who petitioned the court for a liquidation or bankruptcy order.[131]

d) All wages or basic salaries of employees, wholly earned or earned in part by way of commission and limited to four months.[132]

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[123] *Ibid*.
[124] Cap 243 (Laws of Uganda). This corresponds to the position in South Africa.
[125] S 264 of the Insolvency Act.
[126] *Ibid*.
[127] S 12(4)(a) of the Insolvency Act.
[128] S 159 deals with the provisional administrator's right to indemnity for the expenses that the latter incurs during the dispensation of his obligations as provisional administrator.
[129] S 187 deals with the receiver's right to indemnity for the expenses he or she incurs, and such expenses must be directly connected to his official role or powers granted by the Act.
[130] S 12(4)(b) of the Insolvency Act.
[131] S 12(4)(c) of the Insolvency Act.
[132] S 12(5)(a) of the Insolvency Act.

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e) All amounts due in respect of any compensation or liability for compensation under the Worker's Compensation Act, accrued before the commencement of the liquidation or bankruptcy, and which does not exceed the prescribed amount.[133]

f) All amounts that are preferential debts under section 33[134] or section 105.[135]

g) The amount of any tax withheld and not paid over to the Uganda Revenue Authority for twelve months prior to the commencement of insolvency.[136]

h) Contributions payable under the National Social Security Fund Act.[137]

It is important to note that the Insolvency Act does not expressly state that there is a distinction between proceeds recovered from secured assets (encumbered assets) and unsecured assets (unencumbered assets), though it does exist. After the secured creditors have realised the secured assets that were subject to charges, all the proceeds realised from the unencumbered assets together with any balance from the secured asset-proceeds are pooled together, and the rules of distribution set out above will apply.[138]

However, the rules of distribution set forth in section 12 apply subject to section 11(2) of the Insolvency Act, which provides that secured creditors have to give written notice of any debt secured by a charge over any asset, as well as specifics of the asset subject to the charge, and the amount secured to the liquidator or trustee as soon as public notice has been given of the liquidation or bankruptcy.

Section 11(2) further provides that the secured creditor may realise any asset subject to the charge that he or she is entitled to, or if the creditor pleases, he or she may surrender the asset subject to the charge for the benefit of the whole body of creditors. He or she will then claim the whole debt as a concurrent or non-preferential creditor.[139]

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[133] S 12(5)(b) of the Insolvency Act.
[134] S 33 deals with the trustee's power to obtain documents, and the expenses incurred in doing so are categorized as preferent claims.
[135] S 12(5)(c) of the Insolvency Act. S 105 deals with the liquidator's power to obtain documents, and the expenses incurred are categorized as preferent claims.
[136] S 12(6)(a) of the Insolvency Act.
[137] S 12(6)(b). The contributions made in terms of this provision are paid to a pension scheme, from which workers or employees are given a retirement package upon their retirement.
[138] S 12 (4), (5) and (6) of the Insolvency Act.
[139] S 13 of the Insolvency Act.

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2.5 Conclusion

The Insolvency Act and Insolvency Regulations introduce a new regime of insolvency practice clearly attempting to comply with international insolvency law best practices. Uganda currently provides for two procedures, bankruptcy (individual insolvency) and corporate insolvency.[140] The traditional approach to insolvency and creditors' rights is followed, as evidenced by the retention of a wide range of preferential rights for certain creditors.[141]

Bankruptcy and liquidation under corporate insolvency are asset liquidation procedures, which are subject to the *pari passu* principle when it comes to the distribution of the proceeds realised from of the insolvent estate amongst the creditors.[142] The Insolvency Act creates a distinction between these creditors. The system recognises secured creditors and unsecured creditors. Unsecured creditors consist of statutory preferent and concurrent or non-preferential creditors.[143]

Secured creditors are the creditors that hold securities over certain assets of the insolvent estate, in contrast with the unsecured creditors whom the debtor merely owes and who are sometimes required by the trustee to formally lodge dated (the date upon which the debt arose) claims in writing.[144] These secured creditors rank higher than unsecured creditors, since they have priority rights to the secured assets' proceeds in terms of section 11(2).

It is important to note that there are some special creditors' claims created by legislation, and they are sometimes paid before secured creditors out of the proceeds of the secured assets. Examples of these special creditor claims are claims for fees owing to municipalities.[145]

In the following chapter, a comparative study of the statutory preferent claims of creditors in a couple of selected jurisdictions will be conducted.

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[140] Paras 2.2 and 2.3.
[141] Par 2.4.1.
[142] *Ibid*.
[143] *Ibid*.
[144] Par 2.4.2.
[145] Par 2.4.3.

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CHAPTER 3: A COMPARATIVE STUDY OF STATUTORY PREFERENT CLAIMS OF CREDITORS IN OTHER JURISDICTIONS

3.1 Introduction

The previous chapter set out the Ugandan framework in relation to insolvency, recognised creditors, and statutory preferent claims in terms of the Insolvency Act. This chapter explains in detail the statutory preferent claims of creditors in selected insolvency systems. A comparison of Uganda's position will be effected through a study of four insolvency systems namely South Africa, the United Kingdom, the United States of America and Australia. The aim is to ascertain whether the Ugandan position as provided for in the Insolvency Act,[146] is in line with the modern trend pertaining to insolvency law in this regard, and whether the Ugandan position is justifiable.

The selected jurisdictions will be evaluated according to the internationally recognised insolvency best practices, in order to identify aspects that need to be addressed in order to improve Uganda's insolvency law.

3.2 South Africa

3.2.1 Introduction

Section 2 of the South African Insolvency Act[147] defines preferent claims as claims that confer the right to payment out of the assets of the estate in preference to other claims. Statutory preferent claims are those claims that are preferred by operation of law and which are paid from the free residue first.[148] After the confirmation of the trustee's account, the trustee must distribute the proceeds of the estate's assets, or collect from each creditor liable to contribute to the costs of the sequestration application, the amount for which they are liable.[149] The order of distribution is prescribed in the Act,[150] and the ranking of creditors is integral to the order of distribution and contribution.[151]

[146] The Insolvency Act of 2011.
[147] 24 of 1936, hereafter "the Act".
[148] Boraine and Van der Linde "The Draft Insolvency Bill – an Exploration Part 1" 1998 *TSAR* 621 638.
[149] S 113 of the Act. See Nagel *et al Commercial Law* (2015) 585.
[150] Ss 95-103 of the Act.
[151] S 2 of the Act defines security as property of an estate over which a creditor has a preferent right by virtue of any special mortgage, landlord's legal hypothec, pledge or right of retention. See Nagel 585.

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Creditors are divided into secured and unsecured creditors. In order to rank as a secured creditor, a creditor's real security right must already have vested at the time of sequestration of the insolvent.[152] Secured creditors enjoy real security rights over the property of the insolvent, and this security right is recognised by the Insolvency Act.[153] The unsecured creditors have no such security since the debtor or insolvent merely owes them a debt.[154]

South African insolvency law divides unsecured creditors into statutory preferent creditors and concurrent creditors.[155] These categories are important as secured creditors are paid out of the proceeds derived from the realisation of their securities (assets which were used by the debtor as security for credit taken), while statutory preferent creditors are paid out of the free residue (the balance of funds available after payment of secured creditors together with the proceeds from the realisation of the unencumbered assets of the estate).[156]

In terms of the definition of preference as provided for in the Insolvency Act,[157] secured creditors and unsecured creditors who enjoy a statutory preference are referred to as preferent creditors.[158] Therefore, the first category of creditors is referred to as secured creditors because these creditors enjoy preference over the proceeds of specific assets, whereas creditors in the second category enjoy preference as determined by statute – first payment as statutory preferent creditors out of the free residue.[159]

3.2.2 Special creditor rights created by legislation

There is legislation that bestows special rights on certain types of creditors such as the state.[160] These provisions may form exceptions to the distribution rules. Some of these special rights will amount to a charge on the proceeds of the property that serves as security, and will thus have to be paid first as part of the costs of realising such property.[161]

It is important to note the impact of these provisions on the distribution of proceeds.[162] Examples of special rights usually pertain to:

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[152] Nagel 585-586.
[153] The Act. See Nagel 586.
[154] Nagel 586.
[155] *Ibid*.
[156] S 2 of the Act.
[157] *Ibid.*
[158] Nagel 585.
[159] Nagel 586.
[160] *Ibid*.
[161] S 89(1) of the Act. See Nagel 586.
[162] Nagel 586.

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a) Municipalities, upon the insolvency of a ratepayer's estate. The transfer of immovable property out of the insolvent estate cannot be effected without production of a clearance certificate issued by the municipality.[163] The certificate certifies that all amounts due to the municipality in respect of fees, taxes and levies which accrued within two years before the date of the application for the certificate, are fully paid.[164]

b) Costs incurred to realise other immovable property, such as sectional title units. These costs will also include the amount of levies in arrears payable to a body corporate in terms of section 15B(3)(a)(i) (aa) of the Sectional Titles Act.[165] The body corporate may refuse to issue a clearance certificate to the trustee until such amounts are paid.[166]

c) The Land Bank. The Land and Agricultural Bank Act[167] bestows a special statutory pledge[168] over all agricultural produce and all products manufactured therewith, as well as all agricultural products purchased with monies advanced by the Land Bank as long as the debtor owes the Land Bank any amount of money.[169]

d) A purchaser of land on installments who does not take transfer of such property. The purchaser enjoys a statutory preference with regards to the proceeds of the sale of the land upon the insolvency of the owner of the land, provided that the installment sale agreement was recorded in the deeds registry.[170] This enables the purchaser, who does not take transfer of the land so purchased, to rank on the same basis as a mortgagee in respect of such land.[171]

3.2.3 Secured creditor claims under the Insolvency Act 1936

The liquidator or trustee must open an encumbered asset account in order to deal with the distribution of secured asset proceeds.[172] The claims that must be cleared first are the administration costs, which include the liquidator's fees, Master's fees, advertising costs, costs of maintaining and realising property of the estate, and all expenses associated with running

[163] Municipal Systems Act 32 of 2000.
[164] Nagel 586.
[165] 95 of 1986.
[166] Nagel 586.
[167] 15 of 2002.
[168] S 30(1).
[169] Nagel 586.
[170] S 20(5) of the Alienation of Land Act 68 of 1981.
[171] Nagel 586.
[172] Nagel 584.

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the estate while the winding-up and bankruptcy processes subsist.[173] The secured creditor receives the remaining proceeds of the asset as payment for his or her claim, and after deduction of the realisation costs and the proportionate share of the master's fee, trustee's charges and bond of security. Any balance will be included in the free residue.[174]

3.2.4 Unsecured creditor claims under the Insolvency Act 1936

Unsecured creditors are paid from the free residue account, and the statutory preferent creditors are paid first when distributing the proceeds of assets in the free residue.[175] The free residue is the portion of the estate which is not subject to securities, plus the balance that remains after settlement of claims subject to securities.[176] If there is anything left after all preferent creditors have been paid, the remaining amount in the free residue will be paid to the concurrent creditors on a pro rata basis, determined according to the value of their proved claims.[177]

The order of statutory preferences as provided for by the Insolvency Act is as follows:

a) Funeral expenses of the insolvent if the insolvent died before the lodging of the first distribution account with the Master, and the costs of the insolvent's wife or minor child if such expenses were incurred within three months immediately prior to sequestration.[178] These expenses are limited to R300, and anything above that is considered a concurrent claim.[179]

b) Death bed expenses such as those incurred in respect of medical services offered to the insolvent, his wife or minor child.[180] If the free residue is insufficient, death bed expenses and funeral expenses are paid from the proceeds of the securities (encumbered assets), in proportion to the value of the securities.[181]

c) Sequestration and administration costs.[182] These rank in the following order: sequestration costs of the sheriff,[183] the Masters' fees, and in equal ranking order,

[173] S 89 of the Act. See Nagel 589.
[174] Nagel 589.
[175] *Ibid*.
[176] S 2 of the Act.
[177] S 103(1)(a) of the Act.
[178] Nagel 589.
[179] S 96(1) of the Act.
[180] S 96(2) of the Act.
[181] S 96(2) and (3) of the Act.
[182] S 97 of the Act.
[183] S 19(1) of the Act.

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taxed costs of sequestration,[184] costs of the sequestration application and such other costs incidental to sequestration and administration costs, for example the costs of attachment of property by the deputy sheriff.[185]

d) Taxed fees of the sheriff in connection with any execution upon property of the insolvent, and in connection with any proceedings which resulted in that execution, limited to the proceeds of the sale in execution, and any other costs in those proceedings limited to R50.[186]

e) Arrear salaries, wages and related claims of former employees of an insolvent employer.[187] It is important to note that these are subject to statutory limits.[188]

f) Statutory claims payable by the insolvent employer to certain government and other institutions.[189] These may include payments payable by employers in terms of the Compensation for Occupational Injuries and Diseases Act,[190] taxes deducted by employers in terms of the Income Tax Act,[191] and such other payments in terms of the Customs and Excise Act of 1964, the Value Added Tax Act 89 of 1991 and contributions under the Occupational Diseases Act 78 of 1973.[192]

g) Income tax payable by the insolvent for any period before sequestration.[193]

h) Proved claims secured by general bonds and special notarial bonds registered before 7 May 1993 outside the province of Natal.[194] It is important to note that the preference of the bond holder and the general notarial bond in respect of proceeds of assets in the free residue is limited to the realised value of the hypothecated movable assets.[195]

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[184] S 97(3) of the Act.
[185] S 19(1) of the Act.
[186] S 98 (1) and (2) of the Act.
[187] S 98A of the Act.
[188] *Ibid*.
[189] See S 99(2) of the Act.
[190] 130 of 1993.
[191] 58 of 1962.
[192] Nagel 591.
[193] S 101 of the Act.
[194] S 102 of the Act and s 1(3) of the Security by Means of Movable Property Act 57 of 1993.
[195] *First Bank Ltd v Land and Agricultural Development Bank of South Africa* 2015 SA 38 (SCA) paras 38–40.

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i) If there is any balance left after the payment of the preferences in terms of section 96 to 102 of the Insolvency Act, the concurrent creditors are paid in proportion to their claims.[196] This means that they receive a dividend.[197] The non-preferential portions of the claims of statutory preferent creditors are also considered to be concurrent claims.[198]

j) Any remaining surplus must, in terms of the Insolvency Act,[199] be deposited in the Master's Guardian Fund. After rehabilitation of the insolvent, the Master must pay the surplus to the insolvent upon the latter's request.[200]

3.3 United Kingdom

3.3.1 Introduction

The Insolvency Act of 1986 provides that the distribution of the first and any subsequent dividends, should take place whenever the trustee has enough funds after the creditors have lodged their claims, and these claims have been processed by the trustee.[201]

When a dividend is declared and distributed, the trustee must retain such sums as may be necessary for the expenses that may flow from the bankruptcy proceedings.[202] He must also make provision for any bankruptcy debts which appear to be due to persons who, by reason of distance, may not have had sufficient time to tender and establish their claims. He must provide for any debts which are the subject of claims which have not yet been determined, and likewise for disputed proofs of claims.[203]

Fletcher points out that it is by no means established that all the funds in the trustee's hands will simply be distributed amongst all creditors in equal proportions.[204] The law divides the debtor's liabilities into several separate sub-groups, or classes, and the funds of the estate are to be applied in a defined order of priority. Securities bring about priorities, and just like Uganda recognises forms of security, debtors in the UK have the right to borrow and create security rights over any of their assets in the form of a floating or fixed charge. These two

[196] S 103(1) of the Act.
[197] Nagel 591.
[198] *Ibid*.
[199] S 116 of the Act.
[200] Nagel 589.
[201] S 324(1) of the Insolvency Act of 1986, hereafter "the UK Act".
[202] *Ibid*.
[203] S 324(4) of the UK Act.
[204] Fletcher *The Law of Insolvency* (2009) 339.

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forms of security confer some rights which have a bearing on the priority of the creditors' claims as they are to be paid out of the proceeds of the insolvent estate.[205]

3.3.2 Priority claims under the Insolvency Act 1986

The order of priority provided for under sections 324 to 330 of the Insolvency Act, is as follows:

a) The expenses of the bankruptcy proceedings.[206] These are the administrative costs generated in the course of the bankruptcy process, and are also subject to an order of priority.

b) Pre-preferential debts.[207] Several species of pre-preferential debts are paid in priority, which priority is conferred by various statutory provisions.[208] The effect of the operation of these statutory provisions is as per section 328(6) of the Insolvency Act.[209] Creditors who fall in this category include apprentices or articled clerks, who may be articled to the bankrupt, and claim for their salaries or wages.[210] A special priority also extends to trustees of friendly societies where an officer of such a society had money of the society in his possession money when he was declared bankrupt. Article 4(2) of the Administration of Insolvent Estates of Deceased Persons Order of 1986 creates another priority claim in the form of reasonable funeral, testamentary and administration expenses, and lastly a claim for expenses of the trustee for any deed of arrangement which was not implemented due to the bankruptcy of the debtor. [211]

c) Preferential debts.[212] Following the reforms brought about by the Enterprise Act of 2002, the remaining categories currently consist of claims for sums owed by the debtor in respect of contributions to occupational pension schemes, state pension schemes, and claims for arrear salaries or wages owed to the bankrupts' present or former employees.[213] The various categories of preferential claims are enumerated in schedule

[205] Fletcher339. For a detailed explanation on floating and fixed charges, see http://www.companyrescue.co.uk/guides-knowledge/guides/what-are-fixed-and-floating-charges-3919/ (accessed 29-06-2019).
[206] Fletcher 340. See r.6.224(1) of the Insolvency Rules 1986 (as amended) for the detailed provisions setting out the costs, fees and charges which are by virtue of law payable out of the estate.
[207] Fletcher 342.
[208] *Ibid*.
[209] *Ibid*.
[210] *Ibid*.
[211] Fletcher 343.
[212] S 328(1) of the UK Act.
[213] Fletcher 343.

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6 to the Insolvency Act.[214] After the Cork Report, reforms were implemented and the Crown's privileged position as a preferential creditor for unpaid taxes was abolished.[215]

d) Ordinary debts.[216] After the trustee paid all the claims in respect of the first three classes, he must use the remaining funds to pay the debts owed to ordinary creditors.[217] All creditors in this class are on equal footing, all debts rank equally and are paid *pari passu*.[218]

e) Interest.[219] If there is any surplus remaining after full payment of all the debts or claims noted above, the excess funds are used to pay the interest that accrued in respect of the ordinary and preferential debts, since the commencement of the bankruptcy.[220]

f) Postponed debts.[221] The Insolvency Act makes provision for the postponement of payment of certain debts in the event of bankruptcy, and until the claims of all preferential and ordinary creditors have been repaid in full with interest.[222] These statutory provisions are aimed at preventing fraudulent arrangements that are designed to defeat the claims of bona fide creditors. An example is where loans are allegedly made between spouses. In this case, the UK Act postpones such debts, until the claims of all preferential and ordinary creditors have been repaid in full.[223]

g) Surplus (payable to the bankrupt).[224] The bankrupt is entitled to any surplus remaining after full payment of all costs and expenses of the bankruptcy proceedings and after full payment, with interest, has been made to creditors.[225]

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[214] *Ibid*.
[215] Fletcher 346. The Cork Report *Report of the Review Committee on Insolvency Law and Practice* (1982) *Cmnd* 8558. The latter was an investigation which resulted in recommendations on the modernisation and reform of UK insolvency law. It was chaired by Kenneth Cork. One of its notable reforms was the abolition of the Crown preference.
[216] Fletcher 350.
[217] *Ibid*.
[218] S 328(3) of the UK Act.
[219] Fletcher 350.
[220] S 328(4) of the UK Act.
[221] Fletcher 351.
[222] S 328(6) of the UK Act.
[223] Fletcher 351.
[224] Fletcher 353.
[225] S 330(5) of the UK Act.

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3.4 United States of America

3.4.1 Introduction

The priority claims of creditors under the United States' insolvency laws are found in section 507 of the United States' Bankruptcy Code.[226] Priority or preferent claims are unsecured claims in respect of which the creditors are entitled to priority payment in terms of the provisions of the Bankruptcy Code. They are also entitled to different levels of statutory priority, with some creditors' claims enjoying preference over others.[227]

Unsecured claims are sometimes subordinated, that is, their priority is lowered, so that the claim is not paid until all other unsecured claims are satisfied.[228] This occurs when the creditor agreed that his or her claim could be subordinated to the claims of other creditors, or because a court decided to subordinate a creditor's claim on statutory or equitable grounds due to some wrongdoing by the creditor.[229]

Unless all priority claims are paid in full, those with general unsecured claims will usually receive nothing. Furthermore, unless the estate raised sufficient funds to satisfy the claims of all creditors, a shareholder's interest will disappear because the payments to creditors leave nothing for further distribution.[230] Even in a fairly simple bankruptcy case, there might be claims and interests which enjoy different levels of priority.[231]

3.4.2 Priority claims under the Bankruptcy Code

According to the Code,[232] the order of priorities is as follows:

a) All allowed unsecured claims for domestic support obligations that, as of the date of the filing of the petition, are owed to or recoverable by a spouse, former spouse, or child of the debtor, or such child's parent, legal guardian, or responsible relative.[233]

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[226] Title 11 of the Bankruptcy Code, hereafter "the Code".
[227] Ferriel and Janger *Understanding Bankruptcy* (2013) 310.
[228] *Ibid*.
[229] *Ibid*.
[230] *Ibid*.
[231] *Ibid*.
[232] S 507 of the Code.
[233] S 507(1)(A). These domestic support obligations differ from those referred to next in paragraph (b) because the wording of the provision points to the fact that these obligations are owed by the debtor to his dependents who are either living with his or her spouse, a former spouse or guardian.

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b) All allowed unsecured claims for domestic support obligations that, as of the date of the filing of the petition, are assigned by a spouse, former spouse, child of the debtor, or such child's parent, legal guardian, or responsible relative, to a governmental unit or are owed directly to or recoverable by a governmental unit under applicable non-bankruptcy law.[234]

c) If a trustee is appointed or elected, the administrative expenses of the trustee must be paid before payment of the claims for domestic support obligations referred to above, and to the extent that the trustee administers assets that are otherwise available for the payment of such claims.[235]

d) Unsecured claims of any federal reserve bank that relate to loans made through programs or facilities authorised under section 13(3) of the Federal Reserve Act, alongside costs of the bankruptcy proceedings.[236]

e) Unsecured claims which are allowed under section 502(f) of Title 11.[237]

f) Allowed unsecured claims limited to $10,000 for the salary earned by an individual or corporation in the 180 days preceding the date of the filing of the petition or the date of the cessation of the debtor's business, whichever occurred first.[238]

g) Allowed unsecured claims for contributions to an employee benefit plan, arising from services rendered within the 180 day-period before the date of the filing of the petition or the date of the cessation of the debtor's business, whichever occurred first.[239]

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[234] S 507(1)(B). The domestic support obligations referred to here differ from those mentioned in paragraph (a), because the wording of the provision points to the fact that these obligations were assigned by a spouse or guardian to a governmental unit, for example in form of funds to look after the dependent child who is in the custody of the debtor.
[235] S 507(1)(C). The expenses discussed are those listed in paragraphs (1) (A), (2) and (6) of section 503(b). These expenses include the costs of preserving the estate, compensation and reimbursement of officers involved the bankruptcy procedure, and the fees and mileage payable when tendering evidence, due to persons like interpreters.
[236] S 507(2). Section 13(3) of the Federal Reserve Act deals with the discount of obligations arising out of actual commercial transactions.
[237] S 507(3). Section 502(f) deals with allowance of claims or interest.
[238] These claims relate to wages, salaries, or commissions, including vacation, severance, and sick leave pay earned by an individual. They also include sales commissions earned if, during the twelve months preceding the date of filing the petition or cessation of the debtor's business, at least 75 percent of the amount that the individual or corporation earned by acting as an independent contractor, was earned from the debtor. See s 507(4)(A) and (B).
[239] This is limited to the number of employees covered by each plan and multiplied by $10,000; less the aggregate amount paid to these employees; plus, the aggregate amount paid by the estate on behalf of these employees to any other employee benefit plan. See s 507(5)(A)(B) (i) and (ii).

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h) Allowed unsecured claims of persons engaged in the production or raising of grain as per section 557(b), and persons engaged as United States fishermen.[240]

i) Allowed unsecured claims of individuals limited to $1,800 for each such an individual, which arises out of the deposit of money in connection with the purchase, lease, or rental of property; or the purchase of services, for the personal, family, or household use of such individuals and which were not delivered or provided. The money must have been deposited before the commencement of the bankruptcy case.[241]

j) Allowed unsecured claims of governmental units regarding the various types of taxes, for example, income tax, property tax, and excise tax.[242]

k) Allowed unsecured claims based on any commitment by the debtor to a federal depository institutions regulatory agency (or predecessor to such agency) to maintain the capital of an insured depository institution.[243]

l) Allowed claims for death or personal injury resulting from the operation of a motor vehicle or vessel, if such operation was unlawful because the debtor was intoxicated from using alcohol, drugs, or another substance.[244]

3.5 Australia

3.5.1 Introduction

Statutory priorities work against the essential principle of *pari passu* distribution to the disadvantage of ordinary unsecured creditors.[245] Priority creditors are entitled to a statutory right of payment although they are not secured creditors.[246] Traditionally, in Australia, the major categories of priorities include administrative costs of insolvency, employees' claims for wages and other entitlements, and government claims for taxes and debts.[247]

[240] S 507(6)(A)(B). Section 557(b) deals with expedited determination of interests in, and abandonment or other disposition of, grain assets.
[241] S 507(7).
[242] S 507(8) (A-G).
[243] S 507(9).
[244] S 507(10)(b)(c)(d).
[245] Symes *Statutory Priorities in Corporate Insolvency Law an Analysis of Preferred Creditor Status* (2008) 1.
[246] *Ibid*.
[247] *Ibid*.

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Insolvency in Australia is divided into corporate and personal legal procedures and this leads to different statutory priorities in respect of corporate and individual insolvency.[248] There is a clear distinction between the two in general terms.[249] Personal insolvency procedures are known as 'bankruptcy', and corporate insolvency procedures are referred to as 'corporate insolvency'.[250]

The corporate insolvency process is predominantly a creature of statute, whose legal form is found in the principal corporate law statute, the Corporations Act.[251] Keay regards corporate insolvency as a separate field of law, which is no longer merely a part of company or commercial law.[252] Bankruptcy is governed by the Bankruptcy Act[253] and the Regulations made thereunder, unless the contrary is indicated.[254]

3.5.2 Priority claims under the Corporations Act 2001

The main Australian provision in respect of priorities in corporate insolvencies is section 556(1) of the Corporations Act.[255] It provides that, in the winding-up of a company, the following debts and claims must be prioritised above all other unsecured debts and claims and paid in the following order:

a) Expenses (except deferred expenses) duly incurred by a relevant authority in preserving and realising the property of the company, or in carrying on the company business.[256]

b) If the court ordered the winding-up, the costs in respect of the application for the order (including the applicant's taxed costs payable under section 466).[257]

[248] *Ibid*.
[249] *Ibid*.
[250] *Ibid.*
[251] Corporations Act 2001 (Cth), hereafter "the Corporations Act". Symes 2.
[252] Symes 2. See Keay "The Unity of Insolvency Legislation: Time for a Re-think?" 1998 *Insolvency Law Journal* 10.
[253] Bankruptcy Act 1966 (Cth), hereafter "the Bankruptcy Act".
[254] Keay and Walton *Insolvency Law Corporate and Personal* (2012) 13.
[255] Symes 12.
[256] S 556(1)(ba)(i-v) of the Corporations Act.
[257] *Ibid*. Section 466 deals with the payment of the preliminary costs of the winding-up proceedings incurred by the petitioners until the appointment of a liquidator.

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c) The debts in respect of which paragraph 443D(a) or (aa) entitles an administrator of the company to be indemnified, except expenses covered by paragraph (a) of the aforementioned subsection and deferred expenses.[258]

d) If the court ordered the winding-up, the costs and expenses that are payable from the proceeds of the company's property in respect of subsection 475(8).[259]

e) If the company resolved, by special resolution, to be wound-up voluntarily, the costs and expenses payable from the proceeds of the company's property under subsection 446C(8).[260]

f) Any other expenses (except deferred expenses) duly incurred by a relevant authority.[261]

g) Deferred expenses. These expenses include the remuneration or fees for services which are payable to the liquidator or provisional liquidator.[262]

h) If a committee of inspection has been appointed for the purpose of winding-up the company, the expenses incurred by a person as a member of the committee.[263]

i) Wages, superannuation contributions, and superannuation charges payable by the company in respect of services rendered to the company by employees before the relevant date. Superannuation relates to a compulsory practice of placing a minimum percentage of the workers' income into a fund, to cater for their financial needs during retirement.[264]

j) All amounts due on or before the relevant date in respect of an industrial instrument, which relates to leave of absence of employees.[265]

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[258] *Ibid*. Section 443D deals with the right of indemnity of the administrator payable from the proceeds of the company's property.
[259] S 556(1)(da) of the Corporations Act. Section 475(8) provides that a person who compiles a report on the company's affairs must be paid by the liquidator from the proceeds of the property of the company, including costs and expenses incurred during the preparation and drafting of the report and the verification of that report. The payments are effected as the liquidator considers reasonable.
[260] S 556(1) (daa). Section 446C (8) requires the liquidator to pay a current or former official of the company from the proceeds of the company's property, for the expenses that the latter incurred in drafting a report that the liquidator requested him or her to draft regarding the affairs of the company.
[261] S 556(1)(dd).
[262] S 556(1)(de).
[263] S 556(1)(df).
[264] S 556(1A).
[265] S 556(1B)(i-iv).

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k) Retrenchment payments payable to employees of the company.[266]

3.5.3 Priority claims under the Bankruptcy Act 1966

Regarding bankruptcy, section 140 of the Bankruptcy Act requires the trustee to declare and pay dividends on time.[267] A dividend is a creditor's share of the bankrupt's estate and a final dividend will be paid once all the assets have been realised.[268] Before declaring the dividend, the trustee must consider the position of the so-called priority or statutory preferent creditors.[269] These are creditors who are given some special priority for the repayment of their debts.[270]

Section 109 of the Bankruptcy Act sets out the priorities in the following order:

a) Costs and expenses of administration.[271] These include taxed costs of the petitioner and the remuneration of the trustee.[272] If there are insufficient funds to pay all the items specified, regulation 6.01 and schedule 3 of the regulations apply and provide for a scheme of priority payments.[273] The major expenses are to be paid in the following order under schedule 3:[274]

- Expenses reasonably incurred by the trustee in protecting the assets of the bankrupt, carrying on the bankrupt's business or an advance made to the trustee for payment of duly incurred expenses of the estate for any proper purpose, other than the trustee's remuneration.
- Other costs, fees and expenses incurred by the trustee in the course of administering the estate.
- The taxed costs of the petitioning creditor expended to obtain a sequestration order.
- Remuneration of the trustee.

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[266] S 556(1C).
[267] Keay 139.
[268] *Ibid*.
[269] *Ibid*.
[270] *Ibid*.
[271] S 109(1) (a) of the Bankruptcy Act, Keay 141.
[272] Keay 141.
[273] *Ibid*.
[274] *Ibid*.

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b) The remuneration and costs of a controlling trustee who was authorised by the bankrupt, before bankruptcy ensued, to convene a meeting of his creditors pursuant to part X[275] of the Act.[276]

c) Liabilities of part X proceedings, if the arrangement under part X was made within two months of bankruptcy and has been terminated.[277]

d) Wages of employees limited to 3100 dollars per employee in respect of the period up to the date of bankruptcy.[278]

e) Leave payments of employees.[279]

f) Priorities in favour of a creditor or group of creditors agreed by special resolution at a meeting of creditors.[280] It is important to note that any creditor of the bankrupt could apply to court to have the decision reversed, even as regards displacing the priorities, as the court has the discretion to do so.[281]

Should there be insufficient funds to satisfy any class of priority creditors, the remaining funds are divided proportionately among the creditors of that class.[282] If all the priority creditors are paid in full, the balance of funds will be available for proportionate distribution among the unsecured creditors.[283]

3.6 Conclusion

The comparative study showed that the selected jurisdictions have very similar depictions when it comes to the statutory preferent creditors' claims. However, the ranking of claims differ insofar as some claims are deemed more important than others. In Australia, the UK and the USA these claims are referred to as priority claims, whilst they are referred to as statutory preferent claims in South Africa, and preferential debts in Uganda. These prioritised or statutory preferent claims correspond to a great extent, but there are several differences.

[275] Part X of the Bankruptcy Act pertains to personal insolvency agreements.
[276] Ss 109(1)(b) and 188 of the Bankruptcy Act 1966. Keay 141.
[277] S 109(1)(c). Keay 142.
[278] S 109(1)(e). Keay 142.
[279] S 109(1)(g). Keay 142.
[280] S 109(1)(j) and (7)-(9). See Keay 142.
[281] S 109(9) and (10). See Keay 142.
[282] *Ibid*.
[283] Keay 143.

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In jurisdictions like the UK, the income tax preference (Crown preference) was abolished due to the recommendations of the Cork report.[284] The income tax preference still exists in Uganda. This tax preference deprives the insolvent estate of proceeds that would leave the other creditors of the insolvent estate with more proceeds to share. The UK creates further distinctions as regards the ranking and distinguishes between pre-preferential debts,[285] preferential debts,[286] and ordinary debts.[287] This is not the case in Uganda as the insolvency system only provides for preferential debts and no other classes (apart from the general secured and unsecured classes). The ordinary debts in the UK can be likened to what Ugandan law terms as non-preferential debts, but there is no similar pre-preferential class found in Uganda's Insolvency Act.

Similar to the UK with its pre-preferential debts, South Africa has special rights created by legislation and these provisions form exceptions to the normal distribution rules. These special rights are usually in form of charges on the proceeds of the property that serves as a security.[288] Such special rights usually take precedence over statutory preferent claims. Provision is made for priority payment of these charges in Uganda but these special rights are not expressly mentioned in the Insolvency Act – they are provided for by the Local Government Act.[289]

South Africa further expressly differentiates between the proceeds arising from encumbered assets (proceeds distributed from the encumbered asset account) and the unencumbered assets (proceeds distributed from the free residue account) of the insolvent estate.[290] A similar differentiation in respect of accounts does not exist in the Ugandan Insolvency Act. As a matter of practice, after the secured creditors have exercised their rights to the secured assets, any balance from the proceeds of the secured assets are combined with the proceeds of the unsecured assets, and the order of distribution as provided for by section 12 of the Ugandan Insolvency Act is followed.

Statutory preferent claims in South Africa are paid from the free residue, and special claims such as funeral expenses[291] and death bed expenses[292] rank higher than the other preferent

[284] Par 3.3.2.
[285] *Ibid.*
[286] *Ibid.*
[287] *Ibid.*
[288] Par 3.2.1.
[289] Ch 2, par 2.4.3.
[290] Par 3.2.1.
[291] Par 3.2.3.
[292] Par 3.2.4.

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claims. A non-South African scholar would wonder whether such funeral and death bed expenses deserve this special treatment accorded under South African law. The position is different in other jurisdictions like Uganda where funeral cover did not exist in the past, but has now been invented. It is an innovation of which few Ugandans are aware. Uganda has two major funeral service providers, namely "Uganda Funeral Services" and "A Plus Funerals". These two companies are in the initial stages of introducing funeral insurance to Ugandans. Burials or funerals do not take place at general burial sites, but at family ancestral grounds because the land tenure system allows for individual ownership of land. However, the inclusion of funeral expenses might be necessary in the future depending on the Ugandan reception of this new funeral cover invention.

The USA brings forth a unique and special priority for domestic support obligations, and these claims are paid before any other preferent claim.[293] The domestic support obligations do not exist in Uganda and yet, considering the position at hand, the inclusion of same as a statutory preferent creditor claim would probably favour the dependents of the insolvent. The Ugandan Law Reform Commission should consider including domestic support obligation in the list of statutory preferent creditor claims and rank it first of all statutory preferent creditor claims.

Australia, on the other hand, has separate frameworks for corporate and individual insolvency, and this gives rise to different statutory preferent claims of creditors, depending on whether a corporate or individual insolvent estate is present.[294] The statutory priorities or preferent claims under corporate insolvency are found in the Corporations Act,[295] whereas the priorities or preferent claims under individual insolvency are found in the Bankruptcy Act.[296] This distinction makes Australia quite different in her approach to the statutory preferent claims of creditors when compared to other jurisdictions. Uganda has different corporate and individual procedures, but similar statutory preferences when it comes to corporate versus individual insolvencies, found in the same unified piece of legislation. The priority claims that are paid first in Australia differs at corporate and individual insolvency level, whereas the ranking of statutory preferent claims under Ugandan corporate and individual insolvency law is the same. This is because the two procedures follow the uniform rules of distribution found in the unified Insolvency Act.

[293] Par 3.4.2.
[294] Par 3.5.1.
[295] *Ibid.*
[296] *Ibid.*

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In general terms, the ranking of priority or preferent claims is akin to all these jurisdictions. No matter the similarity in these priority claims across the selected jurisdictions, each country ranks them in its desired order considering the country's unique circumstances and policies. As all the selected jurisdictions adhere to international insolvency law best practices, one would argue that the position pertaining to the manner in which these countries currently rank their priority claims should be maintained, since the circumstances in all these countries are different. However, special claims like domestic support obligations, sequestration or bankruptcy costs, among others, should be similarly situated in ranking across all the jurisdictions.

In the following chapter, a study of the international insolvency law best practices pertaining to the statutory preferent claims of creditors will be conducted. The chapter will analyse policy considerations, principles and guidelines set forth by the World Bank and INSOL International.

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CHAPTER FOUR: POLICY CONSIDERATIONS, PRINCIPLES AND GUIDELINES

4.1 Introduction

The previous chapter involved a comparative study of the statutory preferent claims of creditors in selected jurisdictions. This chapter deals with international best practices in the insolvency law field, for natural person and corporate insolvency law. A study of the various recommendations and guidelines from a number of international insolvency law instruments is done, through an analysis of the guidelines set forth by the World Bank Reports of 2016,[297] 2013,[298] and the World Bank Report on the Observance of Standards and Codes of Insolvency and Creditor Rights.[299]

This study will be limited to those guidelines that have a bearing on the distribution of the proceeds realised out the insolvent estate, and the priority rights of creditors. The legal position pertaining to same in the selected jurisdictions will be investigated, as way of confirming their adherence to the recommendations of these Reports.

It is important to note that these Reports do not indicate whether certain priority rights are justified or not, and neither do they suggest anything about the order of preference. The Reports merely provide generalised recommendations for an insolvency system, and indicated the manner in which special or priority creditor-claims must be treated in every jurisdiction.

4.2 The World Bank Report 2016

This Report urges credit-based economies to integrate and harmonise their commercial law systems to encourage affordable, clear and reasonably probable mechanisms to enforce unsecured and secured credit claims by means of individual action. This is done in the form of enforcement and execution, and through joint action.[300]

Regarding security rights which are known for giving a creditor priority status, the report calls for the development of clear rules and procedures for granting security rights in all types of

[297] World Bank *Principles for Effective Insolvency and Creditor/Debtor Regimes* (2016) 14, hereafter "World Bank Report (2016)".
[298] World Bank *Insolvency of Natural Persons Report* (2013) 21, hereafter "World Bank Report 2013".
[299] World Bank *Principles for Effective Insolvency and Creditor Rights Systems* (revised version 2005), at http://www.worldbank.org/ifa/rosc_icr.html, hereafter "The WB ICR ROSC Report".
[300] World Bank Report (2016).

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immovable assets.[301] There should be clear rules of ownership and priority to monitor the ranking of competing claims or rights to the same assets, in order to eliminate or reduce priorities over security rights considerably.[302]

The types of securities recognised in the studied jurisdictions range from pledges, liens, and floating charges to general notarial bonds.[303] In South Africa, a creditor enjoys real security rights in the property of the insolvent, and a creditor's real security right must have vested at the time of sequestration of the insolvent.[304] In the UK, securities bring about priorities, and the debtors have the right to borrow and create securities over their assets in the form of floating or fixed charges.[305] In Ugandan corporate insolvency, a holder of a fixed charge has the right to realise the security at any time after the time frame of the debenture has expired and without any recourse to insolvency procedures.[306] A creditor with a floating charge may not attach his security, but he has the right to petition for insolvency where the debtor failed to pay his debt as it fell due.[307]

The Report further emphasises that legal systems should provide for shortened procedures for debt collection and execution, and that the proceeds from the assets of the insolvent estate ought to be distributed according to the available priority rules.[308] Such priority rules exist in all the jurisdictions which were studied in the previous chapter.

The Report provides that the rights of creditors and the priorities of claims established before insolvency proceedings under commercial, or other applicable laws, must be upheld in insolvency proceedings in order to preserve the sincere prospects of creditors.[309] This encourages greater predictability in commercial relationships, and deviations from this general rule should occur only where necessary in order to promote other important policies.[310] In this regard, the policy to maximize the insolvent estate's value serves as an example. The rules of priority should enable creditors to manage credit efficiently and consistently.[311]

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301 *Ibid*.
302 *Ibid*.
303 See ch 2 and 3.
304 Ch 3.
305 Fletcher 339.
306 Ch 2 Par 2.4.2.
307 Kaweesi "Understanding the Impact of Insolvency on Pre-Insolvency Rights" http: www.academia.udu/Kaweesi.html accessed (13-06-2018).
308 *Ibid*.
309 *Idem* 25.
310 *Ibid*.
311 *Ibid*.

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The priority rights of secured creditors towards assets that serve as security must be upheld, and absent the secured creditor's permission, its interest in the security should not be subordinated to other priorities granted in the course of the insolvency proceedings.[312] This is evident in all the studied jurisdictions, and, in particular, sections 11 and 12 of the Ugandan Insolvency Act uphold the priority rights of secured creditors.[313] In South Africa, the secured creditor receives the remaining proceeds from the secured asset after deduction of the section 89 costs.[314]

Public interests regarding taxes owed to the state must not be given preference over private or individual creditor rights, and the number of priority classes should be kept to a minimum.[315] Workers or employees are a vital part of an enterprise, together with other creditors of the insolvent estate. Careful consideration should be given to balancing their rights with those of other creditors like the state in particular.[316] The Crown (taxes owing to Her Majesty's treasury) preference in the UK was abolished in this regard,[317] although this is still not the position in the other jurisdictions like Uganda.

In respect of employee' rights, all the selected jurisdictions have a uniform approach as these rights fall under statutory preferent claims, and such claims are paid out of the proceeds of the free residue. South Africa and Uganda are the immediate examples insofar as the preservation of workers' rights is concerned. In South Africa, such workers' rights fall under statutory preferent claims,[318] and the position is the same in Uganda as the wages or basic salaries of the workers receive preferential treatment as well.[319]

In liquidation, equity interests or the titleholders of the business are not eligible for a distribution of the proceeds of the assets until the creditors have been fully repaid.[320] This is the position in all the selected jurisdictions dealt with in chapter 3. The same rule should apply in reorganisation proceedings, although limited exceptions may be made under carefully stated circumstances that respect the rules of fairness that entitle equity interests to retain a stake in

[312] *Ibid.*
[313] Ch 2.
[314] See s 89 of the Insolvency Act 24 of 1936.
[315] World Bank Report (2016) 16.
[316] *Ibid*.
[317] Fletcher 346.
[318] S 98A of the Insolvency Act.
[319] S 12(5)(a) of the Insolvency Act.
[320] World Bank Report (2016) 25.

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the enterprise.[321] In Uganda, after liquidation, the liquidator will distribute the surplus according to the company's memorandum of incorporation or articles of association.[322]

4.3 World Bank Report 2013

The Report points out that the simplest enhancement of a collective insolvency system is through eliminating the inefficiencies inherent in multiple individual enforcement actions and fire sales of the debtor's assets.[323] This happens to be one of the objectives of Uganda's insolvency law and is set out in the long title of the Ugandan Insolvency Act 2011. The Report further states that, without a collective insolvency regime, each creditor must engage and finance its own investigation of the debtor's assets.[324]

The benefit for all creditors in the maximization of assets corresponds with the *pari passu* principle – it's the notion of "equality is equity" – since a collective insolvency system rallies behind the interests of a general body of creditors together with equal treatment of similarly situated creditors.[325]

The task of coordinating the decision by numerous individual creditors to accept whatever the debtor has to offer presents a classic collective action problem and it is unlikely that this dilemma can be overcome without some external control.[326] In an insolvency regime, a neutral administrator might coordinate the investigation, evaluation, and negotiated division of the debtor's productive capacity efficiently and effectively.[327] Creditors are more likely to accept the findings of a neutral administrator, and empowering one administrator to strike a reasonable deal with creditors benefits the collective by overcoming the problem of irrational holdouts and conflicting strategic behaviours by isolated creditors.[328] All the studied jurisdictions comply with this requirement.

In consideration of the recommendations of the Report, it does not specifically provide for the order in which priority claims should be ranked, or any special creditor claims which must

[321] *Ibid*.
[322] S 14(b) of the Insolvency Act.
[323] World Bank *Insolvency of Natural Persons Report* (2013) 21, hereafter "World Bank Report (2013)".
[324] *Ibid*.
[325] Seligson 1961 *Vanderbilt Law Review* 115.
[326] World Bank Report (2013) 23.
[327] *Ibid*.
[328] *Idem* 23–24.

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appear in all jurisdictions. It merely gives generalised recommendations regarding the insolvency process, and the distribution of the proceeds from the insolvent estate.

4.4 The World Bank ICR ROSC Report

The ICR ROSCs are assessments of countries led in line with a procedure based on the World Bank's Principles for Effective Insolvency and Creditors Regimes and the recommendations of the UNCITRAL Legislative Guide on Insolvency.[329] Participation in the study and findings in the report are intended to help engineer reform and foster strengthened economic institutions in member countries.[330]

The importance of an ICR ROSC is to analyse and detect the areas for improvement in a country's insolvency and credit systems.[331] The ICR ROSC is intended to assess a country's institutional practices against globally recognised standards and to provide recommendations for improvement by way of a prioritised procedure. It is not a 'grading' exercise, but the ICR ROSC procedure is rather based on a diverse approach: to weigh whether, and how, the goals of an effective insolvency system are achieved.[332]

The ICR ROSC does not specifically recommend which priority creditor claims must exist, neither does is grade these claims when assessing an insolvency system. It merely concentrates on creditors' rights and enforcement systems, and the effectiveness of the institutional and regulatory frameworks when implementing laws in this area.[333]

In respect of creditor rights and enforcement procedures, Uganda recognises secured and unsecured creditor rights.[334] In relation to the regulatory framework for creditor rights and insolvency, the High Court and the Chief Magistrates' Court oversee all the insolvency procedures.[335] The Uganda Law Reform Commission is charged with amending the insolvency laws whenever a need arises, and it is through their efforts that Uganda has a single insolvency

[329] World Bank *Principles for Effective Insolvency and Creditor Rights Systems* (revised version 2005), at http://www.worldbank.org/ifa/rosc_icr.html.
[330] https://www.worldbank.org/en/programs/rosc#4.
[331] An ICR ROSC analysis was conducted by the World Bank in respect of the South African Insolvency system upon the latter's invitation. The team was led by Jose M Garido and assisted by Professor André Boraine.
[332] World Bank Report 2013 74.
[333] *Ibid*.
[334] Ch 2.
[335] S 2 refers to "Courts" as the High Court and any court presided over by the Chief Magistrate.

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Act that provides for corporate and natural person insolvency procedures.[336] The insolvency framework consists of the Insolvency Act 2011 and the Insolvency Regulations.[337]

4.5 Conclusion

As mentioned in the introduction, these Reports do not really express an opinion as to whether certain priority rights are justified or not. They also do not say anything about the order of preference of creditors' claims, but provide only generalised recommendations in respect of a modern and efficient insolvency system, and how special or priority creditor claims must be treated in an insolvency system.

The 2013 Report encourages collective enforcement of debt, and this forms part of the objectives of the Ugandan Insolvency Act 2011 as per its long title.[338] The Report calls for a neutral administrator or trustee, who has to act in the best interests of the general body of creditors.[339] It emphasises the *pari passu* principle, which calls for the equal treatment of similarly situated creditors.[340]

Given the different classes of creditors and the rights that accrue to specific classes, some creditors are treated more favourably than others. However, creditors that belong to the same class are treated equally. This brings about priority statuses when it comes to settling their claims from the proceeds of the insolvent estate.[341] Such special treatment is a result of the rules set forth in a country's insolvency laws, as emphasised by the 2013 Report. The Ugandan insolvency system recognises secured, unsecured preferential and concurrent or non-preferential creditors. The existence of such classes signifies the priority of some creditor claims over others.[342]

Regarding the neutral administrator, the Ugandan courts appoint an administrator charged with the responsibility of handling the process of distribution of the proceeds of the insolvent estate. The administrator distributes the proceeds by following the rules of distribution and adhering to the rules of priority.[343] This practice is found in all the selected jurisdictions.[344]

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[336] Nyombi *et al* 652.
[337] Statutory Instrument 36 of 2013.
[338] Par 4.3.
[339] *Ibid*.
[340] *Ibid*.
[341] Ch 1.
[342] Ch 2 par 2.4.
[343] Par 4.3.
[344] Ch 3.

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The 2016 Report emphasises that clear rules of priority should be set up in order to govern the grading of competing claims or rights to the same assets, which position Uganda upholds.[345] The Report further emphasises that the rights of creditors and the priorities of claims established before insolvency must be maintained in insolvency proceedings in order to preserve the legitimate expectations of creditors,[346] an aspect also dealt with by the Ugandan Insolvency Act.[347]

The Report lastly emphasises that the priority rights of secured creditors towards assets that serve as collateral should be upheld and not subordinated to other priorities granted in the course of the insolvency proceedings.[348] Ugandan insolvency law upholds this requirement to a large extent, although section 12(2) tends to contradict this position.[349] In instances mentioned earlier, like transfer of immovable properties situated in a municipality, the practice discouraged by the Report exists as property cannot be transferred if fees are owed to the municipal authority. This is an unavoidable legislated deviation from the international standards set by the World Bank 2016 report.[350]

The ICR ROSC assesses the insolvency institutional practices against the international best practices and provides recommendation for improvement.[351] The analysis looks at creditors' rights and enforcement of same, together with the regulatory framework of an insolvency system.[352] The effect of sections 11, 12, 13 and 14 of the Ugandan Insolvency Act and the Insolvency Regulations 2013, conform to the framework that the ICR ROSC seeks to analyse in an insolvency system when it comes to the rights of creditors.

South Africa requested the World Bank to undertake an ICR ROSC analysis on her insolvency system and it helped to identify the areas within the insolvency system that required amendment.[353] Uganda has not had an ICR ROSC analysis of on her insolvency system yet. However, considering the findings of this study, such an analysis would be of relevance to Uganda and therefore an invitation to the World Bank will be welcomed.

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[345] Par 4.2.
[346] *Ibid*.
[347] Ch 2.
[348] Par 4.2.
[349] Ch 2.
[350] *Ibid*.
[351] Par 4.4.
[352] *Ibid*.
[353] *Ibid*.

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In the next chapter, the conclusions and recommendations arising out of the findings of the study shall be dealt with.

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CHAPTER FIVE: CONCLUSION

5.1 General

The dissertation sought to answer the question of whether the Ugandan insolvency law position pertaining to the statutory preferent claims of creditors and the rules of distribution in general, adheres to international insolvency law best practice standards. In answering the question, the dissertation provided a thorough background by discussing the law pertaining to insolvency, the procedures involved, the recognised classes of creditors, and the statutory preferent claims of creditors in the Ugandan system.

A comparative analysis of the position pertaining to the statutory preferent claims of creditors in selected jurisdictions was undertaken by studying South Africa, the United Kingdom, the United States of America and Australia. The international insolvency law best practice standards were considered by looking at the policy considerations, principles and guidelines set forth by the World Bank reports on effective insolvency regimes and the treatment of the insolvency of natural persons. The study, in relation to the reports, was concluded by looking at the ICR ROSC (Insolvency and Creditor/Debtor Rights (ICR) Reports on the Observance of Standards and Codes), which is aimed at engineering reform and fostering strengthened economic institutions in member countries.

In consideration of the findings of the study, it is observed that the Insolvency Act 2011 and the Insolvency Regulations 2013 respectively govern Uganda's insolvency law practice and procedures.[354] These two frameworks introduce an insolvency law regime aimed at compliance with international insolvency law best practices.[355] Uganda provides for bankruptcy (natural person insolvency) and corporate insolvency, with a traditional approach to insolvency that is evidenced by the retention of a wide range of preferential rights for certain creditors.[356]

Bankruptcy and liquidation (corporate insolvency) are asset liquidation procedures, and they are both subject to the *pari passu* principle when it comes to the distribution of the proceeds of the insolvent estate.[357] The system recognises secured and unsecured creditors, with the former paid out of the proceeds of secured assets. The unsecured creditors are paid out of the proceeds

[354] Ch 1.
[355] Ch 2.
[356] *Ibid*.
[357] *Ibid*.

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of the unencumbered assets and the balance of the proceeds of the secured assets if all the claims of the secured creditors have been settled in full.[358]

It is important to note that there is a special order which must be followed when the claims of statutory preferent creditors are settled. This order is set out in section 12 of the Insolvency Act 2011. The concurrent or non-preferential creditors' claims rank equal as per section 13 of the same Act, and any balance that remains after the settlement of all creditor claims is paid to the insolvent.[359]

The comparison with the position in other selected jurisdictions found that Uganda, South Africa, the United Kingdom (UK), the United States of America (USA) and Australia have almost similar descriptions regarding the statutory preferent claims of creditors. However, the various jurisdictions have different approaches in respect of claims that rank over and above others, as evidenced in their respective Insolvency Acts.[360] The position regarding the special treatment of secured creditors' claims remains intact in all the jurisdictions.[361]

The state tax preference was abolished in the UK, but it remains embedded in all the other jurisdictions which were the subjects of this study. In order to ascertain whether the tax preference abolition will benefit the other jurisdictions, their legal scholars should critically analyse the position in the UK and the reasons why the Crown preference was abolished. From such an analysis, they will be able to decide whether, and in consideration of the circumstances in their respective countries, the abolition of the tax preference would benefit creditors.[362]

In the UK, South Africa and Uganda, there is legislation that bestows special rights on certain types of creditors in respect of the proceeds from the insolvent estate. In the UK the special rights are referred to as pre-preferential debts, in the form of salaries or wages owing to articled clerks and apprentices.[363] In South Africa and Uganda, these special rights consist of charges on the proceeds realised from secured assets. An example is the fees owing to municipalities as a result of transactions which involve the transfer of immovable properties situated within the jurisdiction of the respective municipalities.[364]

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358 *Ibid*.
359 *Ibid*.
360 Ch 3.
361 *Ibid*.
362 The position of Uganda in this regard will be discussed in the recommendations.
363 Ch 3.
364 *Ibid*.

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The USA introduced a special priority in the form of domestic support obligations, and this claim is paid before any other priority claim is paid out of the proceeds of the unencumbered assets.[365] This special priority claim does not exist in any of the other studied jurisdictions, but in my view and considering the situation pertaining to maintenance of the insolvent's family, such a priority must exist in all of them.[366]

Australia also has a special system that separates natural person insolvency from corporate insolvency. The two procedures are governed by separate pieces of legislation, with a different ranking that applies to the statutory preferent claims of creditors.[367] One could argue that this difference stems from the different circumstances of natural person and corporate insolvency respectively. Ugandan insolvency law provides for different bankruptcy and corporate insolvency procedures in one Act, and the statutory preferent claims of creditors are treated the same in both procedures.[368]

As regards the policy considerations, principles and guidelines,[369] the Reports do not really suggest that certain priority rights are justified or not, and neither do they say anything about the order of preference.[370] However, akin to all the Reports is the encouragement of collective enforcement of debt. It is clear from all the studied jurisdictions that a *concursus creditorum* is created for effective insolvency proceedings. The Reports further emphasise the *pari passu* principle, which calls for equal treatment of similarly situated creditors during the distribution of the proceeds.[371] It is important to note that creditors' rights accrue according to their class, and this means that some creditors' claims are given priority over others.[372]

On the one hand, the 2016 Report emphasises that clear rules of priority should be set up to govern the grading of competing claims or rights to the same assets.[373] The Report also states that the rights of creditors and the priorities of claims established before insolvency must be maintained in insolvency proceedings in order to preserve the sincere prospects of creditors.[374] The report lastly emphasises that the priority rights of secured creditors to assets that serve as

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[365] *Ibid*.
[366] The position pertaining to Uganda will be discussed in the recommendations.
[367] Ch 3.
[368] Ch 2.
[369] Ch 4.
[370] *Ibid.*
[371] *Ibid*.
[372] Ch 1, par 1.1
[373] Par 4.2.
[374] *Ibid*.

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collateral should be upheld and not subordinated to other priorities granted in the course of insolvency proceedings.[375]

All the above requirements pertaining to the rights of creditors and priorities are upheld by the Ugandan Insolvency Act.[376] However, the effect of section 12(2) seems to contradict the non-subordination requirement to some extent since it tends to subordinate the rights of secured creditors. As mentioned earlier,[377] this subordination is acceptable since the fees in the form of levies owed to local government authorities (municipalities) are fair. The fees and levies are used by the municipalities for sanitation, electricity, and the security of the asset. However, the position is different when it comes to taxes owing to the Uganda Revenue Authority, due to rampant corruption.[378]

On the other hand, the ICR ROSC seeks to analyse creditors' rights and enforcement of same, evaluate the regulatory framework in an insolvency system, and detect the areas for upgrading in a country's insolvency and credit systems.[379] Uganda's insolvency system has not been subjected to an ICR ROSC evaluation, but it is proposed in light of the outcomes for her sister nation South Africa, and the reforms which are now considered in pursuit of improvement of her insolvency laws.

5.2 Recommendations and proposals for law reform

Against the background of the position pertaining to distributions, in particular the statutory preferent claims of creditors in Uganda and selected jurisdictions, the study finds that some aspects of the Ugandan insolvency law are still lacking and require reform, notwithstanding adherence to the international insolvency law best practice standards.[380] Below are the aspects of the law that this study found wanting and that the Uganda Law Reform Commission needs to address.

5.2.1 The tax preference

Inspired by what happened in the UK after the Cork Report[381] and considering the socio-economic order in Uganda, the tax preference needs to be removed from the list of statutory

[375] *Ibid*.
[376] Ch 2
[377] Par 4.5.
[378] Uganda Corruption Report – GAN Integrity 2017 https://www.ganintegrity.com (hereafter Uganda Corruption Report) (accessed 10/15/19).
[379] Par 4.4.
[380] Ch 1–4.
[381] Ch 3, par 3.3.2.

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preferent claims, especially in respect of the insolvency of natural persons. The Uganda Revenue Authority's preference deprives the insolvent estate of the proceeds which could be shared equally amongst creditors. The presence of corruption and swindling of income tax by Revenue officials and some top government officials are common knowledge in Uganda.[382] This is evidenced by the poor social service delivery by the institutions that must be developed by the proceeds from the taxes. Examples include the dilapidated roads, government schools and hospitals.[383]

5.2.2 Incorporation of pre-preferential claims into the Insolvency Act

Pre-preferential claims need to be incorporated into the Insolvency Act in the form of "domestic support obligations", as per the position in the USA.[384] The UK has pre-preferential, preferential and non-preferential claims,[385] and since Ugandan law is inspired by the English legal system,[386] incorporating the pre-preferential classification should serve the Ugandan Insolvency law well.

The prefix "pre" connotes "before", and in the UK system pre-preferential claims are cleared before the preferential and non-preferential claims, although in acceptable circumstances.[387] Therefore, domestic support obligations should be attended to before other preferent creditors' claims since it is just and fair when considering Uganda's situation. Currently, domestic support obligations are not priority claims, yet they are important to the dependents of the insolvent. The dependents need a means of survival until their bread winner secures a new source of livelihood.

5.2.3 The ambiguity of section 12

Section 12 of the Insolvency Act is not clear as to which type of assets it refers to when it mentions the assets from which the statutory preferent claims of creditors are paid. A clearer classification like that of the South African insolvency law, pertaining to "encumbered" and "unencumbered" assets should be adopted.[388]

[382] Uganda Corruption Report.
[383] *Ibid.*
[384] Ch 3, par 3.4.2.
[385] Ch 3, par 3.3.2.
[386] Ch 2, par 2.1.
[387] *Ibid.*
[388] Ch 3.

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Lastly, it is important to note that insolvency is a field of law which has existed since the ancient days. However, its level of advancement is not the same across all jurisdictions in the world. Due to international insolvency best practices and standards, an evaluation is inevitable for a jurisdiction to ascertain whether its system is aligned with international standards. Uganda is one of those jurisdictions whose insolvency law has not been vibrant. Several lawyers are not aware of the existence of INSOL International and its roles. They are also less knowledgeable about the World Bank instruments relating to this field. Therefore, this research will surely have an impact on Uganda's insolvency field.

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