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A LAYMANS GUIDE TO INSOLVENCY; PART 1

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What is insolvency?

An individual is insolvent if he/she is unable to discharge his or her debts as they fall due.

A company is insolvent if it does not have enough assets to cover its debts, that is, the value of its assets is less than the value of its liabilities, or if it is unable to pay its debts as they fall due. Generally, put, therefore, insolvency is the inability to pay debts. Insolvency in Kenya is governed by the provisions of the Insolvency Act of 2015.

There are several procedures that are provided under the law once an individual or a company goes through insolvency. Sometimes the procedures enable the individual or the company to return to solvency. This article explores the procedures available to an individual who has unfortunately found himself or herself in debt.

Insolvency of Natural Persons

The meaning of a natural person is a living human being as distinguished from a company or a corporation created by law. The term also denotes a sole proprietor or an individual as understood in common parlance.

The Insolvency Act avails four different types of insolvency procedures available to the individual depending on their circumstances. These are:

- Bankruptcy
- Individual Voluntary Arrangement
- No-Asset Procedure
- Summary Installment Order

Bankruptcy

Bankruptcy is a legal process where the debtor is declared as being unable to pay his debts. The affairs of the debtor (i.e., debtor's assets and liabilities) are then placed before a bankruptcy trustee in the interests of his creditors generally. The bankruptcy trustee will either be the Official Receiver or any Insolvency Practitioner who is a professional licensed to practice insolvency.

Bankruptcy proceedings can be initiated by a creditor or by the debtor himself. The process is commenced by the debtor or creditor filing a petition for bankruptcy. The petition is accompanied by an affidavit, a statement of financial position and an application for the court to appoint a suitable trustee over the debtor's estate. In a bankruptcy, the bankrupt loses any rights to his property apart from his personal effects and tools of trade.

The bankruptcy process is meant to protect genuine people who have unfortunately found themselves in debt. A bankruptcy order bars creditors from harassing the debtor and intermeddling with his properties. A bankruptcy order can be lifted if the debtor pays off his debts. The bankrupt will automatically be discharged from bankruptcy after three years whether the debt is paid or not. Once discharged, the bankrupt is released from his bankrupt debts with some exceptions.

Individual Voluntary Arrangement

The Individual Voluntary Arrangement is one of the three alternatives to bankruptcy, the other two being the No-Asset Procedure and the summary installment order which are discussed briefly in the following paragraphs. It is a less formal procedure, is more flexible and it varies on a case to case basis depending on the nature of the proposal. An individual voluntary agreement cannot affect the rights of a secured creditor or preferential creditor unless they consent to it.

Under ordinary circumstances, the debtor makes a proposal with the assistance of a licensed insolvency practitioner. An application is then made to court for the court to issue an interim order. The court may at this point stay any other legal procedures against the debtor and/or his property. The Insolvency Practitioner must prepare a report to the court on the proposal. If the report is positive, then the court will allow the insolvency practitioner to convene a meeting of creditors. If the report is adverse, then the interim order ceases.

A creditors meeting is thereafter held which considers the proposal and the report of the creditors. The proposal is successful if accepted by 75% of the creditors in value of the debt held at a meeting. The creditors also appoint the Supervisor who implements the proposal and reports to the court.

The IVA is a fairly flexible procedure, without publicity unlike bankruptcy. It also carries less social stigma associated with bankruptcy. It may also be less costly to administer and therefore likely to increase returns to creditors. A successful voluntary agreement binds all creditors regardless of whether they voted for it or not.

No-Asset Procedure

No-Asset Procedure is an arrangement which applies when a debtor has no realizable assets to pay off the debt. The procedure is applicable where the debt is more than Kshs. 100,000/- and less than Kshs. 4,000,000/-. The procedure offers similar protection but which is not identical to bankruptcy. It allows the debtor to sort out his/her financial affairs and get back on his feet without entering formal bankruptcy.

Once a debtor is admitted under this procedure, he/she cannot take up new debt during the period of admission. Additionally, the debtor is obligated to pay alimony, child maintenance and education loans for a dependent child or step child. The No-Asset Procedure is, however, not available to a person who has been previously declared bankrupt or admitted to the same procedure.

A debtor is considered admitted to the No-Asset when the Official Receiver sends out the notices in the prescribed form. The admission is also publicized in the Kenya Gazette. Once admitted to this procedure, the creditors are barred from taking any steps to enforce the debts other than the ones contemplated above.

Summary Installment Orders

A summary installment order is an order from the Official Receiver directing the debtor to pay his debts in full and/or installments to an extent the Official Receiver considers practicable and depending on the peculiar circumstances of each case. A supervisor who is an insolvency practitioner oversees the process. The Official Receiver makes the order upon the application of the debtor or creditor and with the consent of the debtor. Currently the threshold of debt that is prescribed under this procedure is Kshs 500,000/-. Upon approval of the proposal, the debtor is required to pay off his debts within three years or within 5 years if agreed with the supervisor.

MANDATE OF THE OFFICE OF THE OFFICIAL RECEIVER

The Office of the Official Receiver In Insolvency is established under the Insolvency Act, 2015 as the Official Receiver in Insolvency. The office is a department under the Business Registration Service.

The Official Receiver in Insolvency deals with Licensing & Supervision of Insolvency Practitioners, administration & supervision of Bankruptcy of Natural persons & Administration and Liquidation of Companies. The office carries out the functions under the Insolvency Act, No. 18 of 2015 and Bankruptcy Act (Cap 53 Laws of Kenya (repealed)) and Companies Act (Cap 486 Laws of Kenya (repealed)) respectively.

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