THE REPUBLIC OF UGANDA

IN THE HIGH COURT OF UGANDA AT KAMPALA
(CIVIL DIVISION)

MISCELLANEOUS APPLICATION NO…1164… OF 2020
(ARISING OUT OF MISCELLANEOUS CAUSE NO. 173 OF 2017

IN THE MATTER OF THE INSOLVENCY ACT, 2011

IN THE MATTER OF THE COMPANIES ACT, 2010

AND

IN THE MATTER OF UGANDA TELECOM LIMITED – IN ADMINISTRATION

AND

IN THE MATTER OF AN APPLICATION BY RUTH SEBATINDIRA SC., AS ADMINISTRATOR OF UGANDA TELECOM LIMITED FOR COURT'S DIRECTIONS ON THE APPLICATION OF SUBORDINATION TO THE CLAIMS BY GOVERNMENT OWNED AGENCIES AND STATUTORY BODIES IN THE IMPLEMENTATION OF THE ADMINISTRATION DEED

RUTH SEBATINDIRA SC. – ADMINISTRATOR OF UGANDA TELECOM LIMITED – IN ADMINISTRATION] APPLICANT

VERSUS

1. **UGANDA REVENUE AUTHORITY]**
2. **UGANDA COMMUNICATIONS COMMISSION]**
3. **UGANDA ELECTRICITY TRANSMISSION COMPANY LIMITED]**
4. **UGANDA POST LIMITED]**
5. **UGANDA BROADCASTING CORPORATION]**
6. **ATTORNEY GENERAL] RESPONDENTS**

BEFORE HON. JUSTICE SSEKAANA MUSA

RULING

The Applicant brought this application by way of Notice of Motion under Section 173(1) of the Insolvency Act, regulation 203(1) of the Insolvency Regulations, 2013 and Order 52 r 1of the Civil Procedure Rules, for orders that;

1. Directions as to whether the unsecured/non-preferred claims by Government of Uganda agencies shall be subordinated in the implementation of the Administration Deed;

2. The costs of this application be provided for.

The grounds in support of this application are stated in the affidavits of the Administrator, Ruth Sebatindira SC, which briefly states;

1. The Government of Uganda, through the Ministry of Finance, Planning and Economic Development is a shareholder of Uganda Telecom Limited ("the company") with a shareholding of 31%.

2. Government agencies and statutory bodies submitted claims for settlement in accordance with the Insolvency Act, 2011.

3. Uganda Telecom Limited is insolvent with the total value of its assets unable to satisfy its debts.

4. It is in the interest of the fair and equitable distribution of the assets in satisfaction of creditor claims and the orderly management of the administration of Uganda Telecom Limited – In Administration, that this Court gives directions on the ranking and subordination of Government of Uganda agencies and statutory bodies.

5. That some of the company's creditor claims include government agencies and statutory authorities, namely:

a. Uganda Revenue Authority – a statutory authority established under the Uganda Revenue Authority Act Cap. 196, whose claim for U. Shs. 151,902,833,699/= (Uganda Shillings One Hundred Fifty-One Billion Nine Hundred Two Million Eight Hundred Thirty-Three Thousand Six Hundred Ninety-Nine Only);

b. Uganda Communications Commission – a statutory authority established under the Uganda Communications Commission Act, No. 1 of 2013, whose claim in the sum of 39,009,354,656. /- (Uganda Shillings Thirty-Nine Billion Nine Million Three Hundred Fifty-Four Thousand Six Hundred Fifty-Six Only)

c. National Social Security Fund – a fund established under the National Social Security Fund Act Cap 222, whose claim for the sum of U. Shs 47,205,404,084/= (Uganda Shillings Forty-Seven Billion Two Hundred Five Million Four Hundred Four Thousand Eighty-Four Only);

d. National Forestry Authority – a statutory authority established under National Forestry and Tree Planting Act, 2003, whose claim for the sum of U. Shs. 4,324,811,550/= (Uganda Shillings Four Billion Three Hundred Twenty-Four Million Eight Hundred Eleven Thousand Five Hundred Fifty Only;

e. Uganda Electricity Transmission Company Limited – a company owned by the Minister of Finance. Planning and Economic Development and the Minister of State for Finance (privatisation) as per the annual returns of 2017 , whose claim for the sum of U. Shs 1,351,819,302/= (Uganda Shillings One Billion Three Hundred Fifty-One Million Eight Hundred Nineteen Thousand Three Hundred Two Only);

f. Posta Uganda Limited/Uganda Post Limited – a company owned by the Minister of Information Technology and the Minister of Finance, Planning and Economic Development as per its annual returns of

2017, whose claim for the sum of U. Shs 27,461,739/= (Uganda Shillings Twenty-Seven Million Four Hundred Sixty-One Thousand Seven Hundred Thirty-Nine Only);

g. Uganda Broadcasting Corporation also established under the Uganda Broadcasting Corporation Act, 2003 whose claim of U. Shs 325,610,000/= (Uganda Shillings Three Hundred Twenty-Five Million Six Hundred Ten Thousand Only; and

h. Uganda Railways Corporation established under the Uganda Railways Corporation Act Cap. 331 whose claim of U. Shs 174,776,219/= (Uganda Shillings One Hundred Seventy-Four Million Seven Hundred Seventy-Six Thousand Two Hundred Nineteen Only.

6. That the total claims submitted by the above government agencies/statutory bodies is approximately U. Shs 218,812,576,218/= (Uganda Shillings Two Hundred Eighteen Billion Eight Hundred Twelve Million Five Hundred Seventy-Six Thousand Two Hundred Eighteen Only).

7. That of these creditors, only the National Social Security Fund and the Uganda Revenue Authority, to the extent of allowable preceding the insolvency of the company, are preferred creditors under the Insolvency Act, 2011.

8. That I am aware that funds for the operations of Government agencies and statutory bodies are drawn from the consolidated fund which is operated by the Ministry of Finance, Planning and Economic Development.

9. That the Government of Uganda through the Ministry of Finance, Planning and Economic Development is also a shareholder in the company holding 31% the company's share capital.

10. That as such, the settlement of claims of Government agencies and statutory bodies could be interpreted as the settlement of a shareholder claim.

11. That I therefore seek this Court's directions and guidance on whether claims by Government's agencies and statutory bodies should be subordinated to the claims of other unsecured creditors.

In the interest of time the Applicant-Administrator filed written submissions which this court has considered. The applicant was represented by *Mr. Kabiito Karamagi* and *Ms. Rita Birungi Baguma*

Determination

Whether the respondents' claims can be subordinated by court?

The Applicant seeks directions on the premise that while an Administrator is mandated by Clause 5(a) of the Administration deed to adjudicate upon, admit and pay creditors' claims, as stated in Paragraph 8 of the affidavit in support, it may seem unfair to settle claims by the Respondent states agencies along with other unsecured creditors because of shared shareholding or ownership with UTL.

It is not in contest that funds for the operations of Government agencies and statutory bodies, like the Respondents, are drawn from the consolidated fund which is operated by the Ministry of Finance, Planning and Economic Development whose Minister is a shareholder in Uganda Telecom Limited on behalf of the Government of Uganda with a 31% shareholding in the company. This raises a serious question of law as to the settlement of their claims ahead even alongside other unsecured creditors.

Section 173(1) of the Insolvency Act, 2011 provides that upon an application for Court's directions, the Court may give directions on any matter concerning the functions of the Administrator. In ***Re: UTL - An application by Ruth Sebatindira SC., for directions on the continuation of her mandate as the Administrator of Uganda Telecom Limited - Misc. Application No. 783 of 2020,*** this Honourable

Court guided on the application of Section 173(1) of the Insolvency Act, 2011 under which the Applicant seeks directions. It held: -

> *"This provision gives the court wide discretionary powers to give directions on any function of an Administrator. This is rooted in the fact that the court may not be able anticipate the challenges the Administrator will face and as a consequence, the Administrator should always seek guidance and direction on unclear issues in order to protect the administrator from allegations of acting improperly or unreasonably.*
>
> *…*
>
> *The Court remains with the duty to guide the administration or liquidation process and the directions may be sought to ensure that the Administrator or Liquidator acts or is guided by the law." – emphasis ours*

Furthermore, in the recent case of ***Re: UTL - An application by Ruth Sebatindira (SC) for directions in respect of the application of section 12(6) of the insolvency act, 2011 to pension claims made against the company - miscellaneous application no.220 of 2020,*** this Court stated;

> ***'****The applicant (as an Insolvency office holder) is required to make complex, important and time-critical commercial decisions and do so from the 'front line'. In making decisions, there is an obvious threat, challenge and possible litigation with regard to such decisions made. Section 173(1) of the Insolvency Act provides that* ***on application of an Administrator, Court may give directions on any matter concerning functions of the Administrator.***
>
> *The above provision gives the Administrator some comfort whenever faced with any dilemma in administration especially on decisions to be taken that may contemplate potential repercussions for administration and its stakeholders. Court direction on any contentious or unclear issue becomes a tool of comfort.'*

This Court further added that.

> *'The directions of court must be sought in such special circumstances involving guidance on matters of law; questions involving legal procedure; whether a liquidator should act on his commercial judgment to postpone a sale because he recognizes his legal duty ordinarily requires him to reduce the company's assets into cash as soon as possible; or where there are two or more competing purchasers for the company's property and the liquidator can see that it may be alleged that the liquidator has acted in bad faith or in an absurd or unreasonable or illegal way. See* ***Sanderson v Classic Car Insurances Pty Limited (1986) 4 ACLC 114 at 116'***

Therefore, the Administrator comes before this Court for guidance on a matter of law and comfort for a crucial decision to be made regarding settlement of creditor claims. Clause 5 (b) of the Administration Deed provides for the application of the waterfall clauses in the settlement of creditor claims. In the case of ***Siraje Ndugga vs. Kabiito Karamagi and Donald Nyakairu, the Receivers/Managers of Spencon Services Limited – In Receivership, Misc Cause No. 219 of 2020,*** this Honourable Court held as follows: -

> *"The hierarchy laid down by the Insolvency Act determines which group of creditors is paid first and which group is paid last. Each class of creditors must be paid in full before the funds are allocated to the next group."*

Looking at the Sections in the Insolvency Act, 2011 that provide for priority payments, it is clear that under Section 14 of the Act, surplus assets are distributed amongst the shareholders of the company in accordance with the company's incorporation documents after the settlement of all other claims.

However, the Act is silent on the treatment of claims by the entities associated with shareholders of the insolvent. This situation is even more unclear with regard to government agencies. It is this question that we bring before this Honourable Court to determine whether in the settlement of the Respondents' claims, the Applicant will not be interpreted as settling the claims of an insolvent's shareholder's agents ahead of the claims of the general body of unaffiliated unsecured creditors.

Black's Law Dictionary, 9th Edition, at page 1562 defines subordination as the act or an instance of moving something such as right or claim to a lower rank, class, or position. Subordination of claims has historically been purposed to maximize value for deserving creditors in the distribution of insolvency assets by redressing imbalances amongst creditors. It therefore follows that otherwise provable and admissible claims against the bankruptcy estate may be subordinated to other claims either by law, or by court pronouncements upon submission of evidence of instances such as fraud or other irregularities.

There are essentially four common forms of subordinations that are relevant for this matter, namely: Statutory Claim Subordination; Shareholder Claim Subordination; Equitable Subordination and Structural Subordination. Unfortunately, there is no clear jurisprudence in Uganda on subordination of debt in insolvency and to this extent, this case will set an important precedent. It is our submission that the Insolvency Act, 2011 and the available limited jurisprudence on the subject within Uganda only serve to reaffirm the statutory ranking of creditors which, for all intents and purposes, only deal with statutory claim subordination.

Analysis

Section 173(1) of the Insolvency Act, 2011 provides that upon an application for Court's directions, the Court may give directions on any matter concerning the functions of the Administrator. In ***Re: UTL - An application by Ruth Sebatindira SC., for directions on the continuation of her mandate as the Administrator of Uganda Telecom Limited - Misc. Application No. 783 of 2020,*** this Honourable Court guided on the application of Section 173(1) of the Insolvency Act, 2011 under which the Applicant seeks directions. It held: -

> *"This provision gives the court wide discretionary powers to give directions on any function of an Administrator. <u>This is rooted in the fact that the court may not be able anticipate the challenges the Administrator will face and as a consequence, the Administrator should always seek guidance and direction on unclear issues in order to protect the administrator from allegations of acting improperly or unreasonably</u>.*

The Court remains with the duty to guide the administration or liquidation process and the directions may be sought to ensure that the Administrator or Liquidator acts or is guided by the law." – emphasis mine

Furthermore, in the recent case of ***Re: UTL - An application by Ruth Sebatindira (SC) for directions in respect of the application of section 12(6) of the Insolvency Act, 2011 to pension claims made against the company - Miscellaneous Application no.220 of 2020*****,** this Court stated;

'The applicant (as an Insolvency office holder) is required to make complex, important and time-critical commercial decisions and do so from the 'front line'. In making decisions, there is an obvious threat, challenge and possible litigation with regard to such decisions made. Section 173(1) of the Insolvency Act provides that ***on application of an Administrator, Court may give directions on any matter concerning functions of the Administrator.*** *The above provision gives the Administrator some comfort whenever faced with any dilemma in administration especially on decisions to be taken that may contemplate potential repercussions for administration and its stakeholders. Court direction on any contentious or unclear issue becomes a tool of comfort.'*

This Court further added that.

'The directions of court must be sought in such special circumstances involving guidance on matters of law; questions involving legal procedure; whether a liquidator should act on his commercial judgment to postpone a sale because he recognizes his legal duty ordinarily requires him to reduce the company's assets into cash as soon as possible; or where there are two or more competing purchasers for the company's property and the liquidator can see that it may be alleged that the liquidator has acted in bad faith or in an absurd or unreasonable or illegal way. See ***Sanderson v Classic Car Insurances Pty Limited (1986) 4 ACLC 114 at 116****'.*

The applicant (as an Insolvency office holder) is required to make complex, important and time-critical commercial decisions and do so from the '*front line'*.

In making decisions, there is an obvious threat, challenge and possible litigation with regard to such decisions made. Section 173(1) of the Insolvency Act provides that ***on application of an Administrator, Court may give directions on any matter concerning functions of the Administrator.***

The above provision gives the Administrator some comfort whenever faced with any dilemma in administration especially on decisions to be taken that may contemplate potential repercussions for administration and its stakeholders. Court direction on any contentious or unclear issue becomes a tool of comfort. In the case of ***Nortel Networks UK Ltd and Other Companies [2016]EWHC 2769 (Ch)***, the court explained the effect of a court direction as a blessing of the Office holders' action.

The same importance was buttressed in the case of ***Coats v Southern Cross Airlines Holdings Limited(In Liquidation) (1998) 16 ACLC 1393 at 1400***, court held that the primary purpose of the Court's direction to a liquidator [is] the protection of the liquidator from allegations that he or she has acted improperly or unreasonably or has caused actionable loss. See ***Re Mento Developments (Aust) Pty Limited (in Liquidation) 2009 VSC 343***

The court should be reluctant to intervene for purposes of making commercial decisions for the Liquidator/Administrator. The directions of court must be sought in such special circumstances involving guidance on matters of law; questions involving legal procedure; whether a liquidator should act on his commercial judgment to postpone a sale because he recognizes his legal duty ordinarily requires him to reduce the company's assets into cash as soon as possible; or where there are two or more competing purchasers for the company's property and the liquidator can see that it may be alleged that the liquidator has acted in bad faith or in an absurd or unreasonable or illegal way. See ***Sanderson v Classic Car Insurances Pty Limited (1986) 4 ACLC 114 at 116***

In the case of ***Re G B Nathan and Co Pty Limited (in Liquidation) 24 NSWLR 674*** Mc Lelland J stated as follows;

"Although the discretion given under s 479(3) (equivalent to our 173(1) of the Insolvency Act) is wide, it is usually only proper to exercise the power where the matter involves guidance to the liquidator on matter of law or principal or to protect him against accusations of acting unreasonably. The Court does not usually consider it proper to intervene and make the liquidator's commercial decisions for him. Matters in respect of which a liquidator may seek, and obtain, directions or judicial advice may include guidance in matters of law, questions involving legal procedure, where the liquidator should act on his commercial judgment with regards to dealing with the company assets among others."

Therefore the question of whether the administrator should subordinate the claims by the different government agencies against other claimant/creditors is a serious legal issue that the Administrator ought to be guided by court. This application is justified in order to avoid the administrator being labeled unfair or unreasonable in refusing to include or in including the claims which may appear to arise from the government agencies and yet the government was a shareholder in Uganda Telcom Limited.

The powers of this court in interpreting statutes extends to giving full effect of legislations and its major purpose guided by existing principles elucidated under different case law or judge-made laws and principles.

Sometimes, it may be seen to be wrong for the court to take such a course because it would involve a judge effectively overruling the lawful provisions of a statute or statutory instrument. It would be highly problematic in practice because it would throw many liquidations and administrations into confusion: the law would be uncertain, and many creditors who felt that their claims were wrongly left out or questioned by the administrator would make applications to the court to challenge such decisions.

The court's power to subordinate claims of the respondents under the Insolvency Act

The Insolvency Act appears not to give Court express power to subordinate creditor's claims. However, as already stated equitable subordination has its

doctrines in common law and equity. S. 264 of the Insolvency Act expressly save the applicability of rules of equity and common law in insolvency proceedings unless they are inconsistent with the Act. It would therefore appear that the doctrine is applicable to Uganda and that the Courts have the attendant powers in this regard. Therefore, the court can consider the question whether the Court can subordinate the Respondent's claims as Government of Uganda agencies.

The applicant contends that the uniqueness and probably unprecedented nature of this matter is the Respondents' connection with Government of Uganda, particularly the Ministry of Finance, Planning and Economic Development, which is represented by the 6th Respondent. However, as rightly contended by the respondents they separate legal and corporate entities, the fact is that they are Government entities as opposed to group companies.

The uniqueness Government's position is that the Government of Uganda is unlike the ordinary shareholder who is primarily governed by the incorporation documents (Memorandum and Articles of Association) under the Companies Act, 2012. It is also not the ordinary principal and agency relationship that would be principally governed by the provisions of the Contracts Act, 2010 and common law and equity.

The Respondents are governed by a particular class of laws which determine their relationship with their shareholders and Principals. The relationship between the Respondents and the government is, first and foremost governed by the Constitution of Uganda, 1995, pursuant to which all laws are subject, including the laws that establish or provide the premise for the establishment of each of the Respondents.

The Respondents are also governed by the ***Public Enterprises Reform and Divesture Act Cap.98*** by which the Respondents are classified as public enterprises for the purposes of that Act given the majority stake of the government over their shareholding or the oversight role exercised by the government of Uganda over their operations and management. Section 41 of the

Act gives this statute supremacy over all other laws, save for the Constitution, in matters relating to giving effect to the government's policy on reform of these public enterprises.

Section 9(1)(a) of the Act, it is provided that the Government (the Respondents' owner either by statute or shareholding) shall recognise the need for autonomy in public enterprise management, which shall be deemed to be freedom of enterprise to manage its operational and financial affairs efficiently without interference or hinderance. By this provision, the Respondents enjoy a certain degree of autonomy in the exercise of their respect mandates

The net effect of these provisions betrays a sharp contrast between the recognizable corporate legal status and autonomy that the respondents enjoy on the one hand, and the much deeper than ordinary shareholding and agency corporate relationship they have with Government on the other.

As such, in the settlement of their claims, there is a likelihood of this being considered as the settlement of an agent's claim whose allegiance is with the Principal and which Principal just happens to be a shareholder in the same insolvent company against which the agent claims. The intervention of this Honourable Court in this matter therefore aids the Administrator and the general body of creditors who may perceive the participation of the of Government agencies in the distribution as unjust and unfair.

The Respondents are right in pleading unfairness as none of them was directly involved in the management of UTL or even had any specific connection to the company other than the business that gives right to their claim. It is very true that they are all bonafide claimants of the company having offer legitimate service. They are right to argue that the subordination being proposed is not supported by any provision in either the Companies or the Insolvency Acts.

Statutory subordination is rooted in written statutory law under which the law gives a clear priority for the settlement of creditor claims. The waterfall provisions of Sections 12 and 13 of the Insolvency Act provide a clear of statutory claim

subordination. The priority given to the preferential claims by these provisions implies that the claims of secured creditors are statutorily subordinated to the claims of preferential creditors. The application of these subordination has been properly reiterated in the already stated case of ***Siraje Ndugga vs Kabiito Karamagi and Donald Nyakairu, the Receivers/Managers of Spencon Services Limited – In Receivership***.

Shareholders share in the surplus of the assets in accordance with the memorandum and articles of association of the company. However, it is unclear how claims due to shareholders on the basis of their contractual transactions with the company can be treated. In determining the question we put before this Court regarding the respondents eligibility to distributions, it will be important to also consider the question whether shareholders of an insolvent are permitted to claim in *pari passu (i.e. equally)* with unsecured creditors and if so.

The House of Lords faced a similar dilemma in the case of ***Soden and another vs. British Commonwealth Holdings PLC (in administration) and another [1997]4 ALLER 353*** where it was asked to consider the interpretation and application of the S. 74(1) and (2)(f) of the English Insolvency Act 1986 which states as follows:

> *"When a company is wound up, every present and past member is liable to contribute to its assets to any amount sufficient for payment of debts and liabilities and the expenses of the winding up and for the adjustment of the rights of the contributories among others.*
>
> *…*
>
> *(2) This is subject as follows:*
>
> *…*
>
> *(f) a sum due to any member of the company (in his character of a member) by way of dividends, profits or otherwise is not deemed to be a debt of the company, payable to that member in a case of competition between himself and any other creditor not a member of the company, but any such may be*

taken into account for the purpose of the final adjustment of the rights of the contributories among themselves."

In interpreting this provision of the Act, the House of Lords held as follows: -

"Section 74(2)(f) of the 1986 Act required a distinction to be drawn between sums due to a member in ***his character of a member by way of dividends, profits or otherwise, and sums due to a member of a company otherwise than in his character as a member****. The word 'by way of dividends, profits otherwise' are illustrations of what constitute sums due to a member in his character as such. They neither widen, nor restrict the meaning of that phrase. But the reference to dividends and profits are examples of sums due in a character of a member entirely accords with the view I have reached as to the meaning of the section since they indicate rights founded on the statutory contract and not otherwise.*

Moreover, the construction of the section which I favour accords with principle. The principle is not 'members come last': ***a member having a cause of action independent of the statutory contract is in no worse position than any other creditor****. The relevant principle is that the rights of members as members come last, i.e. rights founded on the statutory contract are, as the price of limited liability, subordinated to the rights of creditors based on other legal causes of action. The rationale of this section is to ensure that the rights of members as such do not compete with the rights of the general body of creditors."*

The Court defined is reference to statutory contract as the bundle of rights and liabilities created by the memorandum and articles of association as well as the rights and obligations that are conferred upon a member of a company by law. This covenant is unmistakable in S. 21 of our Companies Act, 2012.

The Australian Federal Court also considered a somewhat similar provision contained Section 563A of the Australian Corporations Act, 2001 in the case of

Sons of Gwalia Limited (Administrators Appointed) v Margaretic (2005)55 ASCR 365. The provision states that:

> *"Payment of a debt owed by a company to a person in the person's capacity as a member of the company, whether by way of dividends, profits or otherwise, is to be postponed until all debts owed to, or claims made by, persons otherwise than as members of the company have been satisfied."*

This provision is an import from the English companies' legislation of 1892, the Companies Act 1862 (UK). In considering its interpretation, the Court held:

> *"What determines the present case is that the claim made by the respondent is not founded upon any rights he obtained or any obligations he incurred by virtue of his membership of the first appellant. He does not seek to recover any paid-up capital, or to avoid any liability to make a contribution to the company's capital. His claim would be no different if he had ceased to be a member at the time it was made, or if his name had never been entered on the register of members. The respondent's membership of the company was not definitive of the capacity in which he made his claim. The obligations he sought to enforce arose, by virtue of the first appellant's conduct, under one or more of the statutes mentioned in the earlier description of the respondent's claim.*
>
> *…*
>
> *For the reasons already given it would be wrong to conclude that, on the true construction of s 563A of the Act, the debt owed to the respondent is owed to him in his capacity as a member of the first appellant."*

The essence of these holdings is that in considering claims submitted by members of a company, a determination must be made as to whether the claim of the member creditor arose from an entitlement under the statutory contract with the company (i.e. obligations imposed by the Memorandum and Articles of Association and company law) or whether the claim arose independent of the statutory contract and purely on a different cause of action.

Sadly, the provisions the current Insolvency Act appears not to have provisions similar to the S. 74(1) and (2)(f) of the English Insolvency Act of 1986 and Section 563A of the Australian Corporations Act of 2001. To this extent, it would appear that any shareholder would, as a general principle, be entitled to dividends in any insolvency estate. However, it would be grossly unfair to the general bodies of creditors to allow a shareholder creditor to press his shareholder rights ahead of or even in the same ranking of other unpaid creditor claims. Although the 6th Respondent has no direct claims against the company, this argument is still relevant because the likely applicability of the next types of subordinations to consider. Court directions in the regard would be helpful in guiding the Administrator address the respondent's claims without attracting antagonisms from the general body of creditors.

Structural subordination arises in instances of group companies. Intercompany dealings in group entities normally create challenges of intercompany debts in insolvency proceedings. It matters not whether the group claimants are insolvent themselves. Such claims may arise from debts from intercompany trading within the group, or loans and subventions made by other companies in the group to support continued trading by the borrowing company. etc.

However, a parent or dominant group company may have adopted a policy of channelling subsidiaries' profits upwards by way of dividend to the parent, leaving the operating subsidiaries' working capital to be financed by loans and subventions from other companies in the group, repayable on demand and provable in a liquidation in competition with debts owed to external creditors.

Therefore, a more mischievous, yet very likely prospect, is where a wholly owned subsidiary is mismanaged and abused for the benefit of a parent company but in which loans from the parent company are employed. When the subsidiary is subjected to insolvency proceedings, its creditors are also forced to compete with the parent company in respect of its loan.

Therefore, while it generally accepted that parent companies are separate entities from their subsidiaries based on the principle laid out in ***Salomon v. A.***

Salomon & Co. Ltd [1897] AC 22., reality is that groups are more likely operate in cohesive manner, often with high levels of unity in ways that are likely to cause confusion during insolvency proceedings. In her book ***Corporate Insolvency – Perspectives and Principles, Second Edition, Cambridge,*** the Learned Author Vanessa Finch states that the difference between commercial reality of the corporate veil and its legal framework can result in unfair allocations of risk to creditors for a number of reasons. The creditors of a subsidiary face at least the following difficulties.

As a result of this unfairness, there is need for the law and the Court to recognise the commercial realities of the above situation to correct the imbalances and attendant injustices caused to the wide body of creditors. While the respondents may not be classified as a group entity as we understand the terms in company law, their similarities to one cannot be missed. It therefore follows that a structural subordination of their claims can be considered so as to give value to the wider faculty of creditors.

Equitable Subordination is a form of subordination that seeks to redress an imbalance caused by an irregularity related to creditor's conduct. Such conduct may include fraud, illegality, breach of fiduciary duty, etc. Although not applicable in the United Kingdom, the remedy, like the name suggests, has its origin in the doctrines of common law equity but was codified in the United States Bankruptcy Code to protect legitimate creditors in insolvency proceedings.

One of the leading cases in the application of this principle is ***Re: Enron Corp. 333 B.R 205 (Bankr. S.D.N.Y 2005)***. The case involved allegations of inequitable conduct by Citibank, Chase Manhattan Bank ("Chase") and Fleet National Bank involved in the bankruptcy of the energy giant Enron. Fleet in particular was accused of receiving prepayment of a substantial portion of the debt owed by Enron, as well as aiding and abetting of Enron in accounting fraud that resulted in injury to Enron's creditors and conferred upon it an unfair advantage in the bankruptcy proceedings.

Enron (now as a debtor in possession under Chapter 11 protection) further asserted that as a result of the Banks' alleged misconduct, the general body of

unsecured creditors were misled as to Enron's true financial condition and induced to extend credit without the knowledge of the company's financial status. And as a result, unsecured creditors stood an unlikely chance of recovering fully on their claims.

Enron therefore sought orders for the subordination and disallowance of the claims held by Fleet, among other orders. The Court ruled that Section 510(c)(1) of the US. Bankruptcy Code gave it the discretion to apply the doctrine where conduct by one creditor has injured other claimants and obtained an unfair advantage over such claimants. The Court further added that it was empowered by the common law concept of the equitable doctrine to subordinate claims where the subordination will promote a just and equitable distribution of the bankruptcy estate. The court further added that it could subordinate a claim only to the extent necessary to offset the harm suffered by the bankrupt and its creditors on account of that conduct.

In yet another American case, ***Pepper v Litton, 308 U. S 295, 305, 60 S. Ct 238*****,** the Court held that in applying this doctrine, it had the power to ensure that that substance does not give way to form and that technical consideration does not prevent substantial justice from being done.

In as much as the above arguments are valid, our Insolvency laws do not have the equivalent of a Section 510 (c) (1) of the United States Bankruptcy Code. It may only be persuasive to justify the circumstances of any given case. The 1st to 5th respondents provided services which were duly consumed by the company and they had a duty to pay for the services and their claims cannot be subordinated against other unsecured creditors. It would be an absurdity to assume that since they are government agencies, their claims should be subordinated.

It can be deduced from the Respondents' affidavits on record, the general theme of their respective cases is that they are entities legally separate entities from the Government of Uganda, each with its own board, management, finances to run operations, etc. The affidavits of the 2nd and 3rd Respondents go as far as to state or insinuate that rather than draw from the consolidated fund, they instead contribute to the fund.

The 3rd Respondent's affidavit also denies receiving any funds from the consolidated fund and supports its corporate character by adding that its operational income is derived from a commercial tariff as allowed to it through an annual budget approved by the Electricity Regulatory Authority. It also adds that it did not intend to remit funds obtained from the settlement of its claims to be paid its shareholders as dividends.

In as much as there is uncontested connection to the institution of Government of the 5 agencies, it is valid to argue that they do not take the character of subsidiary companies under company law. They are independent in their operations as shown earlier and that the Government has, as a matter of law, an oversight role over their operations which is not ground enough to equate them to interrelated companies under company law.

They ought to be considered differently in their unique position as service providers entitled to recover any debts or claims due to them. It matters not whether the same amount shall be remitted to the consolidated fund of Uganda. The fact that the government might hold other interest cannot be a basis for denying its right. See ***Equity bank of Kenya Limited v Kenya Airways PLC, the cabinet Secretary to the National treasury & 10 others Civil Appeal No. 278 of 2017 at p8***, the Court of Appeal of Kenya in Nairobi held:

> *"On the other hand, it is alleged that because the Government is also a shareholder and guarantor it has dissimilar rights making it impossible for other creditors to consult with it. Going back to the test outlined in* ***Re UDL Holdings Limited [2002](supra)*** *a class determination should be based on "… similarity and dissimilarity of legal rights against the company, not on similarity or dissimilarity of interest not derived from such legal rights….." The fact that government might hold other interests cannot be a basis for denying it the rights of an unsecured creditor, so as to necessitate the calling of separate meetings."*

The 1st respondent claims are imposed under the law and should never be subordinated since it is a statutory duty to pay taxes and they have an obligation to collect taxes due from the company-UTL like any other taxpayers in Uganda. The statutory mandate of the 1st respondent-URA to collect taxes in accordance with the laws of Uganda cannot be fettered or overridden by any form of agreement or arrangement. Therefore, tax matters are statutory and not contractual. *See* ***K.M Enterprises and Others v Uganda Revenue Authority HCCS No. 599 of 2001***

The debts or claims of the respondents should not be subordinated to the settlement of other creditors claim and equitable subordination of their claims should not be considered in the circumstances of this case.

Each party shall bear their costs.

It is so ordered.

SSEKAANA MUSA
JUDGE
23rd March 2022