DIGITAL CROSSROADS: NAVIGATING SYSTEMIC IMPEDIMENTS TO SECURED CREDITOR ASSET REALIZATION UNDER KENYA'S INSOLVENCY ACT, 2015

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Abstract

The effective realization of secured assets is a cornerstone for credit markets and economic stability. Kenya's Insolvency Act, 2015, aimed to modernize insolvency law by balancing debtor rehabilitation with predictable security realization for creditors. However, a significant gap exists between this legislative ideal and practical implementation, marked by a persistent inclination towards avoiding liquidation and business rescue over creditors' securities, compounded by specific legal provisions and procedural ambiguities. This discrepancy hinders the efficient and predictable recovery of secured collateral, creating adverse economic and financial consequences such as increased perceived lending risk, reduced credit availability, and higher borrowing costs. Furthermore, the erosion of secured collateral value through protracted insolvency processes undermines the fundamental risk mitigation principle of secured lending. This article identifies and categorizes the key systemic impediments hindering the efficient realization of secured assets by creditors under the Insolvency Act, 2015, in Kenya, drawing on statutory analysis, case law, and research work. By understanding these impediments, the study lays the groundwork for exploring how digital solutions, such as ***Artificial Intelligence (AI)*** *and data analytics, could potentially mitigate these challenges and enhance the efficiency and predictability of secured asset recovery. The objective is to provide insights for evidence-based recommendations to refine the legislative and regulatory framework.*

Keywords: *debt, insolvency, bankruptcy, secured creditors, asset realization, Kenya, Insolvency Act 2015, systemic impediments, AI, digital, legal tech.*

1. INTRODUCTION

Background Information

The extension of credit, frequently fortified by collateral, is an indispensable cornerstone of Kenya's financial and economic architecture, underpinning the vitality of markets, fueling private credit flow, and catalyzing crucial investment.[1] In this dynamic landscape, the efficacy of a nation's insolvency framework is paramount for ensuring the just resolution of financial distress, the robust protection of creditor rights, and the orderly reallocation of essential economic resources. Historically, Kenya's legal terrain for navigating financial failure was fragmented and often inefficient, primarily focused on liquidation with limited avenues for business rescue or debtor rehabilitation.

The enactment of the Insolvency Act, 2015 (the Act), marked a profound and transformative shift, aiming to consolidate and modernize Kenya's insolvency laws to align with international best practices.[2] A pivotal aim was to introduce and bolster alternatives to liquidation, such as administration for companies and various arrangements for both companies and individuals, thereby empowering financially distressed entities to proactively manage their affairs for the collective benefit of their creditors and, where economically feasible, to persevere as thriving going concerns. This fundamental reorientation towards rehabilitation and the conferment of a "fresh start" upon debtors represents a stark and progressive departure from the potentially punitive essence of the repealed Bankruptcy Act. The profound importance of protecting property rights, including the security interests acquired by secured creditors, is constitutionally enshrined in Kenya.

2. Research Problem Statement

Ideally, Kenya's Insolvency Act, 2015, aimed to modernize insolvency law by establishing a clear, efficient, and equitable framework that balances debtor rehabilitation with predictable security realization for creditors. In reality, however, a significant divergence has emerged between this ideal and the practical implementation of the Act, marked by a persistent inclination towards avoiding liquidation and business rescue over creditors' securities, compounded by specific legal provisions and procedural ambiguities. These factors potentially undermine the anticipated ease and cost-effectiveness with which secured creditors can realize their collateral, creating a notable gap between the Act's objectives and its practical impact. This discrepancy generates adverse economic and financial consequences, including increased perceived lending risk, reduced credit availability, higher borrowing costs, and the erosion of secured collateral value through protracted insolvency processes. The apparent preference for debtor rehabilitation over the intended rescue mechanisms for both parties exacerbates these concerns. To address this critical gap, an empirical investigation into the practical impact of the Insolvency Act, 2015, on secured creditors' ability to realize their securities is needed. Such analysis will contribute a deeper, empirically grounded understanding of the realities faced by secured creditors under the new legal framework, moving beyond theoretical objectives.

3. Objectives

The objectives of this study are twofold:

i. To identify and categorize the key systemic impediments against efficient realization of secured assets by creditors under the Insolvency Act, 2015 in Kenya.
ii. To explore the potential of digital solutions, including AI and data analytics, in mitigating the identified systemic impediments and enhancing the efficiency and predictability of secured asset realization within the Kenyan insolvency framework.

4. Scope and Significance

This study focuses on the application of the Insolvency Act, 2015, in Kenya, specifically examining the challenges faced by secured creditors in realizing their security interests. It delves into the legal provisions, judicial interpretations, and practical observations that contribute to inefficiencies and unpredictability in this process. The significance of this research lies in providing a detailed analysis of the practical impact of the Act on secured creditors, an area where comprehensive empirical data and analysis demonstrating these practical hindrances are currently lacking. By identifying and categorizing these impediments, the study offers valuable insights for policymakers, regulators, insolvency practitioners, and creditors. Furthermore, by considering the potential role of digital technologies, the research contributes to the ongoing global conversation about leveraging legal technology ("LawTech") to improve the efficiency and effectiveness of insolvency regimes. The findings can inform targeted legislative or regulatory reforms aimed at improving the efficiency, predictability, and overall effectiveness of secured creditors' rights within Kenya's evolving insolvency regime, fostering greater economic stability and investor confidence.

5. LITERATURE AND LEGAL REVIEW

The Insolvency Act, 2015, marked a pivotal moment in Kenya's legal and economic landscape, consolidating and modernizing the country's insolvency regime, influenced by international best practices.[3] Secured creditors play an important role in insolvency proceedings, holding significant influence and rights, including the right to information, participation in meetings, fair treatment, and the right to challenge decisions. Data analysis plays a crucial role in

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[1] Kibera, Margaret. *Securitization Enhancing Liquidity in Kenya*. IPR Journals and Book Publishers, 2024.
[2] Odhiambo, Eddy Ouma. *Collateralization of intangible assets making-a case for micro, small and medium enterprises in Kenya*. Diss. Strathmore University, 2020.
[3] Onziru, Bernard K. *Adjudication Reforms for the Judiciary in Fighting Corruption in Kenya*. Diss. University of Nairobi, 2021.

reaching appropriate decisions in various processes under the IBC right from the admission of the case to its final closing.

The Act introduces mechanisms such as administration, receivership, voluntary arrangements, and liquidation, which directly impact the ability of secured creditors to realize their security.[4] A core objective is to shift towards assisting financially distressed entities to continue operating, reflecting the "rehabilitation theory" of insolvency law, while also protecting the interests of all stakeholders, including secured creditors who are intended to be in a "forefront position". The UNCITRAL Legislative Guide on Insolvency Law, which informed Kenya's reforms, underscores the importance of recognizing existing creditor rights and establishing clear priority rules, particularly for secured creditors.[5]

However, the practical translation of these legislative aspirations into a consistently streamlined and predictable pathway for the direct and timely realization of security remains a subject of ongoing scholarly debate and nuanced judicial interpretation, heavily influenced by the specific provisions of the Act.

Case Laws and Judgments:

Kenyan case law illustrates the complexities of applying the Act. In *Kahindi Mumba Chome & 23 Others v. ARM Cement PLC Limited*, the court considered the moratorium's purpose against creditors' rights. The *ARM Cement Injunction Case* exemplified judicial intervention imposing conditions and timelines on asset disposal. *Patrick Asuma v ARM Cement Limited* underscored the critical importance of strict adherence to procedural requirements under Section 560. *Allan Ochieng Oliech v Komaza Forestry Limited* and *Owiti, Otieno and Ragot Advocates v Mumias Sugar Co. Limited* demonstrated the court's discretionary power to grant leave under Section 560(1)(d). *Ajay Shah v Deposit Protection Fund Board as Liquidator of Trust Bank Limited* highlighted the potential for protracted legal complexities within liquidation. The cases of *In re Cape Holdings Limited*, *KTK Advocates v Nyambane Coffee Mills Limited*, and *Mertens v Bank of Africa Limited* offer further insights into the application of Sections 560, 424(1), 384, and 32(1) concerning moratoria, liquidation orders, inability to pay debts, and good faith. These cases demonstrate the court's application of the Act's provisions and the factors considered when balancing the interests of debtors and creditors, while also highlighting the importance of procedural compliance and good faith.

Research Work:

Existing research highlights challenges such as the lack of procedural rules on liquidation, contributing to judicial uncertainty and hindering efficient asset realization.[6] Studies also point to a perceived lack of clear and detailed procedural rules, particularly within the context of liquidation under Part V of the Act. The substantial financial costs associated with insolvency proceedings, including remuneration of practitioners and legal expenses, are consistently observed as eroding the value of the insolvent estate, diminishing recovery prospects for secured creditors.[7] The often protracted duration of insolvency proceedings, exacerbated by moratoria, directly impacts the value of underlying assets which may depreciate over time. Research also alludes to a potential systemic inclination towards prioritizing debtor rehabilitation over the expeditious realization of security interests. The statutory imposition of the "prescribed part" under Section 474(2) represents a direct and tangible systemic impediment to the full realization of security by holders of floating charges.[8] Despite the progressive legislative framework, critical empirical and analytical gaps persist regarding the Act's practical impact on secured creditors' realization rights, including the lack of robust quantitative data on post-enactment timelines and recovery rates, precise identification of delay-inducing procedural ambiguities, and adequate empirical benchmarking of systemic cost and time implications.

Digital Context in Legal Practice:

AI is rapidly transforming the legal and financial services landscape, offering opportunities to enhance efficiency and accuracy.[9] AI can play a crucial role in reaching appropriate decisions in various processes.[10] AI tools can categorize documents, analyze financial data, detect trends, and process vast amounts of data quickly and accurately. Predictive modeling can identify early warning signs of economic distress.[11] AI can also assist in fraud detection, document

[4] Muoki, Sharon Ndunge. "Protecting the depositors: a case for a sui generis bank insolvency regime." (2021).

[5] Shukri, Mohamed. *Legal Framework on Sovereign Debt Restructuring in the Face of Debt Crisis Kenya*. Diss. University of Nairobi, 2021.

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[11] Paramesha, Mallikarjuna, Nitin Liladhar Rane, and Jayesh Rane. "Big data analytics, artificial intelligence, machine learning, internet of things, and blockchain for enhanced business intelligence." *Partners Universal Multidisciplinary Research Journal* 1.2 (2024): 110-133.

review, and potentially predict outcomes based on data patterns.[12] However, challenges exist, including the scarcity of quality data, interpretability of AI decisions, risk of bias, compliance with legal regulations, and strict data privacy regulations. Legal data often presents challenges due to complexity and domain-specific language, and potential biases within the data are a concern. Digitization in IBC is currently not conducive to AI applications due to a data-poor environment and lack of standards. Stakeholders often work in silos, and integrating fragmented data is a major challenge. Despite these challenges, AI is considered essential for effective risk management.

6. Theoretical Analysis

This analysis is fundamentally informed by the interplay between the Creditors' Bargain Theory (CBT) and the Rescue Theory (often aligned with a communitarian approach). **CBT posits that insolvency law should replicate the hypothetical agreement rational creditors would reach to maximize collective recovery, emphasizing the protection of pre-bankruptcy entitlements, established priority rules, and efficient liquidation**. It prioritizes ex-ante predictability for creditors, particularly secured creditors. **The Rescue Theory, on the other hand, posits that insolvency law should prioritize the rescue and rehabilitation of viable businesses to preserve jobs, maintain economic activity, and ensure broader societal well-being**. It emphasizes stakeholder inclusivity and advocates for judicial supervision and flexibility, often at the potential temporary expense of strict creditor enforcement. The Insolvency Act, 2015, reflects a move towards the Rescue Theory, introducing mechanisms for rehabilitation. The challenges faced by secured creditors in realizing their security interests highlight the tension between these two theories, as the pursuit of rescue through moratoria and flexible processes can conflict with the CBT's emphasis on predictable and efficient recovery. The identified impediments reveal the practical difficulties in achieving a successful balance between maximizing creditor recovery and promoting business rescue within the specific legal and economic context of Kenya.

7. METHODOLOGY

This study employs a qualitative research approach. The methodology involves an in-depth review of the Insolvency Act, 2015, and its subsidiary legislation to understand the legal framework governing security realization. A comprehensive review of scholarly articles, legal journals, and other pertinent publications on insolvency law in Kenya and comparative analyses of insolvency regimes in other jurisdictions is conducted to establish the existing body of knowledge, identify key debates, and reveal research gaps. A critical component is the detailed examination of selected Kenyan case law, chosen for their relevance in illustrating the practical challenges faced by creditors in realizing their security under the current framework. This case law analysis assesses the judicial interpretation and application of the Act concerning the enforcement of security interests, the interplay between different areas of law, and the courts' approach to balancing debtor and creditor interests. By synthesizing these sources, the study aims to identify and categorize the key systemic impediments to efficient secured asset realization.

8. FINDINGS

Based on the analysis of the Insolvency Act, 2015, relevant case law, and existing research, several key systemic impediments hindering the efficient realization of secured assets by creditors in Kenya have been identified and categorized:

i. **Moratoria and Judicial Discretion:** The introduction of rescue-oriented procedures like administration involves a moratorium on creditor actions, preventing secured creditors from immediately enforcing their security. Section 560(1) imposes a moratorium without administrator consent or court approval. While Section 560(A) outlines considerations for lifting the moratorium, the court's discretionary power, as seen in case law, introduces an element of unpredictability in the timing of realization.

ii. **Requirement for Court Approval in Asset Disposal:** Section 227(1) and (2) explicitly grant the Court power regarding the disposal of charged property, contingent on court satisfaction. This requirement for court approval introduces a layer of potential delay and uncertainty, moving the realization process away from a direct and predictable exercise of the secured creditor's rights.

iii. **Impact of the "Prescribed Part" (Section 474(2)):** In liquidation, Section 474(2) mandates setting aside a "prescribed part" of net proceeds from floating charges for unsecured creditors. This directly impacts the amount realized by floating charge holders, affecting the predictability of their recovery.

iv. **Procedural Ambiguities and Lack of Granular Rules:** Perceived procedural ambiguities, particularly the lack of procedural rules on liquidation proceedings, contribute to judicial uncertainty and a lack of consistency in court handling of cases. This "paucity of the said rules" hinders the effective realization of the Act's objectives. The lack of clear and detailed procedural rules for liquidation under Part V can lead to divergent judicial interpretations and consequent delays. Strict adherence to procedural requirements, as underscored by case law, means procedural missteps can lead to significant delays and wasted costs.

v. **High Costs of Insolvency Proceedings:** Substantial financial costs, including the often prioritized remuneration of administrators/liquidators and legal expenses, significantly erode the value of the insolvent estate, diminishing recovery prospects for secured creditors. Case law provides stark illustrations of how high costs can erode creditor recovery.

[12] Bello, Oluwabusayo Adijat, and Komolafe Olufemi. "Artificial intelligence in fraud prevention: Exploring techniques and applications challenges and opportunities." *Computer science & IT research journal* 5.6 (2024): 1505-1520.

vi. **Lengthy and Protracted Processes:** The often protracted duration of insolvency proceedings, exacerbated by moratoria, directly impacts the value of underlying assets, which may depreciate over time, consequently delaying the point at which secured creditors can effectively recoup their initial investments.

vii. **Systemic Inclination Towards Prioritizing Debtor Rehabilitation:** There is a potential systemic inclination towards prioritizing debtor rehabilitation over the expeditious realization of security interests. If this preference results in unduly prolonged periods of uncertainty and unjustifiably restricts secured creditors' enforcement rights without a realistic prospect of successful rehabilitation, it becomes a significant impediment to efficient security realization.

viii. **Lack of Robust Empirical Data:** A significant gap exists in quantifying the actual efficiency and predictability of security realization post-2015, including empirical data on average delays and the tangible reduction in recoveries for floating charge holders due to the "prescribed part". This lack of data hinders a comprehensive evaluation of the Act's practical effectiveness.

9. DISCUSSION OF FINDINGS

The identified impediments demonstrate the significant challenges faced by secured creditors in achieving efficient and predictable asset realization under the Insolvency Act, 2015. The tension between the Act's objectives of promoting debtor rehabilitation and protecting creditor rights is evident in the impact of moratoria and the systemic inclination towards prioritizing rescue. While moratoria provide necessary breathing space for potential rescue, their duration and the judicial discretion involved in lifting them introduce uncertainty for secured creditors whose ability to enforce security is temporarily suspended. The requirement for court approval in disposing of charged property further layers the process with potential delays, moving away from a more direct realization process. The "prescribed part" directly impacts the recovery amount for floating charge holders, making the outcome less predictable.

Beyond specific legal provisions, procedural ambiguities and the perceived lack of detailed rules, particularly in liquidation, create judicial uncertainty and inconsistency, leading to delays. This highlights a need for clearer procedural guidelines to streamline the process. The substantial costs and protracted duration of insolvency proceedings, exacerbated by various factors, directly diminish the value available for distribution and delay the point of recovery for secured creditors. These systemic inefficiencies are a major source of frustration for creditors and can undermine confidence in the insolvency regime.

The potential systemic inclination towards prioritizing debtor rehabilitation, while aligned with the Rescue Theory, can inadvertently harm secured creditors if it leads to unduly prolonged uncertainty without a clear path to successful rescue. This emphasizes the need for a balanced approach that recognizes when rehabilitation is no longer viable and facilitates a prompt shift to liquidation to maximize asset value.

The lack of robust empirical data on the practical outcomes of the Act since 2015 is a significant impediment to a comprehensive understanding of its impact. Without quantifiable data on delays, recovery rates, and costs, it is difficult to precisely assess the severity of the identified impediments and measure the effectiveness of potential reforms.

Integrating digital solutions, such as AI and data analytics, could offer potential pathways to address some of these impediments. For instance, AI-powered platforms could analyze case data to identify patterns and predict the likely duration of proceedings or the success rate of different rehabilitation strategies, potentially reducing uncertainty and informing decisions about lifting moratoria or pursuing liquidation. Data analytics could provide real-time insights into the costs accumulating in a case, promoting transparency and accountability. Digital portals could streamline procedural steps, document submission, and communication, reducing delays caused by manual processes and procedural ambiguities. AI could also assist in analyzing financial data and asset valuations more efficiently, potentially speeding up the realization process. However, leveraging these technologies requires addressing challenges related to data availability and quality, bias mitigation, interpretability, and regulatory compliance.

10. SUMMARY, CONCLUSION AND RECOMMENDATIONS

Summary

This study identified and categorized key systemic impediments hindering the efficient realization of secured assets under Kenya's Insolvency Act, 2015. These include the impact of moratoria and judicial discretion, the requirement for court approval in asset disposal, the effect of the "prescribed part," procedural ambiguities and lack of granular rules, high costs and lengthy proceedings, a systemic inclination towards prioritizing debtor rehabilitation, and a lack of robust empirical data on the Act's practical outcomes. These impediments highlight the tension between the Act's goals of debtor rehabilitation and predictable creditor recovery.

Conclusion

The Insolvency Act, 2015, while a significant step towards modernizing Kenya's insolvency regime and balancing competing interests, faces considerable challenges in its practical implementation that impede the efficient and predictable realization of secured assets by creditors. The identified systemic impediments contribute to delays, increased costs, and uncertainty, potentially undermining the confidence of secured creditors and impacting the availability and cost of credit in the economy. Addressing these impediments is crucial for enhancing the effectiveness of the Act and aligning its practical outcomes with its stated objectives. Leveraging digital technologies, including AI and data analytics, holds promise in mitigating some of these challenges by improving efficiency, transparency, and predictability in the insolvency process.

Recommendations

Based on the findings, the following recommendations are made:

a. **Empirical Data Collection and Analysis:** The government and relevant institutions, such as the Insolvency and Bankruptcy Board of India (IBBI) in the context of India's IBC, should prioritize the collection and analysis of robust empirical data on key metrics such as the average duration of different insolvency procedures, secured creditor recovery rates across different sectors and types of security, costs of proceedings, and the impact of the "prescribed part". This data is essential for evidence-based policymaking.

b. **Procedural Clarity and Rulemaking:** The development of clear, detailed, and consistent procedural rules, particularly for liquidation proceedings under Part V of the Act, is necessary to reduce ambiguity and judicial uncertainty.

c. **Judicial Specialization and Training:** Investing in training and specialization programs for the judiciary and insolvency practitioners in insolvency law is crucial to ensure consistent interpretation and application of the Act.

d. **Balancing Rehabilitation and Realization:** Mechanisms should be explored to ensure that the pursuit of debtor rehabilitation does not unduly prejudice secured creditors, including clearer guidelines for the duration of moratoria and timely transitions to liquidation when rescue is not feasible.

e. **Leveraging Digital Technologies:** The potential of digital technologies, including AI and data analytics, should be explored and harnessed to improve the efficiency, transparency, and predictability of insolvency processes. This includes developing digital platforms for streamlined communication and document management, and utilizing AI for data analysis, early warning systems for financial distress, and potentially predicting case durations or outcomes. AI could also assist in tasks like document review and fraud detection. This would require addressing challenges related to data standardization, integration, bias, and privacy. Collaboration among legal professionals, technology experts, and regulators is essential for responsible AI adoption.

f. **Review of the "Prescribed Part":** A review of the impact and calculation of the "prescribed part" under Section 474(2) may be warranted to assess its effect on secured creditor recovery and explore potential adjustments based on empirical data.

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