The Secured Transactions in Movable Assets Act, Company Charges and Funding Micro, Small and Medium Enterprises under Nigerian Law

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ABSTRACT

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Having attained a feverish pitch, the clamour for the reform of Nigeria's law of secured transactions has culminated in the recent enactment of the Secured Transactions in Movable Assets Act, 2017 by Nigeria's National Assembly to amongst others 'stimulate responsible lending to micro, small and medium enterprises.' This thesis evaluates the impact of the Act on the Nigerian law of secured transactions and specifically, the implication of the autonomy it gives to companies to continue to grant charges, pursuant to the old system and presumably outside the ambit of the Act. The thesis hypothesizes that despite the Act's obvious similarity to reformed systems of personal property security laws, a reform now being driven by the United Nations Commission on International Trade Law (UNCITRAL), expectations of the Nigerian Act having similar reformative impact and meeting its key objective of stimulating credit to MSMEs may be misconceived.

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INTRODUCTION

Despite some dissent against the provision of security for loans, credit and secured lending remain pivotal business tools by which business organizations realize their objectives globally.[1] The Nigerian economy, like several others, also greatly relies on credit in meeting its public and private sector commitments.[2]

The popularity and use of credit is however matched by the realisation that the common law system of secured transactions, adopted by Nigeria and several other countries may have become inadequate.[3] This has prompted calls for reform to make credit more readily available to business entities.[4] As one legal commentator has observed:

> It is not difficult to work out why having an efficient secured transactions law increases access to credit. A creditor is more likely to want to lend to a business or an individual if it can be sure of being repaid, and being able to take an effective security interest in an asset, which can be protected against other claimants to that

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1 For a discussion of the importance of credit and secured lending see generally G McCormack, *Secured Credit under English and American Law* (Cambridge University Press, 2004) Chapter 1. The importance of credit is further buttressed by the activities of multilateral lending agencies e.g. between 2005 and 2015, the World Bank through its Development Policy Financing which assists mid-low income countries to achieve developmental objectives by supporting a programme of policy and institutional reforms provided funding to various countries to the tune of $117 billion. See www.worldbank.org/en/projects-operations/products-andservices/publication/dpfretrospective2015 (assessed on 9 November 2017)

2 For example, as at 30th September 2017, Nigeria's total external debt stock exceeded US$15 billion. See Debt Management Office, 'Nigeria's External Debt Stock' available at https://www.dmo.gov.ng/debt-profile/external-debts/external-debt-stock/2253-nigeria-s-external-debt stock-as-at-30th-september-2017/file> (assessed on 30 November 2017)

3 Nigeria adopted English law as a consequence of British colonial rule in Nigeria which ended in 1960. By s. 45 of the Interpretation Act Cap 89, 1958, the English common law and doctrines of Equity, together with statutes that were in force in England as at 1st of January 1900 were adopted in Nigeria subject to local enactments. This remains the case to date. Consequently English statutes enacted prior to, and including the limiting date are considered federal Nigerian statutes for the purpose of adoption and English cases are of persuasive authority in Nigerian courts, especially on novel issues. For a detailed discussion of the relationship between English and Nigerian law see generally AEW Park, Sources of Nigerian Law (1st ed. Sweet and Maxwell 1963), ch 1

4 Canada, New Zealand, Australia and Malawi are all examples of countries that have initiated new security regimes in the form of Personal Property Security Acts modelled after Article 9 of the Uniform Commercial Code of the United States of America.

asset and enforced easily and quickly, is bound to reassure a creditor that it is likely to be repaid, even if the borrower becomes insolvent.[5]

A key shortcoming of the common law system is its fragmented, complex and multi-faceted security interests governed by different and often conflicting legal principles resulting in different outcomes for functionally similar transactions. This is aggravated by the dualist nature of English law in which rigid common law rules are often supplemented or diluted by malleable equitable principles. Confirming this with reference to the pre-reform common law system in Australia, Duggan and Brown described the system as 'a patchwork system of statutory initiatives supplemented by common law and equitable principles.'[6] This complexity discourages potential parties from partaking in secured transactions; while the creditor is concerned that a complex system could result in the inability to recoup the loan from the security provided, the borrower faces the difficulty of accessing loans owing to complexities introduced into the loan transaction by creditors seeking additional protective measures to ensure repayment.[7]

These difficulties are particularly immense in developing countries in which the availability of credit is essential to the survival of most business enterprises. In Nigeria for example, micro and small enterprises, generally subsumed under the popular head 'micro, small and medium enterprises' (MSMEs) dominate the business landscape. Although there is no universally acceptable definition of a micro enterprise or for that matter MSME, such

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5 L Gullifer and O Akseli, (eds) *Secured Transactions Law Reform: Principles, Policies and Practice* (Hart Publishing, 2016), 1

6 A Duggan and D Brown, *Australian Personal Property Securities Law* (2nd ed. LexisNexis Butterworths, 2016), 18

7 Such measures include seeking higher interest rates on loans or security in addition or as an alternative to such higher interest rates. See generally N Cohen 'Internationalising the Law of Secured Credit: Perspectives from the US Experience' (1999) U Pa j Int'l Econ L 423.

classifications being driven by unique socio-economic factors,[8] some features of micro enterprises, which distinguish them from other business entities are worth quickly highlighting. First, they are mainly informal types of businesses run by proprietors whose personal resources are often the same as those of the business. Critically, this feature constitutes a huge disadvantage in their quest for loans as the use of their individual persona triggers harsh contractual terms from creditors.[9] Second, owing to their impecuniosity, they often lack valuable assets to dedicate as collaterals for loans. Consequently, their best possible collaterals are either their tools of trade, trade inventory or receivables from business activities such as payment for artisanship or produce from subsistent farming. Their continued survival therefore significantly hinges on their ability to generate funding based on such collaterals.

However, doubts exist about the availability of security over such items under some legal systems.[10] This may have prompted the calls by various reform groups for the reform of personal property laws to eliminate the complexity associated with the common law

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8 The result of the difficulty in having a universal definition has led to reliance on elements that distinguish these entities from other entities. See generally L Gullifer and I Tirado, 'Financing Micro-businesses and the UNCITRAL Model Law on Secured Transactions' (2017) Oxford Legal Studies Research Papers 1; See also O Oliyide, 'Law, Credit Risk Management and Bank Lending to SMEs in Nigeria' [2012] 38 CLB 653 for a discussion of the problem of defining SMEs

9 See para 2.1 of this thesis for a detailed discussion of the peculiarities of these entities and how they impact their quest for funding

10 ibid. See also eg R Kohn and D Morse, 'UNCITRAL: The UNCITRAL Model Law on Secured Transactions' [2016] The Secured Lender, 48 available at <https://search.proquest.com/docview/1840626067?OpenUrlRefId=info:xri/sid:primo&accountid=13042> (assessed on 10 November 2017) where the authors observed that security for small business enterprises must 'enable businesses, particularly small and medium-sized enterprises, obtain financing based on the value of their receivables, inventory and other collateral – a form of financing that is not readily available, or available at all, in many countries.' Another writer also observes that 'for the most part security interests over receivables are normally in the form of a charge or mortgage.' This therefore exposes receivable financing to the problems associated with the traditional financing options generally open to MSMEs discussed in ch 2 of this thesis. See F Oditah, *Legal Aspects of Receivables Financing* (London Sweet & Maxwell, 1991), 82

system and engender a liberal environment for lending beneficial mainly to small business entities. For example, in realisation of the role of secured transactions in international trade, the United Nations Commission for International Trade Law (UNCITRAL) has developed a legislative guide[11] and model law[12] to assist states in developing modern secured transactions laws to promote credit availability.[13] UNCITRAL further proposes that such laws should enable smaller businesses to utilise the value inherent in their assets as a means of reducing lenders' risks of non-repayment.[14]

In Nigeria, calls for reform[15] culminated first, in the enactment of the Central Bank of Nigeria (CBN), Registration of Security Interests in Movable Property by Banks and Other Financial Institutions in Nigeria[16] and then the Secured Transactions in Movable Assets Act of 2017 (STMA) which became effective on 31st May 2017 both of which apparently adopt the model recommended by UNCITRAL that harmonises various forms of security interests into a unitary security interest.[17] However, a deeper and more

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11 UNCITRAL, *UNCITRAL Legislative Guide on Secured Transactions* (United Nations, 2010)

12 UNCITRAL, UNCITRAL Model Law on Secured Transactions (United Nations, Vienna, 2016).

13 ibid n 11, 1

14 ibid, 2; See also the work of the Secured Transactions Law Reform Project in the UK. For a detailed description of what is considered ideal see Secured Transactions Law Reform Project, 'Policy Paper' (2016) available at <http://securedtransactionslawreformproject.org> (accessed on 2 November 2017)

15 The need for reform is far more pressing in Nigeria than in England because unlike England that has undergone several reforms that has made the system more workable, the Nigerian secured transactions system still reflects the unreformed English common law system. See Gullifer and Raczynska, 'The English law of Personal Property Security: Under Reformed?' in L Gullifer and O Akseli (eds) *Secured Transactions Law Reform* (ibid n 5)

16 Regulation No 1, 2015

17 The specific model adopted by Nigeria remains unclear especially with the apparent failure to achieve total harmonisation, a key proposition advanced in this thesis. For a detailed discussion of

analytical review, which this thesis aims to achieve, reveals that these enactments, and specifically the STMA, may not fully realise the objectives for which they were enacted.

S. 1 of the STMA defines its objectives to include the stimulation of 'responsible lending to micro, small and medium enterprises.'[18] Although s. 2(1) defines its scope to include security interests in movable assets created by an agreement that secures payment or the performance of an obligation,[19] s. 2(3) however provides that 'Nothing in this Act shall prevent the creation of a security interest in the form of charges by companies registered under the Companies and Allied Matters Act.' Although there is no statutory definition or judicial interpretation of the phrase 'Nothing in this Act shall prevent', it is hardly arguable that it achieves a converse effect to the phrase 'Notwithstanding any provision of', which has been judicially interpreted in statutes to exclude any impinging or impeding effect of any other provision of the statute or other subordinate legislation to enable the section fulfil itself.[20] Accordingly, the phrase 'Nothing in this Act shall prevent' would exclude an enactment's application to enable the provisions of an alternative enactment fulfil itself. It therefore follows that companies can create charges in

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various recognised models however see Inge Van de Plas, 'The UNCITRAL Legislative Guide, Model Law and Three Country Comparison', (LL.M thesis, University of Toronto, 2015).

18 Other objectives listed in s 1 include the enhancement of financial inclusion in Nigeria, the facilitation of access to credit secured with movable assets, and establishment of a collateral registry. Although what is meant by 'financial inclusion' is not defined by the Act, it may point to the elimination of the feeling of déjà vu that MSMEs may have always felt by their inability to access credit as other business entities.

19 The breadth of transactions constituting security interests is further emphasized by s 63(1) of the STMA which defines security interest as 'a property right in collateral that is created by agreement and secures the payment or other performance of an obligation, regardless of whether the parties have denominated it as a security interest'

20 See Saraki v FRN[2016] 3 NWLR (pt 1500) 531; See also AG Lagos State v AG Federation [2014] 9 NWLR (pt 1412) 217

conformance with and subject to the Companies and Allied Matters Act (CAMA)[21] without the STMA impinging or impeding such transactions. It is therefore contended (and this is a recurring argument throughout this thesis), that the implication of s. 2(3) is that company charges remain legitimate forms of security devices available to companies for use pursuant to the CAMA without reference to the STMA.

This development is worrisome for the immediate reason that the continued legitimization of this form of security device outside the STMA taints the objective of harmonization, an omnipresent feature of other similar secured transactions law reforms.[22] Bearing in mind that a significant factor militating against the grant of credit to MSMEs is their inability to provide valuable assets as collateral for loans,[23] it is suggested that despite s. 2(3), the STMA's acceptance as a reformative enactment would depend on whether it achieves the key objectives for which it has been enacted i.e. of stimulating funding to MSMEs and following UNCITRAL's recommendations, to enable them use the value inherent in their receivables as collateral for loans. Accordingly, it is suggested that floating charges or other similar devices could potentially satisfy these requirements. These types of security devices enable business entities to utilise their receivables and undertakings, or part thereof as security for loans without tying them down solely as collateral or losing

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21 Cap C 20 Laws of the Federation of Nigeria 2004

22 For a discussion of the key elements of a typical PPSA reform See H Beale, 'An Outline of a Typical PPSA Scheme' in L Gullifer and O Akseli (ed.) *Secured Transactions Law Reform* (ibid n 5),7.

23 It is an open secret that Nigerian banks prefer valuable realty as collateral because of their assured appreciation in value and the lack of consistent monitoring, which widespread fraudulent practices have occasioned in respect of movable assets. See generally O Oliyide, 'Law, Credit Risk' (ibid n 8) for a comprehensive discussion of the problems of lending to SMEs in Nigeria

ownership or control of them while the secured transaction subsists.[24] Consequently, the validity of such charges does not depend on the transfer of ownership or possession of the asset, thus raising borrowers' confidence in the preservation of their ownership against uncontrolled losses occasioned by e.g. sale of the asset pursuant to a mortgage. From the creditor's perspective, the risk of allowing the debtor's continued hold of the assets is offset by the unique feature of capturing the debtor's after-acquired assets into the obligation upon crystallization. Further, although these devices perpetuate the debtor's continued ownership of the assets, they nevertheless confer the charge with a proprietary interest, a situation satisfactory and advantageous to both parties. As the repayment of the loan is usually tied to the efficiency with which the business is run, floating charges necessarily encourage chargees to monitor the business affairs of the company. With the sophisticated internal management and wherewithal of most institutional creditors, the benefit of monitoring is invaluable to smaller business entities. Finally, floating charges remove the very difficult requirement of setting aside valuable assets as collateral for loans with the use of receivables and or their undertakings of trade sufficient to meet the collateral needs of creditors, acceptable to satisfy the need of creditors.

Ironically, floating charges are species of company charges potentially excluded from the scope of the Act by s.2(3)[25] With their characteristics similar to that suggested by UNCITRAL, the prerogative given for their use (i.e. where they meet the relevant

24 Coincidentally, the floating charge was developed under similar circumstances - to assist budding business enterprises raise funds in the mid-19th century during the industrial boom occasioned by the industrial Revolution. See R Pennington, 'The Genesis of the Floating Charge' (1960) 23 MLR 630.

25 For a detailed discussion of s. 2(3) please see ch 3 of this thesis.

eligibility criterion) and their potential exclusion from the ambit of the STMA appears ominous. This thesis is therefore instigated by this writer's desire to unravel this mystery.

This research therefore seeks to address the following question: Having regard to the existing legal framework for secured transactions in Nigeria, what are the implications of the STMA and specifically of the provisions of s. 2(3) on the Nigerian law of secured transactions bearing in mind the Act's cardinal objective of stimulating credit to MSMEs?

In order to address this question, the writer suggests that despite their fragility, MSMEs are subject to the same legal and regulatory framework for obtaining credit applicable to other business entities in Nigeria. Relying on the National Policy on Small and Medium Scale Enterprises,[26] the research highlights the peculiarities and challenges of MSMEs in Nigeria. These peculiarities are subsequently used as the basis for evaluating the impact of key elements in the legal framework such as the platforms through which businesses are conducted and the various financing options open to business borrowers. Following this evaluation which is performed in Chapter two, it is concluded that prior to the enactment of the STMA, the environment for accessing credit was unfavourable to MSMEs.

Having these challenges in mind, the STMA is evaluated in Chapter three to first, examine its impact on the challenges identified in Chapter two and second, to ascertain the

26 Small & Medium Enterprises Development Agency of Nigeria (SMEDAN), 'Federal Republic of Nigeria: National Policy on Micro, Small and Medium Enterprises' 2015 available at <http://www.msme-asi.org/images/menu4_od_msme/national_policy_on_msmes_new.pdf> (assessed on 13 November 2017). This policy was enacted by SMEDAN pursuant to powers conferred on it by s 27 of the SMEDAN (Establishment) Act 2003. By virtue of s 37(1) of the Interpretation Act, Cap 123 Laws of the Federation of Nigeria 2004, a subsidiary instrument of an enactment has the same force of law as the enactment. Accordingly, the policy has the force of law and is of equivalent status to any federal statute. See Trade Bank Plc v LILGC [2003] 3 NWLR (pt 806) 11

impact of the potential exclusion of company charges from its ambit on MSMEs' access to funding. Preceding these evaluations is an assessment of the imperatives driving the reform of Nigeria's secured transactions law culminating in the enactment of the STMA which are compared to imperatives for global reform. This comparison reveals some misalignment in the objectives for reform, with the Nigerian reform partially driven by an apparent regulatory objective; this raises concerns about government's commitment to liberalising the credit system.

In evaluating the prerogative granted to companies to grant charges outside the Act, it is noted that an immediate effect of such exclusion is that most MSMEs remain ineligible to grant floating charges because as chapter two reveals, these entities are predominantly informal business entities. In view of the benefits of these charges earlier highlighted, the question of whether the unitary security interest created by the STMA is an acceptable alternative to floating charges is discussed. It is concluded that although the security interest possesses most attributes of the floating charge, it is however defeasible by the right conferred on creditors by the STMA to take possession of secured assets prior to enforcement of their security interests. Further implications of s. 2(3) discussed in Chapter three are the effect of the parallel system of secured transactions in determining priorities of conflicting interests arising from assets filtering across the two systems. It is concluded that the complexities associated with having a multi-faceted system of security interests under the common law are unwittingly introduced into the interpretation of the Act. This is further buttressed by the Act's adoption of the remedies' scheme under CAMA including receiverships. Finally, chapter three also evaluates two unique provisions i.e. the Act's insurance requirement under s. 6(1)(c) and the non-judicial enforcement of security

interests under s. 40 both of which are potential landmines in the realisation of the objectives of the Act.

In conclusion, while acknowledging the benefits of harmonizing most security interests, the writer concludes that the STMA falls short of total harmonisation and of achieving its key objective of stimulating credit to MSMEs. The writer therefore makes several recommendations in Chapter four to address some of the highlighted difficulties.

As the broad objective of this thesis is to assess the implication of a reformative enactment (the STMA) by reference to its primary objective (stimulating funding to MSMEs), having regard to a unique characteristic (the exclusion of company charges), an understanding of the previous legal platform that necessitated the reform is imperative. This understanding is gained through the critical analysis of various ‘black letter’ laws under the previous system and the changes introduced by the new enactment.[27] This approach primarily involves the use of doctrinal research methodology. Further, the creation of a parallel system of secured transactions calls for the comparison of the STMA with other similar systems, including UNCITRAL Model Law and the Australian Personal Property Security Act, achieved through comparative research methodology.

Understandably, there has been no scholarly review of the STMA since its enactment. However, some reactions heralded the enactment of CBN’s Regulation 1.[28] In one article,[29] the authors critically review the CBN Regulation concluding that the exclusion of floating charges from the Regulation results in the unfortunate duality of interests with potential

27 C McCrudden, ‘Legal Research and the Social Sciences’ (2006) 122 LQR 632, 633

28 ibid n 16

29 W Iheme and S Mba, ‘Towards Reforming Nigeria’s Secured Transactions Law: the Central Bank of Nigeria’s Attempt through the Back Door’ (2017) JAL 1.

conflict situations arising from secured assets criss-crossing both systems. Unlike the Regulation which completely excludes company charges from its ambit however, the STMA gives companies the option of granting charges. This thesis nevertheless upholds the views expressed by the learned writers on the duality of security interests where charges are granted pursuant to CAMA without reference to the STMA but however goes further to examine in detail the specific impact of the potential conflicts predicted by the learned authors with particular emphasis on the stimulation of funding to MSMEs. The second article,[30] confirms the views expressed in the first article to the extent that the exclusion of company charges from the ambit of the Regulation amounts to a missed opportunity to harmonise Nigeria's secured transactions laws while emphasizing the obvious benefits of harmonization in reforms of the laws of secured transactions.

30 Otabor-Olubor, 'Reforming the law of Secured Transactions: Bridging the Gap between the Company Charge and the CBN Regulations' Security Interest' [2017] 17 JCLS 39

-2-

THE LEGAL FRAMEWORK FOR CREDIT TRANSACTIONS IN NIGERIA

2.0 Overview

Having regard to the importance of law in credit transactions,[1] this chapter examines the challenges inherent in Nigeria's legal framework that adversely impact MSMEs' access to funding opportunities. This evaluation is imperative to buttress the rationale for reform by exposing the state of the law prior to the enactment of the STMA and using it as a mirror through which the effectiveness or otherwise of the STMA is assessed.

This chapter is divided into three main sections. The first section examines the National policy on MSMEs[2] to highlight the peculiarities of MSMEs and the challenges

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1 In this context, law refers to legislation, case law and any other forms of regulations or guidelines imposed by government to regulate commerce as opposed to agreements between contracting parties which also have the force of law. The importance of such laws in credit transactions under any legal system cannot be overemphasised. First, institutional lending often involves the use of public funds to finance private ventures, with the attendant risk of such funds being depleted or lost, a possibility capable of adversely affecting the economy of one or several countries. Secondly, it is apparent that the established contractual relationship between institutional lenders and their customers is often inadequate to cushion the effect of reckless financial dealings e.g. in Nigeria, an estimated NGN770 billion was incurred by the Asset Management Corporation of Nigeria (AMCON) to mop up bad debts in 2009, the contractual relationship between the affected banks and their customers having failed. See O Olanipekun, 'Banking Regulation and Supervision: Concept, Theory and Rationale' in O Olanipekun (ed), *Banking: Theory, Regulation, Law and Practice* (Au Courant 2016), 3. Thirdly, the extensive compartmentalization of the common law of secured transactions underscores the need for law to play a greater role in credit transactions to address the latent intricacies and potential landmines underlying such demarcations, capable of derailing the overarching objectives of secured transactions. In a recent empirical study of the importance of law in lending, researchers observed rather tellingly that 'there is, however, scant attention paid to understanding the channel through which changes in legal institutions get transmitted to the economy'. This clearly justifies the objective of this chapter i.e. to evaluate the current regulatory framework as a prerequisite for ascertaining the value of the STMA. See R Haselmann, K Pistor and V Vig, 'How Law Affects Lending' (2010) 23 Review of Financial Studies 549 for a detailed discussion of the role of law in lending.

2 See SMEDAN, 'National Policy' ibid ch 1, n 26

they encounter in their quest for funding in Nigeria. The findings there from form the basis for the subsequent impact assessment of Nigerian laws on MSMEs' ability to access loans. The second section reviews the platforms through which business is conducted in Nigeria and whether they provide leverage for MSMEs in their quest for funding. The third section evaluates the financing options available to business entities under Nigeria's current legal framework highlighting the difficulties MSMEs encounter in sourcing funds having regard to their unique peculiarities.

While examining the factors inherent in Nigeria's legal and regulatory framework that adversely affect MSMEs' access to funding, emphasis is placed on highlighting those elements that discourage MSMEs from seeking credit and creditors from extending credit being mindful that an aversion to credit transactions by both parties is hardly the stimulant required for developing a healthy credit system and engendering economic growth.

2.1. The Peculiarities and Challenges of MSMEs in Nigeria

As earlier indicated, a universally acceptable definition of MSMEs or micro entities may not exist.[3] Accordingly, most countries tend to classify the components of MSMEs using various factors. In Nigeria, the agency charged with overseeing, initiating and articulating ideas for MSMEs, the Small and Medium Enterprises Development Agency of Nigeria (SMEDAN)[4] has formulated a policy on MSMEs that forms the basis for evaluating the

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3 See ibid ch 1 n 8

4 SMEDAN, a statutory agency was established by the SMEDAN (Establishment) Act 2003 to amongst others initiate and articulate ideas for small and medium scale industries policy thrusts and oversee, co-ordinate and monitor developments in the small and medium industries sub-sector. See SMEDAN (Establishment) Act, s 8 for its detailed responsibilities in respect of MSMEs.

peculiarities and challenges of MSMEs in Nigeria under this section.[5] The policy, which came into effect in 2015 for a period of 10 years, neither defines MSMEs nor micro entities. It however categorises entities as MSMEs based on two factors i.e. the number of employees and the total assets owned (excluding land and buildings).[6]

Using the said factors, the policy classifies entities employing between 1 and 9 persons and with less than NGN10 million[7] in assets as micro enterprises; those with 10 to 49 employees, with assets of between NGN10 and NGN 99 million as small enterprises, while those with 50 to 199 employees and with an asset base of between NGN100 and NGN1 billion are categorised as medium enterprises.[8] It estimates that 37 million micro enterprises exist in Nigeria providing employment for approximately 58 million people or about a third of the entire Nigerian population.[9] This figure is immense and it is underscored by the vast spectrum of activities covered by this sector, including virtually every aspect of retail trade, artisanship, sale of household goods, manufacturing, agriculture, hospitality and transport and storage businesses in Nigeria.[10]

In terms of modus operandi, the policy states that the typical micro enterprise is operated by a sole proprietor assisted mainly by unpaid family members and the

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5 ibid

6 The policy however states that where conflicts arise between the employment and assets criteria (for example, where an enterprise has assets worth twelve million naira but employs only 7 persons), the employment criterion takes precedence and the enterprise will be regarded as a micro enterprise. See SMEDAN, ‘National Policy’ (ibid ch 1 n 26) para 1.3

7 NGN 10 million amounts to approx. GBP21,000 at the prevailing exchange rate of GBP1: NGN477. See <https://www.oanda.com/currency/converter/> (assessed on 13 November 2017)

8 SMEDAN, ‘National Policy’ (ibid ch 1 n 26)

9 Emphasis mine

10 SMEDAN, ‘National Policy’ (ibid ch 1 n 26), para 1.4.1

occasionally paid employee and apprentice with low output value and an even lower dependence on technology.[11] With the subsistent nature and poor structures of these entities, it is not surprising that their funding is mainly derived from personal savings and friendly loans from family members and traditional mutual funds, with bank loans rarely sought and very rarely obtained.[12]

Typically, micro enterprises are promoted mainly by illiterates and semi-illiterates, which explains their lack of structure and total self-dependence. Most of the promoters of these businesses are unaware of the benefits that come with incorporation or introducing structures into their activities. They are also often wary of utilising third party advisory services and of being fraudulently victimised. However, as noted in the policy, it is projected that with many unemployed school leavers including graduates now engaged in various forms of entrepreneurial pursuits, micro enterprises could very likely enjoy an upgrade in structure and technological input, and potentially, the eligibility for institutional funding.[13]

According to the policy, small enterprises on the other hand cover about the same spectrum of activities as micro enterprises but concentrated in the 'more modern sophisticated end'.[14] The policy puts the number of such enterprises at just under 70,000 employing slightly below 2 million people.[15] While most small enterprises are also sole

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11 ibid

12 ibid

13 ibid

14 ibid para 1.4.2. What constitutes 'more modern sophisticated end' is however unclear from the policy. It is suggested that the phrase relates to the sophistication with which the more enlightened proprietors of small enterprises carry out their activities compared to those of micro enterprises.

15 ibid

proprietorships, an increasing number are incorporated enterprises. The policy further highlights that small enterprises 'have a large reservoir of educated manpower and technical skills, as well as relatively improved access to banks.... and organisationally, they are well represented by professional and trade associations'.[16]

The policy also finds that there are less than 5000 medium enterprises employing fewer than one million people, a grossly insignificant percentage of a population of about 170 million people. Of course most, if not all of these enterprises are incorporated companies, well-structured with good access to bank loans.[17]

SMEDAN classifies the challenges facing MSMEs into two broad groups namely, internal and external challenges.[18] Internal challenges cover such issues as aversion to joint ownership, financial mismanagement, family ties, lack of basic business capacity, poor record keeping, lack of recruitment of qualified personnel, lack of staying power, low capacity to invest in ICT etc. External challenges on the other hand include finance, infrastructural challenges, multiplicity of taxes and levies and government bureaucracy amongst others.[19] It is apparent from the classifications that external challenges are extraneous to the business and beyond their control while internal challenges are those within the control of the business.

It is important to quickly highlight the exact depth of the finance problem from a practical perspective using the policy's characterisation as a basis. For example, a micro

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16 ibid; it is suggested that this comment is made in contrast to the position of micro enterprises.

17 ibid

18 ibid, para 1.5

19 ibid

enterprise with a total asset base of NGN10 million (approx. GBP20,000) (excluding real estate assets which they often don't own) is practically unable to provide suitable realty as collateral because of the high value of such assets. Further, the promoters of these enterprises are usually impecunious and also often do not personally own such assets. These entities can therefore not source asset backed loans, save for some categories of movable assets. Even then, there is serious limitation in the value of movable assets a business valued at GBP20,000 can afford especially when equipment in some sectors with significant MSME presence such as the agricultural sub-sector are usually quite expensive.[20] Bearing in mind other operational expenses, taxes, and the huge infrastructural outlay involved in running businesses in Nigeria,[21] the probability of MSEs providing acceptable collateral for loans is remote.[22]

Classifying finance as an external challenge under the policy is therefore understandable being one seemingly beyond the control of these enterprises. However, the importance of such classification by the body charged with supervising MSMEs lies in the fact that the strategies it would adopt to combat the identified problems will likely be

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[20] For example the cost of purchasing a single agricultural equipment such as a tractor usually exceeds GBP20,000 and even where instalment payments are permitted, the respective instalments may exceed what these impecunious entities can comfortably afford from their meagre earnings.

[21] Some of these include the private costs of providing steady electricity, private security and communal costs of maintaining roads and other infrastructure which are still significantly neglected by the government. For a discussion of the state of infrastructure in Nigeria see V Foster and N Pushak, 'Nigeria's Infrastructure: A Continental Perspective' (A Study of the African Infrastructure Country Diagnostic by the IBRD, 2011) available at<https://ppiaf.org/documents/3154/download> (assessed on 5 January 2018)

[22] The provision of collateral is just one of the conditions set by institutional creditors for obtaining loans. See e.g. the conditions for term loans and advances to SMEs at one of Nigeria's top banks, GT Bank which include proof of identify such as international passports and several documents evidencing incorporation as a company; this potentially rules out most micro and small enterprises. See also definition of SMEs as entities with an annual turnover of NGN500 million contrary to the National Policy's classification available at <http://www.gtbank.com/index.php/loans-and-advances#opening-your-account> (assessed on 12 January 2018)

influenced by how it perceives the problem. Thus, an incorrect definition of the challenges results in poorly defined objectives, which in turn can only result in poor strategies. A good example of this is that although lack of finance is consistently seen as a militating factor to MSME growth, the real problem is often that MSMEs are unable to meet the conditions set by financial institutions to access loans and not that funds are unavailable. Under such circumstances, it is suggested that defining the problem as that of a lack of finance is misleading and could result in the proliferation of schemes that ultimately fail to resolve the problem. Clearly, the Nigerian government has taken the view that as an external problem, it takes utmost responsibility for initiating schemes to address the problem especially in view of the role MSMEs can play in engendering overall economic development. This is buttressed by the overly supportive initiatives that have been churned out by successive Nigerian governments over the years, all of which have failed to achieve the objectives of stimulating growth to small business entities.[23]

While conceding that government's role in enhancing this sector is indubitable, it is suggested that MSMEs perhaps have an equally significant responsibility to ensure that they meet the eligibility requirements for available support, e.g. by striving to run their businesses in a structured and profitable manner and ensuring that previous loans are

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[23] The policy comprehensively identifies the various initiatives by government to support MSMEs since the mid-1960s. In all, a total of 15 schemes, most of which were driven by the CBN are identified. These initiatives range from the provision of technical extensive services such as technical appraisal of loan applications (through the Industrial Development Centres set up by government) to the provision of vocational skills (under the National Directorate of Employment) to the setting up of financial institutions with the sole objective of providing easy access to credit to MSMEs (eg the establishment of the Nigerian Industrial Development Bank in 1964). Some of the more recent initiatives include the Microfinance Policy launched in 2005 resulting in the establishment of new Microfinance banks charged with the responsibility of providing soft loans to qualifying MSMEs. See SMEDAN, 'National Policy' (ibid ch 1 n 26), 20.

promptly repaid. By so doing, they can then be assured of the continued support of relevant stakeholders.[24]

Consequently, although finance is prima facie an external factor, the more compelling factors that encourage creditors to grant credit such as the creditworthiness, and seriousness of the potential debtor, the business structure and growth potential of the business are usually internal factors. These underlying factors can therefore not be ignored in the quest for a solution to MSMEs funding needs.[25]

Drawing on the above, the peculiarities and challenges facing MSMEs is best articulated by reference to micro and small enterprises since they constitute the bulk of MSMEs and also because medium enterprises appear immune from significant funding constraints.

In summary, it is fair to characterise most MSMEs in Nigeria as follows:

i) That they fall into the category of micro and small enterprises and are therefore small, impecunious and have their subsistence tied to the availability of external funding;
ii) Their desperation to secure loans often places them in the weaker negotiating position in credit transactions, which forces them to accept oppressive terms imposed by creditors;

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[24] Repayment of loans e.g. has obviously not been the priority of these entities considering the high rate of default on loans taken by MSMEs eg a recent review of repayment by SMEs on loans disbursed under the Supervised Credit Scheme of Nigeria Agricultural Cooperative and Rural Development Bank (NACRBD) in Kaduna State, Nigeria found that of a total sum of NGN88.7 million disbursed under the scheme between 2004 and 2006, only NGN26.3 million was repaid by borrowers leaving a total of about N62.4 million plus interest outstanding. See generally AO Sambo et al., ‘A Critical Evaluation of the Legal Framework for SMEs’ Loan Redemption in Nigeria’ (2014) 22 IIUMLJ, 56

[25] Unfortunately the policy does not provide specific actions to address the lack of structures characterising these entities.

iii) They are unstructured and averse to third party participation; and

iv) They are formed and managed mainly by illiterates who are uninformed and unaware of how to exploit the benefits inherent in the system.

2.2 Business Platforms

The importance of ascertaining the platforms by which business is carried out in Nigeria, or in any other country for that matter, cannot be overemphasized. While each platform has its respective pros and cons, it would appear that in respect of the critical issue of business financing that the incorporated company provides the best leverage for business owners.[26]

Since the seminal decision of the English House of Lords in Salomon v Salomon,[27] in which the separate legal personality of the registered company as opposed to other business entities was established, the incorporated company has been the preferred vehicle for carrying on business. One important advantage of having a distinct legal personality is that the sustainability of the business entity is not synonymous with that of its promoters. In other words, incorporation confers perpetual succession on businesses. This enables them to source funds easily as investors and creditors are assured that the demise of an alter ego does not necessarily result in the cessation of the business. A further advantage of incorporated companies is that through the concept of capitalisation, an investor's share of the business, and invariably his benefits, relative to other investors is easily ascertainable. This facilitates equity investment and the degree of each shareholder's interest in the

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26 For a detailed discussion of the elements of the incorporated company and the value they hold in engendering the economic exigencies for the modern business enterprise see R Kraakman, J Armour et al, *The Anatomy of Corporate Law* (3rd ed, OUP 2017) ch 1

27 [1897] AC 22

company; it also establishes the extent to which each shareholder becomes liable for the company's indebtedness. Further, the termination of business entities buttresses the benefits of utilising companies over other forms of business platforms for two main reasons. First, it is suggested that creditors' willingness to provide funding may be influenced by the durability of the debtor's existence as they are generally less comfortable extending credit to ephemeral entities. Second, creditors are often concerned about the rules governing the debtor's post-existence such as bankruptcy rules, because of the impact of a debtor's bankruptcy on the outcome of the loan transaction.[28]

Expectedly, the decision in Salomon's case is part of Nigerian law[29] with the existence of both judicial and statutory affirmation of the concept of separate personality. S. 37 of CAMA recognizes the concept of limited liability and separate personality, the effect of which is that companies, as opposed to other forms of business entities, are empowered to carry out several activities in their corporate persona as opposed to the personae of individual members. In FCDA v Unique Future Leaders International,[30] the Nigerian Court of Appeal held that a registered business name did not have the requisite capacity to hold land as it is not so statutorily empowered. The court further held that the

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28 For example while the registrar of business names is empowered to unilaterally remove a registered business name from the register of business names if in his opinion, the business is no longer viable, incorporated companies must go through an extended and often complex process involving court intervention in order to have their existence terminated irrespective of insolvency. The practical benefit of a complicated termination process is huge from the perspective of creditors; they become aware of the debtor's fragile financial state and are therefore able to immediately commence remedial actions in protection of their interests. See CAMA, ss 578 and the entire Part XV of CAMA consisting of 130 sections dedicated to companies winding up. Also further detailed rules are contained in the Companies Winding-Up Rules of 2001, a statutory instrument of 184 sections made pursuant to CAMA as an annexure.

29 See ibid ch 1 n 3

30 [2014] 17 NWLR (pt 1436) 217

capacity to hold land, and for that matter to carry out other activities, is not, and cannot be synonymous by any means with capacity merely to sue and be sued which registration as a business name confers.[31]

Despite the obvious benefits of incorporation however, the use of the other available business platforms i.e. sole proprietorships and registered business names remains prevalent and more popular than the use of companies in Nigeria.[32] Perhaps, sole proprietorships have remained so prevalent because of their informal and unregulated nature, although their use has statutory limitations.[33] Registered business names, the third and final platform used by profit making enterprises are, like incorporated companies, regulated by CAMA,[34] and supervised by the same agency, the Corporate Affairs Commission (CAC).[35]

Save for a few exceptions, Nigerian law generally does not oblige promoters to utilise any particular platform in carrying on business.[36] Consequently, any two or more persons may incorporate a company.[37] In addition, every profit making company is required to have

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[31] Some of these benefits incidental to incorporation have received statutory backing e.g. the power to partake in credit transactions and create security devices over their assets. See CAMA, s 166

[32] See eg The Guardian Newspaper, 'Business News dated 6th September 2017' showing the amount of entities registered between July 2016 and June 2017 available at <https://guardian.ng/business-services/cac-registered-91609-business-names-in-one-year/> (assessed on 6th April 2018)

[33] See CAMA, s. 573

[34] Parts A and B of CAMA regulate the activities of companies and business names respectively. Part C deals with Incorporated Trustees which are non-profit organizations and are therefore out of the scope of this work.

[35] CAMA, ss 7(1)(a) and 569

[36] For example ss 20 and 54 of CAMA also imposes further obligation on minors and foreign companies desirous of carrying on business in Nigeria in respect of incorporating companies in Nigeria. S 19(1) also compels any association of persons for business purposes with a membership of twenty and above to be incorporated as a company under the Act.

[37] CAMA, s. 18.

an initial capitalisation, with the initial subscribers indicated during the incorporation process.[38] Where a promoter however decides against using the platform of an incorporated company, there arises a liability to register the name of the entity based on the provisions of s. 573(1) of CAMA. The section obligates every individual, firm or corporation carrying on business under a business name to be registered as such if its chosen name consists of more than the true forenames or surnames in the case of individuals and firms; in the case of an incorporated company subsequently becoming part of a business name arrangement e.g. through participation in a joint venture, registration is required if the joint venture uses a name other than the corporate name of the company involved in the venture. It would therefore appear that the only real eligibility criterion for registration as a business name is the name selected by promoters. Consequently, any entity that chooses a name that reflects names other than the given names of its promoter(s), irrespective of its size or activities is obliged, at the very least, to register as a business name in conformance with s. 573.[39]

S. 573(1) may however contrast with reality, with the prevalent notion in Nigeria, also expressed by SMEDAN being that MSMEs are mainly informal business entities i.e. entities that are unregistered and carry on businesses as sole proprietors.[40]A gap therefore exists between the legal requirement for registration and current reality with respect to the

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[38] CAMA, s. 27(2)(a); It is submitted that this section is a critical determinant for the choice of platforms by business promoters in Nigeria as it generally discourages many promoters from using companies as incorporation costs is tied to initial capitalisation. However, the requirement is apparently so soft that it has been severely criticized. See VO Onwaeze, 'Some Recent Changes in Nigeria Company Law' [1993] JBL 409

[39] Failure to register attracts punitive measures under CAMA. See CAMA, s 584. There is however no means of tracking compliance with s. 573 and considering the desire of government to boost the growth of small companies, sanctions against them are invariably never pursued.

[40] This can be gleaned from para 3.2.1 of the National Policy (ibid ch 1 n 26).

registration of business names. This gap may however not be unconnected with the notion that the smaller a business entity, the more difficult it would be for such entity to satisfy registration requirements, especially with incorporation requiring initial capitalisation.[41] With the likelihood that the legal liability of micro and small entities to formalize their business through any of the two platforms is higher than perceived, it is necessary to consider the relative benefits of utilising either of those platforms especially in the light of business financing and the fragilities of MSMEs.[42]

Based on the categorisations earlier discussed and the finding that most Nigerian MSMEs are micro and small enterprises, it follows that the bulk of MSMEs, are mainly informal unregistered entities, with a limited few registered as business names.[43] It would therefore constitute a fair assessment to state that most MSMEs in Nigeria lack legal personality and are therefore unable to secure loans by virtue of a corporate persona. This has several disadvantages. First, in a personal capacity, they cannot grant floating charges as security for loans because only companies can create such charges under Nigerian law.[44] This is a significant disadvantage having regard to the benefit of such devices to MSMEs.[45]

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[41] It is however necessary to correct the general perception that companies are more complex to create as same is not supported by available evidence. For instance, in terms of creation costs, the current charges for registering a business name is exactly the same as that paid for incorporating companies with share capitals below NGN1,000,000. See summary of CAC fees <http://new.cac.gov.ng/home/summary-of-fees-and-forms/> (assessed on 13 December 2017). Further, the documentation requirement and incorporation process, a potential cause of concern to budding promoters is also considerably less for new and small companies than it is for established companies. This myth however continues to discourage promoters from utilising this medium of doing business.

[42] Notwithstanding the obligation to register as a business name pursuant to s. 573 of CAMA, a promoter may decide to nevertheless incorporate a company instead. The provisions of s. 573 come into operation in the absence of a promoter not having incorporated a limited liability company.

[43] See SMEDAN, 'National Policy' (ibid ch 1 n 26), para 1.4

[44] See CAMA, the combined effect of ss 166 and 178

[45] ibid ch 1 n 24

Consequently, only assets belonging to promoters of these entities can readily be available as security for loans. This situation is bound to discourage the risk-averse promoters of these entities from seeking credit facilities because of the imminent possibility of losing such assets through default in loan repayment. Finally, as the risk of lending to individuals far outweighs that of lending to companies, creditors typically include onerous terms such as higher interest rates in loan agreements with individuals as buffer against such risks, a further deterrent to MSMEs from lending.

2.3. Financing Options

This section discusses the laws regulating various financing options open to business entities under the Nigerian legal system in order to establish their suitability or otherwise for MSMEs. Importantly, the limitations inherent in the use of respective options prior to the enactment of the STMA are highlighted; these limitations will form the basis for the subsequent evaluation of the STMA and how it reforms the Nigerian law of secured transactions in respect of improving access to funding to MSMEs in chapter three of this thesis.

The financing options examined here under are:

i) Venture capital;

ii) Unsecured credit;

iii) Secured credit; and

iv) Vendor credit.

2.3.1. Venture Capital

Venture capital is not new in Nigeria, with government's involvement in it traceable to 1946 when the Nigerian Local Development Board was established. However, despite government's effort to foster it through various legal and fiscal policies and schemes, it has been mostly unsuccessful. A primary reason for this lack of success appears to be the insistence of the venture capitalist providing medium and long term financing to participate in managing host enterprises to the chagrin of host entrepreneurs.[46]

However, one of the more popular schemes introduced by the Nigerian government to assist MSMEs to generate funds from the organized private sector, contained in the Banks and Other Financial Institutions Act (BOFIA)[47] is worth further examining. The scheme, contained in s. 21 of BOFIA provides that banks may acquire or hold part of the share capital of any agricultural, industrial or venture capital small or medium enterprise company subject to some conditions.[48] These conditions include first that the total value of the investment should not exceed 10% of the bank's shareholders fund unimpaired by losses and second, that the investment should also not exceed 40% of the paid-up share capital of the entity.[49] A third restriction is that the aggregate value of the equity

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[46] See A Daramola, 'New Technology-Based Firms and Venture Capital Policy in Nigeria' (2012) 9(1) Journal of Inn Econ and Mgt, 163. A recent empirical study of 150 small enterprises further showed that as many of these enterprises grew older, their aversion to venture financing also increased, thus prompting the researchers to conclude that venture capital was best used in budding companies. See also R Obasi and P Donwa, 'The Impact of Educational Qualification, Experience and Venture Capital Awareness on Co-Ownership of Small Enterprises in Nigeria' (2013) 3(1) Journal of App Fin and Banking, 137

[47] Cap B3 Laws of the Federation of Nigeria 2004

[48] BOFIA does not define what constitutes small and medium enterprises; in such absence, the definition provided by the National Policy earlier discussed remains relevant. See SMEDAN, National 'Policy' (ibid ch 1 n 26), para 1.3

[49] BOFIA, s 21(1)(c)

participation of the bank in all similar enterprises should not at any time, exceed in the case of a commercial bank, 20% (and 50% for merchant banks) of its shareholders fund unimpaired by losses.[50]

Ordinarily, these provisions should be positive developments because of their potential to spur equity to MSMEs that could considerably ease the funding needs of these entities and provide a platform for the closer involvement of banks in running them. However, considering the aversion of micro and small enterprises to third party involvement in their businesses, it is doubtful whether promoters of such enterprises view s. 21 as a useful means of raising funds and engendering their overall development

The proviso to s. 21 states that a bank may acquire shares in SMEs indebted to it as repayment for loans. Although BOFIA is silent on whether it is permissible for such converted shares to raise the limit of a bank's shareholding beyond the statutory limit indicated in s. 21(1)(c), it is contended that this is an obvious possibility considering that no limit is placed on the amount of loans that may be subject to the debt/equity swap. However, this debt/equity swap is capable of being viewed by MSMEs as a surreptitious switch from lending to 'forced' ownership, capable of discouraging them from venture capital altogether.

Finally, as equity participation by banks is only possible through the acquisition of shares, this presupposes that the benefit of s. 21 can only be enjoyed by entities incorporated as companies since companies are the only forms of business entities that offer share capitalisation under Nigerian law.[51] This provision therefore clearly excludes

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[50] BOFIA, s 21(1)(d)

[51] This further clearly highlights the advantages of companies over other types business entities discussed in para. 2.2.

micro enterprises and to some extent, small enterprises. As these entities constitute the bulk of all MSMEs, the envisioned impact of s. 21 as an avenue through which banks may become venture capitalist and support the funding needs of MSMEs is at best, insignificant.

2.3.2. Unsecured Loans

The highly regulated nature of the financial services sector in Nigeria and the strict rules for lending imposed by the CBN on financial institutions, makes it difficult for most Nigerians, and especially MSMEs to meet the onerous terms imposed by financial institutions for unsecured loans.[52]

It is in apparent realisation of this that the Nigerian government has repeatedly taken steps to address the funding needs of small enterprises through various forms of micro financing schemes.[53] Micro financing is popularly viewed as the provision of small loans either by government, institutional or non-institutional lenders to indigent persons as a means of alleviating poverty.[54] The problem with this view, which apparently reflects the

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52 See eg s 20 of BOFIA for some conditions for grants of loans; See also s. 8 of Central Bank of Nigeria, 'Prudential Guidelines for Deposit Money Banks in Nigeria' 2010 available at <https://www.cbn.gov.ng/OUT/2010/PUBLICATIONS/BSD/PRUDENTIAL%20GUIDELINES%2030%20JUNE%202010%20FINAL%20%20_3_.PDF> (assessed on 21 December 2017). For example, while obliging banks to have a comprehensive SME financing policy, the CBN expects banks to amongst others determine an appropriate security for SME loans, and to comprehensively determine repayment capacities and modalities. See also O Oliyide, 'Law, Credit Risk' (ibid ch 1 n 8) for a comprehensive discussion of the challenges SMEs face in seeking bank loans in Nigeria.

53 See ibid n 23 for a list of previous schemes, some of which were micro finance schemes initiated by government to support MSMEs; The recent history of micro financing in Nigeria is however traceable to the comprehensive bank consolidation initiated by the CBN in July 2004, the thrust of which was to obligate banks to increase their capital base to NGN25 billion, enter into consolidation arrangements with each other in other to meet the capitalization requirement or re-apply for licenses to operate as micro finance banks in the absence of meeting the capitalization requirement. See JE Inmhanlahimi and EJ Idolor, 'Poverty Alleviation through Micro Financing: Prospects and Challenges' (2010) 23 Journal of Financial Management and Analysis, 66

54 See e.g. PN Eluhaiwe, 'Poverty Alleviation Through Micro Financing: The Case of India' (2005) CBN Bullion, Vol 30, No 3, 15 cited in Inmhanlahimi and Idolor, 'Poverty Alleviation' (ibid), 2 wherein the authors defined micro-financing as ''the provision of thrift, credit and other financial

reason for the failures of previous schemes, is that it fails to indicate the reasons for which the loans are provided. With most indigent recipients faced with multiple financial problems, the possibility of diverting funds received through micro financing to satisfy other personal needs is high, thus resulting in default in repayment.

It is contended that the objective of micro financing should solely be the enhancement of small business enterprises. Accordingly, the following alternative definition of micro financing resonates with this writer:

> The financial and other ancillary resources or services (such as savings, money transfers and financial advice) offered to the borrower, sometimes without asset collateral. It is aimed at empowering him/ her, or the group, to undertake an enterprise with a view to achieving optimum success for an improved standard of living and to be able to contribute to the development or smooth organisation of the community.[55]

This definition clearly involves the provision of a bouquet of financial offerings to micro enterprises, including savings and financial advisory services, presumably to inculcate in them the need for the proactive financial and business management of their resources, resulting in positive performances of their business interests. However, until micro financing is viewed in this light and support schemes are implemented accordingly, the possibility of various schemes achieving the objective of supporting the growth of small business enterprises, appears remote.

A related but different problem with micro financing is that historically, in an attempt to encourage participation in various schemes, the Nigerian government had typically lowered the entry requirements for operators of micro financing institutions in comparison

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services and productions in very small amounts to the poor to enable them raise their income levels and improve their standard of living.'

55 See JE Inmhanlahimi and EJ Idolor, 'Poverty Alleviation' (ibid n 53), 67

to for instance, entry into commercial banking.[56] This enabled promoters, unprepared for the challenges of flexible lending, entry into the business of micro financing. With default in repayment of micro finance loans high, many of the micro financing institutions were unable to sustain their businesses, thus closing this window of opportunity to MSMEs.

Apart from micro financing, another avenue through which MSMEs could obtain unsecured loans is money lending.[57] Under Nigerian law, the definition of a money lender is wide, encompassing every person whose business is that of moneylending and any person who lends money on interest or who lends a sum of money in consideration of a larger sum being repaid.[58] From this wide definition emerges the first concern associated with money lending, which akin to micro financing, permits unserious operators entry into this business.[59]

The regulation of the activities of money lenders in Nigeria is recent with the Moneylenders Ordinance of 1927 the first enactment on the subject. Prior to the enactment of this law, the activities of money lenders was prone to abuses as users, who were primarily persons without access to the formal financial sector were often forced to accept oppressive lending terms.[60] However, with the regulation of the activities of money

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[56] For example see the recent history of micro financing as an alternative form of business for failed banks (ibid n 53)

[57] For a comprehensive discussion of the law regulating money lending in Nigeria. See E.E. Eja, 'Money Lending Law and Regulation of Consumer Credit in Nigeria' available at <https://www.ajol.info/index.php/naujilj/article/viewFile/82404/72558> (assessed on 4th June 2018)

[58] Eboni Finance Ltd v Wole-Ojo Technical Services Ltd & Ors [1996] 7 NWLR (pt 461), 349; See also Veritas Insurance Co. Ltd v Citi Trust Inv. Ltd [1993] 3 NWLR (pt 281) 349

[59] In reality, with a population in excess of 170 million people, a significant percentage of which is poor, Nigeria has a huge market for consumer lending; perhaps the largest of any developing country.

[60] See G Ezejiofor, et al, *Nigerian Business Law* (London Sweet & Maxwell, 1982), 145 where the

lenders[61] and the increased protection afforded patrons of money lending, a corresponding need also arose to protect money lenders from exposure in respect of unsecured loans offered to the public. This resulted in the statutory imposition of high interest rates on unsecured loans,[62] which, ironically has now become a significant stumbling block to the use of this means of business finance in Nigeria.

2.3.3 Secured Loans

This section examines the law governing various secured transactions under Nigerian law. In view of the contention that most MSMEs in Nigeria are unable to provide realty as collateral owing to their impecuniosity, this evaluation is limited to secured transactions over personal or moveable property. Accordingly, the types of consensual security examined in this section are:

i) The pledge;

ii) The mortgage of personal property (bill of sale);

iii) The charge.[63]

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learned authors opined with reference to the now repealed Money Lenders Act, Cap 124, Laws of the Federation of Nigeria 1958 that 'the object of the enactment is to protect impecunious, and sometimes foolish individuals who resort to callous and heartless moneylenders for accommodation in order to solve their financial problems'.

[61] Money lending is today regulated by various state laws which contain far reaching provisions on the activities of money lenders in Nigeria. See eg Money Lenders Law, Cap M7, Laws of Cross River State of Nigeria 2004 (MLL)

[62] For example, some state laws regulating money lending in Nigeria allow money lenders to charge as high as 40% interest per annum on unsecured loans while allowing as low as 15% on secured loans. See eg s 1(1) of the MLL (ibid). In contrast, commercial banks, on average, charge between 18-22% interest on personal unsecured loans with the right to increase such rates by giving to their customers

[63] Although resembling security devices, liens are really only rights conferred by law upon persons to retain possession of, or to have a charge upon the real or personal property of another, until certain demands are satisfied. The right is a mere passive right of retention with no corresponding right to sell or deal with the property and as such does not amount to a security right. See Mulliner v Florence

A pledge is a common law security interest created by delivery of possession of tangible property to the pledgee as security for the payment of a debt or performance of another obligation.[64]Although various states in Nigeria have Pawnbrokers' laws, these laws have become mainly redundant as they only regulate loans by pawnbrokers of sums not exceeding NGN40 (less than 10 pence), rather insignificant sums considering the current scale of most business transactions.[65]

Pledges confer on pledgees a number of rights including the right to possession,[66] sale of the property on default,[67] and to sub-pledge without destroying the pledge.[68] They however do not transfer title or ownership of the pledged property to the pledgee during the subsistence of the pledge.[69] A learned commentator has observed that in view of the challenges involved today in pledging physical assets especially when huge commercial loans are involved, pledges are currently more often used in two main ways in the commercial context, namely where documents of title are pledged in trade finance to give security over goods to which they relate and where negotiable instruments are pledged as security for deposits.[70] It must however be pointed out that that in view of the limited scale

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(1878) 3 QBD 484. See also W Clarke (ed.), *Fisher and Lightwood's Law of Mortgages* (LexisNexis 2014), 6

64 Cogg v Bernard (1703) 2 LdRaym 909, per Sir John Holt at 913; See also Ihunwo v Ihunwo & Ors [2013] 8 NWLR (pt 1357) 550

65 See e.g. Pawnbrokers Law, Cap 87, Law of the Western Region of Nigeria, s. 7(1)

66 H. Beale et al, *The Law of Security and Title-Based Financing* (OUP, 2nd ed, 2012), 563

67 ibid

68 Donald v Suckling (1866) LR 1 QB 585

69 E McKendrick, *Goode on Commercial Law* (5th ed, Penguin Books 2016), 687

70 J Naughton, 'Commentary on Commercial Pledges' in M Gillooly, *Securities over Personalty* (1994), 154

of transactions carried out by most MSMEs and especially micro enterprises, such documentaries are rarely ever used by these entities in Nigeria. Rather, creditors tend to seek constructive possession of the pledgor's moveable assets such as farm produce and farming equipment kept in e.g. barns with access to the barn controlled by the pledgee. This makes pledges a veritable type of financing device for the smaller business enterprises.

It is noteworthy that the requirement for the transfer of possession of the asset by the pledgor to the pledgee nevertheless immobilizes the physical use to which the pledgor can place such assets while the secured transaction subsists.[71] Bearing in mind that most MSMEs have limited resources, the curtailment of their assets or any of them as collateral constitutes a significant disadvantage as it robs them of the opportunity of gaining optimal value on such asset. The disadvantage of immobilization is however ameliorated by the pledgor's retention of ownership of the curtailed asset, which on the other hand constitutes a disincentive to the pledgee, who as a result is unable to sell the asset without the pledgor's consent upon the pledgor's default in repayment.[72]

A mortgage of personal property can be created in writing (deed or otherwise) or by parole.[73] Where created in writing however, it is subject to the provisions of the Bills of Sales Act.[74] A bill of sale is, in general, an instrument in writing by which a person transfers

[71] The common law attached great significance to possession because the denial of the right of possession was viewed as the denial of an indicium of ownership which made subsequent transferability difficult for which reason it was widely viewed as perhaps the most effective form of security interest under English law. See E. McKendrick, *Commercial Law* (ibid n 69), 633

[72] Ahmed El-Hag v GKJ Amachree (1962) LLR 10

[73] Reeves v Capper (1838) Bing NC 136

[74] Bills of Sales Act 1878, s 4; Bills of sale are governed by the provisions of the English Bills of Sales Acts of 1878 and 1882 as amended by the Bills of Sales Acts of 1890 and 1891, all of which are statutes of general application in Nigeria. See ibid chap 1 n 3.

to another the property in goods or chattels or a document given with respect to the transfer of goods or chattels in cases where possession is not intended to be given.[75] The delivery of possession of the goods or chattels is therefore not essential, and is in fact prohibited.[76] However, with respect to the use of bills of sale as security for loans, the 1882 Act applies as it specifically deals with security bills of sale i.e. bills which transfers property only as security for debt or the performance of some obligations.[77]

By virtue of s. 9 of the 1882 Act, a security bill of sale is void unless made in accordance with the form specified in the Schedule to the Act. With regard to form, s. 4 of the same Act provides for every bill of sale to contain an inventory of the chattels comprised in it in order for such bill to be effective, otherwise such bills is void, save against the grantor. The implication of ss. 4 and 9 therefore is that failure to comply with the statutory form by including an inventory renders the bill void against third parties, with the grantee losing priority against other competing parties.

Further, the requirement for the description of the chattels in the inventory has been interpreted to mean that the chattels are to be specifically described as for business purposes with regard to the particular subject matter; and in a bill of sale of stock-in-trade, it has been held that a mere reference to the stock-in-trade at a particular place is not specific and cannot amount to an inventory.[78] This requirement of specificity implies that bills of sale

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75 J.O Orojo, *Nigerian Commercial Law and Practice* (London Sweet & Maxwell, 1983) vol 1, para 11.42

76 Mills v Charlesworth (1890) 25 QBD 421

77 Bills of Sales Act 1882, (Part III, ss 7-11)

78 Ihekaire v Taylor (1931) 10 NLR 106

cannot be given in respect of after-acquired property.[79]Accordingly, while creditors may seek to avoid the cumbersome requirement for the description of the chattel on bills of sales, the implication of failing to include them is critical in terms of loss of priority. The above elements of bills of sales disincentives both parties to the secured transactions and makes bills of sales as forms of security devices, less desirable than other security devices. Further, as bills of sale are forms of mortgages, they require the transfer of title with the unwanted consequence that the grantee is unfettered in the ability to sell the chattel upon default in the repayment obligation, a situation that most MSMEs find rather uncomfortable.

The term 'charge' is often used interchangeably with mortgages, and with regard to companies, such usage may be justified in view of s. 197(11) of CAMA which, with reference to the registration of charges provides that a charge includes a mortgage. However, differences exist between a charge and a mortgage, the classic differentiation provided in Swiss Bank Corporation v Lloyds Bank Ltd.[80] In that case, Buckley LJ stated that an equitable mortgage arises when the legal owner of the property enters into some contract, though insufficient to confer a legal estate nevertheless demonstrates a binding intention to create a security in favour of the mortgagee. On the other hand, a charge is created when property is specially appropriated to the discharge of a debt or some other obligation and confers on the chargee a right of realisation by judicial process. Further

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[79] ACB Ltd v Oladapo (1951) 12 WACA 285; Further s. 10 of the 1878 Act which also applies to security bills of sales requires every bill of sale to be registered within 7 days of its creation by delivery to the Registrar of bills the following documents: i) the bill together with every schedule or annexure; ii) an affidavit of the time of such bill of sale being made or given, and of its due execution and attestation and a description of the residence and occupation of the person making or giving the bill of sale

[80] (1982) AC 584

differences are that while mortgages can create both legal and equitable interests in the asset, charges are always equitable interests, the implication of which is that, unlike mortgagees, chargees cannot exercise the right of foreclosure or sale.[81] However, mortgages created by companies governed by CAMA, are like company charges equitable pursuant to the provision of s. 178 of CAMA.

In Nigeria, charges are either fixed or floating[82] with the former closely resembling pledges and mortgages because they limit the chargor's right to deal in the assets during the subsistence of the charge. However, as this thesis is more concerned with floating charges because of their potential benefits to MSMEs[83] and considering that in Nigeria, such charges can only be granted by companies, the inability of most MSMEs which are not companies to grant these devices constitutes the crux of the discussion in Chapter three of this thesis.

a) Vendor Credit

Vendor credit arises under any situation in which a seller of goods agrees to part with possession of such goods to the buyer prior to the complete liquidation of the sale price. In most instances, until the sale price is fully made, the seller continues to have some interest, functionally equivalent to a security interest in the goods sold.[84]

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81 See s. 178(1)(a) of CAMA which empowers a floating chargee to enter into possession on crystallisation of the charge but does not proceed further to entitle the chargee to sell. This issue is examined in greater detail in Chapter three

82 CAMA, s 178

83 See ibid para. 2.2

84 A Hicks, *Nigerian Law of Hire Purchase* (ABU Press, 1977), 1

Vendor credit generally arises in one of four main ways, namely, as credit sales, conditional sales, hire purchase and finance lease transactions. Under a credit sale, the seller parts with both the possession and title to the goods but agrees to accept instalment payments until the total cost is liquidated. As the seller retains no further interest in the property, credit sales essentially amount to unsecured credit with the seller's right limited to a personal action against the buyer in the event of the buyer's default in repayment. [85]

In conditional sales, although the seller parts with possession, he retains ownership of the goods (e.g. by virtue of the insertion of a title retention clause in the agreement) until the complete liquidation of the purchase price. The origin of the conditional sale may be traced to the definition of contracts of sale under the English Sales of Goods Act of 1893 (SGA).[86] S. 1(1) of the Act defines a contract of sale as 'a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a money consideration called the price. S. 1(3) further provides that where under a contract of sale, the property in the goods is transferred from the seller to the buyer, the contract is called a sale but where the transfer of the property in the goods is to occur at a future time or subject to some conditions thereafter to be fulfilled the contract is called an agreement to sell. Consequently, the difference between a sale and an agreement to sell is mirrored by that between a sale and a conditional sale, with the latter amounting to an agreement to sell.[87]

A critical reason for ascertaining the passing of property lies in the fact that it determines whether the buyer can pass title in the goods received to a third party. In the

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[85] Ajagbe v Idowu [2012] 1 BFLR 102

[86] This enactment is also a statute of general application in Nigeria. (See ibid ch 1 n 3).

[87] See Bello v Adefowope [1974] NCLR 153

context of MSMEs and their desire of utilising assets sold subject to vendor credit as inventory before liquidating the purchase price, sales are preferable in view of the principle of *nemo dat quod non habet*. Sellers would, conversely prefer agreements to sell as they preclude buyers from selling precisely for the same reason. However, where under an agreement to sell, the goods are delivered to the buyer, a disposition by the buyer to a third party may be covered by s. 25(2) of the Sales of Goods Act of 1893, subject to fulfilling the conditions indicated in the section irrespective of the existence of a title retention clause.

Hire purchase transactions developed in response to the potential difficulty that sellers could face especially under a conditional sale, when despite the existence of a title retention clause, the buyer could still pass title to third parties.[88] In distinguishing a contract of sale (i.e. both an agreement to sell and sale) from a hire purchase, Atiyah and Adams have opined as follows:

> A sale is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer; that is to say, as soon as the contract is made the ultimate destination of the goods is determined even though the property is not to pass for some considerable time; for example, until all the instalments of the price have been paid. A contract of hire purchase, on the other hand, is a bailment of the goods coupled with an option to purchase them, which may or may not be exercised. Only if and when the option is exercised will there be a contract of sale.[89]

Hire purchase transactions hold limited value for MSMEs because assets subject to them cannot be used as inventory. Although both forms of credit may be used in acquiring

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88 ibid

89 C Twigg-Flesner et al, *Atiyah and Adam's Sale of Goods* (13th ed, Pearson 2016),14-15; See also Helby v Matthews [1895] AC 471

equipment, except where such equipment directly results in income e.g. through sub-hiring, sustaining the instalment payments from their meagre earnings could present difficulties for MSMEs. Further, under a hire purchase agreement, it is always open to the owner of the asset to repossess it on failure of the hirer to pay the instalments, whereas the seller's remedy under an outright sale is an action to recover the loan. This feature constitutes a serious disincentive to MSMEs as this implies that assets subject to hire purchase can only be used for limited purposes and certainly not as inventory or items that can be disposed of for profit.[90]

A finance lease is a form of bailment in which the lessor is the bailor retaining title to the goods at all times. However, the critical difference between the hire purchase and finance lease is that unlike the hire purchase under which the parties' intention is for title to pass upon the complete payment of all instalments where the option to purchase is exercised, the parties under a finance lease never intend for the passing of title; the hirer of the goods hires same for the entire useful life of it.[91] The very nature of finance leases do not allow property subject to them to be used as inventory by MSMEs.[92] However, there ought to be some assurance that the lessee would be capable of utilising the lease to ensure the complete amortisation of the assets, an assurance most MSMEs simply cannot provide.[93]

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[90] Ajagbe v Idowu (ibid n 85)

[91] H. Beale, *The Law of Security* (ibid n 66), 261

[92] In fact most finance leases usually contain an express undertaking by the lessee to retain possession and not dispose of or otherwise encumber the goods with any interest adverse to the lessor financier's title.

[93] See eg s 44 of the Equipment Leasing Act, 2015 wherein "Finance lease" is defined as a lease

Based on the above characteristics of the various types of vendor credit, only contracts of sale enable the acquisition of assets for use as inventory. While limitations on their use may exist e.g. when they contain a title retention clause, an agreement to sell or conditional sale nevertheless amounts to an executory contract, which some learned commentators have observed constitutes ‘a contract pure and simple’.[94] It therefore entitles the buyer to an action for specific performance against the seller to perfect the seller’s part of the transaction, which provides or should provide some comfort to MSMEs.

2.4. Summary

The classification of MSMEs under SMEDAN’s policy while mundane depicts the degree of MSMEs’ impecuniosity, a situation exacerbated by a consistently waning legal tender. Meanwhile, private institutional creditors appear intent on ignoring government policy by redefining what constitutes MSMEs in order to reduce their credit risk exposure. For example, GT Bank’s definition of SMEs as entities with assets of up to NGN500 million,[95] clearly disconnects from SMEDAN’s definition but reveals a determination to avoid the very small entities, which ironically require the most financing.

While finance is seen worldwide as a major problem for MSMEs Nigerian MSMEs being no exception, it may perhaps be more ideal following government’s commendable effort thus far to reassess the true root causes of MSME finance problems. As was

involving rental - payment over an obligatory period sufficient in total to amortise the capital outlay of the lessor and also give the lessor some benefit.

94 Lord Mackay of Clashfern, *Halsbury’s Laws of England* (5thed, LexisNexis 2012), vol 91, para. 29

95 ibid n 22

suggested earlier on, the availability of funds cannot prima facie be a problem under a system that has churned out over 15 major schemes to support MSMEs in the last few decades.[96] The true problem to be tackled is whether MSMEs have the wherewithal to meet the terms on which funding can be assessed, which, amidst intermittent economic recession, can only become more stringent.

Finally, for several reasons make most of the current financing options are unsuitable either for MSMEs or for creditors. The highly regulated nature of the Nigerian credit system and the likelihood of default in loan repayment by MSMEs makes it impossible for most MSMEs to meet the onerous conditions set by institutional creditors for unsecured loans. The alternative medium of unsecured loans i.e. money lending and micro financing have proven unreliable over the years because of the lack of sustainability displayed by operators. It is however with regard to secured lending and vendor credit that the incongruous nature of the unadulterated received common law prior to reform is best appreciated. The lack of functionality of the English common law results in similar transactions resulting in different outcomes purely because of divergences in description; this situation often proves prejudicial to creditors' in recouping loans and to borrowers in accessing them. Thus, while most forms of vendor credit for example play similar roles, contracts of sale, hire purchase and finance leases all produce significantly different outcomes.

[96] ibid n 23

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COMPANY CHARGES AND THE IMPACT OF THE SECURED TRANSACTIONS IN MOVEABLE ASSETS ACT

3.0. Overview

This chapter examines the impact of the reforms introduced by the STMA and is divided into four main sections. The first section evaluates the reform objectives behind the enactment of the STMA and whether, and to what extent such objectives align with global reform objectives. The second section assesses the impact of the STMA on the problems associated with the laws applicable to credit transactions as they affect MSMEs' access to credit examined in chapter two. The third section evaluates the implication of s. 2(3) of the Act which empowers companies to utilise charges as security devices under CAMA and the final section examines some miscellaneous provisions in the Act that could hinder the realisation of its objectives.

In evaluating the STMA's alignment with global requirements, UNCITRAL's Legislative Guide[1] and Model Law[2] are used as primary sources of comparison with the Australian Personal Property Security Act 2009 (APPSA) also sparingly used.

Finally, the categorisations, peculiarities and challenges contained in the National Policy on MSMEs discussed in Chapter two remain relevant here in the absence of alternative provisions under the STMA.

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[1] ibid ch 1 n 11.

[2] ibid ch 1 n 12.

3.1. The Nigerian Reform Objectives

The STMA's apparent adoption of a unitary system of security interest presupposes a legislative intent to adopt the model recommended by UNCITRAL.[3] Consequently, this section seeks to evaluate the extent to which the objectives of the STMA align with the objectives underscoring UNCITRAL's recommendations for reform being mindful that the degree of alignment could impact the extent to which the STMA achieves its objective of reforming the inadequate common law system and in meeting UNCITRAL's expectations of reform in states' legislation.

While UNCITRAL's recommendation is guided by the overarching objective of simplifying secured transactions for the benefit of all potential borrowers, the STMA appears focused on achieving a similar objective, albeit with specific reference to MSMEs.[4] There is no gainsaying the fact that in view of their size and peculiar constraints, MSMEs and particularly micro enterprises deserve special consideration in addressing critical factors affecting their subsistence such as their funding needs. They nevertheless remain an integral part of the overall credit system yearning for reform. Consequently, isolating MSMEs for special treatment in implementing a novel regime such as that contained in the STMA may be impracticable. Moreover, as indigenous businesses that have significant funding constraints are predominantly MSMEs,[5] one can argue that the real intent of

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[3] This model, pioneered by Article 9 of the Uniform Commercial Code of the US has been adopted by Canada, New Zealand and Australia amongst others in reforming their personal property security laws.

[4] However, this objective is not backed by specific or special provisions solely applicable to MSMEs. The Act fails to mention MSMEs anywhere other than in s 1 which contains its objectives.

[5] Based on the National Policy on MSMEs, approximately one third of Nigerians earn their livelihood through MSMEs, with an even greater number of Nigerians dependants on these income earners. See ibid SMEDAN, 'National Policy' ch 1 n 26, para. 1.4.1

liberalising the credit regime through the enactment of the STMA is to leverage such business entities' access to funding. In view of MSMEs' peculiar resource constraints, one could further argue that the more liberal a reform is in facilitating secured transactions, and therefore credit to borrowers, the more likely the suitability of such reform for MSMEs.

The objectives behind UNCITRAL's involvement in secured transactions are the simplification of the laws of secured transactions, harmonizing complex and cumbersome systems in various states that tend to discourage parties from secured transactions with simplified and possibly, unitary systems of security interests that make secured transactions more attractive, easily facilitating credit to potential borrowers.[6]

In contrast, the objectives of reforming Nigeria's secured transactions laws can be gleaned from evaluating the objectives of the STMA and the CBN Regulation.[7] According to its preamble, the Regulation's objective is to improve access to finance for MSMEs while maintaining a strong prudent lending policy to promote sound financial system in Nigeria. On the other hand, s. 1 of the STMA provides the following list of objectives: a) To enhance financial inclusion in Nigeria, b) To stimulate responsible lending to micro, small and medium enterprises, c) To facilitate access to credit secured with movable assets, d) To facilitate perfection of security interests in movable assets, e) To facilitate realisation of security in movable assets; and f) To establish a collateral registry and provide for its operations.

The following deductions can be drawn from a dispassionate interpretation of both sets of objectives: First, it is clear that the principal focus of both enactments is to stimulate

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6 UNCITRAL *Legislative Guide* (ibid chap 1 n 11), 1

7 ibid ch 1 n 16

funding to MSMEs. Second, other than stimulating funding, the enactments also seek to ensure that lending is done responsibly and prudently, with a view to ensuring a sound financial system. It is suggested that this is an indirect message to stakeholders in the financial services sector that despite the need to stimulate the growth of the economy through lending, there is a responsibility to ensure that the economy is protected from abuse by avoiding poor credit transactions.[8] Third, whilst no apparent contradiction exists between both enactments, there appears to be a more deliberate legislative effort to align the STMA with global reform than was done with the Regulation. This is apparent from the robustness of its additional objectives i.e. items (c) to (f) of s. 1 above, which are all elements of the global reform objectives.[9] Further, unlike the Regulation that completely excludes company charges[10] the STMA reverses this total exclusion, thereby affording companies the opportunity of also registering their charge transactions under the STMA.[11]

Interestingly, the STMA introduces these novelties while retaining the reforms introduced by the Regulation such as simplified rules for perfecting security interests and the notice filing system;[12] it also retains the simple priority rules introduced by the Regulation which avoid the doctrine of the bona fide purchaser for value and its nebulous

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[8] The responsibility of safeguarding the economy is primarily that of the Central Bank of Nigeria pursuant to its enabling enactment.

[9] See UNCITRAL's *Legislative Guide* (ibid ch 1 n 11), 22 for a comprehensive list of UNCITRAL's objectives

[10] See s 3(3) of the Regulation

[11] See STMA, s 2(3); this is discussed in detail later in this chapter. This point is the critical point of divergence between the STMA and the Regulation.

[12] This involves the registration of a financing statement similar to the procedure adopted by UNCITRAL Model Law. Such registration does not require filing the security agreements but only of notice of its existence, thus eliminating the cumbersomeness associated with document filing under common law systems. See STMA, ss 8 and 12

exceptions, and the creation of a collateral registry to be interfaced with other similar existing registries amongst others.[13]

It can therefore be safely asserted that the imperatives for the enactment of the STMA substantially align with the objectives for global reform as viewed from the objectives of UNCITRAL's recommendations. The inclusion of an objective of stimulating 'responsible' lending contained in s. 1(b) is however anomalous as it surreptitiously extends the STMA's objectives beyond the boundaries of the global objectives by introducing into an enactment intended to stimulate flexible lending, the need for shrewd regulation. This contention is buttressed by s. 10 of the Act which imposes the responsibility for supervising the collateral registry on the Central Bank of Nigeria (CBN), a financial regulatory agency. While s. 10(1) provides for the establishment of a collateral registry 'in the CBN'[14], s. 10(2) empowers the CBN Governor to appoint the Registrar and staff of the registry as considered necessary for the attainment of the objectives of the Act.[15] With the phrase used in s. 10(1) being 'in the CBN', it is suggested that the objective of the Act is to make the registry an organ or department of the CBN.[16] Considering the significance of publication in the perfection of security interests and determining their priority positions against competing interests, the collateral registry is arguably the single

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13 See STMA, ss 1, 2(1)(c) and 10

14 Emphasis mine

15 The registrar has the responsibility of supervising and administering the operations of the registry. See STMA, s. 10(3)

16 Further responsibilities assigned to the CBN under the STMA include the issuance of guidelines setting out modalities to regulate the Mediation and Dispute Resolution Panel established as the first resource for mediation and settlement over civil disputes between parties to secured transactions. See STMA, s 41

most significant apparatus for the implementation of the Act. Consequently, the content, focus and overall management of the registry are critical to the realisation of the objectives of the Act. Its supervision should therefore have been assigned to either SMEDAN[17] or the CAC, which already performs similar role in respect of company charges[18]

While obviously questionable, the CBN's suitability to perform the responsibilities imposed under s. 10 of the STMA may be further evaluated by examining its principal statutory functions to ascertain whether its s. 10 responsibilities align with them. These responsibilities are contained in the Banks and Other Financial Institutions Act (BOFIA)[19] and the Central Bank of Nigeria Act 2007 (CBNA). While s. 1 of BOFIA confers extensive regulatory powers on the CBN over financial institutions,[20] the CBNA however confers on the CBN its core functions. These are: (a) To ensure monetary and price stability; (b) To issue legal tender currency in Nigeria; (c) To maintain the country's external reserves to safeguard the international value of the legal tender currency; (d) To promote a sound

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17 SMEDAN possesses vast statutory powers over MSMEs, some of which could justify assigning to it responsibility for managing the collateral registry. The obvious argument against SMEDAN managing this responsibility imposed on the CBN vide s. 10 of the STMA however is that the STMA is not an enactment solely for MSMEs as it applies to all security interests in movable assets. See SMEDAN Act (ibid ch 1 n 26), ss 2, 8, 9 and 27 on the scope of the Act and SMEDAN's extensive responsibilities.

18 See CAMA, s. 7(1). Moreover, the planned interface of registries makes it imperative to place the overall responsibility for managing the collateral registry and the teething problems arising from such interface in the hands of an agency already adept at performing such responsibility. This problem could be exacerbated by the potential conflicting situations that may arise from agencies acting at cross purposes. The STMA contains no provision precluding other agencies, especially SMEDAN, from performing functions akin to those assigned to the CBN by s 10 of the Act. It is suggested that at the very least, problems relating to data management strategy and administration from different agencies guided by significantly different objectives could mar the objectives of the Act.

19 Cap B3 Laws of the Federation of Nigeria 2004

20 These powers include the powers to grant, vary and revoke banking licences, approve the operation of foreign banks amongst others. See generally BOFIA, ss 3, 5 and 8, although other specific powers regarding financial institutions are interspersed throughout the Act.

financial system in Nigeria; and (e) To act as banker and provide economic and financial advice to the Federal Government.[21]

Certain pertinent issues in respect of these functions are immediately worth highlighting. First, despite its extensive principal responsibilities, the power of the CBN Governor to make rules and regulations is derived from s. 55(1) of BOFIA as the CBNA's equivalent provision is overly restrictive.[22] S. 55(1) however empowers the CBN Governor to 'make regulations, published in the Gazette, to give full effect to the objects and objectives of this Act.' It is difficult to rationalise how this section can justify the making of a far reaching enactment like Regulation 1 since the regulation of MSMEs is not an object or objective of BOFIA.[23] The CBN's enactment of Regulation 1 therefore clearly violates s. 55(1) of BOFIA and renders its overall involvement in the implementation of policies affecting MSMEs questionable, notwithstanding the provisions of s. 10 of the STMA.

The above makes it imperative to examine the legal exercise of the powers of a statutory agency. While it is trite law that a public authority may not act outside its statutory powers otherwise its actions could be deemed ultra vires,[24] it is however also well-established that once statutorily prescribed, such powers cannot be exercised in any other

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21 CBNA, s 2

22 The CBNA provision i.e. s. 51 empowers the Board (and not the Governor) to make and alter rules and regulations for the good order and management of the CBN. It is submitted that this clearly refers to rules of internal management of the CBN that cannot justify the making of a far reaching enactment like Regulation 1.

23 It should be noted that SMEDAN is an agency of equivalent status to the CBN both being statutory corporations under the law. Cf. s 1(2) of the SMEDAN Act which establishes and defines its status with the corresponding provision under the CBNA, ss 1(2) and (3)

24 Sani Dododo v EFCC [2013] 1 NWLR (Pt. 1336) 468

way and the courts are precluded from interfering with it.[25] It may therefore be argued that despite the apparent misalignment of the CBN's STMA responsibility with those of its enabling statute, the STMA responsibilities remain intra vires being functions or responsibilities that are statutorily imposed. However, some legal commentators have expressed the following views on the propriety of challenging intra vires acts:

> into the bed of Procrustes, accordingly must be fitted not only the more obvious cases of inconsistency with statute, such as failure to follow expressly prescribed procedure, irregular delegation, and breach of jurisdictional condition: but also the more sophisticated types of malpractice, such as unreasonableness, irrelevant consideration, improper motives, breach of natural justice and more recently, mere error of law... [26]

It is therefore contended that despite statutory backing for the CBN's role under the STMA, the propriety of the responsibilities assigned are still legally challengeable on the grounds of reasonability or lack of it. It is further contended that the provisions of s. 10 of the STMA on the CBN's powers fall within the category of intra vires actions that should be so challenged.

An alternative to the above argument, the question of whether the responsibilities imposed by s. 10 of the STMA on the CBN aligns with its core statutory functions may be considered. It is suggested that the absence of alignment could confirm the contention that s. 10 must be viewed as an unreasonable provision which at best amounts to some form of legislative error. In assessing this issue, two potential theories may be considered. First, can the CBN's STMA responsibilities be justified by reference to its responsibility of promoting a sound financial system, being perhaps the broadest of its principal

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[25] ibid

[26] See H Wade and C Forsythe, *Administrative Law* (11th ed., OUP 2014), 27.

responsibilities under s. 2 of the CBNA? In the absence of suitable local guidance on what constitutes a sound financial system and how that quality of soundness is attained,[27] resort can be made to the International Monetary Fund (IMF), which provides some insight on this issue. According to the IMF, controls of financial institutions is necessary in order to avert problems in financial systems that disrupt financial intermediation and undermine the effectiveness of monetary policy, exacerbate economic downturns, trigger capital flight and exchange rate pressures, and create large fiscal costs related to rescuing troubled financial institutions.[28] Consequently, the resilience of financial systems is tied to appropriate regulation and supervision which the IMF describes as prerequisites for both domestic and international economic and financial stability.[29] The promotion of a sound financial system therefore necessarily involves setting rigorous regulatory and prudential parameters for financial institutions, a function that seems antithetical to the flexibility required to manage a regime that promotes liberal lending.

The second theory is whether the CBN's STMA responsibilities fall within its principal responsibility of providing economic and financial advice to the government since the growth of MSMEs is typically viewed as a means of achieving economic development in any country. To the extent that such responsibilities include significant

[27] The CBN classifies financial stability as a supervisory responsibility driven by the Financial Policy and Regulation Department with the mandate of developing and implementing policies and regulations aimed at ensuring financial system stability. See CBN, 'Financial Stability' available at <www.cbn.gov.nd/financialstability> (assessed on 18 January 2018)

[28] International Monetary Fund, 'Factsheet on Financial System Soundness' available at <http://www.imf.org/en/About/Factsheets/Financial-System-Soundness> (assessed on 18 December 2017)

[29] ibid

implementation activities such as managing the collateral registry system, it is argued that such activities clearly exceed the scope of an advisory function.

Consequently, the CBN's extensive responsibilities in the implementation of the STMA cannot be justified by reference to its statutory functions.[30]

3.2. The STMA and the Challenges in the Existing Legal Framework

The impact of the STMA in addressing the challenges discussed in Chapter two is examined in this section by reference to the following:

i) Business Platforms

ii) Financing Options

3.2.1. Business Platforms

The main point made in Chapter two regarding business platforms was that owing to their prevalent informality, most MSMEs and particularly micro enterprises were unable to use floating charges as security for loans thus precluding them from benefitting from the benefits associated with these devices.[31]

The STMA applies to all security interests in movable assets.[32] It defines a security interest as 'a property right in collateral that is created by agreement and secures payment or performance of an obligation, regardless of whether the parties have denominated it as a security interest but it does not include a personal right against a guarantor or other person

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[30] Chapter 4 of this thesis contains recommendations on how the anomaly of assigning functions to the CBN under the STMA can be resolved.

[31] See paragraph 2.2 of this thesis

[32] STMA, s. 2(1)(a)

liable for the performance of the secured obligation'.[33] It thus appears to encompass all forms of security interests including floating charges and other interests, which though not recognised under the common law as formal security interests, nevertheless functionally amount to security interests.

By virtue of s. 2(1)(b), the STMA applies to persons who are creditors, borrowers or grantors under the Act. While the Act does not define the term 'persons', it nevertheless defines its various constituents; a creditor is defined as the person granting a facility on the back of a security interest created under the Act and a borrower, as a person to whom credit is extended with a financial obligation to repay same under a security agreement.[34] While there is nothing in both definitions imposing any special eligibility requirement, the definition of the term 'grantor' is however interesting and one worth further examining. 'Grantor' is defined as 'a person that has rights in the collateral, and includes a grantor of any type of security interest in the form of a charge, chattel mortgage, pledge or lien in movable property.'[35] This definition clearly affirms the importance of the underlying agreement that guides the creation of the security interest[36] in consonance with UNICITRAL's recommendation.[37]

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[33] STMA, s 63(1)

[34] STMA, s 63(1)

[35] ibid; Emphasis mine.

[36] STMA, s 3(1)

[37] UNCITRAL is further categorical that all steps required for the security right to become effective against the grantor should be taken before the security right is considered created. As it observed in its general remarks, 'In many legal systems, however, in addition to the security agreement, another act is required for a security right to be created such as delivery of possession of the encumbered asset to the secured creditor or registration of a notice of the security right in a general security rights registry.' See UNCITRAL *Legislative Guide* (ibid ch 1 n 11), 68;

In view of the provision of s. 2(3) that gives companies the prerogative to grant charges pursuant to CAMA however, it is contended that specifically listing charges in the definition of 'grantor' unwittingly invokes the technical meaning of charges under CAMA which remain the only legal platform through which charges can be validly created in Nigeria. This introduces the requirement that only companies can grant such devices,[38] thus ironically preserving the eligibility criterion which made it impossible for unincorporated business entities to grant charges under the pre-STMA system; an argument buttressed by UNCITRAL's expectations that all valid steps required for the creation of security devices be observed under their respective originating platforms.[39] Consequently, unincorporated MSMEs, which constitute the bulk of business entities in Nigeria remain ineligible to grant charges.

In conclusion, while the STMA contains no additional eligibility requirement for entering into secured transactions, the effect of s. 2(3) and the listing of 'charges' in the definition of 'grantor' under the Act inadvertently preserves the undesired eligibility criterion under the pre-STMA system.

3.2.2. Financing Options

Any expectations of the STMA, or for that matter, any enactment on secured transactions addressing problems associated with unsecured lending may be unrealistic. Accordingly, the problems associated with sourcing unsecured credit or venture capital discussed in

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[38] See CAMA, s. 166 and 178(1). Similarly, in other for charges to be enforceable against a liquidator or other creditors of a company, such charges must be registered in accordance with s. 197 of CAMA. This invariably imposes an additional responsibility on eligible users distinct from the requirements under the STMA.

[39] See ibid n 37

Chapter two subsists. This section therefore focuses on the impact of the STMA on secured transactions, including vendor credit having regard to the factors militating against their use by MSMEs discussed in Chapter two.

a) Secured Credit

In chapter two, the fundamental disadvantage of a pledge in immobilizing the pledgor's access to the pledged property by requiring a specific asset or assets to be set aside for exclusive use as collateral during the subsistence of the pledge transaction, was highlighted. It was nevertheless also stated that in view of the limited scale of transactions carried out by micro enterprises, creditors remained willing to accept constructive possession of some assets vide pledge transactions, thus ensuring that pledges remain veritable forms of security devices in Nigeria.

The STMA recognizes the right of a secured lender to take possession of the pledged asset; it however curiously provides that such possession does not perfect the security interest.[40] Since repossession of assets in enforcement of a security is separately provided for under the Act,[41] the right of possession under s. 8(2) must be viewed as a right for a purpose other than one provided in realisation or enforcement of a security interest. The obvious alternative explanation for s. 8(2) therefore is that while the Act does not recognise possession as a means of perfecting security interests, the right to take possession is nevertheless given to creditors as a means of overreaching their debtors' right to deal in the assets, apparently as a means of protecting the secured assets.

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[40] STMA, s 8(2)

[41] See STMA, s 40

S. 8(2) therefore has several implications. First, the non-recognition of possession implies that security interests can only be perfected and made effective against third parties under the STMA by registering a financing statement pursuant to s. 8(1) of the Act.[42] This position is clearly at variance with the intent and structure of previous reforms of personal property security laws. UNCITRAL for example recognises as one of its basic approaches to secured transactions, the use of possessory forms of security and considers situations in which the grantor retains physical possession of the encumbered asset as non-possessory security rights (and not pledges) irrespective of how the parties have designated such transactions.[43] Similarly, under UNCITRAL Model law, possession is recognised as an effective means of perfecting a security right and making them effective against third parties.[44]

Second, the denial of possession as a means of perfection conflicts with the freedom to contract, a recurring feature in other similar reforms. Significantly, it renders the effect of s. 3(1) of the Act which provides that a security interest is created by a security agreement between a grantor and creditor rather confusing. Since the validity of pledges have traditionally and inviolately been based on the transfer of possession from the debtor

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42 While the rationale for s 8(2) is unclear, it is suggested that it may have been driven by the desire to formulate uniform rules to guide the perfection of security interests and ancillary issues such as priorities.

43 UNCITRAL, *Legislative Guide* (ibid ch 1 n 11), 43

44 UNCITRAL *Model Law*, (ibid ch 1 n 12), Article 18(2); The APPSA also recognises possession as a means of perfecting and publicising a security interest over assets. APPSA, s 21(2)(b). However, possession here excludes seizure, repossession or constructive possession. (See also s 24(1) in respect of constructive possession). See Re Raymond Darzinskas (1981) 34 OR (3d) 782 (ONSC) decided on a provision in the Ontario PPSA similar to s 24(1) of the APPSA in which the court rejected the secured party's argument and held that constructive possession is not sufficient to perfect a security interest. Similarly, Article 2 of the UNCITRAL Model Law defines "possession" as the actual possession of a tangible asset by a person or its representative, or by an independent person that acknowledges holding it for that person.

to the lender,[45] it is suggested that s. 8(2) renders reliance on a pledge agreement an aberration under the STMA.

Third, s. 8(2) of the STMA creates an extra hurdle to secured creditors. Historically, the protection afforded by the transfer of possession of the asset from the pledgor to the pledgee was twofold: first, it enhanced the safety of the security through the curtailment of the pledgor's rights over it and second, by being in possession, the pledgee was also invariably protected against third parties who could not obtain a superior interest to that afforded by possession. S. 8(2) has apparently removed this dual protection, replacing them with an additional obligation to register a financing statement, without which the lender loses that priority position to third parties who fulfil the registration requirement.

By rendering the transfer of possession redundant, it is contended that the Act has removed the attraction for creditors who take possession as a means of optimizing the safety of the collateral. Such creditors will consequently be discouraged from utilising pledges. It is submitted that this effectively kills the pledge as a form of security transaction under the received English law. The use of the term 'pledge' notwithstanding, the impact of s. 8(2) is that Nigerian jurisprudence has reduced the pledge to a non-possessory form of security contrary to UNCITRAL's intention. With this security feature removed, it is further suggested that, save for extreme situations in which possession becomes necessary in order to safeguard the collateral, the taking of possession imposes further obligations on creditors than it does benefits bearing in mind the legal obligations of a creditor who takes possession of the collateral.[46]

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[45] See Ihunwo v Ihunwo, (ibid ch 2 n 64)

[46] Kendle v Melson (1998) 193 CLR 46; See also White v City of London Brewery (1889) 42 Ch D 237

On the brighter side however, with creditors' envisaged hesitance to take possession, s. 8(2) appears to have removed the disadvantage of immobilizing the pledged assets which debtors usually faced, thereby facilitating their interest in creating such devices while still utilising such assets in their businesses. From this perspective, MSMEs may find s. 8(2) beneficial and the pledge more attractive now than it was prior to the enactment of the STMA.

In chapter two, the factors inhibiting parties to secured transactions from using bills of sale were identified. These included the cumbersome process by which they were created, including the mandatory listing of all secured assets during registration, which thus excluded after-acquired property and the fact that as mortgages, they required the transfer of title from the debtor to the creditor as a basis for their validity. However, with the adoption of the functional approach that encapsulates all transactions functionally equivalent to security interests in consonance with UNCITRAL's recommendations,[47] the above difficulties have apparently been resolved subject to the exception of charges. To recap, the STMA security interest is conferred without the need to transfer possession and or title to the secured asset from the debtor to the creditor, provided a financing statement is registered, by virtue of which the interest is automatically extended to after acquired property[48] and proceeds[49] without further action required by either party. The problem of listing the secured assets associated with bills of sale has therefore apparently been resolved.

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[47] UNCITRAL, *Legislative Guide* (ibid ch 1 n 11), General Recommendation 8

[48] This is by implication of s. 6(1) of the STMA

[49] STMA, s 6(2) and 9(1)

Unlike pledges and mortgages, the validity of charges traditionally never depended on the transfer of possession or title to the assets from the debtor to the creditor, charges were only viewed as encumbrances on the assets created in favour of the chargee by the chargor.[50] This peculiarity makes the charge similar to the unitary security interest created under the STMA. Further, both security devices permit the creation of security rights over after acquired assets, empower debtors to use invariably any type of personal property as collateral for loans and do not require that the collateral be set aside solely for the purpose of the security.[51] However, while most MSMEs remain ineligible to grant charges, the security device introduced by the STMA appears available to MSMEs considering that the STMA does not contain fresh eligibility conditions. The value of the STMA security device would therefore depend on how analogous it is to floating charges. This consideration, discussed later in this chapter, constitutes a significant barometer by which the reformative value of the STMA on the Nigerian law of secured transactions is measured.[52]

b) Vendor Credit

In Chapter two, the legal intricacies of the various types of vendor credit were evaluated and it was concluded that whilst vendor creditors preferred finance leases and hire purchase transactions, debtors however preferred contracts of sales which allowed them, subject to appropriate conditions the right to acquire the assets and dispose of them as inventory without infringing the *nemo dat* principle.

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[50] See National Provincial and Union Bank of England v Charnley [1924] 1 KB 431

[51] Although fixed charges usually contain restrictions on the disposal of the secured assets.

[52] See para 3.3 of this thesis

As highlighted in the lasts section, in keeping with the functionality of the unitary security interest created under the STMA, the transfer of title is no longer necessary as a basis for determining the validity of a security interest. This renders the classifications of transactions under vendor credit prior to the enactment of the STMA, unnecessary. Consequently, irrespective of the form of vendor credit granted by the creditor to the debtor, such grant creates a security interest in favour of the creditor.[53]

One significant feature of global reform initiatives is the recognition of the concept of acquisition financing resulting in acquisition financiers or holders of purchase money security interests (PMSIs) being granted elevated priority status over other security interest holders. This feature requires further elaboration. Acquisition financing embraces the full gamut of transactions that may be deployed to enable buyers acquire tangible assets on credit.[54] The key features of acquisition financing are a) the use of the credit for the specific purpose of enabling the buyer or lessee acquire a tangible asset; b) the rights being claimed or retained relate directly to the asset being acquired; and c) the rights being claimed arise by virtue of an agreement.[55] UNCITRAL recommends that state legislation should classify

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[53] Prior to the enactment of the STMA, finance lease was defined by s 44 of the Equipment Leasing Act of 2015 as a lease involving rental - payment over an obligatory period sufficient in total to amortise the capital outlay of the lessor and also give the lessor some benefit. S 63(1) of the STMA however defines it as a lease which transfers ownership of the asset to the lessee at the end of the lease term. It is contended that while the Act obviously seeks to vary the definition under the Equipment Leasing Act, there is really no need for such variance considering the functionality introduced by the STMA.

[54] UNCITRAL, *Legislative Guide* (ibid ch 1 n 11), 320. UNCITRAL however recommends different treatment for different types of assets e.g. in respect of inventory, it requires that a notice of the existence of an acquisition financing right is registered at the collateral registry. See also Article 38 of UNCITRAL's Model Law (ibid ch 1 n 12).

[55] ibid

as acquisition security rights, all rights in movable assets that secure the payment or other performance of an obligation, and that makes them subject to a common set of rules.[56]

The above approach, termed the unitary approach which avoids ownership considerations appears to be the preferred choice in many jurisdictions, with certain categories of rights (not necessarily only those of the conditional seller or financial lessor as suggested by UNCITRAL) granted the elevated status of PMSIs. The STMA also adopts this approach and defines a PMSI[57] as: a) a right in collateral taken or retained by the seller to secure all or part of its purchase price[58]; b) a right taken by a person who provides credit to enable the grantor to acquire the collateral if such credit is in fact so used; and c) the right of a financial lessor. By virtue of s. 27 of the STMA, a PMSI has priority over a non PMSI in the same collateral created by the same grantor provided the PMSI is perfected when the grantor obtained possession of the collateral. This position appears similar to that under the APPSA although under the APPSA, an additional condition for obtaining such priority is that the financing statement must disclose that the security interest is a PMSI.[59]

The implication of adopting this approach is that it renders the use of title retention clauses, pervasive under the common law system, unnecessary while conferring on holders of a PMSI a priority position over other security interests, as an exception to the first in

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56 ibid

57 STMA, s 63(1)

58 This is equivalent to the right of a conditional seller under a title retention agreement the SGA; See SGA, s 1(2).

59 APPSA, s. 62; this requirement is however Australia specific and has been much criticised.

time rule.[60] This exception[61] is apparently justified by several policy considerations and theories, with perhaps the most convincing being the money theory that postulates that the PMSI holder adds new money to the grantor's enterprise by facilitating the acquisition of new assets for the business. By so doing, it assures the entity of increased profitability which guarantees other creditors of the entity's fulfilment of its obligation to them or at the very least, that they do not become worse off.[62]

In the context of Nigerian MSMEs, it is contended that the elimination of the need to transfer title to secured assets under the various forms of vendor credit will boost MSMEs' use of these forms of security devices as it enables them acquire assets on credit without the fear that the transfer of title could subsequently prove prejudicial. From the vendor's perspective, the elevated status of PMSIs is bound to encourage them to more readily grant vendor credit, their parting with possession of the assets notwithstanding.[63]

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60 See UNCITRAL *Legislative Guide* (ibid ch 1 n 11), 332; In Australia, this position may differ since the financing statement is required to have a provision indicating that the interest is a PMSI. See APPSA, s 153(1).

61 However, the PMSI's super-priority can only be enjoyed by the prior filing of a financing statement otherwise it becomes a subordinated interest like every other security interest. See STMA, s. 27

62 For an account of this theory and its criticism see A Schwartz, 'A Theory of Loan Priorities' (1989) 18 Journal of Legal Studies 209; for a treatment of the alternative situational monopoly theory which postulates that the purpose of the PMSI super-priority rules is to counteract the ordinary secured party's monopoly advantage and to facilitate borrowing from other sources see H Jackson and T Kronman, 'Secured Financing and Priorities Amongst Creditors' (1979) 88 Yale Law Journal 1143

63 This is bolstered by the creditor's right to possess the assets at any time prior to enforcement granted by s. 8(2) of the Act. However, this right could discourage debtors although considering the overall structure of vendor credit, debtors have little to lose by releasing possession of an asset that they have not fully acquired.

3.3 Company Charges and the STMA

S. 39(5) of the STMA which provides that 'the remedies available under this Part are in addition to those available under the Companies and Allied Matters Act, including the right to appoint a receiver' clears any doubt about the implication of s. 2(3) in creating a parallel system of secured transactions. This is because s. 39(5) clearly implies the recognition of the existence of an alternative system of secured transactions under CAMA in which remedies exist that parties whose transactions are governed by the STMA may adopt. Consequently, the existence of both regimes results in the following possibilities in terms of the choice exercisable by secured parties under the Nigerian law of secured transactions:

a) That companies can continue to create charges and mortgages in conformance with CAMA without the STMA impinging or impeding such transactions;
b) That companies can however create charges and mortgages but chose to comply with the STMA by registering a financing statement after registering the charge or mortgage as required by CAMA.
c) That companies may however create other forms of security interests (not being charges) in accordance with the STMA;
d) That non-companies may create security interests[64] in conformance with the STMA

While obviously the super-compliant option for companies as it results in total compliance with the registration requirements of both enactments (i.e. CAMA and the STMA), option (b) above however questions the simplicity which harmonization, encapsulated by the STMA, should provide. Suffice to state that dual or cumulative

[64] Parties must avoid designating such security interests as charges in order to avoid being entrapped by the definition of charges, inadvertently retained by s. 2(3). See discussions on this in para. 3.2 of this thesis.

registration for the creation of a single security interest unquestionably contradicts the objectives of global reform.

Following the eligibility requirements for the creation of charges earlier discussed and the fact that most MSMEs remain ineligible to grant charges as security devices, the only option left to most MSMEs therefore is option (d). This makes it necessary to examine in this section whether the security interest under the STMA is comparable to floating charges in terms of the benefits it confers on MSMEs. Bearing in mind the concurrent existence of two systems of secured transactions, the possibility of secured transactions filtering across both systems and the implication of such occurrence is also discussed in this section.

3.3.1 The STMA Security Interest as an Alternative to Floating Charges

Under the STMA, a security agreement must contain distinguishing features such as a description of the parties, the obligation secured and an adequate description of the collateral.[65] Further, the description of the collateral is adequate if it is accompanied with certain specifications, such as the item, kind, type or year of manufacture etc. or a statement that a security interest is taken in all the present and future assets of the grantor.[66] It is suggested that the reference to an interest in future assets is intended to achieve the same result as floating charges as a security device for capturing after-acquired property in favour of chargees.[67]

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65 STMA, s. 5

66 STMA, s. 6(1)(c)

67 See Re Yorkshire Woolcombers Association Ltd [1904] AC 355

However, in order to ascertain whether the STMA's security device is a suitable alternative to floating charges, its features must significantly mirror those of the floating charge. Romer LJ's classifications in Re Yorkshire Woolcombers Association Ltd[68] remains the archetypal means of identifying what security devices may be classified as floating charges. His three-pronged features for identifying a floating charge are; i) That it is a charge on a class of assets of a company present and future; ii) That the class of assets would in the ordinary course of the business of the company be changing from time to time; and iii) That the charge contemplates that the company may carry on its business despite the charge until some future step is taken by or on behalf of those interested in it to halt that empowerment. Items (i) and (ii) are apparently covered under the STMA.[69] It is with reference to item (iii) on the chargor's right to deal, the critical distinguishing feature between a fixed and floating charge that concerns may arise. S. 6(1) of the STMA expressly omits this right to deal, resulting in arguments in favour and against the existence of such a right under previous reforms. For example, some learned commentators have described the similar APPSA security interest as 'a fixed security interest over circulating assets',[70] with the implication that the limitations placed on the rights of debtors to deal on assets that are subject to fixed charges invariably deny debtors any such rights to deal.[71]

The debate over the existence of the right to deal is now examined with the arguments in favour of a continuous right to deal first considered. Advocates of the existence of a right

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68 ibid

69 See STMA, s 6(1)

70 Duggan, *Australian Personal Property Law* (ibid ch 1 n 6), 128; See also Iheme, 'Reforming' (ibid ch 1 n 29)

71 See Re Spectrum Plus [2005] 2 AC 680

to deal often highlight the fact that such a right can simply be inserted into a security agreement by both parties in accordance with the freedom to contract.[72] They argue that since the parties can contract to retain the debtor's right to deal, the absence of an express right in the Act cannot be considered significant. This argument is apparently bolstered by the fact that without expressly curtailing such right in the security agreement, any other form of post-contractual curtailment would often be viewed merely as a means of practical control, which alone cannot deny the debtor of the right to deal, especially with courts tending to uphold such rights in the absence of clear curtailment.[73]

Further, the right to deal aligns with UNCITRAL's expectations of the operation of the unitary security interest. It states:

> …once a legal system permits the creation of non-possessory security rights in all present and future assets of a grantor under a regime that also allows the grantor to dispose of some of the encumbered assets in the ordinary course of its business, many of the specific devices that States have designed to permit businesses to obtain credit by granting security rights over the enterprise as a whole may no longer be necessary. That is, in many legal systems, concepts and terms such as 'enterprise mortgage' and 'fixed and floating charge' have been important because they performed a role in business financing that regular security rights were not able to accomplish.[74]

Third, pro-rights advocates also argue that reform enactments such as the STMA usually contain provisions from which the existence of the right can be deduced e.g. s. 7(1) of the STMA provides that a security interest shall automatically continue in the identifiable or traceable proceeds of the collateral, whether or not the security agreement contains a description of the proceeds. Under the Act, 'proceeds' are defined as the

[72] See e.g. STMA, s. 3(1)

[73] L Gullifer (ed.), *Goode and Gullifer on Legal Problems of Credit and Security* (6th ed., Sweet & Maxwell 2017), 149

[74] UNCITRAL *Legislative Guide* (ibid ch 1 n 11), 83.

‘identifiable or traceable movable assets received as a result of sale, disposition, collection, lease or licence of the collateral including natural fruits, distributions, insurance payments and claims arising from defects in, damage to or loss of collateral.’[75] The activities that may result in proceeds would usually arise from dealings in the original asset by someone with some degree of control over the assets. As a debtor is not precluded from holding possession of the assets under the STMA,[76] there is every possibility that these transformational activities may very well be carried out by the debtor through e.g. the sale of some of the secured assets as business inventory; activities that are clearly consistent with a right to deal. Similarly, the Act provides that a buyer of goods sold in the ordinary course of business of the seller and a lessee of goods leased in the ordinary course of business of the lessor takes the goods free of a security interest created by the seller or lessor unless the buyer or lessee knows that the sale or lease constitutes a breach of the security agreement creating a security interest.[77] Implicit in this provision is legislative tolerance for dealings in goods subject to a security interest disposed by a seller or lessor in the ordinary course of business, with the possibility that the seller or lessor obtained such goods vide a secured transaction consummated on credit terms.

Attractive as these arguments may sound in rebuttal of the ‘fixed charge over circulating assets’ theory, it is nevertheless important to consider the opposing arguments

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75 STMA, s. 63

76 In fact the implication of s 8(2) of the STMA which empowers the secured party to take possession is the expectation that ordinarily, the grantor should have possession of the assets.

77 STMA, s 32(2); A buyer or lessee’s in possession’s rights over the secured assets is analogous to that of a third party’s acquirer of an interest under a floating charge. Either interests overreach or defease the rights of the security holder under both types of transactions prior to the time of enforcement of the security interest.

against the right to deal, which remain relevant in the absence of express statutory provisions. The most significant argument under the STMA is s. 8(2) which empowers a creditor to take possession of the secured asset during the subsistence of the transaction, thus defeasing or overreaching the grantor's right to deal. It is contended that a creditor's possessory right should necessarily have been curtailed were it intended to give grantors an unassailable right to deal,[78] a curtailment necessary to make the STMA security interest analogous to the floating charge. Perhaps, the real significance of s. 8(2) is that secured parties would view it as justification for including in security agreements, terms curtailing the debtor's right to deal; by including such terms in the security agreement, creditors invariably gain legal control sufficient to ensure that the right to deal is truly curtailed.[79] It must be highlighted that with most MSMEs in Nigeria run by illiterates, surreptitiously imposing such onerous terms in their agreementswould present little or no difficulties for creditors.

In conclusion, it is suggested that although grantors obviously have a right to deal in the assets under the STMA, the effect of s. 8(2) is that it empowers creditors to overreach such rights, thus preventing the STMA security interest from being wholly analogous to the floating charge.

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[78] It is settled law under the English legal system applicable in Nigeria before the enactment of the STMA that the curtailment of a debtor's rights to deal with the secured asset during the subsistence of a charge invariably results in such charge being classified as a fixed charge. This however does not preclude the parties to a charge transaction from curtailing the powers of a chargor under such devices based on their freedom to contract. However, courts are more likely to hold that a transaction creates a floating charge if it confers on the chargor the right to deal while the secured transaction subsists subject to the occurrence of a crystallizing event. See Re Spectrum Plus (ibid n 70)

[79] See L Gullifer (ed.), *Legal Problems of Credit and Security* (ibid n 72), 147

3.3.2 The Implication of Assets Filtering Across Regimes

With companies uninhibited from granting charges under CAMA, it is contended that chargees are not obliged to conduct searches at the collateral registry to ascertain whether the charged assets are encumbered by security transactions consummated under the STMA.[80] While there is a possibility, and perhaps the actual intention that assets created under one regime should be identifiable by parties transacting under another regime when, and if all registries of movable assets are interfaced as intended,[81] there is no assurance that such interface will ever be done or that if it is, it would work seamlessly.[82]

Consequently, there is the possibility of assets originating from a transaction in one regime filtering into a transaction consummated under another regime. This possibility is however limited to cases in which the grantor is an incorporated company since only incorporated companies can grant security interests under both systems. This possibility is nevertheless worth highlighting because apart from affecting the few MSMEs that are incorporated companies, they could also affect the smaller entities that are not yet incorporated being mindful that with growth and increased ambition, such smaller entities could in future metamorphose into incorporated companies.

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80 It is argued that imposing an obligation on chargees to conduct searches at both registries contradicts the simplicity required of a reformative enactment such as the STMA.

81 STMA, s 2(1)(c)

82 It is noteworthy that the companies' registry, established in the early 1990s following the enactment of CAMA has never been interfaced with any other similar registry, and notably the bills of sales registry. Issues of assets filtering between transactions under CAMA and the bills of registry are however rare because bills of sales are sparsely used. However, depending on how well the STMA is received, its enactment may reverse this trend with this issue attaining greater significance under the Nigerian legal system.

The following example illustrates the possibility of assets filtering across regimes and will be referred to intermittently throughout this section of the thesis:

> SP1 acquires a security interest over G's present and future undertakings and registers a financing statement but does not take possession of the secured assets. While this transaction subsists, G grants a fixed charge to SP2 pursuant to s. 178 of CAMA; SP2 registers his charge at the companies' registry in conformance with s. 197 of CAMA. Prior to advancing funds to G, SP 2 conducts a search at the companies' registry which does not reveal any encumbrance on the assets. SP1 subsequently decides to enforce his undertakings over the assets but is challenged by SP2.[83]

An implication of sustaining parallel systems of secured transactions is that parties transacting under CAMA are not bound by the STMA's registration requirements, and vice versa. Consequently, under both transactions, the grant of the security interests complies with the respective systems under which they were created, thus making them effective against third parties. While in the case of the STMA, a financing statement is filed, the charge created pursuant to CAMA is also registered. Although s. 63(1) of the STMA defines registration as 'the processing of a financing statement to bring it in compliance with the requirements of this Act', it must be noted that this process is not recognised under CAMA which requires a different process for the registration of charges. It is therefore argued that extending the definition of 'registration' to charges would require that charges comply with the dual registration requirement described as option (b) above which clearly contradicts the objectives of reform. This option will therefore not be discussed further in this thesis.

[83] For the purpose of this example, G is an incorporated company

It is ironic that despite recognising the dual secured transactions systems, the STMA fails to provide clear rules for resolving conflicts across both systems. Consequently, such conflict cannot be resolved solely by considering the notice provided through the registered financing statement, being the first public notification served because the notice provided by the filing of the financing statement is available only to interests created under the STMA. It is further argued that even if the intended interface of registries of moveable assets is seamlessly achieved, it would not automatically subordinate SP2's interest to SP1's earlier interest since the knowledge of SP1's interest under a different regime of secured financing would not result in the legal subordination of SP2's interest to SP1's interest.

The depth of this confusion, capable of being exploited by fraudulent borrowers is discussed under the following heads in the following sections:

i. Priorities; and

ii. Remedies.

i. Priorities

As the notice requirements under each regime is localised to transactions emanating from that system, it is contended that the issue of priorities, usually determined by notice, must also be localised. Consequently, priority rules under this section will be discussed first, under each system before a determination of how it should be dealt with across both systems.

Part V of the STMA provides clear rules for determining the priority of conflicting security interests. The section includes the fundamental rule that priority is determined by

the order of registration.[84] It also contains other rules synonymous with global reforms such as the super-priority status of PMSIs,[85] the transfer of security interests while retaining priority,[86] contractual subordination of security interests,[87] and security interests in proceeds[88] amongst others. CAMA similarly provides clear rules for ascertaining priorities in respect of transactions originating within its domain. By virtue of s. 179 of CAMA, a fixed charge on any property has priority over a floating charge affecting the same property, unless the terms on which the floating charge was granted prohibited the company from granting any later charge having priority over the floating charge and the person in whose favour such later charge was granted had actual notice of that prohibition at the time the fixed charge was granted. In respect of priority between security interests of equivalent stature, the first in time rule applies.[89]

In the context of priorities between transactions emanating under the different systems which is the crux of this discussion however, the question that arises is considering the localised nature of the notice and priority rules under both systems, how should priority be resolved in respect of transactions involving similar assets emanating from one system filtering into transactions in the other? It is suggested that the only clear means of resolving such conflict is by reference to the general principles of law involving the application of

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84 STMA, s. 23. With registration defined as involving the filing of a financing statement under the STMA, it is reiterated that this invariably omits charges created under CAMA.

85 STMA, s 27

86 STMA, s 25

87 STMA, s 26

88 STMA, s. 28

89 Macmillan Inc. v Bishopsgate Trust (No 3) [1995] 1 WLR 978

rules of common law and doctrines of equity that have over time proven unsatisfactory. It must also be highlighted that the reference to general legal principles also negates the intent and objectives of simplification and harmonisation that global reforms have portended and which the STMA should have emulated.

Priority under the general law is determined on a graduated scale of considerations. The first consideration is a determination of the creator's legal right to grant the security interest often expressed in the Latin maxim *nemo dat quod non habet*.[90] Upon overcoming this requirement, further considerations are whether the requirement for the creation of such interest fulfils the general conditions for creating such interest such as registration requirement, the time of creation of the respective interests, and irrespective of time of creation, the existence of any special circumstance that places a specific claimant in a privileged position compared to others (i.e. the exceptional priority rule). These considerations are now assessed against competing claims involving SP1 and SP2.

SP1 and SP2 both comply with the requirement of the *nemo dat* rule. The creation of a security interest in favour of SP1 does not prevent G from creating a further interest in favour of SP2 save where the security agreement with SP1 expressly prohibited the creation of such subsequent interest and SP2 has actual notice of such prohibition. Further, the STMA, under which SP1's transaction was consummated does not preclude the creation of multiple security interests over the same assets. In fact, the essence of recent reforms of personal property focuses on empowering business entities to raise funds, and presumably through multiple sources. Further, with SP1 not exercising his right to take possession of

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[90] For a discussion of priorities see generally S Worthington, *Equity* (2nd ed, Clarendon Law Series 2006), ch 4.

the secured assets,[91] the use of the assets as collateral for subsequent loans apparently falls within the contemplation of the STMA.

Both transactions also fulfil the registration requirements under their respective enabling enactments. While the first registration should ideally constitute notice to potential subsequent lenders with the decision to subsequently lend irrespective of such notice constituting an agreement by the subsequent creditor to take a subordinated interest, such scenario is only possible when all transactions emanate from, and are subject to the same regime. S. 2(3) of the STMA provides a marked departure from this general position following the hypothesis that the autonomy to create company charges under CAMA and outside the ambit of the STMA generally subjects company charges to a parallel notification system. There is clearly no basis to subordinate SP2's interest to SP1's interest following this consideration.

The overarching purpose of the first-in-time rule is to ensure that interests primarily rank in the order in which they are created.[92] However, the origin of the rule is traceable to two equitable maxims i.e. 'where there is equal equity, the law shall prevail' and 'where the equities are equal, the first in time shall prevail'.[93] The outcomes of the interpretation of these maxims when applied to our example are examined next. With regard to the first maxim, SP1's interest would supersede SP2's interest not because of its earlier time of creation but because as an interest created pursuant to and in fulfilment of a statute, it amounts to a legal interest.[94] Although SP2's interest was also created pursuant to a statute

[91] STMA, s. 8(2)

[92] Per Millett J in Macmillan Inc. v Bishopsgate (ibid n 88), 999

[93] This latter rule is expressed in Latin as *qui prior est tempore potior est jure*. For a detailed discussion of both maxims see J McGhee (ed.), *Snell's Equity* (31st ed. Sweet & Maxwell, 2005), ch 4.

[94] The phrase 'legal' is used in a different sense to denote an interest created in full conformance with

i.e. CAMA, it is nevertheless defined by CAMA as an equitable interest.[95] While the first maxim resolves the conflict in SP1's favour without further need to evaluate the second maxim, an evaluation of the second maxim however also results in the same outcome with SP1's interest superior by virtue of being earlier in time of creation to SP2's interest.

It would therefore appear that in most cases of conflict between transactions occurring under both regimes, those occurring pursuant to the STMA will invariably have priority should the first in time principle be applied save where such transactions do not comply with the registration requirement under the Act.[96]

The exceptional priority rule is that a bona fide purchaser for value of the legal estate without notice of prior equitable interest takes free of them.[97] On how the principle works, Worthington, using fictional characters explains that

> B must have purchased a legal interest without having either actual or constructive notice of A's earlier equitable interest....... The principle is commonly justified by the need to make legal transfers of property secure, which presupposes that legal ownership is the pre-eminent property right.[98]

The bona fide principle is one of the core exceptions to the first in time rule which relies more on the nature of interest held rather than the time of creation of the interest, ensuring in support thereof that notice or the lack of it remains an extenuating factor in determining priority. When applied to transactions emanating from both regimes, it overall

the process required for such interest to be created in law in contradistinction to equitable interests. See generally J McGhee (ed.), *Snell's Equity* (ibid para 1-002)

95 CAMA, s 178

96 STMA, s 8(1)

97 Worthington, *Equity* (ibid n 89) 96

98 ibid

places transactions consummated under the STMA in a priority position because only such transactions create valid legal interests in comparison to those consummated under CAMA.

II. Remedies

Part VII of the STMA which deals with the realisation of security interests provides that creditors may exercise their security interests in accordance with the Act, the security agreement and or to any appropriate judicial remedy.[99] The reference to the security agreement implies that the parties may continue to use vide contract, the remedies' scheme prior to the enactment of the STMA.[100] The disadvantage of not limiting the parties' freedom to contract under the STMA is that it enables the stronger contracting party, usually the secured party foist onerous enforcements terms on the grantor.[101]

The adoption of the remedies scheme under CAMA by virtue of s. 39(5) raises three significant issues, namely:

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99 STMA, s. 39(1)

100 The APPSA on the contrary enacts a common remedies scheme for all secured transactions, regardless of form, which originated by replicating Article 9 and the Canadian PPSA models, taking the remedies scheme for mortgages and applying it across board to all forms of transactions. Duggan and Brown, *Australian PPSL* (ibid ch 1 n 6) 383; s 110 of the APPSA however provides that the APPSA does not derogate in any way from the rights and remedies provided for in the security agreement i.e. the security agreement may give the creditor additional rights or remedies to those provided by the statute. For example under s 115(1) of the APPSA, where collateral is not used predominantly for personal, domestic or household purposes, the parties may contract out of specified ch 4 provisions. Certain obligations cannot however be contracted out e.g. obligations requiring the secured party to act in a commercially reasonable manner, obtaining the best price available from a disposal and returning any surpluses from sale to the grantor cannot be contracted out. See Duggan, *Australian PPSL* (ibid), 369

101 However, the STMA contains some provisions through which the secured party's powers may be curtailed e.g. s 47 imposes on the secured party a duty to render account of a sale to the grantor. S. 44(3) also imposes a duty on the secured party to obtain a reasonable price from a sale or disposal while s 41 establishes a Mediation and Dispute Resolution Panel to serve as the first resource for mediation and settlement over civil disputes arising between parties to a secured transaction. Hopefully, the existence of such a panel may curtail the secured party's exploitative tendencies.

i) Whether by adopting the remedies' scheme under CAMA, such remedies can be used by all secured parties or only by chargees pursuant to transactions emanating from CAMA i.e. in cases where chargees decide to comply with the requirement of both regimes;
ii) Whether the adoption of CAMA's remedies' scheme elevates the status of company charges that are statutorily equitable interests[102] to legal security devices;
iii) Whether, and to what extent, the rights of other secured creditors under transactions consummated pursuant to the STMA are affected by the adoption of receiverships into the STMA

In respect of the first issue, it is contended that in so far as the STMA does not expressly limit the exercise of the remedies scheme under CAMA to company charges and mortgages, there is no basis to limit the use of such remedies to these security devices. Moreover, as the creation of charges is omitted from the STMA, presumably because they are subject to a different statutory regime, so too would have their remedies been omitted were the intention to limit their use to company charges. Consequently, it is suggested that the implication of s. 39(5) is the wholesale adoption of the remedies' scheme under CAMA for use by all secured parties under the STMA subject however to agreement by both parties in respect of non-charges.

The importance of the second issue is that the conclusion reached could potentially alter the priority position of transactions carried out under the different regimes discussed in the last section of this thesis. This is because if it is found that company charges have

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[102] See CAMA, s. 178

been elevated to legal interests, they would then have attained an equivalent status as the security interests created under the STMA. At the very least however, it robs the STMA security interest of what would have amounted to a super priority status incidental to its being a legal interest with priority then solely determined by the first in time rule.

The crux of recent reforms of personal property security laws, including the STMA is the elimination of complex legal compartments under the common law, with the objective of simplifying secured transactions and unitizing security interests making them subject to uniform rules. Critically, reform eliminates or should eliminate the dichotomy between equitable and legal interests. It is therefore contended that any argument that seeks to perpetuate such dichotomies contradicts the purpose of harmonization behind the STMA and must therefore be avoided. Consequently, the incorporation of the remedies' scheme under CAMA renders any discussion of legal and equitable interests, unnecessary, making priority determinations subject only to the first in time rule. It must however be highlighted that the dichotomy between charges and the STMA's security interest is sustained in cases in which the parties only conform to the requirements of CAMA since the autonomy to use charges under CAMA implies that such charges remain defined exclusively by CAMA, under which they remain equitable interests.[103] This contrasts significantly from transactions in which the parties agree to conform to the requirements of both regimes under which situations the equitable/legal interests' dichotomy is eliminated.

The recognition of receiverships as a remedy available to secured parties could greatly impact the enforcement of security interests by other creditors under the STMA. By virtue of s. 209(3) of CAMA for example, a receiver appointed by debenture holders

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103 See CAMA, s. 178(1)

has extensive powers including the power to take possession and sell assets subject to the security. Subject to the security agreement, such a receiver may also collect debts owed to the company, to compromise, settle and enter into arrangements in respect of claims by or against the company and negotiate terms for the sale of the company's business. It is contended that such far reaching powers are bound to affect a creditor's ability to realise his security interest under the STMA because it inevitably prevents other creditors from exercising their own interests over assets in the receiver's possession. Even if such creditors' eventually establish a superior claim over the receiver's, the receiver's intervention, at the very least slows down the enforcement process for such creditors

A receiver's expansive powers are further worrisome considering the limited duties receivers generally owe to other creditors. As agents of their appointers,[104] they generally face no greater liability to other creditors than their appointers.[105] With their primary focus being to secure their appointers' repayment, they hold no general duty of care in negligence to other creditors[106] and could escape responsibility for non-diligence.[107]

A receiver's right to take possession of the assets and exercise the rights pursuant to his appointment is however subject to the rights of prior encumbrances.[108] In Union Bank

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[104] CAMA, s. 390(1)

[105] CAMA, s. 390(2)

[106] CAMA, s 390(1); See also Downsview Nominees Ltd v First City Corp Ltd [1993] AC 295.

[107] CAMA however appears to impose stiffer responsibilities on receivers although in respect of their relationship with the company rather than with other creditors. For example, in addition to the duty to act in good faith such a receiver is deemed to stand in a fiduciary relationship with the company, act at all times in what he believes to be the best interests of the company as a whole so as to preserve its assets, further its business, and promote the purposes for which it was formed, and in such manner as a faithful, diligent, careful and ordinarily skilful manager would act in the circumstances. See CAMA, s 390(2)

[108] CAMA, s 393(1)

of Nigeria Plc v Tropic Foods Ltd,[109] the court, in interpreting this section, held that a receiver's right to deal with the goods was subject to all specific charges validly created in priority to the floating charge.[110] The question that arises in applying this decision to our example is whether SP1's interest created pursuant to the STMA would constitute a prior specific charge for the purpose of encumbering the right of a receiver appointed by SP2 pursuant to the fixed charge.

Yet again, the existence of parallel regimes makes this a difficult issue to resolve. The STMA's adoption of the remedies' scheme under CAMA, including receiverships results in the argument that with the presumed elimination of dichotomies in treating interests from both regimes, SP1's interest should therefore be viewed as a prior encumbrance to SP2's subsequent interest. It is however also arguable whether what constitutes a prior encumbrance should be determined by reference to the creation of the security interest or its enforcement. Consequently, as the creation of charges remains within the exclusive domain of CAMA, what CAMA views as a prior encumbrance would also therefore be transactions carried out within its ambit, thereby excluding interests created pursuant to the STMA or any other enactment. This argument is buttressed by the decision in the Union Bank's case which invariably defines prior encumbrance as a prior specific charge, with the priority of all other security devices created under CAMA presumably determined by their order of creation. With this alternative position, it is difficult to invest

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[109] [1992] 3 NWLR (pt 228), 231

[110] The statutory rationale being that by virtue of s 179, a fixed charge over an asset has priority over a floating charge over the same asset save where the terms of creating the floating charge prohibited the creation of a charge superior to the floating charge. See Intercontractors Nigeria Ltd v UAC of Nigeria Ltd [1988] NWLR (Pt.76), 303

interests not affected by CAMA's registration regime with any form of recognition, the incorporation of its remedies' scheme into the STMA notwithstanding.

In other jurisdictions where receiverships outlived reforms, these difficulties were avoided because the functionality introduced by reform was complemented by total harmonization which therefore avoided dual security regimes. Two main methods were adopted in order to avoid such duality and the difficulties that could arise therefrom. Under the first method, creditors are defined under the reformed laws to include 'receivers.'[111] This method is justified by the fact that as agents of their appointing creditors,[112] receivers functionally step into their principals' shoes for the purpose of enforcing their interests and as such are precluded from exercising any extraordinary powers, potentially prejudicial to other creditors, which their appointing creditors could not exercise. Under the second method, the reformed laws provide for the use of receiverships as an alternative means of enforcing the security interest. Commenting on this second approach, adopted under the APPSA,[113] Duggan and Brown observe that the approach 'makes the law governing enforcement of security interests subject to arbitrary variables',[114] an unjustifiable outcome under a harmonized and predictive reformed system.

In Nigeria however, none of these methods was adopted. The STMA's definition of a creditor as 'the person granting a facility on the back of a security interest created

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111 See eg Saskatchewan PPSA, s 56(1)

112 See Owen & Co v Cronk [1895] 1 QB 265

113 See APPSA, s 116 which provides that ch 4 of the Act (that deals with enforcement of security interest) does not apply if there is a receiver or receiver and manager in control of the collateral except if the grantor is an individual.

114 See Duggan, *Australian PPSL* (ibid ch 1 n 6), 370

under the Act'[115] obviously omits the receiver for two main reasons. First, a receiver does not grant a facility but only steps in subsequently as an enforcement mechanism available to creditors. Second, despite the adoption of the remedies' scheme under CAMA, company charges can still not be considered created under the STMA. This therefore clearly excludes transactions consummated pursuant to CAMA.[116] As receiverships are created under CAMA, one can only argue that the definition of creditor omits rather than includes receivers. With s. 39(5) of the STMA providing that the adopted remedies scheme under CAMA 'are in addition', there is no basis to sustain the 'alternative enforcement theory'.

3.4. Miscellaneous Provisions

Two provisions under the STMA capable of further derailing the Act's key objectives of stimulating funding to MSMEs are briefly discussed in this section. The provisions are:

i) The Insurance requirement under the Act; and

ii) The process by which secured creditors may repossess collateral

3.4.1. The Insurance Requirement under the STMA

The STMA provides that a security agreement must amongst others describe the collateral adequately.[117] The Act further provides that in order for such a description to be adequate, it must be accompanied with the item, kind, type, category, year of manufacture or any other description that can identify the collateral or a statement that a security interest is

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115 STMA, s 63(1)

116 Achieved by the phrase 'created under the Act'

117 STMA, s. 5(d)

taken in all present and future assets of the grantor.[118] S. 6(1)(c) however requires that in addition to the above, such a description must also contain 'a description of the insurance cover on the collateral'. The use of the term 'the' instead of 'any' clearly makes the requirement for an insurance cover compulsory for every secured transaction whether in respect of present or future assets.

This raises two main problems. First the cost of insurance constitutes an additional burden on borrowers (MSMEs) irrespective of whose interest is insured because of the tendency of Nigerian institutional creditors to transfer all costs ancillary to secured transactions to borrowers. The second problem is that it raises the issue of whose interest ought to be insured i.e. between the borrower and the secured creditor. As secured creditors would usually be more concerned about getting extra protection against default in repayment, and seeing insurance as a means of achieving such objective, the likelihood is that they would insist that their interest in the assets be insured. This raises a further significant problem i.e. the problem of defining their insurable interest in future assets.

The general rule is that the insured must have an insurable interest in the subject matter of the insurance, otherwise the contract of insurance is void.[119] A person is said to have an insurable interest in a thing if he will benefit from its existence and be prejudiced by its loss.[120] Although this may justify the secured creditor's desire for insurance bearing in mind that the loss of collateral would prejudice his position under the secured transaction, the existence or otherwise of an insurable interest is often not that straight

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118 STMA, ss. 6(1) (a) and (b)

119 See Ezejiofor, *Nigerian Business Law* ibid ch 2 n 60, 342

120 Lucena v Crawford (1806) 2 Bos. & P.N.R 269

forward in respect of future acquired assets. For example, there must be property capable of being insured devolving upon the insured and a relationship must exist between the insured and the property capable of being benefitted from or prejudiced by its loss.[121] It would therefore appear that an insurable interest cannot exist in respect of mere expectancies, and that while contingencies may give rise to insurable interests, the contingent acquirer of the interest who has not obtained property, risks or possession, has no insurable interest in the assets to justify insuring them.[122] While arguable that a secured party could be prejudiced by the loss or destruction of the secured asset, thus justifying claims the existence of risk, it is perhaps even more arguable that until the acquisition of the asset by the borrower, risks is factually non-existent. Accordingly, it is highly improbable that a secured party's interest in future assets is of such weight to found an insurable interest capable of being insured.

Consequently, s. 6(1)(c) of the STMA imposes a difficult and impracticable obligation on parties and questions the Act's affirmation of security interest in future assets from the secured creditor's perspective. It also clearly imposes an additional cost of transaction obligation on the borrower, capable of discouraging impecunious borrowers from secured transactions.

[121] Ezejiofor et al, ibid ch 2 n 60, 343

[122] See R Merkin, *Colinvaux's Law of Insurance* (11th ed. Sweet and Maxwell, 2016), 188-9

3.4.2. Repossession of Collateral

S. 40 (1) of the STMA empowers a creditor to repossess the collateral upon giving notice of default and the intention to repossess the collateral to the borrower. The process for achieving repossession under s. 40 raises a more significant issue having regard to the peculiarities of the Nigerian society.

While s. 40(4)(a) empowers a secured creditor to seek judicial intervention to achieve repossession, it is in respect of non-judicial repossession that concerns however arise. S. 40(5) of the Act provides that 'in the case of repossession without judicial process, a creditor may request for assistance from the Nigerian Police having authority within the location of the collateral'. S. 40(6) then further provides that the Nigerian Police shall provide assistance 'for the peaceable repossession of the collateral, upon presentation by the creditor of a copy of the relevant security agreement and duly certified confirmation statement'.

It is clearly worrisome that the Nigerian Police, a criminal law enforcement agency would be brought into the enforcement of private commercial transactions. In a country in which legitimate powers often tend to be abused at the whims and caprice of the strong at the expense of the weak, there is every possibility that Police involvement in enforcing secured transactions will also be likely abused. It is therefore contended that s. 40 is a veritable tool by which secured creditors could intimidate the weaker MSME operators at the slightest hint of irritation. This is worsened by the exploitative and corrupt tendencies of the Nigerian Police, with the likelihood that MSME operators may be intimidated into giving bribes to police officers to avoid being indiscriminately harassed.

3.5. Summary

The STMA's inclusion of an objective of stimulating responsible lending while surreptitiously justifying the appointment of the CBN, a regulatory watchdog as the key implementer of the Act, nevertheless raises doubts about government's commitment to liberalising a rigid credit system.

The functionality introduced by the Act by adopting the expanded definitions of security interests and agreements and other key features of similar reforms works well in encapsulating a wider spectrum of transactions as security transactions. However, the Act takes functionality to a questionable level by rendering possession redundant in pledge transactions. By so doing, it imposes an additional burden on creditors to register a financing statement while eliminating the benefits associated with possession. This should hardly be the modus operandi of a reformative enactment.

It is however with regard to the exclusion of company charges that the STMA significantly falls short of meeting the core objective of harmonisation, which it should at the very least, achieve. While broadly creating a parallel system of secured transactions, the exclusion of company charges raises fundamental issues on the determination of priorities across both systems and the efficacy of remedies in the enforcement of security interests under the Act. While the potential resort to the general law is both unavoidable and unacceptable in determining priorities under a supposedly reformed system, the adoption of the remedies' scheme under CAMA, including the appointment of receivers unwittingly pollutes the reformed system with the confusion surrounding receiverships prior to the enactment of the Act.

Finally, apart from constituting an additional cost burden to borrowers, the requirement for the provision of insurance cover for secured transaction also raises fundamental issues about the Act's recognition of security interests in future assets. When considered alongside the dubious method for non-judicial repossession, one can only conclude that the STMA conjures an unhealthy admixture of negative provisions capable of discouraging borrowers from partaking in secured transactions altogether.

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SUMMARY OF RESEARCH FINDINGS AND RECOMMENDATIONS

4.0. Overview

This research has evaluated the impact of the STMA as Nigeria's legislative response to UNCITRAL's call for the simplification of state secured transactions' laws to engender funding to small businesses as a catalyst for economic growth. In this concluding chapter, the summary of the research findings and recommendations for improvement of Nigeria's secured transactions system having regard to the need to improve MSMEs' access to funding are presented.

4.1. Summary of Research Findings

The following summarises the research findings:

1) By sheer volume, MSMEs dominate Nigeria's business landscape and provide income for most working class Nigerian adults. As such, their growth could portend economic development in Nigeria. Without adequate access to loans however, doubts exist about their survival. The complex and undiluted common law system of secured transactions practised in Nigeria prior to the enactment of the STMA made it difficult for MSMEs to source loans, discouraging them and institutional creditors from secured transactions.

2) The informal nature of most MSMEs in Nigeria continues to hamper their quest for loans, preventing leverage on the corporate persona of incorporated companies, generally preferred by institutional creditors in extending business credit. Although SMEDAN recognises this concern, its National policy on MSMEs contains no specific action to address the problem.[1]

3) Following UNCITRAL's recommendations and what exists in other reformed systems, the STMA obviously seeks to harmonise various security interests into a unitary security interest. This can be gleaned from its adoption of the definitions of security interests, security agreements and other elements of reform including the notice filing system, uniform rules for perfecting security interests and determining priorities amongst others. By this harmonization, deemed security transactions such as vendor credit transactions have been encapsulated within the scope of security transactions with similar outcomes to consensual security transactions such as mortgages.

4) The curious exclusion of company charges from the STMA however detracts from the objective of harmonization as it results in the recognition of a parallel secured transactions' system governed by CAMA. With the likelihood of assets filtering across both systems, legal problems involving priority issues arise that neither system can suitably

[1] SMEDAN's strategies for addressing these problem includes holding sensitization programmes for MSMEs, collaborating with corporate registration institutions to facilitate their registration and incentivising a fee paying structure to enhance MSME registration. See SMEDAN, 'National Policy' (ibid ch 1 n 26), 39. It however fails to identify the type of registration it would encourage i.e. incorporation of a limited liability company or business name registration considering the difference in both types of registration in the context of access to funding discussed in para 2.2 of this thesis. It is submitted that SMEDAN's strategies are inadequate to resolve this very critical problem as empirical evidence in other jurisdictions show that major programmes to reduce registration cost may have no effect on informality. See AD Rothenberg, A Gaduh et al. 'Rethinking Indonesia's Informal Sector' (2016) World Development Vol 80, 96 available at <https://www.sciencedirect.com/science/article/pii/S0305750X15300978?via%3Dihub> (assessed on 2 May 2018)

resolve without reference to the unsatisfactory common law system. The consequent resort to general principles of law under the common law system potentially introduces the complexity under the general law into the interpretation of the STMA, thus perpetuating the difficulties that had previously made it difficult for MSMEs to access loans.

5) While the Act apparently permits grantors the right to deal in secured assets during the subsistence of the security transaction, s. 8(2) of the Act, which permits the secured party to take possession other than in realisation of the security interest has the effect of providing creditors with a means of overreaching the grantor's rights to deal in the assets. This starkly contrasts with a chargor's right to deal under a floating charge prior to crystallization. The real significance of s. 8(2) is that it provides a basis for secured creditors to curtail the debtors' rights to deal in security agreements.

6) The appointment of the CBN, a financial regulatory agency as key implementer of the Act raises concerns about government's commitment to liberalising the rigid credit system. This concern is justified by the fact that both SMEDAN, the agency currently charged with overseeing MSMEs in Nigeria, and the CAC, which already plays a similar role in respect of company charges were overlooked for appointment. With the CBN's appointment done in apparent violation of the CBNA and BOFIA, the enactments which establish and define its statutory responsibilities, it appears that the appointment may have been influenced by factors beyond the achievement of the Act's core objective of stimulating funding to MSMEs.[2]

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[2] S. 55 of the CBNA provides that CAMA or any of its amendments shall not apply to the CBN. This curious provision, apparently meant to preserve the independence of the CBN as a statutory agency whose management should be divorced from that of incorporated companies may be attributable to the exclusion of company charges (devices provided for by CAMA) in an enactment regulated by the CBN.

4.2. Improvement Recommendations

It is contended that the following recommendations could reduce the complexity of the Nigerian law of secured transactions consequent upon the enactment of STMA. Whilst these improvements may not be exhaustive, they however constitute quick fixes capable of rendering the complexities identified in previous chapters more tolerable.

1) **Consolidate MSMEs in Nigeria**

While obviously outside the scope of the STMA, the structure of entities and the platform by which they conduct business remain critical considerations in obtaining credit. Consequently, the informal structure of MSMEs will continue to hamper their access to loans. Further, the ability of creditors to forecast the debtors' credit state, critical in ascertaining the possibility of repayment depends significantly on information available to them; such information can only come from structured entities which maintain appropriate data on key indicators of their business such as the state of their receivables, outstanding credit and operational costs from which their ability to repay loans can be deduced with reasonable certainty.

Consequently, rather than continue to supervise 37 million impecunious, unstructured and unsustainable MSMEs,[3] it is recommended that SMEDAN should devise a strategy by which the activities of the smaller entities such as micro businesses can be consolidated into larger entities which should then be incorporated as companies with respective stakeholder interest ascertained, quantified and converted into shares upon

[3] See ibid ch 2 n 9

incorporation.[4] This can be done through geographic consolidation, whereby MSMEs involved in similar activities within close geographical proximity e.g. within the same council and carrying on similar or complementary activities are consolidated.[5] The benefits of consolidation could be immense, with immediate benefits including reduced operational costs, economies of scale while sustaining a healthier bottom line for the consolidated entities. Other benefits include the impact of the varied experience of stakeholders on the business and improved access to bank loans amongst others. Further, consolidated and structured business entities are more likely to meet tax obligations to government than unincorporated entities; importantly incorporation provides government with an avenue for tracking such obligations. From SMEDAN's perspective, consolidation reduces the difficulties associated with supervising so many unsustainable entities, especially since its current responsibilities would, in all likelihood, be also shared with the CAC.

2) **Expunge s. 2(3) from the STMA**

The subsistence of a parallel system of secured transactions by implication of s. 2(3) is the STMA's single most significant deviation from the reform objective of harmonization. The objective of harmonization in reforming a fragmented system cannot be overemphasized.[6] Clearly, harmonization is an important method by which a system of laws can be simplified and unified while assuring stakeholders of the predictability of its rules. In secured transactions, both parties undoubtedly require such assurance – for the creditor, that its

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[4] See ibid para 3.2 on the benefit of utilising incorporated companies as leverage for securing loans

[5]

[6] See Otabor-Olubor, 'Reforming the law' ibid ch 1 n 30

position in the comity of creditors is secure and that the loan can be repaid from the secured assets and for the borrower, that the conditions upon which loans are accessed are not unduly onerous.

Against this background, it is recommended that s. 2(3) of the STMA be expunged from the Act with the implication that company charges are brought directly under the scope of the Act and are therefore subject to the Act's rules of perfection and priorities. This has the following immediate implications: First, it ensures the total harmonization of security interests in accordance with UNCITRAL's recommendations and the norms of previous reforms while obviating the need to resort to general common law principles in resolving conflicts amongst competing interests. Second, it invests equivalent interests and remedies on all secured parties as defined by the STMA. This enhances the predictability of interests and the outcome of transactions pursuant to such interests. Third, it indirectly equates receivers to other creditors and by so doing curtails their excessive powers under CAMA and the general law. In order to avoid confusion, it would also therefore be necessary to redefine the term 'creditors' under the Act to include 'receivers and receiver managers'. Further, total harmonization renders the debate on what constitutes a prior encumbrance to a charge discussed in chapter three of this thesis, unnecessary since priorities is then solely determined by reference to the STMA.

However, in order to avoid imposing dual perfection schemes on companies and pledgees,[7] s. 8(1) of the Act should be amended by including provisions recognising registration under CAMA and possession of the secured assets as alternative means of

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7 It is suggested that the redundancy of possession in pledgees arising from the provision of s. 8(2) of the STMA renders pledge transactions subject to dual perfection i.e. the registration of a financing statement irrespective of possession.

perfecting security interests. Such amendment would generally also involve expunging the current curtailment of possession as a means of perfection in s. 8(2) of the Act.

3) **Reassess the CBN's role under the STMA**

Following the recommendations in (1) and (2) above, retaining the CBN as the key implementer of the Act and especially in respect of its role of managing the collateral registry as provided by s. 10 of the STMA becomes unnecessary. Since companies would be subject to the same rules as non-companies following harmonization, extending the responsibility of the CAC which already performs that role with respect to companies to implementing the collateral registry under the STMA becomes a no-brainer.[8]

Consequently, it is recommended that s. 10 of the STMA and other references to the CBN in respect thereto should be replaced with the CAC. It is also further recommended that s. 41 of the Act which sets up a Mediation and Dispute Resolution Panel under the supervision of the CBN (being the CBN's other major function under the STMA) is unnecessary and should therefore be expunged. This is because there already exists in Nigeria an Arbitration and Conciliation Act[9], which generally regulates arbitrations and conciliations. Moreover, the impact of s. 41 is insignificant considering that the STMA empowers secured parties to resort to any appropriate judicial remedy. However, should there be insistence that s. 41 be retained specifically to protect smaller business entities who may be constrained to seek judicial redress, it is alternatively recommended that

[8] The recommendation that MSMEs be consolidated and incorporated as companies is clearly compatible with that for CAC's increased involvement in the implementation of the STMA.

[9] Cap A18 Laws of the Federation 2004

SMEDAN should be the preferred agency to supervise the mediation and dispute resolution process.

It is further recommended that the collateral registry created under the STMA should be a department of the CAC established solely to manage movable assets granted by individuals (as opposed to companies) as collateral.[10] If implemented, this recommendation renders the interface of registries of movable assets provided by s. 2(1)(c) unnecessary since all data regarding movable assets will emanate from the CAC's databases irrespective of the grantor's status.[11] Implementing this recommendation would also result in significant infrastructural cost savings associated with setting-up completely new structures were the CBN to remain implementers of the Act.

4) **Remove or Amend the Insurance Requirement under the STMA**

In view of the problems discussed in para. 3.4 of this thesis, it is recommended that the requirement for a description of the insurance cover be either expunged from the Act or the language used in s. 6(2) amended to replace the term 'the' with 'any'. This is justified by the fact that transactions carried out by micro enterprises are usually of very low value and therefore do not warrant compulsory insurance.

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[10] This should be easily handled by the CAC as loan transactions by individuals are usually less complex than those by companies which the CAC already manages.

[11] The interface would only then be required in respect of movable assets done in respect of bills of Sales which would present few difficulties in view of the sparse use of these security devices.

5) **Revise the Process for Repossession**

The use of the Nigerian Police in effecting repossession impinges the civility of secured transactions and the freedom to contract. As Part VII of the Act already contains a vast array of alternatives from which secured creditors may select an appropriate means of enforcing their security interest,[12] the use of the Nigerian Police is clearly unnecessary. It is therefore recommended that ss. 40(5) and (6) be expunged from the Act.

4.3. Conclusion

The Nigerian government's commitment to liberalising the credit sector as a means of engendering growth to MSMEs has been unquestionable in the last few decades. The enactment of the STMA is a significant step in the process of liberalising the credit sector and further confirms government's unalloyed commitment. As this research has however shown, the STMA leaves much to be desired in making the Nigerian law of secured transactions the ideal for realising UNCITRAL's challenge to states or even achieving the objectives of its enactment. The government would need to comprehensively review the enactment and ensure that necessary revisions are made to the current structure to facilitate the optimal realisation of the benefit of this reform.

[12] See STMA, s. 39 which lists these alternatives to include resort to appropriate judicial remedies and adopts the remedies under CAMA. It is submitted that these remedies are more than sufficient. In respect of repossession, a secured party may seek an expedited judicial remedy in order to gain quick access to the secured assets under numerous rules of civil procedure in Nigeria.

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