African Journal of Applied Research
Vol. 7, No. 2 (2021), pp. 44-56
http://www.ajaronline.com
http://doi.org/10.26437/ajar.10.2021.04

PROTECTION OF EMPLOYEES UPON CORPORATE LIQUIDATION: A CASE OF THE COMPANIES ACT, [CAP. 212 R.E. 2002]

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ABSTRACT

Purpose: This paper examines the scope of protection of employees under the Tanzania Companies Act, the expected reasonable protection standard and the implication towards employees upon company liquidation. The objectives are to assess the effectiveness of Tanzania Companies Act Cap 212 R.E 2002 on the protection of employees and to draw experiences from other jurisdictions in the treatment of employees.

Design/ Methodology/ Approach: The data presented were based on documentary reviews. Various legislation decided cases, books, articles, and reports were reviewed to examine the treatment of employees' interests during the liquidation of the corporate entity.

Findings: The study revealed that the Companies Act does not protect the employees should the event of liquidation materialize. Similarly, the legal framework on the protection of employees during liquidation in some other jurisdictions is fairly adequately compared to the Tanzania jurisdiction.

Research Limitation/ Implication: The study concentrated mainly on the scope of protection of employees during the liquidation process in line with Tanzania Companies Act Cap 212 and five (5) other countries on the same phenomenon for comparative analysis.

Practical Implication: The study created awareness of the ineffectiveness of company legislation towards the protection of employees upon corporate liquidation. In light of this study, the corporate employees will be exposed to their statutory rights and entitlements in priority ranking should a corporate entity proved insolvent.

Social Implication: The knowledge advanced by this study will help law and policy-makers in the amendment of the Companies Act and enactment of specific Acts for insolvency matters.

Originality/ Value: This study also invokes the knowledge to the public on the corporate law and subsequent procedure during the corporate financial distress as far as the settlement of debts is concerned.

Keywords: *Asset. company, employees. insolvency. jurisdiction. liquidation*

ISSN: 2408-7920
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1.0. INTRODUCTION

This paper discusses four major issues namely; the context in which protection of creditors is deployed, the scope of protection of employees under the Tanzania Companies Act Cap 212 R.E 2002, the expected reasonable protection standard upon company liquidation, and the comparative analysis in the protection of employees from other jurisdictions. The paper eventually recommends the way forward in terms of changing the law in Tanzania.

1.1. Context in which Protection of Creditors Deployed

As a matter of law, when a company becomes insolvent, several creditor interests are affected. However, the relationship between employees and their employer is more threatened. Other stakeholder interests and mutual expectations such as continuity of employment may be severely altered or cease to exist completely where the company is either liquidated or sold as a going concern. To this end, various parties with interests in that company may pursue and recover their interests against the debtor company. In the same token, secured creditors such as banks with privately agreed contractual arrangements may choose to pursue their interests by exercising those contractual rights, usually to the detriment of general unsecured creditors like employees. (Nsubuga, 2016 ; Altman, & Hotchkiss, 2010).

It is contended that insolvency regimes are never neutral for the distribution of a debtor's estate to creditors and other stakeholders (Mucciarelli, 2017). The assets of the company may be used to pay off the debts to creditors when proved that it is in financial distress. The manner of payment of such debts is prescribed by law that should be executed in the priority ranking. For instance, debts owed to secured creditors must first be paid in full and thereafter ordinary debts (i.e., debts owed to unsecured creditors). (Mucciarelli, 2017) further asserts that when an employer becomes insolvent, employees' claims for unpaid wages and contributions may be protected through either statutory priorities, or social security schemes, or a combination of both strategies. This is in line with a standard principle, in all insolvency regimes, that secured creditors take priority over other creditors and unsecured creditors are treated equally. Thus, brings adverse effects to the employees.

Secunda (2013) is of the view that corporate liquidations around the world have not only resulted in job losses for employees but also losses of significant pension and wage benefits. In turn, employees, who are considered the most vulnerable of company creditors in the insolvency process because of their lack of voice and their lack of ability to diversify their risk, have been forced either to wait for significant periods to receive payment while the insolvency process takes its course or to navigate complex insolvency procedures. It is undisputed fact that the day to day operation of the company is strongly contributed by the efforts of employees. Albeit to some extent, the statutory priorities, as we shall soon see, in this study place them to the detriment.

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Chen, Azmi, & Rahman (2021) argues that the employees need the company to attain their economic needs just as the company needs the employees for its day to day functioning. Both benefit from each other. Thus, neither the company nor the employees should exert too much pressure on each other if the long term survival of the relationship is to be guaranteed. Indeed, the balance of social policy and economic efficiency is more vital in the treatment of employees during bankruptcy/ insolvency proceedings (Gant, 2020). Under the umbrella of Tanzania company law, during liquidation and upon dissolution of a company, the assets and properties of the company tend to be used to pay debts to the creditors including the employees and other stakeholders as the case may be.

1.2. Scope of Protection of Employees under the Tanzania Companies Act

The assets of the company may be used to pay off the debts to creditors when proved that it is in financial distress. The manner of payment of such debts is prescribed by law that should be executed in the priority ranking. For instance, debts owed to secured creditors must first be paid in full and thereafter ordinary debts (i.e., debts owed to unsecured creditors). Accordingly, section 367 of the Companies Act Cap 212 R.E 2002 stipulates preferential debts. In that regard, employees, being unsecured creditors, are not assured with their entitlements in the letters of law should a company being wound up.

Lwuoha (2021) contends that unsecured creditors' claims cannot be entertained in security assets, the more encumbered the assets company may have, the less opportunity for unsecured creditors to recover their debts in insolvency; this is because priority is given to cover insolvency expenses including remuneration of insolvency practitioners and preferential debts. In this case, on most corporate insolvency occasions, unsecured creditors fail to secure their rights and gain nothing in returns from their service and efforts provided against the company. Ideally, JE Baring & Co Solicitors observed that, in many situations, due to the very nature of insolvency, unsecured creditors can often get very little or even nothing back. Some creditors assume that this will be the case and do not take any part in exercising rights they may have to try and maximize their positions, deciding to not even attend a creditors' meeting as an example.

1.3.0. Overview of Company Liquidation and/or Winding Up

"In most jurisdictions, the terms liquidation and winding up are used interchangeably to refer to the collective insolvency process leading to the end of a company's life, and this is usually done in two ways; voluntary liquidation and compulsory liquidation. Voluntary liquidation comes into play where the company members or creditors pass a resolution to wind it up, while compulsory liquidation occurs as a result of a court order made upon a petition by the company, the directors, or one or more creditors. It should, however, be noted that in Uganda, the Insolvency Act, distinguishes liquidation from winding up. Winding up is limited to the process through which the life of a company may be ended for reasons other

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than inability to pay debts, yet liquidation is separately provided for under the Insolvency Act, and it generally refers to the process through which an insolvent company's assets are distributed to its creditors and/or members as the case may be to bring its life to an end" (Lwuoha, 2021:20)

1.3.1. Liquidation Defined

As it is previously pointed out, liquidation and winding up are synonyms, they carry the same meaning. Winding up or liquidation is the process of bringing to an end the life of a company. The winding-up of a company is the stage, whereby the company takes its last breath. It is a process by which the business of the company is wound up, and the company ceases to exist. (Kazoba, 2014; Lwuoha, 2021)

A company can decide to go into voluntary liquidation in which case the company arranges voluntarily to enter liquidation. But in the circumstances where the creditor(s), if any, wishes to undergo liquidation of an insolvent company for their debts to be paid, the application must be made to the high court for a decision on whether a liquidator should be appointed to realise the assets of the company and to pay the creditors. Fields, & Cheeseman (2016) argues that in a voluntary dissolution, the liquidation is usually carried out by the board of directors. If the dissolution is involuntary or the dissolution is voluntary but the directors refuse to carry out the liquidation, a court-appointed receiver carries out the winding-up and liquidation of the corporation. In Reigate V. Union Manufacturing Co., (Ramsbottom) Ltd. [1918] 1 K.B. 593, it was held that "the passing of the resolution for voluntary winding up does not operate as notice of discharge of the employees of the company if the business is continued by the liquidator or the liquidation is only with a view to reconstruction". Moreover, in Midland Counties District Bank Ltd. V. Attwood [1905] 1 Ch. 357, it was held that "where the voluntary winding up is for amalgamation or reconstruction, the resolution to wind up voluntarily does not operate as a notice of discharge to the employees". Where there are insufficient funds to pay all the creditors, the funds available are distributed to creditors in a particular order of preference. The most likely reason for a company to be wound up is that it has become insolvent, that is, unable to pay its debts. In the case of Gautamjayram Chauda V. Covell Matthews Partnership Ltd [2004] T.L.R. 280, the court had of the view that "it is common knowledge that where it is shown that the respondent company was unable to pay its debts, then the circumstances warranting the winding up of the company would be available."

2.0. Entitlements of Employees

The entitlements or rights of an employee are always determined primarily by the contract of employment. In the ordinary course of business, the interests of creditors are protected through appropriate contractual provisions governing the relationship of the company with its creditors. Thus, the directors, through their fiduciary duties to the company, are duty-bound to enter into transactions with third parties, which take into account the interests of their companies and the shareholders In both situations, employees and

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unsecured creditors have an entitlement to be paid what is owed to them under agreed terms, contractual and statutory rights, collective agreements and those rights arising from custom and practice. Johnson (2010:230) states the following:

"Employees sometimes possess a contractual right to entitlements accrued under their work contracts. In terms of relative priority, these entitlements and rights are no different than those of other unsecured creditors holding contractual rights and claims to payment. Both groups of creditors are on an even legal footing to be paid from the general assets of the company, as distinct from the rights of secured whose in rem rights entitle them to satisfaction from specific assets in the event of a default. Employees are commonly the silent or lost voice in bankruptcy proceedings, however, and often have little influence or bargaining power (outside the collective bargaining process). Yet, they stand to lose the most".

3.0. Preferential Payments of Debts upon Liquidation

Section 367 of the Companies Act specifies in detail the preferential claims in terms of hierarchy should a company be wound up. Albeit, the determination of the preferential claims does depend on the appointment of the receiver. In the case of Leonard Clement Mususa V. Attorney General and Another [2000] T.L.R. 181. Was stated that "the appointment of a Receiver does not alter the tax liability of the company. However, the appointment of the Receiver does determine which tax liability is preferential and which is not…" The provision, in essence, says that in a winding up, the company's preferential debts shall be paid in priority to all other debts. All Government taxes that include local rates and customs and excise duties due from the company at the relevant date and having become due and payable within twelve months next before that date are the top rank of priority under section 367 (2) (a) of the Act and must be paid first in the event of winding up. The second category of preferential debts is all Government rents not more than one year in arrears under section 367 (2) (b) of the Act. The third priority debt under section 367 (2) (c) of the Act is all wages or salary (whether or not earned wholly or in part by way of commission) of any employee not being a director in respect of services rendered to the company during four months next before the relevant date. The last category which occupies rank four under section 367 (2) (d) of the Act is workers' compensation and any other such right owed to the employees.

Apart from the preferential debts incorporate liquidation, it is also necessary to note that the expenses that relate to winding up tend to be paid up first out of assets of the company. The order of such preference is provided for in the *Companies (Insolvency) Rules, 2005*. Rule 254(1) stipulates that the expenses of the liquidation are payable out of the assets in the following order of priority:

(a) Expenses properly chargeable or incurred by the official receiver or the liquidator in preserving, realizing or getting in any of the assets of the company;

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(b) The fees payable under the Act or Rules, including those payable to the official receiver other than the fee, referred to in paragraph (d), and any remuneration payable to him under general regulations;
(c) The fee payable for the performance by the official receiver of his general duties as official receiver;
(d) Any repayable deposit lodged under any such order as security for the fee mentioned in paragraph (d);
(e) The cost of any security provided by an interim liquidator, or special manager by the Act or the Rules;
(f) The remuneration of the interim liquidator if any;
(g) Any deposit lodged on an application for the appointment of an interim liquidator;
(h) The costs of the petitioner, and of any person appearing on the petition whose costs are allowed by the court;
(i) The remuneration of the special manager if any;
(j) Any amount payable to a person employed or authorized, under Chapter 6; to assist in the preparation of a statement of affairs or accounts;
(k) Any allowance made, by order of the court, towards costs on an application for release from the obligation to submit a statement of affairs, or for an extension of time for submitting such a statement;
(l) Any necessary disbursements by the liquidator in the course of his administration including any expenses incurred by members of the committee of inspection or their representatives and allowed by the liquidator under rule 215, but not including any payment of corporation tax in circumstances referred to in paragraph (p);
(m) The remuneration or emoluments of any person who has been employed by the liquidator to perform any services for the company, as required or authorized by or under the Act or the Rules;
(n) The remuneration of the liquidator, up to any amount not exceeding that which is payable to the official receiver under general regulations;
(o) The amount of any corporation tax on chargeable gains accruing on the realization of any asset of the company without regard to whether the realization is effected by the liquidator, a secured creditor, or a receiver or manager appointed to deal with security.
(p) The balance, after payment of any sums due under paragraph (0) of any remuneration due to the liquidator.

Accordingly, any surplus assets available after having paid the expenses of liquidation and the various claims of the creditors must be distributed among members according to their defined rights and interests in the company (Lwuoha, 2021). The question here comes; should the employee rights and entitlements receive special attention and or protection above and beyond other creditors should the company assets proved insufficient?

4.0. The International Labour Organization (ILO)

During the 20th Century, the International Labour Organisation codified the necessity of having priorities in protecting domestic workers. In 1949 the ILO convention on the protection of wages stated in Article

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11.1 that *"in the event of the bankruptcy or judicial liquidation of an undertaking, the workers employed therein shall be treated as privileged creditors either as regards wages due for service rendered during such a period before the bankruptcy or judicial liquidation as may be prescribed by national laws or regulations or as regards wages up to a prescribed amount as may be determined by national laws or regulations".* The Convention declares that employees' claims should be considered to have preference over other preferential debts, especially state debts. Article 11 of the Convention was indeed revised by the Protection of Workers' Claims (Employer's Insolvency) Convention No. 173, which was adopted in 1992, purposely to improve the protection enshrined in the 1949 Convention by setting specific standards concerning the scope, limits and rank of the privilege, which are scarcely provided in the said Convention, and introducing new concepts; namely, wage guarantee schemes, designed to offer better protection than the traditional privilege system.

5.0. Application for Protection of Employees under Section 367of the Tanzania Companies Act

The provision offers preferential status to all wages and salaries to employees in respect of service rendered in the four months before liquidation. Accordingly, employees rank as unsecured creditors (with no preferential status) in the order of priority. To this end, the position of employees in respect of their entitlements significantly cast some doubts. The literature, in many jurisdictions, reveals that in the event where the company is being wound up, either voluntarily or involuntarily, the first and foremost consideration by the company is upon the payment of debts to the secured or insured creditors simply because are the ones who hold the benefit of any guarantee or mortgage on property of the company in the course of loan transactions and the like. Therefore, those stakeholders, including employees whose rights are not secured by the assets or property of the company, must wait until the ranking order of payments based on preferential debts is fully executed.

6.0. Legislative Provisions for the Consideration of Employees by Directors under the Tanzania Companies Act

Section 183 of the Companies Act imposes the duty to the directors to have regard to the interests of the employees. It says that "the matters to which the directors of the company are to have regard in the performance of their functions include, in addition to the interests of the members, the interests of the company's employees". It is argued that since the insolvency or liquidation of a company and consequently the suspension of payments directly threatens the means of subsistence of employees and their families, and the fact that they do not normally have share which may ultimately determine their share or interest or loss of the profit (i.e., they share nothing), their wage claims deserve special protection, and it is found that, though the directors owe this statutory duty to the employees, the duty is not directly enforceable by employees rather it is owed to and enforceable by the company. The provision is silent on striking a balance should the conflicts of interest between the members and the company's employees

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emerge. (Nyombi, 2013). What is provided under sub-section 1 is taken away by sub-section 2. Sub-section 2 states that "the duty imposed by this section on the directors is owed by them to the company (and the company alone) and is enforceable in the same way as any other fiduciary duty owed to a company by its directors". This position was indeed described by the common law in Parke V. Daily News [1962] Ch 927, where the court held that "there was no authority to support the proposition advanced by one of the parties that the board of directors must take into account its duty to employees.

Since the directors are officers of the company, they owe statutory duties to the company, the shareholders, creditors, and employees in all life of the company even in the event of winding up the business undertakings. It is essential to examine the relevant provisions of law that impose duties to the directors and make the analysis as to whether their application may directly afford the protection of employees' interests should a company being wound up. Alternatively, the examination of the duties of directors would ultimately answer the question that to whom the interest should prevail or be taken into consideration over another in the course of exercising the statutory duties vested to the directors? The statute, at common law, has by necessity been forced to intervene to increase such duties owed by directors to their company and the shareholders, employees and creditors of that company to provide a measure of protection for those concerned. Indeed, in Tanzania jurisdiction, the Companies Act provides the basic legal duties of directors when exercising their powers. That the law requires them to act honestly and in good faith for the best interests of the company for proper purposes, and the duty to exercise care, skill and diligence. This has been enshrined under Sections 182(1), 184 & 185. Section 182(1) strictly spells out "the best interests of the company" of which the directors should always rely upon in the course of performing their functions. In other words, what is said to be the best interests of the company should be reasonably and with due care and skills determined by directors themselves, unless otherwise expressly provided by the articles of the company. Courtney (2017: 99) stated the following:
"The directors of the company have an overriding duty to act in the best interests of the company…In terms of hierarchy, the director's overriding duty is to act in the best interests of the company; when a company is a solvent, this is generally considered to be seen as being for the benefit of the company's members; when a company is insolvent, as being for the benefit of its creditors."

Section 182 (1) of the Act and the words quoted above have substance to improve the viability or effectiveness of the business, though, it expressly suggests uncertainty of duty owed to directors with section 183 (1) of the same law as previously pointed out. To recap, the latter requires the directors to consider the interests of the members in addition to the interests of the employees. These two provisions put the directors in a dilemma in the event when the interests of the company's members conflict with the long-term interests of the continuing existence of the company and the relationship with its employees.

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To this end, unlike the general duty of directors to the employees, it is necessary to specifically examine the duty owed to directors towards the creditors in the event of liquidation

7.0. Application for Protection of Employees in Priority Ranking in Other Jurisdictions

7.1. The Uganda Position

Uganda developed a specific Act for insolvency issues; namely, the Insolvency Act, No. 14 of 2011. This Act upholds the interests of unsecured creditors, including employees. Section 10 of the Act allows unsecured creditors to make claims in writing. Moreover, section 12(4) (c) of the same law spells out that, any person who petitioned court claims for reasonable costs upon liquidation or bankruptcy is among the first creditors to be paid. This includes, as per the author's view, unsecured creditors. The notable challenge in the Act as regards to the protection of employees is that the foremost priority is given to the settlement of remuneration and any expenses incurred by the liquidators, trustees, receivers, and administrators, then followed by employees' rights (i.e., all wages or basic salary, all amounts due in respect of any compensation, and all amounts that are preferential debts), and finally government taxes. At this juncture, government taxes and insolvency expenses are not that crucial to be paid in full before other company's debts. Nyombi (2013) critically examines the hereunder varying legal treatment of employees' entitlements in the case of employer's insolvency or judicial liquidation and encourages developing countries to develop insolvency laws that both achieve market strength and efficiency while protecting the rights of those most vulnerable in the insolvency process.

7.2. The South Africa Position

It has been examined by the author that insolvency terminates all employment contracts. It follows therefore that, in South Africa, upon termination, the employees' entitlements are highly considered than secured creditors in a sense that there is no preference over secured. The first ranked is wages up to 3 months, and the next ranked (all paid *pari passu*) are holiday, leave, and severance pay.

7.3. The Australia Position

Likewise, the study examined the legal treatment of employees' entitlements in Australia. It is found that the priority in liquidation is accorded to unsecured debts and claims. Under this jurisdiction, the debts and claims which are given priority to employees include the wages and superannuation contributions, injury compensation, industrial instrument leave of absence, and retrenchment payments.

7.4. The Belgium Position

In Belgium, if the contract is immediately terminated on the employer's insolvency, the salary and benefit claims must be made within 15 days of the close of business. Following the arrangement of payments, the

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preferential claim for unpaid wages, and social security contributions are ranked first followed by the claims secured by specific assets.

7.5. The India Position

Under the India position, the employees are accorded *pari passu* treatment with secured claims. Also, they ranked equally among taxes and fiscal claims. The entitlements due to employees considered thereof include wages or salaries not exceeding 4 months in the prior year, accrued holiday pay, amounts owed under Employees State Insurance Act and Workmen's Compensation Act, and pension fund benefits as the author observes furthermore.

8.0. Analysis of the Protection of Employees upon Corporate Liquidation

8.1. The Companies Act does not Protect Employees during Liquidation Process

The examination of the provisions of the Tanzania *Companies Act* in respect of the treatment of employees reveals the following discussion;

8.2. Preferential Debts

This is the cornerstone element on which the study intended to focus and generate the minimum standard of protection of employees thereof on corporate liquidation process. The study has *inter alia* examined section 367 of the Act and found that the requirement of having debts being paid basing on the prescribed ranks of priorities directly impacts the position of employees as unsecured creditors. The principle that each class of debts is paid in full under the list of priorities may significantly create the possibility that the subsequent class of creditors would not be paid at all. Employees' wages and government taxes, local rates and customs and excise duties are real examples of preferential debts under the Companies Act. However, priorities are subject to limitations. Employees' claims are prioritized to wages of four months only, whilst government taxes, local rates and customs, excise duties and rents to be paid in preference are of twelve months in arrears as it is provided for under Section 367(2) (a-c) of the Act. Therefore, the wording of section 367 of the Act does not protect the interests of employees, as the requirement to pay all wages or salary of the employees in respect of services rendered only during four months next before the relevant date is unjust. This is since sometimes the employees may not have been paid for quite more than four months. Hence, four months payment is deemed unfair as far as the protection of employees is concerned. It is also submitted that the entitlements of employees are also not termed as liabilities of the company by section 357 of the Act, hence, less preferred to be paid by the company. As examined earlier, the international experience emphasizes the protection of employees should the employer becomes insolvent. The article has pointed out the well-established international principle formulated by ILO that requires the countries to treat the employees as privileged creditors in the event of judicial liquidation. It follows, in essence, employees are the creditors most affected by the insolvency of their employer. Their

position can be contrasted with the position of other creditors who are likely to have other sources of revenue and may have securities or personal guarantees to support their debts. Hence, the principle suggests that employees should be fairly protected over other creditors under the law. The paper has examined different countries which significantly offer preference to the employees over and above other debts and claims including the secured in the employer's insolvency. To this end, the said international principle by ILO regarding the standard of treatment of employees in judicial liquidation of the corporate entity is hereby honoured and observed.

8.3. Lack of Enforcement Mechanism by Employees against the Directors of a Company

Chapter VII of the Companies Act provides duties and liabilities of the directors. In particular, the Act requires directors to exercise their power for proper purposes (Section 184), to act honestly and in good faith for the best interests of the company (Section 182). The law also requires directors to consider, in addition to the interests of the shareholders, the interests of the company's employees when performing their duties (Section 183). The implementation of such a requirement can be problematic both conceptually and in practice. Conceptually, shareholders' interests and those of employees tend to conflict. For instance, employees desire stable employment and higher salaries, whilst shareholders require a greater return on their investments in the form of dividends and capital gains. The questions arise here about the criteria for resolving these conflicting interests. In practice, the implementation of this provision is problematic because directors are appointed or selected by shareholders. Therefore, in essence, directors owe their positions and hence allegiance to the company and not to the employees.

9.0. Protection of Employees during Liquidation of Companies in some other Jurisdictions is Fairly Adequately Compared to Tanzania Jurisdiction

Tanzania is not a sole regime that ought to provide a legal framework for the protection of employees during the liquidation process. That being a case, the article has explored the experiences from other jurisdictions and pinpoints the adequacy of protection to employees should a company stand liquidated.

10.0. CONCLUSION

It is the main contention in this paper that the provisions of the Companies Act do not protect employees upon company liquidation. Some tend to conflict with the interests of shareholders and employees. With this aspect, in a real sense, the study found that where such conflict arises the shareholders' interests prevail. In the same vein, secured creditors are accorded the first rank to receive their entitlements in the event of insolvency of the company. This paper has also discussed a variety of jurisdictions in comparison with Tanzania jurisdiction basing on the protection of employees in the event of judicial liquidation of the employer. It found out that the Companies Act weakly protects the rights of employees compared with the treatment and protection of employees in other regimes outside the country. The employees' rights are risked in the hands of powerful creditors like secured and government taxes. The current insolvency

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provisions create gaps among creditors since, at the end of the game, the insolvency consequences leave the employees with nothing in return for the debts. Accordingly, Tanzania is not much developed in corporate insolvency aspects in the light of protection of employees' rights. Thus, it has to learn from other jurisdictions cited in the study how to protect employees' rights to fulfil the main target of insolvency rules. Thus, amendment of the Companies Act to incorporate absolute protection to the employees and to have a specific Act for insolvency matters is fundamental.

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