Corporate restructuring guidelines

Insolvency

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INSOLVENCY

1. Introduction

The directors of a company that is in financial distress, to the extent that it cannot discharge its liabilities as they fall due (which is the primary indicator of an insolvent company), face difficult decisions and a number of choices. The options open to them will depend largely on the extent of the financial difficulties, on the level of support from the company's principal creditors and how quickly the directors react to the particular circumstances. If the company's difficulties are recognised in time it may be possible to rescue the business. Otherwise, the directors will be forced into putting the company into liquidation, or having it wound up by the creditors.

Basically, the directors have two choices:

- To continue trading but on the basis of a compromise or scheme of arrangement reached with or imposed on the creditors of the company; or

- To cease trading and have the company wound up.

To some extent the decision may be taken out of the hands of the company if, for example, having defaulted on the repayment of a loan advanced to it by its bankers, a receiver is appointed over the business and/or assets of the company.

This Chapter will consider the following:

- Schemes of arrangement
  - Informal, out-of-court arrangements
  - Court-approved schemes of arrangement
- Liquidation
- Receivership

It will also consider what remedies are available to creditors of companies that are experiencing financial difficulties and companies that have become insolvent and what action creditors can take to recover amounts due to them and how they can protect their interests and minimise their losses in the event of the debtor companies becoming insolvent.

2. Schemes of Arrangement

These involve arrangements with the creditors of an insolvent company and can be either –

- informal, out of court arrangement with creditors; or

- court-approved scheme of arrangement
  - examinership
  - section 201 arrangement

Informal schemes of arrangement

Informal schemes of arrangement involve the company reaching a compromise with its creditors whereby the creditors agree to defer and/or write down the amount owing to them by the company. Depending on the complexity of the business and the number of creditors, these can be difficult and time-consuming to put together and there is no protection for the company from

the creditors whilst all that is going on. A further drawback is that arrangements of this kind require the approval of all affected creditors – i.e. the creditors whose position is compromised..

Examinership

In Ireland the most common form of court-approved scheme of arrangement is that known as *examinership*. This is a process by which an examiner is appointed by the court to a company that is unable to pay its debts (and, therefore, insolvent) whose function is to propose a rescue plan for the company by means of a compromise or scheme of arrangement with the creditors and the members (i.e. the shareholders) of the company, and whereby the company is protected from its creditors while the examiner formulates proposals for the compromise or scheme of arrangement.

The court has no power to appoint an examiner unless it is satisfied that there is a reasonable prospect of the survival of the company and all or a part of its business as a going concern.

Usually it is the company itself that petitions the court for the appointment of an examiner, but this may also be done by the directors, a creditor, or shareholder of the company or any combination of them.

The petition for the appointment of an examiner must be accompanied by a report from an independent accountant which must include –

- an opinion as to whether the company or any part of its business has a reasonable prospect of survival as a going concern;
- a statement of the conditions which the independent accountant considers essential to ensure survival;
- an opinion as to whether the acceptance of proposals for a scheme of arrangement would offer a reasonable prospect of the survival of the business as a going concern which would be more advantageous to the members of the company and its creditors than a winding-up of the company;
- details of the extent of the funding required to enable the company to continue trading during the period of protection and the source of that funding;
- recommendations as to which liabilities incurred before the presentation of the petition should be paid;
- an opinion as to whether any deficiency between the company's assets and liabilities has been satisfactorily accounted for.

The issue of funding is important and a lack of capital or credit can result in an application for the appointment of an examiner being unsuccessful.

The initial period of court protection is 70 days from the date of the petition, however this may be extended to 100 days, by which time the examiner must have formulated proposals for a compromise or scheme of arrangement, convened meetings of members and creditors to consider those proposals and filed a report with the court indicating the acceptance or otherwise of those proposals.

Once the examiner's report has been filed, the court has the power to continue the period of protection for as long as the court takes to decide whether to confirm the scheme as proposed by the examiner or as the scheme may be modified by the members or creditors with the examiner's

consent at the meetings called by the examiner to vote on the scheme, or as modified by direction of the court.

A scheme that can be shown to produce a better outcome for the creditors, and one that is no worse for members, than would be the case if the company were wound up is likely to be confirmed by the court. The court may not make any decision without affording creditors the opportunity of being heard.

The court may not confirm proposals unless at least one class of the creditors whose interests or claims would be impaired has accepted the proposals and unless the curt is satisfied that the proposals are fair and not unfairly prejudicial.

The examiner is entitled to be paid all costs sanctioned by the court out of the revenue of the business of the company to which he is appointed or the proceeds of realisation of assets, and these costs are paid in priority to all other claims, whether secured or unsecured, under the scheme of arrangement. If no scheme of arrangement is approved, the examiner's costs rank ahead of all claims in any subsequent receivership or liquidation of the company.

The benefits of court protection include the following –

- no action may be taken to wind up the company
- a receiver cannot be appointed
- the property of the company cannot be repossessed or subjected to any form of sequestration
- no proceedings may be taken to enforce any security affecting any property or income of the company
- no action may be taken against any person who has guaranteed the debts of the company
- stock held on a retention of title basis cannot be repossessed by the supplier during the examinership period.

If at the time the petition for the appointment of an examiner is presented a receiver has already been appointed to the company for less than three days the court can direct that the receiver cease acting. The court does not have power to appoint an examiner where a receiver stands appointed to the company for a continuous period of three days. Where a petition to wind up the company has been presented before the presentation of the petition to appoint an examiner the court will generally deal with the examinership petition first and if the application for the appointment of an examiner is not successful the court will then usually appoint a liquidator to the company. If at the time the petition to appoint an examiner is presented a provisional liquidator has already been appointed to the company, the court has power to direct that the provisional liquidator cease acting and may appoint the provisional liquidator (or some other person) as examiner.

During the period of court protection the management of the company remains with the existing management and directors although the examiner is entitled to convene, set the agenda for and attend and speak at directors' meetings and he may also apply to the court for an order that all or some of the functions and powers of the directors be exercisable only by the examiner. Among the matters to be included in the independent accountant's report filed with the petition is an indication of the conditions as regards the internal management or controls of the company which he considers essential for the survival of the company as a going concern. Accordingly, confirmation of a rescue plan could be conditional on management and other changes being made.

An examiner has power to apply to court or take whatever steps are necessary to halt, prevent or rectify any act or omission, course of conduct, decision or contract which in his opinion is detrimental to the company or its creditors or members.

During the period of court protection the company is prohibited from paying any pre-petition debt unless it is included among the debts recommended for payment in the independent accountant's report or unless the court directs otherwise.

Whilst it is possible for the examiner's proposals to compromise not only amounts owing to creditors as at the date of the petition, but also future liabilities, there is a specific section in the legislation which states that an examiner's proposals may not contain a provision providing for the reduction of the amount of any rent or other periodic payment under a lease that falls to be paid after the compromise or scheme of arrangement takes effect or the complete extinguishment of the right of the landlord to any such rental payments. The same applies to any lease of property other than land if, in the court's opinion, the value of that property is substantial. Of course, this does not prevent lessors agreeing to any such proposals being included in the scheme.

Where a creditor's debt is guaranteed and the creditor wishes to enforce the obligations of the guarantor, the creditor must within specified time limits (which depend on the length of notice of the meeting convened to consider any proposals for a compromise or scheme of arrangement) serve notice on the guarantor containing an offer in writing to transfer to the guarantor any rights to vote on the proposals in relation to the guaranteed debt.

Case study

Company X loses a substantial contract. The company's directors consider a business plan to return the company to a sound financial footing. However, the directors fail to reduce the company's overheads sufficiently and the company comes under pressure from its bankers who hold personal guarantees from the directors. The directors continue the business hoping things will improve if they can secure new business, and give a charge to the bank over the company's assets. However, things quickly disimprove and application is made for the appointment of an Examiner. The Examiner is appointed and, due to concerns on the part of the Examiner and the Court about the granting of the charge to the bank, the Examiner's scheme which is approved by the Court treats the bank debt as though it were unsecured (with the Bank ensuring it retains its rights under the personal guarantees). The Examiner's scheme provides a dividend to creditors which is partly funded by new investment made by investors to whom there is a forced transfer of all the shares in the company and whose nominees are appointed as directors in place of the former directors of the company.

Section 201 scheme

This is a reference to section 201 of the Companies Act 1963 under which a scheme of arrangement that has the approval of a majority in number representing three fourths in value of an affected class of creditors can be made binding by the court on all the creditors in that class. It is an infrequently used method of rescuing a company – possibly due to the absence of any statutory framework. On the other hand, one of its advantages is the fact that there are not the same strict time limits that apply in the examinership process. The court has power to stay all proceedings or to restrain further proceedings against the company for as long as it thinks fit. However, the appointment of a receiver cannot be prevented while a company is trying to formulate and have approved such a scheme.

3. Liquidation

There are two types of insolvent liquidation in Ireland, namely a Creditors' Voluntary Liquidation and a Court Liquidation and these will be dealt with in turn.

Creditors' Voluntary Liquidation

This is a process initiated by the directors of an insolvent company who arrange for the calling of shareholders' and creditors' meetings. Creditors have to be given at least ten days' notice of the creditors' meeting. The shareholders' meeting usually takes place immediately before the creditors' meeting and resolves by ordinary resolution that the company cannot by reason of its liabilities continue in business and that it be wound up voluntarily. The shareholders nominate a liquidator, usually a professional accountant.

The directors of the company must present a full statement of the position of the company's affairs at the creditors' meeting together with a list of the company's creditors and the estimated amount of their claims.

The creditors' meeting can be important from the viewpoint of the creditors as it presents them with an opportunity to question the chairman of the meeting, who must be one of the directors, regarding the affairs of the company.

The creditors may also nominate a person to be liquidator, and if a majority (not by number but by value) of the creditors vote for a particular person to act as liquidator then that person prevails over the person chosen by the shareholders.

The creditors may appoint up to five people to a Committee of Inspection and the shareholders of the company have the power to appoint up to three more persons to act on the Committee. This Committee, if appointed, acts as a forum for the liquidator to consult with the creditors.

The liquidator in a creditors' voluntary liquidation –

- realises assets;
- advertises for creditors' claims;
- pays preferential debts (typically employee claims for arrears of wages etc., Revenue debts and Local Authority rates);
- reports to the Office of the Director of Corporate Enforcement and, unless relieved from having to do so by the Office of the Director of Corporate Enforcement, applies to the Court for a restriction order against the directors under Section 150 of the Companies Act, 1990 (see below);
- distributes the proceeds of the company's assets rateably among the creditors (after payment of liquidation costs and preferential creditors).

Restriction Orders

In the case of an insolvent liquidation (either a creditors' voluntary liquidation or a court liquidation) the liquidator must report to the Office of the Director of Corporate Enforcement and (unless relieved from doing so by the Director) make an application to court for a restriction order against the directors which, if made, will prevent them for a period of five years, from being appointed or acting in any way as a director or from being involved in the promotion of any company unless that company has a minimum paid up capital of €317,435 in the case of a public company and €63,487 in the case of a private company.

The court is obliged to make a restriction order against any director (or shadow director) who fails to satisfy the court that he or she acted honestly and responsibly in relation to the conduct of the affairs of the company. Although the legislation specifically applies to shadow directors and although it has been decided that a company can be a shadow director, it has only recently (December 2008) been held by the Supreme Court that a corporate shadow director cannot be the subject of a restriction order because it is prohibited under company law from being a company director in the first place.

To ensure that directors can show they have acted honestly and reasonably it is critical that they have accurate and up to date financial information relating to the company and that they take appropriate financial and legal advice to assist and guide them in making the correct decisions.

The liquidator calls annual meetings of shareholders and creditors during the course of the liquidation at which he presents an account of his acts and dealings. This account must be filed in the Companies Registration Office.

The liquidation concludes when the liquidator calls a meeting of shareholders and also a creditors' meeting at which he presents a final account of the winding up showing how the liquidation has been conducted and the property of the company disposed of. That final account is lodged in the Companies Registration Office which then dissolves the company.

Case study

Company Y cannot pay all its debts and realises it will not be able to trade out of its difficulties. It seeks advice from its auditors who assist it in convening a meeting of the company's shareholders and a meeting of the company's creditors. At the shareholders' meeting Mr. A is nominated as Liquidator. However, at the creditors' meeting the majority of creditors in value have voted in person and by proxy for Mr. B who is, therefore, the Liquidator. During questioning at the creditors' meeting the directors admit that in the months before liquidation they repaid substantial personally guaranteed monies to the company's bank. Mr. B subsequently successfully pursues the directors for the amounts repaid to the bank.

Court Liquidation

This is a court-supervised process which is generally commenced by a creditor petitioning the court because the company is unable to pay its debts.

The court may also order the winding up of a company on the company's own petition or when the court is of opinion that it is just and equitable to wind up the company or where the court is satisfied that the company's affairs are being conducted or the powers of the directors are being exercised in a manner which is oppressive to any shareholder.

A petitioning creditor generally sends a letter of demand to the company before issuing the petition for liquidation. This avoids disputes as to whether a company is insolvent because

under Irish company law a company is deemed to be unable to pay its debs when a creditor has demanded a sum exceeding €1,269.74 and that sum remains unpaid for three weeks.

A winding up petition must be advertised in the press before the hearing of the winding up petition and creditors are entitled to attend and be heard at the Court hearing.

Sometimes a provisional liquidator is appointed by the court pending the court's hearing of the winding up petition, particularly in cases where the company's assets are at risk.

The liquidator is appointed by the Court as liquidator of the company and the Court requires the directors to make a statement of affairs setting out the assets and liabilities of the company. The Court may also grant the liquidator any powers that are considered necessary for the winding up of the company.

Any execution against the property of the company is void after the commencement of the winding up. Any disposition of the property of the company and any transfer of shares or alteration in the status of the shareholders of the company made after the commencement of the winding up is also void (unless the Court otherwise orders).

After the liquidator is appointed no proceedings may be proceeded with or commenced against the company without the permission of the Court.

In cases of substance the Court will usually require the liquidator to prepare a business plan setting out how he intends to handle the liquidation.

The liquidator in a Court winding up –

- realises the assets of the company;
- advertises for creditors;
- pays the preferential debts;
- reports to the Office of the Director of Corporation Enforcement and unless relieved from having to do so, applies to the Court for a restriction order against the directors (explained above);

When he has realised the assets and dealt with the adjudication of creditors' claims he applies to Court for liberty to pay a dividend to the creditors;
distributes the proceeds of the company's assets (after payment of liquidation costs and preferential creditors) rateably among the creditors by way of dividend in respect of what they are owed.

The liquidator applies to the Court for a final Order ending the liquidation. That Order is filed in the Companies Registration Office which then dissolves the company.

Case study

Company Z has not paid a substantial debt due to one of its creditors and appears to be in a state of continually avoiding its liabilities. The aggrieved creditor sends a 21 day demand which is not paid. The creditor then petitions to wind up the company and applies for the appointment of a provisional liquidator. The Court appoints a provisional liquidator with power to take possession of the company's assets pending hearing of the winding-up petition. At the hearing of the petition the company's directors object on the basis that new finance from its main commercial partner is imminent. The Court adjourns for 1 week to see if the investment materialises, but it does not, and no one applies for the appointment of an Examiner as there is no prospect of the company surviving without the new investment. The Court orders the winding-up of the company and appoints the provisional liquidator as official liquidator. The official liquidator

proceeds to wind down the business and sell the assets of the company and he takes restriction proceedings against the directors.

4. Receivership

A receivership is a process based on contract which is not conducted under the supervision of the court. Typically, the contractual right to appoint a receiver is given by a company to its lenders and will be contained in a debenture taken by a bank creating fixed and floating charges over the assets of the company.

The debenture provides that if the company defaults in repayment of the loan the bank may appoint a receiver or receiver and manager over the property charged by the debenture. Usually the receiver is a professional accountant.

A company can also request a bank to appoint a receiver pursuant to the debenture but this does not occur too often.

The receiver's function is to sell the assets charged by the debenture so that the bank can be repaid the money it loaned to the company together with the interest due to the bank.

In the case of a fixed charge the bank receives all the sale proceeds less receivership costs.

In the case of a floating charge the receiver has to pay the preferential creditors first of all and the bank receives the remainder less receivership costs.

There are procedures available to the receiver under company law to apply to the court for directions if difficult issues arise during the course of a receivership.

A receiver is not obliged to make an application to the court for a restriction order against the directors.

Case study

A company has charged its principal assets to its bank. The bank has given a number of extensions of time for payment. The time given in the latest extension has passed and the bank issues a demand for repayment of its full indebtedness plus interest owing. The company has not the money to pay. The bank appoints a Receiver the day after it issued its demand. The next day the company applies to Court and goes into Examinership. The Receiver is sidelined. However, the Examinership is not successful because the Examiner is not able to attract new investment to improve the position of creditors and the bank maintains the position that it wants the Receiver to take control of the charged assets and sell them in an orderly fashion. The Examiner is discharged by the Court and the Receiver takes over the charged assets. The Court also appoints an official liquidator who deals with the remaining property of the company which was not charged to the bank.

5. Creditor's remedies

Court Proceedings

Creditors can consider bringing Court proceedings to obtain Judgment against the debtor for the debt due to it, usually following letters of demand from the creditor or from its solicitor.

The District Court has jurisdiction for amounts up to €6,348.69.

The Circuit Court has jurisdiction for amounts up to €38,092.14.

The High Court has unlimited jurisdiction.

The Commercial Court (a division of the High Court) was set up in recent years and is available to deal very quickly with large commercial disputes involving amounts in excess of €1,000,000.

The Supreme Court is the final Court of Appeal which usually deals with complex points of law.

The threat of registering a Judgment in the Trade Gazettes is sometimes more effective than obtaining Judgment and then trying to enforce the Judgment by the means mentioned below.

Once Judgment has been obtained from the Court there is a range of remedies open to the creditor to try and secure payment of the amount owed –

- the Court Order (an Execution Order) is sent to the Sheriff (usually the County Registrar except in Dublin City and County) to seize and sell the debtor's assets;

- register the Judgment as a Judgment Mortgage on the debtor's land and then move to obtain a Court Order to sell those lands;

- if the creditor is aware that money is owing to the debtor by a third party it may seek to attach/obtain that money by obtaining a Garnishee Order from the Court.

In serious cases where there is sufficient evidence of an attempt by a debtor to dissipate its assets or remove its assets from the jurisdiction of the court a creditor may be advised to seek an injunction (a Mareva Injunction) to prevent that happening.

European Order for Payment

A relatively recent development (December 2008) in the Member States of the EU (with the exception of Denmark) was the introduction of a European Order for Payment. It was set up to provide a simplified system for a creditor to collect an uncontested debt from a debtor in another Member State.

Out-of court remedies

Liens

Creditors may by contract or by custom of a particular trade or business be entitled to hold onto goods in its possession belonging to a customer until the sum due is discharged by the customer. For example if a customer leaves his car in for repairs with a garage the garage may be able to hold on to the car until the repair bill has been discharged.

Pledges

If goods have been pledged as security for a loan (say with a pawnbroker) the creditor may have the right to retain and sell the goods if there is a default by the customer.

Set-off

The right of set-off (if available) may be useful where two parties have mutual trading (i.e. each party owes money to the other party) and rather than paying monies over to the other party (particularly where the other party may be insolvent) the amount due can be set off (or deducted) from the sum due by the party making the deduction.

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Trust Claims

If money is paid to an intermediary or agent for transmission to a third party who is providing the service or goods and the money is not passed on to that third party the possibility exists (if the intermediary has a bank account in credit to which the payment can be traced) of obtaining the return of the money, This is particularly important in the case where the intermediary goes into liquidation and the money may not then form part of the money available to the creditors generally but is held in trust by the liquidator for the customer of the intermediary.

Retention of Title

A supplier who sells goods on the condition that ownership of the goods will not pass to the buyer until the goods are paid for may be entitled to retrieve its goods and this right is particularly valuable if the buyer becomes insolvent. A supplier will not be able to take back goods if the buyer (being a company) is in examinership.

To enable the goods to be recovered the goods supplied must –

- be identifiable;
- not have been manufactured into something different;
- not have become a fixed part of something else.

If the goods have become something else or part of something else then the creditor may lose its right to retrieve the goods as a court is likely to hold that the retention of title provision in the contract amounted to a charge which required registration under the Companies Act. If a charge is not registered the retention of title claim will fail in the case of an insolvent buyer.

It is important to note that a creditor should be careful not to vote at a Creditors' Meeting where it has a retention of title claim as if it votes it may be deemed by the liquidator to have lost or surrendered its claim.

Further information:

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