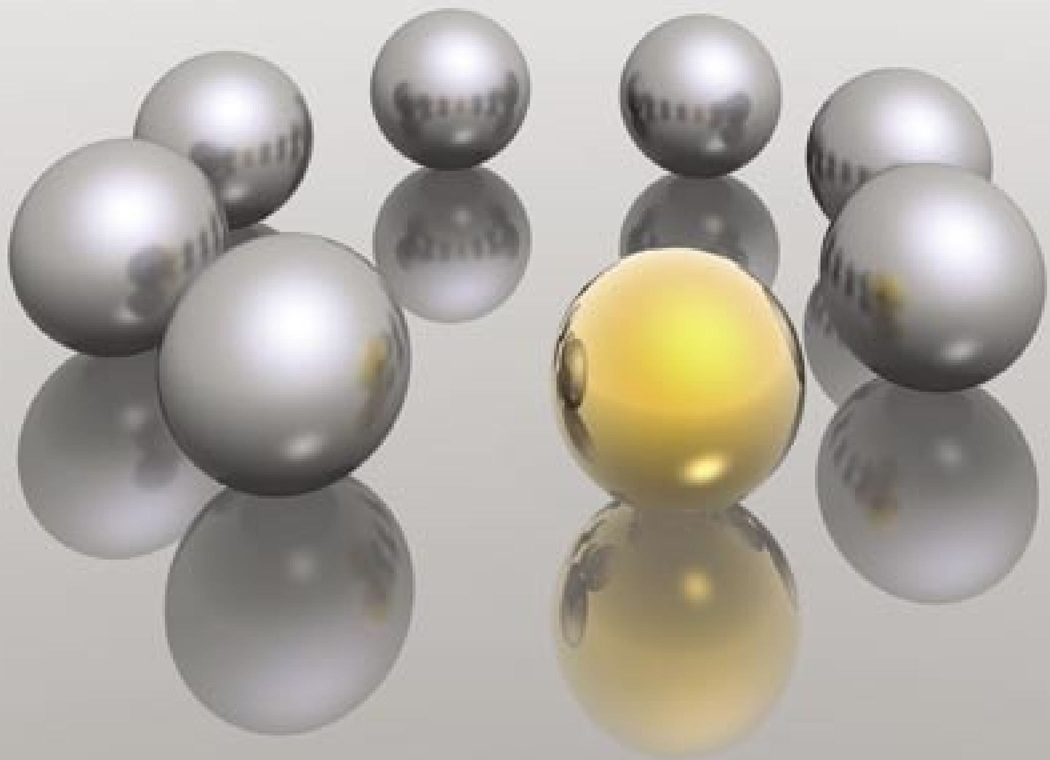
COMPANY LAW REVIEW GROUP

an grúpa athbhreithnithe dlí cuideachtaí

Report of the Company Law Review Group

2007



Report of the Company Law Review Group 2007
Table of Contents

Chairman's Letter and Membership of the Company Law Review Group

Chapter 1: Overview and Update on the Companies Consolidation and Reform Bill

Chapter 2: Work Programme of the Company Law Review Group for 2007

2007 Company Law Reform Agenda – Review Group's Committees' Terms of Reference 12

Chapter 3: Registration and Incorporation Issues

3.1 Changes to and Use of Registers of the Companies Registration Office (CRO) 17

3.1.1 Registration of Judgment Mortgages 17
3.1.2 Non-Publication of Directors' Addresses 19
3.1.3 Power of Registrar to Rectify Entries Made in the Register of Companies and the Re-Use of CRO Information 21
3.1.4 Location and Cost of Registers 24

3.2 Operational Issues 25

3.2.1 Thresholds for Defining Small and Medium-Sized Companies 25
3.2.2 Removal of the Requirement for Companies to have a Common Seal 27
3.2.3 Review of Measures relating to Irish Registered Non-Resident Companies 28
3.2.4 Limitation on the Number of Directorships 29

Chapter 4: Partnership Law

4.1 Limited Liability Partnerships (LLPs) 33
4.2 Limitation on Number of Partners 40
4.3 Questionnaire on LLPs and the Limitation on Number of Partners 41

Chapter 5: Audit and Financial Issues

5.1 Auditors' Liability 43

5.2 Other Audit-related Issues 51

5.2.1 Audit Committees – Section 205B of the Companies Act 1990 51
5.2.2 Audit Exemption Thresholds 59
5.2.3 Extension of Audit Exemption to Small Groups of Companies and to Dormant Subsidiaries 60
5.2.4 Power of the Office of the Director of Corporate Enforcement (ODCE) Regarding Entitlement to Audit Exemption 62
5.2.5 Miscellaneous Amendments proposed by the Irish Auditing and Accounting Supervisory Authority (IAASA) 64

5.3 Recognition and Protection of the Term 'Accountant' 67

Chapter 6: Compliance and Enforcement Issues

6.1 Consent Procedures in lieu of Restriction and Disqualification of Directors 73
6.2 Proposal to allow ODCE to put Directors on Notice of a Contravention 80
6.3 Proposal to Permit Multiple Proceedings on the Same Facts Within a Single Set of Summary Proceedings 82
6.4 Good-faith Reporting ('Whistleblowing') of Breaches of Company Law 87

Chapter 7: Modernisation Issues

7.1 Introduction 97
7.2 Prohibitions on Company Transactions with Directors and Connected Persons 98
7.3 Financial Assistance in connection with the Acquisition of Shares 103
7.4 Preferential Payments in a Winding-Up or Receivership 105
7.5 Distributions and Share Capital 120

Chapter 8: EU Developments

8.1 Introduction 123
8.2 Regulation for a European Private Company Statute (EPC) 123
8.3 EU Company Law Simplification Initiative 124
8.4 EU Action Programme to Reduce Administrative Burdens 124
8.5 Directives Currently being Transposed 125

Chairman's Letter to the Minister for Enterprise, Trade and Employment, Mr Micheál Martin T.D.

Dear Minister

It is my privilege to present to you the Report of the Company Law Review Group on our 2007 Work Programme.

The Work Programme was challenging, ranging from technical and legal issues to issues which undoubtedly impinge on the operation of company law in Ireland but may also have wider ramifications in terms of socio-economic policy. The approach of the Review Group was to seek to preserve the balance between the need for a positive corporate governance culture in Ireland, targeting real mischief, and the need to minimise the regulatory burden on business, while at all times staying within our statutory remit.

In the earlier part of 2007 we finalised and published the General Scheme of the Companies Consolidation and Reform Bill. This massive undertaking (the General Scheme runs to nearly 1,300 sections) was the culmination of the first seven years, including three reports, of the Review Group's work. As well as the consolidation of the existing thirteen Companies Acts and numerous statutory instruments into one piece of legislation, the General Scheme modernises and simplifies the company law regime in Ireland. Our proposals radically overhaul the presentation and content of company law by placing the private company limited by shares at the centre of the legislation and by making a number of changes which will simplify the law, particularly for small companies which are the lifeblood of enterprise in Ireland.

Company law reform may not excite the public imagination as much as other issues but there can be no doubt that, as a body of law intended to facilitate enterprise, the importance to the economy of a modern framework cannot be overstated. I know that you recognise this, are committed to company law reform and are taking a keen interest in the progress of the General Scheme. The Review Group is very pleased that on your recommendation the Government has seen fit to adopt the Review

Group's proposals and has proceeded with the drafting of the Bill. The Review Group stands ready to assist you and your Department in progressing this exercise through to publication and enactment of the Bill.

Company law is constantly evolving. No country can allow its company laws to stand still and Ireland is no exception. If the Government sees fit to accept the recommendations in this Report, it will be necessary to make some changes to the General Scheme. This is because the Review Group has discerned trends in other jurisdictions which have caused it to develop certain areas beyond the position proposed in the General Scheme.

As the membership of the Review Group expands and despite best efforts to achieve compromise, it has become increasingly difficult to secure unanimous support for all recommendations. Where indicated, some recommendations represent the majority view of the Review Group; these matters were not put to a formal vote and were carried by a clear majority of members but with some dissenting voices.

There were a total of 26 items on the Work Programme you set for us in 2007 and the research and discussion was facilitated in the first instance through 5 Committees. I would like to acknowledge the work of the Chairpersons of those Committees in driving the process, namely:

- Committee on Registration and Incorporation: Mr. Paul Farrell, Registrar of Companies;
- Committee on Partnerships: Mr. Mark Pery-Knox-Gore, the Law Society of Ireland;
- Committee on Audit and Financial Issues: Mr. Conall O'Halloran, Consultative Committee of Accountancy Bodies-Ireland;
- Committee on Criminal and Enforcement Issues: Mr. Paul Appleby, Director of Corporate Enforcement;
- Committee on Modernisation Issues: Mr. Paul Egan, Partner, Mason Hayes + Curran.

I would also like to acknowledge the work of the Steering Group (Paul Egan, Paul Farrell, William Johnston, Vincent Madigan and Ralph MacDarby) who met on a weekly basis for nearly three months to develop the Report before it received the full Plenary Group's approval.

I would also like to thank the Review Group's Secretary, Mr Eugene Forde, who heads-up the Secretariat (Ms Niamh King (replaced by Mr Eric Giguère) and Ms Jane Dollard), for his and their dedication to the task in hand, hard work in ensuring that deadlines were met and, generally, for his and their unfailing support to the Review Group and to myself as Chairperson.

On behalf of the Company Law Review Group, I commend the Report on the 2007 Work Programme to you.

Dr. Thomas B. Courtney
Chairman

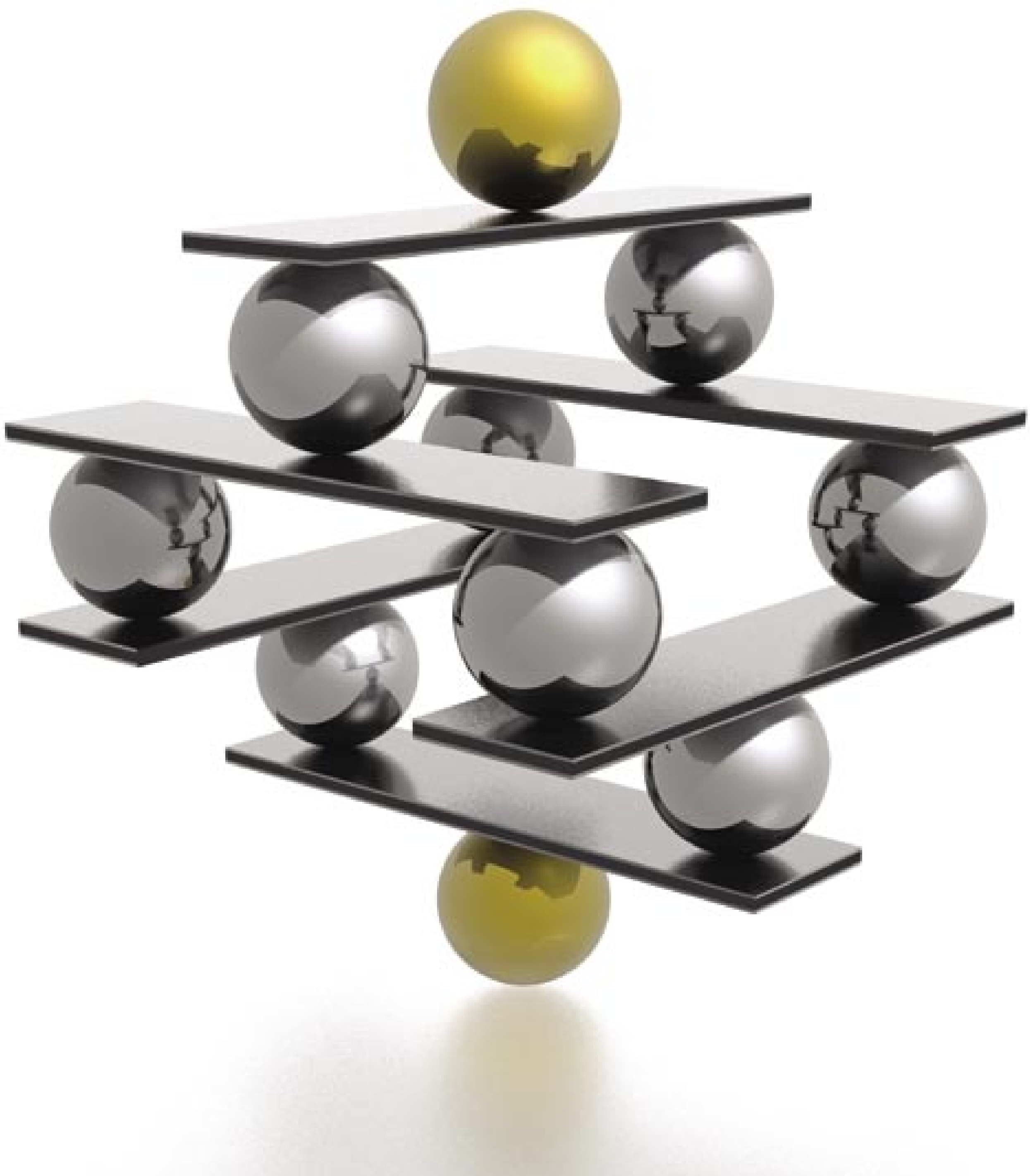
Members of the Company Law Review Group 2007

Dr. Thomas B. Courtney (Chair)	Arthur Cox
Paul Appleby	Director of Corporate Enforcement
Jonathan Buttimore	Office of the Attorney General
Marie Daly	IBEC
Ian Drennan	Irish Auditing and Accounting Supervisory Authority
Paul Egan	Mason Hayes + Curran
Paul Farrell	Registrar of Companies
Michael Halpenny	SIPTU
Muriel Hinch (replaced by Jim Byrne)	Revenue Commissioners
Tanya Holly	Department of Enterprise, Trade and Employment
William Johnston	Arthur Cox
Lyndon MacCann S.C.	Bar Council
Ralph MacDarby	Institute of Directors
Vincent Madigan	Department of Enterprise, Trade and Employment
Martin Moloney	Financial Regulator
Maire O'Connor	McCann Fitzgerald
Conall O'Halloran	Consultative Committee of Accountancy Bodies-Ireland
Mike Percival	Irish Banking Federation
Mark Pery-Knox-Gore	Law Society of Ireland
Nora Rice	Companies Registration Office
Noel Rubotham	Courts Service
Jon Rock	Institute of Chartered Secretaries and Administrators
Deirdre Somers (replaced by Daryl Byrne)	Irish Stock Exchange

Table of Acts	
1963 Act	Companies Act 1963
1977 Act	Companies (Amendment) Act 1977
1982 Act	Companies (Amendment) Act 1982
1983 Act	Companies (Amendment) Act 1983
1986 Act	Companies (Amendment) Act 1986
1990 Act	Companies Act 1990
1990 (Amendment) Act	Companies (Amendment) Act 1990
1999 Act	Companies (Amendment) Act 1999
1999 (No2) Act	Companies (Amendment) (No2) Act 1999
2001 Act	Company Law Enforcement Act 2001
2003 Act	Companies (Auditing and Accounting) Act 2003
2005 Act	Investment Funds, Companies and Miscellaneous Provisions Act 2005
2006 Act	Investment Funds, Companies and Miscellaneous Provisions Act 2006

Chapter 1:

Overview and Update on the Companies Consolidation and Reform Bill



Chapter 1: Overview and Update on the Companies Consolidation and Reform Bill

1.1 Company Law Review Group

The Company Law Review Group was established under the 2001 Act to advise the Minister on changes required in companies' legislation and, more specifically, to promote enterprise, simplify legislation and enhance corporate governance. The Review Group consists of business representatives, company law practitioners, IBEC, ICTU and Government Agencies, including the Revenue Commissioners, the Office of the Director of Corporate Enforcement (ODCE) and the Irish Auditing and Accounting Supervisory Authority (IAASA).

1.2 Companies Consolidation and Reform Bill

The major activity of the Review Group since its establishment has been the drafting of a Bill to modernise and consolidate company law. The Group presented the General Scheme of the Bill[1] to the Minister for Enterprise, Trade and Employment in March 2007.

The General Scheme of the Companies Consolidation and Reform Bill was a massive undertaking (the General Scheme runs to nearly 1,300 sections) which was the culmination of the first seven years, including three reports, of the Review Group's work. As well as the consolidation of the existing thirteen Companies Acts and numerous statutory instruments into one piece of legislation, the General Scheme modernises and simplifies the company law regime in Ireland.

An important aspect of the Bill is that it modernises the law to reflect modern business practice. The new law revolves around the 'private company limited by shares', which represents 90% of businesses in Ireland today. (Previous legislation was based on the public limited company model). The new and simplified provisions (see para 1.3 below) for the new model company are now wholly integrated and, as a result, will be more easily accessible to company officers and practitioners.

What are the benefits for Ireland? Ireland's reputation as a competitive location for business investment is enhanced as it sends a strong message that Irish company law is modern, with simplified procedures for establishing and operating a company, while maintaining a strong compliance and enforcement regime. This consolidation and modernisation is timely as other common law jurisdictions, such as the UK, Hong Kong, Canada and New Zealand have also reformed their companies' codes.

1.3 Key Provisions of the General Scheme of the Bill

The key features of the new 'private company model', provided for in the General Scheme, are:

1. It will have a one-document Constitution, which will replace the Memorandum and Articles of Association.
2. It will not be required to have an 'objects' clause in its Constitution (i.e. limiting it to certain types of activities), which is seen as unnecessarily restrictive.
3. The new company type will be required to have just one director (currently two), but the company secretary cannot be the same person as the sole director.
4. In general, it may have between 1 and 99 members.
5. It will be limited by shares and must have a share capital.
6. Members can waive the holding of an AGM (but if 10% of the membership request an EGM it must be held). All decisions of the company must be recorded.
7. For specific activities (e.g. loans for directors), currently restricted by law, the new Bill provides that directors may do so by undertaking a 'validation procedure' to the effect that the company is solvent. A director may be held personally liable, without limit, for any subsequent debts of the company.
8. The company will be eligible for audit exemption up to much higher thresholds. (Exemption from audit removes the need for companies to engage an independent, external auditor to carry out a statutory audit of a company.).

The net effect of these proposed changes will be to ease the regulatory burden attaching to the

[1] See www.clrg.org.

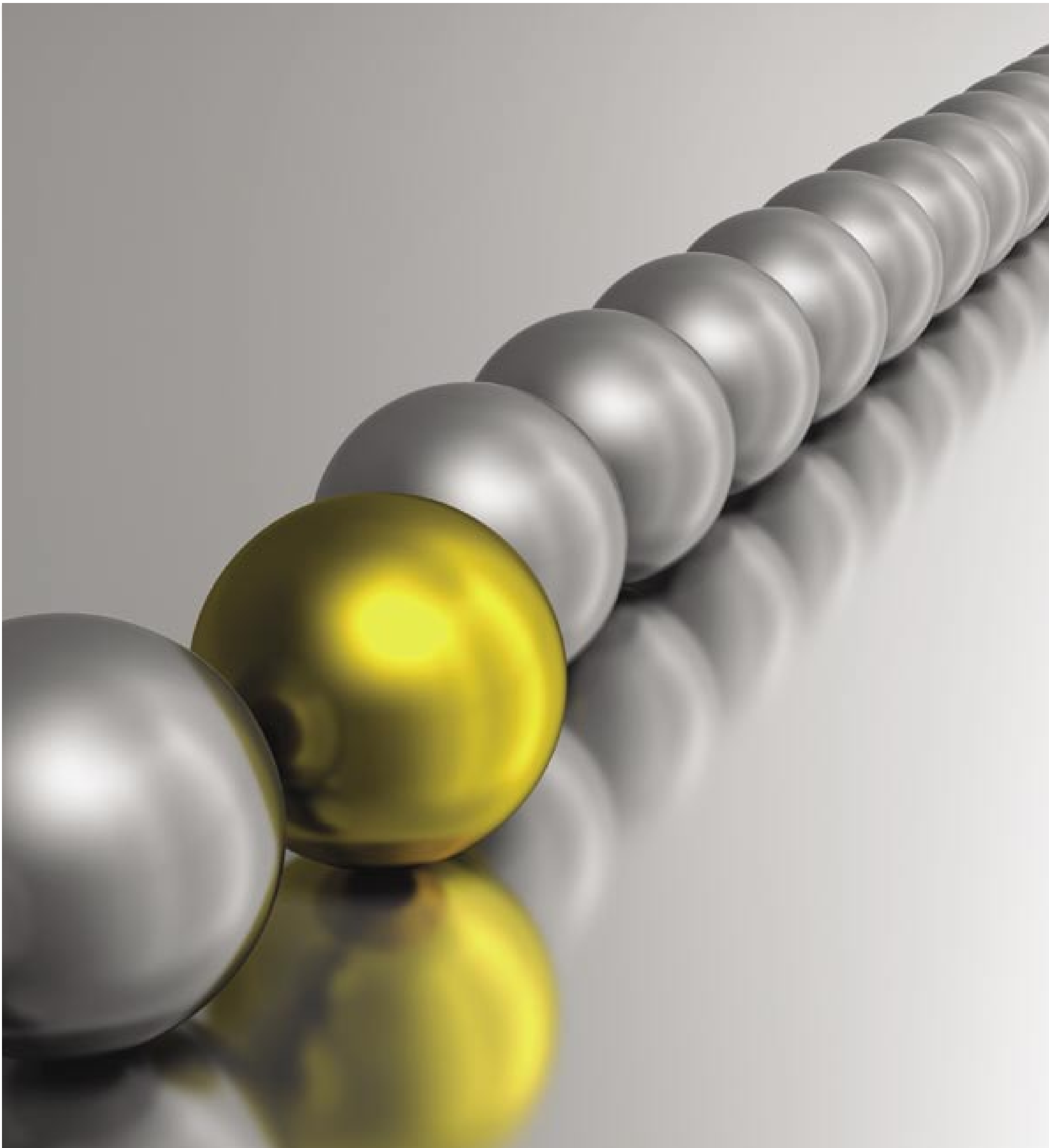
establishment and operation of private companies in Ireland. It will be easier for companies to undertake business activities and operate on a daily basis, subject to certain safeguards. The full duties of company directors and company secretaries in complying with the law are clearly set out. Also, the powers of the enforcement agencies, which have been strengthened in recent years, have been maintained and brought together clearly in the proposed Bill.

1.4 Current Position

The General Scheme was approved by Government for drafting in July 2007 and is currently being drafted by the Office of the Parliamentary Counsel.

Chapter 2:

Work Programme of the Company Law Review Group for 2007



Chapter 2:
2007 Company Law Reform Agenda – Review Group's Committees' Terms of Reference

2.1 Introduction

Set out below are the issues which formed the Work Programme of the Review Group for 2007, as given to the Review Group by the then Minister for Trade and Commerce, Mr. Michael Ahern, T.D. The issues were grouped into five categories and each group of issues was examined by a Committee formed for that purpose. The membership of the Committees is also listed.

2.2 Committees' Terms of Reference, Chairs and Membership

2.2.1 Committee A – Registration & Incorporation Issues
Chair: **Paul Farrell** **Members:** **Adrian Brennan (ODCE)** **Jonathan Buttimore** **Jim Byrne** **Marie Daly** **Vincent Madigan** **Nora Rice** **Jon Rock**
Power of the Registrar to rectify incorrect entries made to the register of companies
Amendment of section 99 of the 1963 Act and consequent amendments (sections 102 and 291) regarding judgment mortgages
Use of Companies Registration Office (CRO) information by other websites (e.g. credit check sites) – data protection and privacy issues
Removal of the requirement for companies to have a common seal
Section 195 of the 1963 Act – register of directors and especially the non-publication of directors' addresses by company itself and by CRO
Irish Registered Non-Resident (IRNR) Measures 1999 – review in light of EU mobility initiatives
Limitation on number of directorships held (Section 45(1) of 1999 (No.2) Act)

2.2.2 Committee B – Partnership Law
Chair: **Mark Pery-Knox-Gore** **Members:** **Jim Byrne** **Ralph MacDarby** **Vincent Madigan** **Marie O'Connor**
Introduction of limited liability partnerships
Removal of limit restricting size of partnership to 20 members

2.2.3 Committee C – Audit and Financial Issues
Chair: **Conall O'Halloran** **Members:** **Marie Daly** **Ian Drennan** **Jim Byrne** **Aidan Lambe (ICAI)** **Vincent Madigan** **Mike Percival** **Kevin Prendergast (ODCE)** **Deirdre Somers**
Auditors' liability
Proposed power to ODCE to require evidence of entitlement of companies to avail of audit exemption. Proposed amendment of section 33 of the 1999 (No.2) Act
Whether the term 'accountant' should be given statutory recognition and protection
IAASA request for consideration of amendments to 2003 and 2001 Acts (Sections 23, 27, 31, 33, 26 and 15 of 2003, Section 110A of 2001)
Extension of audit exemption to small groups of companies which in aggregate meet the criteria and dormant subsidiaries regardless of size of group of which they are part
Requirement pursuant to section 205B of the 1990 Act for PLCs to establish an audit committee
Review of thresholds relating to small and medium-sized companies

2.2.4 Committee D – Criminal & Enforcement Issues
Chair: **Paul Appleby** **Members:** **Jonathan Buttimore** **Jim Byrne** **Marie Daly** **Michael Halpenny** **Ann Keating (ODCE)** **Ralph MacDarby** **Vincent Madigan** **Martin Moloney** **Noel Rubotham**
Consent procedures in lieu of restriction and disqualification of directors
Proposal to allow ODCE to put directors on notice of a contravention and then use that notice to create a presumption of knowledge for prosecution
Proposal to permit multiple prosecutions on the same facts within a single set of summary proceedings
Good-faith reporting of breaches of certain company law provisions by companies and agencies governed by the Companies Acts

2.2.5 Committee E – Modernisation Issues
Chair: **Paul Egan** **Members:** **Jim Byrne** **William Johnston** **Vincent Madigan** **Kevin O'Connell (ODCE)** **Marie O'Connor** **Mike Percival**
Relaxation of restrictions in Part III of the 1990 Act (transactions with directors) as proposed in the UK's Companies Bill
Removal of prohibition on financial assistance in connection with the purchase of own shares for private companies as proposed in the UK's Companies Bill
Relaxation on capital maintenance rules
Abolition of Revenue Preference, as already effected in the UK

Chapter 3:

Registration and Incorporation Issues

Chapter 3: Registration and Incorporation Issues

3.1 Changes to and Use of Registers of the Companies Registration Office (CRO)

3.1.1 Registration of Judgment Mortgages
3.1.2 Non-Publication of Directors' Addresses
3.1.3 Power of Registrar to Rectify Entries Made in the Register of Companies and the Re-Use of CRO Information
3.1.4 Location and Cost of Registers

3.2 Operational Issues

3.2.1 Thresholds for Defining Small and Medium-Sized Companies
3.2.2 Removal of the Requirement for Companies to have a Common Seal
3.2.3 Review of Measures relating to Irish Registered Non-Resident Companies
3.2.4 Limitation on the Number of Directorships

3.1 Changes to and Use of Registers of the Companies Registration Office (CRO)

A number of issues concerning the registration of company information held by the Companies Registration Office (CRO) were reviewed by the Company Law Review Group:

- amendment of section 99 of the 1963 Act and consequent amendments (sections 102 and 291) regarding judgment mortgages;
- the register of directors and the non-publication of directors' addresses by the company and by the CRO;
- the power of the Registrar to rectify incorrect entries made in the register of companies and the re-use of the CRO information; and
- the location and cost of registers.

3.1.1 Registration of Judgment Mortgages

3.1.1.1 Introduction

A creditor who has obtained judgment for a sum of money may have the judgment converted into a mortgage affecting any lands owned by the debtor. Such a mortgage is referred to as a judgment mortgage.

3.1.1.2 Current Position

Part IV of the 1963 Act (sections 99-112)[2] establishes a system for the registration of charges created by companies on their assets. Section 99 provides that particulars of certain charges must be delivered to the Companies Registration Office within 21 days of their creation. Charges that are not registered are void against the liquidator and any creditor of the company. However, the general position regarding the registration of judgment mortgages is complicated. Section 99 of the 1963 Act only governs charges created 'by a company' and does not apply to judgment mortgages which are created by companies' creditors.

Section 102 of the 1963 Act contains separate provisions for the registration of judgment mortgages. These provisions differ substantially from those relating to charges created by the company voluntarily. This section provides that the judgment creditor shall cause two copies of the affidavit required to register the judgment as a judgment mortgage (certified by the Land Registry or Registry of Deeds as the case may be), to be delivered to the company within 21 days of such registration. The company is in turn required to deliver one of these copies to the Registrar of Companies within three days of receiving it. Section 102 also requires the Land Registry or the Registry of Deeds to deliver a copy of the relevant affidavit to the Registrar of Companies 'as soon as may be'. It is an offence for a judgment creditor or a company not to comply with these provisions. Failure to comply with the filing requirements in section 102 does not, however, render the charge void.

The question of judgment mortgages was considered by the Company Law Review Group in its Second Report[3]. At that time, the Review Group recommended that the requirement on the creditor to furnish certified copies of the affidavit to the company should be replaced with a requirement on the creditor to deliver one certified copy to the Registrar of Companies.

[2] Equivalent to Part A7 Chapter 3, Heads 7-18 of the Companies Consolidation and Reform Bill, www.clrg.org.

[3] Section 8.10 of the Second Report of the Company Law Review Group, www.clrg.org.

The Review Group also proposed that the Companies Acts should make provision for priorities as to charges. In respect of judgment mortgages, it recommended that priority be created at the time of lodgement in the Companies Registration Office. Those recommendations are unaffected by subsequent developments and are retained.

After the publication of its Second Report, the Law Reform Commission, in its Consultation Paper on Judgment Mortgages[4], recommended that a judgment mortgage should be void against the liquidator and any creditor of the company, unless it is filed under the same conditions as those set down in section 99 of the 1963 Act, i.e. within 21 days of creation.

3.1.1.3 Conclusion

The Review Group has considered the Law Reform Commission's document and agrees with its recommendation that the failure of the judgment creditor to register the charge should render it void.

Some consideration had to be given to the commencement of the period for the filing of a judgment mortgage. By contrast with a consensual charge, a judgment creditor has the extra task of needing the affidavit to be certified by the Land Registry or the Registry of Deeds, as the case may be, before it can be delivered to the Registrar of Companies. The Review Group recommends, therefore, that the 21-day period should commence upon receipt, by the judgment creditor, of the certified copies. To avoid uncertainty, the Review Group recommends that the date of receipt should be deemed to be three days after the date upon which the appropriate Registrar has sent notification to the judgment creditor or his or her agent, unless the contrary is proved.

In order to cater for the different circumstances which will continue to govern judgment mortgages, the Review Group recommends that (by reference to existing provisions) judgment mortgages should not be added to section 99 but that, instead, the avoidance provision of section 99 should be carried through to section 102.

3.1.1.4 Recommendation

The Review Group recommends that Head 11 of Part A7[5] (the equivalent of section 102) of the proposed Companies Consolidation and Reform Bill should be amended to provide as follows, subject to any drafting changes advised by Parliamentary Counsel and the advice of the Attorney General:

Head 11 Registration and Priority of Judgment Mortgages

(1) When a judgment is obtained against a company and such judgment is subsequently converted into a judgment mortgage affecting any property of the company, that judgment mortgage shall be void against the liquidator and any creditor of the company, unless subhead (2) is complied with.

(2) The registration of a judgment mortgage may be effected by the delivery to the Registrar, of particulars, in the prescribed form, accompanied by a copy (certified by the Land Registry or the Registry of Deeds, as the case may be, to be correct copies) of the affidavit required for the purpose of registering the judgment as a mortgage within 21 days after the date upon which notification of the judgment mortgage is received by the judgment creditor.

(3) The date upon which notification of the judgment mortgage is received by the judgment creditor shall be a date three days after the date upon which the appropriate Registrar has sent notification to the judgment creditor, or the judgment creditor's agent, unless the contrary is proved.

(4) Subject to head 10, subhead (2), in so far as the priority of a charge is not otherwise prescribed by law, a judgment mortgage will take effect as to priority on the date of delivery to the Registrar pursuant to subhead (2).

(5) This head shall not apply to any judgment mortgage created before the commencement of this head.

[4] Consultation on Judgment Mortgages (LRC – CP 30-2004). Also available at http://www.lawreform.ie/files/Consultation%20Paper%20on%20Judgment%20Mortgages.pdf.

[5] Chapter 3 of Pillar A of the General Scheme of the Companies Consolidation and Reform Bill, www.clrg.org.

3.1.2 Non-Publication of Directors' Addresses

3.1.2.1 Introduction

The Company Law Review Group received submissions asking it to consider the possibility of withholding the private residential addresses of company directors for reasons of personal security.

A number of Irish companies operating in certain sectors, have concerns about the safety of their directors and their families as a result of those companies operating in sensitive sectors of the economy. These companies have pointed out that there have been incidents involving the picketing of company premises and the intimidation of employees and visitors to those premises. There have also been 'home' incidents involving protests and intimidation of employees and their families at their private residences. These companies argue that such incidents have been facilitated by the fact that directors' home addresses are open to public inspection in the Companies Registration Office.

3.1.2.2 Current Position

Under section 3 of the 1982 Act, certain details must be filed with the Registrar of Companies. These include all of the details as are required to be kept on a company's own registers, which include the residential addresses of directors.

Under section 195 of the 1963 Act as amended by section 51 of the 1990 Act, companies are further obliged to keep a register containing details relating to each director, including his or her residential address. In addition, the company is obliged to notify the Registrar of Companies of any changes among its directors or to the particulars contained in the register.

3.1.2.3 UK Position

Since 2002, company directors in the UK have had the right to apply for a Confidentiality Order to prevent their home addresses appearing in public records, if they can demonstrate that they (or someone who lives with them) might be at risk of violence or intimidation if their address is publicly available. This entitlement was further extended in the UK Companies Act 2006 which provides for a dual register system whereby all directors are given an automatic option to file a service address for the public record and home addresses may be recorded on a non-public register which is only available to named regulators.

The UK legislation in this area can be summarised as follows-

- A company's register of directors which is open to inspection by any person, must include a service address for each director (section 163(5)), which may be the company's registered office (section 163(5));
- A separate register of directors' residential addresses must be maintained by the company(section 165);
- Chapter 8 (sections 240-246) sets out the provisions protecting company directors' residential addresses from disclosure. These addresses are deemed to be 'protected information' and may only be disclosed by the company or the Registrar in precisely defined circumstances, for example, pursuant to a court order;
- The provisions relating to the use of service addresses for the service of documents are set out in detail in sections 1139 and 1142. In particular,
  - a service address is defined in section 1141(1) as an address at which documents may be effectively served on a person;
  - section 1142 states that "any obligation under the Companies Acts to give a person's address is, unless otherwise expressly provided, to give a service address for that person".

3.1.2.4 Conclusions and Recommendations

The Review Group considers that provisions should be made in the Companies Acts to allow companies to make applications to have private residential addresses removed from the public register and replaced with service addresses. Such applications should be accompanied by a certificate obtained from An Garda Síochána, who it is considered is best placed to assess the security implications in making available to the public, the private residential address of a director or secretary. Discussions will have to take place with the Department of Justice, Equality and Law Reform on the details of these proposals, including the rank of Garda that would be required to furnish the necessary certificate.
This would apply equally to non-Irish addresses.

The following head is proposed, subject to any drafting changes advised by Parliamentary Counsel and the advice of the Attorney General:

1. Provide that an exemption be made available to any person who is required by the Acts to supply their residential address to the Registrar of Companies.

2. Provide that an application for exemption be made to the Registrar, on a form to be prescribed, in respect of each person who wishes to have their residential address removed from all places in the register.

3. Provide that each application be accompanied by a supporting certificate from An Garda Síochána.

4. Provide that such exemption be valid for as long as the Garda certificate applies to that person.

5. Provide that where the certificate expires and is not renewed, then all future documentation to contain the private residential address of the person for inclusion on the public register. The onus is to be on the person to renew the certificate.

6. Provide that this facility be open equally to persons resident outside the State, subject to the same criteria. Such persons to need a Garda certificate and to supply whatever documentation required by the Gardaí in order to be issued with such a certificate[6].

7. Provide that provision be made whereby a refusal by the Gardaí to issue or renew a certificate could be appealed to the Court and any proceedings should be *in camera*. The Registrar of Companies not to be involved in the process.

8. Provide that the applicant to supply a service address (such as the Registered Office) in lieu of a private residential address and this to appear on the public register in the Companies Registration Office.

9. Provide that the person supply their actual residential address to be kept private by the Companies Registration Office.

10. Provide that the private residential address to be made available only to those State Bodies and Government Agencies prescribed by the Minister for Enterprise, Trade and Employment.

11. Provide that such bodies and agencies be put under an obligation to maintain the privacy of such addresses.

12. Provide that the rights of access to such information by the Revenue Commissioners or the Office of the Director of Corporate Enforcement not be prejudiced.

13. Provide that access be given to any person authorised by the Court or as a result of a Court Order.

14. Provide that the company notify any change of residential address to the Registrar.

15. Provide that the register not make any reference to the fact that the residential address has been withheld.

The Review Group is also of the opinion that similar provisions would need to be inserted in the Business Names Act 1963.

[6] Part B7, Chapter 2, Head 3 (2)(f)(iii) of the General Scheme of Companies Consolidation and Reform Bill will need to be amended accordingly, www.clrg.org.

3.1.3 Power of Registrar to Rectify Entries Made in the Register of Companies and the Re-Use of CRO Information

3.1.3.1 Introduction

The Company Law Review Group was asked to consider whether the Registrar of Companies should be given the power to make corrections in the register of companies and also to consider the re-use of information in the Companies Registration Office.

It occurs from time to time that companies lodge forms that become registered in the Companies Registration Office, but which are subsequently found by the company to have inadvertently contained incorrect information.

There would clearly be a benefit to having a straightforward mechanism to correct the register but currently only limited provision exists, as provided by section 122(5) of the 1963 Act.

The Companies Registration Office stores data electronically in two Parts. Part 1 has been in existence since 1985 and is the database containing all the information on companies that is stored in fields and thereby amenable to analysis, such as names, addresses, officers' names and addresses and details of charges. Included in Part 2 are images of all documents filed since 1990 and all other documents on all live companies, as well as images of scanned documents that are filed. Extracts from this database can be purchased in bulk, pursuant to a licence agreement.

Power of the Registrar to Rectify Entries Made in the Register of Companies

3.1.3.2 Current Position

It is generally accepted that for most purposes the register of companies is reflective rather than determinative of a company's position. Accordingly, the role of the Registrar is restricted to enforcing the submission of information by companies for publication on the register and the maintenance of the register itself. He is not generally empowered to alter or amend submissions received. The onus remains on the company itself and, by extension, its officers, to furnish correct details. If the imperative were to rest on the Registrar, it would fundamentally alter his role from that of a collator and publisher of information, to that of an investigator.

3.1.3.3 Issues Arising

However, the above rationale has had regrettable consequences in practice. In particular, presenters who inadvertently submit a document containing erroneous particulars have no subsequent administrative avenue to amend the details appearing on the register, as the Registrar is not empowered to act in these circumstances. The publication of information on the register is statutorily restricted to the information received and affords the Registrar no editorial privileges. Accordingly, it has been necessary for presenters to obtain a High Court Order in circumstances where details which have been registered require amendment, as the High Court has jurisdiction in matters concerning the Companies Acts.

Consequently, the significant cost of attendance at the High Court is imposed on presenters who are guilty of what, in many cases, is merely an administrative error and this could be considered punitive in circumstances where the presenters actively wish to rectify the error.

However, more importantly, the current cumbersome method of rectification could be interpreted as being contrary to public policy in that third parties viewing the register may be misled as to the true position of the company in circumstances where the company actively wishes to rectify it.

It might appear relatively straightforward to allow companies to file corrections to forms filed, however, the implications of allowing a company to make statements on the register and then to alter those statements at a future date needs to be fully explored.

The following issues at least arise:

Firstly, it may create opportunities for false information to be deliberately filed and placed in the public domain. Subsequently, when some advantage has been gained, a correction may be furnished.

It is true that provisions could be included to allow the prosecution of offences and that civil remedies could be put in place to provide redress, but in such circumstances the onus of proof would lie with the prosecutor or plaintiff.

Secondly, by allowing changes to the register, the value of the register as a fixed source of information would be reduced.

Thirdly, it is an open question as to what discretion should be left to the Registrar to reject proposed amendments. These could be considered under two headings (a) suspected wrongdoing and (b) trivial versus significant changes. It might appear to the Registrar that a company is attempting to mislead, but as stated above, he does not have powers of investigation. A procedure may be provided for whereby the Registrar could decide on minor amendments, leaving the High Court to decide only the complex issues.

By way of example, one jurisdiction which provides such a procedure is Gibraltar which has a broadly similar registration system to that in Ireland. There are 30,000 companies on the Gibraltar register. On that register, minor clerical errors can be corrected by substituting amended forms and more serious errors can be rectified either by the Registrar or by the Courts. On average, they receive about 1200 applications for substitution and about 40 applications for rectification each year. About 10 applications per year are referred to the Court. The Registrar has discretion to decline to register an amendment if he has concerns that a company might be using the rectification system to mislead third parties or to otherwise retrospectively amend actual decisions made. If he declines to register an amendment, the company may apply to the Court for approval.

The Gibraltar Registrar has advised that the procedure is time consuming and that it is difficult to exercise discretion consistently and to delegate the decision-making to staff members unless they are highly experienced.

Any provisions made would have to clearly define the Registrar's discretion and what would constitute minor and serious errors, having regard to the possible implications.

Fourthly, it requires to be determined whether the Registrar should be given statutory power to require the company to initiate the procedure to amend incorrect information. Quite often an error appears on the register which has not been identified previously. This can have the effect of rendering subsequent documentation on the register incorrect and can prevent the registration of subsequent documents.

Fifthly, the Review Group needs to consider what, if any, exclusions should be made from a general provision

3.1.3.4 Analysis and Conclusion

The Review Group appreciates concerns as to why it may not be desirable to allow amendments to the register of charges. It is crucial to business that the register of charges provides certainty. Allowing alterations to that register without proper consideration could prove injurious to third parties, especially creditors, and the reputation of Ireland as a place to do business.

In particular, for example, care must be taken in allowing changes to the register concerning a company's issued share capital. A number of cases that have arisen in the past relate to the issued share capital of the company. The reasons for requesting an amendment are varied, but in most cases are to correct genuine mistakes as a result of clerical error. However, to accede to every request to amend registered documents would be detrimental to the veracity of the register and could leave the system open to abuse. An example of this would be where a company could register a large issue of shares in order to impress creditors or potential creditors and, having achieved this objective, could then request an amendment to the register claiming a clerical error. In a recent case of clerical error referred to the High Court, the judge accepted a reduction in share capital, caused by a clerical error (to the value of €30 million), but said that it was proper that such cases should come before the Court.

These are only two examples but it is necessary to be clear on the implications of changes to other documents, for example to a memorandum of association or to a company's name.

The Review Group also believes that if there is discretion vested in the Registrar to reject applications for any reason, consideration has to be given to an appeal to the Court against any decision.

In conclusion, the Review Group is of the opinion that, in principle, there should be a mechanism to facilitate factual, straightforward amendments to the register that are required to be made as a result of genuine and inadvertent clerical mistakes.

However, the provision of such a mechanism raises the fundamental question of the role and purpose of the register. Two major issues to be addressed are whether the mechanism should be confined to corrections of limited, specified data and whether the Registrar should be permitted to refuse applications for rectification which he considers to be dubious or suspect.

As indicated above, the Review Group needs to examine the various issues outlined and possible solutions to them, based on the experiences in other countries, before making a recommendation in that regard. The Review Group therefore asks the Minister for permission to extend its consideration of the issue into the next Work Programme.

Re-use of Information in the Companies Registration Office

3.1.3.5 Current Position

The provision and use of data, maintained at the CRO, are subject to legislation. Section 370 of the 1963 Act provides that any person may (a) inspect the documents kept by the Registrar, on payment of such fee as may be fixed by the Minister and (b) require an extract of any such document on payment of such fee as the Minister may fix.

With regard to copyright, rights in databases have been created by the Database Directive and by the Copyright and Related Rights Act 2000. The Database Directive creates a *sui generis* right in databases. Article 13 of the Directive, however, leaves it open to Member States to make their own provisions in respect of public documents.

3.1.3.6 International Position

United States

In the US there is very little personal data on the public register. In respect of such information as is on the register, the authorities are concerned about privacy and personal identity theft.

There is now in train a process called "redaction" whereby any information that can identify private individuals, such as their home address or their social security number, is blanked out on forms on the public register. This is performed either on a case-by-case basis or in bulk. In general, a copy of a document (or of the scanned image) is made and the personal information removed. The original copy is retained in the internal storage but the modified document is made available to the public.

United Kingdom

The UK has an existing provision whereby, with the agreement of the police, a director need not provide a home address for inclusion in the public register. The home address is retained on a register within the Companies House and may be inspected by the proper authorities. In such a case, the public register must contain a service address for the director that may be the registered office of the company.

There are proposals to allow all directors to avail of this facility. One of the issues under discussion is the position of data already on the public register. As in Ireland, copies of the UK register have been in private hands for many years. It will be necessary to make provision for severe restrictions on the use of such data and for a redaction process on existing documents.

What is intended at the present time is that home addresses will be made available to registered credit-referencing companies so that they can identify the relevant individual. Other search firms would not have access to a director's home address.

Rest of Europe

In most countries in Europe a director is identified to the registry by furnishing at least a copy of the national ID card. That would not, however, be placed on the public register.

Many countries also consider that information in the public register is subject to normal data protection rules. Sweden, for example, allows a director to state that he or she does not want any personal information to be disclosed.

At least Belgium, Denmark, Estonia, Finland, Greece, Italy, Latvia, Sweden and Spain allow companies to be searched by directors' names. In Ireland, the CRO only allows access via the company, but the Review Group is aware that some private data providers do allow search by name.

3.1.3.7 Conclusion

In relation to the re-use of CRO information, the Review Group accepts that certain concerns such as identity theft and data protection issues have arisen and understands that the Data Protection Commissioner is looking at this area. The Review

Group requests permission from the Minister to extend its consideration of the issue into the next Work Programme.

3.1.4 Location and Cost of Registers

3.1.4.1 Introduction

The Company Law Review Group was asked to examine the lack of consistency in the provisions relating to the various registers which companies themselves are obliged under the Companies Acts to maintain and also the very low charges which companies and in particular, public limited companies, are permitted to charge in order to provide copies of their registers to the public.

3.1.4.2 Conclusion and Recommendations

In view of the different requirements relating to each register, the Review Group considers that the requirements should be harmonised for all, and accordingly, the following head is proposed, subject to any drafting changes advised by Parliamentary Counsel and the advice of the Attorney General:

1. Provide that all registers which companies are obliged to keep under the Acts must be kept in the State but not necessarily at the Company's registered office, provided that the Registrar is notified of the location.

2. Provide that the Registrar of Companies be notified in all cases where the register is kept outside the Registered Office.

3. Provide that there be a fixed fee chargeable by any company in respect of the inspection of any of their registers, except the register of directors' service contracts/memoranda (Part A4, Chapter 3, Head 23(6) of the General Scheme of Companies Consolidation and Reform Bill[7] and section 50(6) of the 1990 Act). Part A4, Chapter 3, Head 38 of the General Scheme of Companies Consolidation and Reform Bill already proposes a fixed fee of €10.00 per inspection. Where more than one register is inspected per inspection the maximum fee chargeable should not exceed €15.00.

4. Provide that the fees chargeable by companies to supply copies of their registers, except the register of Directors' service contracts/ memoranda (Part A4, Chapter 3, Head 23(6) of the General Scheme of Companies Consolidation and Reform Bill and section 50(6) of the 1990 Act) be fixed as follows:

[7] www.clrg.org/companiesbill.

– In respect of all companies, other than those listed in Part B2 of the General Scheme of the Companies Consolidation and Reform Bill, a fee of €10.00 per copy.

– In respect of those companies listed in Part B2 of the General Scheme of the Companies Consolidation and Reform Bill, a fee of €10.00 for the first 100 entries or part thereof, €35.00 for the next 1000 entries or part thereof and €25.00 for every subsequent 1000 entries or part thereof. However the total charged to be subject to a maximum fee of €1000.00 per register.

All of the above is without prejudice to the Review Group's recommendation contained in Part A7, Chapter 3, Head 7 – (8th paragraph of the explanatory note to head 7) that the requirement to maintain a register of debenture holders be removed.

3.2 Operational Issues

With regard to issues of incorporation, the Company Law Review Group was asked to consider a number of issues, namely:

- thresholds for defining small and medium-sized companies;
- removal of the requirement for companies to have a common seal;
- review of measures relating to Irish Registered Non-Resident Companies; and
- limitation on the number of directorships held in section 45(1) of the 1999 Act.

3.2.1 Thresholds for Defining Small and Medium-Sized Companies

3.2.1.1 Background and Current Position

In the Companies Acts, a number of exemptions apply to the documents which small and medium-sized companies must deliver to the Registrar of Companies. Small companies need not deliver to the Registrar the profit and loss account or the directors' report prepared for the members, and may instead deliver only the balance sheet and accompanying notes. Exemptions also apply to the material which needs to be included in the balance sheet.

The exemptions applying to medium-sized companies are much less extensive than those for small companies. Medium-sized companies must deliver to the Registrar a balance sheet, abbreviated profit and loss account, directors' report and a special auditor's report.

The exemption provisions for small and medium-sized companies were introduced by section 8 of the 1986 Act which gave effect to the 4th EC Company Law Directive, dealing with the content and publication of the annual accounts of public and private limited companies. The ceilings on qualification for exemption were last revised in Ireland by the European Communities (Accounts) Regulations 1993 and were set as follows:

Irish Limit	Balance Sheet Total	Turnover
Small Company	**€1.9m** (*£1.5m*)	**€3.8m** (*£3.0m*)
Medium Company	**€7.6m** (*£6.0m*)	**€15.2m** (*£12.0m*)

The Review Group considered the issue in the context of the proposals for the Companies Consolidation and Reform Bill and decided to recommend that these rates be increased in line with inflation (from the period 1993 to 2004) as follows:

Irish Limit	Balance Sheet Total	Turnover
Small Company	**€2.5m**	**€5.0m**
Medium Company	**€10.0m**	**€20.0m**

These new limits are accordingly set out in the proposed heads of Part A6 of the General Scheme of the Companies Consolidation and Reform Bill[8].

The recommendation took account of the following:

- The amounts proposed are within the EU permitted maxima;
- The competitiveness needs of Irish small and medium-sized firms vis-à-vis their EU counterparts;
- The lack of evidence that the issue gives rise to companies locating outside of the jurisdiction;
- The fact that a very large proportion of Irish registered companies file small company accounts only; and
- Small-firm creditors of small and medium-sized companies are disadvantaged by the lesser accounts data to be filed.

3.2.1.2 Recommendation

The Review Group recommends that the thresholds included in the General Scheme of the Companies Consolidation and Reform Bill be updated to take account of inflation since 2004.

[8] www.clrg.org.

3.2.2 Removal of the Requirement for Companies to have a Common Seal

3.2.2.1 Introduction

The Company Law Review Group was asked to review whether it should be compulsory for all companies to have a common seal in light of recent changes to UK legislation which have made use of the common seal optional.

3.2.2.2 Current Position

One of the principal and recognised consequences of incorporation is that a company has a common seal (section18 (2) of the 1963 Act).

> *"From the date of incorporation mentioned in the certificate of incorporation, the subscribers of the memorandum, together with such other persons as may from time to time become members of the company, shall be a body corporate with the name contained in the memorandum, capable forthwith of exercising all the functions of an incorporated company, and having perpetual succession and a common seal, but with such liability on the part of the members to contribute to the assets of the company in the event of its being wound up as is mentioned in this Act."*

In addition, there are statutory requirements incidental to incorporation, such as that in section 114 (1)(b) of the 1963 Act which requires that a company must, *inter alia*,

> *"…have its name engraven in legible characters on its seal".*

However, the requirements of any given company depend entirely upon its particular articles of association. It is usual for companies to adopt the provisions of model Regulation 115 of Table A. Regulation 115 provides:

> *"…every instrument to which the seal shall be affixed shall be signed by a director and shall be countersigned by the secretary or by a second director or by some other person appointed by the directors for that purpose".*

3.2.2.3 UK Position

In the UK the use of the common seal is optional. The necessity for a common seal was abolished by section 130(2) of the UK Companies Act 1989 which reads:

> *"(1) Under the law of England and Wales the following provisions have effect with respect to the execution of documents by a company.*
>
> *(2) A document is executed by a company by the affixing of a common seal.*
>
> *(3) A company need not have a common seal, however, and the following subsections apply whether it does or not…"*

Section 45 of the UK Companies Act 2006 reads:

> *(1) "A company may have a common seal, but need not have one."*

3.2.2.4 Conclusion

The Review Group has already examined this matter in detail in its First Report (see Appendix 1 of this Section).

Having considered this matter further, the Review Group remains of the view that, on balance, given the small cost involved and the uncertainty that such an option could give rise to, particularly in relation to the authentication of documents, the requirement on companies to have a common seal should remain. Therefore, no changes are proposed to Part A2, Chapter 4, Head 25[9] as set out in Pillar A of the General Scheme of the Companies Consolidation and Reform Bill.

[9] www.clrg.org/companiesbill.

3.2.3 Review of Measures relating to Irish Registered Non-Resident Companies

3.2.3.1 Introduction

The Company Law Review Group was asked to consider whether the provisions relating to Irish directors could be extended to provide for an EU Director i.e. that the provisions of the 1999 (No.2) Act could refer only to directors resident outside the European Union rather than just the State. The request was in the context of EU freedom of movement, in particular, the free movement of persons, in an enlarged European Union.

3.2.3.2 Current Position

The 1999 (No .2) Act introduced provisions requiring all companies to have an activity in the State and at least one director resident in the State, or alternatively to provide a bond where there is no such director. The Act also empowers the Registrar of Companies to strike companies off the register where they fail to comply with these requirements.

These provisions were designed to address the Irish Registered Non-Resident Company (IRNR) issue and form part of a package of measures, the remainder of which are to be found in tax legislation.

3.2.3.3 Issues Arising

These provisions were introduced in response to the practice which existed whereby companies formed and registered in Ireland, but did not otherwise have any link to the country and engaged, with relative impunity, in undesirable activity worldwide, which seriously threatened the reputation of Ireland as a well-regulated jurisdiction.

In introducing the measures in 1999, a balance was struck between the burdens that would be imposed on legitimate businesses and those that were damaging the reputation of Irish business generally.

Whilst the requirement to appoint an Irish resident director is portrayed by some as a serious impediment to securing inward investment, it will be noted that alternatives are provided in the law, such as obtaining a certificate under section 44 of the 1999 (No.2) Act or taking out a bond, either in the first year of a company's activity or on an annual basis.

3.2.3.4 Conclusion

The Review Group considers that the combined taxation and company law measures have been relatively successful in tackling the IRNR issue. However, given that complicated issues of EU and national policy are involved, the Review Group requests the permission of the Minister to keep the matter under review in the course of its 2008/2009 Work Programme.

3.2.4 Limitation on the Number of Directorships

3.2.4.1 Introduction

The Company Law Review Group was asked to consider section 45(1) of the 1999 (No.2) Act which states that a person shall not be a director of more than 25 companies simultaneously.

It has been argued that this restriction is particularly difficult for securitisation companies which have grown considerably in Ireland since the 1999 (No.2) Act was first introduced.

A securitisation company is a company whose principal objective is the purchase of one or more portfolios of assets (e.g. mortgages, trade receivables etc.), financed through the issue, by the securitisation company, of securities secured against the relevant asset portfolio. The Irish securitisation industry was in its infancy in 1999 and as a result it was not considered necessary at that time to provide for an exemption for such companies.

Exemptions from this restriction were provided for under section 45(3) of the 1999 (No.2) Act in respect of the following:

- PLCs, public companies and those in respect of which a certificate under section 44(2) is in force;
- a company licensed (or exempted from a licence) under the Central Bank Act 1971; and
- those set out in the Second Schedule of the 1999 (No.2) Act.

Until the passing of the 2006 Act, the vast majority of securitisation companies were PLCs which came within the exemption provided for in section 45 (2) of the 1999 (No.2) Act. Since the passing of the 2006 Act, it has been possible for private companies to issue and list debt securities in securitisations. The problem is that private companies are currently outside of the exemptions in section 45 of the 1999 (No.2) Act.

3.2.4.2 Conclusion

A majority of the Review Group therefore recommends an amendment to the Second Schedule to include securitisation companies as those companies defined in section 110 of the Taxes Consolidation Act 1997.

The following head is proposed, subject to any drafting changes advised by Parliamentary Counsel and the advice of the Attorney General:

Provide that the Second Schedule of the 1999 (No.2) Act be amended by the addition to the list of companies contained therein, of a new category as follows:

(21) A company as defined in section 110 of the Taxes Consolidation Act 1997.

Requirement for a company seal

4.3.2 One of the principal and recognised consequences of incorporation is that a company has a common seal.[10] In addition, there are statutory requirements incidental to incorporation, such as that in s 114 of the 1963 Act, which requires that a company must, *inter alia*, "(b) … have its name engraven in legible characters on its seal". Most companies adopt Regulation 115 of Table A which provides:

The seal shall be used only by the authority of the directors or of a committee of directors authorised by the directors in that behalf, and every instrument to which the seal shall be affixed shall be signed by a director and shall be countersigned by the secretary or by a second director or by some other person appointed by the directors for the purpose.

4.3.3 The key points in this model regulation are: (i) the authority of the directors; and (ii) the fact of two signatures. There is, however, no legal minimum or maximum on the number of countersignatories to a company seal. Companies incorporated under the Companies Consolidation Act 1908 adopted (subject to amendment by specifically adopted articles) a 1908 Table A provision requiring the signatures of two directors and of the secretary. Some companies adopt an article requiring only one countersignatory[11]. All variations are permissible.

4.3.4 There are relatively few legal documents that are required to be executed under seal. The principal ones are:

(i) conveyances and transfers of freehold land;
(ii) mortgages and certain fixed charges over land;
(iii) documents agreeing transactions with a "voluntary" or gratuitous element;
(iv) deeds poll – documents executed by one party only – to a greater or lesser degree purporting to bind the party, such as a power of attorney;
(v) share certificates;
(vi) transfers of securities in the form of stock transfer forms specified under the Stock Transfer Act 1963;
(vii) certain court documents required to be under seal[12].

4.3.5 Many other documents are, as a matter of practice, executed under seal, such as:
(i) transactions in leasehold property[13];
(ii) contracts with financial institutions, especially guarantees and security documents;
(iii) building agreements;
(iv) establishment of trusts, including those for pension funds.

4.3.6 In addition, significant commercial agreements – for example long-term supply or distribution agreements will often be executed under seal. What distinguishes all of the above documents from other contracts is their relative importance to the parties executing them.

4.3.7 The Law Reform Commission recently considered this issue in depth in the context of execution of property transaction documents[14]. The Commission concluded:

"The Commission accepts that for a small number of large companies, notwithstanding the provisions of section 38(1)(b) of the Companies Act 1963, it is inconvenient to have to execute large numbers of documents under the companies' seal. On the other hand, for the vast majority of companies, the number of times that such companies are required to execute documents under seal is very limited. When such execution is required it is normally in respect of very significant documents such as those dealing with the transfer of interests in land or the establishment or variation of pension schemes. It is the Commission's view that the completion of such instruments, in the case of the majority of companies, is a matter of such importance to those companies that it should be marked with appropriate formality. Accordingly it recommends the retention of the requirement of sealing for those documents which are required to be deeds[15]."

7.7.8 In Chapter 10[16], the Review Group recommends that in the interests of settling the authority of the person who affixes and signs instruments to which the seal is affixed, greater use could be made of the mechanism in Regulation 6(2) of S.I. 163 of 1973 whereby a person can be registered to act on a company's behalf.

The Review Group considered whether a company ought to be required to have a company seal. In principle, the Group sees no inherent merit in the fact of there being a seal, but considers there is merit in the corporate procedures which are routinely required in connection with the affixing of the company seal. The Group therefore agrees with the Law Reform Commission on this subject and, accordingly, recommends the retention of the company seal. The Group also recommends that a person registered under Regulation 6(2) of S.I. No 163 of 1973 should be deemed to be a person appointed by the directors to affix the seal and sign the instrument under seal and that in such a case, no countersignature is required.

[10] Section 18 (2), Companies Act 1963.

[11] The securities seal (the 'official seal') provided for public companies under section 3 of the 1977 Act is routinely applied by registers of companies without countersignature of the directors or other officers.

[12] e.g. a bankruptcy petition. The Rules of Court (Order 76 Rule 20(1) provides: "A creditor's petition by a limited company or body corporate shall be sealed with the seal of the company or body corporate and signed by two directors or by one director and secretary. Such seal and signature shall in all cases be attested."

[13] Notwithstanding ss 4, 7 and 9 of the Landlord and Tenant Law Amendment Act, Ireland 1860 ("Deasy's Act"), which permit leases, surrenders of leases and assignments/ transfers of leasehold property to be effected by, inter alia, "note in writing".

[14] The Law Reform Commission Report on Land Law and Conveyancing Law: (6) Further General Proposals including the Execution of Deeds (LRC - 56 – 1998) May 1998.

[15] ibid. para 2.76.

[16] See 10.10.6.

Chapter 4:

Partnership Law

Chapter 4: Partnership Law

4.1 Limited Liability Partnerships (LLPs)

4.2 Limitation on Number of Partners

4.3 Questionnaire on LLPs

4.1 Limited Liability Partnerships (LLPs)

4.1.1 Introduction

Following a Law Society of Ireland submission to Government on the issue of Limited Liability Partnerships ('LLPs'), the Minister for Trade and Commerce asked the Company Law Review Group to examine the issue as part of its 2007 Work Programme. This chapter outlines the principal features of the law of partnership as it is currently in force in Ireland and the problems which current partnership law is perceived to cause for certain types of business organisation in Ireland. It addresses whether these problems are real and substantial and concludes that they are indeed so. It then explores how the introduction of LLP legislation could address these problems, citing examples of LLP legislation in other jurisdictions. It addresses the types of safeguard which might need to be put in place to protect clients/customers, and third parties generally, in their dealings with LLPs. It then considers whether the problems raised by current partnership law can be resolved by other means, without the need to amend the law of partnership. It examines some issues which affect the debate in an Irish context. Finally, it reaches conclusions and recommendations on the case for further consideration of the merits of introducing LLPs.

4.1.2 Current Partnership Law

The principal legislation dealing with partnerships in Ireland is the Partnership Act 1890 (the "1890 Act"). Two subsequent enactments – the Limited Partnerships Act 1907 and the Investment Limited Partnerships Act 1994 – amend the 1890 Act, but only for certain specific types of partnership[17]. The vast majority of partnerships formed in Ireland are general partnerships subject to the provisions of the 1890 Act.

The 1890 Act begins by defining the nature of partnership:

> *"Partnership is the relation which subsists between persons carrying on business in common with a view to profit."*[18]

[17] Limited partnerships and investment limited partnerships should not be confused with LLPs.

[18] Section 1(1), Partnership Act 1890.

Members of companies or associations formed or registered under certain legislation (including the Companies Acts) do not have the relationship of partners. In all other cases, when two or more persons carry on business together, partnership is the default form of legal relationship between them: unless they incorporate a company or establish another recognised legal entity as the vehicle for their business, they are likely to become partners in the legal sense, regardless of whether they intend to form a partnership or not.

It is likely that, as a consequence of this, many people come together to form partnerships without even being aware of the nature of their legal relationship and the consequences which arise from their decision to do business together.

The most important and far-reaching consequence of entering into a partnership is that each of the partners is jointly liable for the debts and obligations of the partnership[19] and for any loss or injury caused to any third party by any wrongful act or omission of any partner acting in the ordinary course of the business of the partnership[20].

Thus a partner is personally liable, on a full and unlimited basis, for the debts and obligations of the firm of which he or she is a partner and for the wrongful acts of his or her fellow partners.

The restriction placed on the partners with limited liability, in the Limited Partnerships Act 1907, from taking any part in the management of the limited partnership business (section 6(1) of 1907 Act) has restricted the usefulness of that form of partnership to groups of persons who wish to conduct business where all parties participate in the activities of the firms.

4.1.3 Personal Liability in Professional Service Firms

The consequences of unlimited personal liability in partnerships are particularly stark in the case of large professional service firms such as legal or accountancy practices, which often advise on transactions or audit businesses where the value of the transaction or business concerned runs into hundreds of millions of euro – amounts which greatly exceed the partnerships' professional indemnity insurance cover.

However, it is worth making the point that certain types of professional service firm have little or no choice but to establish as partnerships. In most trades and professions, individuals wishing to carry on business with others can choose to do so either through partnership or through the incorporation of a limited liability company. However, in some of the traditional professions such as law, medicine and accountancy, this flexibility is not available because members of such professions are prohibited, either by statute or by their own internal regulatory codes, from using companies as a vehicle for carrying on such professions. Yet, even in those professions where there is no express prohibition on incorporation, for practical reasons incorporation does not offer a viable alternative. Partnership remains by far the most suitable business model for organisations such as legal and accountancy practices, where large numbers of participants both own and manage their business and where entry to and exit from ownership of the business needs to be easily managed. The ease and flexibility with which capital can be introduced to and withdrawn from a partnership and the lack of a requirement to disclose financial information are attractive additional reasons why a partnership is the preferred form of business structure for professional service firms which are comprised of large numbers of owner/managers.

The limited liability company does not satisfy these requirements and is not a suitable structure for many professional service firms, which find it difficult or impossible to carry on business other than as partners in a general partnership. This leaves partners exposed to unlimited joint and several liability for the debts, obligations and negligent acts and omissions of their fellow partners.

Anxieties about personal liability have also been articulated by the legal and accounting professions in this country. Both the solicitors[21] and the accountants have complained that it is unfair and anachronistic that partners' personal assets can be put at risk by the actions of other partners over whom they have no control or of whom they have little knowledge. The point is often made that the imposition of unlimited liability on partners stems from an earlier time when few varieties of professional service were available, financial capital requirements of partnerships were relatively low, services were

[19] Section 9, Partnership Act 1890.

[20] Section 10, Partnership Act 1890.

[21] Barristers in Ireland are not directly affected, since they work as sole practitioners and are prohibited from forming partnerships.

normally provided by very small groups of people and potential exposure to significant professional negligence claims was relatively remote.

Professional responsibility has evolved with the development of tort liability and the expanded recognition of duties owed to persons other than clients. Professionals now face potential liability from a variety of sources, including third parties, relying on the work of the professionals with or without their knowledge.

It appears to the Review Group that these views are valid. Professional service firms are frequently sued for negligence, and the quantum of such claims could far exceed the amount of a firm's professional indemnity insurance cover[22]. If the insurance is insufficient to cover the entire amount of the claim, this is not necessarily the fault of the firm – it may reflect the fact that insurance at the levels required to cover the full amount of the potential liability is simply not available or that it is available only on prohibitively expensive terms. In the view of the Review Group this argument may have merit and needs further consideration.

Another argument often put forward by the traditional professions is that the risks associated with unlimited personal liability act as a deterrent to those considering entry into one of these professions. We are not convinced that there is any firm evidence to support this view, and therefore we are sceptical as to its merits.

On balance, however, we take the view that unlimited personal liability in professional service firms is a problem which deserves further examination. While we are not aware of any catastrophic claim in Ireland which has lead to the partners in a professional services firm losing their personal assets as a result of the negligence of their fellow partners, we accept the argument that the risk of such an eventuality increases year by year given the global nature and the scale (in financial terms) of many business transactions. In our view, an examination of the alternative means to limiting liability, including alternative business models, deserves examination.

[22] The demise of the leading international accountancy firm, Arthur Andersen, led to the exposure of partners in the global practice to liability for the malpractice of certain partners in the US even though many of the innocent partners were practising exclusively outside the US and never came into contact with the client companies at the centre of the financial and accounting scandals which brought down the firm.

4.1.4 The Limited Liability Partnership and its Background

The LLP was created in the United States in response to concern among professionals, mainly accountants and lawyers, that they were overexposed to liability claims for negligence or wrongful acts of their partners. The event which triggered the introduction of LLP legislation was a slump in oil and property prices in Texas in the late 1980s, which led to the collapse of a number of banks and savings and loan institutions. Professional service providers which had advised these institutions were called upon to compensate the class action plaintiffs even though their culpability was minor compared to that of other defendants. The inadequate insurance or financial resources of the other defendants placed the professional firms in the position of being the effective insurer of their co-defendants' risk.

- **The US Model**

The original form of limited liability partnership created in Texas in 1991 provided a shield against liability of a partner for the negligence or wrongful acts of another partner (partial shield liability). As the LLP form spread throughout the US, the protection was broadened to cover ordinary contractual debts of the partnership (full shield liability). Many US jurisdictions which initially adopted a partial shield have amended their legislation to adopt the full shield. However, a sizeable minority of States only provide the partial shield. The Uniform Partnership Act[23], as amended in 1996, is full shield legislation. It provides as follows: -

> *"An obligation of the partnership incurred while the partnership is a limited liability partnership, whether arising in contract, tort, or otherwise is solely the obligation of the partnership. A partner is not personally liable, directly or indirectly, by way of contribution or otherwise, for such an obligation solely by reason of being or so acting as a partner."*[24]

The principal features of the US model are as follows: -

1. Innocent partners have no personal liability for the negligent acts of other partners.

[23] The Uniform Partnership Act is in effect the equivalent of our Partnership Act, 1890. It is the model form of legislation for the individual states.

[24] Section 306 of the Uniform Partnership Act.

2. The partnership will continue to be liable to the extent of the partnership's assets and the negligent partner will remain personally liable in tort for his or her negligence.

3. Partners do not generally have personal liability in an insolvency situation beyond the amount of capital they have contributed to the partnership.

4. The tax status of the partnership is unaffected. LLPs are treated in the same way as general partnerships for income tax purposes.

5. The LLP must file an annual report in the Office of the Secretary of State setting out the name of the LLP and the address of its chief executive office.

6. The LLP is not a body corporate with separate legal personality and there are no financial disclosure requirements.

Furthermore, in the case of full shield protection,

7. The partners do not have any personal liability for the contracted debts and obligations of the partnership. Recourse is limited to the partnership's assets.

In certain states, LLPs can only be formed for specified professional uses. For example, in California only firms providing legal, accountancy or architectural services can use the LLP structure.

- **The Canadian Model**

Most of the Canadian provinces have introduced LLP legislation[25], borrowing heavily from the US model. Some provinces restrict the use of LLPs to "eligible professions", i.e. professions which are regulated by statute in Canada, such as accountants, lawyers and doctors.

In 2005, British Columbia adopted LLP legislation which places no restriction on the types of business which can register as LLPs. Instead, the responsibility for addressing the question of whether and on what terms a professional firm may use the LLP structure is placed in the hands of the profession, its governing body and the Government Department responsible for the oversight of the profession.

- **The UK Model**

In April 2001, the Limited Liability Partnerships Act 2000 came into effect in England, Scotland and Wales. Similar legislation has since been introduced in Northern Ireland. The 2000 Act created a form of LLP which is markedly different from the US/ Canadian model. The UK form of LLP is a body with legal personality separate from its members (i.e. the partners). It is governed by a hybrid system of law partially derived from company law and partly based on partnership law. Unlike general partnerships, the members are not personally liable for the debts and obligations of the firm and the liability of the members of the LLP on its winding-up or dissolution is limited to the amount of capital they contributed to the LLP. The LLP is liable for the wrongful acts or omissions of a member, but the members are not jointly and severally liable for the acts or omissions of another member. This is due to the fact that the LLP has legal personality separate from its members.

The members of a UK LLP are subject to income tax on their trading income in the same way as a general partnership. The LLP is tax transparent or "pass-through" for tax purposes as it pays no tax itself on the income or gains of the LLP.

The right to form a UK LLP is not restricted to certain types of profession. The LLP structure is available to any lawful business which is carried on with a view to profit.

4.1.5 Safeguards for Third Parties Dealing with LLPs

It is widely accepted that the privilege of LLP status should come at a price. The reduction in the potential exposure of partners to liability should be counterbalanced by measures which protect the interests of clients, creditors and other third parties dealing with the LLP.

The safeguards may be located in primary LLP legislation or, following the example of British Columbia referred to above, the responsibility for addressing such issues may be left to the bodies which regulate the professions to which the LLP privilege is extended or to legislation which is specific to such professions.

The following safeguards have been adopted in many jurisdictions which have introduced LLPs:-

[25] Ontario, Alberta, Manitoba, Quebec and Nova Scotia have adopted partial shield LLP legislation. Saskatchewan, New Brunswick and British Columbia have adopted the full shield.

1. There is usually a requirement that the LLP meets certain minimum levels of professional indemnity insurance. For example, under the Corporations Code of California, an LLP providing accountancy services must maintain an errors and omissions policy of at least $100,000 multiplied by the number of "licensed persons" rendering professional services on behalf of the firm. For LLPs with fewer than 5 partners, the aggregate limit of liability under the policy must be not less than $500,000. The policy is not in any event required to exceed $5,000,000.

2. Typically, there are restrictions on the distribution of partnership assets to the partners. Such restrictions are based on similar principles to those which underpin restrictions on distributions to members of limited companies.

   "Distribution", in this context, means a transfer of money or other partnership property whether as a share of profits, return of contributions to capital or otherwise.

   In the laws of many US states and Canadian provinces the restriction on distribution is expressed in the following, or similar, terms:-

   "(1) A limited liability partnership shall not make a distribution of partnership property in connection with the winding up of its affairs unless all partnership obligations have been paid or satisfactory provision for their payment has been made.

   (2) In circumstances other than in connection with the winding up of its affairs, a limited liability partnership shall not make a distribution of partnership property if there are reasonable grounds to believe that after the distribution
   (a) the partnership would be unable to pay its partnership obligations as they come due; or
   (b) the value of the partnership property would be less than the partnership obligations."

   Where there is a wrongful distribution of LLP property to a partner, the partner receiving the distribution is liable to restore the property to the LLP, and partners who authorised the distribution are jointly and severally liable for any shortfall in the amount recovered from the partner receiving the distribution.

3. The LLP must undergo a registration process and is required to file an annual return in a public registry in each year. Often, the register of LLPs is maintained by the same registration authority which is responsible for the registration of companies. Partnerships which fail to register continue as general partnerships.

4. The LLP is required to have the words "Limited Liability Partnership" or the abbreviation "LLP" as part of and at the end of its name.

5. On registration as an LLP, the partnership must immediately send to all its existing clients and creditors a notice which advises them of the registration and explains in general terms the potential changes in liability of the partners resulting from registration.

6. The liability of a partner as a general partner in respect of debts, obligations or negligence incurred or arising before conversion to LLP should not be limited or affected by conversion.

7. Requirements similar to those above are usually imposed on foreign LLPs which carry on business in the relevant host jurisdiction.

   As a separate but related issue, the question arises as to which law should govern the liabilities of an LLP formed in another jurisdiction but which carries on business in the host jurisdiction. Should the partners' individual liability be determined by the laws of the host or the home jurisdiction? In the Canadian provinces, the law of the home jurisdiction of an extra-provincial LLP applies to the liability of its partners for debts, obligations and liabilities incurred in the host province.

8. One also has to consider whether the LLP should be required to submit to a financial disclosure requirement by filing annual audited accounts or other abbreviated financial information with its annual return. In the US/Canadian model, there is generally no financial disclosure requirement even in the case of full shield protection. UK LLPs are required to make financial disclosure on a similar basis to limited companies, the rationale being that the UK LLP is an entity with legal personality separate from its members and each member of the LLP enjoys protection against liability similar to the protection afforded by incorporation as a limited company.

4.1.6 Limitation of Liability by Other Means

As a matter of general principle, a party to a contract can usually seek to negotiate terms which limit its liability to the other party or parties, whether the liability arises in contract, tort or otherwise. However, exclusion clauses in contracts must conform to certain requirements based in common law and statute. Limitation of liability provisions are a common feature of both business-to-business and business-to-consumer contracts.

Certain restrictions have been placed on the extent to which some professions – notably solicitors and auditors – can limit their liability to their clients. These professions have in recent years sought reform of the laws which prevent them from limiting liability. For example, the Law Society of Ireland has sought the repeal and replacement of certain provisions in the Attorneys and Solicitors Act 1870, so as to allow solicitors to limit their liability by contract for both contentious and non-contentious work. The issue of auditors' liability is considered in Chapter 5 of this Report.

It seems to the Review Group that, irrespective of the outcome of these review processes, contractual limitation of liability should not be seen as a universal remedy for the unlimited liability issue to which the traditional professions are exposed under current partnership legislation. In the first place, it may not be possible in practice for professionals to negotiate satisfactory limitation of liability provisions where they are needed most, i.e. in engagements to provide advice on high value financial and corporate transactions. Powerful clients are unlikely to accept such limitations of liability, and professional firms which insist on including limitation provisions in their terms of engagement may find that the work goes to other firms. Secondly, professional liability has extended with developments in the law of negligence so that professionals now owe duties to persons other than their own clients. Contractual limitation of liability will not come to their assistance if a claim is made against them by a third party, as the doctrine of privity of contract still applies in Ireland and the only parties who can rely upon the terms of an agreement are the parties to the agreement.

4.1.7 Issues Arising in an Irish Context

A number of issues are deserving of consideration in any discussion about the possible introduction of LLP legislation in Ireland.

Firstly, there is always a risk that the introduction of sweeping changes to legal structures will create unforeseen opportunities for large-scale tax avoidance. If Irish LLPs were found to be a vehicle for use in international tax avoidance strategies, this could do considerable damage to Ireland's reputation as a business centre.

Secondly, the same considerations which led to the introduction of measures against non-resident Irish companies would arise again if LLPs were to be introduced. Similar safeguards to those contained in sections 43 and 44 of the 1999 (No 2) Act might need to be put in place. These might include a requirement either that the LLP provides evidence that it has a real and continuous link with an economic activity in Ireland or alternatively that a certain minimum number or proportion of the partners are resident in Ireland.

Thirdly, further investigation may be required to establish whether the introduction of LLPs is of interest to the financial services community in Ireland. One of the main reasons for the introduction of the Limited Liability Partnerships Act 2000 in England, Scotland and Wales was, the Review Group understands, the imminent introduction of LLP legislation in Jersey and the concern that many financial service firms would register as LLPs under Jersey law and thus allow regulation of their affairs to pass out of the control of English law. Since the introduction of the Limited Liability Partnerships Act 2000, similar legislation has been introduced in financial services centres such as Dubai. The question therefore arises whether the introduction of LLP legislation which follows the UK model would attract financial services firms to set up businesses in Ireland. There may also be an argument that the availability of the LLP structure in Ireland would create a more favourable and competitive environment for financial services firms already carrying on business in Ireland. The Review Group is not aware, however, of any demand from the Irish financial services industry for the LLP structure.

Finally, the introduction of LLP legislation should only be considered if another method of limitation of liability, or another form of body corporate, cannot adequately address concerns. Further, there would need to be a reasonable expectation that the new form will be taken up in sufficiently large numbers as to make the amendment of the law of partnership a worthwhile exercise. In this regard, it is relevant to note that the Investment Limited Partnerships Act 1994 was introduced for the purpose of providing a more favourable environment and a more complete set of alternatives for businesses in the investment funds industry wishing to set up funds in Ireland. However, experience has shown that there has been little use of the investment limited partnership.

4.1.8 Conclusion and Recommendations

It is the view of the Review Group that LLP legislation is deserving of further consideration, as the issues which have led to the introduction of LLP legislation in other jurisdictions are equally relevant in Ireland. However, the main impetus for reform of partnership law in this area is coming from the professions and further examination of the issue is required, giving due weight and attention to any contrary views which may be expressed by other interested parties, including clients and customers of professional service providers. Consideration should be given to all or any competing solutions to the professional liability problem which might render the LLP solution unnecessary or inappropriate.

Therefore, it seems to us that the final decision on whether LLPs should be introduced, and on the shape and form which LLP legislation should take, can only be reached after a full consultation process involving all of those affected by the issues arising. With that objective in mind, the Review Group proposes to engage in a public consultation based around the following key issues:

- Does Ireland need a new approach to address the issue of unlimited liability in business partnership arrangements?

- What are the pros and cons of introducing the LLP model, e.g. based on the US, Canadian or UK models?

- What are the pros and cons of other forms of limiting liability, either contractually or through company incorporation?

- In the case of LLP status, what safeguards should be introduced to protect the interests of clients and creditors, including financial disclosure?

- Are there any other issues regarding LLPs which need to be brought to the attention of the Review Group?

The Review Group has formulated a series of questions (see Questionnaire at Section 4.3) to inform the public consultation noted above. The Review Group requests permission from the Minister to extend its consideration of this issue into the next Work Programme.

4.2 Limitation on Number of Partners

4.2.1 Introduction and Current Position

Generally speaking, partnerships are limited to twenty persons. This arises from section 376 of the 1963 Act which states that:

> *'No company, association or partnership consisting of more than twenty persons shall be formed for the purpose of carrying on any business (other than the business of banking), that has for its object the acquisition of gain by the company, association or partnership, or by the individual members thereof, unless it is registered as a company under this Act or is formed in pursuance of some other statute.'*

A similar restriction is contained in section 4(2) of the Limited Partnerships Act 1907.

Under section 13 of the 1982 Act, as amended, an exception to the general limit arises in the case of solicitors and accountants, subject to certain conditions. The limit does not apply to investment limited partnerships formed under the Investment Limited Partnerships Act 1994 in respect of which an authorisation has been given by the Financial Regulator. Furthermore, under section 13 of the 1982 Act the Minister has the power, by regulation, to exempt further categories of partnerships from the 20-partner limit. This power was exercised in 1988 and 2004 to exempt partnerships formed for the purpose of carrying on or promoting the business of thoroughbred horse breeding, and partnerships formed for the purpose of investment and loan finance to persons engaged in industrial or commercial activity.

Section 376 was modelled upon equivalent provisions in UK companies legislation which have now been repealed by the Regulatory Reform (Removal of 20 Member Limit in Partnerships etc.) Order 2002, S.I. 3203 of 2002.

4.2.2 Issues Arising

The Review Group intends to seek the views of the public, including in particular, professional or other bodies which may have an interest in the matter, as to whether the current law causes any general difficulties for either the creation of business organisations that wish to use the partnership model or in such organisations' ability to conduct their business.

For example, it appears the current restriction under section 376 of the 1963 Act causes some difficulty in structuring property syndicates as there are a number of transactions where more that 20 persons are brought together to purchase commercial property for investment purposes. These persons would almost invariably have relevant business and/or investment experience. Representatives of the accountancy profession have commented that the exemption in section 13 of the 1982 Act is not wide enough as it prevents them from including within their partnerships persons who are not qualified to act as accountants, contrary to the trend for accountancy firms to be multidisciplinary in composition.

4.2.3 Conclusion

The Review Group is reluctant to recommend simply abolishing the 20-member limit in case this opens up an avenue for unscrupulous promoters. However, consideration might be given to an amendment to permit partnerships in excess of 20 in specific instances where the limit might give rise to problems.

The Review Group will solicit views as to whether or not there is a need to remove the prohibition generally or to remove it for specific areas of activity (including multidisciplinary practices). It will also consider whatever alternative solutions might be available. The Review Group has formulated a series of questions (see Question 14 of the Questionnaire at Section 4.3) to inform the public consultation noted above. The Review Group requests permission from the Minister to extend its consideration of this issue into the next Work Programme.

4.3 Questionnaire on LLPs and the Limitation on Number of Partners

1. Does Ireland need a new approach to address the issue of unlimited liability in partnerships?

2. Should the LLP privilege be available to all forms of business or should it be limited to certain professions?

3. Can the problem of unlimited personal liability in partnerships be addressed by other means, without resort to a new LLP structure? Are contractual limits on liability or statutory caps on liability a viable alternative to the introduction of LLPs?

4. Should LLP legislation in Ireland provide for (a) partial shield protection (i.e. protection against the negligence of a partner), (b) full shield protection (i.e. protection against the negligence of a partner and against the contractual debts of the partnership) or (c) separate legal personality of the LLP?

5. Should LLPs be required to undergo registration on a public register? With whom should the LLP be required to register?

6. Should the safeguards against misuse of the LLP be contained in primary legislation or in the rules of the bodies charged with oversight of the relevant professions?

7. Should LLPs be required to make financial disclosure similar to limited companies?

8. Is the introduction of LLPs of interest to the financial services industry in Ireland?

9. If given a choice, would partners in a professional service firm ("PSF") partnership choose to form a company as a vehicle for carrying on their profession instead of practising through a partnership?

10. Is there a substantial risk that partners in a PSF partnership could lose their personal assets as a result of a claim not covered (or insufficiently covered) by insurance?

11. Does the availability of insurance not meet concerns about the unlimited personal liability of partners in a general partnership?

12. If policies of insurance are inadequate to meet concerns about unlimited personal liability, what are the specific reasons for this? Is insurance prohibitively expensive?

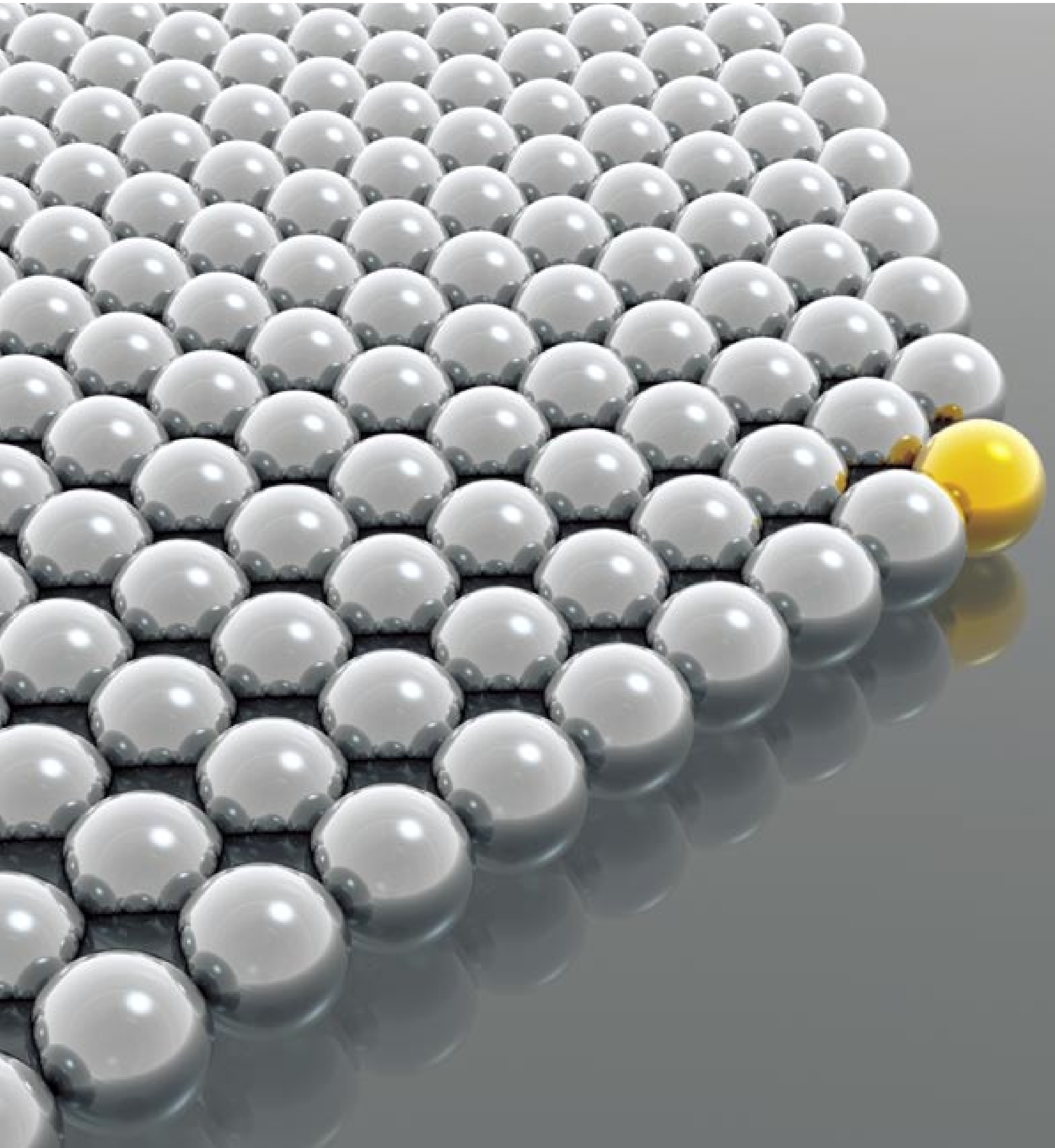
13. Is insurance more of an issue for PSF partnerships than for non-PSF partnerships?

14. Is the general limit restricting the size of partnerships to twenty members a constraint on using partnerships as a business model and should it be removed? Or, is it only a constraint in relation to certain sectoral activities and should it thus be removed only in certain specific instances?

15. Are there any other issues regarding LLPs which ought to be brought to the attention of the Company Law Review Group?

Chapter 5:

Audit and Financial Issues



Chapter 5: Audit and Financial Issues

5.1 Auditors' Liability

5.2 Other Audit-related Issues

5.2.1 Audit Committees - Section 205B of the Companies Act 1990

5.2.2 Audit Exemption Thresholds

5.2.3 Extension of Audit Exemption to Small Groups of Companies and to Dormant Subsidiaries

5.2.4 Power of the Office of the Director of Corporate Enforcement (ODCE) Regarding Entitlement to Audit Exemption

5.2.5 Miscellaneous Amendments proposed by the Irish Auditing and Accounting Supervisory Authority (IAASA)

5.3 Recognition and Protection of the Term 'Accountant'

5.1 Auditors' Liability

5.1.1 Introduction – Auditors' Role and Profile of the Irish Audit Profession

Auditors, in providing an independent opinion on companies' financial statements, play a key role in supporting and enhancing investors' confidence and, moreover, make a significant contribution towards companies' and directors' compliance with their respective obligations under company law.

Recent data suggests that there are currently approximately 1,460 audit firms based in Ireland, with a further 160 individuals approximately, also eligible to act as statutory auditors[25] [26]. While there are, in addition, many firms that are based in the UK that are eligible to act as auditors under Irish company law, it is not known to what extent this entitlement is actually availed of. Of the foregoing, the vast majority of audits of listed entities (i.e. entities whose securities have been admitted to trading on a regulated market operating or situated in the State) are performed by the Irish arms of the 4 global audit networks[27].

5.1.2 Background to the Review Group's Consideration of this Issue

Reform of auditors' liability has been a stated objective of the auditing profession for many years in most of the world's developed markets. The demise of the global audit firm, Arthur Andersen, and the resultant reduction to the current position of only 4 global audit firms have added further impetus to the profession's calls for liability reform. Against this backdrop, the Minister for Trade and Commerce requested that the Review Group examine the issue of auditors' liability and report its conclusions and recommendations to him.

5.1.3 Parallel EU Developments of Relevance

In early work on the 8th EU Directive on Statutory Audit ('the Statutory Audit Directive'), there were

[25] IAASA Annual Report, 2006 (Chapter 5, Table E.2 refers). IAASA's Annual Report in respect of 2006 can be accessed at www.iaasa.ie.

[26] There are currently six Recognised Accountancy Bodies under Irish company law, i.e. bodies that are entitled to authorise their members to act as statutory auditors.

[27] Deloitte, Ernst & Young, KPMG, PricewaterhouseCoopers.

proposals for pan-European reform of auditors' liability. However, as adopted, the Directive is silent other than providing an undertaking to the effect that the EU Commission would undertake a review of the various auditor liability regimes across Europe and issue a Recommendation to Member States.

On foot of that undertaking, a London based consultancy, London Economics, was retained by the EU Commission to carry out a study on the economic impact of the auditor liability regimes in Member States and the resultant report was released in September 2006. Having carried out an extensive analysis of the different regimes prevailing across Europe, London Economics concluded that the limitation of auditors' liability is desirable in the interests of ensuring the continuity of supply of audit services in the public interest.

More recently, the current EU Commissioner for the Internal Market, Commissioner McCreevy, has announced his intention to issue that Recommendation in 2008. He has further announced that this Recommendation, while recommending that Member States limit liability in some form, will not be prescriptive in that regard but, rather, will leave the most appropriate means of effecting reform to Member States themselves.

5.1.4 Current Position regarding Auditors' Liability in Ireland

Section 200 of the 1963 Act prohibits statutory auditors from exempting themselves, limiting their liability, or obtaining any indemnity from the company whose financial statements are being audited, in respect of such liability. Coupled with this, section 187 of the 1990 Act precludes auditors from constituting themselves as bodies corporate. As a consequence of the foregoing, statutory auditors are currently exposed to unlimited liability. Moreover, due to the principle of joint and several liability which exists in Irish law, auditors are potentially accountable not only for losses caused by their own actions or failings but also for those who may have primary responsibility for such losses but have no resources to meet claims awarded against them. For example, in an action arising as a result of a corporate collapse, where the directors and other senior management of a company have been found to be principally at fault, and where the auditor's culpability has been relatively minor, the auditors may still have to bear 100% of the loss arising, due to the insignificant resources of the other defendants to the claim.

In relation to private companies, the 2006 Act greatly increased the thresholds in line with EU law, below which companies do not, subject to meeting certain criteria, have to undergo a statutory audit. It is estimated that a significant number of companies could avail of this exemption and this may result in a significantly reduced number of audits being undertaken, thereby reducing the potential exposure of audit firms. However, the most substantial threat to the profession and to any particular firm is likely to arise in the very large/listed company audit market where the scale of the potential losses could threaten the viability of one of the large audit firms.

5.1.5 Issues Arising

The auditor's role is unique in that auditors are in general the only advisors who have an obligation to report directly to the members of a company rather than to the company itself. In addition, the auditor's report is also available to other future investors, who are not necessarily shareholders at the time of issue of the report.

The position of auditors in Ireland is that, unlike the case in many other EU Member States, there are no statutory provisions for limited liability partnerships (see discussion in Chapter 4 of this Report), nor is there ability for audit firms to establish as incorporated entities. Irish auditors are, therefore, significantly more exposed to the risk of 'catastrophic losses' than their European counterparts.

The prohibition on bodies corporate from acting as auditors means that the personal assets (including, for example, private residences) of all partners in audit firms are exposed in the event of a 'catastrophic loss', notwithstanding that most partners will have no involvement or culpability in the matter giving rise to that loss.

The Irish auditing profession has put forward the case, from the legal perspective, for reform of the auditor liability regime, based primarily on public policy arguments, designed to ensure continuity of supply of audit services, i.e. with a view to preventing the failure of a major network firm that audits clients beyond the capacity of smaller firms.

Furthermore, the auditing profession argues strongly that there is a real and present danger that another failure of a major firm will see the industry decimated and competition, at the upper end of the market, severely restricted. In addition, there is a recognised need to make the large/listed entity audit market more attractive to mid-tier firms to promote competition at the higher end of the market.

A brief summary of the main arguments put forward by the Irish Auditing profession is as follows:

a) Consequences of 'catastrophic' failure.

Currently the 'Big 4' audit firms (Deloitte, Ernst & Young, KPMG, PWC) globally are responsible for the audits of almost every public company on each of the world's major Stock Exchanges. This is true in Ireland, where substantially all listed entities are audited by the 'Big 4', as it is in the UK and other Stock Exchanges across Europe. Whilst this reliance on four service providers is recognised by regulators, the profession and all other stakeholders, as being unhealthy, there is no short-term remedy available. It is also accepted that there exists a substantial risk to the supply of audit services in the event of the collapse of one of the 'Big 4'. It is the view of the profession, that if one of the remaining 'Big 4' were to fail as a result of a significant corporate collapse, the remaining 'Big 3' would not necessarily (a) have the resources, or (b) have the desire to become auditor to all of the clients of that failed firm. In such circumstances, according to the profession, it is also likely, based on an analysis of risk, that certain of the country's larger corporates, including financial institutions, funds and other higher risk entities, could fail to find an auditor as the larger audit firms make a conscious decision to exit those particular segments of the audit market considered to pose an unacceptably high risk to their future existence.

The argument has been made, therefore, that from a national interest perspective, reform of the existing liability regime is necessary to ensure the continuity of supply of audit services to Ireland's capital markets.

(b) Significance of existing claims against audit firms.

Whilst historically audit firms have generally managed to settle claims outstanding for amounts that have not threatened their existence, there can be no guarantee that this will continue. Data provided to London Economics shows that there are 16 claims outstanding in the EU where damages sought from the large firms are in excess of $200 million, while five of these claims are in excess of $1 billion. AON, the global insurance consultancy, concluded that it is more likely than not that a member firm of one of the large audit networks will, within the next five years, have damages awarded against it of such magnitude as to raise serious doubts as to the survival of its global network. On this basis, it would appear that there is more than a remote likelihood of the 'Big 4' global partnerships becoming the 'Big 3' over the next five years.

(c) The availability of insurance.

The availability of commercial insurance at economically viable prices has all but disappeared for the global audit firms. As a result, most of these firms have resorted to 'captive' insurance arrangements which are more akin to a financing policy as opposed to true sharing of commercial risk. Most of these captives operate on the basis of the availability of a certain pool of assets in the event of a claim but, ultimately, with a finite level of resources being available. It is a common misconception that the existence of unlimited liability is matched by unlimited resources; the structure of the insurance arrangements of most of the global audit networks is such that only very limited insurance is available in the event of significant claims. According to the London Economics study, the availability of commercial insurance for high tranches of cover has fallen sharply to the point that such insurance would cover less than 5% of the large claims faced by some audit firms today.

(d) Reform in other EU States.

Reform exists in most EU States with Ireland being the only country which has no ability to limit liability, along with a prohibition on incorporation and on acting as a limited liability partnership. Currently, statutory maximum caps on auditors' liability are imposed in at least five EU Member States – Belgium, Austria, Greece, Slovenia and Germany, with such caps being absolute in monetary terms under Greek, Slovenian and German law. In addition, in other EU Member States (Czech Republic, Denmark, Latvia, Lithuania, Poland, Spain, Sweden and UK) parties can negotiate contractual caps, some of which also allow for proportionate responsibility.

The UK has become the latest Member State to amend its domestic law and now makes it possible for auditors to make limitation agreements with the client company to limit the auditors' liability, subject to endorsement of the company's members and to the legal requirement that the agreement be fair and reasonable.

The profession would argue, in light of all of these developments across the EU, coupled with the reform that has taken place in Australia and elsewhere recently, that reform in Ireland is now urgently required.

(e) Attractiveness of the audit profession.

The ability of the auditing profession to deliver high quality audit services is dependent to a significant degree on the attractiveness of the profession to the brightest of graduates. Heretofore, the major accounting firms have been successful in attracting bright graduates to the profession and this has been a significant factor in the development of a high quality audit profession in most countries. However in recent years, large accounting firms have begun to identify the significant difficulties in retaining this talent in the profession once they have qualified. Most firms have experienced difficulties in retaining professionals in audit once their training contracts have expired as the profession is increasingly viewed as highly regulated, technically demanding in terms of the range of expertise which is expected and professionally unrewarding. This is particularly so when viewed in the context of reaching the top of one's profession and then having one's personal assets exposed in the event of losses arising from the actions of others. A crucial element in the argument for reform of the profession is to make it attractive to professionals who wish to specialise in audit and to retain them in professional practice throughout their career.

A recent MORI survey of 1,500 professional staff of the large firms in Europe reveals that 67% of all respondents see a career as an auditor as less attractive than it was two years ago, while at partner level, this rises to 78%. 58% of all respondents and 83% of partners believe that potential liability in cases of corporate wrongdoing is a major contributory factor.

(f) Large company audit market is unattractive for mid-tier firms.

The dominance of the 'Big 4' audit firms in the large company/public company audit market place is a source of concern for corporates, regulators and the profession alike. The mid-tier firms have generally found it difficult to break into this marketplace and it is generally accepted that the level of risk attaching to the larger corporates make this market even more unattractive for mid-tier firms. The existing large company/public company audit market in Ireland is also dominated by the 'Big 4' global networks. It is contended by the profession that reform of the liability regime, where the liability of audit firms would be capped at a predetermined or otherwise fixed amount, will open up this market to mid-tier firms and provide a more attractive and level playing field for competition.

(g) Greatly increased oversight systems.

The audit profession believes that while there are many drivers of audit quality, the vast majority of professionals are motivated by the desire to do a good job as much as they are by the threat of sanctions if they get it wrong. The recent shift away from self-regulation and the establishment of independent oversight bodies performing periodic inspections of the large firms provide further assurance that there are other checks and balances to preserve audit quality. In Ireland, the Irish Auditing & Accounting Supervisory Authority ('IAASA') was established under the 2003 Act as a direct response to concerns, both nationally and internationally, regarding the audit profession's capacity to fulfil its role effectively. IAASA's role, as provided for by the Act, is, *inter alia*, to supervise the Recognised Accountancy Bodies' regulation and monitoring of their members and member firms. Accordingly, under the model provided for by the Act, the professional bodies carry out quality assurance reviews of all audit firms. Through the discharge of its supervisory remit, IAASA performs ex-post reviews of the manner in which the professional bodies have performed such reviews.

Most of the large Irish accounting firms are also registered with PCAOB (Public Company Accounting Oversight Board) in the USA and submit themselves to annual inspections by their network organisations.

(h) Improved audit quality.

The last five or six years have shown very significant developments in seeking to improve audit quality (for example, the introduction of Internal Standards on Auditing and Quality Control) and the audit profession has made significant investments which have contributed to better quality financial reporting. In addition to the convergence of accounting standards and independence standards, the adoption of International Standards on Auditing has greatly improved the quality and consistency of audit reports with the result that the role and responsibilities of the auditor are now more highly valued than ever before. The audit profession believes it has contributed significantly to this enhancement of quality and sees reform of an inequitable liability regime as long overdue.

5.1.6 Options to Address the Issues

The audit profession, in its submissions to the Review Group, has presented five separate possible solutions as follows:

(a) Allow incorporation of audit firms: this would effectively require the amendment of section 187(2) of the 1990 Act and would allow auditors to operate as limited companies. This solution, while not preventing the failure of a large accounting firm, would nevertheless provide a more equitable playing field for auditors relative to other professionals and indeed auditors operating in other jurisdictions.

(b) Implement limited liability partnership legislation: many other jurisdictions now have limited liability partnership legislation in place and, like incorporation, this would go some way towards levelling the playing field in Ireland. However, while protecting the assets of innocent partners, it does not address the public policy issue of continuity of supply of audit services in the event of a collapse of one of the major accounting firms.

(c) Removal of section 200 prohibitions, allowing liability capping by contract: this solution would address many of the concerns of the audit profession and would remove section 200 of the 1963 Act, thereby allowing audit firms to contract with their clients to limit their liability in the event of failure. Removing the cap however, may not produce the required result as there is some apprehension that auditors would force their clients to accept too low a cap.

(d) Introduce proportionate liability: one of the concerns of the audit profession is the issue of responsibility for losses caused by others, where those others are unable to contribute their share of the loss. Reform of the proportionate liability regime is theoretically an option which would result in the auditors being found liable only for the losses for which they are directly to blame and not losses caused by others. However, legal opinion has indicated that there are significant constitutional difficulties associated with this proposal. In addition, it would not provide any protection to a firm in the event of a direct award against it at a level that it could not bear.

(e) Introduce a statutory cap on liability: this solution would involve a statutory limit on the amount which an auditor would be liable for in the event of claims arising from statutory audit work. This amount would be determined in statute, assessed at a level which is determined to be fair and reasonable.

The view of the Institute of Chartered Accountants in Ireland, as a representative of the majority of auditors based in the State, is that there should be a removal of the existing prohibition on incorporation for audit firms and there should be a maximum statutory cap on the liability of an auditor in respect of each statutory audit he or she undertakes, to be the lesser of a multiple of the audit fee and an absolute maximum amount. Such a model would, therefore, benefit audit firms across the market spectrum – those auditing large, listed companies and also those which audit small companies.

5.1.7 Views of the Irish Auditing & Accounting Supervisory Authority (IAASA)

IAASA is of the view that the current arrangements, whereby audit firms are jointly and severally liable for losses incurred in circumstances where they are less than 100% culpable, is inherently unjust and inequitable. In that context, IAASA is of the view that reform of auditors' liability is merited.

As regards how reform might best - and most justly - be effected, IAASA tends towards the view that the first option that should be examined is the introduction of proportionate liability, which would serve to ensure that, where culpable, auditors would only be required to meet the corresponding proportion of any loss or other damage suffered as a result of their own actions.

In the same way as the introduction of auditors' entitlement to incorporate will not, the introduction of proportionate liability will not necessarily prevent the failure of an audit firm in the event of a catastrophic claim being successfully pursued against it. Therefore, in the event that the intended purpose in effecting liability reform is to prevent the demise of a major audit firm from exiting the market as a consequence of a catastrophic claim, it may be considered appropriate to move beyond proportionate liability and introduce some predetermined means of limiting liability. It has, in parallel, been argued that the introduction of a predetermined limitation on auditors' liability would serve to render it easier for so called 'mid-tier firms' to compete in the market for the audits of the largest corporate entities. While liability reform would undoubtedly be of assistance in this regard, there are many other barriers to those firms' entering this market, including for example, relative lack of experience and expertise in specialist audit work (e.g. banks, insurance undertakings and financial institutions), absence of global reach and presence on a scale of that possessed by the four global networks (a consideration that is of importance in the context of cross border audits) and Boards' and Audit Committees' reluctance to move away from global firms as auditors, based on the perceived risks associated with doing so.

In the context of the foregoing, those options that have been mooted include a statutory cap on liability which would apply to claims from all parties and liability limitation by contract (which would apply to the auditor-client relationship only).

With regard to any proposals to introduce predetermined capping of liability, IAASA tends towards the view that the levels at which any such cap would be set would have to be carefully considered having regard, *inter alia*, to:

- an objective assessment of the risk of a claim (or claims) being filed against an Irish audit firm that is(are) of sufficient magnitude to threaten the existence of the firm;

- what level such a claim(claims) would have to be at to threaten the existence of the firm;

- the structures of the firms that the measures are seeking to protect – for example, logic would suggest that, before setting a cap level, information would be required as to the extent to which an Irish firm could be liable for meeting a claim filed against another member firm of the network – this goes to the heart of assessing the risk of a 'catastrophic claim' that could directly threaten the existence of an Irish audit firm;

- any cap level that it might be considered appropriate to set should, while seeking to prevent a failure that would be injurious to the public interest, not seek to remove to an inappropriate degree, the risks associated with statutory audit, which is a profitable business;

- the possible adverse effects on audit quality of setting cap levels too low;

- whether it is appropriate to set differing levels of cap depending on, for example, whether the client company is listed or unlisted or on the size of the client;

- other interested parties' views (including investor and shareholders' groupings/representatives).

With regard to the possibility of allowing auditors to further limit their liability to their clients by contract, IAASA is of the view that any such arrangements, if introduced, should require shareholder bodies' prior approval on an annual basis. As evidenced, there are further questions, of course, as to whether shareholders, and particularly institutional shareholders, would be willing to enter into such arrangements.

IAASA has pointed out that the European Commission is expected to publish shortly a formal Recommendation on 'Quality Assurance' relating to auditors of public interest entities (as defined). It is the view of IAASA that any proposal addressing auditor liability reform should have regard to this.

Finally, IAASA is of the view that, were an artificial cap to be introduced, the protection afforded by it should not extend to protect against instances of fraud or intentional/wilful misconduct.

5.1.8 Risk Analysis

- **Risks associated with proceeding with the options outlined**

Removal of Ban on Incorporation

1. There is no guarantee that, of itself, the ability of auditors to incorporate would ensure the quality and continuity of supply of persons into the profession. Incorporation of itself does not offer the desired outcome of ensuring the continuity of supply of audit services by protecting against catastrophic loss.

2. Incorporation could be open to abuse, e.g. establishment of small subsidiaries for individual audits to minimise exposure. However, it is highly likely that clients, the regulating authorities and the market itself would dictate that the risk is sufficiently mitigated. There is no evidence that such abuse has taken place in any other jurisdiction where reform has been introduced.

3. There is a risk that, despite the exposure involved, partnership might continue, for other reasons, to be the preferred business model for the larger audit firms.

Limited Liability Partnerships

1. While Limited Liability Partnerships protect the innocent partners, there is a risk that the firm

itself may not survive. In such circumstances, the effective functioning of the audit market and the continuity of supply into the profession would not be enhanced.

Proportionate Liability

1. There is a risk that the introduction of proportionate liability to replace 'joint and several' responsibility could be difficult to achieve constitutionally. Moreover, a regime based on proportionality alone would not provide the necessary safeguard to supply of audit services as any liability amount arrived at on a proportionate basis could still potentially exceed amounts that firms could afford to pay out.

Capping of Liability by contract or in statute - General

1. There is a risk that competition may not be enhanced by the introduction of a cap. It is difficult to anticipate the impact of a contractual capping mechanism on the audit market. The ability to negotiate a cap should promote a more level playing field among large and mid-tier firms. However, it is unclear whether small firms would be able to offer to cap liability up to the levels of the larger firms.

2. There is a risk that any contractual cap on liability, while aimed at ensuring the survival of the auditor, could be to the detriment of the client company. The UK mechanism to allow limitation by contract appears to give rise to concerns by both parties.

3. In such circumstances the cap may be meaningless. Any negotiated cap could easily be challenged subsequently in court. Insofar as any cap puts a limit on damages which may be sought or obtained, it could be unconstitutional. It could be argued that where limited liability is allowed as a result of incorporation, contract law applies, thus obviating any need for a cap.

4. Simply removing the current restriction on capping is insufficient; too low a cap would not be acceptable to client firms; a cap 'ceiling' would be necessary to protect firms.

5. Capping by contract could give either party an unfair advantage, where one is in a stronger negotiating position for whatever reason, and even where guidance on such capping agreements is available from the regulating authorities. In addition, the ability to negotiate caps freely would likely be used to the disadvantage of smaller firms in competing with the caps offered by larger firms. Guidance on negotiations could be confusing and open to interpretation, carrying risks for either party.

6. There is a risk that the introduction of a capping mechanism could adversely affect audit quality, which would be contrary to the public interest.

7. A cap established by statute, and establishing a realistic upper limit on the potential liability of the auditor, however, has a number of attractions:

   a. It addresses the public policy concern of ensuring a stable supply of audit services and encouraging competition in that market;

   b. It avoids the scenario of an audit firm collapsing as a result of a single catastrophic claim;

   c. It provides greater certainty;

   d. It enables the auditor to obtain insurance cover in a more certain environment;

   e. It ensures audit risk is more commensurate with remuneration.

- **Risks associated with not proceeding with reform**

1. It is clearly not in the national interest for the supply of audit services, particularly to the capital markets, to be significantly threatened by the potential demise of a large audit firm. Failure to enact reform would perpetuate this risk and the risk that remaining firms would be unable or unwilling to provide audit services to certain clients of that firm.

2. In the modern business world, where audit firms are both local and global businesses, the outdated restriction on incorporation, and thus on limited liability, would be maintained, as would the consequential risks to audit firms and their clients.

3. Innocent partners in the firm would continue to be liable, up to and including personal bankruptcy, for the negligence of others.

4. In such circumstances there is a risk of reduced competition at the upper end of the audit market.

Smaller firms would not easily be able to fill the gap created

5. Even without any failures, unlimited liability ensures that competition is restricted as the mid-tier firms are less inclined to take on the large company audit market and the potential financial risk.

6. Given the options to limit liability that pertain in other Member States in the EU, Irish audit firms are at a disadvantage relative to their EU counterparts in that they would continue to be unable to protect their assets, including the private assets of partners. As a consequence, client firms are not getting the most competitive service.

7. Any lowering of the quality or competition in the audit profession would have serious downside risks for the effectiveness of the corporate governance regime, the enforcement of company law and the reputation of the Irish economy as a business location.

5.1.9 Conclusions

The Review Group accepts that a strong and effective audit profession is a vital component of the efficient operating of the markets, of good corporate governance standards in Ireland and of our company law compliance and enforcement culture.

It is, therefore, in the interests of investment and enterprise in Ireland that competition and the continuity of supply of highly qualified personnel to the profession is promoted. Unlimited liability is no longer appropriate in the modern business world, given the potential negative impact on the audit profession, its practices and recruitment, and the knock-on implications for corporate governance standards and confidence in the capital markets.

Currently Ireland is out of step with a number of our fellow Member States on this issue. The EU will shortly present options on limitation of auditors' liability in the context of the 8th Directive.

In other jurisdictions we were informed that there is evidence that statutory caps on liability promote competition in the audit market. One reason for the introduction of statutory caps was to maintain competition by avoiding potential discrimination against smaller audit firms with less financial resources. Such measures appear to have been successful as demonstrated by the greater level of competition in the audit market for publicly quoted companies in Germany, Austria and Greece where such caps exist.

However, the introduction of measures to address auditor liability would have to be overseen and kept under review by IAASA.

Overall, while the Review Group notes that the introduction of limited liability could affect a client company's rights, the balance of benefits in so doing is in favour of stability in the audit profession, the continued supply of qualified personnel and a consequentially stronger corporate governance regime and compliance with company law.

5.1.10 Recommendation

The Review Group recommends as follows:

1. Removal of the ban on incorporation. The Review Group notes that this is currently permissible under EU legislation and that the transposition of the revised 8th Company Law Directive will include further safeguards on appropriate governance of statutory audit firms that are corporate entities.

2. A statutory cap on liability should be provided for in legislation. The exact figure should be determined by the Minister and subject to periodic review, following consultation with the relevant stakeholders including a cross-section of audit firms, their clients and insurers. The Review Group recommends that approaches to capping in other EU Member States should be considered in this context. The Review Group makes this recommendation taking into consideration that:

    - this is the most transparent approach to limiting liability;
    - it can be implemented relatively simply;
    - it facilitates the work of the major audit firms without imposing serious risks on their clients;
    - it will allow mid-tier firms to compete;
    - it will not apply in cases of fraud or intentional malpractice;
    - the figure should be subject to ongoing review.

5.2 Other Audit-related Issues

5.2.1 Audit Committees- Section 205B of the Companies Act 1990

5.2.1.1 Introduction and Background

Section 205B of the 1990 Act requires Public Limited Companies (PLCs) to establish an audit committee. Section 205B(2) provides that

> *"the board of directors of a public limited company (whether listed or unlisted) shall establish and adequately resource a committee of directors, to be know as the audit committee".*

Section 205B can be found in Appendix 1 to this Section.

However, the section was never commenced, due primarily to concerns over the exact scope of entities covered, and also certain overlapping requirements of the EU 8th Directive on Statutory Audits that is to be implemented shortly. (Article 41 of this Directive can be found in Appendix 2 to this Section).

In light of these requirements, the Minister for Trade and Commerce asked the Review Group to consider if section 205B was still necessary given the forthcoming 8th Directive or whether it should be removed or altered to operate on a 'comply or explain' basis, having regard to the 8th Directive. The Directive is due to become law in Ireland on 29th June 2008.

5.2.1.2 Issues Arising

In its consideration of the issue, the overriding concern for the Review Group was that obligations on Irish firms in the context of the implementation of EU legislation, should not be more onerous than obligations on their EU competitors. In that context, it was considered that the proposal as set out in section 205B could add unnecessarily to the burden on industry and has potential adverse implications for Ireland's attractiveness as a location for foreign investment. The Review Group was concerned that companies should have all the necessary flexibility in implementing any such a provision and that by commencing certain provisions now would potentially cause confusion relative to the new obligations which would be required in the EU 8th Directive.

Views of the ODCE

> The ODCE is of the view that section 205B of the 1990 Act is a very useful basis for the implementation of the 8th Directive's requirements for audit committees in public interest entities. Compared with Article 41 (and the related Article 42) of the Directive, section 205B contains additional worthwhile provisions, including those specifying a more detailed set of responsibilities for audit committees that are broadly consistent with the Directive, those stipulating certain minimum standards relating to the constitution, composition and independence of audit committees and those requiring the development of written terms of reference describing an audit committee's role.
>
> Section 205B was developed in response to considered recommendations made by the Review Group on Auditing arising from various corporate governance failures in the late 1990s. Bearing this in mind, the ODCE favours the retention of these additional elements of section 205B in applying the general obligation in Article 41 to public interest entities.

The main underlying issue, therefore, is the scope of application of any such measure, i.e. in what circumstances should audit committees be required and what functions should they have.

The situation reflecting current Stock Exchange rules, the provisions of section 205B and Article 41 of the 8th Directive is summarised in Table 1 below.

Table 1:

Scope	Existing Stock Exchange Requirement	Proposed Section 205B of the 1990 Act	Article 41 EU 8th Directive
• Listed PLCs	Yes	Yes	Yes
• Non listed PLCs	No	Yes, unless below threshold	No (unless a PIE[28])
• Large private companies	No	Yes, or explain why not	No (unless a PIE)
• Relevant Undertakings[29]	No	Yes, or explain why not	No (unless a PIE)
• Plc issuers of asset backed securities	No	Yes, but open to consultation	Yes, but exemption option available
• Plc collective investment undertakings	No	Yes, but open to consultation	Yes, but exemption option available
• Credit institutions <100m	No	Yes, but open to consultation	Yes, but exemption option available

5.2.1.3 Recommendation

The Review Group is of the majority view that the provision for an audit committee (as envisaged at section 205B of the 1990 Act) should instead be provided for as follows:

a) In transposing the 8th Directive, Ireland should provide that listed PLCs (as defined in the 'Transparency Directive') should have an audit committee (subject to the options available in the 8th Directive);

b) 'Relevant undertakings' (as defined in the 2003 Act), unless they are a 'Public Interest Entity' - PIE, should either comply with the requirement to have an audit committee or be required to explain why not; and

c) Large private companies should only be included in the definition of 'Public Interest Entity' if it is clear that other Member States are including large private companies in their definitions.

[28] Public Interest Entity (PIE), as will be defined in the transposition of the 8th Directive.

[29] as defined in the 2003 Act.

Appendix 1: Section 205B of the Companies Act 1990

(1) In this section-

'affiliate' in relation to an auditor, means a firm, body corporate or partnership considered under section 182(2) to be an affiliate of the auditor at the relevant time;

'amount of turnover' and 'balance sheet total' have the same meanings as in section 8 of the Companies (Amendment) Act 1986;

'internal audit' means an examination of the internal control system of a public limited company, a large private company or a relevant undertaking that is conducted within the public limited company, large private company or undertaking or otherwise at the request of its audit committee, directors or other officers;

'internal auditor' means a person who conducts an internal audit;

'large private company' means either of the following;

(a) a private company limited by shares that, in both the most recent financial year of the company and the immediately preceding financial year, meets the following criteria:
 (i) the balance sheet total of that company exceeds for the year -
  (A) €25,000,000, or
  (B) if an amount is prescribed under section 45(1)(1) of the Act of 2003 for the purpose of this provision, the prescribed amount;
(b) a private company limited by shares if the company and all its subsidiary undertakings together, in both the most recent financial year of that company and the immediately preceding financial year, meet the criteria in paragraph (a);

'parent undertaking' and 'subsidiary undertaking' have the same meaning as in the 1992 Regulations;

'relevant undertaking' means either of the following;
(a) an undertaking referred to in Regulation 6 of the 1993 Regulations that, in both the most recent financial year and the immediately preceding financial year of the undertaking, meets the following criteria;
 (i) the balance sheet total of that undertaking exceeds for the year -
  (B) €25,000,000, or
  (C) if an amount is prescribed under section 48(1)(1) of the Act of 2003 for the purpose of this provision, the prescribed amount;
 (ii) the amount of turnover of that undertaking exceeds for the year -
  (A) €50,000,000 or
  (B) if an amount is prescribed under section 48(1)(1) of the Act of 2003 for the purpose of this provision, the prescribed amount;

(b) an undertaking referred to in Regulation 6 of the 1993 Regulations if that undertaking and all of its subsidiary undertakings together, in both the most recent financial year and the immediately preceding financial year of the parent undertaking, meet the criteria in paragraph (a).

(2) Subject to subsection (16), the board of directors of a public limited company (whether listed or unlisted) shall establish and adequately resource a committee of directors, to be known as the audit committee, with the following responsibilities;

(a) reviewing, before they are presented to the board of directors for approval -
 (i) the company's [individual accounts], and
 (ii)if the company is a parent undertaking, the group accounts of the group of undertakings of which the company is the parent undertaking;

(b) determining whether the [individual accounts] so reviewed comply with section 205A (2) and whether, in the committee's opinion, they give at the end of the financial year a true and fair view of –
 (i) the state of affairs of the company, and
 [(ii) the profit or loss of the company, even if, by virtue of section 7(1A) of the Companies (Amendment) Act 1986 or section 148(8) of the Act of 1963, is not laid before the members in annual general meeting;]

(c) determining whether the group accounts so reviewed comply with section 205A(2) and whether, in the committee's opinion, they give at the end of the financial year a true and fair

view of –
(i) the state of affairs of the group of undertakings of which the company is the parent undertaking, and
(ii) the profit or loss of that group;

(d) recommending to the board of directors whether or not to approve the [individual accounts] and group accounts so reviewed;

(e) determining, at least annually, whether in the committee's opinion, the company has kept proper books of account in accordance with section 202;

(f) reviewing, before its approval by the board of directors, the statement required to be made under section 205E(5) and (6);

(g) determining whether, in the committee's opinion, the statement so reviewed–
(i) complies with section 205E(5) and (6), and
(ii) is fair and reasonable and is based on due and careful enquiry;

(h) recommending to the board of directors whether or not to approve a statement reviewed under paragraph (f);

(i) advising the board of directors as to the recommendation to be made by the board to the shareholders concerning the appointment of the company's auditor;

(j) monitoring the performance and quality of the auditor's work and the auditor's independence from the company;

(k) obtaining from the auditor up to date information to enable the committee to monitor the company's relationship with the auditor, including, but not limited to, information relating to the auditor's affiliates;

(l) recommending whether or not to award contracts to the auditor or an affiliate of the auditor for non-audit work;

(m) satisfying itself that the arrangements made and the resources available for internal audits are in the committee's opinion suitable;
(n) reporting, as part of the report under section 158 of the Principal Act, on the committee's activities for the year, including, but not limited to, the discharge of its responsibilities under paragraph (j);

(o) performing any additional functions prescribed by regulation under section 48(1)(m) of the Act of 2003;

(p) performing any other functions relating to the company's audit and financial management that are delegated to it by the board of directors.

(3) Subject to subsection (16), the board of directors of each large private company and of each relevant undertaking shall either –

(a) establish an audit committee that -
(i) has all or some of the responsibilities specified in subsection (2), and
(ii) subject to subsection (8), otherwise meets the requirements of this section, or

(b) decide not to establish an audit committee.

(4) The board of directors of each large private company and of each relevant undertaking to which subsection (3) applies shall state in their report under section 158 of the Principal Act –

(a) whether the company or undertaking, as the case may be, has established an audit committee or decided not to do so,

(b) if the company or undertaking, as the case may be, has established an audit committee, whether it has only some of the responsibilities specified in subsection (2), and

(c) if the company or undertaking ,as the case may be, has decided not to establish an audit committee, the reasons for that decision.

(5) For the purpose of applying subsection (2) to a large private company or relevant undertaking that decides under subsection (3)(a) to establish an audit committee with some or all of the responsibilities specified in subsection (2) –

(a) a reference in any applicable paragraph of subsection (2) to a public limited company or the company is to be construed as a reference to the large private company or relevant undertaking, as the case may be, and
(b) subsection (2) applies to the extent specified by the large private company or the relevant undertaking with any other modifications

necessary for that purpose.

(6) The audit committee is to consist of such directors as the board of directors concerned thinks fit, provided, subject to subsection (8), both of the following requirements are met:

(a) the committee consists of not fewer than 2 members;
(b) all those appointed to the committee qualify under subsection (7).

(7) A director qualifies for appointment to the audit committee unless he or she –

(a) is, or was at any time during the 3 years preceding appointment to the committee-
(i) an employee of the company or undertaking concerned, or
(ii) an employee of any subsidiary of the company concerned or of a subsidiary undertaking of the undertaking concerned, or

(b) is the chairperson of the board of directors.

(8) The requirements specified in paragraphs(a) and (b) of subsection (6) do not apply if

(a) only one director on the board of directors of the company or undertaking concerned qualifies under subsection (7),

(b) that director –
(i) is appointed as the sole member of the audit committee, or
(ii) is appointed as the chairperson of an audit committee consisting of not more than 2 members (including the chairperson) and has, in the case of an equal division of votes, a second or casting vote,

(c) any conditions prescribed under section 48(1)(m) of the Act of 2003 are met, and

(d) the directors of the company or undertaking concerned state in their report under section 158 of the Principal Act the reasons for the company's or undertaking's exemption from these requirements.

(9) Written terms of reference concerning the audit committee's role in the audit and financial management of the company or relevant undertaking concerned shall –

(a) be prepared and approved by the board of directors,

(b) be submitted for the information of the shareholders of the company or undertaking concerned at its annual general meeting; and

(c) be reviewed each year by the board of directors.

(10) Without limiting the matters that may be included under subsection (9), the terms of reference must –

(a) specify how the audit committee will discharge its responsibilities, and

(b) provide for a programme of separate and joint meetings with the management, auditor and internal auditor of the company or undertaking concerned.

(11) Subsection (9) applies also in relation to any amendments of the audit committee's terms of reference.

(12) Where the board of directors of a public limited company to which subsection (2) applies, fails to establish an audit committee that is constituted in accordance with this section, each director to whom the failure is attributable is guilty of an offence.

(13) Where a director of a large company or relevant undertaking to which subsection (3) applies fails to take all reasonable steps to comply with the requirements of subsection (4), the director is guilty of an offence.

(14) A reference in this section to the directors of a relevant undertaking is to be construed in the case of an undertaking that does not have a board of directors as a reference to the corresponding persons appropriate to that undertaking.

(15) For the purpose of applying this section to a partnership that is referred to in Regulation 6 of the 1993 Regulations and that is a relevant undertaking –

(a) the partnership is to be treated as though it were a company formed and registered under the Companies Acts,

(b) a reference in this section to a report under section 158 of the Principal Act is to be construed as a reference to a report under Regulation 14 of the 1993 Regulations, and

(c) this section applies with any other modifications necessary for that purpose.

(16) This section does not apply to –

(a) a public limited company that is a wholly owned subsidiary undertaking of another public company , or

(b) any company or undertaking of a class exempted under section 48(1)(j) of the Act of 2003 from the application of this section.

Appendix 2:
Article 41 of the EU Directive on Statutory Audits

Audit committee

1. Each public-interest entity shall have an audit committee.

The Member State shall determine whether audit committees are to be composed of non-executive members of the administrative body and/or members of the supervisory body of the audited entity and/or members appointed by the general meeting of shareholders of the audited entity.

At least one member of the audit committee shall be independent and shall have competence in accounting and/or auditing.

In public-interest entities which meet the criteria of Article 2(1), point (f) of Directive 2003/71/EC (1), Member States may permit the functions assigned to the audit committee to be performed by the administrative or supervisory body as a whole, provided at least that when the chairman of such a body is an executive member, he or she is not the chairman of the audit committee.

2. Without prejudice to the responsibility of the members of the administrative, management or supervisory bodies, or of other members who are appointed by the general meeting of shareholders of the audited entity, the audit committee shall, inter alia:

(a) monitor the financial reporting process;

(b) monitor the effectiveness of the company's internal control, internal audit where applicable, and risk management systems;

(c) monitor the statutory audit of the annual and consolidated accounts;

(d) review and monitor the independence of the statutory auditor or audit firm, and in particular the provision of additional services to the audited entity.

3. In a public-interest entity, the proposal of the administrative or supervisory body for the appointment of a statutory auditor or audit firm shall be based on a recommendation made by the audit committee.

4. The statutory auditor or audit firm shall report to the audit committee on key matters arising from the statutory audit, and in particular on material weaknesses in internal control in relation to the financial reporting process.

5. Member States may allow or decide that the provisions laid down in paragraphs 1 to 4 shall not apply to any public interest entity that has a body performing equivalent functions to an audit committee, established and functioning according to provisions in place in the Member State in which the entity to be audited is registered.

In such a case the entity shall disclose which body carries out these functions and how it is composed.

6. Member States may exempt from the obligation to have an audit committee:

(a) any public-interest entity which is a subsidiary undertaking within the meaning of Article 1 of Directive 83/349/EEC if the entity complies with the requirements in paragraphs 1 to 4 of this Article at group level;

(b) any public-interest entity which is a collective investment undertaking as defined in Article 1(2) of Directive 85/611/EEC. Member States may also exempt public-interest entities the sole object of which is the collective investment of capital provided by the public, which operate on the principle of risk spreading and which do not seek to take legal or management control over any of the issuers of its underlying investments, provided that those collective investment undertakings are authorised and subject to supervision by competent authorities and that they have a depositary exercising functions equivalent to those under Directive 85/611/EEC;

(c) any public-interest entity the sole business of which is to act as issuer of asset-backed securities as defined in Article 2(5) of Commission Regulation (EC) No 809/2004 (2).

In such instances, the Member State shall require the entity to explain to the public the reasons for which it considers it not appropriate to have either an audit committee or an administrative or supervisory body entrusted to carry out the functions of an audit committee;

(2) OJ L 149, 30.4.2004, p. 1.

(d) any credit institution within the meaning of Article 1(1) of Directive 2000/12/EC whose shares are not admitted to trading on a regulated market of any Member State within the meaning of point 14 of Article 4(1) of Directive 2004/39/EC and which has, in a continuous or repeated manner, issued only debt securities, provided that the totalnominal amount of all such debt securities remains below EUR 100 000 000 and that it has not published a prospectus under Directive 2003/71/EC.

5.2.2 Audit Exemption Thresholds

5.2.2.1 Introduction and Background

Exemption from audit removes the need for companies to engage an independent, external auditor to carry out a statutory audit of a company. The scope for small companies to have an exemption from the requirement to have an audit carried out was first introduced by the EU 4th Council Directive, which stipulated the upper limits which Member States could apply. These limits, which have been increased periodically since then, relate to turnover, balance sheet total and number of employees. The granting, by Member States, of this concession to companies (subject to prescribed maximum levels) is discretionary. Ireland extended this concession to qualifying companies under the 1999 (No.2) Act and the provision took effect from 21 February 2000. Its introduction followed a proposal and recommendation in a Task Force on Small Business Report.

As the EU permitted thresholds were increased recently and as the UK has signalled that it intends to move to the new threshold levels, the Minister for Trade and Commerce asked the Review Group to consider if Ireland should follow suit.

5.2.2.2 Current Position

The current position regarding the audit exemption thresholds in Ireland and the EU is set out in Table 2 below. In summary, the 2006 Act increased the thresholds considerably, close to the current levels permitted by the EU.

Table 2

	Current Thresholds (under 2006 Act)	Previous Thresholds (under 2003 Act)	Maximum Thresholds currently under EU Directive
Turnover not exceeding	€7.3m	€1.5m	€8.8m
Balance sheet total not exceeding	€3.65m	€1.9 m	€4.4 m
No. of employees	50	50	50

5.2.2.3 Issues Arising

An intrinsic requirement of company law has been that companies (other than those which qualify for exemption) are obliged to engage independent external auditors to conduct statutory audits. This requires the auditor, *inter alia*, to state whether in his or her opinion the company's balance sheet and profit and loss account have been properly prepared in accordance with the provisions of the Companies Acts and give a true and fair view of the company's financial situation.

The independent audit enhances internal corporate governance and management in the company and reduces the risk that creditors, including suppliers', employees' and, for example, the Revenue's interests would be abused.

The issue of the increase in the audit exemption threshold arises against a background of reducing unnecessary regulatory burdens on the enterprise sector and allowing them to conduct their affairs and relate to stakeholders, in compliance with wider company law provisions.

The Companies Registration Office has indicated that a total of 14,817 companies (out of a total register of 165,000 companies) stated that they had claimed audit exemption under the existing thresholds in annual returns received up to the end of 2007.

The current UK audit exemption thresholds are the same as in Ireland. However, the UK has provided for the raising of the audit exemption thresholds to the

EU maxima through the draft Companies Act 2006 (Accounts and Reports) (Amendment) Regulations 2008. It is understood that no final decision has been taken as to when the new thresholds will come into effect.

It is estimated by the Department of Enterprise, Trade and Employment that the savings to small business, due to the increase in the thresholds from 2003 to 2006, were of the order of €10 to €20 million per annum. On that basis, a further increase to the new permitted maxima could yield further annual savings of €2.5 to €5 million.

5.2.2.4 Conclusion and Recommendation

The Review Group wishes to emphasise, as it does earlier in this Chapter, the fundamental importance of the auditing profession and effective independent auditing to good corporate governance and to public confidence in that regime.

Given:

- the need to balance regulation with the likelihood of the occurrence of corporate wrongdoing;
- the extent and impact of likely mischief in the circumstances;
- the relatively small numbers of companies availing of the audit exemption so far; and
- the competitiveness issue vis-à-vis the UK and Northern Ireland,

the Review Group recommends that the threshold be increased to the EU limits.

5.2.3 Extension of Audit Exemption Regime to Small Groups of Companies and to Dormant Subsidiaries

- **Small Groups of Companies which in Aggregate Meet Exemption Thresholds**
- **Dormant Subsidiaries Regardless of Size of Group**

5.2.3.1 Small Groups of Companies which in Aggregate Meet Exemption Thresholds

5.2.3.2 Introduction

The general approach and background to audit exemption is set out in Section 5.2.2. above.

As per section 32(3)(a)(v) of the 1999 (No.2) Act, audit exemption is not available in the following circumstances:

Where the company is-

1) a parent or a subsidiary undertaking (within the meaning of S.I. 201 of 1992 (the Group Accounts Regulation));

2) a holder of a licence under section 9 of the Central Bank Act 1971, or a company that is exempt under that Act to hold such a licence;

3) a company subject to S.I. 23 of 1996 (Insurance Undertakings); or

4) a company referred to in the Second Schedule (other than paragraph 18) of the 1999 Act (basically ‘regulated’ type entities).

The effect of point 1 above is that companies that are members of a group are not eligible to avail of audit exemption, nor is a ‘small’ group – a group of companies whose aggregate turnovers, balance sheet totals, and employee numbers are equal to or are less than the criteria applying to individual companies.

In the light of the thrust of audit exemption, that is to relieve small companies of the ‘administrative burden’ of conducting an annual audit, the Minister for Trade and Commerce asked the Review Group to examine whether dormant subsidiaries and small groups should also be able to avail of the exemption.

5.2.3.3 Current position

To explain the situation in practical terms:

Company A is a private company limited by shares and operates 3 shops from 3 different premises, each having a turnover of €2 million; Company A has assets of €2 million and employs 10 staff. As a single entity Company A has:

- Turnover €6 million;
- Balance sheet total of €2 million;
- Employees 10.

Company A can therefore avail of audit exemption.

On the other hand, Company B, also a private company limited by shares, has 3 subsidiary companies, all private and limited by shares. Each subsidiary operates a shop in different locations, each with a turnover of €1 million and each with assets of €100,000. Each company employs 2 staff. The combined figures for the group are:

- Turnover €3 million;
- Balance Sheet total €300,000;
- Employees 6.

As Company B and its subsidiaries constitute a 'group', audit exemption is not available as it falls within the scope of point 1 in Section 5.2.3.2 above, in spite of the economic entity being significantly smaller than Company A.

The ability to exempt small companies from the audit requirement is contained in the EU 4th Company Law Directive. The EU 7th Directive addresses similar issues but in respect of companies that are 'groups' i.e. parents and subsidiaries. It too contains certain reliefs in respect of smaller entities that are groups. For example, companies with subsidiaries ('parent companies') may be exempt from the requirement to prepare group accounts where the group, in aggregate, meets the criteria defining medium-sized companies contained in the 4th Directive.

5.2.3.4 Issues Arising

Clearly the intention of the exemption was to reduce the burden of the annual audit on small individual companies. It seems that where there is a group of companies, each subsidiary of which is below the defining threshold and in turn where the aggregate legal threshold is below the permitted EU maxima, then the group should be entitled to avail of the exemption also.

Under the provisions, subsidiaries which are below the thresholds, but where the Group aggregate is above the threshold, are not entitled to exemption. The view is that such a situation is potentially open to abuse, whereby a group could spin off subsidiaries for the express purpose of avoiding audit. Industry's view however, is that a group is unlikely to do so solely for that reason.

In the UK, under the Companies Act 2006, relief from the requirement to have an audit is available to 'small groups'. Extending the existing audit exemption regime to small groups (and to dormant companies), with appropriate safeguards and exclusions, appears to be appropriate in terms of providing a level playing field with the UK and Northern Ireland and is consistent with Government's aim of streamlining and reducing the regulatory burden for small and medium-sized enterprises (SMEs).

5.2.3.5 Dormant Subsidiaries Regardless of Size of Group

In the Review Group's opinion, whether or not 'dormant' subsidiaries should be entitled to avail of the exemption depends on the definition of 'dormant company'.

In the UK, dormant companies may also avail of audit exemption. The term 'dormant' is commonly applied to a company that, in legal terms, has 'no significant accounting transactions' during a financial year. Amounts paid for shares when the company is first formed and the incidental costs incurred to keep the company compliant in terms of registration, etc. do not count as significant accounting transactions. Companies may be dormant for a variety of reasons, e.g. protection of a company name, in anticipation of future activity, or the holding of an asset, tangible or intangible. However, the responsibilities of directors of such companies remain the same as for those of a trading company – holding meetings, ensuring appropriate returns are made, keeping accounts, etc.

In the UK, dormant companies are exempt where:

- they have been dormant since their formation or the end of the previous year; and

- they qualify as small[30]; and
- they are not banking or insurance companies, or are required to prepare group accounts; and
- no 'significant accounting transaction' has taken place.

These provisions apply to stand-alone dormant companies and dormant companies that are subsidiaries within groups. Many dormant companies qualify as small because they have no turnover and no employees. The only 'restriction' applies where dormant companies that were previously active must have complied with the size criteria for two years in order to qualify as small.

It is not possible (by definition) to get reliable statistics on the numbers of dormant companies in Ireland. Such companies can vary widely in terms of their assets or the purpose for which they were established for example. In the circumstances, it is difficult to agree a generic view on whether or not they should be exempt from audit. The Review Group considered that it was up to the entities involved to justify why they should benefit from the audit exemption regime.

5.2.3.6 Conclusions and Recommendations

- In the light of the position in the UK/NI, and the possibility of so doing under EU law, the Review Group recommends that in Ireland, 'small groups', i.e. those whose aggregate activity is below the relevant thresholds, should be permitted to avail of the audit exemption (excluding any company, that for any other reason, is not entitled to avail of the exemption).

- The Review Group does not consider that individual subsidiaries that meet the criteria, but where the group as a whole does not, should be afforded exemption.

- Regarding dormant subsidiaries, the Review Group considers that it would need more data and analysis on the scale of dormant companies in Ireland, their purpose and activities, as well as a satisfactory definition, before it could recommend that they could avail of audit exemption.

[30] or would do were it not for membership of an ineligible group (see section 384 of the Companies Act 2006).

5.2.4 Power of ODCE Regarding Entitlement to Audit Exemption

5.2.4.1 Current Position

As stated in Section 5.2.2 above, companies under €7.3 million turnover, €3.65 million balance sheet total or with less than 50 employees can avail of exemption from audit. According to Company Registration Office data, some 14,817 companies have stated that they have availed of the audit exemption in the period to the end of 2007.

5.2.4.2 Issues Arising

Once directors are of the opinion that the company meets the criteria, they may elect not to have their accounts audited. Such companies are also allowed to file limited information with the Companies Registration Office under the filing exemption rules contained in section 8 of the 1986 Act. Such information does not include details of either the company's turnover or its number of employees. Therefore, compliance with the audit exemption criteria is not transparent.

Moreover, the ability of the ODCE to react to a public complaint and enquire into an instance of possible non-compliance is seriously limited in the case of companies eligible to avail of audit exemption. The absence of an audit means that the reporting requirement on auditors, contained in section 194(5) of the 1990 Act, to disclose a breach of the audit exemption requirement is no longer relevant.

Under section 19 of the 1990 Act, the Director of Corporate Enforcement can seek to examine company books and documents in order to establish and acquire evidence of wrongdoing. However, it requires the Director to form an opinion that there are circumstances suggesting fraud, prejudice or other illegality before using the powers provided for in the section. Clearly, he will be unable to form the required opinion in the absence of a substantial indication of a breach of the conditions for audit exemption.

In the UK, the Secretary of State is enabled to initiate an investigation if he thinks there is good reason to do so.

On the other hand, the audit exemption was introduced for small companies, primarily privately owner managed, where the benefits of an audit were far outweighed by the costs, and with the intention of reducing the regulatory burden on such firms. The obligation on directors to prepare accounts that give a true and fair view under company law continues to apply.

5.2.4.3 Views of IBEC

From a business perspective, there would be objection to a wide-sweeping power to interrogate a company on its entitlement to claim an audit exemption without having any evidence or suggestion of wrongdoing by the company in question. This would be an overly intrusive power and tantamount to legitimising a "fishing expedition" by the ODCE, which could be used for purposes other than what is intended. A company faced with such a request would need to involve (and pay) its accountants to deal with the enquiry, particularly if it requires an independent professional audit. This additional cost is not justified on small companies without there being reason to believe the company is misusing the exemption. In fact, it defeats the purpose of giving the exemption, to cut down on unnecessary expense, if a company then needs to incur professional costs to prove its entitlement to avail of the exemption.

5.2.4.4 Views of the ODCE

The ODCE's view is that it is prudent that the conferral of a concession in law should be accompanied by a legally effective means of verifying any person's claim of entitlement to that concession. The ODCE's proposal seeks to allow it to check that entitlement, on giving its reason for doing so, by inspecting the company document or documents which evidence the three primary criteria for audit exemption in the relevant year, namely the balance sheet total, the amount of turnover and the average number of employees.

The ODCE is satisfied that its proposal is a balanced one and cannot be properly regarded as intrusive, excessive or costly. Moreover, it is not prepared to accept any alternative proposal which the ODCE considers has no practical value in verifying a company's entitlement to audit exemption.

5.2.4.5 Conclusions and Recommendations

In its proposals under the General Scheme of the Companies Consolidation and Reform Bill, the Review Group was conscious of getting the balance right between the obligations on companies and their officers, and the sanctions applying for breaches of the law. It is necessary, therefore, to get the balance right in this specific instance between the power to conduct an investigation and the evidence of wrongdoing necessary to justify such an investigation.

A majority of the Review Group is also concerned that if random inspections could be carried out without some requirement to justify them, this would counteract, in large measure, the reduced regulatory burden of audit exemption. The Review Group considered a proposal whereby the ODCE would be obliged to make good the cost of proving eligibility where companies were successful in showing that they had an entitlement but this was rejected by the ODCE.

A majority of the Review Group considers that, given that there is as yet no evidence of any serious level of transgression in this instance, there is no proven need for this additional power at this time. Consequently, there was a majority view that the proposed measure was neither necessary nor justified. The Review Group recommends that the situation be kept under review in the light of the emergence of further evidence on compliance with the audit exemption regime.

5.2.5 Amendments Proposed by the Irish Auditing and Accounting Supervisory Authority (IAASA)

Amendments are proposed to:

- **the Companies (Auditing and Accounting) Act 2003 (Sections 23, 27, 31, 33, 26 and 15)**
- **the Company Law Enforcement Act 2001 (Section 110A)**

5.2.5.1 Introduction

The Irish Auditing and Accounting Supervisory Authority was established pursuant to the provisions of Part 2 of the 2003 Act. Under section 8 of the Act, IAASA has three principal objectives, namely to:

- supervise how the prescribed accountancy bodies regulate and monitor their members;
- promote adherence to high professional standards in the auditing and accountancy profession;
- monitor whether the accounts of certain classes of companies and other undertakings comply with the Companies Acts and, where applicable, Article 4 of the IAS Regulation.

In the period during which IAASA has been operating on a statutory footing, it has identified a number of issues and encountered a number of difficulties which led to its proposing a number of amendments to the Companies Acts.

The Minister for Trade and Commerce asked the Review Group to consider the proposed amendments in conjunction with IAASA and to make recommendations for any changes considered necessary.

5.2.5.2 Issues Arising

IAASA has identified specific issues arising from certain sections of the 2003 Act and the 2001 Act as set out hereunder.

5.2.5.3 Section 23 of the 2003 Act — Recoupment of costs from the prescribed accountancy bodies.

Sections 23 and 24 of the 2003 Act confer upon IAASA the right to initiate and conduct investigations and enquiries into a prescribed accountancy body and a member of a prescribed accountancy body respectively. Both processes are highly formal in nature and as a consequence, are likely to have significant cost implications for IAASA. Notwithstanding this, while section 24 provides that in circumstances where IAASA finds that a member has committed a breach of a prescribed accountancy body's standards, the member concerned is, *inter alia, '...liable to pay the amount specified by the Supervisory Authority towards its costs in investigating and determining the case'*. Section 23 contains no similar provision. Consequently, in IAASA's assessment, a similar provision should be added to section 23.

5.2.5.4 Recommendation

The Review Group agrees that IAASA should be able to recoup costs under both sections 23 and 24.

5.2.5.5 Section 27 of the 2003 Act — Delegation of provisions and their impact on complaints handling.

Section 27(4) provides that *'The Supervisory Authority may, if it reasonably considers it appropriate to do so, perform any of its other functions or exercise any of its other powers through or by any of its officers or employees or any person duly authorised by it in that behalf'*. The significance of the word *'other'* in this context is that IAASA may not delegate any of its functions or powers as provided for by sections 23 to 26 inclusive, other than to Committees comprising:

- directors of IAASA and such professional or other advisors as considered necessary (in the case of sections 23 to 25); and
- directors of IAASA and such professional or other advisors as considered necessary; or comprising only such professional or other advisors as considered necessary (in the case of section 26).

Arising from the foregoing, IAASA sought legal advice on the implications of these provisions for its ability to perform enquiries, essentially, whether it is permissible for preliminary enquiries in response to complaints to be conducted by IAASA staff, or whether all such complaints must automatically be elevated to the Board and/or its Committees.

In any event, IAASA is of the view that any uncertainty should be removed and advocates an amendment to the 2003 Act for the purposes of making clear that IAASA staff may, at the Board's discretion, be delegated the function of conducting preliminary enquiries in response to complaints received.

5.2.5.6 Recommendation

The Review Group agrees with the IAASA view on this issue.

5.2.5.7 Section 31 of the 2003 Act — Confidentiality of information

Section 31 of the 2003 Act contains a prohibition against the disclosure of information obtained in performing the functions or exercising the powers of IAASA that has not otherwise come to the notice of the public. The prohibition applies to the following persons:

- members, directors and former members and directors of IAASA ;
- employees and former employees of IAASA; and
- professional and other advisors to IAASA, including former advisors.

A contravention of this prohibition constitutes a criminal offence, punishable on conviction on indictment by a fine of up to €10,000 and/or a term of imprisonment not exceeding three years.

The only exceptions to this general prohibition are provided in section 31(3) of the Act. Section 31(3)(a) permits disclosure generally if such disclosure is necessary to enable IAASA to state the grounds on which a decision was made. Under section 31(3)(b) IAASA may disclose confidential information to the following persons or entities if the information is connected with their functions:

- the Minister;
- the Minister for Finance;
- An Garda Síochána;
- the Director of Public Prosecutions;
- the Director of Corporate Enforcement;
- the Revenue Commissioners;
- the Comptroller and Auditor General;
- the Central Bank and Financial Services Authority of Ireland;
- the Irish Takeover Panel;
- the Pensions Board;
- a prescribed accountancy body;
- a member of a recognised accountancy body who is qualified for appointment as an auditor;
- an inspector appointed under any other enactment; and
- any person prescribed under section 48(1)(i) for the purposes of section 31(3).

Through a combination of practical experience to date and a detailed review of the section, IAASA has identified a number of significant difficulties arising as a consequence of the manner in which section 31 is formulated. A key example of the practical difficulties arising is the current prohibition on sharing information with IAASA's counterparts in other countries. This prohibition gives rise to particular difficulties in dealing with the IAASA's counterparts in the UK, given that a number of the accountancy bodies coming within IAASA's supervisory remit also fall within the remit of the Financial Reporting Council (FRC).

While the Minister can prescribe additional entities for the purpose of the section, the 2003 Act does not permit him or her to prescribe classes of entity e.g. authorities performing functions, similar to those of IAASA, in another State. IAASA has sought to mitigate the extent of these difficulties by tabling proposals for the prescription of additional bodies by way of Ministerial Order. However, this approach represents, at best, no more than a temporary solution in IAASA's assessment.

In light of the foregoing, IAASA advocates that section 31 be amended to enable IAASA to share otherwise confidential information with the following parties/classes of entities/circumstances:

- an authority or person performing functions in another State which are similar to the functions of IAASA (including, *inter alia*, functions relating to financial statement review and the oversight of the accountancy/auditing profession) providing such authority operates under similar restriction on disclosure of information so given;
- the disclosure of information in a report of IAASA or for the purpose of legal proceedings under the 2003 Act or pursuant to an order of a Court of competent jurisdiction for the purposes of any proceedings in that Court;
- in circumstances where a person to whom

the information relates has consented to the disclosure and, if the information was obtained from another person, the consent of that other person has also been obtained;
- any person to whom the disclosure of information is required for the purposes of criminal proceedings;
- to a relevant undertaking and/or a director or corresponding person appropriate to an undertaking as defined in section 26, for the purposes of complying with the requirements of procedural fairness;
- to a member of a prescribed accountancy body for the purposes of complying with the requirements of procedural fairness.

IAASA also proposes that section 31 be further amended by inserting the word 'confidential' before the word 'information' each time that it occurs in the section. As currently drafted, the scope of the prohibition extends to information that comes to IAASA's attention, that is not in the public domain, but which is not of the type of information that would normally be considered to be confidential.

5.2.5.8 Conclusion and Recommendation

The Review Group supports the general thrust of the amendments to section 31 proposed by IAASA but recommends however, that they be further considered by the Department of Enterprise, Trade and Employment in the context of the implementation of the EU 8th Directive on Statutory Audit.

5.2.5.9 Section 33 of the 2003 Act - Liability of Supervisory Authority for acts or omissions

Section 33(1) provides that –

'Neither the Authority nor any person who is or was a member, director or other officer or employee of the Supervisory Authority is liable for damages for anything done, anything purported to be done or anything omitted to be done by the Supervisory Authority or that person in performing their functions or exercising their powers under this Act, unless the act or omission is shown to have been in bad faith'.

Section 33(3) further provides that –

' ...the Supervisory Authority may indemnify any person who is or was a member, director, officer or employee of the Supervisory Authority in respect of anything done or omitted by that person in good faith in carrying out duties under this Act'.

Section 33 does not extend the above protections to any advisors or agents that IAASA appoints to assist it in discharging its functions, notwithstanding that section 27 specifically provides that IAASA may do so. In IAASA's view, the inability to offer such protection could make it more difficult to attract people to assist IAASA in the discharge of its functions. In that context, IAASA advocates an amendment to section 33, whereby the protections currently afforded to certain named parties would be extended to advisers and agents.

5.2.5.10 Recommendation

The Review Group agrees that section 33 be amended to extend protection to any agent of IAASA, as proposed.

5.2.5.11 Section 110A of the 2001 Act

Section 110A[31] provides that, in certain legal proceedings, certificate evidence may be given by *'appropriate officers',* thereby dispensing with

[31] Section 110A provides, inter alia, that in any legal proceedings (including proceedings relating to an offence) a certificate signed by an appropriate officer in the course of performing his/her functions is, in the absence of evidence to the contrary, proof of the following:

(a) if it certifies that the officer has examined the relevant records and that it appears from them that during a stated period an item was not received from a stated person, proof that the person did not during that period furnish that item and that the item was not received;
(b) if it certifies that the officer has examined the relevant records and that it appears from them that a stated notice was not issued to a stated person, proof that the person did not receive the notice;
(c) if it certifies that the officer has examined the relevant records and that it appears from them that a stated notice was duly given to a stated person on a stated date, proof that the person received the notice of that date;
(d) if it certifies that the officer has examined the relevant records and that it appears from them that a stated notice was posted to a stated person at a stated address on a stated date, proof that the notice was received by that person at that address on a date 3 days after the date on which the document was posted;
(e) if it certifies that the officer has examined the relevant records and that it appears from them that a document was filed or registered with or delivered at a stated place, on a stated date or at a stated time is, proof that the document was filed or registered with or delivered at that place, on that date or at that time.

the requirement for oral evidence to be given by such officers. At present, the term *'appropriate officers'* includes, *inter alia*, the Director of Corporate Enforcement and/or an officer of the Director, an Inspector appointed under the 1990 Act and the Registrar.

It is IAASA's view that it would be beneficial from an administrative perspective to add designated officials of IAASA to the list, thereby permitting the use of certificate evidence in certain legal proceedings involving IAASA. Examples of instances where such evidence could be used include sections 10, 23, 24, 26 and 29 of the 2003 Act and Regulations 43(1)(b), 47, 54, 55, 66 and 70 of the Transparency (Directive 2004/109/EC) Regulations 2007. In this context, IAASA would suggest that a new subsection (f) be added to the section providing thus:

> *"(f) in respect of functions that, under the Companies Acts, are to be performed by the Irish Auditing and Accounting Supervisory Authority, a director of the Supervisory Authority or another person authorised in its behalf by the Supervisory Authority"*

5.2.5.12 Recommendation

The Review Group recommends acceptance of the IAASA amendment in this case.

5.3 Recognition and Protection of the Term 'Accountant'

5.3.1 Background

During the passage of the 2003 Act through the Oireachtas, a number of parties made representations to the effect that the term 'Accountant' should be afforded legal protection under the Companies Acts, thereby preventing persons not possessing specified accountancy qualifications from holding themselves out as an 'Accountant'.

Furthermore, at that time and subsequently, a number of accountancy bodies called for an end to the situation whereby persons calling themselves accountants, but who do not belong to a professional accountancy body, can provide services to the public without being subject to any form of regulation or supervision (by either a professional body or by the State).

Given the potential complexities surrounding the issue and the fact that any such protection would, in all likelihood, require the enactment of primary legislation, the view was taken at that time that the potential merits and demerits of such a proposal would require careful and detailed consideration before any determination could be arrived at. In that context, the Minister for Trade and Commerce gave an undertaking that he would refer the matter to the Irish Auditing and Accounting Supervisory Authority ('IAASA') for its consideration once it had been established on a statutory basis.

Subsequent to the establishment of IAASA on a statutory basis (in December 2005), the Minister formally requested IAASA to:

- consider the question of whether the term 'Accountant' should be afforded legal protection under the Companies Acts; and
- having concluded its deliberations on the matter, to report its views to the Minister.

5.3.2 Current Position

As the law currently stands, there are no legal provisions under the Companies Acts preventing the use of the term 'Accountant' by persons who are not members of an accountancy body.

The manner in which the accountancy profession is regulated in Ireland is governed by detailed legislative provisions. The following is a brief summary of the extant Irish regulatory and supervisory regime applicable to the accountancy profession:

- the Prescribed Accountancy Bodies ('PABs'), of which there are nine, are responsible in the first instance for regulating their members (including handling complaints relating to members, conducting investigations into alleged malpractice on the part of members/member firms and imposing disciplinary sanctions in instances where malpractice has been proven);

- the Recognised Accountancy Bodies, of which there are six, are responsible for monitoring those of their members/member firms authorised to perform audit work under the Irish Companies Acts;

- IAASA has responsibility for supervising all PABs (including the subset of those bodies comprising the six recognised bodies) and for satisfying itself on an ongoing basis that they are discharging their regulatory and associated obligations to the standards required by IAASA. Where this is found by IAASA not to be the case, IAASA has the power to impose certain specified sanctions on the relevant PAB. IAASA is also empowered, should it deem it appropriate to do so, to conduct investigations into possible breaches of standards by members/member firms;

- persons providing accountancy services in the State who are members of accountancy bodies other than the PABs (e.g. bodies based outside Ireland and/or the UK) are subject, to varying degrees, to regulation by the accountancy bodies of which they are members. However, those accountancy bodies are not currently subject to supervision by IAASA (as they are not PABs under the Irish Companies Acts);

- persons providing accountancy services in the State who are not members of any accountancy body are not currently subject to any form of regulation or supervision.

5.3.3 Views of the Irish Auditing and Accounting Supervisory Authority

Having concluded its deliberations on the matter, which were informed, *inter alia*, by a major public consultation exercise, IAASA tabled its conclusions and recommendations to the Minister.

In the view of IAASA, members of the PABs are subject to a range of significant regulatory and monitoring measures, including, for example:

- the requirement to successfully complete professional examinations and to obtain minimum experience requirements prior to being admitted to membership;

- the requirement to obtain minimum post membership experience (and in some cases successfully complete a further examination) prior to being authorised to offer services to the public;

- the requirement for members engaging in public practice to have in place minimum levels of professional indemnity insurance and practice continuity arrangements;

- the requirement that all members adhere to the PABs' respective codes of conduct and standards, including those relating to professional ethics (which require to be approved by IAASA, as do amendments thereto);

- the requirement for members to keep their competencies up to date by undergoing continuous professional development on an annual basis;

- being subject to the PABs' complaints, investigations and disciplinary processes and, by virtue of membership, affording aggrieved parties the right to seek recourse to these processes and procedures.

Members of the public, in IAASA's view, reasonably assume that any person describing himself or herself as an 'Accountant':

- has succesfully completed the requisite examinations;

- has satisfied the necessary experience requirements; and

- is subject to the foregoing regulatory and monitoring measures.

On the other hand, persons currently holding themselves out as accountants, but who are not members of the PABs (or certain other professional bodies) are not, however, subject to the aforementioned requirements.

Moreover, by virtue of not being members of the PABs, such persons are not subject to oversight by IAASA, a situation that might be reasonably expected, in IAASA's assessment, to be difficult for members of the public to understand in circumstances where the legislature has established a statutory body to supervise the accountancy profession.

IAASA acknowledged that members of the public are quite entitled, should they so choose, to engage the services of an unqualified person. However, the current entitlement of such persons to hold themselves out as an 'Accountant' gives rise, in IAASA's assessment, to consequential risks that members of the public may inadvertently engage such persons on the understanding that they have in fact satisfied the foregoing requirements, thereby unknowingly exposing themselves to:

a) the risk of financial or other loss occasioned by acting on advice received from an unqualified person; and

b) a lesser degree of recourse in the context of making a complaint than would have been available had the person engaged been a member of a PAB.

The existence of such risk, in IAASA's view, runs counter to and militates against the public policy principles underpinning the enactment of the 2003 Act and IAASA's core object of enhancing public confidence in the accountancy profession and its outputs.

IAASA also indicated that it has received a number of complaints from members of the public regarding persons who, while complainants believed them to be members of a PAB, have transpired not to be such, thereby resulting in IAASA having no jurisdiction over such persons. In IAASA's view, having had to advise members of the public of this fact diminishes public confidence in the oversight system.

By virtue of not being subject to any form of regulation and the associated costs, 'unqualified' persons can operate at a cost advantage to those who are subject to regulation and oversight, a concept which could reasonably be considered to be counter-intuitive.

In light of the foregoing, IAASA recommended that:

1. a legal restriction on the use of the term 'Accountant' should be introduced such that only certain persons would be entitled to use the descriptor;

2. the aforementioned restriction should not, however, apply to the provision of accountancy services;

3. the restriction should apply to persons providing services to members of the public only, i.e. it should not extend to persons in employment;

4. the restriction should also extend to firms, i.e. only those firms controlled by persons entitled to describe themselves as 'Accountants' should be entitled to use the descriptor;

5. persons who are members of the nine PABs should be automatically entitled to use the descriptor;

6. persons, other than members of the nine PABs, who are currently eligible to act as auditors under the Companies Acts should also be entitled to use the descriptor;

7. in addition, any enabling legislation should further provide a mechanism whereby other persons would have the right to apply to a competent authority (to be determined) for the purpose of seeking the entitlement to use the term and that their eligibility to use the term should be based on predetermined considerations, including their qualifications, experience and the provisions of relevant EU Directives on the mutual recognition of qualifications;

8. all persons entitled to use the descriptor should be subject to a similar level of regulation and oversight, irrespective of whether they are members of a prescribed body or not;

9. consideration should be given to requiring persons who are not members of the PABs but who would nevertheless be permitted to use the descriptor, to submit themselves to regulation by a PAB, with the implications which this entails under the 2003 Act. Among the considerations

underlying IAASA's recommendation to the Minister in relation to this approach were that:

- regulated persons would, by paying registration fees to the PABs (who in turn provide 60% of IAASA's funding), fund their own regulation as well as contributing to the oversight costs associated with their entitlement to use the descriptor;

  such an approach would mirror the approach taken by section 35(c) of the 2003 Act, whereby individually authorised auditors must submit themselves to regulation by the recognised accountancy bodies within 3 years of the commencement of the subsection or, on failing to do so, their audit authorisations will be rendered void;

10. any future legislation should contain reasonable transitional provisions. In respect of transitional provisions, these could, for example, include measures allowing individuals/firms offering accountancy services to the public and describing themselves as 'Accountants' at the time of commencement of the legislation to apply to a competent authority for approval to continue to use this term, provided they subjected themselves, within a specified timeframe, to regulation by a PAB. On expiration of any transitional period, use of the term would be restricted to members of the nine PABs, other persons eligible to act as auditors under the Companies Acts, qualifying firms and those making a successful application under the mechanism as envisaged at point 7 above.

5.3.4 Views of the Competition Authority

In the view of the Competition Authority, the accountancy profession is, in general, an adaptable and agile one, able to respond to new market opportunities and directions. This is, to a great extent, because it is not tied down by layers of regulation. Rather, in the Competition Authority's view, the profession is generally lightly regulated, except for detailed statutory provisions relating to auditing and, to a lesser extent, to insolvency practice, and the Authority is strongly of the view that is the way things should stay.

New regulation should, in the Competition Authority's view, only be introduced where there is clear evidence of market failure or very damaging consumer harm and that, in its view, is patently not the position here. Thus, there is, in the Authority's assessment, no case, compelling or otherwise, for introducing a system of regulation for the profession generally.

On the contrary, introducing such a system would put at risk the suppleness and agility of the profession and its ability to respond to client need that is its strength – be that in traditional areas such as tax advice or management accounts, or in emerging fields such as succession planning.

New layers of regulation would also stultify further growth and innovation and deaden creativity, since its prime effect is to create a rule driven institutional dynamic, opposed to fostering market-based risk and reward.

Having examined the issue from the standpoint of the principles of 'Better Regulation' and on the basis of the information available, the Competition Authority concluded that there is no public interest case requiring legal protection of the term 'Accountant' at this time.

It follows that the Authority also considers that there is no case for applying full-blown regulation to the accountancy profession either. On the contrary, there would be significant downsides to either proposal.

5.3.5 Views of the ODCE

The ODCE is of the view that, on balance, there is not a sufficient case at this time for legally protecting the title 'Accountant'. In particular, it has no knowledge of any significant difficulties being experienced by the consumers of accounting services. To the extent that there may be some need to improve public awareness of the benefits of conducting business with regulated firms and individuals, this could be satisfied by a public information campaign. This would likely be an effective alternative to the cost and burden of legal protection.

5.3.6 Views of the Accounting Profession

A key component in the approach recommended by IAASA to giving effect to the restriction of the use of the term 'Accountant' to certain persons, is the willingness of the PABs to assume responsibility for regulating such persons. As recommended by IAASA, this approach would also have to make provision for appropriate safeguards to ensure that the PABs could not unreasonably or unfairly refuse to regulate a person who had applied successfully to use the term.

The Review Group, therefore, wrote to the PABs in order to ascertain their views on the thrust of the proposal and, if they are supportive of this approach, to receive confirmation of their willingness to assume the requisite regulatory role in giving effect to the restriction of use of the term to certain parties.

The Consultative Committee of Accountancy Bodies- Ireland ('CCAB- I') which represents the larger accountancy bodies established in Ireland has responded favourably to the recommendations of IAASA and confirmed a willingness to undertake a regulatory role in respect on 'non-members' wishing to provide accounting services and use the descriptor 'Accountant'. A similar willingness in principle to perform such a role has also been indicated by the other PABs who responded to the Review Group.

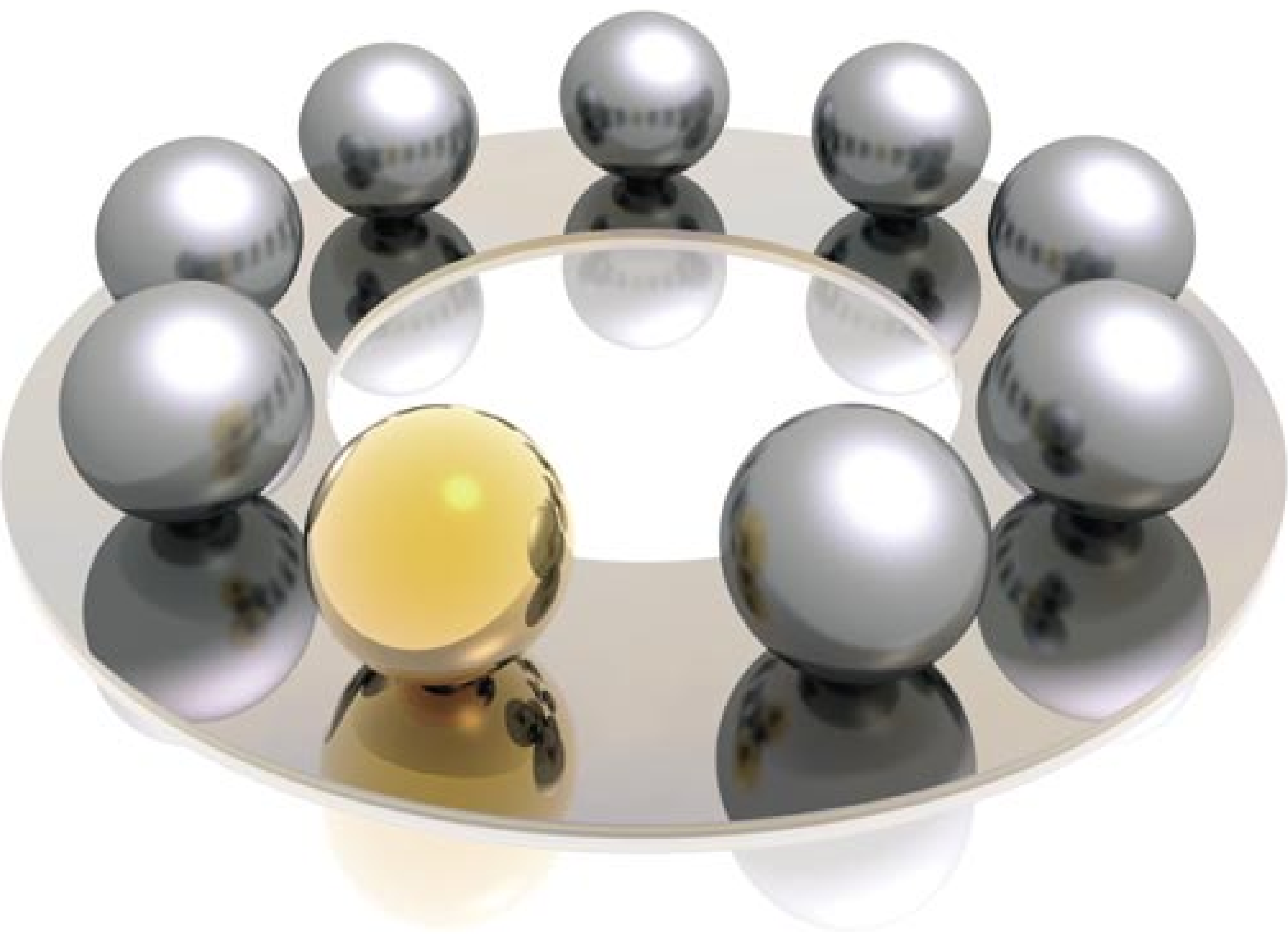
5.3.7 Comments and Conclusion

The Review Group examined the IAASA proposal in the context of company law and a majority sees no difficulties with IAASA's recommendations arising under the Companies Acts. A majority of the Review Group, therefore, endorses the analysis in favour of affording legal recognition of the term 'Accountant'.

In particular, a majority of the Review Group accepts the consumer protection issue identified by IAASA and that there is an expectation on the part of those using the services of an 'Accountant' that such a person is regulated appropriately. The PABs exercise a regulatory function, overseen by IAASA, in respect of all of their respective members, and not just those activities specifically reserved by statute, i.e. statutory audit work and investment business advice. In addition, the remit of IAASA clearly extends to all members of the PABs.

Chapter 6:

Compliance and Enforcement Issues



Chapter 6: Compliance and Enforcement Issues

6.1 Consent Procedures in lieu of Restriction and Disqualification of Directors

6.2 Proposal to allow ODCE to put Directors on Notice of a Contravention

6.3 Proposal to Permit Multiple Proceedings on the Same Facts Within a Single Set of Summary Proceedings

6.4 Good-faith Reporting ('Whistleblowing') of Breaches of Company Law

6.1 Consent Procedures in lieu of Restriction and Disqualification of Directors

6.1.1 Background and Current Position

In the preparatory work which culminated in 2007 in the publication of the General Scheme of the Companies Consolidation and Reform Bill, the Review Group examined the question as to whether a regime of restriction and disqualification undertakings should be facilitated by Irish company law, similar to the disqualification undertaking regime introduced in the United Kingdom by legislation enacted in 2000. The General Scheme as published[32], contains provision for such an undertaking at Head 51, Part A13.

Currently, under section 160(2) of the 1990 Act, an order is made only where the Court is satisfied in the relevant proceedings as to the existence of circumstances pursuant to which disqualification may follow and, even then, the order is made for such period as the court thinks fit. Likewise under section 150(1), a declaration of restriction is made unless the Court is satisfied as to any of the matters specified in section 150(2).

Disqualification Proceedings

The extent to which these provisions imposed an active obligation on the High Court was noted by Kelly J in *Re National Irish Bank Ltd: Director of Corporate Enforcement v. D'Arcy*[33] which was a case in which, even prior to the commencement of proceedings, the respondent had indicated that he did not intend to contest the application and that he was willing to give an undertaking of equivalent effect to a disqualification order. There is an absence from Irish law of any provision whereby an undertaking offered by a respondent could be accorded the same effect as a disqualification order, and therefore, it was necessary for the proceedings to be commenced.

Restriction Proceedings

So far as section 150 proceedings are concerned, the Review Group's survey of the written judgments to date has disclosed none in which the High Court or Supreme Court has found it necessary to address specifically the nature of its duty to scrutinise the appropriateness of making a restriction order, notwithstanding the consent of the respondent director.

[32] http://www.clrg.org/companiesbill.

[33] [2006] 2 I.R. 163.

However, a clear indication of the extent to which the Court sees itself as having an important role in ensuring that section 150 orders are made only in appropriate cases is provided by the decision of Peart J in *Re Usit World Plc*[34], a case in which two of the respondent directors neither filed affidavits nor sought to be represented at the hearing of the application for the restriction order. Other directors were represented, however, and had filed affidavits in opposition to the liquidator's application.

During its preparatory work on the drafting of the General Scheme of the Companies Consolidation and Reform Bill, the Review Group observed that in the UK approximately 80% of disqualifications were now made by way of the undertakings procedure. Furthermore, there was no obvious increase in the numbers being disqualified and the costs involved in disqualifying directors by undertaking were substantially less following the introduction of the procedure. It was considered that the availability of a similar procedure in Ireland would reduce unnecessary use of resources in the making of Court applications. Undertakings also had the potential to restrict or disqualify directors in a more expeditious manner.

As a result, the Review Group gave endorsement to a proposed head dealing with undertakings. However, subsequently, the ODCE had occasion to consider the matter further and as a consequence the matter was again referred to the Review Group for consideration.

6.1.2 Issues Arising

The first issue is whether, as a matter of constitutional law, it was appropriate to have a system of consent orders under which a non-judicial personage (the Director of Corporate Enforcement) would be conferred with a function of accepting undertakings which would have the effect of deeming a person to be restricted or disqualified. Is such an act executive or administrative (and accordingly, one that can properly be vested in the Director) or does it represent an exercise of a judicial power (and, accordingly, one which Article 34.1 of Bunreacht na hÉireann vests exclusively in the Courts, subject only to the right of the Oireachtas to confer limited judicial powers on non-judicial personages in non-criminal cases in the manner contemplated by Article 37.1 of the Constitution)?

A second question raised was whether there was a risk that persons who had entered into restriction or disqualification undertakings might subsequently claim that they had done so under duress. The intention in implementing a regime of undertakings was that it would be emphasised to the director in question that it was a voluntary process and that he or she should take legal advice as to his or her circumstances and the implications of an undertaking before agreeing to give one. However, there was a concern that even with these safeguards, a person who entered into an undertaking might be able to overturn it by reason of his or her claimed vulnerability, for financial or other reasons, at the time it was made.

The ODCE was also anxious to seek confirmation as to the extent to which it would be in a position to recover some of the costs which might be incurred in an investigation of the misconduct giving rise to the decision to offer a restriction or disqualification undertaking to one or more parties.

In the light of these concerns, the Review Group considered and concluded that —

(a) the powers presently vested in the High Court under section 150 and section 160 of the 1990 Act are judicial in nature;

(b) given that the effect of such a disqualification order or even a restriction order is to restrict the director in question from following a particular vocation, trade or career and further impacts adversely on his or her reputation, these powers could not be regarded as being "limited" for the purposes of Article 37.1 of the Constitution[35];

(c) it follows that these powers could not be exercised in contested cases by a non-judicial personage such as the Director of Corporate Enforcement, and legislation which proposed to transfer such functions to the Director in respect of such cases could be found to be unconstitutional; and

(d) while the issue of whether the Director could be vested with such a jurisdiction in consent cases is far less clear-cut than in the case of contested applications, the Review Group remained of the view that it could not safely be concluded that this jurisdiction in such cases could be so

[34] [2005] I.E.H.C. 285, unreported, High Court, Peart J., 10 August 2005.

[35] Article 37.1 provides as follows: "Nothing in this Constitution shall operate to invalidate the exercise of limited functions and powers of a judicial nature, in matters other than criminal matters, by any person or body of persons duly authorised by law to exercise such functions and powers, notwithstanding that such person or such body of persons is not a judge or a court appointed or established as such under this Constitution."

transferred. This is in part due to the fact that the making of these orders - even by consent - concerns issues of status and operate *in rem.* A Court would, for example, have a jurisdiction to decline to make such orders (even where the making of such an order was by consent), where it considered that, for example, the director was not properly advised or there was duress.

The Review Group considers that a potential solution to this problem, which would not require or involve the Court process, would be to offer the director or other person the opportunity of submitting to a disqualification or restriction pursuant to a statutory contract, the effect of which would be that the person would be disqualified or restricted from holding a directorship in the manner akin to the present section 150 or section 160. It might further be provided that an agreement of this kind would have the same status as an actual order made pursuant to section 150 or section 160. This process would be similar to the "on the spot fine" procedure whereby an accused agrees to pay a fixed sum and in return the Gardaí undertake not to prosecute the offender. Of course, if the director declined to submit to the offered restriction or disqualification, then the existing Court procedure could be set in motion. The main advantage here would be that the Director of Corporate Enforcement would not make the restriction or disqualification, but rather the director or other person would elect to submit to a restriction or disqualification through the mechanism of an enforceable and binding statutory contract. In other words, the election by the affected individual to submit to a binding statutory contract rather than face Court proceedings, would be a voluntary decision which he or she would not be able to contest as against the Director at a later date.

The Review Group also considers that it would be better not to allow the consent procedure to be used in cases where a period of disqualification in excess of five years was the desired outcome.

The Review Group also accepts that a cost provision would not in itself be unconstitutional, provided that the recovery of costs is capped at relatively modest levels, such as €5,000 or €10,000 for a restriction and disqualification undertaking, respectively.

6.1.3 Conclusions

In the context of the Government's policy to lighten the regulatory burden on business, the Review Group was primarily concerned, given the many cases which now come before the High Court, to facilitate the option where prospective respondents who wish to avert the need for legal proceedings in which they do not wish to raise a fundamental defence or objection, can have the matter dealt with more expeditiously and significantly less expensively. The Review Group sees this as a beneficial advancement in Irish company law and one which should also lead to a diminution in the demands being made of the High Court.

The Review Group accepts, however, that it no longer appears viable to recommend that the option of dealing with disqualification cases by way of an out-of-Court undertaking be made available in all cases.

On the issue of costs, the Review Group accepts that the primary purpose of undertakings is to deal with uncontested cases which currently give rise to unnecessary Court hearings and associated legal and other costs. It seems likely that, in the revised undertakings model, few persons would elect to give undertakings if the undertakings had to be accompanied by a contribution to ODCE's investigative costs (unless the contribution was of a nominal character which in itself would be of little practical value in meeting those costs). In the circumstances, and in the interests of exploiting the full potential of an undertakings regime for cost savings in the costs borne within company liquidations and by potential respondents, the Review Group has decided to recommend that no contribution to ODCE costs should be part of the undertakings regime. The overall cost savings are likely to substantially outweigh the small increase in ODCE investigative and administrative costs which will arise from its management of the proposed undertakings regime.

6.1.4 Recommendation[36]

The Review Group recommends that the two heads for a Disqualification Undertaking and Restriction Undertaking[37], in the form attached in Appendices 1 and 2 to this Section, subject to any drafting changes advised by Parliamentary Counsel and the advice of the Attorney General, be included in the new Companies Consolidation and Reform Bill. For the reasons outlined above, a costs provision has not been included in the Review Group's recommended provision.

[36] In making its recommendation, the Review Group takes note of the case In the matter of *Tralee Beef and Lamb Ltd (In Liquidation) Kavanagh -v- Delaney & Ors [2008]* I.E.S.C. 1, Supreme Court, 1 February 2008.

[37] Although Head 51 was intended to deal with restriction and disqualification undertakings together, it is now thought better to deal with them separately.

Appendix: 1
51A: Disqualification Undertakings

(1) Subject to subhead (4), where the Director of Corporate Enforcement has reasonable grounds for believing that one or more of the circumstances specified in Head 42(2) [equivalent of section 160(2) of the Companies Act 1990] applies to a person, the Director may, in his or her discretion, deliver to the person or to the person's duly authorised agent a notice in the prescribed form stating—
   (a) which of the circumstances specified in Head 42(2) [equivalent of section 160(2) of the Companies Act 1990] the Director of Corporate Enforcement believes apply to the person ("the underlying circumstances");
   (b) particulars of the facts and allegations which have given rise to that belief ("the underlying facts and allegations");
   (c) the period of disqualification ("the disqualification period") which, in the opinion of the Director of Corporate Enforcement, is warranted by the underlying circumstances, facts and allegations;
   (d) the date of commencement of the disqualification period ("the specified date") which the Director of Corporate Enforcement proposes, subject to subhead (2), should be the date of commencement of the disqualification period, if a disqualification undertaking were to be given by the person;
   (e) that the person to whom the notice is delivered may, during such period as may be specified in the notice (being a period not less than 21 days beginning on the date of the notice) ("the notice period"):
      (i) notify the Director of Corporate Enforcement in the prescribed manner of his or her willingness to give a disqualification undertaking for the disqualification period, and
      (ii) return to the Director of Corporate Enforcement any associated statutory contract to this effect duly signed;
   (f) that the Director of Corporate Enforcement will refrain from making an application in respect of the person to whom the notice is delivered under Head 42 [equivalent of section 160 of the Companies Act 1990] arising from or in connection with the underlying circumstances, facts and allegations during the notice period;
   (g) that, in the event of the person giving in the prescribed manner within the notice period a disqualification undertaking for the disqualification period and returning any associated statutory contract to this effect duly signed, the Director of Corporate Enforcement will make no application in respect of the person under Head 42 [equivalent of section 160 of the Companies Act 1990] after the expiry of the notice period arising from, or in connection with, the underlying circumstances, facts and allegations;
   (h) the effect of giving a disqualification undertaking for the disqualification period beginning on the specified date;
   (i) that, in the event of the person giving a disqualification undertaking for the disqualification period beginning on the specified date, the person can seek to be relieved (whether in whole or in part) from the disqualification undertaking only by applying to the Court under Head 42(13) [equivalent of Section 160(8) of the Companies Act 1990] and that, in the event of such an application, the Court may grant such relief only if it deems it just and equitable to do so, and then only on whatever terms and conditions the Court sees fit.

(2) Where a notice is delivered to a person under subhead (1), the Director of Corporate Enforcement may at any time prior to the specified date, where he or she considers it appropriate to do so, agree to or amend any proposal made by or on behalf of the person to vary that date. Where the Director of Corporate Enforcement varies the specified date, the notice shall continue in full force and effect as though the date so varied had been stated therein as the specified date.

(3) Where a notice is delivered to a person under subhead (1), the Director of Corporate Enforcement and every person who has knowledge of the notice shall not, during the notice period, make an application under Head 42 [equivalent of section 160 of the Companies Act 1990] in respect of the person to whom the notice under subhead (1) is delivered arising from, or in connection with, the underlying circumstances, facts and allegations.

(4) Where the person to whom the notice under subhead (1) is delivered notifies the Director of Corporate Enforcement in the prescribed manner during the notice period of his or her willingness to give a disqualification undertaking

for the disqualification period and returns any associated statutory contract to this effect duly signed—

(a) the Director of Corporate Enforcement shall, as soon as practicable—
    (i) cause the Registrar to be furnished with prescribed particulars of the undertaking at such time and in such form and manner as may be prescribed, and the Registrar shall enter the prescribed particulars in the register of disqualified persons kept pursuant to Head 50 [equivalent of Section 168 of the Companies Act 1990], and
    (ii) notify the person of the prescribed particulars of the undertaking having been furnished to the Registrar and furnish a copy of the statutory contract executed by or on behalf of the Director of Corporate Enforcement;
(b) the Director of Corporate Enforcement and every person who has knowledge of the giving of the undertaking shall not, after the expiry of the notice period, make an application under Head 42 [equivalent of section 160 of the Companies Act 1990] in respect of the person to whom the notice under subhead (1) is delivered arising from, or in connection with, the underlying facts and allegations;
(c) for the duration of the disqualification period beginning on the specified date—
    (i) the person shall not be appointed or act as an auditor, director or other officer, receiver, liquidator or examiner or be in any way, whether directly or indirectly, concerned or taking part in the promotion, formation or management of any company or any society registered under the Industrial and Provident Societies Acts, 1893 to 1978;
    (ii) the person shall be deemed, for the purposes of this Bill, to be subject to a disqualification order.

(5) The Director of Corporate Enforcement shall not exercise his or her power under subhead (1) where—
(a) in the Director's opinion, a period of disqualification in excess of five years is warranted by the underlying circumstances, facts and allegations, or
(b) the Director is aware that an application under Head 42(2) [equivalent of section 160(2) of the Companies Act 1990] has already been made in respect of the person to whom the notice would be delivered arising from, or in connection with, the underlying circumstances, facts and allegations.

(6) Where a person gives a disqualification undertaking and he or she is already disqualified by virtue of an earlier disqualification undertaking or disqualification order, the period specified in the former undertaking shall run concurrently with any remaining period for which the person is already subject to disqualification.

(7) Where a notice is given under subhead (1) and either—
(a) the person to whom it is delivered does not give the disqualification undertaking as outlined in the notice within the notice period, or
(b) no proper disqualification undertaking, including any associated statutory contract to this effect duly signed, is returned to the Director of Corporate Enforcement before the expiry of the notice period, the Director will be entitled to institute proceedings for the disqualification of the person after the expiry of the notice period arising from, or in connection with, the underlying circumstances, facts and allegations without giving the person the notice envisaged under Head 42(12) [equivalent of section 160(7) of the Companies Act 1990].

(8) The Minister may make regulations in respect of any matter that is referred to in this section or that is necessary or advisable to give effect to this section, including regulations prescribing the forms for:
(a) the giving of a disqualification undertaking (including any associated statutory contract),
(b) for the making of any proposal under subhead (2), and
(c) to be used by the Director of Corporate Enforcement in registering a disqualification undertaking.

(9) In this section — 'disqualification' means being prevented by law from being appointed or acting as an auditor, director or other officer, receiver, liquidator or examiner or being in any way, whether directly or indirectly, concerned or taking part in the promotion, formation or management of any company or any society registered under the Industrial and Provident Societies Acts, 1893 to 1978.

Appendix 2: Revised Head 51B: Restriction Undertakings

(1) Subject to subhead (4), where the Director of Corporate Enforcement has reasonable grounds for believing that Part A13, Heads 31 to 40 ("Heads 31 to 40") [equivalent of Part VII, Chapter 1 of the Companies Act 1990] applies to a person, the Director may, in his or her discretion, deliver to the person or to the person's authorised agent a notice in the prescribed form stating—

- (a) the Director's belief that Heads 31 to 40 apply to the person ("the underlying circumstances");
- (b) particulars of the facts and allegations which have given rise to that belief ("the underlying facts and allegations");
- (c) the date of commencement of the five year restriction period ("the specified date") which the Director of Corporate Enforcement proposes, subject to subhead (2), should be the date of commencement of the period of restriction, if a restriction undertaking were to be given by the person;
- (d) that the person may, during such period as may be specified in the notice (being a period not less than 21 days beginning on the date of the notice) ("the notice period")
  - (i) notify the Director of Corporate Enforcement in the prescribed manner of his or her willingness to give a restriction undertaking, and
  - (ii) return to the Director of Corporate Enforcement any associated statutory contract to this effect duly signed;
- (e) that the Director of Corporate Enforcement will refrain from making an application in respect of the person under Head 32 [equivalent of section 150 of the Companies Act 1990] arising from or in connection with the underlying circumstances, facts and allegations during the notice period;
- (f) that, in the event of the person giving in the prescribed manner within the notice period a restriction undertaking and returning any associated statutory contract to this effect duly signed, the Director of Corporate Enforcement will make no application in respect of the person under Head 32 [equivalent of section 150 of the Companies Act 1990] after the expiry of the notice period arising from, or in connection with, the underlying circumstances, facts and allegations;
- (g) the effect of giving a restriction undertaking beginning on the specified date;
- (h) that in the event of the person giving a restriction undertaking beginning on the specified date, the person can seek to be relieved (whether in whole or in part) from the restriction undertaking only by applying to the Court under Head 34(1) [equivalent of Section 152(1) of the Companies Act 1990] and that, in the event of such an application, the Court may grant such relief only if it deems it just and equitable to do so, and then only on whatever terms and conditions the Court sees fit.

(2) Where a notice is delivered to a person under subhead (1), the Director of Corporate Enforcement may at any time, prior to the specified date, where he or she considers it appropriate to do so, agree to or amend any proposal made by or on behalf of the person to vary that date. Where the Director of Corporate Enforcement varies the specified date, the notice shall continue in full force and effect as though the date so varied had been stated therein as the specified date.

(3) Where a notice is delivered to a person under subhead (1), the Director of Corporate Enforcement and every person who has knowledge of the notice shall not, during the notice period, make an application under Head 32 [equivalent of section 150 of the Companies Act 1990] in respect of the person to whom the notice is delivered under subhead (1) arising from, or in connection with, the underlying circumstances, facts and allegations.

(4) Where the person to whom the notice under subhead (1) is delivered notifies the Director of Corporate Enforcement in the prescribed manner during the notice period of his or her willingness to give a restriction undertaking and returns any associated statutory contract to this effect duly signed—

- (a) the Director of Corporate Enforcement shall, as soon as practicable—
  - (i) cause the Registrar to be furnished with prescribed particulars of the undertaking at such time and in such form and manner as may be prescribed, and the Registrar shall enter the prescribed particulars in the register of restricted persons kept pursuant to Head 35 [equivalent of Section 153 of the Companies Act 1990];

(ii) notify the person of the prescribed particulars of the undertaking having been furnished to the Registrar and furnish a copy of the statutory contract executed by or on behalf of the Director of Corporate Enforcement;

(b) the Director of Corporate Enforcement and every person who has knowledge of the giving of the undertaking shall not, after the expiry of the notice period, make an application under Head 32 [equivalent of section 150 of the Companies Act 1990] in respect of the person to whom the notice under subhead (1) is delivered arising from, or in connection with, the underlying circumstances, facts and allegations;

(c) for the period of five years beginning on the specified date—

(i) the person shall not be appointed or act in any way, whether directly or indirectly, as a director or secretary or be concerned or take part in the promotion or formation of any company unless it meets the requirements set out in subhead (4) of Head 32 [equivalent of Section 150(3) of the Companies Act 1990];

(ii) the person shall be deemed, for the purposes of this Bill, to be subject to restriction.

(5) The Director of Corporate Enforcement shall not exercise his or her power under subhead (1) where he or she is aware that an application under Head 32(1) [equivalent of section 150(1) of the Companies Act 1990] has already been made in respect of the person to whom the notice would be delivered arising from, or in connection with, the underlying circumstances, facts and allegations.

(6) Where a person gives a restriction undertaking and he or she is already restricted by virtue of an earlier restriction undertaking or restriction declaration, the five year period of restriction arising by virtue of the former restriction undertaking shall run concurrently with any remaining period for which the person is already subject to restriction.

(7) The Minister may make regulations in respect of any matter that is referred to in this section or that is necessary or advisable to give effect to this section, including regulations prescribing the forms:

(a) for the giving of a restriction undertaking (including any associated statutory contract),

(b) for the making of any proposal under subhead (2), and

(c) to be used by the Director of Corporate Enforcement in registering a restriction undertaking.

(8) In this section — 'restriction' means being prevented by law from being appointed or acting in any way, whether directly or indirectly, as a director or secretary or being concerned or taking part in the promotion or formation of any company unless it meets the requirements set out in Subhead (4) of Head 32 [equivalent of Section 150(3) of the Companies Act 1990].

6.2 Proposal to allow ODCE to put Directors on Notice of a Contravention

6.2.1 Background

Pursuant to the general principle that company directors must act in the interests of the company, Part III of the 1990 Act (Directors' Transactions) contains rules defining the limited circumstances in which company assets may be used for non-company purposes. These rules seek to protect the interests of the general body of company stakeholders (creditors, employees, investors, etc.) from any dissipation of the company's assets by directors or other connected persons.

In recent years, the breach of company law most frequently reported by auditors to the ODCE has been directors' transactions in excess of the limits permitted in Part III. On being made aware of these defaults, many directors have acted promptly to correct them and the ODCE has accepted this remedial action as a satisfactory compliance outcome. Its practice is to issue a cautionary letter to those directors warning that any further breach will render them liable to potential criminal liability. The ODCE has issued several hundred such letters to company directors at this stage.

Unusually, the accompanying offence provision for excessive directors' transactions in section 40 of the 1990 Act has a very high burden of proof. Were a prosecution to be contemplated, the ODCE not only has to prove a breach of section 31, but it also has to prove beyond a reasonable doubt that at the time the company entered into the transaction the officer(s) who authorised or permitted or procured the company to do so knew, or had reasonable cause to believe, that the company was thereby contravening the law.[38]

In early 2006, the ODCE proposed that section 40 (and Head 26 of Part A5 of the Companies Consolidation and Reform Bill[39]) be amended to provide in a new subsection (3) that if a Court were satisfied that a director had been previously notified (in writing or otherwise) of the provisions in section 31, then that notice would, until the contrary was shown, be recognised as sufficient proof of the knowledge required by section 40. The ODCE proposal was referred to the Review Group for evaluation.

6.2.2 Issues Arising

The ODCE made the following points in support of its proposal:

- the incidence of detected Part III breaches in recent years has remained significant, notwithstanding the ODCE's publication of detailed guidance in 2003, the issue of ODCE material to all Irish-registered company directors in 2004 and the referral of a small number of large value directors' transaction cases to the Revenue Commissioners in 2006. However, there was a welcome 43% drop, to 135, in the number of breaches reported by auditors in 2007;

- while the ODCE planned to maintain indefinitely its general approach of encouraging administrative rectification to a detected section 31 breach[40], it was concerned that this might not be sufficient to correct the incidence of ongoing non-compliance and that the high burden of proof in section 40 might seriously compromise its ability to take enforcement action in appropriate cases;

- because of the inherent difficulty of seeking to prove issues of knowledge or belief, the law often provides for appropriate rebuttable presumptions, and these exist both in the Companies Acts and

[38] See the English case of Re Saunders, 6 November 1989, unreported, referred to at paragraph 14.015 and 14.016 of Arlidge & Parry on Fraud, 3rd Edition, London, Sweet & Maxwell (2007). The authors quote from the judgment of Henry J which included the following—
"It is quite clear that in [certain] statutory formulations the intent to evade the actual prohibition was an ingredient of the offence. Examination of the Companies Acts shows that where the draftsman wished a director only to be liable if he knew or had reasonable cause to believe that the transaction in question constituted a breach of the Act, then in those circumstances the matter is not dealt with under this officer in default formulation of section 730(5), but is expressly spelled out. By way of example, section 330 [of the Companies Act 1985] lists prohibitions on loans to directors … section 342 deals with criminal penalties in relation to breaches of the section and provides in subsection (1): 'A director of a relevant company who authorises or permits the company to enter into a transaction knowing or having reasonable cause to believe that the company was thereby contravening section 330 is guilty of an offence.' There clearly the prosecution must prove (1) that the director authorised or permitted the acts constituting the offence and (2) that the director knew or had reasonable cause to believe that the company was thereby contravening section 330 … That formula must be contrasted with the 'officer in default' provisions, where the officer in default is liable if he knowingly or wilfully authorises or permits the contravention and the contravention is established by the proof of the section 151 offence and not by proof of the fact that the officer knew the law making that an offence."

[39] http://www.clrg.org/companiesbill.

[40] See also Chapter 7, Section 7.2.

in other legislative codes (e.g. section 19A of the 1990 Act (as inserted by section 29 of the 2001 Act) in respect of the knowing falsification or destruction of documents relevant to an actual or anticipated company investigation). The ODCE proposed that section 40 would be suitable for a similar rebuttable presumption;

- the modest and legitimate purpose of the proposed amendment was to provide for a rebuttable presumption that a defendant had acted with a certain knowledge or reasonable cause for belief in certain clearly defined circumstances. The ODCE indicated that the proposed presumption would operate only where—
  - o the ODCE had succeeded in proving beyond a reasonable doubt that the defendant did authorise, permit or procure a company to enter into a transaction or arrangement that contravened section 31; and
  - o a Court was satisfied beyond a reasonable doubt that the defendant had been previously notified of the requirements of section 31.

Even then, the ODCE submitted that the presumption would only operate *"until the contrary is shown"*. The ODCE recalled the low level of proof which is faced by a defendant that seeks to displace a rebuttable statutory presumption. As was stated by the Supreme Court in *DPP v. Byrne [2002] 2 ILRM 68*, *"it is then for the defendant to show to the contrary so as to raise a reasonable doubt in the mind of the trial judge."* In doing so, a defendant will obviously be entitled to raise any issues which he or she thinks relevant. It is not the case, therefore, that the defendant must disprove the presumption beyond a reasonable doubt.

In summary, the effect of the proposed amendment was to provide that where a company officer had been previously notified of the requirements of section 31 and had failed to comply with it, a burden of proof would rest with the defendant to prove that he or she was unaware of the consequences of the default. The proposal would, therefore, enhance the credibility of the enforcement option in the face of circumstances of deliberate default.

In considering the above argument made by the ODCE, the Review Group also considered:

- whether the perceived difficulty with section 40 had not already been resolved by the general shifting of the burden of proof now contained in section 383 of the 1963 Act (as amended by section 100 of the 2001 Act). The ODCE's view is that this provision is not relevant, because section 383 only applied to offences with the words *"an officer of a company who is in default"* (and section 40 did not contain these words);

- whether the offence provision in section 40 should be changed to a strict liability offence. The ODCE indicated that it was not advocating such a change, as it was only interested in effectively prosecuting cases where there was evidence of knowing default or reasonable belief of default;

- the nature of the equivalent offence provision in the UK. The ODCE indicated that the UK offence provision in section 342 of the Companies Act 1985 was similar to section 40.[41]

6.2.3 Conclusions

Overall, the Review Group has some doubts about the ODCE proposal. The Review Group supported the ODCE's primary focus of obtaining a return to the company of the funds which were being used by the directors or other connected persons for personal or other non-company purposes. However, the Review Group questions whether the proposed amendment would, in reality, enhance the prospects of a conviction as the relevant Court would be made aware of any correspondence between parties in the course of proceedings under section 40 anyway. The amendment also appears to involve an increase in regulatory burden while the need for it remains uncertain.

6.2.4 Recommendation

In the light of these reservations and the more fundamental policy questions relating to the issue of directors' transactions which are separately addressed in Section 7.2 of this Report, the Review Group recommends that further consideration of the ODCE proposal be postponed until the outcome of that broader policy discussion is concluded.

[41] UK legal commentary (Hannigan, Annotated Guide to the Companies Acts, Butterworths 2001, page 628) has noted the difficulty of establishing the necessary mens rea and the corresponding absence of a prosecution for an excessive directors' transaction offence in the UK. It has recently come to attention that no criminal liability now attaches to excessive directors' transactions in the UK following the enactment of the Companies Act 2006 which has introduced a revised framework for regulating directors' transactions. The liability issue will no doubt be addressed as part of the options for the development of a revised statutory framework in the State which are being evaluated at present.

6.3 Proposal to Permit Multiple Proceedings on the Same Facts Within a Single Set of Summary Proceedings

6.3.1 Background

Section 240A of the 1990 Act, inserted by section 105 of the 2001 Act, had the objective of consolidating in a single set of summary proceedings, multiple prosecutions of companies and directors which were based on the same set of facts. However, it did not achieve this purpose in all cases, as the Office of the Director of Corporate Enforcement (ODCE) was required in certain instances to prosecute companies and directors in various District Courts, notwithstanding the existence of the same set of key facts in each case.

A practical consequence of these different Court determinations has been that where one or more persons in one Court were treated more harshly than their co-defendants in another Court, they would be inclined to appeal the Court's determination. In order to eliminate these repetitious Court proceedings, consequential inefficiencies and unnecessary costs, to the benefit of all of the parties to the proceedings, the ODCE proposed that section 240A be amended to achieve the objective which was originally intended for the provision.

6.3.2 Current Position

Section 240A currently reads: -

> *"For the purposes of any provision of the Companies Acts which provides that the company and every officer of the company is guilty of an offence, summary proceedings against the company or an officer of the company may be brought, heard and determined either—*
>
> *(a) in the court area in which the offence charged or, if more than one offence is stated to have been committed, any one of the offences charged, is stated to have been committed,*
>
> *(b) in the court area in which the accused has been arrested,*
>
> *(c) in the court area in which the accused resides,*
>
> *(d) in the court area specified by order made pursuant to section 15 of the Courts Act, 1971, or*
>
> *(e) in the court area in which the registered office of the company is situated."*

However, section 240A only applies to certain offences, specifically *"any provision of the Companies Acts which provides that the company and every officer of the company is guilty of an offence"*. Therefore, any section of the Companies Acts which creates an offence but which does not contain the highlighted words above is not covered by section 240A.

Where the highlighted words are not contained in the section creating the offence, then a prosecutor must rely on the general provision of the Courts legislation as to jurisdiction, *viz.* section 79 of the Courts of Justice Act 1924, the relevant part of which reads:

> *"Provided that the jurisdictions by this Act vested in and transferred to the District Court shall be exercised by [a Judge] severally as follows: —*
>
> *…. In criminal cases, by a Justice for the time being assigned to the District wherein the crime has been committed or the accused has been arrested or resides;"…*

Order 13 of the District Court Rules regulates the manner in which District Court proceedings may be initiated and establishes the District Court area as the criterion in this regard. Order 13 currently provides:

> *"1. Criminal proceedings shall be brought, heard and determined either—*
>
> *(a) in the court area wherein the offence charged or, if more than one offence is stated to have been committed within a Judge's district, any one of such offences is stated to have been committed; or*
>
> *(b) in the court area wherein the accused has been arrested, or*
>
> *(c) in the court area wherein the accused resides, or*
>
> *(d) in the court area specified by order made pursuant to the provisions of section 15 of the Courts Act 1971, or*
>
> *(e) in a case to which section 79A(1) of the Courts of Justice Act 1924 (inserted by section 178 of the Criminal Justice Act 2006) applies, in any*

court area within any of the districts referred to in that sub-section."

Section 240A, as currently worded, entails that a prosecutor wishing to initiate proceedings against both the company and the directors, arising out of an offence under any section of the Companies Acts which does not contain the words shown in bold aforementioned, must, if the registered office of the company and the directors' places of residence are in two or more different District Court areas, bring separate sets of proceedings in the different areas based on the same facts. Clearly, multiple Court sittings at first instance and on appeal, to hear the same set of facts, are wasteful of time and resources.

6.3.3 The ODCE's Additional Proposal

In the interests of regulatory efficiency and consistency and the minimisation of legal time and expense, the ODCE proposed that for all offences prosecuted summarily, the law should enable two or more persons (including a company or companies) to be prosecuted together within a single set of summary proceedings in the same District Court and that those proceedings should be capable of being brought with reference to the Court area in which the company's registered office is situated. No unfair burden would be likely to arise for an accused company officer from such a provision, as it would be expected that an accused would already have some connection or association with the location of the company's registered office.

Moreover, as the proposed amendment seemed equally beneficial for non-Companies Act prosecutions, the ODCE suggested that it should apply to all summary prosecutions involving companies and not just prosecutions under the Companies Acts, so that other prosecutors and the Courts could also benefit from the resultant efficiency[42].

6.3.4 Issues Arising and Conclusions

1. The Review Group considered that the initial proposal to allow multiple proceedings to be brought in a single set of proceedings was a good proposal which did not unduly affect the rights of accused persons, facilitated the administration of justice and would lead to greater uniformity in sentencing. Accordingly, the Review Group recommends that the law be so amended to provide as set out in Appendix 1 to this Section.

The Review Group also considered the need for any proposed amendment to confer explicit jurisdiction on the Courts, even if the existing section 240A did not do so. One consideration was that the primary source of the criminal jurisdiction of the District Court is section 79 of the Courts of Justice Act 1924 and that any failure to allude to section 79 would give rise to a potential jurisdictional deficit. While in the Review Group's opinion, there is no necessity to refer specifically to section 79 of the 1924 Act in the amendment, the Review Group decided that it would be best for the avoidance of any possible doubt. It is also the view of the Review Group that the term 'District Court district' replace 'District Court area' in the revised section 240A, because this was the standard terminology used and because it offered greater flexibility for the prosecutor.

2. The Review Group also considered that it was appropriate to extend this provision to the prosecution of indictable offences under the Companies Acts. Section 240A as it stands makes no provision for the location of the registered office of a company being a sufficient basis on which to trigger the jurisdiction of the Circuit Court judge within whose circuit that registered office is located. Under section 25 of the Courts (Supplemental Provisions) Act 1961, the location of the accused person's arrest, his or her place of residence and the location where the offence charged has been committed are the only factors on which the Circuit Court's jurisdiction can be founded.

3. The Review Group then considered the ODCE's additional proposal and, specifically, whether it was within its statutory remit to make a recommendation which extended beyond the Companies Acts, in this case to make a recommendation concerning the prosecution of companies and their officers for offences allegedly committed under other legislation such as health and safety, environmental law, competition law, etc. In this context, the Review Group examined its statutory functions at section 68(1) of the 2001 Act. The relevant provisions are as follows:

Section 68 (1)

(1) The Review Group shall monitor, review and advise the Minister on matters concerning -

[42] Head 53 of Part A13 of the proposed Companies Consolidation and Reform Bill already reflects the ODCE proposal.

(a) the implementation of the Companies Acts,

(b) the amendment of the Companies Acts

(c) the consolidation of the Companies Acts,

(d) the introduction of new legislation relating to the operation of companies and commercial practices in Ireland,

(e) the Rules of the Superior Courts and case law judgements insofar as they relate to the Companies Acts,

(f) the approach to issues arising from the State's membership of the European Union, insofar as they affect the operation of the Companies Acts,

(g) international developments in company law, insofar as they may provide lessons for improved State practice, and

(h) other related matters or issues, including issues submitted by the Minister to the Review Group for consideration.

The Review Group concluded that the only circumstances in which it could or should opine on laws contained in statutes other than the Companies Acts were where the Minister had specifically referred such matters to the Review Group and in the clearest possible terms.

The Review Group also considered if it was appropriate that such a wide-ranging provision be located in the Companies Acts. In this context, the Group noted that ODCE had pointed to section 382 of the 1963 Act which universally applies to the prosecution of companies on indictment, regardless of the Act under which the prosecution occurs. The Review Group considered that section 382 of the 1963 Act was located in the Companies Acts because, although companies are separate legal persons in the eyes of the law, it is necessary to make provision for the fact that companies can only act through agents or representatives and cannot act for themselves. Accordingly, although section 382 applies to all indictable offences, it does so merely to accommodate the realities of prosecuting an artificial legal person on indictment by allowing a body corporate (for it applies not only to Irish companies) to "appear at all stages of the proceedings by a representative".

The Review Group noted that the views of a number of parties (including the Department of Justice, Equality and Law Reform, the DPP, the Competition Authority and the Revenue Commissioners) had been canvassed, and that all were favourably disposed to such a provision. The Review Group concluded, however, that it was inappropriate to make a recommendation for a change in the Companies Acts which would have the effect of determining the appropriate venue in which to bring proceedings for breaches of non-Companies Acts legislation. The Review Group considered that a change in law which entitled the prosecution to determine the venue for the prosecution of offences could touch upon the civil and constitutional rights of the accused and did not feel that a group established to opine on company law had any role in opining on the prosecution of offences other than offences under the Companies Acts.

The Review Group appreciates that laws may differ as to their objectives, interpretation and application and that approaches to enforcement should not be a driving force in improving compliance, nor be subject to a 'one size fits all' approach. As such, the Review Group feels that the above proposals, while worthy in the context of company law, and designed to ease the compliance burden on companies, should be further examined by Government insofar as they have implications for the enforcement of other areas of the law.

4. Finally, the Review Group considered a request by the Registrar of Companies that all of his summary prosecutions for annual return defaults (see Head 52(8) of Part A6 of the proposed Companies Consolidation and Reform Bill[43]) should be capable of being prosecuted in the Dublin District Court regardless of the location of the company's registered office. The Registrar usually undertakes these prosecutions in bulk and has often arranged for a special sitting of Dublin District Court to hear the cases on the basis that the offence of failing to file the annual return in question occurred at the Companies Registration Office (CRO) in Dublin. However, a recent Court case has cast doubt on Dublin District Court being the appropriate venue where the company's registered office is based outside of Dublin, on the basis that it was not clear that the default occurred at the CRO in Dublin.

Despite the relocation of CRO to Carlow, it is the

[43] See http://www.clrg.org/companiesbill.

Registrar's desire that these prosecutions would continue to be dealt with by a judge in a single District Court district, preferably Dublin District Court. His reasoning includes the following considerations:

- it would be more efficient for these cases to be dealt with together in a single Court district;
- many companies will continue to have their registered office in Dublin;
- Dublin District Court has experience of these case types;
- Dublin District Court has a greater capacity to deal with these cases in bulk.

Having considered the matter, the Review Group believes that there would be constitutional difficulties with specifying that prosecution proceedings take place in a District Court district bearing no identifiable relationship with the place of commission of the offence. While a court of competent jurisdiction within the Dublin Metropolitan District is often deemed to be the appropriate jurisdiction for the prosecution of certain offences committed outside the State (e.g. section 5(3) of the Criminal Justice (Safety of United Nations Workers) Act 2000), the Review Group was not aware of any Irish legal provision, comparable to that now proposed by the Registrar, for offences committed within the State.

However, the Review Group is of the view that it would be necessary, in order to proceed with this amendment, for the Department of Enterprise, Trade and Employment to confirm from the Attorney General's Office whether it is constitutionally permissible for the offence of failing to file annual returns to be deemed to have occurred at the new Carlow office of the Registrar. If constitutionally permissible, this would allow Carlow District Court to deal with all of the Registrar's summary prosecutions for annual return defaults.

On this revised basis and in the light of the efficiency benefits of having these cases dealt with by a single District Court, the Review Group is accordingly disposed towards facilitating the Registrar in the proposed head, subject to the other options as to venue remaining in place. This flexibility would allow, for instance, the ODCE to continue to prosecute, as it does occasionally, a company and/or its directors for annual return defaults in conjunction with other company law offences in the District Court district where the company's registered office was located.

6.3.5 Recommendation

Having fully considered these issues, the Review Group recommends that the revised Head 53 (see Appendix 1 to this Section) be incorporated in the Companies Consolidation and Reform Bill, subject to any drafting changes advised by Parliamentary Counsel and the advice of the Attorney General.

Appendix 1: Recommended Revised Head 53 for Part A13 of the Bill

(1) Summary proceedings under the Companies Acts against—

(a) a company, or
(b) a director, shadow director, officer, promoter, receiver, liquidator or auditor of a company (as the case may be), or
(c) a purported director, shadow director, officer, promoter, receiver, liquidator or auditor of a company a (as the case may be),
may be brought, heard and determined either
(i) in accordance with section 79 of the Courts of Justice Act 1924, or
(ii) before and by a judge of the District Court for the time being assigned to the district court district in which the registered office of the company is situated immediately prior to the commencement of the proceedings, or
(iii) before and by a judge of Carlow District Court where the offence is an offence under Head 52(8) of Part A6 of the Bill.

(2) Where an indictable offence under the Companies Acts is charged against—

(a) a company, or
(b) a director, shadow director, officer, promoter, receiver, liquidator or auditor of a company (as the case may be), or
(c) a purported director, shadow director, officer, promoter, receiver, liquidator or auditor of a company (as the case may be),
the jurisdiction vested in the Circuit Court by subsection (1) of section 25 of the Courts (Supplemental) Provisions Act 1963 may be exercised either
(i) in accordance with subsection (3) of the said section 25, or
(ii) by the judge of the circuit in which the registered office of the company is situated immediately prior to the commencement of the proceedings in the District Court from which the accused person was, or is to be, sent forward for trial.

(3) For the purposes of this section, the place for the time being recorded by the Registrar as the situation of the registered office of a company shall be deemed to be the registered office of the company notwithstanding that the situation of its registered office may have been changed.

6.4 Good-Faith Reporting ('Whistleblowing') of Breaches of Company Law

6.4.1 Introduction

Following a proposal from the Irish Congress of Trades Unions (ICTU), the then Minister for Trade and Commerce, Mr Michael Ahern T.D., asked the Company Law Review Group, as part of its 2007 Work Programme, to examine the inclusion of 'whistleblowing' provisions in Irish companies legislation. 'Whistleblowing' is usually interpreted to mean the reporting, in good faith, of a breach or potential breach of the law, and the according of a measure of protection to the person reporting, against penalisation by the entity about whom the report has been made.

6.4.2 Background

In 1999, Mr Pat Rabbitte, T.D., introduced a Private Members' Bill in Dáil Eireann, entitled the Whistleblowers' Protection Bill 1999. The Government subsequently indicated that it was broadly supportive of the purpose of the Bill and would introduce its own legislative measure in due course.

In March 2006, the Government decided that it would not proceed with a general legislative provision. Its decision was described in the following terms by the then Minister for Labour Affairs, Mr Tony Killeen T.D.:

> *"The Government decided on 7 March 2006 to formalise the sectoral approach as part of its policy on addressing the issue of whistleblowing by requiring Ministers, in consultation with the Office of the Parliamentary Counsel, with legislation either on the Government's legislative programme for the current Oireachtas session or currently in the course of preparation to include, where appropriate, whistleblowing provisions therein. Such an approach also acknowledges situations where the provision of whistleblowing provisions may not be appropriate."*[44]

It is the Review Group's understanding that the 'sectoral' approach implies confining consideration of the appropriateness of 'whistleblowing' and related protection, to breaches of the legislation under consideration. In that context, the issue here is the appropriateness of such provisions in the case of company law. In the Review Group's opinion, the substantive issue (as ICTU would hold) is the protection of employees from penalisation by employers for reporting breaches of company law.

6.4.3 Company Law Context

The Review Group is a statutory advisory expert body charged with advising the Minister for Enterprise, Trade and Employment on the review and development of company law in Ireland. In so doing, the Review Group is charged "to promote enterprise, facilitate commerce, simplify the operation of the Companies Acts, enhance corporate governance and encourage commercial probity". It is clear, therefore, that any proposed changes to the law must seek to balance corporate governance and commercial probity with the wider promotion of enterprise and the facilitation of commerce.

In its work to date on consolidating, reforming and modernising company law, the Review Group has sought to ensure that that balance is achieved; that the Irish companies code contributes to the competitiveness of the Irish economy; and that Ireland remains an attractive location for investment.

In this context, the main question is what advantages or disadvantages would be conferred by whistleblowing provisions, in the strict company-legal context, in the wider business sense and given the competitiveness climate?

6.4.4 Wider Public Policy Context

Given the origins and the debate on whistleblowing generally in the Irish context, it is worth bearing in mind that where such provisions have been introduced, they generally seek to improve enforcement of laws that have a wider public policy interest, such as a threat to life or limb, or those which have a macro effect on the economy to the detriment of a large element of the population, for example. Whistleblowing provisions currently exist in Irish legislation relating to Child Abuse, Ethics in Public Office, Health and Safety, Competition and Consumer Law.

[44] Dáil Debates, 8 March 2006.

6.4.5 Review Group Approach

In approaching the issue of whistleblowing in the context of company law, the Review Group examined the proposals contained in the ICTU submission (which is reproduced at www.clrg.org). However, as will be evident from the later analysis in this Section, it was the Review Group's opinion that some aspects of the ICTU proposals fell outside of the Group's remit.

The Review Group is also indebted to the Director of Corporate Enforcement and his staff who, in their capacity as Chairman and members of the Review Group Committee which considered the issue, produced an extensive analysis of whistleblowing, both generically and in relation to company law aspects, and on which a good deal of the discussion in this Section is based. This discussion paper is also reproduced at www.clrg.org.

Finally, the Review Group went on to consider other dimensions which might affect company law, such as the philosophy behind whistleblowing and the wider public policy implications, evidence of breaches of company law that would justify specific whistleblowing provisions, the international competitiveness dimension of company law and a risk analysis of proceeding with some form of company-law specific whistleblowing provisions at this time.

6.4.6 Good-faith Reporting and the Public Policy Interest

6.4.6.1 The Philosophy behind Good-faith Reporting

Current whistleblowing provisions in Irish law are contained in:

- Ethics in Public Office Acts 1995 to 2001;
- Protections for Persons Reporting Child Abuse Act 1998;
- Competition Act 2002;
- Garda Síochána Act 2005;
- Safety, Health and Welfare at Work Act 2005;
- Employment Permits Act 2006;
- Consumer Protection Act 2007;
- Health Act 2007; and
- Communications Regulation (Amendment) Act 2007; and
- Charities Bill 2007.

It will be evident that many of these provisions predate the recent Government decision in favour of a 'sectoral' approach. However, it is also evident that good-faith reporting provisions have increasingly become a part of recent Government legislation.

When one looks at the policy areas concerned, one could loosely define the 'public policy interest' as any threat to the health and safety of the individual or a threat to the proper functioning of the economy or economic markets. The objective of such legislation is to prevent major malpractices which have significant implications for the public at large (e.g. preventing child abuse, corruption, public ethics, health and safety, risks to consumers) or matters that affect the macro-economy, such as cartels.

In respect of the impact of these provisions, the Review Group is not aware of any published information which discusses the value of the good-faith reporting provisions in the above codes to date. Moreover, the recent enactment of many of these provisions would not have allowed sufficient time for a proper assessment of their impact to be undertaken.

As Minister for Enterprise, Trade and Employment, Micheál Martin T.D. pointed out in the March 2006 Dáil debate:

> *"Whistleblowing provisions will not provide a panacea for resolving all issues and problems. Issues pertaining to culture, status and a range of other matters are also factors as regards some of the unacceptable activities that have occurred in a wide range of areas that have been alluded to by Deputies in the course of this debate".*

He went on to say that the *"important public issues"* that had given rise to the original proposal (given by Deputy Rabbitte) had not diminished and that it *"is imperative that persons giving sensitive information in the public interest are provided with appropriate safeguards"*. However, *"the financial world, for example, is much different from the health world, health and safety, employment law and labour rights"*.

6.4.6.2 Evidence of a 'Public Policy Interest' deficit in Relation to Company Law

Using company law as an example, there are some broad 'public policy interest' considerations, e.g. the corporate governance and related investment climate that exists and their role in Ireland's national competitiveness.

It cannot be said, generically, that breaches of company law pose any significant threat to health and safety. While such threats may exist from time to time in any given company, or in particular sectors, they do not exist by virtue of the rationale for a companies code and are not, therefore, suitable to be addressed through the companies code. The Review Group shares the view that such risks are best treated in the context of appropriate 'sectoral' or 'thematic' legislation, e.g. health and safety legislation (as is in fact the case).

In terms of wider economic impacts, there are philosophical arguments around the extent to which a comprehensive and comprehensively enforced regulatory regime is necessary, on the one hand to promote the stability that is essential to business, or on the other hand, which has the potential to hinder entrepreneurship and investment. One cannot say that there is any evidence of endemic failure in relation to corporate governance or its enforcement in Ireland that negatively affects the investment climate and which requires enhanced 'whistleblowing' provisions.

Later in this Section, consideration is given to the international competitiveness of our companies code vis-à-vis good-faith reporting provisions in other countries.

Legal research undertaken by the ODCE[45] did not uncover any Irish case law dealing with good-faith reporting in the context of disputes with respect to employer/employee relationships. However, the Courts have favoured, in two RTÉ cases, the disclosure of matters of public interest over the private interests of the relevant companies. It seems unlikely, therefore, that the Courts would intervene to block the disclosure of indicated misconduct to an appropriate regulatory authority for investigation.

Insofar as good-faith reporting has arisen in the context of disputes with respect to employer/employee relationships, the following appears to be settled law in England and could be influential. A director or other officer or senior employee may, in certain circumstances, be under a duty to disclose internally his or her own misconduct and the misconduct of any others within the company by virtue of his or her prudential duties to the company. An employee (who is not a director or officer or senior employee) may, in certain circumstances, be similarly duty-bound to disclose internally his or her own misconduct as well as the misconduct of his or her fellow employees, by virtue of his or her contractual duty to the company. Officers and employees are permitted to disclose misconduct to an appropriate external authority or the press if it involves a breach of law or is otherwise in the public interest.

In contacts with a number of supervisory agencies which work in policy areas that have good-faith reporting legislation, it seems that such reporting has given rise to a small number of useful reports which would not otherwise have come to attention.

6.4.6.3 Good–faith Reporting and Company Law in Practice

Given that the Government has decided to pursue a 'sectoral' approach to good-faith reporting, three questions are posed in the company law context:

1 Is there evidence of company law breaches that would justify additional 'whistleblowing' provisions and protection of employees?

2 What would be the benefits to companies and their employees; in particular, if the primary objective is to afford protection to employees?

3(a) What are the implications for the company law code?

3(b) Is company law the most appropriate location for such a provision?

It should be pointed out that there have been many improvements in terms of the legislation and machinery relating to compliance with company law over the past decade. The establishment of the Office of the Director of Corporate Enforcement in 2001 and the Irish Auditing and Accounting Supervisory Authority in 2003 has raised the public profile of the role and obligations under company law and facilitated reporting, statutorily or otherwise, of suspected breaches. It is worth noting also that compliance with reporting requirements to the Companies Registration Office has increased from 13% in 1997 to 85% currently.

Research carried out by ODCE shows that out of a total of 1019 complaints to ODCE in 2006, 344 (34%) came from the public, up from 27% in 2005. Many of the complaints relate to improper trading, alleged

[45] See ODCE Discussion Paper on www.clrg.org.

non-payment of monies due, conduct prejudicial to directors or shareholders, the provision of false information and a range of other matters. However, ODCE experience is that roughly a third of these complaints do not relate to company law breaches at all and are not, therefore, a matter for ODCE attention.

Evidence that there would be an increase in the number of reports of breaches of companies legislation as a result of protection for employees who make such reports is not conclusive. There is a lack of evidence to suggest that the existence of a whistleblowing provision might have adverted to or exposed any company law malpractice. Neither is there any evidence indicating that protection of employees in such circumstances would prevent an employee from being victimised as a result of making any good-faith report concerning breaches of company law.

The ODCE favours the inclusion of a balanced and limited good-faith reporting provision in Irish company law. It believes that it is in the public interest:

- to facilitate the disclosure and investigation of matters of serious wrongdoing by or on behalf of a company; and
- to protect employees who make disclosures of information to appropriate persons within or outside the company.

According to the ODCE, the Organisation for Economic Cooperation and Development (OECD) is a consistent advocate of good-faith reporting in, for example, its Principles of Corporate Governance and many individual OECD Member States have either adopted legal provisions in general Acts or in company law or have otherwise facilitated the introduction of good-faith reporting arrangements.

The ODCE also points out that good-faith reporting provisions are already enshrined in Irish law governing competition, consumer protection, employment permits and health and safety as well as in other economic regulatory areas such as communications regulation.

The ODCE believes that there is good reason why company law should also be covered by good-faith reporting provisions. Employees will occasionally be able to identify misconduct as diverse as insider dealing/market abuse, fraudulent trading, falsified or mis-stated company accounts and other serious breaches. Such misconduct can be deterred, rectified or investigated and sanctioned by the availability of a controlled environment for good-faith disclosures.

At the same time, many companies (including the majority which make every effort to comply with the law) may have some genuine concerns about good-faith reporting provisions generally. The question therefore, in the ODCE's view, becomes: how can we bring to attention hidden misconduct through a good-faith reporting provision while minimising the potential adverse effects?

In the ODCE's view, a balanced good-faith reporting provision in company law can meet both objectives by containing the following elements:

- it would be confined to serious company law offences (i.e. those classified as categories 1 and 2 in the planned Companies Consolidation and Reform Bill);
- it would only cover past and current breaches and would exclude future suspected breaches of law;
- protection would be afforded to employees and similar persons. Creditors and others outside of a company who reported misconduct would not be covered;
- employee disclosures would only enjoy protection if they meet certain pre-conditions (e.g. deal with a serious company law offence and are made in good faith);
- there would be a bias (other than in exceptional cases) towards reporting first within a company, so as to allow the issue to be regularised if that is possible;
- good-faith reporting direct to the ODCE or An Garda Síochána would enjoy protection if it complied with certain pre-conditions (e.g. where no action is known to have been taken within the company to remedy the default);
- the employee must identify himself or herself in making a good-faith report (unless a company permitted anonymous internal disclosures), although the person's identity would be subject to strict conditions of confidentiality.

6.4.6.4 Implications for Company Law

A fundamental question here is whether any whistleblowing provision should apply to company law generally, in the interest of enhancing the enforcement of the corporate governance regime, or just to those company law provisions that are capable of having a wider public impact? Company law is a corpus of law with circa 400 offences, the vast majority of which are technical offences. Such technical offences are, in the view of the Review Group, totally unsuited to whistleblowing as there is no significant public policy interest at stake. For example, there is no comparison between health and safety issues and technical breaches of the Companies Acts, such as failure to file an annual return.

Given that much of company law is highly technical and complex, it can give rise to many inadvertent breaches and again there is no strong public policy argument for encouraging the reporting of breaches outside of the company.

Company law already provides significant protection (both in law and through the existence of enforcement agencies) to stakeholders whose interests are prejudiced. There is an issue here as to whether the public interest requires that the agencies of company law enforcement need, and if so whether they should be given, public assistance in the enforcement of the Companies Acts.

If the number of reported breaches arising from new whistleblowing provisions were to rise significantly, it would be necessary to allocate increased resources to the agencies of company law enforcement arising from the requirement to investigate all complaints made. Alternatively, resources would have to be diverted from existing cases which arise primarily from reports by auditors and liquidators or from internal investigations. On the other hand, if there is no significant increase in disclosures as a result of the introduction of whistleblowing, then either the measure was ineffective or unnecessary.

6.4.6.5 Implications for Companies and Employees

This Section looks at the implications for companies' interests, including the interests of directors and managers, as well as those of the creditors and shareholders. In addition, the introduction of whistleblowing provisions will affect employee interests, as well as having implications for employer/employee relationships.

At the wider market level, the creation of a regime encouraging employees to report their employers for technical breaches of a code which was originally designed to facilitate commerce, risks decreasing the competitiveness of that company. Ultimately, such a regime could place indigenous business on an uneven playing field internationally. There is a real risk of damaging companies' reputations in facilitating (and encouraging) the reporting of technical breaches to enforcement agencies, even where such reports are made in good faith.

The risk of a company's competitors using such reports to damage a company's reputation in the market would be lessened if there were already some form of internal reporting procedures in place. An important issue for consideration, therefore, is whether employees should have a duty to report suspected breaches internally before making an external report. For example, should employees have a statutory duty to report suspected breaches of the Companies Acts to the board of directors so as to facilitate the company rectifying such breaches privately?

Consideration must be given to the possibility that the protection conferred may be misused by 'disgruntled' employees to cause difficulties for employers. This is particularly true if reports of all technical breaches of company law are included under the terms of the protection available, e.g. a simple filing offence.

There should be some reluctance to impose a legal obligation on employees to report breaches of company law by the company, given that it is the company as a whole which will be liable to prosecution, although one of its agents (officers or employees) will invariably be the person responsible for the breach.

There is an issue therefore, in the first instance, as to the duty of an employee to report versus the degree and nature of protection. If, as the case law suggests, there already exists a duty to report breaches, and given that the Courts would not intervene to block disclosures, what further degree of protection is necessary and would it serve any additional public interest?

Finally, if the objective is to protect employees (as defined in employment law), by creating such provisions strictly for registered companies the majority of business entities (and their employees) will not be covered. In practice, there would be different regimes for employees of registered companies on the one hand, partnerships, sole traders, co-operatives, industrial and provident societies, unincorporated associations, statutory corporations and the public sector on the other.

Given that the protection in question is in relation to penalisation or discrimination in the context of the employer/employee relationship, the Review Group would not wish to express a view on what is essentially a matter of employment law, which itself is already extensive, complex and has its own dedicated dispute machinery. In all the circumstances, the Review Group does not believe that the company law code is suitable for dealing with the employer/employee relationship.

6.4.6.6 Proportionality Between the Provisions Proposed and the Threat Envisaged

Proportionality of any legal provision proposed relative to the threat foreseen is at the heart of the Review Group's approach to the consolidation and reform of company law.

Proportionality is a key criterion of the Government's drive to improve the regulatory environment for business[46].

Based on the foregoing discussions, proportionality in this context means:

Proportionality,

- Between a simplified pro-enterprise company law code, and corporate 'reputational' risk;
- Between the extent or likely extent of malpractice, the efficacy of the solution, and the breadth of the measures proposed;
- Between the practicality of the solution proposed, in terms of 'user-friendliness', and the potential for abuse;
- Between embracing all 400 offences in company law, and an approach limited to those breaches likely to cause serious damage to the company, its stakeholders or the wider economy;
- Between public companies or large private companies and small private owner-managed companies;
- Between, reporting 'in good faith', and the threshold to be met in order to benefit from the protection proposed, i.e. 'sufficient cause' or 'likely to be true';
- Between protection of the whistleblower, and the right of the company to take action (e.g. if Authorities do not see grounds to proceed);
- Between availing of internal procedures and complaining to external authorities.

6.4.7 International Dimensions

Based on the ODCE work on this issue, the Review Group examined the existence and application of whistleblowing provisions internationally, both generally and specifically in a company law context.

English speaking countries such as the United States, United Kingdom, Canada, Australia, New Zealand and South Africa have enacted public disclosure legislation which prohibits an employer from retaliating against employees for disclosing unlawful conduct. All of these statutes cover both the public and private sectors to some extent. This legislation is broadly similar in its intent to the broad whistleblowing approach which was proposed in the 1999 Private Members Bill but which the Government decided not to pursue in 2006. Australia and the US have specific provisions relating to company law breaches. In the latter case (through the Sarbanes Oxley Act), the audit committees of 'listed' companies are required to put in place internal procedures for the reporting of specific matters.

The Review Group found no evidence of specific company law provisions in any other EU Member State. Continental European countries have, by and large, taken the non-statutory route. However, the influence of the whistleblowing provisions in Sarbanes Oxley in the US has seen some EU countries adopt some analogous provisions, while others have issued guidelines for companies that wish to implement internal whistleblowing policies without violating EU data protection law.

Experience with this legislation, especially as it has related to company law, is limited. However, some conclusions from a review of the situation in New Zealand[47] had a certain resonance for the Review Group. One conclusion that could be drawn from the issues raised and the findings of the review

[46] Government White Paper 'Regulating Better', January 2004.

[47] See ODCE Discussion Paper on www.clrg.org.

of the situation in New Zealand is that if good-faith reporting protection is to have any reality, an employee making a protected disclosure should have a statutory entitlement to a fair and expeditious investigation of the complaint. This would also be in the interests of the employer. A fair and expeditious internal investigation would also remove the possibility of unwanted external investigations. Secondly, confidentiality and anonymity are of great importance to any person making a disclosure. If, as suggested in the New Zealand Review, employees in this situation virtually always end up unemployed, this would be an undesirable 'balance of benefits'.

As stated earlier, the Review Group could find no directly applicable model due to the international absence of a company law-specific provision. There are a variety of reasons for this, ranging from the fact that a more general 'whistleblowing' law exists, to concerns about possible negative implications for investment and competitiveness.

Undoubtedly there is a risk that provisions which encourage employees to bring breaches, especially technical breaches, of company law to the attention of enforcement agencies, in an area of policy that is meant to promote enterprise, could carry serious reputational risks for the company and the economy, and thus put it at a competitive disadvantage vis-à-vis foreign operators that do not have to comply with such provisions. To have one regime for registered companies in the jurisdiction and a lighter regulatory burden on foreign companies serving the market creates an uneven playing field.

It seems clear, therefore, that internationally the trend is not to make provision for whistleblowing and employee protection within the law which relates to the registration, governance and duties of companies and their officers.

6.4.8 Risk Analysis

Having reviewed the material in the foregoing sections, the Review Group considers that the following risks attach in the event of proceeding, or not proceeding, with the introduction of whistleblowing legislation.

- **Risks of Not Proceeding with a Whistleblowing Provision**

1. There would be no specific protection for employees disclosing breaches of the Companies Acts, including for minor technical breaches, which represent the majority of the 400 offences under the Companies Acts.

2. In the circumstances, there is a risk that an employee would be victimised by his or her employer company, especially in the absence of a remedy in employment law.

3. In consequence, there is a real risk that an employee will be aware of a suspected breach of company law but will not report it.

4. The company law enforcement agencies will have to rely on their own efforts, without the help of employees, to police compliance and enforcement with company law.

5. Therefore, some individual company-specific breaches of company law might go undetected.

6. We would not gain the benefit of experiencing how such a regime might work (unless it were otherwise facilitated through some other code of law, e.g. employment law).

7. If such provision were not made, the general perception of Ireland as having a strong and well-policed company law regime would be weakened.

- **Risks of Proceeding With a Whistleblowing Provision**

1. There is risk of negative connotations attaching internationally to the heretofore positively perceived Irish business sector and to the reputation of companies. In such circumstances, there is a knock-on impact for employees, their jobs and a focus on 'wrongdoing' within the company.

2. Given the fact that no analogous provisions exist in other EU countries, Irish companies could gain a reputation, mischievously, for having an underlying disregard for good corporate governance practice, which is patently not the case.

3. Ireland's reputation as a lightly regulated economy could suffer.

4. Such loss of reputation could be used by competitor countries, especially in the field of Foreign Direct Investment.

5. Such provisions could be a disincentive to entrepreneurs or investors, to the detriment of job creation. Further, it could cause investors to re-locate business in other jurisdictions, including Northern Ireland, Scotland or Wales, where the same focus on wrongdoing in company law does not exist.

6. There is a risk that the measure will not be used for its legitimately intended purpose. Inappropriate reporting of technical breaches will damage renowned companies' reputations. Individual Irish companies could suffer a loss of market competitiveness through a damaged reputation or distraction as a result of disclosure and investigation.

7. Where a specific whistleblowing provision is created only for registered companies as proposed, it creates a divide vis-à-vis other corporate forms, such as partnerships, co-operatives, etc. Dysfunctional behaviour will be encouraged so that foreign and indigenous business might use an alternative form of corporate vehicle to the 'company'.

8. As always, there is a great risk of a disproportional effect on small business given the limited markets and small number of employees involved and the greater need for employer/employee trust.

9. There is a risk that, no matter what the law says, protection of the employee may be ineffective, resulting in no benefits, but with the attendant loss of reputation of the economy and individual companies. Skilled and mobile employees in growth sectors will be less impacted than unskilled workers in more traditional sectors.

10. There would be less incentive to resolve issues through internal procedures e.g. to directors, board or auditors, especially where the nature or extent of alleged wrongdoing is unclear.

11. There is a risk that the wrongdoer could avail of the provisions to evade action being taken against him.

12. The equitable *quid pro quo* for such a measure will be the necessity to impose a statutory obligation on employees to report suspected breaches to the separate legal entity, that is the company, in circumstances where it is not desirable that employees should be put under such a duty.

13. The corporate enforcement agencies (IAASA, ODCE, CRO, Department of Enterprise, Trade and Employment, the Irish Takeover Panel) will be obliged to expend resources on analysing and, if within their competence, investigating complaints concerning technical breaches of a complex code. For any measure to be effective, such investigation would have to be obligatory. This could lead to a distraction from more serious reported breaches or other investigations by the agencies.

14. There is a risk that the efforts to modernise, reform and simplify company law will be undone. Irish company law will be made more complicated by the housing of inappropriate provisions in the Companies Acts. There will be confusion over whether a breach of a provision in company law *can* be reported by an employee or *must* be reported by an employee.

Some members of the Review Group did not agree with some of the specific risks outlined above, but a majority agreed that the overall balance of the risks analysis was valid and justified the following conclusions and recommendation.

6.4.9 Conclusions

In conclusion, the Review Group believes that the balance of risks involved is heavily weighted against proceeding to insert specific company law whistleblowing provisions in the Companies Acts. There is no compelling public policy interest at stake. Based on available evidence, the benefits of creating such provisions are not deemed to be justified by the extent of company law malpractice in play, by their likely effectiveness, either in individual cases or in broader company law enforcement terms. Finally, given the international situation, there is no economic rationale to support Ireland's being in the vanguard on the issue.

In terms of the philosophy behind company law, and particularly in the proposals we have brought forward to modernise the code, there is a balance to be struck between the extent of malpractice, the impact of any malpractice and the penalties and the enforcement machinery in place. The Review Group believes that the balance in the new Companies Bill is correct and that, other than in the interest of ensuring a pro-enterprise code, the balance should not be disturbed unless and until there is a serious threat of major malpractice in the area of company law.

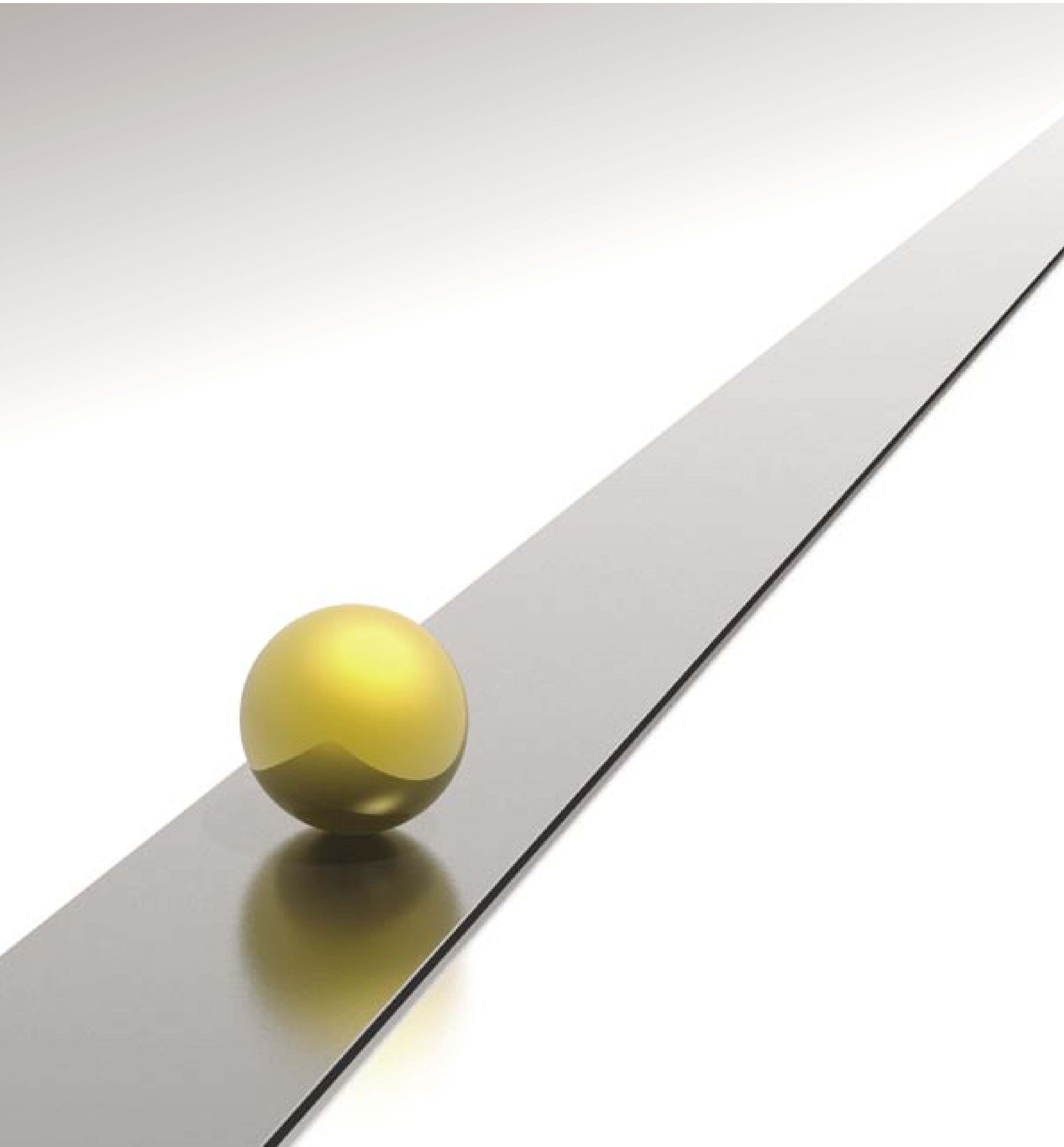
The Review Group does not believe that protection of employees against penalisation for disclosure is a matter exclusive to company law. However, as is evident from the foregoing analysis, the issue that comes to prominence in considering the question of good-faith reporting focuses more on the protection of the employee rather than the disclosure of the alleged wrong-doing that would be the subject of the good-faith reporting. As already alluded to in the earlier part of this Section, the Review Group believes that this is a matter which is not exclusive to company law; essentially it is a matter that needs consideration and resolution in the context of appropriate legislation governing the employer/employee relationship. The Review Group believes that if an appropriate way forward could be devised in such a forum, which would have application to breaches of *all* laws affecting the employer/employee relationship, and not just company law, that that would be the appropriate manner in which to address what is a difficult issue. Accordingly, the Review Group believes that this matter be further considered in that forum. The Review Group would, however, urge that any such consideration be mindful of the serious consequences, that have been outlined in this Section, that could arise from legislating in this area.

6.4.10 Recommendation

Taking into account the degree of malpractice, the required nature and extent of the disclosure, the reputational risk for companies and the extra resources, or diversion of resources, for the enforcement agencies, the Review Group's majority recommendation is that a company law-specific whistleblowing provision should not be included in the new Companies Consolidation and Reform Bill.

Chapter 7:

Modernisation Issues



Chapter 7 : Modernisation Issues

7.1 Introduction

7.2 Prohibition on Company Transactions with Directors and Connected Persons

7.3 Financial Assistance in connection with the Acquisition of Shares

7.4 Preferential Payments in a Winding-Up or Receivership

7.5 Distributions and Share Capital

7.1 Introduction

At the request of the Minister for Trade and Commerce, the Company Law Review Group examined a number of provisions of the Companies Acts which were identified by various users of company law as matters that added cost to doing business, involved an element of administrative bureaucracy and had the potential to interfere with the efficient conduct of business, without necessarily providing any particular benefits.

The objective was to examine legislative provisions to see whether such provisions might benefit from amendment in order to make Ireland more competitive.

In conducting such analysis, the Review Group was cognisant of its statutory remit in section 68(2) of the 2001 Act which requires the Review Group in advising the Minister to seek to "promote enterprise, facilitate commerce, simplify the operation of the Companies Acts, enhance corporate governance and encourage commercial probity".

The Review Group acknowledges that Ireland competes for economic activity in every sphere and that competitiveness, including competitiveness in the State's commercial laws, has been identified as key in a number of other European countries – e.g. in the UK, company law reform was organised under the heading of *Modern Company Law for a Competitive Economy.* Similarly, the new Member States have been making great efforts to ensure that they transpose EU legal measures on time in order to maximise commercial advantage.

The Review Group believes that it does not automatically follow that deregulation of a particular part of a legal regime will improve competitiveness and it is committed to developing and maintaining a quality legal environment in Ireland which it believes is imperative in the new Europe and indeed the global economy.

In the context of ensuring a modern and competitive corporate governance regime, the Review Group examined four issues:

- prohibitions on company transactions with directors and connected persons;
- financial assistance by a company in connection with the acquisition of its own shares;
- preferential payments in a winding-up or receivership;
- distributions and share capital.

7.2 Prohibition on Company Transactions with Directors and Connected Persons

7.2.1 Introduction

At present, these provisions are found in Part III of the 1990 Act (Head 17, Part A5 of the Companies Consolidation and Reform Bill). The cumulative objective of these provisions is to ensure fair dealing by directors. Whilst the common law prohibits self-dealing by directors without the consent of shareholders, in the 1990 Act it was decided that certain transactions should be prohibited, regardless of the shareholders' wishes, in recognition of the fact that in many companies the shareholders were the directors in whose favour such transactions would be made. Part III of the 1990 Act attempts to strike a balance between the regulation of self-dealing by directors and the unnecessary regulation of *bona fide* commercial transactions.

The current effect of section 31 of the 1990 Act in particular can be to adversely affect routine transactions, such as money flows in joint ventures. The Review Group was also influenced by the fact that the UK has recently amended its comparable law, both widening and lightening it.

7.2.2 Current Position

Section 31 of the 1990 Act, in summary, prohibits a company from:

(a) making a loan or a quasi-loan;
(b) entering into a credit transaction as creditor; or
(c) entering into a guarantee or providing security in connection with a loan, quasi-loan or credit transaction made by any other person,

to or for a director of the company, a director of its holding company or a person connected with such a director.

There are a number of exceptions to the general prohibition i.e.:

– Loans, quasi-loans and credit transactions to directors or persons connected with directors are permitted where the total value of the arrangement (and any other arrangements) is less than 10% of the company's relevant assets;

– Guarantees and the provision of security in connection with a loan, quasi-loan or credit transaction made by any person for a director of the company or of its holding company or for a person connected with such a director, is permitted where the members resolve by special resolution in favour of the transaction and the directors swear a statutory declaration of solvency;

– All or any of the prohibited transactions (loans, quasi-loans, credit transactions and guarantees and the provision of security in connection with loans, quasi-loans and credit transactions) are permitted where entered into or made by a company in favour of its holding company, subsidiary company or to a fellow subsidiary company in its group of companies;

– Nothing in the prohibition shall prohibit a company from doing anything to provide any of its directors with funds to meet vouched expenditure properly incurred or to be incurred for the purposes of enabling the director properly to perform the director's duties; and

– Loans, quasi-loans and credit transactions by a company in favour of a director or person connected with a director which are entered into in the ordinary course of business and at arms' length.

7.2.3 Position in Other Countries

The Review Group looked at the law applying in two jurisdictions, New Zealand and the United Kingdom.

<u>New Zealand</u>

Section 161 of New Zealand's Companies Act 1993 provides *inter alia* that—

(1) The board of a company may, subject to any restrictions contained in the constitution of the company, authorise—

...(c)the making of loans by the company to a director;

(d) the giving of guarantees by the company for debts incurred by a director;

if the board is satisfied that to do so is fair to the company.

...(4) *Directors who vote in favour of authorising a payment, benefit, loan, guarantee, or contract under subsection (1) of this section must sign a certificate stating that, in their opinion, the making of the payment or the provision of the benefit, or the making of the loan, or the giving of the guarantee, or the entering into of the contract is fair to the company, and the grounds for that opinion.*

<u>United Kingdom</u>

The United Kingdom recently altered its law. Section 330 of the UK Companies Act 1985 prohibited any company from making loans to directors and any "relevant" company from making a quasi-loan or entering into a credit transaction, or entering into a guarantee or providing any security in connection therewith, subject to exceptions not dissimilar to those at present in Irish law. (That said, the 10% of net assets exception is unique to Ireland).

A "relevant company" under section 331(6) of the UK 1985 Act meant a company which was:

– a public company; or

– a subsidiary of a public company; or

– a subsidiary of a company which has as another subsidiary a public company; or

– has a subsidiary which is a public company.

The new UK Companies Act 2006 amends the statutory rules to provide scope for shareholders' approval and some changes to the exemptions. The Companies Act 1985 outright prohibition on loans to directors is replaced by a requirement for shareholders' approval.

– A UK company may not –

  (a) make a loan to a director of the company or of its holding company, or

  (b) give a guarantee or provide security in connection with a loan made by any person to such a director,

unless the transaction has been approved by a resolution of the members of the company.

– A UK public company (or company associated with a public company) may not–

  (a) make a quasi-loan to a director of the company or of its holding company, or

  (b) give a guarantee or provide security in connection with a quasi-loan made by any person to such a director,

  (c) enter into a credit transaction as creditor for the benefit of a director of the company or of its holding company, or a person connected with such a director, or

  (d) give a guarantee or provide security in connection with a credit transaction entered into by any person for the benefit of such a director, or a person connected with such a director,

unless the transaction has been approved by a resolution of the members of the company.

7.2.4 Issues Arising

7.2.4.1 The Need for Regulation

In the ODCE's view, despite the enactment of Part III, and the very considerable attention paid to it (especially since 2001), the propensity for at least some controlling directors to feel entitled to use money belonging to their company as if it was their own (and not that of the separate legal entity which is the company), remains something that the law needs to regulate appropriately. From its inception, the ODCE has observed non–compliance with the requirements of section 31 as reported by auditors discharging their statutory role under section 194(5) of the 1990 Act (as amended). The number of reports (both in absolute and relative terms) and the scale of the underlying loans (so far as the ODCE has been able to ascertain them) have been considerable.

It should be pointed out, however, that the existing provisions prohibiting loans to directors, in fact, do not address an equally important mischief which the law purported to address. A loan between unconnected persons will be in writing and have certainty as to the parties, the amount of the loan, a repayment date or contingency and ancillary terms. The mischief spoken of by many commentators on this law and its enforcement is in fact being critical of inchoate indebtedness arising by reason of loose accounting practices or the absence of any proper accounting.

It is fair to observe that the argument that loans made to directors constitute assets of the company does not reflect the likelihood, or at least the possibility, that such loans may never be repaid. In a number of cases reported to the ODCE, the level of loans given to the company's directors has been such that, if they were removed from the company's balance sheet, the extent of the company's net assets would be reduced considerably – sometimes even by turning the net assets (as per the company balance sheet) into net liabilities.

The extent to which a loan to anyone is truly an asset of the lender obviously depends on the extent to which the borrower will be genuinely able to repay it as it falls due. Where loans by owner-controlled companies to their directors are concerned, the Review Group believes that an important factor to be borne in mind is that the event on which the repayment of the loan will most likely be needed is upon the insolvency of the company. However, in such a situation it may well be the case that the directors who were the beneficiaries of the loans are the same persons who have been required to give personal guarantees to banks to secure the company's corporate borrowings. The existence of such guarantees may well limit the extent to which the directors will therefore be able to repay the borrowings they received from their former companies – especially if those borrowings were used otherwise than for the acquisition of tangible assets which have continued to hold their value.

If it is proposed to facilitate the making of a loan by a company to a director, or more correctly speaking, to permit an indebtedness (actual or contingent) to arise on the part of the director in favour of the company, then it ought to be permitted only when such a transaction is not adverse to the company's interests.

7.2.4.2 *Bona Fide* Transactions

The prohibition in section 31 of the 1990 Act operates to prevent companies from entering into any of the prohibited transactions or arrangements in favour of directors or persons connected with directors and in so providing, prevents companies from entering into many innocent or *bona fide* transactions where neither the company's creditors nor any other stakeholders will be prejudiced. A loan to a director or person connected with a director will only prejudice creditors where (a) a company having made such a loan becomes insolvent and (b) the loan is not repaid. A credit transaction, such as a lease of land, will only prejudice creditors where it does not reserve a market rent and guarantees and security will only be prejudicial to creditors when they are called upon, the company becomes insolvent and the company does not recover the monies expended from someone else.

Directors owe duties to their company not to abuse their position or divert company property. With the enactment of the new Companies Consolidation and Reform Bill, these duties will be both amplified and enshrined in statute (see Head 9 of Part A5[48]). The United Kingdom has substantially removed the equivalent prohibition on transactions involving the directors of UK private companies and the Review Group considered whether this was also an option for Ireland.

While loans to directors have been all but prohibited since the commencement of the 1990 Act, it has always been the law that companies may, where permitted by their objects clause and authorised by their directors and shareholders, make gratuitous dispositions.

Where loans are repaid or where a liquidator has an enforceable right to sue a director for repayment of a loan, the creditors of an insolvent company must, by definition, be better off than if the company had made a gratuitous disposition of its assets.

Finally, the Review Group was influenced by the importance of transparency in the whole process of loans being made by companies to directors and vice-versa. It was considered that the making public of the existence of such a loan when it was made could alert third parties dealing with the company to a transaction involving a director and that sacrificing privacy in favour of transparency could justify the lightening of the prohibition.

7.2.4.3 Limiting or Abolishing the Prohibition

It could be argued that rules against self-dealing should apply only to public companies or companies connected with public companies, along the broad lines chosen by the UK in 1985 or the more nuanced lines in their 2006 Act. As against such an argument, it appears to be the case that transactions in the past which would be in breach of these provisions have tended to add to the difficulties in all companies, regardless of whether they are public or private.

48 http://www.clrg.org/companiesbill.

This debate as to a different applicability of the law to public companies took place prior to the enactment of the 1990 Act, the general thrust of the conclusion of which being that the paucity of public companies and the prevalence of private companies in trouble indicated a general application of the prohibition.

The Review Group did consider whether the corporate environment of Ireland in 2008, nearly 20 years after the introduction of the Bill which was to become the Companies Act 1990, required such a law. Would it not be satisfactory to rely on the environment of disclosure (through accounts) and enforcement (through the ODCE)? The Review Group came to the conclusion that the law should provide a compass away from the type of self-dealing behaviour which was outlawed by section 31, however bluntly.

7.2.5 Conclusion and Risk Analysis

A number of potential outcomes of the Review Group's deliberations were discussed:

- that the law be left unchanged; or
- that the law be repealed altogether; or
- that the general prohibition be relaxed; or
- that the exceptions to the general prohibition be widened; or
- that the exceptions to the general prohibition be widened so as to target prejudicial conduct but also introducing a new more targeted requirement to address a mischief that the Review Group identified in its review of the law in this area.

In parallel with such overall outcomes, consideration was given to specific drafting issues which might deal with some of the hard cases that arise.

The Review Group is of the view that, central to all breaches of the prohibitions on loans and quasi-loans, etc., was the informality of the indebtedness which arose. In a sense, if the loan were a true loan, with all the incidents of a loan – an amount to be lent, an interest rate, repayment dates and covenants relevant to the continuance of the loan – then that would be an improvement. The thrust of law in this area has been to remind incorporators that company law means that the company is a separate legal entity and the funds of the company are not the funds of the incorporators.

A prevalent ethic underpinning breaches of these provisions is a disregard of the corporate existence of the company, with directors routinely running a directors' drawings account or a directors' loan account, which is rectified around financial year-end.

As a final observation, the Review Group noted both the ODCE information as well as anecdotal evidence pointing to most insolvent companies having loans *by* rather than *to* the directors. The effect of this is to include an insolvent company's directors among the ranks of its creditors and allowing them to share *pari-passu* with those creditors.

The Review Group believes that the general prohibition on loans, etc. to directors and persons connected with directors should be retained. The Review Group has concluded, however, that the existing regime can and should be adjusted by widening the exceptions to the prohibition whilst at the same time tightening the evidential requirements concerning arrangements and transactions between directors and their companies. The Review Group would stop short of making enforcement dependent upon transactions or arrangements being in writing but would reward certainty (through the reduction of terms and conditions to writing) and transparency by giving evidential advantage. Similarly, the absence of certainty or transparency would attract evidential disadvantage.

The Review Group considered the risks of proceeding with the proposed reforms against the risks of not proceeding:

- **Risks of Proceeding with Proposals**

1. The new evidential presumptions where loans and other transactions to or from directors and connected persons are not made or evidenced in writing, will become an additional administrative burden on companies.

2. The extension of the exemptions to the prohibition on self-dealing will permit unscrupulous directors to make loans and enter into other transactions that they cannot currently make and enter into, to the detriment of creditors.

- **Risks of Not Proceeding with Proposals**

1. There will be no incentive for directors and their companies to document in writing transactions and arrangements *inter se*, with the consequence that the uncertainty surrounding transactions and arrangements, especially loans, from (and to a lesser extent to) directors caused by the

absence of a written record, will continue.

2. The absence of encouragement to document self-dealing leaves it open to the unscrupulous and dishonest directors to both (a) assert fictitious claims against a company's assets and (b) deny the existence of actual debts owed to the company, to the detriment of creditors and other stakeholders.

3. The recent changes to the law in the United Kingdom, upon which the Irish legislation was, in the first instance based, will make Ireland a harder place to do business with more obstacles to doing business.

4. An opportunity will be lost to strike a more appropriate balance between regulation and ease of doing business.

5. *Bona fide* commercial transactions will be prevented by unnecessary regulation.

The Review Group considers that the risks of not proceeding are more serious than the risks of proceeding and believes that the risk analysis supports the proposals it is now putting forward for reform.

7.2.6 Recommendation

The Review Group proposes that the following changes be made to the law relating to loans to directors:

That the general prohibition be retained in its current form and in its current application to directors and persons connected with directors as proposed in Head 17 of Part 5 of Pillar A of the General Scheme of the Companies Consolidation and Reform Bill[49].

(a) Where it is claimed that a company has made a loan or a quasi-loan in favour of a director of the company and where the terms of that loan or quasi-loan are not in writing or where they are in writing but ambiguous, there will be a rebuttable presumption in favour of the company that such loan or quasi-loan is repayable on demand and that until it is repaid, it bears interest at a commercial rate. For the purpose of this provision "director" shall include a director of the company, a director of its holding company, a shadow or *de facto* director of either and a person connected with such a director.

(b) Where it is claimed that a director or person connected with a director has made a loan or quasi-loan in favour of that director's company and where the terms of a loan or quasi-loan are not in writing or where they are in writing but ambiguous, there will be a rebuttable presumption in favour of the company that no loan or quasi-loan was in fact made to the company and where it is shown that a loan or quasi-loan was made to the company, there should be a further rebuttable presumption that any such loan or quasi-loan is interest free, unsecured and subordinated to all other indebtedness of the company. For the purpose of this provision, "director" shall include a director of the company, a director of its holding company, a shadow or *de facto* director of either and a person connected with such a director.

(c) That the existing exception in section 32 of the 1990 Act (Head 18, Part A5 of the General Scheme of the Companies Consolidation and Reform Bill) be extended to include guarantees and the provision of security in connection with loans, quasi-loans and credit transactions, so that it will apply to all facets of the prohibition.

(e) That the existing exception in section 34 of the 1990 Act (Head 20 of Part A5 of the General Scheme of the Companies Consolidation and Reform Bill) be extended to include loans, quasi-loans and credit transactions and not just confined to guarantees and the provision of security in connection with loans, quasi-loans and credit transactions, so that it will apply to all facets of the prohibition.

(f) That the existing exception in section 35 of the 1990 Act (Head 21, Part A5 of the General Scheme of the Companies Consolidation and Reform Bill) be clarified by making clear the intention that it may be invoked by a company in favour of any body corporate that is its holding company, subsidiary company or sister subsidiary company, wheresoever incorporated.

(g) That the existing exemption in section 37 (Head 22, Part A5 of the General Scheme of the Companies Consolidation and Reform Bill)
(i) be extended to include guarantees and the provision of security in connection with loans, quasi-loans and credit transactions, so that it will apply to all facets of the prohibition

[49] http://www.clrg.org/companiesbill.

and (ii) be amended so that the alternative requirement that an exempt business transaction be 'reasonable' be changed instead to 'not unreasonable'.

7.3 Financial Assistance in connection with the Acquisition of Shares

7.3.1 Introduction and Current Position

The prohibition on financial assistance by a company in connection with the purchase of, or subscription for, its own shares was originally set out in section 60 of the 1963 Act.

The section 60 provisions were overhauled in the 2005 Act. (Head 15 of Part A3 of the General Scheme of the Companies Consolidation and Reform Bill[50] embodies the revised provisions).

The history of this law is that the integrity of the share capital of the company was perceived to be central to creditor protection. The 2005 Act removed the prohibition in many situations, incidental to an acquisition, where it had caused difficulty.

At EU level, the provision by a company of financial assistance is regulated only in public limited companies, so EU Member States are at liberty to permit or prohibit such assistance in private companies or unlimited companies.

The Review Group noted that in a number of other countries (notably in the USA) there was no comparable law. However, it also noted that in many European jurisdictions of similar size to Ireland there is an absolute prohibition on financial assistance[51].

In the UK, the law has been overhauled in the Companies Act 2006 (sections 677 *et seq*) to the effect that private companies can provide financial assistance for the purpose of the acquisition of their own shares or the shares of their holding companies, provided their holding company is not a public company.

7.3.2 Issues Arising and Risk Analysis

The primary rationale for having restrictions on a company giving financial assistance for the purchase of or subscription for its shares (or the shares of its holding company) is the requirement to protect the company's members and creditors as well as to ensure that the giving of financial assistance will not result in the company's insolvency with loss to its members or creditors.[52] The validation procedure[53] imposes a duty on the directors to consider the details of the transaction in question and the implications for them should the company

[50] http://www.clrg.org/companiesbill.

[51] For example Belgium, Denmark, Finland and Norway.

[52] See the United Kingdom Report of the Company Law Amendment Committee, HMS0 Cmd 2675 (1926) (the Greene Committee) para 30 and 31 which considered financial assistance to be "highly improper" and "open to the gravest abuses"; Report of the Committee on Company Law Amendment (Cohen Report 1945) Cmd 6659 of 1945 para 170 which recommended the extension of the UK prohibition to subscriptions; Report of the Company Law Committee (Jenkins Report 1962) Cmd 1749 of 1962 para 170 to 187 – "If people who cannot provide the funds necessary to acquire control of a company from their own resources, or by borrowing on their own credit, gain control of a company with large assets on the understanding that they will use the funds of the company to pay for their shares it seems to us all too likely that in many cases the company will be made to part with its funds either on inadequate security or for an illusory consideration. If the speculation succeeds, the company and therefore its creditors and minority shareholders may suffer no loss, although their interests will have been subject to an illegitimate risk; if it fails, it may be little consolation for creditors and minority shareholders to know that the directors are liable for misfeasance. In recent times there have been some flagrant abuses of this kind to the serious detriment, particularly, of minority shareholders"; and in Ireland the Report of the Company Law Reform Committee 1958 (Pr 4523) (the Arthur Cox Report) para 73 and 74.

[53] Reference First Report of the Company Law Review Group, Chapter 5, page 81 and now embodied in Chapter 7, Head 71, Part A4 of the General Scheme of the Companies Consolidation and Reform Bill, www.clrg.org.

become insolvent. The validation procedure means, firstly, the members are obliged to approve of the assistance (with appropriate safeguards for minority interests) and, secondly, the directors of the company are obliged to consider carefully the implications of the giving of financial assistance and the potential difficulty they would encounter should the company become insolvent.

There is a view that the liquidator's duty to report on insolvent liquidations to the ODCE and the resulting Court application involving the disqualification or restriction of directors will concentrate the mind of each director in carrying out his or her duty. However, the validation procedure, apart from protecting members and creditors, is a sound corporate governance procedure and the Review Group believes that it has worked well in practice.

Unlike the position in the United Kingdom, where its application required all of the company's directors (rather than a majority of the directors) to make a declaration and the completion of an auditors' report, the validation process in Ireland is simpler and less onerous, both in terms of cost and executive time.

Furthermore, the recent changes introduced by the 2005 Act have, as indicated, reduced the number of circumstances where the validation procedure is required (the 2005 Act repealed the requirement of validation for transactions which were not core to the rationale for the restriction).

The words "in connection with" used by section 60 of the 1963 Act have been described in a High Court judgment as being "of wide import"[54]. Such language, in practice, results in the validation procedure being complied with to avoid any doubt, notwithstanding that many such validated transactions would not have been perceived by the legislature as a transaction giving rise to financial assistance, in the first place. This is no criticism of such transactions being validated. Banks and other commercial entities want certainty that the security being relied upon will not be invalidated by a decision of the Court that a corporate governance process should have been carried out. Accordingly, the section should be restricted to financial assistance (within the meaning of that term in the legislation) used directly or indirectly for the purpose of the acquisition of shares. The emphasis should be on "the purpose" rather than "in connection with", the latter being words used in the initial UK Report giving rise to the restriction (which did not use the word "purpose")[55]. The current section 60 has "purpose of or in connection with", following the language of the UK's Companies Act 1929, which extends the ambit of legislation giving rise to the restriction beyond what is either sensible or necessary for the protection of members or creditors[56].

7.3.3 Conclusion and Recommendation

Having considered the matter, the Review Group recommends as follows:

(a) Section 60(1) of the 1963 Act be amended by the repeal of the words "or in connection with".

(b) The law outlawing financial assistance in connection with subscriptions for shares in public companies should be mitigated to the fullest extent. Some amendments should be made to the exceptions in section 60, in particular to provide expressly for brokerage and commission in the terms of the recently repealed section 59 of the 1963 Act.

(c) The prohibition on financial assistance in connection with the purchase of shares will not prohibit a company from giving financial assistance for the purchase of shares in itself or its holding company if—

  (i) the company's principal purpose in giving the assistance is not to give it for the purpose of any such acquisition, or
  (ii) the giving of the assistance for that purpose is only an incidental part of some larger purpose of the company, and
  (iii) the assistance is given in good faith in the interests of the company.

[54] Murphy J in *Eccles Hall Ltd v the Bank of Nova Scotia, Paramount Enterprises Ltd and O'Keeffe* H.C. 3 February 1995.

[55] The Greene Committee (1926).

[56] The words "in connection with" were in the UK Companies Act 1948 s 54 but removed by the replacement s 42 of the Companies Act 1981.

7.4 Preferential Payments in a Winding-Up or Receivership

7.4.1 Background

Section 285 of the 1963 Act, as amended and supplemented by an accumulation of accompanying legislation, contains a diverse panorama of preferential payments, from tax to rates to employee remuneration to certain awards to employees under social legislation. The proliferation of preferences under section 285 has occurred in a piecemeal fashion. Whilst some of the measures in this accumulated *acquis* may have been carefully considered, the Review Group has been unable to discern any perceptible effort to take an overall strategic approach to these provisions.

In a company winding-up situation, the most prominent area of creditor preference concerns the Revenue Commissioners' preferential status in relation to taxes, primarily, e.g. PAYE/PRSI, VAT and Corporation Tax. As requested by the Minister, the Review Group is examining this issue because of its company law implications, notably in terms of its implications for company liquidations and creditors generally. As we discuss later, however, there are also tax policy and wider socio-economic implications to be considered, but which are not within the remit of the Review Group.

In the Second Report of the Review Group at paragraphs 4.18 *et seq*, the Review Group considered the issue of Revenue Preference in the light of then recent developments in the UK, and came to the conclusion that preferential status for the Revenue Commissioners should be retained.

The Review Group has decided to re–examine preference payments on two levels. First, there is the issue as to whether there ought to be preferential payments at all, in particular in favour of taxation authorities, who, it can be argued, have considerably greater means at their disposal to collect money than many or most unsecured creditors. Secondly, there is great disorder in the classes of preferential payments and the Review Group saw merit in considering how to simplify whatever class(es) of preferential payments as are considered worth keeping.

7.4.2 Introduction - Section 285 of the 1963 Act

In a winding-up or receivership, as a matter of law, the priority of the insolvent company's creditors is as follows:

- the Revenue Commissioners, in respect of deductions from employees' salaries in respect of social welfare contributions of employees;
- the Revenue Commissioners in respect of PAYE and VAT, in respect of moneys recovered from the holder of a charge which includes a fixed charge over book debts;
- creditors secured by a pledge, lien, mortgage or fixed charge in respect of assets the subject of such security;
- creditors whose debts are preferential payments under section 285 of the 1963 Act, as amended, and other complementary legislation;
- creditors secured by a floating charge in respect of assets the subject of such security;
- unsecured creditors.

As a matter of practice, certain creditors can in fact achieve a better position in a number of ways:

– the Revenue Commissioners have elevated powers of attachment arising under section 1002 of the Taxes Consolidation Act 1997 in a pre-liquidation situation;
– suppliers can reserve title to assets supplied to the company pending payment in full for all sums owing to them;
– creditors can exercise a lien over an important asset in their custody;
– creditors who establish a proprietary interest in the property, for example, through the operation of a tracing remedy.

The Review Group approached the issue of preference by reference to whether the State should reinforce any unsecured creditor advantage through company law and bearing in mind that in an insolvent liquidation or receivership, if any one otherwise unsecured creditor is given an advantage, it means that another unsecured creditor is likely to be put at a disadvantage.

7.4.3 Historical Background and Current Position

The origin of the Crown's right of preferential payments in insolvency appears to arise from the King or Queen's pre-eminence over all subjects in the lands governed by the monarch[57]. The Courts consistently applied this principle[58]. As the duties and responsibilities of the monarch were divested, specific legislation was enacted to give priority to its organs and, for public policy reasons, individuals for unpaid wages[59].

In 1958 *The Company Law Reform Committee*[60] recommended that the list of debts accorded preferential status should be amended to remove preferential status for all debts payable to the State[61] (other than rates[62]). In the view of the Committee, *"…the priority given to sums due to the Central Fund inflicts hardship and injustice on many small investors: it cannot seriously be contended that small traders are in a better financial position to bear the loss than is the Central Fund"*. However, they recommended the retention of preferential status for employees and an increase in the limit protected.

In 1972 the *Bankruptcy Law Committee*[63] considered the issue of preferential creditors in the context of personal bankruptcy law. It concluded with a "Major Recommendation" that "Preferential Payments of all kinds should be abolished"[64]. In the subsequent Bankruptcy Act 1988, the retention of preferential creditor status in bankruptcy was defended, *inter alia,* on the rather circular basis that if preferential status were abolished in bankruptcy, it could hardly be defended in corporate insolvency.

In 1994, an *ad hoc* Company Law Review Group[65] rejected a proposal that preferential status be extended to farmer creditors.

Lynch, Marshall, O'Ferrall in *Corporate Insolvency and Rescue*[66] set out the issues in the policy decision to be made. The authors do not firmly conclude regarding the appropriateness of preferential status, however, the clear weight of the arguments raised is against preferential status.

Section 285 of the 1963 Act as originally enacted, provided for a limited class of unsecured creditors to have a preference over other unsecured creditors and creditors secured by a floating charge. This section has been amended, and in various other statutes, notably those concerned with employee rights, preferential status has been afforded to payments to be made under those Acts

The preferred creditors are set out in the following Table.

57 See for example the judgment of Kingsmill Moore J in *re Irish Employers Mutual Insurance Association Limited [1955]* IR 170 and the Report of the Bankruptcy Law Committee (1972) ch. 55.
58 For an early decision see *Stringfellow v Brownsoppe* (1550) 1 Dyer 67b.
59 See Preferential Payments in Bankruptcy (Ireland) Act 1889.
60 Chaired by Arthur Cox, Pre. 4523.
61 Other than Schedule A income tax.
62 "we would make a similar recommendation in relation to rates due to a local authority were it not for the great difficulties in title and conveyancing which the abolition of this preference would cause." (para 203).
63 Chaired by Mr Justice Budd Pre. 2714.
64 Chapter 55
65 Chaired by James Gallagher.
66 Butterworths 1996 at para 4.46 to 4.53.

Preferred Creditor	Nature of Debt	Maximum Amount	Applicable Law
Local Authority	Unpaid rates	Not more than one year's rates	Companies Act 1963, s 285(2)(a)
Revenue Commissioners	Corporation tax on profits and capital gains	The largest amount of tax assessed in any year of assessment	Companies Act 1963, s 285(2)(a)(ii)
Revenue Commissioners	Value Added Tax	Amount becoming due in 12 months prior to commencement of winding up	Finance Act 1972, s 62
Revenue Commissioners	Income tax of employees to be deducted at source (PAYE)	Amount becoming due in 12 months prior to commencement of winding up	Taxes Consolidation Act 1997, s 995
Employees	Unpaid wages of any "clerk or servant" 4 months before the commencement of winding up	€3,174.35	Companies Act 1963, s 285(2)(b)
Employees	Unpaid wages of any "workman/labourer" in respect of services rendered to the company 4 months before the commencement of winding up	€3,174.35	Companies Act 1963, s 285(2)(c)
Ex– employees	Company's contribution to redundancy payments	€3,174.35	Redundancy Payments Act 1967, s 42
Employees	Accrued Holiday remuneration becoming payable to any "clerk/ servant/ labourer" on the termination of employment before or by effect of the winding up	None	Companies Act 1963, s 285(2)(d)
Social Welfare Authorities	Employers' PRSI contribution; National training levy	Not Applicable	Companies Act 1963, s 285(2)(e)(i) and (ii); Social Welfare Consolidation Act 1993, s 16
Employees or ex– employees	Damages for personal injuries	None[67]	Companies Act 1963, s 285(2)(f) and (g)

[67] Civil Liability Act 1963, s 62: "Where a person (hereinafter referred to as the insured) who has effected a policy of insurance in respect of a liability or a wrong …… if a corporate body, in wound up …… moneys payable to the insured under the policy shall be applicable only to discharging in full all valid claims against the insured in respect of which those moneys are payable, and no part of those moneys shall be assets of the insured or applicable to the payment of the debts (other than those claims) of the insured …… in the winding– up or dissolution, and no such claim shall be provable in the …… winding up or dissolution.

Preferred Creditor	Nature of Debt	Maximum Amount	Applicable Law
Ex– employees	Compensation for unfair dismissal	104 weeks' remuneration	Unfair Dismissals Act 1977, ss 7 and 12
Employees or ex– employees	Payments in lieu of notice	8 weeks' remuneration[68]	Minimum Notice and Terms of Employment Act 1973, s13
Female employee or ex– employee	Compensation for failure to provide maternity leave	20 weeks' remuneration[69]	Maternity Protection Act 1994, ss 32(30 and 36
Employee or ex– employee	Compensation for failure to provide adoptive leave	20 weeks' remuneration[70]	Adoptive Leave Act 1995, ss 33(3) and 38
Employee or ex– employee	Compensation for failure to provide parental leave	20 weeks' remuneration[71]	Parental Leave Act 1998, ss 21(2)(a) and 24(1)
Employee or ex– employee	Arrears of minimum wage	None	National Minimum Wage Act 2000, s 49
Employee or ex– employee	Compensation for failure to provide carer's leave	26 weeks' remuneration[72]	Carers Leave Act 2001, ss 21 and 25(1)
Employee, ex– employee, person not engaged as an employee	Compensation for breach of the Employment Equality Act	None	Employment Equality Act 1998, s103
Pension fund of an employee or ex– employee	Payments due pursuant to arrangements concerning a personal retirement savings account (PRSA) whether the company's contribution or amount deducted from employees' salaries	None	CA 1963, s 285(2)(j), inserted by the Pensions Act 1990, s 121, as itself inserted by the Pensions (Amendment) Act 2002, s 3

[68] Statutory provision, although higher amounts have been awarded by the Employment Appeals Tribunal.
[69] being increased to 104 weeks remuneration by the Employment Law Compliance Bill 2008.
[70] being increased to 104 weeks remuneration by the Employment Law Compliance Bill 2008.
[71] being increased to 104 weeks remuneration by the Employment Law Compliance Bill 2008.
[72] being increased to 104 weeks remuneration by the Employment Law Compliance Bill 2008.

7.4.4 Issues Arising

The Review Group examined the issue of preferential payments under the following headings:

- arguments in favour of Revenue preference
- arguments in favour of other preference
- arguments against preference
- experience in other jurisdictions

7.4.5 Arguments for Revenue Preference – The View of the Revenue Commissioners

The Review Group received the following representations from the Revenue Commissioners, arguing against the abolition of the Revenue preference.

Views of the Revenue Commissioners

The Revenue Commissioners wishes to make it clear that Revenue preference represents a strategic imperative in its efforts to collect corporate debt and that it was not prepared to acquiesce to its abolition or to any material change in its status.

Impact on Business and the Community of the Abolition of Revenue Preference

1. In Ireland the role of the ODCE in insolvency matters is in an early development stage and the reality is that Revenue is the only arm of the State that finances liquidations in seeking to have the liquidators, ODCE and ultimately the courts determine the culpability of errant directors. This results in:-

   • Section 150– (Restriction) - The Court determining whether the directors have acted honestly and responsibly in relation to the affairs of the company; and

   • Section160- (Disqualification) - The Court determining whether the directors have acted fraudulently or negligently.

   In the absence of Revenue Preference, Revenue is less likely to finance the liquidation process to the same degree as heretofore, particularly where it comes to financing disqualification proceedings against directors. The fact that fewer disqualification actions might be taken by liquidators against directors would reflect badly on Ireland's corporate image and would almost certainly result in errant directors continuing to operate as directors in other companies, to the detriment of the business community as a whole. Revenue has been to the forefront in this area and has sent a clear message to company directors that their actions are open to challenge. Preferential status facilitates Revenue in undertaking such action by ensuring that there is a benefit to outweigh or sometimes offset the cost.

2. Revenue is regarded by the Courts as a representative creditor and through involvement in Committees of Inspection, Revenue works to ensure that all creditors get maximum benefit from liquidations. Clearly in the absence of their preferential status, Revenue's capacity for and inclination towards monitoring of the insolvency process would be negatively impacted were it not to have preference. This would have a detrimental effect on the liquidation process, as the reality is that often, were it not for the presence of Revenue at creditor meetings, no substantive questioning of directors would take place, nor would Committees of Inspection be formed. Revenue, as a member of Committees of Inspection, looks not simply to recover their own debt but has regard to the debt owed to all creditors.

3. Revenue's preferential status was designed to compensate for both the nature of the debt and Revenue's special position as a creditor. The abolition of Revenue Preference would undoubtedly impact on the business dynamic between Revenue and its customers. Loss of preference for Revenue would lead to a review by Revenue of the extent of the flexibility and timeframe it affords companies at present in trying to address trading difficulties and ultimately would be very likely to lead to earlier liquidation action by Revenue. In the absence of its preferential status, Revenue, in order to protect its debt, is likely to have to reduce the breathing space that can currently be afforded companies in cash flow difficulties. This would also undoubtedly result in Revenue being less inclined to allow phased payment arrangements to companies and would in turn give rise to earlier enforcement action.

4. The loss of Revenue Preference would only act to the benefit of floating charge holders and not to the benefit of unsecured creditors. It would be seen by the general public and businesses

as simply aiding the financial institutions in recovering their debt. Financial institutions typically secure the bulk of their debts by means of fixed charges and personal guarantees from the directors. It would be difficult to justify a State subsidy for these groups of creditors

5. The fact that the unsecured creditors would not benefit from the loss of Revenue Preference, means that the risk to the wider community of creditors of companies going into liquidation is not reduced by any abolition proposal. If small business creditors are to be helped in an insolvency situation then it is reasonable that the financial institutions be seen to play their part in alleviating the pain of the small business creditor.

6. The general public would also legitimately view the abolition of preference as simply denying the exchequer legitimate debts due (principally VAT and PAYE) which is collected but not remitted by insolvent companies, and instead, passing this money on to financial institutions as floating charge holders. The abolition of Revenue Preference would create a perception that it is acceptable to retain and not pay over such taxes and might actively encourage non-compliance. In this regard, public reaction to the abolition of Revenue Preference is likely to be highly critical.

7. The Social Welfare (Consolidation) Act 1993, section 16, provides for "super-preferential" status for unpaid employees' PRSI contributions. Were this preferential status to be abolished it would affect the Social Insurance Fund. This would be a negative development, particularly in the current more difficult business climate and the vulnerability of jobs in an open economy.

8. The abolition of Revenue Preference would leave a tax shortfall that, though not enormous in the context of overall tax receipts, would still have to be met from elsewhere. The fact that this could impact on all other compliant taxpayers/businesses, would be seen as anti-competitive. Moreover, maintaining Revenue's legal capacity to secure the payment of trust taxes, from a small minority, protects the reputation of business generally.

9. In the view of the Revenue Commissioners, the proposal to abolish Revenue's Preference was not sought by representatives of small business. The supposed rationale for abolishing Revenue's Preference to help support such small businesses, to whom a debt is due in an insolvency situation, has no basis in reality.

10. Preferential status provides a balance for the unique circumstances of Revenue as a creditor. Revenue is in fact an involuntary creditor. Revenue cannot choose its customers on a risk assessment basis. Ordinary trade creditors can protect themselves by using retention of title clauses, rights of set–off, use of liens or by insisting on cash up front. Financial institutions can get security (fixed and floating) on company assets as well as securing letters of guarantee from directors. By obtaining fixed charges, financial institutions rank ahead of preferential creditors and unsecured creditors. Even an unsecured creditor can cease to trade with an errant creditor, thus limiting its exposure. Revenue cannot avoid giving credit to companies.

11. In addition, quite frequently Revenue is the lender (albeit involuntary) of last resort, with tax demands being ignored, while suppliers and other creditors continue to be paid. While Revenue operates best practice in terms of collection, it is still at a disadvantage compared with a creditor who knows their customer and whose business relationship is based on mutually accepted arrangements. Accordingly, there is limited scope for dispute as to the amount of the debt. In many instances Revenue has to seek out companies that commence to trade without registering for tax. Determining a company's tax debts is not always a straightforward exercise. It may often require the gathering of evidence and pursuit of cases through the various appeal mechanisms. Despite this, in many instances where a business falls into short-term arrears, Revenue will work with this business, by perhaps entering into a short-term instalment arrangement, to eliminate such debts. The existence of preference allows Revenue to consider this option in appropriate cases. Otherwise, Revenue might be forced to liquidate earlier and more frequently. This could only have the effect of forcing more businesses to close. Given recent commentaries on the economic outlook, Revenue's approach to the collection of tax, i.e. of working with businesses and giving appropriate businesses time, may come to be relied on more frequently. A proposal to abolish or restrict Revenue Preference would run counter to this pro-business approach.

In summary, Revenue's involvement in corporate insolvency and rescue has practical implications. Revenue is regarded by the Courts as a representative creditor and through involvement in Committees of Inspection, Revenue works to ensure that all creditors get maximum benefit from liquidations. Through its financing of liquidations of defaulting companies, Revenue also aids liquidators in having directors restricted and disqualified, where the conduct of the directors merits it. Any material change to Revenue Preference would almost certainly impact on Revenue's direct involvement in the insolvency process. In the absence of its preferential status, Revenue, in order to protect its debt, is likely to have to reduce the breathing space that can currently be afforded companies in cash flow difficulties.

In the view of the Revenue Commissioners, the business community would not welcome many of the consequences of the abolition of Revenue Preference and there is no suggestion that it would support a more competitive business environment.

7.4.6 Arguments in relation to Other Preference

The other preferential payments arise largely under employment legislation. The protection of employees in an insolvency is seen as a public policy objective.

However the mélange of rights to preferential payment bring the potential for significantly unfair outcomes. For example, a non–employee not hired by the company in breach of equality legislation (and where there is no limit on the amount of the claim) may take more out of the company than the employees who have actually worked with the company up to its insolvency. Further, in such circumstances, unsecured creditor companies and their employees stand to lose out.

7.4.7 Arguments against Preference

The argument against preferential payments is set out in paragraphs 1409 to 1417 inclusive, of the 1981 Review by the Insolvency Law and Practice Committee in the UK[73]. Because of the similarity of English law preference at that time to current preferences in Ireland, the arguments against Revenue preference put by the Cork Committee have equal relevance to Ireland today. The Report stated:

"The Crown's claim to preference for unpaid tax is of great antiquity. Whatever may have been the historical basis for this privilege, only two grounds for its retention in modern times have been put forward in evidence to us. It has been represented to us that sums due in respect of unpaid tax ought to have priority, first because they are owed to the community; and secondly because the Revenue, unlike others who give credit, is an involuntary creditor.

We unhesitatingly reject the argument that debts owed to the community ought to be paid in priority to debts owed to private creditors. A bad debt owed to the State is likely to be insignificant in terms of total Government receipts; the loss of a similar sum by a private creditor may cause substantial hardship, and bring further insolvencies in its train.

We are grateful to the Scottish Law Commission for drawing our attention in this connection to the comments of Lord Anderson in Admiralty v Blair's Trustee in 1916. His view, with which we agree, was that the very fact that the doctrine of Crown preference resulted in the benefit of the general community at the expense of the individual was a reason for condemning the principle. He continued: 'Why should individuals be made to suffer for the general good, especially in a case like the present, where the general benefit is infinitesimal but the individual loss substantial?' He pointed out that the claim was hostile to the general policy of the Bankruptcy Acts, which aim at equal treatment of all creditors in the distribution of the bankrupt's estate.

It is the fact that the Crown is an involuntary creditor in respect of unpaid tax. Unlike other creditors, the Revenue cannot choose those with whom it will transact business. Obliged to accept its taxpayers as it finds them, it cannot avoid giving them credit; taxing authorities necessarily operate after the event. Even if there are no delays on the part of the taxpayer, there will inevitably be a significant lapse of time after the transactions giving rise to the tax liability before any attempt to collect the tax can be made. There is no means, such as may be available to private creditors, to restrict the amount of credit which is extended, or to require existing tax liabilities to be discharged before further transactions, giving rise to fresh tax liabilities, are entered into. Moreover, it is a

[73] Cmnd 8558, chaired by Sir Kenneth Cork (the Cork Committee).

common experience to find that the taxpayer, in his efforts to avoid impending insolvency, has ignored the demands for payment of tax while continuing to pay suppliers and other creditors whose goodwill is essential to his commercial survival.

We recognise these facts, but we are not persuaded that they justify the conclusion that debts due to the Crown in respect of unpaid tax ought to be paid in an insolvency in priority to other debts. In recent years, the Revenue's position has been greatly strengthened by the granting by Parliament of additional powers to raise assessments and to charge interest on unpaid or late paid tax. It has powers to impose penalties, and possesses remarkable powers of entry, search and seizure. HM Customs and Excise enjoy even more extensive powers. It may be correct to describe the Crown as an involuntary creditor in respect of unpaid tax, but it is only fair to add that it has recourse to exceptional remedies which are not available to the ordinary creditor.

In any event, the Crown is not alone in being an involuntary creditor. Many suppliers of goods and services are constrained to extend credit facilities in accordance with the custom of the trade. In a practical sense they have no real choice in the matter, and are sometimes unable to exercise credit control. Many other categories of involuntary creditor may readily be called to mind: litigants who obtain judgments for costs, for example, and the victims of breach of contract and tort do not normally extend credit voluntarily to their debtors. It is no fault of theirs that they find themselves owed money by an insolvent. In many cases, such creditors are deserving of much sympathy, yet their debts are subordinated to the Crown's preferential claim to tax. In our view, sympathy for the misfortune of an involuntary creditor is not a sufficient ground for setting aside the cardinal principle of rateable distribution of an insolvent's estate.

The Blagden Committee[74] reported that many witnesses had been in favour of the abolition of priority for rates and taxes, and accepted that there was much to be said for that view. Since then the complete abolition of all State preferences has been recommended by bankruptcy reform committees in Canada and the Republic of Ireland, and has been accepted in principle by the Canadian Senate. The Australian Government has agreed to forego Crown preference for debts other than tax instalment deductions (which correspond with PAYE) and withholding tax, and by section 51 of the (Australian) Bankruptcy Amendment Act 1980, Crown priority in respect of income tax and social security contributions has been repealed. The multiplicity of divergent systems of preferences is a major obstacle to the harmonisation of insolvency law within the European Economic Community.

It has not been suggested to us that the net loss to the Revenue would be significant if Crown preferences were abolished. A substantial proportion of the tax lost would no doubt be recouped from the increase in dividends payable to ordinary commercial creditors, thereby reducing the amount of bad debts written off by them against trading profits.

In our view, the ancient prerogative of the Crown to priority for unpaid tax cannot be supported by principle or expediency, and cannot stand against the powerful tide calling for fairness and reform."

[74] "The UK Board of Trade Bankruptcy Law Amendment Committee".

The Revenue make the point that the revocation of its preferential status would help the floating charge holder, assuming there is one, ahead of other creditors. While in many circumstances this would be true, this suggestion ignores one of the reasons for the development of the economy, namely the free availability of credit. The availability of credit was greatly increased in the 1960s following the State's Economic Plan of 1958. In addition to private banks making credit available, Taisci Stait was established in 1963 to enable the State to make funds available to industry. This institution later became Foir Teoranta. Bankers were prepared to make funds available on the strength of a mortgage over a company's lands, buildings and fixtures and a floating charge over all other assets of the company including book debts, movables and stock. This enabled corporate borrowers to carry on business in the ordinary course.

Notwithstanding the Cox Report's recommendation in 1958 that preferential creditors be scaled back, they were continually increased, first by the 1963 Act then the Value Added Tax Act of 1972, the 1982 Act and as can be seen from the Table above, by a series of other legislation. The extent of the increasing arm of the preferential creditors, particularly the Revenue Commissioners, led banks to seek ways in which the new imbalance could be rectified. This gave rise to the fixed charge on book debts which first gained common use in England following the High Court decision in *Siebe Gorman v Barclays Bank* and which subsequently gave rise to the practice in Ireland, altered only following the Revenue Commissioners super-preferential status introduced by the Finance Act 1986. The constant struggle between financiers and the Revenue Commissioners to gain the upper hand since the 1960s has been at the expense of the trade creditor and indeed farmers, thereby giving rise to each sector endeavouring to find its own ways to protect its position whether by way of retention of title or withholding of future services.

7.4.8 Experience in Other Jurisdictions

United Kingdom

In the view of the Cork Committee, there was much public dissatisfaction with the elaborate system of priorities then in force in UK law. The Committee considered that there would be public support for a distribution system based on the interests of justice and fairness and also recommended the abolition of preferential status for rates and other forms of tax as well as for employee creditors. It considered that employees were already protected under the Employee Protection Acts and there was no need for overlapping provisions.

In a broader context, the Cork Committee adopted a perspective which focused on rescue, the preservation of businesses as going concerns with the goal of delivering the realisation of full payment for all creditors. Preferential status was perceived as meaning that preferential creditors did not have the same commitment to corporate rescue. Indeed, it was in the interests of the preferential creditor that liquidation occur as quickly as possible so that it could realise its debts.

The Cork Committee recommendation regarding Crown priority was endorsed again in *Insolvency: A Second Chance*[75] and given effect in the Enterprise Act 2002. The benefit was directed primarily but not exclusively at unsecured creditors.

An important aspect of the Enterprise Act 2002 is that the removal of Crown preferential status comes in the context of a broader re-shifting of the policy balance in favour of corporate rescue and a less penal response to personal bankruptcy. Thus, the abolition came in the context of a more general shift towards an "enterprise culture". In this regard, it was argued in *Insolvency: A Second Chance* that the increased possibility of a business surviving should mean that the Crown could hope to recoup its debts from businesses which were saved. In this regard, the rescue culture first promoted by the Cork Committee retains currency and has been accorded a greater degree of legal recognition.

The categories of preferential debts are set out in Schedule 6 to the UK Insolvency Act 1986. All of these categories of preferential debt ranked equally among themselves.

Prior to the UK Enterprise Act 2002, the categories of preferential debt were as follows:

- debts due to Inland Revenue for 12 months prior to the relevant date;
- debts due to Customs and Excise for the 6-12 months prior to the relevant date;
- Social Security Contributions for the 12 months prior to the relevant date;
- contributions to occupational pension schemes;
- remuneration to employees; and
- levies on coal and steel production.

In section 251 of the Enterprise Act 2002, certain categories of debt lost preferential status. These are:

- debts due to Inland Revenue;
- debts due to Customs and Excise; and
- Social Security contributions.

The estimated value to the Crown of this de-categorisation was £70 million per annum (which is a very small proportion of the amount of unpaid debts owed by insolvent companies).

It is important to note that the benefits arising from the de-categorisation of Crown debts do not go wholly to floating charge holders. Rather, section 252 of the Enterprise Act (inserting section 176A into the Insolvency Act 1986) requires a prescribed amount (a "reserve fund") of the net property to be top-sliced for unsecured creditors unless the funds available are less than the prescribed minimum or the costs of the distribution would be disproportionate to the benefit.

The reserve fund is calculated as follows: the net property constitutes the property after fixed charge holders and liquidation/administration costs have been paid.

- where the net property is no more than £10,000 in value, 50% is retained for the reserve fund;

[75] Cm 5234, 2001.

- where the net property is between £10,000 and £1 million, 10% is retained for the reserve fund;
- for values over £1 million, 5% of the net property is retained for the reserve fund.

On the basis that in an insolvent liquidation, there is, in general, little moneys available for creditors, on a summary examination the Review Group saw little merit in devising such an elaborate regime that would be unlikely to yield any significant benefit to unsecured creditors.

In general, academic commentary from the UK has tended to favour the approach taken to the removal of Crown privilege in the Enterprise Act 2002. However, some points should be noted:

- firstly, McBryde and Flessner *Principles of European Insolvency Law* (Kluwer, 2003) question how much practical difference the removal will make to unsecured creditors - noting that Crown debts actually constitute a small proportion of debts owed;

- secondly, Finch *Corporate Insolvency Law: Perspectives and Principles* (Cambridge University Press, 2003) questions the retention of the preferential status of employees as creditors.

United States

As a preliminary point, it is necessary to note that the concept of a floating charge, as a distinct legal entity, is not a feature of US law. Rather, US law recognises the functional equivalent of the floating charge as a security interest over shifting collateral. This has the same priority status as other security interests.

Under section 507 of the US Bankruptcy Code, certain debts are accorded priority status. In order, these are:

- administrative expenses, fees and charges assessed against the estate;
- unsecured claims allowed under section 502 of the Code;
- unsecured claims up to $4,000 per person or corporation earned within 90 days before the date of filing for (a) wages, salaries, commissions including vacation, severance and sick leave and (b) earned commissions;
- unsecured claims for contributions to employee benefit plan;
- unsecured claims for persons involved in grain production;
- claims in relation to lease or purchase of property up to $1,800;
- claims to a spouse, former spouse or child for alimony or maintenance;
- claims for certain taxes over income or receipts (typically for the previous 12 months); property tax; withholding tax; employee tax; excise tax;
- customs duties;
- penalties.

However, priority creditors only take priority over unsecured creditors and subordinated creditors. There is no subdivision of security interests between fixed and floating under US law and, therefore, all secured claims are met before any priority claims are met.

In making comparisons with the US, it is also important to note that, in a more general sense, US law might traditionally be described as more rescue-oriented and more pro-debtor than UK or Irish law; for example, a debtor is allowed an automatic stay on realisation of assets and an unimpeded petition for reorganisation (see McCormack *Secured Credit under English and American Law* (Cambridge University Press, 2004), p 118.

Canada

In Canada, the *Report of the Advisory Committee on Bankruptcy and Insolvency* (the Colter Report) (1986) recommended the removal of Crown priority for tax purposes. This occurred in large part in the Bankruptcy and Insolvency Act 1992 which substantially limited Crown priority.

The removal of Crown priority is, by and large, supported by Canadian academic commentary. Professor Jacob Ziegel presents a commonly held view among academics[76]. He notes that governments are usually in an excellent position to diversify their losses yet they show little disposition to be ranked with other unsecured creditors. He disputes the argument raised by governments "to justify their self-serving legislation" that they, like employees and tort victims are involuntary creditors; that they have a responsibility to protect the public finances and that revenue claims are "morally" superior to trade creditor claims. He argues that few independent observers have been convinced

[76] "Preferences and Priorities in Insolvency Law: Is there a Solution?" (1995) 39 St Louis University Law Journal 793.

by these claims. Ziegel is less certain regarding employees' preferential status (and in this he also reflects broader opinion). He acknowledges the widespread justification that employees are involuntary creditors, that they did not anticipate bankruptcy and that, in any case, they would be powerless to protect themselves against this. It is also more difficult for employees to diversify their debt – unlike trade creditors, the State, etc., they are, by necessity, locked in to one particular debtor. However, he questions whether this can in fact be resolved by social insurance rather than preferential status.

A proponent of the retention of Crown privilege, Shanker, contends[77] that the elimination of government priority requires more justification than the fact that business creditors do not like it. He disputes the claim that governments can better absorb loss than individual creditors and argues that it is inappropriate to judge the status of a creditor by the depth of his pocket. Shanker also argues that governments are involuntary creditors and that the extent of the debt can only be ascertained after the debt is overdue. Therefore, he contends that the State is not in a position to protect itself in the way that trade creditors can.

Australia

In 1988, the Law Reform Commission of Australia published a Report entitled *A General Insolvency Inquiry* (Report No 45) (the Harmer Report). This Report recommended the abolition of the category of priority creditors as running contrary to the fundamental principle of equality of distribution. It recommended the abolition of most existing categories of preferential creditors, including the State, but recommended the retention of priority for two categories: administration costs and employee benefits unless, in the case of employees, a wage-earner protection fund was created. This was seen as a more effective way to protect employees because this would ensure that in an insolvency situation, all employees would be paid, regardless of the level of assets available for distribution.

Preferential status for tax debts was abolished in Australia in the subsequent Corporations Act 2001. This move appears to have been broadly welcomed and there does not appear to be any critical academic commentary regarding this aspect of the Act.

Other Jurisdictions

In contrast to the general move away from preferential Crown status, in the recent New Zealand Insolvency Act 2006, Crown preference was retained. In other regards, too, the Insolvency Act went against international trends by increasing (albeit relatively minimally) the categories of preferential creditor. This move has been criticised by commentators[78]. Preferential status is also retained in South Africa.

EU Experience

• *Germany*
The German Insolvency Regulations (Insolvenzordnung) do not recognise the category of preferential creditor. In a wide-ranging reform of the Code which entered into force on January 1 1999, all priority rights for tax authorities, social security authorities and employees' claims were abolished.

• *Portugal*
Under Portuguese bankruptcy law, debts are divided into a number of categories:
- guaranteed creditors (credores garintidos) – which comprises secured creditors and special preferred claims, in particular employees' claims;
- privileged creditors (credores privilegiados);
- common creditors (unsecured creditors);
- subordinated creditors.

• *Denmark*
The rules for bankruptcy proceedings in Denmark are set down in the Bankruptcy Act (most recently Act 118 of 1997 as amended by Act 402 of 1998). Under the Act, preferential claims (Privilegerede (fortrinsvis berettigede) fordringer) are:
- claims for salary and other claims for work in the debtor's service in the 6 months prior to the "relevant date" until the bankruptcy/winding-up order is issued,
- other employment related claims.

A separate category of floating charges is not recognised under Danish law. Therefore preferential claims take priority only over unsecured claims.

A brief review of other EU jurisdictions came up with widely differing results. The majority provide for preferential status to both unpaid taxes and unpaid employee remuneration but many of these provide for arrears of tax to be paid only after all unpaid employee remuneration has been discharged first. Others give preferential status to employees only and a few give preferential status to farmers.

[77] See Shanker "The Worthier Creditors: And a Cheer for the King "(1975-76") 1 Canadian Business Journal 341.

[78] See Harper "Insolvency Bill Should have Abolished or Curtailed IRD's Preferential Status (2006) 42 Law News 5.

7.4.9 Summary

In the past decade or so, a number of jurisdictions have chosen to abolish preferential status in relation to State interests (see for example, UK, Germany, Australia). The primary justification for this is greater equity among creditors and a broader move towards a rescue culture.

In brief, the current status of the conclusions of the Cox Report and of the Cork Committee regarding the removal of State preference remain relevant and cogent. Indeed, they are now widely accepted across a number of jurisdictions.

In relation to the Cox Report's recommendation regarding the retention of priority for employees, it is noteworthy that, since the Cox Report, the State has enacted the Protection of Employees (Employers Insolvency) Acts 1984-2004. However, the Acts cover wages, holiday pay, etc. for a period of 8 weeks only as opposed to the more generous provisions accorded preferential status. Therefore, the removal of preferential status for employee creditors would have a detrimental effect on this class of creditors. In this regard, therefore, the recommendation of the Cox Report has not been wholly overtaken by the introduction of this Act.

The weight of commentary tends to question the appropriateness of preferential status, especially in relation to the State. The weight of academic commentary would also favour the benefits of the removal of preferential status falling to unsecured creditors.

The primary arguments raised against preferential status for the State are:

- the essential unfairness/inequity of the preferential model;
- the State's ability to diversify resources when compared with other creditors;
- the lack of incentive for preferential creditors to support corporate rescue;
- a view of preferential status as anti-enterprise.

The arguments in favour are:

- the State is, by necessity, an involuntary creditor and has no contractual means to protect itself;
- the clear linkage between the State's capacity to provide basic services and its capacity to recover revenues due to the State;
- the State is not in a better position to absorb loss and even if it is, it is inappropriate to determine policy on the basis of which creditor has the deeper pocket

7.4.10 Risks Associated with Removing the Preference

(i) The abolition of Revenue Preference would result in a reduction in the tax take and could leave a tax shortfall which, though not enormous in the context of overall tax receipts, might still have to be met out of increased taxation elsewhere. This could impact negatively on all other compliant taxpayers/businesses. Moreover, maintaining Revenue's legal capacity to secure the payment of trust taxes, from a small minority, protects the reputation of business generally.

(ii) The loss of Revenue Preference could be of primary benefit to floating charge holders and not necessarily to the benefit of unsecured creditors. Financial institutions typically secure the bulk of their debts by means of fixed charges and personal guarantees from the directors. The fact that the unsecured creditors may not benefit considerably from the loss of Revenue's Preference, means that the risk to the wider community of creditors of companies going into liquidation is not reduced by any abolition proposal.

(iii) In the absence of Revenue Preference, Revenue is less likely to finance the liquidation process to the same degree as heretofore, particularly where it comes to financing disqualification proceedings against directors. The fact that fewer disqualification actions might be taken by liquidators against directors, could reflect badly on Ireland's corporate image and could result in errant directors continuing to operate as directors in other companies. Preferential status facilitates Revenue in undertaking such action by ensuring that there is a benefit to outweigh or sometimes offset the cost.

(iv) Loss of preference for Revenue could lead to a review of the flexibility and timeframe it affords companies at present, in trying to address trading difficulties. In the absence of its preferential status, Revenue, in order to protect its debt, might reduce the breathing space that is currently afforded to companies in cash flow difficulties. This could result in Revenue being less inclined to allow phased payment arrangements to companies and could in turn give rise to earlier enforcement action.

(v) The removal of Revenue's preferential status could negatively impact upon its capacity for, and inclination towards, monitoring of the insolvency process. This could have a detrimental effect on the liquidation process.

7.4.11 Risks Associated with Maintaining the Preference

(i) Small and medium-sized creditors of insolvent companies may themselves become insolvent: the burden created by the State preference is carried by small, unsecured, creditors who are less able to sustain financial loss compared to the State – essentially a lack of justice and equity.

(ii) In certain circumstances, small and medium-sized firms could be discouraged from advancing credit to other firms in the knowledge that if those other firms become insolvent, they will continue to rank after the State in terms of priority of repayment of the credit advanced.

(iii) An opportunity would be lost to encourage lending institutions to increase their provision of credit to growing companies which have not yet acquired fixed assets and which can only offer floating charges as security for their borrowings.

(iv) Apart from foregoing an improvement in the lot of unsecured creditors, an opportunity would be lost to increase the amount available to employees (who remain preferential creditors) in payment of preferred remuneration owed to them.

(v) Decisions by the Revenue Commissioners to deal flexibly with a company owing taxes could be perceived negatively by those who are tax compliant.

(vi) More broadly, the approach to insolvency in Ireland would continue to be led by the tax authorities and thus based principally on tax policy considerations. This militates against full and proper consideration of the need for a State insolvency service, based on pro-enterprise considerations such as business promotion and start-up and risk/reward policies.

(vii) Finally, Ireland would continue to be out of step with many other common law jurisdictions which have voluntarily relinquished the traditional State or "Crown" preference, especially in the context of supporting small businesses which have taken risks by providing unsecured credit.

7.4.12 Conclusions and Recommendations

In its analysis of the situation regarding preferential creditor status, and based on the tabular analysis of preferential payments set out in Section 7.4.3, the Review Group notes the many different types of preferential creditor and different types of debts which are accorded preferential status.

In the context of the Revenue's Preference, in the Review Group's opinion there is a significant difference between (i) monies collected in "trust" for the State and (ii) monies owing directly by a company by way of taxes arising from its trading and other activities, i.e.:

(i) Moneys collected in trust for the State, and which are never in the beneficial ownership of the trustee which collects them on the State's behalf, but are rightfully due to be paid to the State. Payments such as VAT, RCT, PAYE and PRSI fall into this category, given that they are collected in trust by the company, from employees and customers, but are fully owing to the Revenue or the Social Insurance Fund; and

(ii) Moneys owing directly by the company (such as corporation tax to the Revenue Commissioners or rates to a Local Authority) by way of taxes arising from its trading and other activities.

In the context of employee and others' preference, in the Review Group's opinion there is a significant difference between (i) sums owed to employees for remuneration, on the one hand, and (ii) sums awarded to employees and putative employees in other circumstances, i.e.:

(i) Moneys owing to employees of the company as remuneration, and rightfully due to the employee in return for services provided; and

(ii) Moneys owing to a range of other persons, either legally connected with the company or not, and deriving from a variety of policy reasons. Into this category falls, for example, persons awarded exemplary damages against the company under Unfair Dismissals legislation or a person who failed to get employment with the company on equality grounds.

The State's Preference

The Review Group has considered the strong and wide-ranging views advanced by the Revenue Commissioners as to why its preferential creditor status should not be abolished.

The Review Group concludes, principally, on two main grounds that the State preference should not be abolished in its totality. The reasons why the Review Group comes to this conclusion are:

1. "Trust" taxes, such as PAYE, PRSI, RCT and VAT payable[79], which are collected by the company and transmitted to Revenue on behalf of workers and consumers, are never the insolvent company's property, and no other creditor has a better claim or is more entitled to those funds than the State for which they were collected in trust. The Review Group sees a very clear distinction in the nature of those taxes collected in trust on behalf of employees or customers and those owing by the company itself such as corporation tax. The Review Group accepts Revenue's view that its right to preference in the former case is fully justified given: the State's unquestionable entitlement to trust taxes; the fact that they are likely to be the more significant portion of moneys owing in a winding-up and; the fact that failure to collect trust taxes serves to damage not only the State, through lost revenue, but more importantly any loss of PRSI for example, would be to the detriment of employees who benefit from payments out of the Social Insurance Fund.

2. The fact that, in the absence of a State insolvency service, preference status gives Revenue such a vital role in relation to insolvency as argued strongly by the Revenue Commissioners. However, in so concluding, the majority of the Review Group rejects the "involuntary creditor" argument and does not accept that the notion that a tax payer "forces" the Revenue to be its creditor and that the Revenue is "obliged" to be owed money from the taxpayer reflects the reality or is a realistic assessment of the relationship between the Revenue and taxpayers.

[79] Money deducted by an employer from employees remuneration in respect of PAYE and PRSI goes towards satisfying the employees tax liability, and such deducted sums are ethically, if not legally, entrusted to the employer. Money received by a company in respect of VAT on supplies to a customer, is not subject to a legal trust in favour of the Revenue Commissioners. It is, however, paid by a VAT- paying customer in deduction of the customer's VAT liability, and in expectation of its being remitted to the Revenue.

On the other hand, there seems to be no strong rationale as to why the State should retain preferential status, vis-à-vis other creditors, in relation to debts owing directly by the company. Indeed, by making this distinction, the legitimate primacy of monies collected in trust can be continued and the less defensible aspect of State preference can be abandoned. In the view of the majority of the Review Group, Revenue would continue to have strong grounds to act not only in its own interests but also in the interests of the liquidating company, other creditors and indeed the common or public interest.

The majority of the Review Group believes that if preferential status for trust taxes was retained but was removed for taxes owing directly by the company:

- The priorities in an insolvent liquidation would be fairer than at present;
- The tax shortfall should be relatively small and should not necessarily result in an increased burden on other taxpayers or give rise to any serious competitive advantage to non-compliant firms;
- Revenue should be a no-less willing participant in the liquidation process, including as a financial contributor;
- Revenue, in the absence of a State insolvency service, should not be any less pro-enterprise in its approach to liquidations and in terms of showing flexibility in pursuing unpaid taxes;
- Lending institutions might be more inclined to advance funds to start-up companies which can only offer security in the form of floating charges, an end that in 2008 has acquired a greater importance than in the past;
- There would be no greater threat overall to unsecured creditors but a potential benefit to employees and individual unsecured creditor firms;
- Non-compliance with company law by directors would not be facilitated and errant directors would be no less likely to be disqualified or restricted.

Recommendation in the case of State Preference

On balance, therefore, the majority view of the Review Group is to recommend that the Revenue Preference in relation to recovery of taxes such as VAT payable, PAYE, RCT and PRSI (being "trust" taxes) be maintained but that it be removed entirely in relation to taxes owing directly by the company to the State i.e. corporation tax, capital gains tax, capital acquisitions tax and any other tax arising from companies' trading and other activities (including rates). The Review Group bases this recommendation on the substantive difference between moneys collected on behalf of the State from third parties and taxes due by companies in their own rights; the distinction is more than a "label" and taxes owing from a taxpayer's own activities can never properly be classified as trust taxes.

This recommendation is made in a company law and in a pro-enterprise and employment context. It will introduce more fairness in distributing assets to creditors in the liquidation process and, as such, it reduces the risks to and promotes the giving of credit by suppliers (an aspect strongly supported by business in view of the changing economic climate in 2008). It has the potential to release more funds for distribution to employees. It reflects the growing practice in other countries and should involve no great loss to the Revenue or impact adversely on other taxpayers.

In making this recommendation, the Review Group recognises that it is based primarily on company law-related aspects and that other aspects such as tax policy implications and wider socio-economic implications need to be examined in responding to it.

Other Preferences

The Review Group believes that employees' remuneration (including holiday pay and entitlements) should continue to have preferential creditor status, given that employees have provided value at a market rate to the company and which, by its delay in payment, has failed to honour its side of the contract for personal services. Having accepted that employee remuneration should in principle have priority to ordinary unsecured creditors, the Review Group believes there may be scope to enhance the maximum amount of employee-remuneration claims.

On the other hand, there appears to have been a predisposition in recent legislation to award preferential status to a variety of other persons, and (the Review Group accepts) for a variety of sound policy reasons that go beyond company law. However, where such claims are, for example, in the form of exemplary damages, the case for punishing the payor, rather than rewarding the payee, collapses, where the payor is insolvent. Thus the rationale for payment of exemplary damages in priority over other creditors does not exist as there is no public policy interest in making the insolvent-payor's creditors suffer. The Review Group does not believe that this approach is justified from a company law perspective or indeed on wider enterprise policy grounds.

Recommendation in Relation to Employees' and Others' Preference

The Review Group is strongly of the opinion that employees should continue to receive preference in relation to their unpaid remuneration and that the Department of Enterprise, Trade and Employment should consider whether to enhance the preference by extending the maximum amount that has preference. However, the Review Group recommends that all non-employee remuneration based claims should rank *pari passu* with insolvent companies' unsecured creditors and that the Department of Enterprise, Trade and Employment should re-formulate its policy on the priority of non–remuneration related debts in liquidation.

7.5 Distributions and Share Capital

7.5.1 Introduction

The Companies Acts reinforce the common law principle that a limited company ought not make unlawful distributions to shareholders. The heads of the proposed Companies Consolidation and Reform Bill with regard to distributions (Chapter 7 of Part A3[80]) contain substantial reforms of the law, implementing most of the provisions proposed in the Review Group's Second Report.

However, one further aspect of the law in relation to distributions was brought to the Review Group's attention, relating to the assessment of the quantum of a potential distribution of a non-cash asset in transactions between groups of companies. It is not agreed among legal practitioners as to how the particular asset should be quantified, i.e. whether its book value or market value should be utilised.

7.5.2 Issues Arising

The question has long been a matter of debate both in Ireland and in the UK, and particularly since the decision in *Aveling Barford v Perion*[81]. The problem arising as a result of the *Aveling Barford* decision was examined by the UK Company Law Review ("CLR") in its June 2000 review of *Modern Company Law for a Competitive Economy*. The CLR noted that the decision did not decide anything about the situation where a company has positive distributable reserves, but noted that there was a body of opinion, prompted by the decision, that an intra-group sale of an asset may constitute a distribution for the purposes of section 263 of the UK Companies Act 1985 if the asset concerned is sold for an amount equal to its book value, where this is less than its market value, even where the company has distributable reserves.

It noted:

"The result of Aveling Barford and the debate it has engendered have cast doubt on the validity of intra-group asset transfers conducted by reference to book value rather than by reference to market value. It is understood that such transactions are often carried out by reference to book value rather than to market value for a variety of business, administrative or tax reasons. Because of this doubt such transactions are therefore commonly carried out in a more complicated way (often involving revaluation of the asset concerned and then its sale/distribution, relying on section 276, which provides that a distribution in kind of an asset carrying an unrealised profit is to be treated as a realisation of the profit) or do not proceed at all".

The CLR put forward proposals to clarify the uncertainty and doubt. The UK Government White Paper of March 2005 agreed that *Aveling Barford* (which was decided by reference to common law rules on distributions and maintenance of capital rather than the statutory rules) was widely considered to have cast doubt on the validity of intra-group asset transfers conducted by reference to book value rather than by reference to market value. It proposed an amendment to the UK statutory rules to " make clear that where the transferring company has distributable profits, its assets can be transferred at book value. This will remove any uncertainty about the current law, and also avoid the need for companies to carry out complex asset revaluations requiring significant professional advice and fees to advisors."

That proposal was duly adopted and section 845 of the UK Companies Act 2006 ("section 845"), which will be commenced in April 2008, provides:

> **"845 Distributions in Kind: Determination of Amount**
>
> *(1) This section applies for determining the amount of a distribution consisting of or including, or treated as arising in consequence of, the sale, transfer or other disposition by a company of a non-cash asset where:*
> *(a) at the time of the distribution the company has profits available for distribution, and*
> *(b) if the amount of the distribution were to be determined in accordance with this section, the company could make the distribution without contravening this Part.*
>
> *(2) The amount of the distribution (or the relevant part of it) is taken to be:*
> *(a) in a case where the amount or value of the consideration for the disposition is not less than the book value of the asset, zero;*

[80] http://www.clrg.org.
[81] [1988] BCC 488.

(b) in any other case, the amount by which the book value of the asset exceeds the amount or value of any consideration for the disposition.

(3) For the purposes of sub-section (1)(a) the company's profits available for distribution are treated as increased by the amount (if any) by which the amount or value of any consideration for the disposition exceeds the book value of the asset.

(4) In this section "book value': in relation to an asset, means:
(a) the amount at which the asset is stated in the relevant account, or
(b) where the asset is not stated in those accounts at any amount, zero.

(5) The provisions of Chapter 2 (justification of distribution by reference to accounts) have effect subject to this section. "

7.5.3 Conclusion and Recommendation

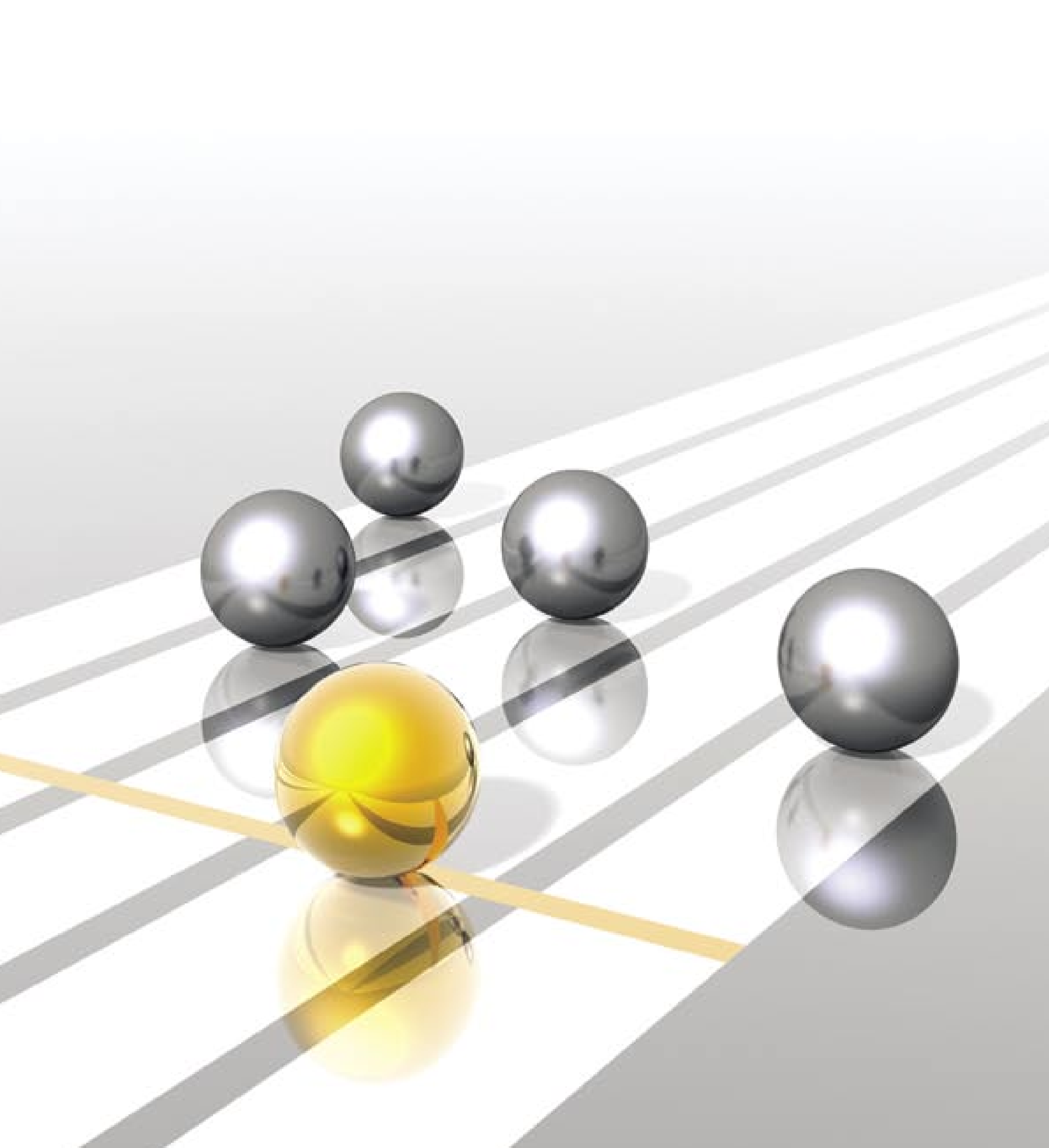
In many transactions with an international scope, there has, to date, been a level of understanding of the Irish position on this issue given that it was so closely aligned with that pertaining in the UK (albeit there is currently no statutory equivalent to section 276 of the UK Companies Act 1985). However, with the advent of the commencement of section 845, there is the possibility that transactions conducted by Irish companies may suffer a competitive disadvantage compared with those utilising UK companies.

The arguments in support of an amendment to the statutory rules put forward by the UK CLR in 2000 are equally applicable in Ireland today. The ambiguity in Ireland as to the correct test to be applied is exemplified by the significant disparity of legal opinion on the issue in Ireland, with the consequent expense and uncertainty.

The Review Group is of the view that the issue needs to be examined in more detail before it can come to a conclusion and, therefore, requests permission from the Minister to extend that examination into its 2008/2009 Work Programme.

Chapter 8:

EU Developments



Chapter 8: EU Developments

8.1 Introduction

8.2 Regulation for a European Private Company Statute (EPC)

8.3 EU Company Law Simplification Initiative

8.4 EU Action Programme to Reduce Administrative Burdens

8.5 Directives Currently Being Transposed

8.1 Introduction

In this Chapter, the Review Group presents information on recent developments in Company Law at EU level. This Section is not an analysis by the Review Group, nor does it contain any recommendations, but is provided purely to inform readers on developments.

8.2 Regulation for a European Private Company Statute (EPC)

The idea of a European Private Company (in Latin, Societas Privata Europaea) has been around for over 10 years, having originated in France. It was only in 2004, however, that the Commission decided to carry out a feasibility study and subsequently sought comments on the need for an EPC in a public consultation on the future of the Company Law and Corporate Governance Action Plan (December 2005 to March 2006). The outcome of the study and consultation was inconclusive – support was confined mainly to Germany and France, with others largely sceptical.

Subsequently, in November 2006, an influential Committee of the European Parliament called on the Commission to bring forward a proposal for an EPC and provided the Commission with a template for such a proposal. In response, the Commission carried out a further consultation, including an on-line survey among companies in July 2007 "in order to get the facts and evidence needed for a legislative proposal". The Commission published the results of this consultation in December 2007. A majority of respondents to the consultation exercise favoured having an EPC but emphasised that it would have added value only if its statute is simple, self contained and uniform i.e., if it relies as little as possible on national law. The results of the consultation are available at http://ec.europa.eu/internal_market/company/docs/epc/consultation_report.pdf.

In addition to the ongoing consultation, the Commission held a public conference in March 2008 before finalising its legislative proposals.

The EPC will form part of the Small Business Act (a package of measures to support the development of the small business sector in the EU) announced by EU President Barroso in November 2007 and which will be developed in 2008 as part of the EU Single Market Review. Acknowledging the importance of the SME sector in the overall economy, the Spring European Council meeting, held on 13/14 March, indicated that it would strongly support the European Private Company statute. The intention is to have an EPC proposal ready for consideration during the French Presidency of the EU (July-December 2008).

The Review Group expects to give its views and advice to the Government on the EPC as the work progresses.

8.3 EU Company Law Simplification Initiative

In July 2007 the Commission published a communication on a simplified business environment for companies in the areas of company law, accounting and auditing. While a number of the EU Directives in these areas have been updated several times over the years to adapt to new developments, their scope and content have remained fundamentally unchanged. This simplification initiative is aimed at assessing the continued relevance of these Directives given the extent to which the business and indeed legal environment for companies has changed since the Directives were first adopted, some of which are over 30 years in existence. According to the Commission, this assessment will take account of the principles of 'better regulation' together with subsidiarity and proportionality.

The Communication outlines measures which would simplify the business environment for EU companies. The proposed measures would remove or reduce a range of administrative requirements that are considered outdated or excessive by:

- either repealing company law Directives that deal mainly with domestic situations or removing certain information obligations in the company law Directives;
- simplifying disclosure requirements for companies and for branches;
- further reducing reporting and auditing requirements for small and medium-sized enterprises (SMEs).

The overall objective is to ensure that Community legislation in the fields of company law, accounting and auditing corresponds to today's business needs and to allow European businesses to compete effectively in a highly competitive global environment.

The communication was the subject of an open consultation process in July 2007 and the Commission is currently assessing the responses received with a view to developing legislative proposals, which are expected to be published in 2008.

At the Competitiveness Council in February 2008, the Council of Ministers called upon the Commission is bring forward proposals, based on impact assessments, to promote an open exchange amongst Member States on best practices and to further consider the need for integration in EU legislation in the fields of company law, accounting and auditing.

However, while there is a general acknowledgement of the need for effective simplification initiatives, a large number of Member States do not favour the radical policy initiatives suggested in the Commission's Communication. Consequently, the Commission's legislative proposals, when they emerge in 2008, are more likely to focus on specific and targeted simplification measures on particular pieces of existing legislation, reflecting the outcomes of the consultation exercise and impact assessments.

The Review Group will express its views on the detailed proposals when they emerge.

8.4 EU Action Programme to Reduce Administrative Burdens

As agreed at the 2007 Spring European Council, the European Commission has launched a process to cut administrative burdens (or so-called 'red tape') on business in thirteen policy areas, starting with company law. The overall objective is to reduce the administrative burden by 25% by 2012.

(http://ec.europa.eu/enterprise/admin-burdens-reduction/admin_burdens_en.htm)

A consortium of consultants has 'mapped' all the 'Information Obligations' (IOs - that is, the specific requirements on companies to provide or retain e.g. records, returns, reports, applications) under a number of company law Directives and is currently measuring the cost to business involved. The Commission will then select the most costly IOs and make proposals to cut the cost to business. The proposals are expected before Summer 2008.

The Review Group will give its advice on the issue, having examined the proposals from the Commission.

8.5 Directives Currently being Transposed

8.5.1 Directive 2006/68/EC on the formation of public limited liability companies and the maintenance and alteration of their capital

Directive 2006/68/EC was transposed into Irish law in April 2008. The implementing Regulations are essentially an interim measure to ensure that Ireland complies with the mandatory provisions of the Directive, pending the enactment of the proposed Companies Consolidation and Reform Bill.

The Regulations shift the burden of proof from the company to the creditors in establishing grounds for an objection to the Court Order relating to a reduction in share capital. This is to prevent unnecessary delays in cases where such creditors unduly demand security for their claims, by more closely defining the circumstances in which a creditor may apply to the Courts to delay or prevent a reduction in share capital. It is also designed to facilitate a level EU-wide playing field in this area, with creditors in one particular country not having greater or lesser rights to object than creditors in another Member State.

The Regulations also tighten up the current legislation dealing with the purchase by a company of its own shares. The 1990 Act is being amended to make it clear that such purchases can only be funded from profits available for distribution and under the restriction on the distribution of assets specified in section 46 of the 1983 Act.

Finally, there is also a clear statement of the principle that all shareholders who are in the same position should be treated equally.

8.5.2 The 8th Directive (on Statutory Audits) - 2006/43/EC

The 8th Directive on Company Law deals with the professional integrity, independence and qualifications of corporate auditors. Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts (amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC), was adopted on 17th May 2006 and requires transposing by 29th June 2008.

The Directive reinforces and harmonises the statutory audit function throughout the EU and sets out principles for public supervision in all Member States along with a requirement for external quality assurance and clarifies the duties of statutory auditors. It also sets out principles of independence applicable to all statutory auditors and further improves the independence of auditors by requiring listed companies to set up an audit committee with clear functions to perform. (See also Chapter 5.)

8.5.3 The 10th Directive on Cross Border Mergers - 2005/56/EC

This Directive facilitates cross-border mergers by providing a framework for the cross-border merger of companies (subject to certain possible exemption categories) which are entitled to merge under their national legislation. It provides for employee participation in a company created by a cross-border merger where this is already a feature of one or more of the entities involved.

8.5.4 Amendments to the 4th and 7th Company Law Directives (Accounts) - 2006/46/EC

This Directive, which was adopted on 14th June 2006, amends the 4th (78/660/EEC) and 7th (83/349/EEC) Directives which primarily form the basis for EU accounting requirements relating to the annual accounts of certain types of companies and consolidated accounts, respectively. The purpose of the amendment is to further enhance confidence in the financial statements and annual reports published by EU companies by requiring them to provide more reliable and complete information to shareholders and other stakeholders.

8.5.5 Amendments to the 3rd and 6th Company Law Directives (Mergers and Divisions) - 2007/63/EC

The 3rd (78/855/EEC) and 6th (82/891/EEC) Directives set out the rules and procedures for mergers and divisions of public companies. Directive 2007/63/EC amends the 3rd and 6th Directives by giving shareholders the option, if they all agree, to dispense with the requirement to have a written expert's report on the draft terms of a merger or division.

Designed by Legato Design

clrg™

Earlsfort Centre, Hatch Street Lower, Dublin 2
Tel: 353 1 6312763 **Fax:** 353 16312553 **Web:** www.clrg.org

PRN A8/0566