COMPANY LAW REVIEW GROUP

REPORT ON PROPOSALS TO REDUCE THE COST OF RESCUING VIABLE SMALL PRIVATE COMPANIES

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1. EXECUTIVE SUMMARY OF FINDINGS AND RECOMMENDATIONS

Findings

1. The Review Group considers that examinership, in the form currently available to small private companies (SPCs), is inadequate by reason of the costs involved which are prohibitive.

2. The more effective a rescue system is in writing down debts owed by an ailing business, the more likely is it that other businesses (perhaps better managed and more deserving of survival) will receive less than they are owed such that their own solvency may be endangered.

3. It is essential that giving an unfair competitive advantage to companies through an examinership must be avoided. Although there will always be companies which fail - examinership is not a process to be used to prop up economically unviable companies. Winding up insolvent companies should always be the default position.

4. The test of a company's "reasonable prospect of survival" is considered essential to any corporate rescue regime.

5. Significant jurisprudence has been developed by the Superior Courts in relation to the interpretation and application of the Companies (Amendment) Act 1990.

6. In Ireland, our Constitution requires that any compulsory write down of debts for less than market value requires compensation for the loss, consent of the creditors or a court order whether by substantive approval of a scheme of arrangement or a right of objection to the Court for dissenting creditors.

7. Other jurisdictions that permit non-judicial procedures to compulsorily write-down third party debt may not be subject to the same constitutional restraints concerning the writing-down of property rights as are provided for by the Irish Constitution.

8. There are no constitutional, legal or conceptual obstacles to extending the jurisdiction of the Circuit Court to permit all aspects of examinership law for SPCs, as contained in the Companies (Amendment) Act 1990, to be brought and determined by the Circuit Court.

9. In considering a non-judicial mechanism for corporate rescue, it is possible to distinguish between the approval of a scheme of arrangement or compromise of debts (which requires *judicial sanction*) from the initiation of an examinership through the appointment of an examiner (which can happen by administrative act) with limited judicial oversight.

10. Were it to be decided, in the case of an SPC, to allow the initiation of an examinership by the appointment of an examiner by administrative, instead of judicial act, some State agency would need to be charged with responsibility for that process.

11. While a number of agencies exist (ODCE, CRO, IAASA etc) the proposed *Insolvency Service* to be established by enactment of the Personal Insolvency Bill 2012 would, given its proposed purpose and functions, appear to be best suited to making an administrative decision that a particular SPC might have a reasonable prospect of survival were an examiner appointed to it. However it is understood that the proposed agency will face significant challenges in establishing capacity to carry out the remit envisaged for it in the Personal Insolvency Bill, that it also faces potentially significant challenges in meeting demand for the proposed new personal insolvency remedies, and that, by virtue of the State's commitments to the IMF and EU under the Programme of Financial Support for Ireland, priority attaches to the effective implementation of the reform of the personal insolvency regime.

Recommendations

1. **Amendment of existing examinership provisions for small private companies** – That small private companies, within the meaning of section 8 of the Companies (Amendment) Act 1986 should be able to apply directly to the Circuit Court to have an examiner appointed, and not be required to apply to the High Court although that should remain an option. This could be implemented as a stand-alone solution in a timely manner (as the legislative change required is not vast) and would have the immediate impact of lower costs and greater accessibility for SPCs in that it eliminates the requirement for any High Court involvement with associated costs.

2. **Introduction of simplified administrative initiation of examinership for small private companies** – That, subject to the identification of an appropriate agency, and further analysis and deliberation on the policy issues, it appears to the Review Group that it would be legally possible for small private companies to be given an alternative option to traditional examinership, whereby they can initiate the application to be placed into examinership by availing of a non-judicial administrative procedure. The simplified procedure should only extend to the appointment of an examiner. Any scheme or proposal formulated by the examiner must be approved by the Circuit Court.

3. **Possible extended role of new Insolvency Service –** That policy consideration should be given at an appropriate juncture to the practicability of extending the role of the new *Insolvency Service*, proposed to be established following the enactment of the Personal Insolvency Bill 2012, to include the administrative determination as to the initial appointment of an examiner to an SPC, having regard to the priority requiring to be given to the mandate concerned for that agency under the Bill.

4. **Law applicable to small company examinerships** – That with certain limited exceptions (e.g. a shorter initial period of protection, a higher majority of creditors being required to agree to a scheme and possible right of appeal to the High Court of creditors with significant liabilities written down) the provisions of the Companies (Amendment) Act 1990 as interpreted and developed by the Superior Courts, should be applied, mutatis mutandis, to all other aspects of an examinership that is initiated by simplified administrative act.

5. **Examinership in the High Court** – That medium sized companies should continue to have the option of applying for the appointment of an examiner in the High Court.

The full Review Group met on 27 September 2012 to consider the recommendations of the Committee and by a significant majority, the ODCE and Revenue Commissioners expressing reservations, the Review Group approved this report. Revenue stated their view that the proposed approach (in recommendation 2) constitutes a new mechanism, entirely distinct from the established examinership process and, accordingly, that different considerations – including as regards the treatment of tax debts – should, in the view of Revenue, necessarily apply (see sections 7 and 13(10) below)

2. MINISTER'S REQUEST, THE TERMS OF REFERENCE AND THE APPROACH OF THE REVIEW GROUP

The Minister for Jobs, Enterprise and Innovation has requested the Company Law Review Group ('The Review Group') to examine the feasibility of introducing a new structured and non-judicial commercial debt settlement and enforcement system.

This request is made in the context of the commitment contained in the Programme for Government to introduce new legally binding voluntary commercial debt plan structures to allow small business to restructure debts without recourse to expensive court procedures. Similarly, the Action Plan for Jobs, which was launched in mid-February, contains a commitment to examine the feasibility of introducing a new structured and non-judicial debt settlement and enforcement system to meet SME needs – this has been referred to as "Examinership Light".

In the context of advancing the commitments in the Programme for Government the Minister wished to have the considered views of the Company Law Review Group as to the potential benefits or challenges from a company law perspective of advancing proposals in this regard. Accordingly, the Minister has asked the Review Group to examine the appropriateness of introducing a legally binding non-judicial commercial debt and enforcement system, to be used by small and medium sized businesses ("SMEs") into the Companies Acts, and set out a number of factors to be taken into account. The full terms of reference are in Appendix 1 to this report.

The Review Group approached its task by establishing a Committee chaired by Mr William Johnston. Membership of the Committee was open to all members of the Review Group who expressed an interest in this matter and the Committee met on five occasions from June 2012 to September 2012 to consider the matter set out in the Minister's terms of

reference . The Committee included a number of alternate members and others with expertise of the area and its membership is set out in *Appendix 2*.

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3. BACKGROUND AND HISTORY OF EXAMINERSHIP

The Review Group approached the Minister's request mindful of the effects of the most serious economic downturn in the history of the State on business. When a business becomes insolvent, by definition there is insufficient money to go around and pay off its creditors. The default position in such cases is that it is wound up and its creditors are paid, if anything, so many cent for every euro owed by the company. Where rescue legislation, such as examinership, can be invoked, the company is allowed to continue in existence but the cost is that its creditors' debts are written down, such that they are owed less than they would otherwise be entitled to receive. Ironically, the more effective a rescue system is in writing down debts owed by an ailing business, the more likely is it that other businesses (perhaps better managed and more deserving of survival) will receive less than they are owed such that their own solvency may be endangered.

Whereas the process of court protection or examinership, first introduced by the Companies (Amendment) Act 1990, has operated effectively and has saved a number of ailing businesses, the compromising of lawful claims has come at a cost in the form of sometimes significant advisory fees (e.g. legal, accounting, etc) incurred by the creditors and others whose rights are to be impaired. The reality is that every creditor will legitimately seek to ensure that the write-down of what is owed to them is minimised which requires them to retain advisors to advise on whether what is being proposed in the scheme is legal, fair, reasonable and proportionate.

The Minister's proposal for a legally binding non-judicial commercial debt and enforcement system was made in this context and the challenge faced by the Review Group was to determine whether such a system was legally and constitutionally possible in an Irish context.

The only report to consider the benefit or otherwise of examinership is the Company Law Review Group's report of December 1994 which states at paragraph 2.7:-

> "In looking at the examinership legislation and its application to date we sought to identify the justification for setting aside, in the hope of securing the future of an ailing company, normal commercial rights and interests. Examinership involves a cost which has to be borne, principally by creditors but also by competitors. The justification for the introduction of the legislation must lie within the concept of the public interest – that the benefit accruing to a wider group justifies the impairment of the rights of others".

The Review Group's Report of 1994 highlighted that of 64 companies having examiners appointed, 32 subsequently resulted in a receivership or liquidation (the figures excluded the three largest group of companies subject to examinership).

The Companies Registration Office has indicated that in 2008, 49 companies went into examinership of which 24 had a scheme of arrangement approved by the Court and then successfully emerged from the process, an almost identical ratio to the process of the early 1990s. However since 2008, the outcome of examinership has been more encouraging (notwithstanding that the figures do not take account of companies having come through the examinership process successfully, ultimately failing at a later stage):-

	Examinership	**Successfully exited Examinership**	**Success ratio**
2009	84	61	73%
2010	29	21	72%
2011	30	21	70%

The increased success ratio could in part be attributed to the recommendations of the 1994 Review Group as introduced by the Companies (Amendment) Act 1999, requiring an independent accountant's report to be prepared for the court to assist in its assessment whether the company (or part of it) by going into examinership has "a reasonable prospect of survival", rather than the less onerous requirement under the 1990 Act of a company (or part of it) requiring to show "some prospect of survival".

The recommendations in the 1994 report were prescribed in recognition of the presumption that creditors will have their debts written down to a greater, or lesser, extent in an examinership. This can have an adverse financial effect on suppliers, particularly the smaller ones who may, themselves, face insolvency if what is owed to them is written-down. In addition, the ability to write-down debts accrued in the course of running a business can distort competition with those competitors who discharge their liabilities in full being placed at a considerable disadvantage. The justification for examinership must, therefore, be founded in the presumption that saving the whole or part of the business involved accrues benefits for society as a whole, best exemplified by the protection of employment, that outweighs the costs suffered by creditors and competitors.

4. RELEVANCE OF EXAMINERSHP TO SMEs

Overall, the Review Group considered that there is a difficulty with smaller companies accessing the existing examinership procedures – primarily for cost reasons – and that there is scope for improving access for such companies to court protection and corporate rescue.

However, it is also recognised that any non-judicial debt settlement arrangements open to any category of companies carries the potential for significant loss to creditors whether they be employees, the Revenue Commissioners, local authorities, utility enterprises, lenders or trade creditors. This is clearly not desirable. The difficulty encountered in other jurisdictions in creating robust models highlights the need to ensure there are adequate safeguards, particularly where court oversight is diminished.

It is generally seen that SMEs, which are often family owned and managed, are less likely to attract new investment, which in many cases is essential for the continued viability for companies post examinership.

The Review Group heard anecdotal evidence that some companies which went into examinership did so solely to mitigate their debts. It is important to avoid the "phoenix company" scenario, bearing in mind that Part VII of the Companies Act 1990 was enacted to counter the "phoenix company". It is essential that giving an unfair competitive advantage to companies through an examinership must be avoided. Although there will always be companies which fail - examinership is not a process to be used to prop up badly managed or economically unviable companies. Winding up insolvent companies should always be the default position.

The principal issues which were identified, discussed and considered by the Review Group were:

- Difficulties in establishing the future viability of the whole or part of the business;
- Absence of any source of additional funding for the company;
- Absence of likely interest from new owners/managers to become involved in the business (possibly reflecting a reluctance on the part of present ownership management to cede control of the business in some cases);
- Costs of the process.

These factors would apply to all companies in financial difficulty but may be more pronounced in the case of SMEs, especially when dealing with family owned businesses. The group identified cost as a particular obstacle for small businesses.

The option of replacing the management of the company for the duration of the examinership, or providing some external oversight was considered but is likely to work only in certain cases and may not be practical for most smaller, family run businesses. Related to this would be the option of having a temporary, non-executive director to sit on the board. However, it is considered unlikely to think that persons with the appropriate skills, experience and judgment would agree to become a director of a failing company in such circumstances. It could be made more attractive by absolving such persons from some of the personal liabilities for directors, but they would still be required to act responsibly. It is also likely that such persons would require to be reasonably remunerated for taking on such a role and that given the highly pressurised nature of the role and the attendant risks, a premium would be required on what would normally be charged in such circumstances. In proposing solutions for ailing companies, the Review Group is mindful of the shortage of finance.

The possibility of using a service akin to the Financial Services Ombudsman was considered. However, it was felt that a similar arrangement would still need a right of appeal/judicial review, which is costly. The possibility of re-establishing a state bank was discussed. However, it was indicated this was not favoured at the time examinership was brought into Irish law (when Foir Teoranta was wound down) and this could now give rise to EU State aid issues which could be resolved only on a case by case basis which would not be practical.

5. COSTS

While the Review Group was not in a position to review actual cost data for examinership, it was agreed that currently examinership is not generally a possibility for many SMEs due to the cost associated with the High Court procedure. Figures of up to €300,000 have been indicated for the cost of an examinership although there are also cases where costs came in at much less than that. The main reason for the extent of costs is the need for the preparation of an independent accountant's report, a number of High Court hearings during the examinership process and the costs of the examiner during the 70 or 100 day protection period. It was accepted that there will still be professional fees involved for the accountant's report and the examiner (and his or her advisors), but that if the fees are reduced by spending less time in court and being able to avail of the Circuit Court without first having to apply to the High Court (as is currently the position) and the maximum protection period reduced for SMEs, this could open up examinership to SMEs.

It was understood that costs could be reduced if the number of times a party has to apply to court was reduced. In particular, High Court hearings result in significant legal fees. It should be kept in mind that if costs are to be reduced, input from professional advisors and court involvement need to be curtailed – this could adversely affect the quality of examinerships.

The Review Group noted that the legislation already empowers the Circuit Court to oversee the examinership process. However, the application must first be submitted to the High Court and then be remitted to the Circuit Court. Furthermore, the case can be remitted to the Circuit Court only if the total liabilities of the company (taking into account its contingent and prospective liabilities) are less than €317,434.52 (though the draft Companies Bill envisages this threshold being increased to €500,000).

The Review Group considered that the costs of applications which are heard before the Circuit Court would, in all probability, be lower than if heard in the High Court. However, the group was not able to form a view on the extent of any such reduction in costs. Having regard to the fact that costs were identified as an obstacle to access to the examinership process, particularly for smaller companies, the Review Group was anxious to identify any opportunities to reduce costs while still not compromising the integrity of the process.

Against this background, the Review Group considered that the existing and, indeed, the revised threshold for access to the Circuit Court is too low. Rather than attempting to determine an appropriate level at which access should be possible, the Review Group agreed that it should recommend that access to the Circuit Court for examinership applications should be extended to all small private companies, as defined in the Companies Acts. Furthermore, the Review Group felt that the requirement for applications to be filed initially with the High Court should be dispensed with, as is considered further in point 12.

Although the Circuit Court does not currently have direct experience of corporate insolvencies, it was noted that it was planned to give the Court a role in the new personal insolvency regime. Accordingly, the Court could be expected to quickly build a level of expertise in the type of issues arising in insolvency proceedings.

6. THE NEED FOR JUDICIAL OVERSIGHT

It was noted that some other jurisdictions have dispensed with the need for court involvement (New Zealand) and others do not require court involvement to enter the process, but only to approve the proposals upon exiting examinership (Canada). It was noted, however, that compulsory interference with property rights which are expressly protected under the Irish Constitution and any compulsory write down of debts for less than

market value requires either compensation for the loss, consent of the creditors or a court order whether by substantive approval of a scheme of arrangement etc. or a right of objection to the Court for dissenting creditors. This is to ensure that there is a proportionate and objectively justified interference with the creditors' property rights in the interest of the common good and to respect the constitutional right to fair procedures. The advantage of court involvement is that there is a built-in judicial process for protecting the constitutional rights of debtors and creditors.

There need to be adequate safeguards and balances to protect the rights of both creditors and debtors in any system that compulsorily writes down debts. Any compulsory interference with property rights requires an objective policy justification in the first instance and then has to be assessed as to whether it is a necessary and proportionate means to achieve that purpose. Write down of debts without consent or court order could be regarded as an unjustified and disproportionate interference with property rights in contravention of Article 40. The main concern for any court in considering any constitutional challenge will be to:

(a) identify the extent to which minority secured creditors' rights who did not consent to the debts write down have been impaired

(b) establish whether there is an objective justification for this impairment, and

(c) assess whether there are adequate safeguards and protections in any legislative scheme to minimise the adverse impact that the scheme will have upon secured creditors' rights.

The crux of the impairment of minority secured creditors' rights is the possible requirement of a minority creditor to crystallise its security immediately and take a write-down of debt without Court involvement. A secured creditor adversely affected (in its view) by any scheme of arrangement which requires it to accept the immediate sale of the property of which it has a security and which requires it to accept a write-down of its debt (albeit to a sum no less than the value of its security) may challenge the constitutionality of such a system. It is noted that the courts have shown great willingness to interpret legislation to protect the constitutional and property rights of individuals and companies. It is not possible to predict with any certainty the attitude that the courts would take to this proposal and the facts of any particular case. This is emphasised by the fact that the Personal Insolvency Bill is not yet enacted nor has any model under the Bill been tested in the Courts. If the Review Group's proposal is accepted by Government for enactment, legal and drafting advice would be required from the Attorney General's Office on the final form of the proposal to ensure compliance with the Constitution.

It was considered that compulsory interference with property rights which are expressly protected under the Constitution and any compulsory write down of debts for less than market value requires either compensation for the loss, consent of the creditors or a court order whether by substantive approval of a scheme of arrangement etc. or a right of objection to the Court for dissenting creditors. This is to ensure that there is a proportionate and objectively justified interference with the creditors' property rights in the interest of the common good and to respect the constitutional right to fair procedures. This interference with secured creditors' rights occurs not only on a compromise or scheme of arrangement at the conclusion of an examinership, but also at the commencement of an examinership where creditors' rights for the enforcement of debts owing to them are stayed. Thus court involvement is a pre-requisite both at the beginning and end of the protection period. The

advantage of court involvement is that there is a built-in judicial process for protecting the constitutional rights of debtors and creditors. The court would not sanction an unconstitutional scheme of arrangement – i.e. one which infringes the rights of a party to the extent that it is excessive, disproportionate or unfair.

7. APPOINTMENT OF AN EXAMINER

A test of a company's "reasonable prospect of survival" was considered essential to any regime. There is a view that in a number of cases it has been too easy to pass the reasonable prospect of survival test at present. This appears to have arisen not from the approach of the Court but from the outcome and manner in which the independent accountant's report is prepared and presented. It was noted that a consequence of a company entering examinership is not only to give a temporary and hopefully long term reprieve for employees of the company but also a write down of debt owed to suppliers thereby putting the business and employees of suppliers at risk. If examinership is obtained by a company which would otherwise go into liquidation, the write off of debt owed to suppliers may ultimately be more significant if the company subsequently enters liquidation, as the company would have wasted its meagre resources on professional fees incurred in obtaining and going through an examinership.

It was also considered whether an event stipulated in a list of exceptional circumstances which may occur in an SME that could trigger examinership – e.g. collapse of major customer; death or incapacity of principal shareholder/director; sudden interruption of business etc. However, it was felt that it would be too difficult to prescribe these events in the legislation.

8. PRIORITY OF CLAIMS

Since the introduction of examinerships, the Courts have developed a consistent approach as to the extent and relative percentage write down of debts in approved schemes of arrangement. Different approaches have been developed for secured, preferential, unsecured and subordinated creditors. It is suggested this approach would continue for SMEs undertaking examinership through the Circuit Court.

However, the Revenue Commissioners disagreed on this point. They were strongly of the view that the Review Group proposal is for a new mechanism, entirely distinct from the existing examinership process. They see it as being, in reality, closely aligned to the debt settlement arrangements provided for in the Personal Insolvency Bill and contend that there is an overlap between the type of businesses that may have recourse to the personal insolvency regime as sole traders and the small companies that may seek protection under this proposal. That being the case, the Revenue Commissioners argue that there should be similar treatment of debts under both arrangements. In particular, they consider that those debts that are specifically excluded from the personal insolvency arrangements (unless the relevant creditor agrees in writing to accept the compromise on offer) should be similarly excluded here. Excluded debts in that context would include taxes, duties, levies and other charges owed to the State.

The view of the majority of the Review Group's members was, however, that while it is suggested that the proposed *Insolvency Service* could play a role in the administrative decision to appoint an examiner, this was the only relevant similarity with the Personal Insolvency Bill 2012. The Review Group proposes that save in respect of the initial

appointment of an examiner, with minor more restrictive modification the law applicable to the carriage of the examinership should be based on the existing law. A majority of the Review Group did not consider that there was any basis in principle to distinguish a scheme approved by the Circuit Court following the appointment of an examiner by administrative act from a similar scheme approved by the Circuit Court or High Court where the examiner is appointed following an application made to that court. Consideration of a new system of priority or increased preference for categories of creditors of insolvent companies whether for employees, the Revenue, local authorities, utility enterprises, lenders or trade creditors would be best undertaken by a separate review.

9. LICENSED OR QUALIFIED INSOLVENCY PRACTITIONER

The Personal Insolvency Bill introduces the concept of a licensed insolvency practitioner. On the other hand, the draft Companies Bill proposes to introduce a qualification regime for liquidators, and this qualification regime will apply also to examiners. The intention here is to ensure so far as reasonably possible that the independent accountant's report on the company filing for examinership (as well as the scheme ultimately proposed to creditors) is prepared in an appropriately objective manner to minimise the risk that the company will obtain protection on foot of a report which on its face appears adequate but which in fact gives a misleading picture as to a company's prospects of survival.

Concern was expressed that a licensing or qualification system which is primarily linked to membership of professional bodies, without a mechanism for investigation of competence and independence in the exercise of insolvency – specific functions, has its limitations as a means of enforcing standards in the specific field of insolvency practice.

It was noted that the new Companies Bill links examinership with the new qualification regime for liquidators. The view was expressed that effective regulation of insolvency practitioners requires that a designated regulator have the power to both authorise and strike off practitioners and, in that context, to investigate complaints from interested parties as to the extent to which practitioners have fully discharged their responsibilities in individual cases. Regarding qualification/licensing arrangements, the accountancy profession has signalled that they may have to increase their fees if there is a qualification requirement.

The Review Group considered that a reduced court involvement may need to be balanced by additional protections, such as closer regulation of insolvency practitioners, in order to provide the assurance of independence and professional competence traditionally provided by court oversight of examinerships.

10. APPROACH OF OTHER JURISDICTIONS

In approaching the issues, the Review Group considered systems adopted in some other jurisdictions, which may be summarised as follows:-

Australia – A voluntary administration procedure may be initiated by the company without any court involvement. The administrator must be a qualified liquidator registered with the Regulator.

The administrator will put forward a proposal on which the creditors must vote at a meeting. A secured creditor is not required to be bound by the vote but if the secured creditor's dissent threatens the restructuring, the court may require the creditor to refrain from enforcing its security.

In many cases the court will have no involvement but it will intervene to prevent abuse.

Canada – This involves a licensed trustee in bankruptcy filing a proposal with the Office of the Superintendant of Bankruptcy whereupon creditors' claims are stayed. There is no court involvement for this stage.

A meeting of creditors is convened by the trustee at which the company will make its proposals for a debt settlement. If the proposal is accepted by the creditors it must then be approved by the court.

France – There are two procedures for insolvent companies. Under the conciliation procedure a conciliator is appointed to the company whose management remains in control. The role of the conciliator is to negotiate a voluntary arrangement with the creditors, all of whom must agree.

Under the redressement judicaire a petition is filed with the court. An administrator is appointed and has six months to devise a plan with a stay on creditors in the meantime with management remaining in control. The court approves the arrangement.

Hong Kong – The procedure involves a compromise between the company and its creditors which is subject to the sanction of the court. This is preceded by a court application for the holding of a creditors' meeting. These are new proposals which are designed to minimise court involvement and provide for greater involvement of creditors.

Malta - This involves the court placing a company under a company recovery procedure by appointing a special controller to manage and administer the company's business for up to 12 months with a possible extension for a further 12 months. The special controller will ultimately make a proposal to the court which if approved will be binding.

New Zealand - The first procedure is a compromise whereby the company proposes a compromise at a meeting of its creditors. The decision of a 75% majority will be imposed on the minority. It appears this procedure does not involve a stay on creditors.

The second procedure is a voluntary administration. The company appoints an administrator. During that time there is a stay on creditors' claims. For an arrangement to be agreed 75 per cent in value and 50 per cent in number of the company's creditors must agree. While the court can intervene, a voluntary administration can be conducted without court involvement.

Northern Ireland – The CVA is operated in Northern Ireland. A CVA is a Company Voluntary Arrangement which involves a private arrangement between the company and its creditors. It is not subject to any publicity and envisages creditors agreeing a debt settlement with the company. The proposal for a debt restructuring is set out by a Nominee at a meeting of creditors which if approved (by 75% in value of all creditors and 50% in value of unconnected creditors) is binding on all creditors. It can be challenged in court if there is a material irregularity or there has been unfair prejudice.

Norway – The approval here involves debt settlement procedures whereby an insolvent company files a petition with the court. The company comes under the control of supervision of the court. In a compulsory debt settlement, 75% in number and value of unsecured creditors must support this and unsecured creditors must receive at least 25% of their claim. It is understood that this procedure has encountered difficulties in practise.

South Africa – A new procedure has been established where the company makes a filing with the Commission. Affected persons may apply to court to set aside the appointment of a Business Rescue Practitioner (who must be licensed and is subject to regulation). A stay is put on creditors' proceedings, although set off is permitted. The proposal arrangement must be approved by 75% of creditors (in value) and 50% of independent creditors (in value).

The Review Group carefully considered whether any of the foregoing regimes might be capable of being adopted in Ireland. The Review Group had the benefit of the advice of its member representing the Office of the Attorney General and concluded that, absent the consent of all creditors, the compromise of third parties' rights, in Ireland, required judicial sanction. The Review Group is satisfied that the law already adequately facilitates the consensual compromise of debt.

The Review Group also considered that the experience from other jurisdictions indicated that it was necessary that an independent person should be responsible for the formulation of a scheme. In an Irish context, this role is currently fulfilled by an *examiner* and the Review Group saw no reason to create a new position in the context of formulating schemes for small companies.

Within the strictures of the constitutional requirement that the non-consensual compromise of third parties' claims requires judicial sanction, the Review Group still considered that the models in other jurisdictions provided a basis for developing a non-judicial aspect to the process. In this regard the Review Group distinguished between the *appointment of an examiner* from the *sanction of a compromise scheme*. Accordingly, the Review Group focussed its attention to developing recommendations based on:

- having less judicial involvement in the appointment of an examiner, and
- having no judicial involvement in the appointment of an examiner.

11. EXTENDING THE ROLE OF THE CIRCUIT COURT

At present, the Circuit Court can oversee the examinership process, but the application must first be submitted to the High Court and then be remitted to the Circuit Court. It was suggested that the role of the High Court could be removed to allow direct access to the Circuit Court. The current threshold for remitting a case to the Circuit Court is where the total liabilities of the company (taking into account its contingent and prospective liabilities) are less than €317,434.52, which is to be increased to €500,000 in the Companies Bill.

The Review Group considered that the "liabilities" test for qualifying to bring application in the Circuit Court, would be better replaced by a test based on more objective criteria. For this reason, the Review Group believes that the appropriate test should be that applicable to the requirement relating to the preparation of financial statements based upon whether companies are small, medium-sized or large private companies.

Of these, the Review Group considered that its focus should be on small private companies ("SPC"). An SPC is a company falling within section 8(1)(a) of the Companies (Amendment) Act 1986 and means a private company that, in a particular year and in the immediately preceding financial year, satisfies at least two of the following conditions:

— its balance sheet total did not exceed €4,400,000;
— its turnover did not exceed €8,800,000;
— its average number of employees did not exceed 50.

Although some concern was expressed by the ODCE that an SPC, as defined, could have liabilities of many millions of euro, it was thought that adequate protection would be afforded to all creditors by operation of a judicial process and that consideration might be given to providing that a creditor whose debts are written-down over a certain amount (e.g. €4,400,000) will have an automatic right of appeal to the High Court.

If the jurisdiction of the Circuit Court is extended, the Review Group is conscious that this would involve an increase in resources and requires consultation with the Department of Justice and the Courts Service. The need for any increased resources should be justified by extending the examinership process to companies which would otherwise fail and the beneficial impact on jobs, not only socially, but for increased tax revenue for the State would more than compensate for any additional resources required. Although the Circuit Court may not have direct experience to deal with examinerships, the proposal to include the Circuit Court in personal insolvencies should give a degree of critical mass to ensure reasonable familiarity with insolvency proceedings.

The High Court examinership process has worked. The jurisprudence that has been developed by the High Court has resulted in few creditors having a legitimate grievance after the approval of a court scheme of arrangement. The primary reason why it is not working for SPCs is because of the costs involved which are considered to be disproportionate to the resources of SPCs. While the Review Group believe that for some SPCs, even allowing an application to be brought completely within the Circuit Court structure will involve too much cost, it nevertheless feels it would be a lost opportunity to preclude SPCs from bringing a traditional examinership application in the Circuit Court.

The Review Group therefore recommends that SPCs should be able to apply directly to the Circuit Court to have an examiner appointed, and not be required to apply to the High Court although that should remain an option.

By section 8(3) of the Companies (Amendment) Act 1986, a private company qualifies to be treated as a 'medium-sized' company for any financial year if, both in that year and in the immediately preceding financial year, it satisfies at least two of the following conditions:

— its balance sheet total did not exceed €7,618,438;
— its turnover did not exceed €15,236,857;
— its average number of employees did not exceed 250.

These thresholds have only recently been revised upwards and are now at such a level that the Review Group concluded, with some reservations, that, given their new larger size, ailing medium-sized companies should continue to have only the option namely, to apply to the High Court for the appointment of an examiner.

12. PERSONAL INSOLVENCY BILL AND THE PROPOSED INSOLVENCY SERVICE

In considering a non-judicial mechanism for corporate rescue, as noted under point 10 above, the Review Group considered that it is possible to distinguish between the approval of a scheme or compromise (which requires judicial sanction) from the initiation of an examinership through the appointment of an examiner (which could happen on an administrative basis).

Were it to be decided, in the case of an SPC, to allow the initiation of an examinership by the appointment of an examiner by administrative, instead of judicial act, some State agency would need to be charged with responsibility for that determination.

The Review Group considered the Personal Insolvency Bill 2012 which it noted is stated to cover trade debt, and found that a number of provisions in the Bill may be usefully adopted for certain companies also. The Review Group, in particular considered that while a number of agencies exist (ODCE, CRO, IAASA etc) the proposed *Insolvency Service* to be established by the Personal Insolvency Bill 2012 would, given its proposed purpose and functions, appear to be best suited to making an administrative decision that a particular SPC might have a reasonable prospect of survival were an examiner appointed to it.

The Review Group is mindful, however, that the proposed agency will face significant challenges in establishing capacity to carry out the remit envisaged for it in the Personal Insolvency Bill, that it will also face potentially significant challenges in meeting demand for the proposed new personal insolvency remedies, and that, by virtue of the State's commitments to the IMF and EU under the Programme of Financial Support for Ireland, priority attaches to the effective implementation of the reform of the personal insolvency regime.

Accordingly, the Review Group recommends that consideration should be given to the practicability of extending the role of the new *Insolvency Service*, proposed to be established to include the administrative determination as to the initial appointment of an examiner to an SPC, having due regard to the priority requiring to be given to the mandate concerned for that agency under the Personal Insolvency Bill.

13. PROPOSAL FOR SIMPLIFIED INITIATION OF EXAMINERSHIP

The Review Group believes that a proportionate response to the difficulties faced by many SPCs is to provide such companies with an alternative, less expensive, option to the current initiation of an examinership which necessitates a court application.

The Review Group proposes that, subject to the identification of a suitable State agency, and further analysis and deliberation of the policy issues, it appears to the Review Group that it would be legally possible for the SPCs to be allowed to initiate examinership by non-judicial procedure. . The simplified procedure should only extend to the appointment of an examiner. Any scheme of arrangement or proposal formulated by the examiner must be approved by the Circuit Court.

By majority, the Review Group believes that the law applicable to the carriage of examinership and the determination of any compromise or scheme proposed by the examiner, should be that currently applicable to High Court examinership subject to the

variations set out below. The Revenue Commissioners expressed a dissenting view arguing that the proposed approach would be an entirely new scheme requiring careful consideration on its own merits.

While carrying on business, the directors of a company which finds itself insolvent, or likely to become insolvent, have a duty towards creditors either to cease trading and wind up the company or, if they consider, with court protection the company or part of it, has a reasonable prospect of survival, should seek to put the company into examinership. An examinership may offer the prospect of recovery for the ultimate benefit of the company's employees, creditors (who are likely to have the debts already owing to them compromised) and shareholders (who may face dilution).

The Review Group considered that the existing examinership process is adequate for the needs of medium companies (within the meaning of Section 8(1)(b) of the Companies (Amendment) Act 1986) as well as larger companies. Accordingly, the Review Group considered that its proposal for administrative appointment of an examiner should be available only to small companies within the meaning of Section 8(1)(a) of the Companies (Amendment) Act 1986.

This new scheme would offer an alternative to the existing examinership process for small companies but would not prevent small companies opting for traditional examinership in either the Circuit Court or the High Court if they so wish.

The following was considered to be a possible way forward to enable SPCs that may not be able to afford the traditional examinership process to obtain protection for a limited period to restructure the company for the benefit of employees, creditors, shareholders and thus the economy as a whole.

(1) An SPC which is insolvent, or likely to become insolvent, whose directors or shareholders wish to seek court protection for the SPC has a report prepared by an independent expert (within the meaning of Section 501(2) of the draft Companies Bill) (the "Expert"). The primary function of the Expert is to assess the suitability of the company for entry to the process – this will include an assessment of the company's survival prospects as well as the likelihood of being able to formulate a successful proposal.

(2) The Expert files his/her report with the Insolvency Service (an office dedicated to companies but forming part of the Insolvency Service to be set up under the Personal Insolvency Bill) which, if satisfied that there is a reasonable prospect of survival of the company (or part of it), will issue a protection certificate and file it with the Circuit Court, who will hear any application by a dissenting creditor against the issue of a protective certificate.

(3) On the filing of the certificate with the Circuit Court, in the absence of any contrary order, a stay is put on creditors' actions and any debt enforcement measures. Once a protection certificate has been issued, an examiner is appointed [by the Insolvency Service and notice of appointment is filed with the Circuit Court]ultimately to formulate a proposal for submission in the first instance to a creditors meeting.

(4) Recognising the potential for conflicts of interest, particularly given the limited court oversight involved, there was some support for requiring the examiner and the Expert to be different persons (and to be from different professional firms). On

balance, the Review Group considered that it should be allowable for the examiner to be the same person as the Expert as this could save duplication of work and cost.

(5) Neither the Expert nor the Examiner should be a person who has a material connection with the SPC or any of its directors or shareholders.

However, because of the perception or otherwise that having the same person preparing both the Report and the proposal for creditors could be open to potential abuse arising from the absence of scrutiny by the Court, the Review Group considered there may be a case for Experts and examiners to be subject to regulation and/or for a creditor to be able to object to the same person taking on both roles if a creditor considered it inappropriate in any case.

Any new regulatory system would need careful consideration and should have regard, inter alia, to the restricted time scale available for the preparation of an Expert's report.

(6) The preferred protection period should be 70 days, which could on a successful application to the Circuit Court be stretched to 100 days. As the length of time taken to formulate a proposal is generally a cost factor, it would be envisaged an extension of an examinership to 100 days would be unusual unless there were compelling reasons for the extension. An SPC should generally be capable of being saved within 70 days or not at all.

(7) The Examiner would prepare a proposal for submission to a creditors' meeting. If approved by not less than 65% of unconnected creditors in value and not less than 50% in number in each case, the proposal is sent to the Circuit Court for approval, who will also hear any application by a dissenting creditor against approval.

(8) In view of the fact that for SPCs a successful examinership may result in the same directors remaining or the board of an SPC, and that the potential for abuse may be increased through diminished court involvement, one of the Examiner's functions should be to examine the conduct of the SPC's directors and their fitness to continue as directors of the SPC into the future and to report their findings to creditors in advance of the vote on any proposal. In the course of such review, any material misrepresentation given by a director in the course of the preparation of the Expert's Report should result in such director incurring personal liability for the discount of the SC's debts permitted under the approved scheme of arrangement.

(9) Costs for an SPC seeking and going into examinership should be much reduced from the current levels due to the use of the Insolvency Service and the Circuit Court rather than the High Court as a result of a reduced number of court hearings as well as the reduced legal costs in the use of a lower court.

(10) The majority considered that the priority and level of write down of claims in the categories of secured, preferential, floating charge, unsecured, subordinated and shareholders should follow the current jurisprudence of the courts in approved schemes of arrangement of companies successfully exiting examinership to ensure a proportionate and objectively justifiable interference with the private property rights of creditors. The Revenue Commissioners disagreed on this point and, as set out at section 7 above, articulated the view that this is a new mechanism, entirely distinct from the existing examinership process but closely aligned to the debt settlement arrangements provided for in the Personal Insolvency Bill and, as such, that taxes and other debts should be treated in the same way as applies to those

personal debt settlement arrangements. A majority of the Review Group did not consider that there was any basis in principle to distinguish a scheme approved by the Circuit Court following the appointment of an examiner by administrative act from a similar scheme approved by the Circuit Court or High Court where the examiner is appointed following an application made to that court.

The foregoing proposal is recommended as a possible way forward to enable SPCs to obtain protection for a limited period (at less cost than for a medium sized or large private companies or PLCs) to restructure the company for the benefit of employees, creditors, shareholders and thus the economy as a whole.

14. Conclusion

The Review Group considers that the task it faced raised very difficult, complex and in some cases irreconcilable issues of law, policy and principle which were not specific to company law. In attempting to guide the Minister on possible ways to assist small companies the Review Group has suggested the involvement of a State agency that has not in fact as yet been established. Accordingly, the Review Group acknowledges that its recommendations, in relation to the identity of the State agency which would make the administrative determinations, are necessarily tentative. Moreover, should the Minister decide to pursue the proposals suggested by the Review Group, there would need to be a significant amount of inter-Departmental consultation and policy analysis required to draft appropriate heads of Bill.

The Review Group realises that its suggestions relating to the *Insolvency Service* will necessitate consultation with the Department of Justice and Equality and the Courts Service in view of the implications of those recommendations for their respective legislative remits.

By contrast, subject to establishing that the Circuit Court has the necessary resources available to it and the policy agreement of the Department of Justice, the Review Group believes that there is no other reason why the changes proposed to permit all SPCs to bring application directly to the Circuit Court cannot be quickly progressed.

28 September 2012

Appendix 1

Terms of Reference

The Minister asked the Review Group to examine the appropriateness of introducing a legally binding non-judicial commercial debt and enforcement system, to be used by small and medium sized businesses ("SMEs") into the Companies Acts, having regard in particular, but not exclusively, to the following factors:

1. The adequacy or otherwise for small and medium sized businesses of the procedures currently available in this regard under the Companies Acts, and in particular the existing examinership procedure;

2. Whether the particular needs of small and medium sized businesses could be catered for by introducing appropriate modifications to these existing procedures, for example by making greater use of courts below the High Court, or substituting alternative non-judicial safeguards for creditors, such as is proposed in the Summary Approval Procedure in the new Companies Bill;

3. The appropriate level of involvement, if any, of the courts in a non-judicial system, for example, whether there should be a confirmation of any proposal by the court, or a right of creditors to object, or no court involvement;

4. If a non-judicial system were to be introduced, whether its availability should be subject to a test comparable to the current "reasonable prospect of survival" test for examinership, and if so, by whom such an assessment could be made in the absence of court involvement

5. Potential issues regarding secured debts, and whether such security could legally be subject to the application of any non-judicial procedure;

6. Potential Constitutional issues, whether in relation to the possible writing-down of secured debts, or otherwise;

7. Potential cost issues, including the extent to which costs incurred under the existing procedures may be reduced by removing the involvement of the High Court, or any court, from those or any alternative procedures;

8. Potential competitiveness issues, including among competing participants in the same field of economic activity;

9. Potential implications for the willingness of credit institutions to lend to small and medium sized businesses if a non-judicial debt settlement and enforcement system becomes available for such companies;

10. Potential implementation issues, for example, the extent of the availability of any new non-judicial procedure in group situations where some companies are sufficiently small to qualify for such a procedure, but related companies within the group are not so qualified.

Appendix 2

Membership of the CLRG Committee (including alternates)

William Johnston	**Chairman**
Jonathan Buttimore	Attorney General's Office
Jim Byrne	Revenue Commissioners
Marie Daly	IBEC
Helen Dixon	Companies Registration Office
Mark Fielding	ISME
Noel Gaughran	Irish Banking Federation
Joseph Gavin	Central Bank of Ireland
Brian Hutchinson	UCD Centre for Commercial Law
Esther Lynch	ICT U
Ralph MacDarby	Institute of Directors
Vincent Madigan	CLRG
Kathryn Maybury	Small Firms Association
Tom Murphy	Collector General's Office
Theresa O'Connor	Central Bank of Ireland
Conor O'Mahony	ODCE
Mark Pery-Knox-Gore	Law Society of Ireland
Breda Power	Department of Jobs, Enterprise & Innovation
Kevin Prendergast	ODCE
Nóra Rice	Companies Registration Office
Conor Verdon	Department of Jobs, Enterprise & Innovation

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