Corporate Insolvency in Ireland

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Introduction

The collapse of the "celtic tiger" in Ireland has triggered a significant increase in the number of corporate entities incorporated in Ireland which are being deemed "insolvent" and which are no longer in a position to continue operating as viable going concerns. This has of course necessitated directors, creditors and shareholders of such companies together with their professional advisors turning their attention to the mechanisms available under Irish law to deal with those entities. The purpose of this article is to give a brief overview of some of the mechanisms available to companies, their directors and of course creditors under Irish law where the companies concerned have fallen victim to the current domestic and global economic crisis.

Mechanisms of Corporate Insolvency

The primary legislation governing the law of corporate insolvency is contained in the Companies Acts, 1963 to 2006 (the "Companies Acts") and, in the case of receivership, the Conveyancing and Law of Property Act 1881.

The principal mechanisms for dealing with insolvent companies are as follows:-

(a) Liquidation;
(b) Examinership;
(c) Receivership.

Liquidation

Liquidations are governed primarily by the Companies Act, 1963 (the "Principal Act"). Liquidation is a terminal process which sees the liquidation of the assets of the Company, payment of creditors and ultimately the dissolution of the company and its removal from the Register of Companies.

The winding-up of a company under Irish law may be effected by one of the following:

(i) court liquidation;
(ii) creditors' voluntary liquidation (where the company is insolvent);
(iii) members' voluntary liquidation (where the company is solvent).

In light of the focus of this article we do not intend to address the members voluntary liquidation process on the basis that this is applicable to solvent companies only.

(i) Court Liquidation

A court or official liquidation occurs where a company or more usually one of its creditors petitions (makes application to) the High Court in Ireland (the "Court") for an order seeking the winding-up of the company and the appointment of a liquidator. The principal reason for a court liquidation is the company's inability to pay its debts. Pursuant to the Principal Act a company is deemed to be unable to pay its debts if:-

1) a demand for a sum exceeding Euro 1,250 has been served on the company and such demand has not been met within 3 weeks without the dispute of the debt;
2) a Court order in respect of a debt remains unsatisfied after attempted execution;
3) it is proved to the satisfaction of the Court that the company is unable to pay its debts.

However there are other grounds on which the Court may exercise its jurisdiction to order the winding up of a company and appoint a liquidator, including where it is of the view that it is just and equitable that the company should be wound-up. Accordingly it may be possible for a creditor to week an order for the winding up of a company in circumstances other than its inability to pay its debts in accordance with the Principal Act.

As is the case in most jurisdictions, the official liquidation process is one which is subject to very specific procedural steps as set out in the Companies Acts and the applicable rules of court. The primary aim of these procedures is to ensure that all relevant parties are given adequate notice of the presentation of the petition and to provide interested parties with the opportunity to have their concerns heard by the Court prior to the Court granting any order for the winding up or the appointment of the liquidator

(ii) Creditors' Voluntary Winding-Up

In the case of a creditors' voluntary winding-up, the process is again usually initiated by a creditor who will take such steps as it believes are necessary to prompt the company and its directors to commence the winding up process on the basis that the company cannot by reason of its liabilities continue its business. It should be noted however that where a company is insolvent it is usually the directors of the company who first become aware of the company's insolvency and in such circumstances the directors of the company have a duty to take such steps as are necessary to wind up the company.

Irrespective of who first identifies the financial difficulties of the company, the creditors' voluntary winding-up will involve the directors resolving to convene two meetings namely a meeting of the members of the company, and one of the creditors. At the members' meeting ordinary resolutions are passed resolving (a) to wind-up the company by reason of its insolvency and the inability to continue in business, and (b) to appoint a liquidator. This must be followed almost immediately by a meeting of the company's creditors and again the Companies Acts prescribe very specific procedural steps which must be adhered to in the conduct of a creditors' voluntary winding up. In contrast to the Court liquidation it is in effect the creditors of the insolvent company who are in control of the liquidation process. While the creditors' meeting will be chaired by a director of the insolvent company the purpose of the meeting its purpose is to enable the creditors to consider the director's "statement of affairs". The Principal Act requires that the directors' make available a full statement of the position of the company's affairs together with a list of the creditors of the company and the estimated amount of their claims. At the creditors' meeting the directors will be expected to account to the creditors as to the causes of the company's insolvency. The creditors may also at this meeting appoint an alternative liquidator in place of the one which was appointed by the shareholders of the company in general meeting. In addition the creditors are also entitled to appoint a committee of inspection comprised of up to five people nominated by the creditors with up to three additional members nominated by the members of the Company which such nominees may be objected to by the creditors. The committee of inspection has, inter alia, the power to fix the remuneration of the liquidator, determine whether the liquidator should continue the business of the company and to determine whether the powers of the directors should continue. This element of control together with the perceived cost benefits of the voluntary liquidation process means that many creditors prefer the creditor's voluntary process to that of an official liquidation.

(iii) *Functions of the Liquidator*

As outlined above, in both a creditor's voluntary winding-up and a Court liquidation, a liquidator is appointed to wind up the affairs of the company. In practical terms the liquidator will identify the assets of the company, take those assets under control, liquidate those assets, identify creditors and distribute those assets in order to satisfy all or part of the claims of such creditors in accordance with the law relating to priority of payments (which we will touch on further below).

In addition to the statutory duties owed by the liquidator to members and creditors (e.g. in terms of preparing a final statement of account), the liquidator owes fiduciary duties to the company as opposed to individual creditors. In exercising its duties, the powers of the liquidator are equally subject to the parameters set out in the Companies Acts. In general terms the powers of the liquidators are those usually attributable to the directors of the insolvent company whose powers to act generally cease on the appointment of a liquidator. That said there are distinctions between the powers which may be exercised by an official liquidator appointed in connection with a Court liquidation and those which may be exercised by the liquidator appointed in respect of a creditors' voluntary liquidation. Many of an official liquidator's powers may only be exercised with the sanction of the Court or the Court appointed committee of inspection while others may be exercised without the sanction of the Court but are subject to Court control. In contrast a voluntary liquidator will generally have much greater freedom in the exercise of those powers which are in the course of an official liquidation are exercisable only with the sanction of the Court.

(iv) Liquidation and Creditors' Rights

Obviously the primary concern of a creditor of an insolvent company is when and how much of the debt owed to it may be recovered out of the assets of the Company. In both a Court liquidation and in a creditor's voluntary liquidation the liquidator will advertise for creditors to prove their claims. Any dispute of a creditors claim will be determined by the Court.

The benefit of a being a secured creditor of course is that a secured creditor may rely on their security in a liquidation rather than prove their claims to the liquidator. Where the security is a fixed charge, the assets subject to such security are not available to meet any expenses or claims in the liquidation. The holder of a fixed charge will generally appoint a receiver and the receiver will take control of the assets subject to the fixed charge and dispose of same with the view to satisfying either in whole or in part the secured creditors' claim. Any surplus must be paid over the insolvent company. Where the security is a floating charge (such as the charge over book debts) and a receiver (see below) has not been appointed by the holder of the security prior to the commencement of winding-up, the expenses of a liquidator as well as any preferential creditors must be met out of the proceeds of realisation of the security. Any balance is then available to the secured creditor.

In summary after the holders of a fixed charge have been paid the order of payments to be made by the liquidator is as follows:-

1) liquidator's fees and expenses;
2) preferential creditors claims (which comprises of certain statutory tax and employee benefit liabilities);
3) claims of the holder of floating charges which have not crystallised prior to the winding up;
4) unsecured creditors claims;
5) deferred debts ranking pari passu; and
6) members or contributories to the Company.

Alternatives to Liquidation

Of course one of the difficulties with the liquidation process is that it does not contemplate or facilitate the continuation of the company as a going concern even where the directors, members and creditors believe that the company itself may have a future but is struggling in current market conditions. In this regard we will turn our attention to the mechanisms which might be available under Irish law to facilitate the continuation of the company, all be it insolvent, as a viable business proposition.

Schemes of Arrangement

Even where a company is insolvent and a liquidator appointed there is a provision of the Principal Act which may be invoked to bring a company back from the finality of liquidation. Pursuant to Section 201 of the Principal Act a liquidator on behalf of the company may prepare proposals for the compromise of debts and other obligations. The various classes of creditors and shareholders must approve the proposals which must be confirmed by the Court before becoming effective.

Examinership

The examinership procedure was introduced into Irish law by the Companies (Amendment) Act 1990 (as amended) (the "CAA"). In short, examinership provides a maximum one hundred day period in which a Court appointed official i.e. the examiner, seeks to take control of the company and manage it so that the company may continue to trade.

The examinership procedure may be initiated by the company, the directors of the company, by a creditor or a prospective creditor or by members of the company holding not less than one tenth of the paid-up capital of the company having voting rights. The basis for the petition must be that the company is or is likely to be unable to pay its debts (with in the meaning of Section 2 of the CAA), that no order has been made up for the winding-up of the company and no resolution subsists for the winding-up of the company.

A petition to appoint an examiner to a company must be accompanied by a report in relation to the company of an "independent accountant". In order for the petition to be successful the report must confirm that, inter alia, the independent accountant believes that there is "reasonable prospect of the survival of the company on the whole or any part of its undertaking as a going concern" and the Court will only make an order appointing an examiner if it is satisfied that this is the case.

Effect of Examinership

Once the examiner has been appointed no proceedings may be commenced against the company, no execution may be made against the company's assets and no secured creditor may enforce its rights under the security.

As noted above the examiner's function is to examine the affairs of the company and to formulate proposals for its survival. Management of the company does not automatically vest in the examiner but the examiner does exercise a supervisory role in the conduct of the business by its management. Where an examiner deems it necessary to do so he/she may apply to the Court to assume such management functions where the examiner is of the opinion that the company is being mismanaged.

As soon as practical, after his/her appointment, the examiner must formulate proposals for a compromise or scheme of arrangement, to facilitate the survival of the relevant body as a going concern. Such proposals must be accepted by each class of creditors to which they relate and must be confirmed by the Court. The Court can confirm the proposals only to the extent that they have been accepted by at least one class of creditors who are effected by same, that they are fair and equitable having regard to the rights of all classes of creditor and they are not contrary to the interests of any interested party.

Once confirmed by the Court, the proposals become binding on all creditors whether secured or unsecured and their rights are accordingly modified.

Effect of Examinership on Secured Creditors

Unfortunately for secured creditors the CAA provides that no secured creditor can act in respect of the property of the company which is secured in its favour for the duration of the examinership period without the consent of the examiner. Furthermore the examiner has certain powers to dispose of assets subject to a fixed and/or floating charge with leave of the Court. While for a fixed charge holder this means that it will receive the net proceeds of any such disposal (though less the remuneration, costs and expenses incurred by the receiver if the Court so determines), a floating charge holder may not receive the proceeds of disposal of any of the assets discharged in its favour.

Powers of the Examiner

An examiner has broad powers to prevent the company from acting in a manner in relation to its assets where he is of the opinion that such conduct will be or is likely to be detrimental to the company. However an examiner may not repudiate a contract that has been entered into by the company prior to the period during which such company is under the protection of the Court save for agreements constituting negative pledges where he is of the view that the enforcement of such negative pledge would be detrimental to the companies prospects of survival.

Receivership

Receivership arises in the context of secured creditors and provides a framework in which they may act so as to enforce their security interest. A receiver is typically appointed to a company by either a debenture holder or the Court to take control of the assets of a company with a view to ensuring the repayment of the debt owed to the debenture holder, either through receiving income or realising the value of the charged asset. The most common form of receivership is that of a receiver-manager appointed by a debenture – holder pursuant to a debenture document that creates a floating charge over all the company’s assets.

It should be noted that while it is often the commencement of insolvency proceedings or the imminent threat thereof which triggers the appointment of a receiver this is not always the case and in many circumstances there will be provision made for the appointment of a receiver even where the company may not be deemed to be insolvent either for the purpose of the liquidation or examinership process. In the case of a receiver to be appointed pursuant to the terms of a debenture this will of course depend on the terms of the contract and the events of default which may give rise to the appointment of a receiver. In the alternative, the Court has inherent equitable jurisdiction to make this appointment.

Receivership has a dual function in respect of companies in financial difficulty: (i) to realise the assets of the company so that the secured creditor's debt is repaid as quickly and efficiently as possible; and (ii) the other and less frequently exercised function is to manage the company in such a way so as to salvage the company (or part thereof) which will be to the ultimate benefit of both the company and the debenture –holder.

It should be noted however that where a receiver has been appointed to a company to which a liquidator has been or is subsequently appointed, the liquidator of that company may apply to the Court to order that the receiver cease to act or act only subject to the control the Court.

Conclusion

Ultimately the appropriate mechanism to be employed in respect of a company facing financial difficulties will be dependent upon the extent to which those difficulties impact on the ability of the company to meet the obligations owed by it to creditors. There is of course some comfort for both companies and creditors alike that the Irish statutory framework at least contemplates solutions which draw back from the finality of ultimate dissolution of a company and facilitates interested parties a way forward through these recessionary times perhaps even to the benefit of all parties concerned.

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