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CHAPTER 1

INTRODUCTION TO INSOLVENCY: OVERVIEW AND RECENT DEVELOPMENTS

Michael Quinn

1.1 Introduction

Until recent years, the study of bankruptcy and insolvency laws dealt mainly with the traditional remedies available to creditors, such as the penalisation of recalcitrant debtors (which, historically, included terms of imprisonment). Trends in this area of commercial and legal practice now focus on more positive concepts, such as the rehabilitation of the debtor. The so-called 'rescue culture' aims at recovery and reconstruction, with the principal benefits being the saving of value for all stakeholders, whether they are investors, creditors or employees. At the same time, recent developments are designed to curb those who abuse the concept of limited liability, to penalise those who perpetrate such abuses and to protect third parties from the effects of repetition.

To understand the benefits that can be achieved by the orderly conduct of insolvency procedures, it is necessary to develop a knowledge of the basic remedies and procedures available. Therefore, this book covers all forms of insolvency law and practice, namely bankruptcy, liquidation, receivership and examinership.

This chapter is an introduction to the basic concepts of insolvency. You will already have encountered some of these when studying company law. However the laws governing insolvency are a blend of company law, equity and trusts, property law and other aspects of commercial law generally. If acting for a liquidator or receiver, you will invariably encounter numerous other areas of regulatory, commercial and contract law largely because many companies which are insolvent and which are subjected to the formal processes discussed in this text, such as liquidation and receivership, are, almost by definition, in default in their obligations to third parties and frequently in their statutory obligations.

Most frequently in commercial practice, one will encounter the insolvency of limited liability companies. The term 'bankruptcy' is used to describe insolvency procedures relating to natural persons or partnerships of natural persons. The principles of bankruptcy were originally governed by specific bankruptcy statutes, mainly the Irish Bankrupt and Insolvent Act 1857 and the Bankruptcy (Ireland) Amendment Act 1872. Each of these and several other statutes relating to bankruptcy were repealed and replaced in Ireland by the Bankruptcy Act 1988, which is now the principal source of law. This text includes a separate chapter dedicated to bankruptcy law and practice. However, it should be noted that many of the principles which govern the winding up of insolvent companies are based on traditional concepts of bankruptcy law.

Typically you will only encounter bankruptcy cases in the following situations:

(a) Where a person trades commercially in his own right or in a partnership as distinct from doing so through a limited liability company, and the business venture fails.
(b) Cases where directors and officers become personally liable for the debts of a company and are unable to meet those debts, leading ultimately to personal bankruptcy. This can arise under specific provisions of the Companies Acts which identify the exceptional circumstances in which personal liability would be imposed on directors and officers, notably liability for fraudulent or reckless trading, or failure to keep proper books and records. The other common such circumstance arises where directors or officers or others may have given personal guarantees in favour of third parties in respect of the debts of a company and default on the guarantee.
(c) Bankruptcies arise also from what are known as 'consumer debt' cases, typically arising from inability to meet repayments on credit card accounts, personal loan defaults, etc.

In bankruptcy practice there is no direct equivalent of the concept of a liquidator or receiver, who in corporate insolvency practice will generally be an accountant in private practice appointed to the office of liquidator or receiver. Where the High Court makes an order adjudicating a person a bankrupt, the affairs of the bankrupt are administered by the Official Assignee in Bankruptcy, who is an officer of the High Court and in the full-time employment of the Courts' Service.

1.2 Corporate insolvency procedures

Formal insolvency and winding up procedures applicable to companies are:

(a) voluntary liquidation, which includes members' voluntary liquidation and creditors' voluntary liquidation;
(b) compulsory or court liquidation;
(c) receivership;
(d) examinership.

Company insolvencies are governed by the Companies Acts 1963 to 2001, the Rules of the Superior Courts, Ord 74 (SI 15/1986) and case law.

There are two tests for establishing insolvency:

(a) the 'cash flow' test, which requires showing that the company is unable to pay its debts as they fall due for payment; and
(b) the 'balance sheet' test, which depends on showing that the value of the company's assets is insufficient to meet its liabilities, including (for certain statutory purposes) contingent and prospective liabilities.

These separate tests have different applications, depending on the particular statutory provision being applied (see Chapter 4 on liability of directors and shareholders).

This book contains separate chapters relating to each of the four areas listed above and deals with a number of subjects that apply to more than one form of insolvency procedure. This chapter contains an introduction to some principles which are common to those separate processes. These include such topics as the rules of priority among creditors in a winding up and the remedies available to liquidators in respect of pre-liquidation transactions or conduct.

One of the best ways to describe liquidation is that it is a form of 'collective debt collection'. Until some recent changes, the French term for their equivalent procedure was particularly apposite, namely 'procedures collectives'. The company is in default towards its creditors–unable to pay its debts as they fall due for payment–and the core functions of a liquidator are to take possession of and realise all the assets of the defaulting company and to distribute the proceeds of that realisation among the admitted creditors in accordance with the priorities set by law. The other very important duties and powers of a liquidator are for the most part directed to this core function. They concern such objectives as establishing that all of the assets have been traced and realised for the benefit of creditors, and that creditors are not treated unfairly or unequally as a consequence of actions or transactions perpetrated prior to the liquidator's appointment. The liquidator has certain powers to set aside preferences, to challenge certain pre-liquidation transactions and to investigate the conduct of directors, officers and others. Where appropriate, the liquidator must pursue persons who may be personally liable for debts of the company. His functions in relation to the restriction and disqualification of directors are in order to protect other parties who might be exposed to repeated business failures by the same persons.

We now turn to the different forms of insolvency process for companies. The first distinction to note is between voluntary and compulsory liquidation.

The term 'voluntary' denotes a liquidation which is commenced on the company's own initiative. The company is placed in liquidation by resolution of the shareholders. A 'members' voluntary liquidation' is a solvent winding up. A 'creditors' voluntary liquidation' occurs where the company is insolvent.

The term 'compulsory liquidation' denotes a winding up which is commenced by order of the court. Here the company is invariably, but not necessarily in certain circumstances, insolvent.

1.2.1 Members' voluntary liquidation

This is a form of company winding up distinct from an insolvency procedure. It arises where the members of a solvent company decide for their own commercial reasons to wind up the company voluntarily. To avail of this procedure, the company must be solvent and the creditors' debts must be paid in full.

A members' voluntary liquidation can be distinguished from a creditors' voluntary liquidation by the fact that in a members' voluntary winding up, the directors must complete and file with the Registrar of Companies a statutory Declaration of Solvency. This is a sworn declaration to the effect that the company will be able to pay its debts in full within a period not exceeding 12 months from the commencement of the liquidation.

The provisions specifically applicable to a members' voluntary liquidation are ss 256–64 inclusive of the Companies Act 1963 as amended by s 9 of the Companies (Amendment) Act 1982 and s 128 of the Companies Act 1990.

The winding up commences when the shareholders at a duly convened EGM pass a Special Resolution to wind up the company voluntarily and appoint a liquidator. All or the majority of the directors must swear a Declaration of Solvency within 28 days prior to this General Meeting. A Statement of Assets and Liabilities is exhibited to the Declaration. A report by an independent person must be appended to the Statement of Assets and Liabilities, to the effect that in the opinion of the directors the company will be able to pay its debts in full within 12 months, and that the statement of the company's assets and liabilities embodied in the Declaration are reasonable. Under the Act, the independent person is a person qualified to be an auditor to the company, and usually this is the auditor.

The directors' powers cease on the appointment of the liquidator. In such a case, the liquidator is answerable to and reports to the members of the company.

1.2.2 Creditors' voluntary liquidation

This form of liquidation arises where a company is insolvent and unable to pay its debts. It is referred to as 'voluntary' simply because the shareholders, frequently on the recommendation of the board of directors, decide to place the company in liquidation without being compelled (from a legal point of view) to do so by a third party, such as a creditor. The procedure is governed by ss 265–73 inclusive of the Companies Act 1963 as amended by the Companies Act 1990 and the Company Law Enforcement Act 2001.

In this form of liquidation, the directors are responsible for the preparation of an estimated statement of the company's affairs setting out its assets and liabilities.

The legal process of a creditors' voluntary winding up commences by a resolution by the members that the company be wound up voluntarily. This meeting will invariably be preceded by board meetings which decide to initiate the process (see Chapter 7 on creditors' voluntary winding up), but it is the passing of the shareholder resolution which places the company in liquidation. At the same time, the members also pass a resolution appointing a liquidator and the directors' powers cease. A meeting of the creditors must be held the same day or the day after the day on which the resolution is passed. The creditors' meeting must have been advertised in two national daily newspapers at least 10 days in advance and notified in writing to all creditors of the company.

The creditors' meeting must be chaired by a director of the company. The business of the meeting is as follows:

(a) The Statement of Affairs is presented to all creditors in attendance. Questions on the Statement are addressed to the chairman of the meeting.
(b) The liquidator appointed by the company must attend and report to the creditors on any actions he has taken since his appointment.
(c) Creditors may confirm the appointment of the liquidator nominated by the company or alternatively they may elect their own nominee as liquidator, in which case the creditors' nominee prevails.
(d) A Committee of Inspection comprising representatives of creditors and members of the company may also be appointed. At the end of this meeting, the company will be in creditors' voluntary liquidation and a liquidator will have been appointed. The liquidator is answerable to and reports thereafter to the creditors of the company.

1.2.3 Compulsory liquidations

Section 213 of the Companies Act 1963 prescribes the circumstances in which the court can order the winding up of a company. The most frequent such case is where a company is unable to pay its debts as they fall due or that it is just and equitable that the company be wound up. In this text, compulsory liquidation is examined principally in the context of insolvency.

A petition to the court for a winding up order may be presented by one or more of the following parties:

(a) one or more creditors with undisputed debts;
(b) the company itself, if authorised by the special resolution of members;
(c) a member of the company (subject to certain conditions).

Of these three, by far the most common is the creditor's petition.

Sections 206–50 inclusive and ss 283–313 inclusive of the Companies Act 1963 (as amended by the Companies (Amendment) Act 1983 and the Companies Act 1990) and the Company Law Enforcement Act 2001, govern compulsory liquidations.

On hearing the petition, the court may dismiss it, adjourn it or make a winding up order. A winding up order places the company in liquidation and appoints the Official Liquidator, who becomes its sole officer.

After the presentation of a petition and before the hearing, the court can, on sufficient urgency being shown, appoint a provisional liquidator for the purposes of continuing the company's business or protecting its assets pending the hearing.

In a court liquidation, the company is usually, although not necessarily, insolvent.

In a court liquidation, the liquidator acts at all times under the auspices of the court. A liquidator appointed by the court is an officer of the court and is called an 'Official Liquidator'.

1.2.4 Receivership

Although receivership in its true legal form is merely a method of enforcing a security, and as such is not a 'collective procedure', it is in practice frequently treated as a form of insolvency procedure.

A receiver is appointed on foot of a debenture or charge which confers on the secured creditor the power in defined circumstances, usually including default by the borrower, to appoint its own receiver for the purposes of realising the assets secured by the debenture.

Irish law provides for several different types of receivership (including the appointment of a receiver by the court). However, the most common type occurs where a secured creditor (usually a lending institution) appoints a receiver under contractual powers granted by the company in a debenture/charge. The debenture is a contractual document and all the powers of the debenture holder and of the receiver are governed by this document except for a small number of statutory provisions. Such a receiver's appointment extends only over assets which have been charged.

The appointment of the receiver does not change the legal status of the company. Although the directors cease to control the assets over which the receiver has been appointed, their normal powers and duties continue in respect of other assets and liabilities of the company.

Receivership is a temporary condition affecting a company which, unlike liquidation, does not necessarily lead to the company's dissolution. After a receiver has been discharged, the directors resume their normal functions in relation to all of the company's affairs, unless a liquidator has been appointed in the meantime. In practice, many receiverships do result ultimately in the dissolution of the company, whether or not following liquidation.

Most modern debentures confer the power to appoint a receiver who has the power to manage the company, that is, to continue the management of the business of the company.

The principal function of the receiver is to realise the charged assets and distribute the proceeds to the holder of the charge, subject to any other valid priorities. If a receiver is appointed on foot of a floating charge as distinct from a fixed charge, a receiver must first pay in full those creditors whose claims would be accorded priority in a winding up, in other words the preferential creditors (s 98 of the Companies Act 1963).

A receiver and liquidator may act concurrently in respect of the same company, but a liquidator is precluded from taking possession of or dealing with those assets under a receiver's control. This is a consequence of the company having contracted, with the lender, by the instrument of debenture or charge, to give the appointed receiver exclusive power and control over the charged assets.

1.2.5 Examination

This procedure is intended to facilitate the rescue of insolvent and nearly insolvent companies. It entitles the company to a period of 70–100 days 'protection of the court' when its creditors are restrained from exercising their rights to pursue claims, and secured creditors are prohibited from exercising their security, subject to certain protections for the priority such security affords them. The High Court appoints an examiner whose function is to formulate proposals for a compromise or scheme of arrangement between the company, its members and its creditors. Such a scheme of arrangement typically involves a combination of new investment, a write down of creditors' claims and payment of dividends to creditors over a period of months. The company continues to trade during the protection period and the directors remain in control of and responsible for the day to day operations of the company. If the scheme of arrangement is confirmed by the court, it becomes binding on the company and all its members and creditors. If it is successfully implemented by the company, the company resumes its ordinary 'life' after the process, with its affairs restructured by the process. If a scheme is not confirmed by the court or successfully implemented, the protection of the court is withdrawn and liquidation or receivership invariably follows.

Not all companies are suitable for examinership. Before appointing an examiner, the court must be satisfied that there is reasonable prospect of the survival of the company, and that the appointment of an examiner will facilitate that objective.

1.3 Common insolvency principles

A number of principles apply to both bankruptcies and liquidations. In strict legal terms, they have no direct application in receivership or examinership but in practice, many of them are relevant and, in some cases, applied by analogy. These principles are discussed in detail in Chapter 3.

1.4 Creditors

The classes of creditors in any insolvency and the ways in which the liquidator or receiver will administer the rights of these creditors and the proving of their debts are discussed in Chapter 2.

1.5 General provisions as to priorities

1.5.1 Liquidators

A liquidator's obligations are to take control of all the property and assets of the company, to realise those assets and to apply the proceeds of the realisation to the discharge as far as possible of the claims proved against the company. Where there is a deficit, he must refer to the law as to priorities. The priority rules are the same in all cases and are summarised in Chapter 2.

1.5.2 Receiverships

In a receivership, the receiver must realise the assets subject to the fixed and floating charge provided for in the Debenture Deed. Essentially, the same priorities apply in a receivership as have already been listed in relation to liquidations. In addition, under a decision of Mr Justice Lardner in the matter of *Eisc Teoranta (In Receivership and In Liquidation)* [1991] ILRM 760, it was held that s 98 of the Companies Act 1963 imposes a positive duty on the receiver to pay preferential creditors out of the proceeds of sale of assets which are subject to a floating charge. This obligation arises whether or not the debenture holder or secured creditor has already been paid in full out of the proceeds of sale of other assets, namely the assets subject to the fixed charge.

1.5.3 Examination

The Companies (Amendment) Act 1990, which governs examinership law and practice, does not stipulate rules as to the priority of creditors' claims. Because the examiner's proposals are required to show by contrast the likely outcome of a winding up, schemes of arrangements tend to recognise the priorities which would apply in a liquidation, but with some modifications.

Because the company continues to trade, it may pay debts arising in the examination period. However, where it is unable to do so, the examiner has power to certify a liability as necessarily incurred by the company. Where the examinership ultimately fails, certified liabilities, which would otherwise have been paid in the normal course of business, will rank behind the examiner's remuneration and any fixed charges, but ahead of any floating charge.

In a subsequent liquidation or receivership, an examiner's remuneration ranks ahead of all claims, including that secured by a fixed charge.

1.6 Recent developments affecting insolvency law and practice

In recent years, there have been very significant developments in insolvency law. As far as domestic laws are concerned, these developments go some distance towards increased transparency and raising the standards applied to the conduct of directors and officers of limited liability companies. These developments are dealt with more fully in Chapter 4 of this text. However, the most important of these developments are:

(a) the Company Law Enforcement Act 2001;
(b) the Companies (Amendment) (No 2) Act 1999, which contains substantial changes to the law relating to examinership; and
(c) the EU Insolvency Regulation No 1346/2000 which entered into force on 31 May 2002.

1.6.1 Company Law Enforcement Act 2001

This Act establishes the office of the Director of Corporate Enforcement and is directed towards increasing levels of compliance with company laws generally. It confers on the Director of Corporate Enforcement a number of investigative powers which were previously vested in the Minister for Enterprise and Employment. It also confers on the Director a number of powers which are directly relevant to the conduct of liquidations and receiverships. The most significant of those which are relevant to insolvency practice, and which are dealt with in more detail in following chapters, are described below.

1.6.1.1 Restriction and disqualification

The Companies Act 1990 established a new system for imposing restriction and disqualification orders on directors and officers of insolvent companies. In particular, s 150 of the Companies Act 1990 provides for a system whereby the court shall declare that a person who has acted as a director of an insolvent company within 12 months prior to the commencement of the winding up shall be liable to a restriction order, unless he can persuade the court that he has acted honestly and responsibly in relation to the affairs of the company. The effect of a restriction order is that such a person shall not, for a period of five years from the making of the order, act as a director or a secretary or be concerned or take part in the promotion or formation of another company unless it meets certain minimum paid up capital requirements. Those were, in the case of a public limited company, at least IR£100,000 (€ 126,973) and in the case of any other company, at least IR£20,000 (€ 25,395). The 2001 Act has increased those figures to IR£250,000 (€ 317,434) and IR 50,000 (€ 63,487) respectively.

The Company Law Enforcement Act 2001 provides that in every insolvent liquidation the liquidator must bring before the High Court an application for a restriction order unless the Director of Corporate Enforcement has first relieved him from doing so.

Prior to the 2001 Act the High Court had directed that in every compulsory liquidation, a restriction application should be made. However, the Companies Act 1990 does not itself make a distinction between compulsory and voluntary liquidations for this purpose and accordingly there was an anomaly in that restriction applications were typically only brought in compulsory liquidations (with some exceptions). This anomaly is effectively removed by the mandatory requirement.

1.6.1.2 Powers to inspect books and papers

The Act confers on the Director of Corporate Enforcement power to inspect books, records and documents of a company in liquidation, including the books and records of the liquidator. The Director also has power to require inspection of the books and records of any liquidator in relation to all cases to which he has been appointed. The liquidator concerned can also be required to answer any questions of the Director concerning the contents of books provided to him and the conduct of a particular liquidation or all liquidations.

1.6.1.3 Reporting of defaulting liquidators

Section 58 provides that where a disciplinary committee or tribunal of a prescribed professional body finds that one of its members conducting a liquidation or receivership has not maintained appropriate records, or has reasonable grounds for believing that such a member has committed an indictable offence under the Companies Acts during the course of a liquidation or receivership, that body shall report the matter with details to the Director.

These provisions are designed to enable the Director of Corporate Enforcement to monitor and take steps in relation to any person taking appointments as liquidators or receivers. Under Irish law there is no system for the licensing of insolvency practitioners, as exists in the UK. Section 300 of the Companies Act 1963 merely stipulates the parties who are not qualified to act as liquidator of a company. They include an undischarged bankrupt, a body corporate, or a person who within 12 months from the commencement of the company has been an officer or servant of the company, or persons connected to such an officer or servant.

1.6.1.4 Other powers of the Director

The 2001 Act also enables the Director of Corporate Enforcement to initiate actions which previously were only available to liquidators and individual creditors, such as misfeasance proceedings under s 298 of the Companies Act 1963, examination proceedings under s 245, and proceedings for the arrest of an absconding contributor or officer under s 282.

Section 251 of the Companies Act 1990 contained a provision to the effect that in the case of a company which is insolvent and is not being wound up and the only reason why it is not being wound up is the insufficiency of its assets, a number of the remedies which were previously only available to liquidators could be invoked, such as proceedings to hold directors personally liable for fraudulent or reckless trading, misfeasance proceedings, or proceedings to hold directors personally liable for failure to keep proper books of account of the company. The 2001 Act extends the power to commence such proceedings to the Director of Corporate Enforcement.

1.6.1.5 Voting at creditors' meetings

Prior to the 2001 Act, at a meeting of creditors for the purpose of appointing a liquidator, the creditors could only appoint a liquidator who would override the appointment of the members' nominee if at the meeting of creditors there was a vote by a majority in number and value of those attending and voting in favour of an alternate liquidator. Section 47 of the 2001 Act amends this provision so that the creditors' nominee will be elected and prevail if there is a vote to that effect passed by a majority in value only of the creditors present personally or by proxy and voting on the resolution. This is a significant change as it was previously possible for the wishes of the majority of creditors in value terms to be defeated if enough individual creditors, even by proxy, having appointed the chairman of the meeting, voted against such a resolution.

1.6.2 Examinership

The concept of examinership was established by the Companies (Amendment) Act 1990. The Companies (Amendment) (No 2) Act 1999 became effective on 1 February 2000 and contains a number of measures intended to streamline the examinership process.

In particular, there had been a perception that the threshold for securing the appointment of an examiner under the original 1990 Act was undemanding. Section 2 of the 1990 Act provided that the court could appoint an examiner if it considered that to do so would be 'likely to facilitate the survival of the company' as a going concern. Section 5 of the 1999 Act amends this provision to stipulate that the court shall not make an order appointing an examiner unless it is satisfied 'that there is a reasonable prospect of the survival of the company'. The new section has been the subject of one important test judgment in the matter of *Tuskar Resources plc* [2001] IR 668 where McCracken J declined to appoint an examiner and instead made an order for the winding up of the company and appointed an official liquidator.

The 1999 Act also contains a provision to the effect that a petition for the appointment of an examiner must be accompanied by a report by an independent accountant. The information to be contained in this report is essentially the information which under the 1990 Act was contained in the examiner's first report to the court made 21 days after his appointment. The objective of the amending provision is to ensure that before the court will allow a company to avail of the benefits of examinership, it must have available to it information which would previously only have been available 21 days, and sometimes longer, after the appointment had been made. Apart from basic financial information and statements of opinion as to the prospects for the survival of the company, the report of the independent accountant must also contain details of the extent and source of the funding required to enable the company to continue trading during the period of the protection. It had become the practice, even prior to this amendment, that the court sought such information in considering examinership petitions. However, this was not previously a statutory requirement.

The 1999 Act also shortened the timeframe for examinerships, reducing the protection period, which under the 1990 Act was three months, to 70 days, although this can be extended in certain special circumstances to 100 days.

Another very fundamental amendment to examinership law under the 1999 Act is that under the original legislation, a scheme of arrangement could only be brought forward to the court for confirmation if it had been approved by at least one class of members *and* one class of creditors. The requirement for approval by at least one class of members has now been abolished, thereby removing the potential veto by members of the company. There remains however the overriding requirement that the proposals for a scheme of arrangement must not be unfairly prejudicial to any interested party, and that obviously includes the members of the company.

There are a number of other important amendments to the operation of examinership, which will be dealt with in more detail in Chapter 10. Essentially, the effect of the 1999 amendments is to heighten the threshold so that the examinership process is only used in cases which are truly appropriate for the process, with the court applying a more rigorous test to the question of whether there is a reasonable prospect for the survival of the company on a 'going concern' basis, and to shorten and streamline the process following the examiner's appointment.

1.6.3 EU Council Regulation No 1346/2000 on insolvency proceedings

One of the most important practical difficulties which liquidators and other insolvency office holders frequently encounter once appointed is ensuring that their appointment and powers will be recognised in other jurisdictions. The Brussels Convention and the more recent Regulation No 44/2001, both relating to jurisdiction of courts and enforcement of judgments in civil and commercial matters specifically excludes from their scope bankruptcies, proceedings relating to the winding up of insolvent companies, judicial arrangements, compositions and analogous proceedings. Accordingly there were different, and frequently inconsistent, approaches adopted by the courts of different Member States to the recognition of liquidators and enforcement of insolvency related judgments on a cross-border basis. This has now been addressed by the introduction of Regulation No 1346/2000 which came into force on 31 May 2002.

This Regulation is not an attempt to harmonise substantive bankruptcy and insolvency laws. Instead it establishes a regime for the improved efficiency and effectiveness of the conduct of cross-border insolvencies. This is achieved by providing for cross-border recognition and enforcement of basic orders such as the appointment of liquidators and other insolvency office holders and of the remedies which are typically invoked in insolvency proceedings. It also establishes a regime for the management of asset realisation and processing of creditor claims in multi-jurisdictional cases, and for the opening of secondary proceedings in Member States other than the State of the company's main centre of interests.

Being an EU Regulation, this only alters the rules as far as Member States are concerned. Denmark has opted out of this Regulation and accordingly the rules for recognition and enforcement with that State are those which applied before and which continue to apply to non-EU Member States.

The Regulation only has application where the company concerned has its centre of main interests within a Member State of the EU.

Cross-border insolvency issues, including this Regulation, will be considered in Chapter 12.

CHAPTER 2

LIQUIDATORS—POWERS, DUTIES AND FUNCTIONS

Barry Cahir

2.1 Creditors

For the purpose of this chapter, it will be helpful to define the types of creditors of an insolvency and the ways in which the liquidator should administer the rights of these creditors and the proving of their debts.

2.1.1 Secured creditors

A creditor holding a security in the nature of a mortgage or other form of fixed charge is entitled to be paid in full from his security without deduction of costs and expenses except those directly attributable to its realisation. Therefore, a secured creditor should be paid his full debt and costs as a first priority in the liquidation.

2.1.2 Preferential creditors

Certain debts have been granted a statutory priority over other claims on insolvency (s 285 of the Companies Act 1963 (CA 1963)). These consist primarily of sums due to employees and various rates and taxes. These preferential debts rank in priority behind a fixed charge and ahead of a floating charge.

An example of a preferential creditor would be rates due on a property to a corporation or county council for the 12 months prior to the liquidation.

2.1.3 Unsecured creditors

All claims that may be admitted, which are not secured or preferred, rank as unsecured claims. The main bulk of creditors in a liquidation situation usually consists of unsecured creditors. However, a receiver rarely has to deal with unsecured creditors, because his responsibility under the debenture deed is only to deal with the assets held by a fixed or floating charge. Accordingly, once he has realised these assets and paid the debentureholder, he has no further responsibility.

An example of an unsecured creditor would be a creditor who has obtained a judgment but has taken no further steps, such as a judgment mortgage, to secure that judgment.

2.1.4 Deferred creditors

A creditor can contract to have his debt rank after any other creditor or groups of creditors (see s 275 CA 1963, as amended by s 132 of the Companies Act 1990).

2.2 General provisions in relation to liquidators

A liquidator's obligations are to take control of all the property and assets of the company, to realise the assets in such a way as to discharge all the company's liabilities and to pay all the creditors if possible. If it is not possible to pay all the creditors, the liquidator must refer to the law as to priorities.

In every liquidation, priority in which claims are paid is the same and is set out broadly as follows:

(a) fixed charges rank in order of priority against the property upon which they are charged;
(b) costs and expenses of the winding up;
(c) fees, costs and charges of an examiner (see Chapter 10);
(d) fees due to the liquidator;
(e) any claim under s 120 of the Social Welfare (Consolidation) Act 1981;
(f) preferential debts ranking *pari passu* with each other;
(g) uncrystallised floating charges rank in the order of their creation;
(h) unsecured debts ranking *pari passu* with each other;
(i) deferred debts ranking *pari passu* with each other.

Priority in relation to costs in a liquidation is set out in RSC Ord 74 r 128 (see later).

2.3 Continuation of proceedings against a company when a winding up order is made

Section 222 of the Act provides that where a winding up order has been made or a provisional liquidator has been appointed, no action or proceeding shall be either proceeded with or commenced against the company except by leave of the court and subject to such terms as the court may impose. A party who wishes to proceed with or commence such an action should seek such liberty by issuing a Notice of Motion based upon a grounding affidavit exhibiting relevant copy pleadings or proposed proceedings which should be served on the liquidator. In general, the court will give liberty to proceed with or commence an action if there is a *prima facie* case in favour of the plaintiff and it is apparent or likely that there will be assets available to meet the claim in whole or in part (should it be successful) or, in a case where there are no available assets, the claim is indemnified by insurers and there is evidence of indemnification before the court.

2.4 Liquidation after receivership

Just as the event of a liquidation does not prevent the appointment of a receiver, the appointment of a receiver does not prevent a liquidation. A winding up order may not be refused simply on the grounds that the assets of the company are charged in a sum equal to or in excess of their value or that the company has no assets. The commencement of a winding up and the appointment of a liquidator in such circumstances will allow a large number of provisions of the Companies Act which may operate to the benefit of unsecured creditors, including preferential creditors, to be brought into play. In general, those sections of the Companies Act containing what might be termed investigative provisions with regard to insolvency are operative only in a liquidation and not in a receivership. The foremost of these are the provisions of ss 286 and 288 CA 1963. These relate to fraudulent preference and the invalidity of floating charges created within 12 months prior to the commencement of the winding up (or 24 months if the grantee of the charge is 'a connected person'; see s 136 of the Companies Act 1990). If the liquidator can succeed in attacking the charge under which the receiver was appointed as either a fraudulent preference or as an invalid floating charge under these provisions, the receiver's title and the security of his appointor can be set aside.

The provisions of ss 293 and 299 inclusive of CA 1963 provide effectively for investigation of pre-liquidation trading by the liquidator to establish whether there are any grounds for, for example, an action for personal liability on the part of any parties involved in the trading of the company for fraudulent trading, for liability on the part of directors or officers for misfeasance or for reporting any matters to the court which might lead to criminal prosecutions of directors or officers. The ancillary provisions of s 245 CA 1963 which allow for examination of directors and officers of the company before the court, are also available only in a liquidation and not in a receivership. Finally, the provisions of s 292 CA 1963, which restrain sheriffs from proceeding with seizures or from disposing of goods seized, apply only in a liquidation.

From the above, it will appear that there may be good reasons for ordinary creditors to seek the appointment of a liquidator, even where a receiver has been appointed, for example, where the company's assets appear to be charged to an amount in excess of their value. However, a proposed liquidator in such circumstances would normally require some level of indemnification in respect of his costs and expenses before accepting the appointment.

2.5 Effect of appointment of a liquidator on agency and powers of receiver

The mortgage debenture under which a receiver is appointed usually provides that the receiver shall be the agent of the company. The commencement of a liquidation of the same company either by the making of a winding up order or by the passing of a resolution to wind up automatically terminates the agency of that receiver. Although the receiver retains a right to custody and control over the charged assets, the company is no longer liable after the commencement of the winding up for any debts which the receiver may incur in carrying on the company's business. Any such debts are not provable in the liquidation of the company. The position of a receiver is made more difficult by the appointment of a liquidator; as he cannot bind the company with fresh obligations, he now acts as a principal and will be personally liable in respect of fresh contracts, although he will have a right to indemnity out of the assets. The liquidator may compel the receiver to perform his statutory duties to render and verify proper accounts of his receipts and payments and pay over to the liquidator any amount properly payable to him.

2.6 Function of a liquidator

A liquidator's primary function is to get in the assets of the company and pay off the creditors. Before he does anything, a liquidator must ensure he is validly appointed and it is his solicitor who should check on the procedures already set out. However, failure to comply with any of the steps does not make the appointment invalid; it merely imposes a fine on the company, its directors or other officers of the company (see s 266(6) CA 1963).

The liquidator should also:

(a) check that the company has not been struck off the register; and
(b) check as a preliminary matter that there are some funds in the company.

He may resign (s 270 CA 1963), but if the creditors do not appoint another liquidator he has to apply to the court to be removed.

2.7 Duties of liquidator

These can be divided into statutory, general and extra-statutory duties, which are listed below.

2.7.1 Statutory duties

The liquidator must:

(a) file notice of his appointment in the Companies Office (s 278(1) CA 1963);
(b) ensure that the resolution to wind up is filed in the Companies Office (s 252 CA 1963), together with (in the case of a creditors' voluntary winding up) a certified copy of the resolutions of the creditors;
(c) serve notice of his appointment on the sheriff (s 292 CA 1963);
(d) ensure that the words 'In Liquidation' appear on all letters, invoices and orders (s 303(1) CA 1963);
(e) file a report with the Director of Corporate Enforcement within six months after his appointment and at intervals as required by the Director (s 56 of the Company Law Enforcement Act 2001);
(f) hold statutory meetings (ss 272, 273 CA 1963);
(g) bring an application pursuant to s 150 of the Companies Act 1990 for an order restricting the Directors.

2.7.2 General duties

The liquidator must:

(a) take possession of the company's property;
(b) insure his interest as liquidator;
(c) serve notice on all employees still employed;
(d) take possession of the books and records of the company and the company's Seal;
(e) change the registered office;
(f) write to banks asking for any balances;
(g) open his own bank account;
(h) carry out filing and returns.

2.7.2.1 Members' winding up

In a members' winding up, the liquidator has the following additional duties. He must:

(a) hold a general meeting within three months of the end of each year of the liquidation (s 262(1) CA 1963);
(b) produce an account of his dealings at the end of each year;
(c) file that account within seven days in the Companies Office (s 262(1) CA 1963);
(d) hold a general meeting at the end of the liquidation, which is to be advertised 28 days in advance in two daily newspapers (s 263(2) CA 1963);
(e) produce and file a copy of his final account (s 263(3) CA 1963);

(f) fulfil alternative provisions where the liquidation in the opinion of the liquidator must be continued as a creditors' voluntary winding up (s 264 CA 1963).

2.7.2.2 Creditors' winding up

In a creditors' winding up, the liquidator has the following additional duties. He must:

(a) hold a general meeting of the company and the creditors within three months of the end of each year of liquidation (s 272(1) CA 1963);
(b) produce an account of his acts and dealings at the end of each year of the liquidation;
(c) file that account within seven days in the Companies Office (s 272(1) CA 1963);
(d) hold a general meeting of the company and the creditors at end of liquidation, to be advertised 28 days in advance in two daily newspapers (s 273(1) CA 1963);
(e) produce at meetings and file an account of his dealings in the Companies Office (s 273(3) CA 1963);
(f) if the liquidation continues for more than two years, file every six months thereafter an account of his dealings in the central office (RSC Ord 74).

2.7.3 Extra-statutory duties

The liquidator has additional extra-statutory duties, as follows:

(a) He (or she) must settle the list of contributories (s 208 CA 1963).
(b) He must examine the conduct of officers of the company. There is ample scope for the liquidator to ensure that he gets full assistance (s 293 CA 1963). An 'officer', in addition to the normal definition, includes any person in accordance with whose directions or instructions the directors of the company have been accustomed to act.
(c) He must recover property and money if retained by the directors or officers (see *In Re Duomatic Ltd* [1969] 1 All ER 161).
(d) When examining the conduct of the 'officers' of the company the liquidator has power under ss 245 and 280 CA 1963 to summon an officer to be examined before a judge of the High Court (in practice this will be the Master). The Supreme Court has also decided that in certain circumstances a creditor may apply to have a director of a company examined (see *Comet Food Machinery Co Ltd (In Voluntary Liquidation)* [1999] ILRM 475).
(e) He must pay and agree creditors.
(f) He has a duty to distribute any surplus (s 275 CA 1963).
(g) He has a duty to dissolve the company ultimately (s 273 CA 1963).

2.8 Powers of liquidator

The liquidator has the following powers:

(a) to bring or defend any action or other legal proceedings in the name or on behalf of the company;
(b) to carry on the business of the company so far as may be necessary for the beneficial winding up;
(c) to appoint a solicitor to assist him in the performance of his duties;
(d) to sell the real and personal property of the company;

(e) to do all acts and to execute, in the name and on behalf of the company, all deeds, receipts and other documents and, when necessary, to use the company's Seal;
(f) to deal with the estate in bankruptcy of all contributories;
(g) to draw, accept, make or endorse any bill of exchange or promissory note in the name and on behalf of the company;
(h) to borrow money on the security of the assets of the company;
(i) to take out in his name Letters of Administration to any deceased contributory;
(j) to give security for costs in any proceedings commenced by the company or by the liquidator in the name of the company;
(k) to appoint an agent to do any business which the liquidator is unable to do himself;
(l) to do all such other things as may be necessary for the winding up of the company and distributing its assets (s 231 CA 1963, as amended by s 124 of the Companies Act 1990).

In addition, the liquidator may:

(a) exercise the power of the court under the Act of settling a list of contributories;
(b) exercise the power of the court in making calls on contributories;
(c) summon general meetings of the company for the purpose of obtaining the sanction of the company by resolution or for any other purpose as he may think fit.

He also has the power to:

(a) pay the debts of the company;
(b) adjust the rights of the contributories among themselves;
(c) apply to the court to determine any question arising in the winding up of the company (s 280 CA 1963);
(d) apply to the court to exercise all or any of the powers which the court might exercise if the company were being wound up by the court (s 280 CA 1963);
(e) take proceedings against past or present promoters, directors, managers, liquidators or officers of the company to compel the restoration of money or property or the payment of compensation in respect of misapplication, retainer, misfeasance or breach of trust (s 298 CA 1963);
(f) disclaim, with the approval of the court, onerous or unsaleable property or unprofitable contracts (s 290 CA 1963).

The liquidator cannot sell non-cash assets to a former officer of the company without giving 14 days' notice to the creditors (s 124 of the Companies Act 1990).

2.9 Committee of Inspection

The appointment and powers of a liquidator are set out more fully in Chapters 6 and 7. It should be noted here, however, that the exercise of his powers in a voluntary liquidation can be subject to the Committee of Inspection.

2.10 Appointment of a liquidator subsequent to receiver

A floating charge created within 12 months prior to the commencement of a winding up is invalid as to any prior advances, unless the company was solvent 'immediately' after the creation of the charge (see s 288 CA 1963). A company is solvent if it can pay its debts as they fall due (see also s 286 CA 1963 as to fraudulent preference).

2.10.1 Effect of appointment of liquidator

Ordinarily the instrument creating the debenture confers on the holders or their trustees a right to appoint a 'receiver and manager'. A supervening liquidation will not affect their right of appointment. Indeed that standard form of debenture specifies the presentation of a petition or a resolution for a voluntary liquidation as events which give rise to an immediate liability to repay all outstanding interest and to a right to appoint a receiver and manager. Just as the event of liquidation does not prevent the appointment of a receiver, the appointment of a receiver does not prevent a liquidation.

The commencement of a winding up, in particular the appointment of a liquidator, may deter a potential receiver and manager from accepting a preferred appointment if he has reason to suspect that the charge under which his appointment would be made is in any way vulnerable. The charge may be a fraudulent preference or may infringe the statutory provisions restricting the creation of floating charges within a certain period prior to a winding up. It may not have been registered or properly executed or there may be some other flaw.

2.10.2 Effect on agency of receiver

Usually the mortgage debenture provides that a receiver and manager appointed thereunder shall be the agent of the company A compulsory winding up order automatically terminates that agency Likewise, the commencement of a voluntary winding up, by the passing of a resolution to wind up, brings to an end the agency of a receiver and manager. So far as the receiver is concerned, although he retains his right to custody and control over the company's assets, the company, whose agent he is, no longer has full and free capacity to continue its business in terms of the objects in its memorandum. The company cannot authorise the receiver to do any act which it is unable to do itself, so that it cannot empower the receiver, after the date of the liquidation, to carry on its business so as to create debts provable against the unmortgaged assets of the company; but the receiver can still continue to exercise his powers in the name of the company although the company is no longer liable for any debts which he may incur in so doing. The agency ends but not the receivership and the receiver is still in control. His position is peculiar and made more difficult. He cannot bind the company with fresh obligations. Acting, as he does, as a principal he will be personally liable in respect of contracts, albeit with the right to be indemnified out of the assets of the company. If, despite the termination of his agency, he purports to act in the name of the company, he may be held liable for breach of warranty or authority.

2.10.3 Effect on powers

While a compulsory winding up order or the commencement of a voluntary winding up brings to an end the agency of the receiver and manager, some of his powers survive the death of his agency. He may continue to carry on the company's business, although not so as to impose fresh liabilities on the company. He is, of course, entitled to take possession of the assets comprised in the debenture, and so that power remains. He may continue to get in and realise all the company's assets, both real and personal, comprised in the debenture.

Again, he retains the power to continue proceedings in the name of the company in order to collect assets of the company comprised in the debenture. The termination of the authority of the receiver to act as agent of the company does not affect his power to hold or dispose of property comprised in the debenture.

Another power which remains undisturbed by the event of liquidation is the right of the receiver and manager to retain all documents needed to evidence the title of the debenture-holder. If those documents have found their way into the hands of the liquidator, they can be recovered.

2.10.4 Effect on duties of receiver

The receiver has an obligation to deal with preferential creditors as per s 98 CA 1963. This obligation is dealt with more fully in Chapters 8 and 9.

2.10.5 Effects on receivership of appointment of liquidator

The priority of charge registered will obviously also be relevant if one is acting not for the receiver but for a party who wishes to challenge the appointment of the receiver or the validity of the debenture under which the receiver is appointed. For example, the company itself or an unsecured creditor of the company or a liquidator of the company. Since the facts may, however, be difficult to check without winding up the company such person may also have to consider liquidating the company, and this will definitely be necessary if one wishes to be able to invoke the provisions of s 288 CA 1963 which provides (as amended):

> Where a company is being wound up, a floating charge on the undertaking or property of the company created within 12 months before the commencement of the winding up shall, unless it is proved that the company immediately after the creation of the charge was solvent, be invalid, except as to money actually advanced or paid, or the actual price or value of goods or services sold or supplied, to the company at the time of or subsequently to the creation of, and in consideration for, the charge, together with interest on that amount at the rate of 5 per cent per annum.
>
> For the purposes of sub-s (1) the value of any goods or services sold or supplied by way of consideration for a floating charge is the amount in money which at the time they were sold or supplied could reasonably have been expected to be obtained for the goods or services in the ordinary course of business and on the same terms (apart from the consideration) as those on which they were sold or supplied to the company.
>
> Where a floating charge on the undertaking or property of a company is created in favour of a connected person, sub-s (1) shall apply to such a charge as if the period of 12 months mentioned in that subsection were a period of two years.
>
> In this section 'a connected person' means a person who, at the time the transaction was made, was:
>
> (a) a director of the company;
> (b) a shadow director of the company;
> (c) a person connected, within the meaning of s 26(1)(a) CA 1990, with a director;
> (d) a related company, within the meaning of s 140 CA 1990; or
> (e) any trustee of, or any surety or guarantor for the debt due to, any person described in paragraph (a), (b), (c) or (d).

This section does not avoid the debt itself so that the debenture-holder can still prove in the winding up as an unsecured creditor for a debt incurred before the floating charge was given to secure it, or for interest in excess of five per cent.

When a floating charge is invalidated by the company being wound up, the charge is invalidated for all purposes so that mortgagees and others may assert rights against property subject to the floating charge and thus prevent the liquidator from taking it for the benefit of the unsecured creditors of the company (see *Capital Finance Co Ltd v Stokes* [1968] IR 573).

It should be noted that the courts have liberally construed the requirement that the loan should be made at the time of or subsequent to the creation of the floating charge so as to uphold it in the company's liquidation. If a loan is made on the understanding that a floating charge will be given as security, the charge is taken as being created at the time the loan is made, even though the debenture is not actually executed until some time after the lender advances his money, provided the company's promise to give the floating charge is unconditional (see *Re Columbian Fireproofing Co Ltd* [1910] 2 LR 120; *Re FE Staunton (No 2)* [1929] 1 LR 180.

The section will not apply if the debenture-holder can prove that the company was solvent immediately after the creation of the charge. It has been held that a company is not solvent at the time unless it is able to pay its debts as they fall due (see *Re Patrick andLyon Ltd* [1933] Ch 786). Therefore the mere fact that the value of its assets exceeds its total liabilities does not necessary mean that the company is solvent.

Note the application of the rule in *Clayton's Case* (1816) 1 Mer 572 if a company goes into liquidation within 12 months of the creation of a floating charge. All monies paid into the company's bank account after the floating charge is executed are deemed to have been appropriated to reduce the debt outstanding at the time of execution, and all subsequent drawings amount to new lendings secured by the charge. Therefore, if the amount so paid in equals or exceeds the debt outstanding at the time of execution, the charge will be fully effective. *See Re Thos Mortimer Ltd (1925)* [1965] 1 Ch 187 and *Re Yeovil Glove* [1965] Ch 148.

Also, under the provisions of s 286 CA 1963, any mortgage, debenture or other act created or done within six months before commencement of its winding up which would in the case of an individual be void as a fraudulent preference in bankruptcy is likewise void in the event of the company being wound up, but there can be great difficulty in successfully invoking this section as it is necessary that the mortgage, debenture or other act was entered into with a view to preferring the mortgagee over other creditors.

It may, however, now be easier for a liquidator to prove fraudulent preference than it has been in the past in view of the decision in *Re FP and CH Matthers Ltd* [1982] 1 All ER 339. There, the Court of Appeal held that a payment was made with a view to giving a creditor preference over the other creditors within the meaning of s 44 of the Bankruptcy Act 1914 if at the time of making the payment the debtor knew that he could not pay his debts as they arose and intended to pay one of his creditors in full ahead of the others; it was not sufficient for a debtor to genuinely believe that all the creditors would be paid within three to six months in the future.

There is no fraudulent preference if the mortgage is not given voluntarily. If the company pays a debt under the threat of legal proceedings there is no preference, but a company cannot be said to discharge an obligation under the threat of legal proceedings when the obligation is owed to its own directors. Where the directors benefit from a transaction the court is more willing to infer an improper motive. An improper motive was inferred when directors who had guaranteed the company's bank overdraft repaid it at a time when they knew the company was insolvent and when they had already stopped paying its current trading debts (*Re M Kushler Ltd* [1943] 2 Ch 481). Similarly a mortgage of the company's property which the directors gave to themselves as an indemnity against their liability under their guarantee of the overdraft was held to be a fraudulent preference (*Gaslight Improvement Co v Terrell* (1870) LR 10 EG 168).

The result of a transaction being held to be a fraudulent preference is that the liquidator may recover the money paid or property transferred to the creditor or have any mortgage or charge given to him set aside. The money or property recovered is distributable among the creditors of the company generally and the holder of a floating charge on the company's undertaking has no prior charge on it.

2.10.6 Termination of receivership by a liquidator

It is important to note that since the Companies Act 1990, it is open to a liquidator to apply under s 322 CA 1963 (as amended by s 176 of the Companies Act 1990) to limit or bring to an end a receivership. The liquidator can also seek the co-operation of the lender to have the receiver removed without the necessity for a court application.

2.11 Retention of title

2.11.1 Introduction

A common feature of commercial life recently has been the increasing number of insolvencies of companies leaving a queue of unpaid creditors. In many cases of such insolvencies the suppliers will have to write off the debt because the secured creditors (such as banks holding fixed and floating charges over all the assets of the company) and the preferential creditors (such as the Revenue Commissioners and the company's employees) rank before the unfortunate suppliers. Many suppliers are under commercial pressure to give long terms of credit to large outlets and the exposure can be very high. In some cases the insolvency of one company can result in a number of suppliers themselves becoming insolvent.

2.11.2 What the solicitor does

Very often a client setting up in business may see his solicitor for advice and it is prudent for solicitors to advise this type of client of the importance of having a comprehensive set of conditions of trading and including in those conditions of trade a retention of tide clause. A solicitor will advise a client on the proper way of introducing such conditions and ensuring that the conditions are brought to the attention of the buyer and an acknowledgment obtained if possible. The retention of title clause is therefore used by the supplier of goods to retain ownership in goods supplied by him to the buyer or at least to give himself some form of interest in those goods, in order to protect himself against the buyer's insolvency by giving himself some priority over the general body of unsecured creditors.

2.11.3 Present law in relation to retention of title

Although the common use of retention of title clauses has developed quite recently, that use was approved of in Ireland by the Court of Exchequer Chamber in *Bakeman v Green and King* (1868) IR 2 CL 166), and in 1895 the Irish case of *McEntyre v Crossly Brothers Ltd* [1895] AC 157) went to the House of Lords which upheld a seller's claim under a retention of title clause to a gas engine supplied by the seller to the buyer who became insolvent before he paid the price. Lord Watson said:

> It does not in the least follow that, because there is an agreement of sale and purchase, the property in the thing which is the subject matter of the contract has passed to the purchaser. That is a question which entirely depends on the intention of the parties. The law permits them to settle the point for themselves by an intelligible expression of their intention.

The modern case which most people associate with retention of title is that of *Aluminium Industrie Vaassen BV v Romalpa Aluminium Ltd* [1976] 2 All ER 552 (known as the *Romalpa* case). This decision did lead to a huge increase in and use of retention of title clauses.

The basis in law for the use of retention of title clauses is now governed by s 19(1) of the Sale of Goods Act, which provides:

> where there is a contract for the sale of specific goods or where goods are subsequently appropriated to the contract, the seller may, by the terms of the contract or appropriation, reserve the right of disposal of the goods until certain conditions are fulfilled. In such cases, notwithstanding the delivery of the goods to the buyer, or to a carrier to other bailee or custodian for the purpose of transmission to the buyer, the property in the goods does not pass to the buyer until the conditions imposed by the seller are fulfilled.

This provision clearly authorises the seller of goods to insert a term in the contract of sale between himself and the buyer providing that property in the goods is not to pass from the seller to the buyer until a specified condition is fulfilled. The condition may be that the purchase price of goods must be paid in full or even that the buyer must discharge all indebtedness to the seller.

2.11.4 When to use retention of title clauses

Because retention of title clauses are used to protect the seller of goods in the event of the buyer becoming insolvent, questions as to their validity and scope generally only arise when and if the buyer becomes insolvent. Solicitors are frequently involved in advising their clients on the validity of the retention of title clause and in dealing with liquidators and receivers of companies in an attempt to recover goods belonging to a client which have been supplied to a company which has gone into liquidation or receivership.

The liquidator or receiver will scrutinise the validity of the retention of title clause and it is a clear example of how a clause drafted by a solicitor will be tested thoroughly. In many cases the buyer's assets are subject to floating charges and the receiver will be attempting to repay the debt secured by the charge out of the buyer's estate and will therefore be attempting to include as many assets as possible within the scope of the buyer's estate. The receiver will generally resist any attempt by suppliers to enforce their retention of title claim and will usually challenge the validity of such a clause. Similarly, a sheriff attempting to enforce a judgment against the buyer's estate will also attempt to reject a claim by the seller of goods based on a retention of title clause.

The solicitor is frequently contacted by suppliers who have lost substantial sums of money to a buyer who has become insolvent and it is vital to act immediately on the instructions of the supplier and contact the liquidator or receiver and notify them of all the details of the supplier's retention of title clause. It is also prudent when claiming retention of title to have the liquidator keep the supplier's goods separately and, if he has already sold such goods, to keep the proceeds of sale of such goods in a separate trust account.

The common arguments used by liquidators and receivers to challenge the validity of a retention of title clause are as follows:

(a) The retention of title clause has not been properly incorporated into the contract of sale between the buyer and seller and so the buyer is not bound by it.
(b) Even if the retention of clause is part of the contract, it is invalid for some reason, for example because it is attempting to create a charge over the buyer's assets and is therefore void because it has not been registered under the relevant company legislation or Bills of Sale Act.

Both of these arguments have been discussed in the case law dealing with retention of title, and when drafting a retention of title clause for a client one has to bear in mind the current state of case law on the matter. It is also important to inform a client, when furnishing them with a draft retention of title clause, that the clause at present conforms with the various cases on the matter but that the law in this area may be subject to change.

2.11.5 Incorporation of a retention of title clause

It is a general principle of contract law that a party is not bound by a term of the contract unless, at the time the contract was made, he knew or ought to have known of its existence and the other party took all reasonable steps to bring it to his notice. For example in *Western Meats v National Ice and Cold Storage Co* [1982] ILRM 99, Barrington J refused to allow one of the parties to a contract to rely on an exemption clause because the other party had not been given adequate notice of the clause and so was not bound by it. Similarly, the buyer in a contract of sale is not bound by a retention of title clause relied upon by the seller either if it has not been brought expressly to his notice or he could not be expected to know of its existence, for example, by previous dealings between the parties.

When advising a supplier on retention of title it is important to inform him that he should write to the individual buyers informing them of the introduction of the retention of title clause and obtain an acknowledgment and acceptance by each of the buyers of the new terms. If this can be done, it can overcome a lot of difficulties later on when dealing with liquidators or receivers in demonstrating that the conditions of trade did apply to the contract between the supplier and buyer. One can also argue that the retention of title clause was clearly printed on all invoices between the supplier and the buyer. Certainly the case law at present would support such an argument, but it would be better if the supplier could obtain an actual acknowledgment and acceptance of the terms.

All of the cases on the matter show the importance placed by the courts on proper incorporation of retention of title clauses and the factors taken into account by them in considering this issue. It is obvious from the case law that it is up to the seller who is seeking to rely on a retention of tide clause to prove it has been effectively incorporated into any contract between the parties and the court will consider the facts of the case, such as the knowledge and prior experience of the parties, any documents involved and any previous dealings between them, to establish whether or not both parties truly agreed to the incorporation of such a clause in the contract between them. One particular area where problems arise in interpreting the intention of the parties in relation to the terms of the contract involves the type of case known as the 'battle of the forms'. This is where the buyer and seller use standard forms and both appear to enter into the contract on the basis that their own general conditions will apply. There are two main approaches to such a problem.

The first is that there is no contract because there is no true agreement between the parties as to terms (*Hyde v Wrench* (1840) 3 Beav 334).

The second is that the last set of forms sent by either party before the contract was entered into governs and so its terms apply (*Butler Machine Tool Co Ltd v Ex-Cell-O Corp (England) Ltd* [1979] 1 All ER 965).

Again it is a matter for the courts to decide if the parties have truly agreed as to whether or not the retention of title clause is to apply.

The cases on incorporation of a retention of title clause are as follows:

- *Re Stokes and McKiernan* (High Court, 12 December 1978, unreported, Mc William J);
- *Sugar Distributors Ltd v Monaghan Cash and Carry Ltd* [1982] ILRM 399;
- *Knppstahl AG v Quitmann Products Ltd* [1982] ILRM 551;
- *Union Paper Co Ltd v Sunday Tribune* (High Court, 27 April 1983, unreported, Barron J);
- *Carbery Pig Procedures Co-Operative Society Ltd v Lunham Brothers Ltd* (High Court, 16 April 1986, unreported, Carroll J);
- *Aluminium Industrie Vaassen BV v Romalpa Aluminium Ltd* [1976] 2 All ER 552;
- *Re Bond Worth Ltd* [1979] 3 All ER 919;
- *Robt Horn Paper v Print (1979)* 129 NLJ 651;
- *Wavin Nederland BV v Excomb Ltd (1983)* 133 NLJ 937;
- *John Snow and Co Ltd v DBG Woodcroft* [1985] BCLC 54.

2.11.6 Validity of a retention of title clause

Once it has been established that a retention of title clause does form part of a contract of sale, the next problem involves establishing its validity and scope. This depends on the type of clause used by the seller. Because each buyer of goods may intend to use them for a different purpose, for example, resale or use as a raw material, a number of different types of retention of title clauses have developed to try to protect the seller as fully as possible in each situation. Each type of clause must be considered separately in determining its validity and effectiveness.

2.11.7 'Simple' retention of title clause

2.11.7.1 Validity of a simple retention of title clause

The simple retention of title clause is so called because it simply purports to reserve title in the goods in the seller until the buyer pays the price of the goods. It is the most basic form of retention of title clause and is generally used at least as the first part of a retention of title clause even where the clause goes on to extend ownership further. In such a case, even where the extended part of the clause is, for some reason, found to be invalid, the 'simple' part can be severed and will itself be valid (*Clough Mill Ltd v Martin* [1984] 3 All ER 982).

No particular form of words is necessary to constitute a valid 'simple' retention of title clause. Some examples of a 'simple' retention of title clause are as follows:

> The ownership of sugar…shall only be transferred to the purchaser when the full amount of the purchase price has been discharged (*Sugar Distributors Ltd v Monaghan Cash and Carry Ltd* [1982] ILRM 399).
>
> Unless the company shall otherwise specify in writing, all goods sold by the company to the purchaser shall be and remain the property of the company until the full purchase price thereof shall be paid to the company (*Hendy Lennox (Industrial Engines) Ltd v Grahame Puttick* 2 All ER 152).

While a contract of sale containing a 'simple' retention of title clause is in existence the buyer is not necessary prevented from reselling or using the goods supplied before payment is made. It is taken to be the intention of the parties on entering into the contract that the buyer is free to use the goods as he pleases because otherwise the goods would, in effect, be useless until paid for in full. The clause itself may expressly provide that the buyer is free to use the goods pending payment, as was the case in *SA Foundries du Lion MV v International Factors (Ireland) Ltd* (High Court, 1 March 1984, unreported, Barrington J) where the simple retention of title clause expressly provided that the goods supplied by the seller could be resold or used by the buyer as long as they were not given as security. If the right to resell or use the goods is not expressly provided for, the court will employ it, in some cases, in order to give business efficacy to the contract. See *Four Point Garage Ltd v Carter* (1985) 3 AERT 12 and *Hendy Lennox (Industrial Engines) Ltd v Grahame Puttick Ltd* [1984] 2 All ER 152 and *Re Andrabell Ltd* [1984] 3 All ER 407) where it was agreed that the buyer had an implied right to sell the goods before payment was made.

2.11.7.2 Some unenforceable clauses

A further problem emerges when the buyer avails of his freedom to use the goods supplied and the pending retention of title clause ceases to have effect if the goods do not remain in the state in which they were delivered to the buyer. This raises a number of problems in relation to the use by the buyer of goods in a manufacturing process. If the goods totally lose their identity, a simple retention of title ceases to apply and the seller cannot claim title over the product manufactured.

This occurred in *Borden (UK) Ltd v Scottish Timber Products Ltd* [1979] 3 All ER 961, where the seller supplied resin under a contract which contained a retention of title clause, the first sub-clause of which was a 'simple' retention of title clause, knowing that the buyer would use the goods before payment was made. The buyer used the resin in the manufacture of chipboard before he paid the seller. The resign was unidentifiable in the chipboard but the seller claimed that the seller's resin could be traced into the chipboard. The Court of Appeal held that the effect of the retention of title clause was to reserve title in the resin only as long as it remained in an identifiable form, but once it was used in the manufacturing process it ceased to exist and the seller's title to it also ceased to exist.

This decision was considered in a later case of *Re Peachdart Ltd* [1983] 3 All ER 204, which involved the sale of leather under a 'simple' retention of title clause to a buyer for the purpose of making leather handbags. The buyer went into receivership without paying the sellers and they claimed to be entitled, not only to the unused leather, but also to the partly completed and completed handbags. They tried to distinguish *Borden* on the basis that in that case the resin was lost but in this case the leather was still identifiable after use in the manufacturing process. Vinelott J in the High Court accepted that an expert might have been able to identify which bag was made from the unpaid leather but said that the parties must have intended that once a piece of leather was used in the manufacturing process it would cease to belong to the sellers who would instead have a charge on the handbags manufactured as a security. The charge in this case was held void because of non-registration under s 95 of the UK Companies Act 1948 (s 99 CA 1963).

If, however, the goods supplied under a 'simple' retention of title clause are incorporated by the buyer into other goods before payment, but remain readily identifiable and removable, the retention of title clause continues to operate in respect of the incorporated goods. In *Hendy Lennox (Industrial Engines) Ltd v Grahame Puttick Ltd* (see above) Staughton J held that under a contract containing a 'simple' retention of title clause which had been incorporated by the buyer, engines supplied before payment, which had been incorporated into generator sets could be recovered by the sellers because they could be removed simply by undoing a number of bolts. He distinguished cases such as *Borden* and *Peachdart* where the goods supplied changed their identity once they were used by the buyer in the manufacturing process.

The leading Irish case in this area is the High Court decision of *Somers v Allen* [1984] ILRM 43 in which the general principle that a 'simple' retention of title clause is effective to reserve title in goods as long as they remain identifiable was affirmed.

The problem with a 'simple' retention of title clause is that of identifying the goods supplied by the seller which have not yet been paid for. This is especially difficult if the parties have dealt frequently with each other. If, for example, a seller sells two identical consignments of goods to the buyer under two separate contracts at £1,000 and the buyer pays £1,000 it may be difficult on an insolvency to prove which half of the goods supplied has been paid for. The general assumption is that the buyer uses the goods in order of receipt but this may not necessarily be so in all cases. Yet for the seller to repossess goods not yet paid for he must prove, to the satisfaction of the person dealing with the insolvent's estate, that the goods repossessed by him are in fact those for which the payment is outstanding. This may involve checking serial number and markings, if any are used, and may cause a lot of dispute. To avoid this problem many suppliers of goods use an 'all sums due' clause, which is dealt with next.

2.11.8 'Current account' retention of title clause

2.11.8.1 Validity of a current account retention of title clause

This clause is also known as an 'all sums due' clause because it purports to reserve title or ownership in the seller in the goods supplied until not only the purchase price for the actual consignment of goods has been paid, but also any outstanding sums owed by the buyer to the seller. Such a clause therefore is an extended variation of a simple retention of title clause and is frequently added on to such clause or may stand on its own. Some examples of a 'current account' clause are as follows:

- The product supplied shall, unless otherwise agreed, remain the property of the supplier until in the future and arising from the business connection with the purchaser have been paid in full (*In Re Interview Ltd* [1975] IR 382).
- The ownership of the material to be delivered by (the sellers) will only be transferred to the purchaser when he has met all that is owing to (the sellers) no matter on what ground (the *Romalpa* case [1976] 2 All ER 552).

The validity of a 'current account' clause as an effective means of protection for the seller was doubtful for many years but this doubt was dispelled by the decision of the Court of Appeal in *Clough Mill v Martin* (see above) which upheld such a clause. However, current account clauses had been considered and upheld by Irish courts for a number of years prior to this decision in a number of cases without any particular consideration of their effects (*Re Stokes and McKiernan Ltd* (see above); *Kruppstahl AG v Quitmann Products Ltd* (see above)).

2.11.8.2 Some problems

As in the case of the simple retention of title clause, problems arise when the goods supplied are mixed with other goods. In general, if the seller of goods wishes to give himself security for payment knowing that the buyer intends to use the goods before payment is made, he must consider the type of use which the buyer is contemplating and the effect that it will have on his goods. If the goods will be identifiable and removable after use, a simple form of retention of title clause will be sufficient to protect the seller but if the goods will lose their identity or will not be removable without materially injuring the goods to which they are attached, a simple form of retention of title clause to protect the seller and any security interest obtained by him over the goods produced will rank as a charge and be void if not registered under the relevant legislation.

It has already been noted that in the case of a contract between a buyer and seller incorporating a retention of title clause, it is generally assumed to be the intention of the parties that the buyer is free to resell the goods in the ordinary course of business although the seller has reserved ownership in the goods supplied pending payment of the price by the buyer, which has not yet been made. The problem arises as to whether the supplier can, under his retention of title clause, have an equitable right to trace into the proceeds of sale of his goods supplied and sold on. The cases in the English courts indicate a distinct reluctance to hold, in a particular case, that a fiduciary relationship exists, giving the seller of goods under a retention of title clause the equitable right to trace into the proceeds of sale of the goods supplied. They will only do so where the facts of the case clearly establish that such a relationship exists. This, however, has not been the position adopted by the Irish courts in the few cases in which the question has arisen.

In *Re Stokes and McKiernan Ltd* (see above), four retention of title clauses were involved, only one of which referred specifically to proceeds of sale. This clause provided that 'equitable and beneficial ownership shall remain with the seller until full payment has been received, or until prior resale in which the seller's beneficial entitlement shall attach to the proceeds of re-sale or to the claim for such proceeds'. McWilliam J said that this particular condition was perfectly clear and that the buyer was bound to hold the proceeds of resale of the goods on trust for the seller and the seller could follow the proceeds. He referred to the *Romalpa* case and continued:

> It seems to me that the decision in that case is based on the grounds that the goods remain the property of the vendor and, although the purchaser was entitled to resell them in the course of his business, the purchaser was selling on behalf of the vendor to the extent to which money was still owing to the vendor in respect of the goods and that the purchaser was, therefore, bound to account to the vendor for this money. I accept that this is the position and that the claimants in this case are entitled to trace the purchase price of their goods in the hands of the receiver.

The Irish decision in *Re Stokes and McKiernan* has been approved in *Sugar Distributors Ltd v Monaghan Cash and Carry Ltd* [1982] ILRM 399 and also in *SA Foundries du Lion MV v International Factors (Ireland) Ltd (High* Court, 1 March 1984, unreported, Barrington J).

It is clear that if a seller of goods wishes to establish a fiduciary relationship between himself and a buyer, he ought to refer to as many as possible of the following matters in the retention of title clause used by him in the contract of sale:

(a) the buyer is to hold the goods supplied as the seller's agent and bailee;
(b) the relationship between the buyer and seller is a fiduciary one;
(c) the buyer is to keep the goods supplied by the seller separately from his own, in such a way as to clearly show that they belong to the seller;
(d) the buyer is to keep the proceeds of sale separately for other monies possessed by him;
(e) the buyer should not be free to deal with the goods as he pleases pending payment to the seller;

(f) the retention of title clause should refer to the property in the goods not passing from the seller to the buyer until 'all sums due' to the seller are paid, rather than simply until the purchase price of a particular consignment of goods is paid.

It is important to confirm one's tracing rights to the proceeds of sale of goods which have been supplied and not to claim rights to trace the proceeds of sale of both the goods supplied and those in which they have been incorporated if subsequently manufactured as this would be deemed to be creating a charge which would be registrable pursuant to s 99 CA 1963 (see *Kruppstahl AG v Quitmann Products Ltd* [1982] ILRM 551.

In practical terms, one problem which the seller may face in claiming the right to trace the proceeds of sale of goods supplied by him or the proceeds of sales of products manufactured from goods by him is that of identification of the proceeds as having derived from those goods or products. If the buyer has sold the goods in question to a sub-purchaser as part of the sale of other goods, then the seller may find it difficult to establish which proceeds arise from the sale of his goods. Of course, the right to trace ceases once there is nothing to trace. However, the buyer may still be owed the purchase price of the goods in question by the sub-purchasers to whom he has sold them, and so the seller could protect himself further against the buyer's insolvency by seeking to claim the buyer's rights against the sub-purchasers.

2.11.9 Conclusion

It is clear from an examination of all aspects of retention of title clauses that their use causes a lot of problems of interpretation in relation to their validity and scope. While they can provide a seller of goods with an effective means of security against the buyer's nonpayment and insolvency, they must be drafted very carefully, in the light of general principles and of case law, to be of any worthwhile protection for the seller.

CHAPTER 3

PROOF OF DEBT AND ASSET RECOVERY

Barry Cahir

3.1 Common insolvency principles

The following principles apply to both bankruptcies and liquidations. Legally, they have no application in receivership or examination but in practice some of these principles are relevant and, in some cases, applied by analogy

3.2 The *pari passu* rule

All debts rank equally against the assets under this rule incorporated in s 275 of the Companies Act 1963 (CA 1963). However, many exceptions to the principle now exist, created both by contract and by law. See the section on priorities below. Where debts rank equally and the assets are insufficient to meet them, the debts abate in equal proportions; that is to say, on a distribution each debt is paid a similar proportion or percentage of the amount outstanding.

3.3 Proof of debt

In liquidation and bankruptcy, the onus of proof of an amount due lies on the creditor. The debts which may be proved in a liquidation are specified in s 283 CA 1963 and a similar provision is found in s 75 of the Bankruptcy Act 1988.

Section 284 CA 1963 applies the rules for admitting debts for the time being in force under the law of bankruptcy to the liquidation of companies. Thus Schedule 1 to the Bankruptcy Act 1988 is incorporated into company law. The rules in the Schedule to the Bankruptcy Act provide the procedure for valuing the debts due by the bankrupt. See also RSC Ord 74. Not all debts are due at the date of commencement of bankruptcy. There may be a credit period before the amount is due. The debt may be contingent, as in the case of a guarantee. The claim may involve a number of payments due over a future period, such as rent.

3.4 Set off

Rule 17 of the Schedule to the Bankruptcy Act 1988 provides for set off. Where at the commencement of the bankruptcy there are debts due by and to the bankrupt and another party in the same right, then one debt is credited against the other and only the balance due can be proved in the bankruptcy or collected by the assignee in bankruptcy. This concept seems very simple, but has given rise to a great deal of litigation. The courts have established that if the right to set off existed prior to the appointment of the liquidator, such a right continued after his appointment (see *Freaney v The Governor and Company of the Bank of Ireland; Murphy v Revenue Commissioners* [1976] IR 15). The matter was further considered in the case of *Continental Irish Meats Ltd (In Receivership) v Minister for Agriculture*

[1975] IR 376 where it was held that the Minister for Agriculture was not entitled to set off levies due by the company to the Minister acting as agent for the importing State (Italy) against compensation due to the company by the Minister acting as the intervention agent carrying out the Common Agricultural Policy.

This case clearly illustrates the lack of mutuality. The debt due by the Minister was due by him acting in one capacity whereas the debt to him was due in another capacity. The parties were not both acting in the same right and set off was not permitted. The question of the timing of the right to set off was considered in the case of *Dempsey v Bank of Ireland* (Supreme Court, 6 December 1985, unreported). In the case *of Patrick Joseph Casey, a Bankrupt* (High Court, 1 March 1993, unreported, Hamilton P) the intervention of thirdparty rights was considered. Prior to the commencement of his bankruptcy, Mr Casey had an interest in property, which was damaged by fire. His insurers paid him compensation. However, due to the circumstances of the fire, Mr Casey was entitled to compensation under the Malicious Injuries Scheme from the local authority. Because his insurers had paid him, they were entitled to the benefit of the malicious injuries claim under their subrogation rights. However, Cork County Council claimed to be entitled to set off an amount due for rates against the sum ordered under the malicious injuries claim. The insurers disputed the entitlement of the local authority to set off a debt against their claim. The court held that the insurance company could be in no better position than the insured and that the county council was indeed entitled to set off.

3.5 Priorities

The rules as to priorities, which are discussed in more detail below, are common to bankruptcy and liquidations save only that a floating charge will not occur in bankruptcy (because an individual cannot create such a security) and there is no provision in the Bankruptcy Act 1988 for the recognition of deferred debts.

3.5.1 Application of priority rules to receivership and examination

In a receivership, the proceeds of a fixed charge will be paid to the debenture holder. The remuneration, costs and expenses of the receiver rank with the debenture holder's debt. Under s 98 CA 1963, preferential debts rank in priority to a floating charge. Thereafter, floating charges rank in the order of their creation and again the receiver's costs and expenses rank with the sums due to the floating charge debenture holder and are paid out of the assets with the debenture holder's debt.

A receiver will not be concerned with charges ranking after the charge on foot of which he was appointed, nor will he deal with unsecured creditors.

In examination, no legal rules as to priorities are applied. However, in formulating a scheme, an examiner will bear in mind the commercial reality that each creditor, in considering a scheme of arrangement, will compare what is on offer under the scheme with what he might hope to receive if the company were to be liquidated. If the liquidation option seems more attractive, a creditor will be more inclined to consider voting against a scheme of arrangement. For this reason, examiners have tended to formulate the classes of creditors at least partly along the lines of their priority on liquidation and examiners have tended to offer more favourable terms to secured and preferential creditors than to unsecured creditors. Ultimately the court will only sanction a scheme if it is fair and equitable having regard to all affected interests. In this consideration, the court will take account of priorities, which would have applied in a winding up.

3.5.2 Fraudulent preference

The concept of fraudulent preference arises in bankruptcy and in liquidations. Section 286(1) CA 1963 (as extended by s 135 of the Companies Act 1990) provides that:

> Any conveyance, mortgage, delivery of goods, payment, execution or other Act relating to property made or done by or against the company which is unable to pay its debts as they become due (taking into account the contingent and prospective liabilities) in favour of:
> (a) any creditor;
> (b) any person on trust for such creditor with a view to giving such person a preference over the others
> shall, if the winding up commences within six months thereof, be a fraudulent preference.

The onus of proof will still be on the liquidator to prove fraudulent preference. The case of *Corran Construction Ltd v Bank of Ireland Finance Ltd* [1976–77] ILRM 175 sets out the three principles used to determine fraudulent preference. These are:

- the act creating the mortgage etc must be a voluntary act of the company;
- the company must go into liquidation within a six-month period;
- the act creating the mortgage etc must be done with the dominant intention to prefer a creditor or a class of creditors over and above the other creditors.

There have been two other decisions in this area, the second of which changed the onus of proof, and they are:

- *Kelleher v Continental Irish Meats Ltd* (9 June 1978) where the surrounding evidence and the activities of the creditor and a member of the staff of the company led the judge to conclude that fraudulent preference had taken place.
- In *Re Station Motors Ltd (In Liquidation) v AIB* [1985] IR 756, the judge decided that in the absence of evidence of the intention of the directors of the company to prefer the creditor, she could infer an 'intention to prefer' from the surrounding facts and, where the directors had given guarantees to the creditor (in this case, the bank), the subsequent action of the company (acting by its directors) in paying the bank must be looked at with suspicion.

In the case of *Else Teoranta (In Liquidation) v Irish Seafresh Foods Ltd* [1991] ILRM 760 the court applied a similar test.

Section 135(3) of the Companies Act 1990 provides that:

> A transaction to which s 286(1) applies (conveyance, mortgage, delivery of goods, etc) is made in favour of a connected person which was made within two years before the commencement of the winding up of the company shall, unless the contrary is shown, be deemed in the event of the company winding up:
>
> (a) to have been made with a view to giving such person a preference over the other creditors; and
> (b) to be a fraudulent preference, and be invalid accordingly.

Subsection (5) provides that in that section:

> A connected person means a person who, at the time that the transaction was made, was:
>
> (a) a director of the company;
> (b) a shadow director of the company;
> (c) a person connected within the meaning of s 26(1) of the Act with a director;

(d) a related company within the meaning of s 140 of the Act;
(e) any trustee of, or surety or guarantor for the debt due to any person described in paragraph (a), (b), (c) or (d).

3.5.3 Judgment mortgages

Section 284 CA 1963 (as amended by s 51 of the Bankruptcy Act 1988) refers to the validity or invalidity of judgment mortgages.

The effect of this section is to make invalid any judgment mortgage which has been registered within three months of the passing of a resolution for voluntary winding up (or in the case of a company being wound up by order of the court, the date of the presentation of the petition of the winding up).

3.6 Priority of payment in liquidations

Section 281 CA 1963 provides that:

> All costs, charges and expenses properly incurred in the winding up, including the remuneration of the liquidator, shall be payable out of the assets of the company in priority to all other claims.

This section applies to 'every voluntary winding up'.

Accordingly, the following are the priorities applying to the distribution of the funds in every voluntary winding up:

(a) fees, costs and charges of an Examiner;
(b) costs, charges and expenses of the liquidation;
(c) any claim under s 120 of the Social Welfare (Consolidation) Act 1981;
(d) any claim by preferential creditors (see schedule of the current preferential debts);
(e) payment due to the holder of any floating charge;
(f) payment to unsecured creditors.

In the above list, any amount due to the holder of a fixed charge has been disregarded. Obviously, payment to the holder of such a charge would be made out of the proceeds of sale of the asset which has been charged.

For court liquidations, RSC Ord 74 r 128 provides a statement of the priority for payment of costs and claims.

This statement does not exist for voluntary liquidations, but it is likely that the priorities provided for in RSC Ord 74 r 128 will apply in a voluntary liquidation where relevant. Some of the items referred to in RSC Ord 74 r 128 will not apply in a voluntary liquidation and, therefore, can be disregarded.

3.6.1 RSC Ord 74 r 128

In a winding up by the court, the assets of a company which remain after payment of the fees and expenses properly incurred in preserving, realising or getting in the assets, including where the company has previously commenced to be wound up voluntarily such remuneration, costs and expenses as the court may allow to a liquidator appointed in such voluntary winding up, *shall,* subject to any order of the court, be liable to payment which shall be made in the following order of priority, namely:

(a) First, the costs of the petition, including the costs of any person appearing on the petition whose costs are allowed by the court.
(b) Secondly, the costs and expenses of any person who makes or concurs in making the company's statement of affairs.
(c) Next, the necessary disbursements of the official liquidator, other than expenses properly incurred in preserving, realising or getting in the assets hereinbefore provided for.
(d) Next, the costs payable to the solicitor for the official liquidator.
(e) Next, remuneration of the official liquidator.
(f) Finally, the out-of-pocket expenses necessarily incurred by the Committee of Inspection (if any).

No payments in respect of bills or costs, charges or expenses of solicitors, accountants, auctioneers, brokers or other persons, other than payments for costs, charges or expenses fixed or allowed by the court shall be allowed out of the assets of the company unless they have been duly fixed and allowed by the Examiner or the Taxing Master as the case may be.

Section 29(3) of the Companies (Amendment) Act 1990 provides that the costs and expenses of the Examiner shall be paid before any other claim, secured or unsecured. Expenses certified by an examiner under s 10 of the Companies (Amendment) Act 1990 (as amended by the Companies (Amendment) Act 1999) rank after the claims of fixed charge holders but before those of floating charge holders.

3.7 Compulsory liquidations

3.7.1 Protection of Employees (Employers Insolvency) Act 1984

Under the provisions of this Act, payments of certain debts to employees under employment contracts or under the provisions of protective legislation arising from employers' insolvencies occurring on or after 22 October 1983 are guaranteed out of the Redundancy and Employers Insolvency Fund. This fund was formerly known as the Redundancy Fund. Where the employer is a company, for the purposes of the application of the Act 'insolvency' includes the appointment of a receiver on behalf of any debenture holder secured by a floating charge, the commencement of a voluntary winding up or the commencement of a compulsory winding up. The principal debts for which payment is guaranteed are, subject to a limit of £300 per week in respect of any debt calculated by reference to remuneration, the following:

(a) arrears of wages of up to eight weeks;
(b) the amount of any award by the Employment Appeals Tribunal of compensation under the Minimum Notice and Terms of Employment Act 1973;
(c) arrears of holiday pay for a period of holiday not exceeding eight weeks;
(d) awards of compensation under the Unfair Dismissal Act 1977.

For the purposes of administration of payment of the guaranteed sums in a liquidation, the liquidator is the 'relevant officer' and he arranges for the submission of statements of claim on prescribed forms to the fund which is administered by the Department of Labour. The Act also contains provisions guaranteeing the payment of certain unpaid contributions to occupational pension schemes of insolvent companies.

Where any payment out has been made by the Fund to employees, the Minister for Labour is subrogated to those employees' preferential rights as creditors in the winding up of the company.

3.7.2 Preferential debts

Under s 285 CA 1963 (as amended) certain debts must be paid out of the realised assets of a company in liquidation after the costs, charges and expenses of the liquidation have been paid but prior to the claims of creditors secured by registered floating charge and the unsecured creditors.

Section 134 of the Companies Act 1990 introduces a provision which limits preferential status to those of the listed liabilities below which are notified to or become known to the liquidator within six months after advertisement by the liquidator for claims in two daily newspapers.

If the assets are insufficient to pay the preferential debts in full, then the debts abate in equal proportions.

In the following list, the phrase 'the relevant date' means:

(a) Where the company is ordered to be wound up by order of the court:

- the date of the appointment of a provisional liquidator;
- if no provisional liquidator has been appointed, then the date of the winding up order; unless in either case the company had commenced to be wound up voluntarily before that date.

(b) Where, prior to the date of the appointment of a provisional liquidator or the date of a winding up order, the company had passed a resolution for the winding up of the company the date of the passing of that resolution.

In these circumstances, the following are preferential debts.

3.7.2.1 Rates and taxes

Rates and taxes which are preferential debts are defined as follows:

(a) Local rates: any amount due at the relevant date and having become due and payable within 12 months before that date (s 285(2)(a)(i) CA 1963).
(b) Assessed taxes: unpaid amounts assessed on the company up to 5 April next before the relevant date and not exceeding in the whole one year's assessment (but inclusive of any interest chargeable thereon) (s 285(2)(a)(ii) CA 1963).
(c) Capital gains tax (to 5 April 1976) (s 285(2)(a)(ii) CA 1963; s 550 of the Income Tax Act 1967; Schedule 2, para 15 of the Capital Gains Tax Act 1975).
(d) Corporation tax (including tax on capital gains with effect from 6 April 1976) (s 285(2)(a)(ii) CA 1963; s 550 of the Income Tax Act 1967; s 145(5) of the Corporation Tax Act 1976).
(e) Income tax deducted from payments (s 285(2)(a)(ii) CA 1963; s 151 of the Corporation Tax Act 1976).
(f) Value added tax: unpaid tax due by the company for any taxable period(s) which ended within the period of 12 months next before the relevant date and any interest payable thereon (s 6 of the Finance Act 1976; s 21 of the Value Added Tax Act 1972).

3.7.2.2 Wages and salaries

Wages and salaries which are deemed to be preferential debts are as follows:

(a) The amount due in respect of services of a clerk, servant, workman or labourer in the four months next before the relevant date subject to a maximum of £2,500 in any case (CA 1963, s 285(2)(a), (b), (c), s 285(3); Companies (Amendment) Act 1982, s 10(b)).
(b) The whole or proportionate part of a lump sum payable under contract to a farm labourer at the end of a year of hiring (CA 1963, s 285(4)).
(c) 'Wages' include any remuneration in respect of the period of holiday or absence from work through good cause (CA 1963, s 285(11); Companies (Amendment) Act 1982, s 10(d)).
(d) All accrued holiday remuneration (CA 1963, s 285(2)(d)).
(e) Advances to pay wages/salaries. Any person who has advanced money to a clerk, servant, workman or labourer for the payment of wages, salaries, accrued holiday remuneration, absence from employment due to ill health or pursuant to any scheme or arrangement for the provision of superannuation benefits to or in respect of such workers is preferred to the extent to a maximum of £2,500 per employee for the four months period prior to the relevant date before the payments have been made (that is, the same rights as those of the employee concerned) (CA 1963, s 285(6); Companies (Amendment) Act 1982, s 10(c)).
(f) Social welfare contributions. All amounts due in respect of contributions payable during the 12 months next before the relevant date by the company as employer of any persons under the Insurance (Intermittent Unemployment) Act 1942 or the Social Welfare Acts 1952 to 1961 (CA 1963, s 285(2)(e)).
(g) Deductions by a company from payment to:

- employees;
- sub-contractors;
- individuals not in insurable employment.

(h) Any amounts due to the Revenue Commissioners in respect of deductions made (or which should have been made) during the period or periods falling within the period of 12 months before the relevant date from:

- Salary or wages of employees in respect of:
  - Income Tax (PAYE) together with any chargeable interest thereon (CA 1963, s 285(2)(a)(iii); Income Tax Act 1967, s 132; Finance Act 1968, s 11; Income Tax Act 1967, s 550);
  - Youth Employment Levy (from 6 April 1982) (CA 1963, s 285(2)(a)(iii); Income Tax Act 1967, s 132; Youth Employment Agency Act 1981, s 26(i));
  - Income Levy (from 6 April 1983) (CA 1963, s 285(2)(a)(iii); Income Tax Act 1967, s 132; Finance Act 1983, s 16).
- Payments to sub-contractors (where the company in liquidation is the principal contractor) (CA 1963, s 285(2)(a)(iii); Income Tax Act 1967, s 132; Finance Act 1970, s 17(2); Income Tax Act 1976, s 14).
- Payments in respect of health contributions (CA 1963, s 285(2)(a)(iii); Income Tax Act 1967, s 132; Health Contributions Act 1979, ss 6 and 15(1)).

(i) Workman's compensation. All amounts including costs due to an employee in respect of compensation or liability for compensation insofar as they have not been effectively covered by insurance (CA 1963, s 285(2)(f)).

(j) Accidents. All amounts due in respect of damages and costs to an employee in connection with an accident in the course of employment insofar as they have not been effectively covered by insurance (CA 1963, s 285(2)(g)).
(k) Sickness schemes. All sums due to an employee arising out of any scheme or arrangement for the provision of payments to an employee while he is absent from employment due to ill health (CA 1963, s 285(2)(h); Companies (Amendment) Act 1982, s 10(a)).
(l) Unfair dismissals. All compensation payable under the Unfair Dismissals Act 1977 by the company to an employee (Unfair Dismissals Act 1977, s 12(i)).
(m) Minimum notice. All compensation payable to an employee under the Minimum Notice and Terms of Employment Act 1973 (Minimum Notice and Terms of Employment Act 1973, s 13).
(n) Redundancies. Contributions to the redundancy fund (other than employers' weekly redundancy contributions to which s 28 of the Redundancy Payments Act 1967 (as amended by s 3 of the Redundancy Payments Act 1979) applies) payable by the company during the 12 months before the commencement of the winding up order (Redundancy Payments Act 1967, s 42; Redundancy Payments Act 1979, ss 3 and 14).
(o) Any lump sum (or portion of a lump sum):

- payable by the company under the Redundancy Payments Act 1979; or
- reclaimed by the redundancy fund (but subject to the 60 per cent rebate recoverable or deductible, as the case may be, from the fund).

3.8 Remedies to swell available assets

3.8.1 Contribution and pooling (ss 140 and 141 CA 1963)

3.8.1.1 General

The Companies Act 1990 contains provisions which allow the High Court:

(a) in certain circumstances, in the course of liquidation of a company, to order a related company not in liquidation to pay part or all of the debts of the company being wound up; and
(b) in other circumstances, to order that in the case of two or more related companies being wound up, such liquidations are to be conducted as one.

These are the contribution and pooling provisions respectively. They represent a significant statutory breach of the principle of separate legal personality of companies by incorporation which underlies Irish company law. The prescribed criteria upon which a contribution or pooling order will be made leave a very wide discretion to the High Court. It also appears to be the case that the provisions are capable of being applied in respect of liquidations commenced prior to the Act coming into force and, therefore, can be of retrospective effect.

Against what companies may a contribution order or pooling order be made?

The companies potentially affected are described as 'related companies' and are defined to include all of the following, assuming that 'Insolco' is the company being wound up:

(a) Insolco's holding company;
(b) Insolco's subsidiary;
(c) a company which together with other companies related to it holds more than 50 per cent in nominal value of Insolco's equity share capital;

(d) a company more than 50 per cent of whose nominal value equity share capital is held by members who also hold such a proportion of Insolco's capital (common control);
(e) a company which either alone or together with companies related to it or whose related companies can exercise or control the exercise of more than 50 per cent of voting power at any general meeting of Insolco;
(f) a company whose business has been carried on in such a way that its and Insolco's separate businesses, or a substantial part thereof, are not readily identifiable;
(g) a company which is related to another company to which Insolco is also related.

From this example it can be seen that the net is cast very wide indeed and that the implications of the new law for all companies 'related' to insolvent companies, and indeed for lenders to and ordinary creditors of such companies, are far-reaching.

3.8.1.2 Criteria for making of a contribution order

The High Court may make a contribution order if satisfied that it is just and equitable to do so. In deciding whether it is just and equitable, the court is to have regard to three matters:

(a) the extent to which the related company took part in the management of Insolco;
(b) the conduct of the related company towards the creditors of Insolco;
(c) the effect which a contribution order would be likely to have on the creditors of the related company.

Additionally:

1 the High Court must be satisfied that the circumstances that gave rise to the winding up of Insolco are attributable to the actions or omissions of the related company; and
2 an order may not be made if the only ground is either that the company is a related company or that creditors of Insolco have relied on the fact that the company is a related company.

The liquidator or any creditor or contributory of the company that is being wound up may apply for a contribution order.

3.8.1.3 The effect of a contribution order

If a contribution order is made against a related company the amount of the liability thereby imposed will rank as an ordinary or unsecured liability of that company.

Until the first cases of applications for contribution orders have been decided by the High Court, it is not possible to describe with any certainty what conduct, actions or omissions by a related company will leave it exposed to a contribution order. The interpretation, which the High Court will give to the criteria laid down in the Act will determine how far-reaching these provisions will be. In the absence of certainty the following is speculation only.

At one end of the spectrum, there is the situation of the insolvent group subsidiary in the management of which the parent company had minimal participation. It is not perhaps too absurd to suggest that the Act could be interpreted so that if the parent does not fund or continue to fund the subsidiary which has become insolvent, say because of a sharp downturn in its sector of activity, some significant bad debts and high overheads, it could be held that the circumstances giving rise to winding up are attributable to the acts or omissions of the related company.

At the other end of the spectrum, there is the company whose business has been carried on in such a way that its separate business and Insolco's separate business are not readily identifiable.

If it is assumed that the court will be concerned mainly with the interests of the creditors of Insolco, the new provisions at their widest will allow the court to impose liability on related companies located anywhere in this spectrum and whose degree of involvement in the operation and management of Insolco may range from minimal to total.

3.8.1.4 Pooling orders

Where two or more related companies are being wound up, the liquidator of any of them may apply to the High Court for an order that the companies be wound up together as if they were one company.

As for contribution orders, the High Court must be satisfied that it would be just and equitable to make the order. In deciding whether it is just and equitable to make an order the court must have regard to four matters:

(a) the extent to which any of the companies took part in the management of any of the other companies;
(b) the conduct of any of the companies towards the creditors of any of the other companies;
(c) the extent to which the circumstances that gave rise to the winding up of any of the companies are attributable to the actions or omissions of any of the other companies; and
(d) the extent to which the businesses of the companies have been intermingled.

The first two criteria are identical to those for the making of contribution orders, the third echoes the pre-requisite for a contribution order and the fourth is a characteristic peculiar to pooling cases. There is no statutory guidance on what constitutes intermingling. However, Laf Toy J, in the case of *Templemore Express Couriers* (an *ex tempore* judgment) refused to make a pooling order in a 'phoenix situation' where the related company only began to trade after Insolco ceased to trade. This was so even though the related company used the same name, staff and premises, etc, as the old company.

As in the case of contribution orders, it is specifically provided that it shall not be just and equitable to make such an order if the only ground for making the order is:

(a) the fact that a company is related to another company; or
(b) that creditors of a company being wound up have relied on the fact that another company is or has been related to the first-mentioned company.

3.8.1.5 The effect of a pooling order

The High Court in making a pooling order may make the order subject to such terms and conditions as it sees fit. The court may order that the related companies be wound up together to such an extent that, for example, a pooling order may relate to part only of the assets and/or liabilities of any one of the related companies. The rights of secured creditors are specifically protected. It is provided that no pooling order is to affect the rights of any secured creditor of any of the companies. Unless the court orders otherwise, the claims of all unsecured creditors of all the related companies rank equally among themselves. The court may remove any liquidator of any of the related companies and appoint any person to act as liquidator of all the companies.

It is notable that it is specifically provided that in deciding the terms of an order for pooling the court is obliged to have particular regard to the interests of persons who are shareholders in some but not all of the related companies affected. There is no requirement to have similar regard to the interests of persons who are creditors of some but not all of the relevant related companies.

The parties who would be disadvantaged by the making of a pooling order will be the unsecured creditors of the least insolvent of the related companies. Those creditors are not given a specific entitlement to appear and object to the making of the pooling order–the persons who must be served with notice of an application for a pooling order are the relevant related companies and such other persons as the court may direct. Such creditors must, therefore, rely on the exercise of the court's discretion for a right of appearance. It is to be hoped that notification to such creditors will be adopted as practice. Contrariwise, the parties who would benefit most from the making of a pooling order are the unsecured creditors of the most insolvent of the relevant related companies. It will be interesting to see how the High Court balances the competing interests of these two groups of creditors.

3.9 Section 139 of the Companies Act 1990

Where property of a company has been disposed of in a way which defrauded the creditors or members, the court may order the return of the property or its value on the application of a liquidator, creditor or contributory.

3.10 Sections 202–05 of the Companies Act 1990

These sections set out details of the standard books and records to be kept by a company. Breach of the requirements can result in personal liability for the officers of the company, where it is insolvent and in liquidation and the court forms the view that the lack of proper books contributed to the insolvency or impeded the liquidation. See *Mehigan v Duignan* [1997] 1 IR 340, more commonly known as the *Mantruck* case.

3.11 Floating charge

Section 288(1) CA 1963 provides that a floating charge of the undertaking of property of the company created 12 months before the commencement of the winding up shall, unless it is proved the company was solvent immediately after the charge was created, be invalid, except:

> to the amount of any cash paid to the company at the time of or subsequently to the creation of and in consideration of the charge.

A test as to whether or not the company was solvent was established in the *Creation Group* case *(Crowley v Northern Bank Finance Corp Ltd* [1981] IR 353) where Mr Justice Kenny stated:

> The test (for the purposes of s 288) in determining this (solvency) is whether immediately after the debenture was given, the company was able to pay its debts as they became due.

Section 136 of the Companies Act 1990 provides:

(a) where goods or services are provided as security for the floating charge then they are valued in money terms at that time; and

(b) where a floating charge is created in favour of a connected person, the period is two years instead of 12 months.

3.12 Set off

A set off is permitted post-liquidation where:

(a) the debts are trading debts;
(b) they exist in the same right (that is, are 'mutual') and are made between the same parties.

The courts have established that if the right of set off existed prior to the appointment of the liquidator, such right continued after his appointment (see *Freaney v The Governor and Company of the Bank of Ireland; Murphy v Revenue Commissioners* [1976] IR 15). The matter was further decided in the case of *Continental Irish Meats Ltd (In Receivership) v Minister for Agriculture* [1975] IR 376 where Mr Justice McMahon held that the Minister for Agriculture was not entitled to offset levies due by the company to the Minister acting as agent for the importing State (Italy) against a compensation due to the company by the Minister acting as intervention agent carrying out the Common Agricultural Policy. In particular, the right of banks to set off were considered in the *Freaney* case as between current and deposit account and in *Robert Dempsey v Bank of Ireland* (Supreme Court, 6 December 1985) in the case of a guarantee account.

CHAPTER 4

LIABILITY OF DIRECTORS AND SHAREHOLDERS

Julie Murphy-O'Connor

4.1 Introduction

A company is insolvent when it is unable to pay its debts. While this may appear to be a statement of the obvious, and a straightforward and easily applicable test, as discussed below, it is neither. There is no obligation under Irish law on a company or its directors to take any steps to wind up the company or to put it into examinership when a company is insolvent. Indeed, neither insolvency nor trading while insolvent in themselves give rise to criminal or civil liability for directors. It is only when the company is put into examinership or liquidation that consequences may flow for directors. Where a formal insolvency procedure has begun, the solvency of the company, not only at the time of the beginning of the insolvency procedure, but at any time prior to the beginning of the insolvency procedure may need to be determined as part of the examiner's or liquidator's investigation into the directors' actions.

4.2 Definition of insolvency

There are two primary tests of inability to pay debts or insolvency:

(a) the cash flow test; and
(b) the balance sheet test.

Applying the cash flow test, a company is insolvent when it is unable to pay its debts as they fall due. The fact that a company's assets exceed its liabilities is irrelevant for the purposes of this test. The balance sheet test is whether the company's assets are insufficient to discharge its liabilities. There are a number of variations of both tests and different tests apply under different statutory provisions.

The most common application of the cash flow test is contained in s 214(a) of the Companies Act 1963 (CA 1963), where it is provided that a company shall be deemed to be unable to pay its debts if a creditor owed in excess of IR£1,000 (€1,269.74) has served a written demand on the company requiring it to pay the sum due within three weeks and the sum has not been paid. Clearly, a company may have an excess of assets over liabilities and yet, due to the nature of the assets, may not be in a position to pay such a debt. This deemed insolvency can be the basis for a petition to have the company wound up. The balance sheet test, however, is the relevant test when considering whether a director has traded recklessly (s 214(a), (b) or (c) CA 1963 must, at a minimum, apply) or fraudulently, as the issue of reckless or fraudulent trading arises only where creditors have suffered some loss arising from the directors' actions. The balance sheet test applies also for the purpose of a declaration of solvency pursuant to s 256 of the 1963 Act, which is a pre-requisite to putting a company into members' voluntary liquidation as opposed to creditors' voluntary liquidation. In this instance, however, the fact that assets frequently realise less than their value on a break-up basis, and also the costs of liquidation, must be taken into account. In practice, however, where one test applies the other will generally be satisfied also.

4.3 Issues for directors who are trading while insolvent

4.3.1 Fraudulent and reckless trading

Section 297A(1) CA 1963 provides that:

> If in the course of winding up of a company (subject to s 251 of the Companies Act 1990 which, in certain circumstances, allows this section to be availed of where the company is not in liquidation, but where the principal reason for its not being in liquidation is the insufficiency of its assets) or in the course of proceedings under the Companies (Amendment) Act 1990 [Examinership proceedings], it appears that:
>
> (a) any person was, while an officer of the company, knowingly a party to the carrying on of any business of the company in a reckless manner; or
>
> (b) any person was knowingly a party to the carrying on of any business of the company with intent to defraud creditors of the company, or creditors of any other person or for any fraudulent purpose
>
> the court, on the application of the receiver, examiner, liquidator or any creditor or contributory of the company, may, if it thinks it proper to do so, declare that such persons should be personally responsible, without any limitation of liability for all or any part of the debts or other liabilities of the company…

4.3.1.1 Fraudulent trading

Part (b) of the above section describes fraudulent trading. Fraudulent trading is also a criminal offence (s 297 CA 1963). Fraudulent trading, even in its civil form, involves conduct on the part of directors, which is more blameworthy than reckless trading, as indeed the terms themselves would suggest.

This section requires two basic proofs:

(a) the intent to defraud; and
(b) knowledge of such intent.

The phrases 'intent to defraud' and 'fraudulent purpose' are phrases which, it has been held, 'connote actual dishonesty involving, according to current notions of fair trading among commercial men, real moral blame' (*Re Patrick and Lyon Ltd* [1993] Ch 786). Somewhat similarly, it has been held that fraudulent trading involves conduct which goes 'well beyond the bounds of what ordinary people engaged in business would regard as honest' (*Re EB Tractors Ltd* (*High* Court of Justice in Northern Ireland, 21 March 1986, unreported, Murray J)).

Essentially, if the directors of a company continue to carry on business or to incur debts at a time when they know that there is no prospect of the creditors ever receiving payment (*Re William C Leitch Bros Ltd* [1932] 2 Ch 71) or indeed if the directors incur credit on behalf of a company knowing that there is no good reason to think that the funds will be available to pay the debt when it becomes due or shortly thereafter (*R v Grantham* [1984] 3 All ER 166), such conduct on their part constitutes fraudulent trading.

Fraudulent trading will, almost by definition, always amount to reckless trading also, save that liability for fraudulent trading is not confined to the officers of the company and could be perpetrated by parties who have not carried on or even assisted in the carrying on of the company's business, but have nevertheless in some way participated in the fraudulent acts. In addition, the intent to defraud for the purpose of fraudulent trading may not be in relation to the company but may relate to the creditors of some other person or may relate to any other person.

The leading Irish case in relation to fraudulent trading is *Re Hunting Lodges Ltd* [1985] ILRM 75. This concerned a company which was massively indebted to the Revenue Commissioners. It sold its principal asset, a public house, concealing a substantial part of the purchase price which was paid 'under the counter' to one of the directors. Four directors were made personally liable for the company's debts to differing extents.

This case is also authority for the proposition that a single act may be regarded as the 'carrying on of any business of the company', and accordingly be deemed to be fraudulent trading.

It is clear, however, that a person will not be deemed to be 'knowingly a party' to fraudulent trading simply because he was aware of fraudulent conduct on the part of other persons, active participation being necessary to attract liability (*Re Kelly's Carpetdrome Ltd (No 2)* (High Court, 13 July 1984, unreported, O'HanlonJ).

Liability for fraudulent trading may be compensatory or punitive. In *Re Hunting Lodges Ltd,* for example, different levels of liability were imposed on each respondent. Two respondents were made liable for the amount of misappropriated monies which the liquidator was unable to recover, another respondent was made liable to the extent of monetary advances made to her over a four-year period, and the last respondent was made liable for all of the debts of the company. It is clear from the judgment that CarrollJ did not consider it necessary to establish a causal link between loss suffered by creditors and the liability imposed on the directors.

4.3.1.2 Reckless trading

Section 297A(1)(a) CA 1963 describes reckless trading. The definition is extended in s 297A(2) which provides as follows:

> Without prejudice to the generality of subsection (1)(a), an officer of a company shall be deemed to have been knowingly a party to the carrying on of any business of the company in a reckless manner if:
>
> (a) he was a party to the carrying on of such business and, having regard to the general knowledge, skill and experience that may reasonably be expected of a person in his position, he ought to have known that his actions or those of the company would cause loss to the creditors of the company, or any of them, or
>
> (b) he was a party to the contracting of a debt by the company and did not honestly believe on reasonable grounds that the company would be able to pay the debt when it fell due for payment as well as all its other debts (taking into account the contingent and prospective liabilities).

Section 297A(6) CA 1963, however, provides that:

> Where it appears to the court that any person in respect of whom a declaration has been sought under subsection (1)(a), has acted honestly and responsibly in relation to the conduct

> of the affairs of the company or any matter or matters on the ground of which such declaration is sought to be made, the court may, having regard to all the circumstances of the case, relieve him either wholly or in part, from personal liability in such terms as it may think fit.

The inclusion of the word 'knowingly' in s 297A(2) imports subjectivity into the definition of reckless trading. As Lynch J, in the only reckless trading case litigated in full to date *(Re Hefferon Kearns (No 2)* [1993] 3 IR 191) pointed out, however, s 297A(2)(a) and (b) extended the definition to include circumstances which clearly contemplated an objective assessment of the directors' conduct. He felt that s 297A(6) reinforced his views in this regard. He put it as follows:

> The objective nature of the test of recklessness is emphasised by subsection 6 which presupposes that a director may be reckless, although he acted honestly and responsibly. The plaintiff must show that the defendants took an unjustified risk, but that is to be assessed on the basis of what they ought to have known and not merely on what they in fact knew. Merely continuing with the business when that fact involved an unjustifiable risk and caused loss to creditors is enough.

In summary, recklessness equates with a reasonable man test, although it is clear from s 297A(2)(a) that the 'general knowledge, skill and experience' of a person in the position of the director whose conduct is under scrutiny is taken into account.

In *Re Hefferon Kearns Ltd (No 2)* the directors managed to persuade the court that they had acted 'honestly and responsibly'. The case is not particularly helpful for a number of reasons, the principal one of which is that Murphy J, in a preliminary hearing, decided that the section did not have retrospective effect and therefore limited the period to which the subsequent court could look in deciding whether reckless trading occurred to a period of approximately six weeks. In addition, the loss incurred by creditors during that period was minimal, which the court expressly took into account. Lynch J found that reckless trading pursuant to s 297A(1)(b) had occurred for a period of approximately two weeks, but took into account a number of 'prudent and responsible' steps which the directors took in their concern for the creditors of the company. He noted that:

(a) one of the defendants had personally borrowed money in order to improve the company's cash flow,
(b) the decision to carry on trading had been taken in the belief (supported by the subsequent examiner's report) that to do so would improve the creditors' position,
(c) the decision to carry on trading was taken on the basis that the company would not incur further credit (although as it happened the overall indebtedness was increased, taking into account the fact that some creditors were paid),
(d) two of the defendants had jointly guaranteed the company's debts with a bank and had been willing to surrender their shares in other companies for the benefit of the company,
(e) all of the defendants had co-operated fully with the examiner.

Lynch J also took into account the fact that the directors tried to keep creditors informed of the position. In doing so he may have taken cognisance of s 297A(4) which requires the court to have regard to whether a creditor referred to in s 297A(1)(b) was, at the time that the debt was incurred, aware of the financial state of affairs of the company and, notwithstanding such awareness, consented to the incurring of the debt.

It is unclear whether the courts will insist on a causal link between loss caused to creditors and the actions of directors in the context of reckless trading proceedings as opposed to fraudulent trading proceedings. There is a suggestion, however, in *Re Hefferon*

Kearns Ltd (No 2) that the courts will try to establish a link before imposing personal liability. Where the applicant is a creditor, however, arising from s 297A(3), the creditor in question must have suffered loss as a consequence of the impugned behaviour. It is noteworthy also that where fraudulent or reckless trading proceedings are brought by a creditor, the court may order payment directly to the creditor in question as opposed to requiring that the proceeds of such an award be held as part of the assets available for the general body of creditors (see *Re Cyona Distributors Ltd* [1967] 1 Ch 889).

Finally, as regards reckless trading, it is reasonable to assume that, based on case law relating to fraudulent trading, awareness of reckless conduct on the part of other officers is not sufficient and that active participation only will attract liability; a single transaction is sufficient to constitute reckless trading. (Clearly where s 297A(2)(b) applies the incurring of a single debt is sufficient.)

4.3.2 Failure to keep proper books of account

Section 204 of the Companies Act 1990 (the '1990 Act') provides as follows:

> (1) Subject to subsection 2 if:
>
> (a) a company that is being wound up and that is unable to pay all of its debts has contravened section 202, and
>
> (b) the court considers that such contravention has contributed to the company's inability to pay its debts or has resulted in substantial uncertainty as to the assets and liabilities of the company or has substantially impeded the orderly winding up thereof,
>
> the court, on the application of the liquidator or any creditor or contributory of the company, may, if it thinks it proper to do so, declare that any one or more of the officers and former officers of the company who is or are in default shall be personally liable, without any limitation of liability, for all, or such part as may be specified by the court, of the debts and other liabilities of the company.
>
> (2) On the hearing of an application under this subsection, the person bringing the application may himself give evidence or call witnesses.

(Section 202 of the 1990 Act prescribes the books of account required to be kept by a company.)

Of the three alternatives contained in s 204(1)(b), the third, that the contravention 'has substantially impeded the orderly winding up thereof would appear to be the easiest to establish.

This provision has been employed by a liquidator in only one case to date, *Mehigan v Duignan* [1997] 1 IR 340, which is more commonly known as the *Mantruck case*. In this case, Shanley J found that proper books of account had not been kept. He found that the contravention had not in itself resulted in any loss to the company, but had substantially impeded the orderly winding up of the company or resulted in substantial uncertainty as to its assets and liabilities.

While it would also appear, by analogy with s 297 A CA 1963, that liability may be compensatory or punitive, Shanley J opined that the court, in the exercise of its discretion as to whether to impose liability for all of the liabilities of the company, must have regard to the extent to which the contravention resulted in financial loss and if so, whether or not such losses were reasonably foreseeable by the officer as a consequence of the contravention. On the facts of the case, he found that the losses sustained by the company resulting from the contraventions of the provisions in relation to the keeping of proper books of account were reasonably foreseeable by the respondent and made an order imposing personal liability for the additional costs incurred in the liquidation arising from the contravention.

4.3.3 Restriction and disqualification

A director of an insolvent company, or a person who was a director within 12 months prior to the commencement of the winding up of a company, must be restricted by the High Court unless he satisfies the court that he acted honestly and responsibly in relation to the conduct of the affairs of the company and that there is no other reason why it would be just and equitable that he should be subject to restriction. A restriction is a prohibition on acting in any way as a director or secretary or being concerned in or taking part in the promotion or formation of a company, for a period of five years, unless the company has a paid up share capital, in the case of a public company, of IR£250,000 (€ 317,435) and in the case of a private company, IR£50,000 (€ 63,487).

The original provisions in relation to restriction orders are contained in Pt VII of Chapter 1 of the 1990 Act. The chapter applies only where, at the time of the commencement of the winding up of the company, it is proved to the High Court or at any time during the course of the winding up the liquidator certifies or it is otherwise proved to the High Court, that the company is unable to pay its debts (1990 Act s 149(1)). The chapter applies to any person who was a director or a shadow director within the period of 12 months prior to the commencement of the winding up (1990 Act s 149(2), (5)).
Section 150(1), (2) and (3) of the 1990 Act provides as follows:

(1) The court shall unless it is satisfied as to any of the matters specified in subsection (2) declare that a person to whom this Chapter applies shall not, for a period of five years, 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 subsection (3); and, in subsequent provisions of this Part, the expression 'a person to whom section 150 applies' shall be construed as a reference to a person in respect of whom such a declaration has been made.

(2) The matters referred to in subsection (1) are:

(a) that the person concerned has acted honestly and responsibly in relation to the conduct of the aVairs of the company and that there is no other reason why it would be just and equitable that he should be subject to the restrictions imposed by this section, or

(b) subject to paragraph (a), that the person concerned was a director of the company solely by reason of his nomination as such by a financial institution in connection with the giving of credit facilities to the company by such institution, provided that the institution in question has not obtained from any director of the company a personal or individual guarantee of repayment to it of the loans or other forms of credit advanced to the company, or

(c) subject to paragraph (a), that the person concerned was a director of the company solely by reason of his nomination as such by a venture capital company in connection with the purchase of, or subscription for, shares by it in the first-mentioned company.

(3) The requirements specified in subsection (1) are that:

(a) the nominal value of the allotted share capital of the company shall–in the case of a public limited company, be at least IR£250,000 (€ 317,435), in the case of any other company, be at least IR£50,000 (€ 63,487),

(b) each allotted share to an aggregate amount not less than the amount referred to in sub-paragraph (i) or (ii) or paragraph (a), as the case may be, shall be fully paid up, including the whole of any premium thereon, and

(c) each such allotted share and the whole of any premium thereon shall be paid for in cash.

The courts have been quite lenient in interpreting s 150 of the 1990 Act. The leading decision of the Supreme Court in relation to the matter is the decision of *Re Squash (Ireland) Ltd* [2001] 4 IR 586. The company in question ran the eponymous leisure facilities. The Supreme Court reversed the decision of the President of the High Court to restrict the directors. The principal basis upon which the President of the High Court concluded that directors had not acted honestly and responsibly was that they continued to take subscriptions from members at a time when they were becoming aware that liquidation was imminent.

The directors planned to sell one of their premises, and had entered into an agreement with a building firm to do so, for a sum of IR£700,000 (€888,817), contingent on them being able to deliver a freehold title. Their landlord in those premises was the Department of Education. The sale of the premises for this sum would, apparently, have cleared off their major creditors and rendered the company viable. On 1 December 1997 the Department of Education notified them that the provisions of the Landlord and Tenant (Amendment) Act 1980 on foot of which the directors thought that they had a valuable interest in the premises, did not apply to State property. The directors sought their own independent advice from counsel, which they received on 10 December 1997 and which confirmed what the Department of Education had said to them. Subscriptions continued to be collected between 1 December 1997 and 10 December 1997.

McGuinnessJ, delivering the decision of the Supreme Court, adopted the criteria set out by Shanley J in *La Moselle Clothing Co (In Liquidation) and Rose Gem Ltd (In Liquidation) v Djamel Soualhi* [1998] 2 ILRM 347 contained in the following passage from Shanley J's judgment:

> Thus it seems to me that in determining the 'responsibility' of a director for the purposes of s 150(2)(a) the court should have regard to:
>
> (a) the extent to which the director has or has not complied with any obligation imposed on him by the Companies Acts 1963 to 1990,
> (b) the extent to which his conduct could be regarded as so incompetent as to amount to irresponsibility,
> (c) the extent of the director's responsibility for the insolvency of the company,
> (d) the extent of the director's responsibility for the net deficiency in the assets of the company disclosed at the date of the winding up or thereafter,
> (e) the extent to which the director, in his conduct of the affairs of the company, has displayed a lack of commercial probity or want of proper standards.

Applying these criteria the Supreme Court reversed the restriction orders. McGuinnessJ (having expressed the view that the directors had acted honestly by virtue of the fact that they had not gained anything from the company dishonestly, had lost considerable sums of their own money and had to meet the IR£30,000 (€ 38,092) deposit paid by the building company personally) found that the directors had not acted irresponsibly because she had 'little doubt but that the requests for subscriptions [in the period between 1 and 10 December 1997] were sent out automatically through the staff of the company'. She went on to say:

> It is probable that the directors should have taken positive steps to stop these demands being sent out on 1 December when they received the notification from the Department of Education but it is I think understandable that they waited until they had their own counsel's opinion on 10 December. Probably they were hoping against hope that it would turn out that the Department of Education's position was legally wrong. What they did was open to criticism but I do not feel that it was sufficient to be categorised as irresponsible.

The Company Law Enforcement Act 2001 specifies the parties who can make an application for a restriction order (s 41(1)(c)) as follows:

(a) the Director of Corporate Enforcement;
(b) a liquidator;
(c) a receiver.

The 1990 Act did not specify by whom an application could be made. Lyndon MacCann (in *Companies Acts, 1963–1990* (Butterworths Ireland Ltd, 1993) has expressed the view that a liquidator, receiver, creditor or contributory would have sufficient *locus standi* to bring an application. The company must be in liquidation for Pt VII Chapter 1 of the 1990 Act to apply (save, as a result of s 54 of the Act, in circumstances where s 251 of the 1990 Act applies). (Section 251 of the 1990 Act provides for the application of certain specified insolvency provisions in relation to a company which has not been wound up where, in summary, the reason that the company has not been wound up is insufficiency of assets.)

The Company Law Enforcement Act 2001 also provides the court with a statutory basis for the long-standing practice of the court of awarding the costs of an application under s 150 of the 1990 Act against the directors (Company Law Enforcement Act 2001, s 41(1)(c)), but only if a restriction order has been made. To date the courts have tended (even where directors have successfully defended an application under s 150 of the 1990 Act) to award a contribution towards the applicant's costs only, which contributions have frequently been no more than nominal. Section 150(4B) (as inserted by s 41(c) of the 1990 Act) provides that the court:

> …may order that the directors against whom the declaration is made shall bear the costs of the application and any costs incurred by the applicant in investigating the matter.

This provision may well be used by the courts to make more realistic costs orders compensating the applicant in respect of all costs incurred in investigating the matter and making the application.

Although the wording of s 150 of the 1990 Act is mandatory ('the court *shall* make a restriction order unless it is satisfied as to matters referred to in sub-s 2'), a major lacuna in the section for a long time was the failure of the legislature to provide a mechanism whereby liquidators and receivers were compelled to make an application and thereby require directors of insolvent companies to defend their actions. This lacuna was adverted to in *Business Communications Ltd v Keith Baxter and Colm Parsons* (High Court, 21 July 1995, unreported), where Murphy J observed that:

> A particularly surprising feature of [the provisions relating to restriction orders in the 1990 Act] is that neither the legislation nor any rules made pursuant thereto impose a duty on any party or person to bring a case before the court so that it can exercise the mandatory duty imposed on it. In windings up by the court this lacuna has been overcome by the court on the further consideration of the order for liquidation directing the Official Liquidator to bring the appropriate application on notice to persons appearing to be directors thereof. In the case of voluntary liquidations the court does not have either the responsibility or the machinery for giving comparable directions.

The practice to which Murphy J referred was one whereby, upon making a winding up order, the judge hearing the application adjourns the matter from the Chancery list to the Examiner's list and the judge dealing with the Examiner's list directs the Official

Liquidator to bring an application seeking to have all parties appearing to be directors during the oneyear period prior to liquidation restricted. Instances of voluntary liquidators making applications under s 150 of the 1990 Act were extremely rare in the past and, indeed, in advising directors of insolvent companies, the desirability of avoiding a court liquidation, for this reason, was a major consideration. However, the Company Law Enforcement Act 2001, at s 56, seeks to address this problem, and provides as follows:

> (i) A liquidator of an insolvent company shall, within six months after his or her appointment on the commencement of this section, whichever is the later, and at intervals as required by the Director thereafter, provide to the Director a report in the prescribed form.
>
> (ii) A liquidator of an insolvent company shall, not earlier than three months nor later than five months (or such later time as the court may allow and advises the director) after the date on which he or she has provided to the director a report under subsection (1), apply to the court for the restriction under section 150 of the Act of 1990 of each of the directors of the company, unless the Director has relieved the liquidator of the obligation to make such an application.

Section 56 came into effect on 1 June 2002. The commencement order giving effect to s 56 provides that this provision shall only relate to liquidators:

(a) appointed on or after 1 June 2002; or
(b) appointed on or after 1 July 2001 and before 1 June 2002 where, in respect of the company to which the liquidator was appointed,

- an order has not been made under s 249(1) CA 1963 (being an order which may be made by the court upon the liquidator's application, once the affairs of the company have been completely wound up, that the company be dissolved from the date of the order); or
- the meetings required under s 273(1) CA 1963 (which are general meetings of the company and a meeting of the creditors called by the liquidator when the affairs of the company are fully wound up, where the liquidator lays the final account before the meetings and gives an explanation thereof) have not been held.

The purpose of s 56 of the Company Law Enforcement Act 2001 is to provide the Director of Corporate Enforcement (the Director) with information setting out how the company became insolvent and if and how the directors of the company led to the insolvency thereof. The information furnished assists the Director in making the decision as to whether or not he will relieve the liquidator of the statutory obligation of having to make a section 150 application to the High Court for the restriction of each of the directors of the company. Generally the Director will relieve the liquidator of the obligation to make a section 150 application, if the liquidator states that he is satisfied that the directors acted honestly and responsibly in relation to the affairs of the company. Applications recommending that the section 150 application should not be imposed and vice versa should be accompanied by details of factors which support the liquidator's contention. When forming a view of the conduct of directors it is not necessary to list all isolated technical failures; a soundly-based view about each director's overall conduct should be formed.

If the relief is not granted by the Director, the liquidator must apply to the High Court not earlier than three months nor later than five months from the date that the report was submitted to the Director.

Failure on the part of a liquidator to comply with s 56 of the Company Law Enforcement Act 2001 constitutes a criminal offence.

Depending on the attitude that the Director adopts in relation to reports furnished to him by voluntary liquidators, this may have the effect of remedying the lacuna. In addition, it may have the negative effect of discouraging directors from putting insolvent companies into liquidation and discouraging potential liquidators from taking appointments, especially where assets are limited.

The provisions in relation to disqualification are contained in s 160 of the 1990 Act. Disqualification is a total prohibition on acting as 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. A disqualification order may be made in a number of circumstances, generally involving conduct of a more serious nature than that required in order for a restriction order to be made. Such an order may be made if a person has been convicted on indictment of any indictable offence in relation to a company or involving fraud or dishonesty. In a number of circumstances, including where a declaration has been made pursuant to s 297A of the 1963 Act, a disqualification order may be made by the court of its own motion or as the result of an application.

The amendments to the 1990 Act in relation to disqualification orders contained in the Company Law Enforcement Act 2001 (s 42) are less far-reaching. The principal changes are that the Director is added to the list of persons who can bring an application for a disqualification order (s 42(e)). The Company Law Enforcement Act 2001 also provides that the court may make a restriction order if it considers that a disqualification order is not justified and the court may award the costs against a disqualified or restricted person, including the costs of investigating the matter: s 160(9A), (9B)9A and 9B of the Company Law Act 1990 (as inserted by s 42(f) of the Company Law Enforcement Act 2001).

4.3.4 Fraudulent preferences

A fraudulent preference is a payment or disposal of the property of a company, which at the time is unable to pay its debts as they fall due, in favour of any creditor, within six months of the commencement of a winding up, with a view to giving the creditor a preference over the other creditors (s 286 CA 1963). Such payment is invalid and is recoverable by a liquidator. Where the payment or disposal of the asset was made in favour of a connected person, the period of six months is replaced with a period of two years and there is a presumption that an intent to prefer existed (s 286(3) CA 1963). A 'connected person' is defined in s 286(5) CA 1963 to include a director, a shadow director, a person connected to a director pursuant to s 26(1)(a) of the 1990 Act, a related company within the meaning of s 140 of the 1990 Act and any trustee or surety or guarantor for a debt due to any such person.

Six conditions have to be satisfied before a security document can be invalidated as a fraudulent preference. Thus a transaction will only be a fraudulent preference if:

(a) a conveyance, mortgage, delivery of goods, payment, execution or other act relating to property was made or done by or against the company;
(b) at the time such act was made or done, the company was unable to pay its debts as they became due;
(c) such act was done or made in favour of a creditor of the company or of any person on trust for such a creditor;

(d) such act was done or made with a view to giving such creditor, or any surety or guarantor for the debt due to such creditor, a preference over other creditors of the company;
(e) the company went into liquidation within six months (or of the act was made or done in favour of a connected person within two years) of the making or doing of such act;
(f) the company at the commencement of the liquidation was unable to pay its debts (taking into account its contingent and prospective liabilities).

From the foregoing it can be seen that the crucial condition is (f). Case law in this area has found that for a transaction to be a fraudulent preference, it must have been the 'dominant intention' to prefer the creditor in question. The intention is found by examining the motives of the person, or body of persons, within the company responsible for the transaction (usually the directors).

In other words, in order to prove that a transaction is a preference, it is not sufficient to show that the effect of the transaction was to give a preference; rather the phrase 'with a view to giving…a preference' has been interpreted as meaning that the transaction must have been entered into with a dominant intention to prefer (*Corran Construction Co Ltd v Bank of Ireland Finance* [1976–77] ILRM 175; *Station Motors Ltd v Allied Irish Bank Ltd* [1985] IR 756; *Kelleher v Continental Meats Ltd* (High Court, 9 May 1978, unreported, Costello J); *Re Northside Motor Co Ltd* (High Court, 24 July 1978, unreported, Costello J).

A *bona fide* belief that the company will be able to pay its debts at some future date does not negative an intention to prefer in circumstances where, at the time of payment, the company was well aware of its own insolvency (*Re FP and CH Matthews Ltd* [1982] 2 WLR 495).

If the bank puts sufficient pressure on the company to pay the debts so as to overbear the will of the company's controllers, the transaction will not be regarded as being a fraudulent preference (*Corran Construction v Bank of Ireland Finance Co* (above); *Re Boyd* (1885) 15 LR Ir 521; *Taylor (Assignees of) v Thompson* (1869–70); *Taylor (Assignees of) v Killeleagh Flax Spinning Co* (1869–70) IRCL 120)). The logic behind this reasoning is well summarised by Porter MR in the case of *Re Daly and Co Ltd* (1887–88) 19 LR Ir 83, who stated as follows:

> Where pressure exists so as to overbear the volition of the debtor a payment is not made with a view to prefer the creditor extending it, but because the debtor cannot help it. The view to prefer is absent; or at least is not the real view, or motive or reason, actuating the debtor…

The result of these cases is that the more oppressive the creditor, the less likely it is that the payment will be regarded as a fraudulent preference. It is only where a company has given a charge to a previously unsecured creditor when it was not under pressure to do so that an intention to prefer will more than likely be inferred.

There is persuasive English authority for the proposition that a fraudulent preference does not in itself amount to fraudulent trading (*Re Sarflax Ltd* [1979] Ch 592). One may assume that this applies also to reckless trading. The rationale for this proposition is that a fraudulent preference, far from causing loss to creditors, in fact constitutes a payment to a creditor and merely upsets the application of the *pari passu* rule in the administration of the assets of the company in liquidation. It is certainly arguable, however, that the sanctioning of a fraudulent preference by one or all of the directors of a company could make it difficult for the director or directors in question to rely, in defending either a reckless trading or a restriction application, on the defence that they acted 'honestly and responsibly'.

4.3.5 Duty of directors to act in the interests of creditors

Recent case law in Ireland has indicated that the directors of an insolvent company have a duty to act in the interests of its creditors. The leading case is *In Re Frederick Inns Ltd* [1991] ILRM 582. In that case four companies in a group went into liquidation. Shortly before their liquidation, one of the companies made payments to the Revenue Commissioners out of the proceeds of sale of a pub belonging to it. The Revenue knew of the sale of the pub and had threatened to liquidate the company unless certain tax arrears were satisfied. By agreement the payments made by the company were applied not only in satisfaction of tax due from the company itself but also tax payable by other members of the group. The liquidator challenged the validity of the payments in so far as they related to the liabilities of the other group members.

The court upheld the liquidator's challenge, first, on the ground that the payments were *ultra vires* (which is not relevant to the present discussion) and secondly on the ground that the payments were misapplications of the company's assets made in disregard of the rights and interests of general creditors and that accordingly the Revenue held the payments as constructive trustee for the company and the creditors generally. In the course of his judgment in the Supreme Court BlayneyJ said:

> Where, as here, a company's situation was such that any creditor could have caused it to be wound up on the ground of insolvency, I consider that it can equally well be said that the company has ceased to be the beneficial owner of its assets with the result that the directors would have had no power to use the company's assets to discharge the liabilities of other companies. Once the company clearly had to be wound up and its assets applied *protanto* in discharge of its liabilities, the directors had a duty to the creditors to preserve the assets to enable this to be done, or at least not to dissipate them.

It should be noted that the *Frederick Inns* decision was novel and this is a developing area of jurisprudence: the courts have not yet worked out all the implications of the decision.

4.4 Advising directors of insolvent companies

Trading while insolvent is fraught with difficulty. The safest course of action for directors when a company has become insolvent is to take steps to put the company into creditors' voluntary liquidation (see s 251 and ss 266–68 CA 1963) or petition to the High Court for the appointment of an examiner. The reckless trading provisions do not apply during a period when a company is under the protection of the court (s 297A(8) CA 1963).

If for whatever reason the directors do not want to put the company into either liquidation or examinership, or want time to consider the matter, the only absolutely safe course of conduct to adopt is to neither take further credit nor reduce the assets of the company. It is not safe to keep the level of creditors static because, pursuant to s 297A(2)(b) CA 1963, for example, liability may be incurred in relation to the contracting of a single debt.

If, therefore, the directors wish to continue to trade while insolvent, in order to ensure that no further credit is incurred, suppliers, including utilities, need to be paid in advance. Even this course of action can only be justified if the continuation of trading is likely to protect, if not increase, the assets which will ultimately be available to creditors in the event that liquidation ensues.

If the directors decide to continue to trade while insolvent, there is clearly a serious risk of personal liability if the company ultimately goes into liquidation. There are a number of steps that they can take to improve their chances of being able to rely on the 'honestly and responsibly' defence, including:

(a) convening frequent board meetings;
(b) obtaining financial advice, preferably from an accountant with insolvency experience;
(c) preparing a budget/business plan;
(d) keeping creditors informed of the financial state of affairs in relation to the company at all times;
(e) obtaining legal advice in relation to the insolvency law implications of what they are doing;
(f) ensuring that there can be no suspicion of fraudulent preference by, for example, opening a new bank account with a new bank so that all receipts can be lodged to that account and not to the company's own account in reduction of an overdraft or other facilities, particularly where the overdraft or other facilities are personally guaranteed by the directors.

In summary, as soon as a director is aware that there is no reasonable prospect of avoiding insolvent liquidation, or fears that that is the case, he must raise the problem with the rest of the board with a view to their taking independent professional advice. Further credit should almost certainly not be incurred pending such advice and directors must take every step to minimise the potential loss to creditors. If a pessimistic director fails to persuade his colleagues despite his best efforts, it may be sufficient for him to resign in protest and he would be well advised to seek independent personal advice to ensure that there are no other steps for the protection of creditors available to him. The onus on the rest of the board will then be greater.

4.5 Issues for shareholders of insolvent companies

Section 207(1) CA 1963 provides as follows:

> In the event of a company being wound up, every present and past member shall be liable to contribute to the assets of the company to an amount sufficient for payment of its debts and liabilities, and the costs, charges and expenses of the winding up, and for the adjustment of the rights of the contributories among themselves, subject to subsection (2) and the following qualifications:
>
> (a) a past member shall not be liable to contribute if he has ceased to be a member for one year or more before the commencement of the winding up;
> (b) a past member shall not be liable to contribute in respect of any debt or liability of the company contracted after he ceased to be a member;
> (c) a past member shall not be liable to contribute unless it appears to the court that the existing members are unable to satisfy the contributions required to be made by them in pursuance of this Act;
> (d) in the case of a company limited by shares, no contribution shall be required from any member exceeding the amount, if any, unpaid on the shares in respect of which he is liable as a present or past member;
> (e) in the case of a company limited by guarantee, no contribution shall, subject to subsection (3), be required from any member exceeding the amount undertaken to be contributed by him to the assets of the company in the event of its being wound up;
> (f) nothing in this Act shall invalidate any provision contained in any policy of insurance or other contract whereby the liability of individual members on the policy or contract

is restricted, or whereby the funds of the company are alone made liable in respect of the policy or contract;

(g) a sum due to any member of the company, in his character of a member, by way of dividends, profits or otherwise, shall not be deemed to be a debt of the company, payable to that member in a case of competition between himself and any other creditor not a member of the company, but any such sum may be taken into account for the purpose of the final adjustment of the rights of the contributories among themselves.

Section 207(3) provides:

> In the winding up of a company limited by guarantee which has a share capital, every member of the company shall be liable, in addition to the amount undertaken to be contributed by him to the assets of the company in the event of its being wound up, to contribute to the extent of any sums unpaid on any shares held by him.

Holders of fully paid up shares are included in s 207 as potential contributories but their liability to contribute is restricted, as described above under s 207(1)(d).

CHAPTER 5

COMPULSORY LIQUIDATIONS

Tony O'Grady

5.1 Introduction

Companies may be wound up by one of two means: by resolution of the shareholders, known as members' or creditors' voluntary liquidation depending on whether the company is solvent or insolvent respectively, or by order of the High Court. This chapter deals with liquidations commenced by order of the court only. The principal differences between voluntary liquidations and liquidations commenced by court order (which are referred to in this chapter as court liquidations) are that, in the case of court liquidations, liquidators are required to obtain leave of the court under s 231 of the Companies Act 1963 (CA 1963) before exercising many of their powers, whereas in voluntary liquidations no such leave is required. (See, however, s 276 CA 1963, which requires voluntary liquidators to obtain the consent of the members in the case of members' voluntary liquidations and the Committee of Inspection, or if there is no such Committee of Inspection, the creditors' approval before exercising certain powers.) The Examiner of the court exercises a supervisory role in relation to court liquidations. A court-appointed liquidator is described as an Official Liquidator.

Court liquidation occurs where a creditor (generally speaking, see s 215 CA 1963 for the parties entitled to petition for the winding up of a company) or the company itself petitions to the court for an order seeking the winding up of the company and appointing a liquidator. In the case of insolvent companies the usual ground relied upon is that the company is *unable to pay its debts* (s 213(e) CA 1963), although an insolvent company may also be wound up on the basis that it *is just and equitable* that the company should be wound up (s 213(f) CA 1963). A court liquidation is deemed to commence at the time of the presentation of the petition for the winding up (s 220(2) CA 1963). Presentation of the petition takes place when the petition is filed in the Central Office of the court and the registrar allocates a date for the hearing of same, unless a voluntary liquidator has previously been appointed, in which case the liquidation is deemed to have commenced at the date of the passing of the resolution for the winding up of the company (s 220(1) CA 1963). Court liquidation is supervised by the court and by the Examiner of the court.

5.2 Appointment

As already mentioned, court liquidation is usually commenced by the presentation by a creditor or the company itself (but not, oddly enough, the directors) of a petition for the winding up of the company. The petition is verified by affidavit to which the petition, which has duly been presented, is an exhibit. In the case of a creditor's petition the creditor's financial or credit controller is usually the deponent. The registrar dealing with the matter in the Central Office of the court allocates a hearing date for the petition at the time of its presentation in the Central Office. The date fixed by the registrar must allow the petitioner sufficient time to advertise the petition in accordance with the registrar's directions, usually in two national daily papers and *Iris Oifigiúil*. A creditor petitioning to wind the company up may rely on s 214 CA 1963 (as amended) in order to establish that the company is unable to pay its debts. This is a deeming provision which contains a procedure whereby the creditor, provided the company is indebted to it in a sum exceeding € 1,269.74 (IR£1,000), serves on the company, by leaving it at the registered office of the company, a demand in writing requiring the company to pay the sum due. If the company does not pay the sum due within three weeks of service of the demand, the company is deemed to be unable to pay its debts (s 214(a) CA 1963). Although a creditor is not precluded from relying on other evidence of the debtor company's inability to pay its debts, the statutory demand method of getting over the petitioning creditor's burden of proof is the one generally employed. In order to defend a petition the company may try to argue that, where the petitioner purports to seek the winding up of the company as a creditor, the petitioner is not a creditor and therefore does not have *locus standi* to seek an order winding up the company or that the debt is the subject of a *bonafide* dispute. These bases for opposing a winding up petition amount in practice to the same thing (see *Truck and Machinery Sales Ltd v Marubeni Komatsu Ltd* [1996] IR 12. Because of the potentially damaging effect of a winding up petition on the business of a debtor company, where the debtor has a *bonafide* dispute in relation to the alleged debt upon which the petition is based, the debtor company may obtain an interim or interlocutory injunction restraining the petitioner from advertising the petition or, if advertisement has already taken place, proceeding with the petition. In the case of a creditor relying on the deeming provision (s 214(a) CA 1963), the company must be in a position to establish that there is no undisputed debt in a sum in excess of € 1,269.74 (IR£1,000). In the event that there is such an undisputed amount, the debtor company will have the option either to pay the undisputed amount or lodge the undisputed amount in court. It should be noted also that the power vested in the court to wind up a company is a discretionary one.

The court may, and frequently does, appoint a provisional liquidator after the presentation of the petition. A provisional liquidator is generally appointed on the basis of evidence presented to the court of the necessity for the appointment in order to protect the assets of the company, which are in imminent danger of dissipation. The provisional liquidator's powers are limited to those afforded to him by the court (s 226 CA 1963).

The liquidator appointed by the court is usually nominated by the petitioner and is required to indicate his written consent in advance. It is necessary for an affidavit of suitability to be sworn, usually by the solicitor whom the liquidator, when appointed, will retain. Other creditors from time to time nominate alternative liquidators, but the court in recent years has tended to appoint the petitioning creditor's nominee, unless there is evidence available to it as to the unsuitability for appointment of the petitioner's nominee. There are a number of grounds upon which individuals are disqualified from appointment as liquidator (see ss 300 and 300A CA 1963) but, to date, there is no licensing system or requirement, either in the case of court-appointed or voluntary liquidators, that they possess any specific academic or professional qualifications. The Company Law Review Group (established pursuant to Pt 7 of the Company Law Enforcement Act 2001 (the 2001 Act) recommended, however, in its report furnished to the Minster for Enterprise, Trade and Employment on 31 December 2001, the introduction of statutory licensing for insolvency practitioners monitored by a regulatory body.

5.3 Powers and duties

The liquidator is 'the executive officer appointed by the court for the purpose of winding up proceedings' (per johnston J in *Re Whiterock Quarries Ltd* [1937] IR 363 at 366). See also *Re Union Accident Insurance Co Ltd* [1972] 1 All ER 1105 at 1113, where Plowman J observed that 'the liquidator assumes and the directors usually lose, the functions and authority which they previously held'. It is clear from the judgment of Plowman J that the necessity to use the word 'usually' was due to the fact that the directors may retain some powers whilst a provisional liquidator stands appointed such as, for example (and as was the case here), the power to retain lawyers to defend the winding up petition on the company's behalf.

The liquidator's function is to collect the assets of the company and to pay over any surplus after the expenses of liquidation and his own remuneration to the creditors in accordance with statutory priorities (see in particular s 285 CA 1963 in relation to preferential creditors). The liquidator has an array of statutory and common law powers available to him to enable him to swell the assets of the company for the benefit of the creditors, some of which involve an examination by the liquidator of the conduct of directors of the company for the purpose of establishing whether they are liable personally for the debts of the company.

In addition, the liquidator has an enforcement role from which the creditors derive no direct benefit.

The powers available to the liquidator in order to swell the assets available for the creditors include the following:

(a) to take fraudulent or reckless trading proceedings (s 297A CA 1963). See also *Re Hefferon Kearns Ltd (No 2)* [1993] 3 IR 191 in relation to reckless trading);
(b) to seek to have officers of the company declared to be personally liable for all or part of the liabilities of the company or the costs of liquidation (s 204(l) of the Companies Act 1990, referred to as the 1990 Act). See also *Mehigan v Duignan* [1997] 1 IR 340, otherwise known as the *Mantruck* case;
(c) to obtain contribution or pooling orders (ss 140 and 141 of the 1990 Act);
(d) to seek the recovery of monies paid or assets transferred which constitute fraudulent preferences (s 286 CA 1963);
(e) to establish whether floating charges created by the company within 12 months before the commencement of the winding up are invalid (s 288 CA 1963);
(f) to seek the recovery of assets of the company disposed of after the date of commencement of the liquidation (s 218 CA 1963).

The powers/duties of a liquidator as part of his role in connection with the policing of standards of business conduct from which creditors derive no direct benefit include:

(a) the duty to take restriction proceedings against directors of the company (s 150 of the 1990 Act);
(b) the power to take disqualification proceedings against directors of the company (s 160 of the 1990 Act);
(c) a duty, if so directed by the court, to advise both the Director of Public Prosecutions and the Director of Corporate Enforcement of the commission of a criminal offence in relation to the company by a past or present officer of the company (s 299 CA 1963 as amended by s 51 of the 2001 Act).

As regards the exercise of the liquidator's powers, there is a distinction between courtappointed and voluntary liquidators. Court-appointed liquidators are required to obtain the consent of the court (s 231 CA 1963) before exercising a variety of powers, including:

(a) bringing or defending legal proceedings on behalf of the company. It should be noted that the making of a court order to wind up a company or the passing of a resolution for same does not affect the status of the company. Unless an order vesting the property of the company in the liquidator is made pursuant to s 230 CA 1963, the company's assets continue to be owned by the company albeit, arising from the decision of the Supreme Court in *Re Frederick Inns Ltd (In Liquidation)* [1994] 1 ILRM 387, on trust for the creditors of the company. Proceedings in relation to assets of the company such as, for instance, recovery of debts, are taken in the name of the company and not in the name of the liquidator);
(b) carrying on the business of the company;
(c) compromising claims with debtors or creditors.

In a creditors' voluntary liquidation, however, save in a number of instances such as the compromising of claims, where Committee of Inspection or creditor approval is required, the liquidator does not require the approval of anybody to exercise his powers and carry out his functions (see s 276 CA 1963).

As mentioned above, all court liquidations are supervised by the Examiner of the court and indeed, in some instances, an application to the court itself is required in relation to the exercise of certain powers of the liquidator. The liquidator is obliged to bring the liquidation before the Examiner by issuing a notice to proceed. In order to proceed before the Examiner the following must be lodged in the Examiner's Office:

(a) notice to proceed with five copies, with appropriate notice parties thereon (that is, others who attended the hearing of the petition);
(b) affidavit of service of notice to proceed on the various parties who attended in court on the hearing of the petition and on the company;
(c) copy petition;
(d) copy verifying affidavit;
(e) copy winding up order;
(f) copies of any affidavits referred to in the winding up order (such as affidavit of service and affidavit verifying suitability);
(g) letter to the Examiner advising as to whether any court orders were made between the presentation and hearing of the petition and subsequent to the winding up order;
(h) draft bond;
(i) recent company search;
(j) copy statement of affairs, if available;
(k) evidence of service of the winding up order on the following parties:

- the company,
- the registrar of companies,
- the sheriff,
- the Bank of Ireland,
- the directors;

(l) original newspaper and *Iris Oifigiúil* advertisements;
(m) authorisation to open bank account, duly completed by the liquidator;
(n) letter of consent to act from the Official Liquidator;
(o) authorisation to appoint a solicitor, duly completed by the liquidator;
(p) affidavit of suitability;
(q) report of Official Liquidator.

After the initial sitting before the Examiner, the Examiner usually adjourns his consideration of the liquidation from time to time. This is a practice that has also been adopted by the court itself, which, in recent years, has taken to adjourning the winding up order for further consideration, sometimes for the entire duration of the liquidation. At the first sitting at which the winding up order is considered further by the court, the judge taking the Examiner's List in the court will usually:

(a) award the petitioner its costs;
(b) refer the level of the bond into which the liquidator is required to enter to the Examiner;
(c) refer the dates up to which, each year, the liquidator is required to account to the Examiner;
(d) direct the liquidator to take proceedings pursuant to s 150 of the Companies Act 1990.

The Examiner's most substantial input into the liquidation process occurs at the time when the liquidator has realised all of the company's assets and wishes to make a payment of a dividend to the creditors. The process of proof of creditors' claims is initiated by the Examiner. Clearly, the procedure is only necessary in circumstances where there are sufficient monies to pay a dividend to creditors, whether preferential creditors only or preferential and unsecured creditors. The costs and expenses of liquidation take precedence over creditors' claims. The order of priority of payment of costs and expenses is set out in RSC Ord 74r 128 as follows:

(a) fees and expenses properly incurred in realising or getting in the assets;
(b) where the company has previously been wound up voluntarily the remuneration, costs and expenses of the voluntary liquidator;
(c) the petitioner's costs and the costs of all persons awarded their costs in respect of the hearing of the petition;
(d) costs in relation to the preparation of the statement of affairs;
(e) the costs and necessary disbursements of the liquidator;
(f) the liquidator's solicitors' fees;
(g) the liquidator's own remuneration;
(h) the out of pocket expenses incurred by the Committee of Inspection, if any.

The necessary disbursements of the liquidator may include rent on leasehold property where the liquidator has *adopted* the lease (see *Re GWI Ltd* (High Court, 16 November 1987, unreported, Murphy J) and *Re ABC Coupler and Engineering Ltd (No 5)* [1990] 1 WLR 702) or the costs awarded against the company to a successful litigant in respect of an action brought against the company whilst in liquidation or on the company's behalf by the liquidator (see *Comhlucht Paipear Riomhaireachta Teo v Udaras na Gaeltachta* [1990] ILRM 266). In addition, the unsecured creditors are only entitled to a dividend where secured creditors' debts are paid in full, whether those creditors' debts are secured by fixed or floating charges, or both, and where super-preferential and preferential creditors are paid in full. The super-preferential debts consist of PRSI contributions deducted from the employees' wages (see s 16 of the Social Welfare (Consolidation) Act 1993). Those creditors whose claims have preferential status are set out in s 285 CA 1963, for example, s 14 of the Minimum Notice and Terms of Employment Act 1973 in respect of statutory minimum notice. It should be noted also that both super-preferential and preferential creditors' claims rank ahead of the claims of holders of floating charges (see s 285(7)(b) CA 1963). See also s 29 of the Companies (Amendment) Act 1990 (the 1990

Amendment Act). The procedure is set out in RSC Ord 74 rr 95–109. The liquidator's solicitor places advertisements signed by the Examiner or Assistant Examiner in the daily newspapers in which he is directed to place them by the Examiner or Assistant Examiner. The advertisements indicate the date upon which the adjudication by the Examiner or Assistant Examiner is to take place. This date is usually a week or two after the deadline specified in the advertisements for receipt of claims. After the deadline has passed, the liquidator is required to swear an affidavit specifying those claims which, in his view, should be admitted and those in respect of which further proof is required. In the event that the Examiner or Assistant Examiner dealing with the matter is of the view that any claim or claims require further proof, he or she will direct the liquidator to serve *notices to prove* on the creditors in question specifying an adjourned date upon which these creditors are required to attend and prove their claims and also indicating that they are required to file an affidavit in support of their claims. The better view appears to be that, when filing his affidavit indicating whether creditors' claims should be admitted or should be required to be proved further, the liquidator should take account of claims of which he is aware but in relation to which no formal claim pursuant to the advertisements placed in the newspapers has been received (see *Corporate Insolvency and Rescue,* Lynch Marshall and O'Ferrall, 1996, Butterworths, pp 53–54). If, ultimately, a creditor does not prove his claim to the satisfaction of the Examiner or Assistant Examiner dealing with the case, the court may order, on the application of the liquidator, that the creditor in question be excluded from the benefit of any distribution.

5.4 Restriction applications

In practice the most significant duty imposed upon a liquidator in a court liquidation is the obligation pursuant to s 150 of the 1990 Act to bring a restriction application against all persons appearing to be directors of the company within a one-year period of liquidation.

Section 150 of the 1990 Act provides that the court must declare that any person who was a director of a company which has gone into insolvent liquidation within the period of 12 months prior to the commencement of the liquidation be subject to a restriction, unless the director satisfies the court that he acted honestly and responsibly in relation to the conduct of the affairs of the company and that there is no other reason why it would be just and equitable that he should be subject to a restriction.

A restriction is a declaration in relation to a director that he may not, for a period of five years, 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, in the case of a public company, it has a paid up share capital of €317,434.52 (IR£250,000) or in the case of a private company €63,486.90 (IR£50,000). This must be paid for in cash. The financial thresholds were increased from IR£100,000 and IR£20,000 respectively by s 41 of the 2001 Act, which came into force on 1 March 2002.

It is also provided in s 150 of the 1990 Act that a director may avoid restriction on the basis that he was a director solely by reason of his nomination by a financial institution in connection with the giving of credit facilities to the company, provided that the institution in question has not obtained from any director of the company a personal guarantee in relation to the credit being advanced, or, that the director was a director solely by reason of his nomination by a venture capital company in connection with the purchase of or subscription by the venture capital company for shares in the company. Both of these defences, however, are, somewhat strangely, stated to be subject to the requirement that the director establishes that he acted honesdy and responsibly in relation to the conduct of the affairs of the company and that there is no other reason why it would be just and equitable that he be restricted. This begs the question as to what precisely the legislature intended when the provisions in relation to directors nominated by financial institutions and venture capital companies were inserted. There has been no real judicial guidance given to date in relation to the significance of these provisions. It seems, however, that the intention was that some account should be taken of the fact that a person was a director purely by virtue of having been nominated by a financial institution or venture capital company.

In general, it seems fair to say that it has not proved particularly difficult for most directors who have been subject to restriction applications to satisfy the court that they acted honestly and responsibly and that there is no other reason why it is just and equitable that they should be subject to a restriction. In the most recent Supreme Court decision on the subject, *Re Squash (Ireland) Ltd* [2001] 4IR 586, Ms Justice McGuinness reversed restriction orders made in the High Court, attaching great significance to the fact that the directors had gained nothing from the company dishonestly, had lost considerable sums of their own money and in fact had to meet a liability of the company personally. She also adopted the following criteria to which the court should have regard in determining whether a director behaved responsibly, set out in an earlier case by Mr Justice Shanley in the High Court in *La Moselle Clothing Co (In Liquidation) and Rose Gem Ltd (In Liquidation) v Djamel Soualhi* [1998] 2 ILRM 347:

(a) the extent to which the director has complied with obligations imposed on him by the Companies Acts;
(b) the extent to which the director's conduct could be regarded as so incompetent as to amount to irresponsibility;
(c) the extent of the director's responsibility for the insolvency of the company;
(d) the extent of the director's responsibility for the net deficiency in the assets of the company disclosed at the date of winding up or thereafter;
(e) the extent to which the director, in his conduct of the affairs of the company, has displayed a lack of commercial probity or want of proper standards.

Section 41 of the 2001 Act has had the effect of clarifying the position as to who is entitled to make an application for a restriction order. It provides that such applications may be made by the Director of Corporate Enforcement, a liquidator or a receiver. Although the 1990 Act was silent as to who could apply for a restriction order, it was generally assumed that liquidators, both court-appointed and voluntary, and receivers could take such applications. In addition, s 54 of the 2001 Act, by amending s 251 of the 1990 Act, has had the effect of allowing restriction applications to be made in relation to directors of companies which have not gone into liquidation, but only in cases where, essentially, the company is insolvent and the reason that it has not gone into liquidation is the fact that the company has few or no assets. The major change, however, which the 2001 Act has brought about is that all liquidators of insolvent companies may be compelled to bring restriction orders against all directors of the company (s 56 of the 2001 Act). This provision was inserted in response to a gap in the legislation identified by Murphy J in *Business Communications Ltd v Baxter* (High Court, 21 July 1995, unreported). Section 150 of the 1990 Act provides that directors of insolvent companies *'shall'* be restricted unless they satisfy the court that one of the defences identified earlier applies to them. The 1990 Act does not, however, actually compel liquidators or receivers to bring restriction applications in relation to directors. In relation to court-appointed liquidators only, this gap in the legislation has been remedied by the development of a practice, mentioned above, whereby the court will order all liquidators under its supervision to bring restriction applications against all persons who appeared to be directors within the period of 12 months prior to liquidation.

The new provisions in the 2001 Act require liquidators of all insolvent companies to report to the Director of Corporate Enforcement within six months of appointment in a prescribed form (see SI 324/2002). If the Director of Corporate Enforcement has not relieved the liquidator of the obligation to bring a restriction application within three months of being furnished with the report by the liquidator, the liquidator is required to bring restriction applications against all directors of the company within five months of furnishing the Director of Corporate Enforcement with the report. Any liquidator who fails to comply with his obligations in this regard will be guilty of a criminal offence. Such an offence is punishable on summary conviction (District Court) by a fine not exceeding €1,904.61 (IR£1,500) or a prison sentence not exceeding 12 months or both or, on conviction on indictment (in the Circuit Court before a judge and jury), by a fine not exceeding €12,697.38 (IR£10,000) or imprisonment for a term not exceeding five years, or both.

The new provision has retrospective effect, applying to directors of all companies which went into liquidation since s 150 of the 1990 Act came into force and not only companies going into liquidation after s 56 of the 2001 Act took effect. The provision has so far been brought into force in respect of those liquidators (i) who are appointed on or after 1 June 2002, or (ii) who were appointed on or after 1 July 2001 and before 1 June 2002 and the liquidation had not been completed by 1 June 2002 (SI 263/2002).

5.5 Remuneration

A court-appointed liquidator is required to obtain court approval before payment of his own remuneration (s 228(d) CA 1963). The liquidator's remuneration and his expenses are determined by the court at the hearing of the liquidator's application for final orders in relation to the liquidation. It is the practice, however, for liquidators to apply at least once in the course of the liquidation for a payment on account of fees and expenses. Expenses such as the liquidator's legal costs also require court approval and such costs are required to be taxed by the Taxing Master (see RSC Ord 74 r 128(2)). Section 29 of the 1990 Amendment Act should be noted in this regard, as it gives the remuneration and expenses of an examiner pursuant to the 1990 Amendment Act priority over all other claims, whether secured or unsecured, in receivership or in winding up. This has been held by the Supreme Court in the *Springline* decision to include the liquidator's remuneration and expenses *(Re Springline Ltd (In Liquidation)* [1999] IR 467.

5.6 Discharge

When a court-appointed liquidator has carried out all of his functions he is required to apply to the court for final orders which will include an order discharging him as liquidator. Discharge occurs only after the liquidator has made all payments which he is required to make pursuant to the final orders of the court and after the Examiner of the court has filed in the Central Office of the court a *certificate as to due disposal of the assets* of the company.

5.7 Filing requirements

In addition to the matters set out above in connection with the *notice to proceed* in the Examiner's Office, if the liquidation is not concluded within two years of commencement, the liquidator is required to file in respect of each year thereafter an account in the Companies Registration Office.

CHAPTER 6

VOLUNTARY LIQUIDATIONS

Nicholas Comyn

6.1 Voluntary winding up: overview

A company may be wound up voluntarily under s 251(l) of the Companies Act 1963 (CA 1963) in the following three circumstances:

(a) when the period, if any, fixed for the duration of a company by its Articles expires, on the occurrence of which the Articles provide that the company is to be dissolved, and the company in general meeting has passed a resolution that the company be wound up voluntarily;
(b) if the company resolves by special resolution that the company be wound up voluntarily;
(c) if the company in general meeting resolves that it cannot by reason of its liabilities continue its business and that it should be wound up voluntarily.

Any resolution passed under any of the three above headings is called a 'resolution for voluntary winding up', and, most importantly, s 253 CA 1963 provides that a voluntary winding up shall 'be deemed to commence at the time of the passing of the resolution for voluntary winding up'. This is the date on which the resolution is passed at a general meeting of the company. The reasons the members' and creditors' windings up are called Voluntary winding up' is because these are decisions made by the shareholders to wind up and not decisions imposed by an outside party, that is, the court.

The first two categories in s 251 comprise the members' winding up and the third category, the creditors' winding up. The main difference between the two types of winding up is 'solvency'. In a members' winding up, the company is in a position to pay its debts and a Declaration of Solvency has been filed within the time provided by the legislation. In the case of a creditors' winding up, the company is insolvent and not in a position to pay its debts. The powers and the duties of the liquidator are similar for both the members' and the creditors' winding up but the procedures to set each in motion are different as well as the accountability of the liquidator: in the former to the members, in the latter to the creditors.

The liquidator must give his prior consent in writing to be appointed as liquidator, otherwise his appointment is of no effect (s 133 Companies Act 1990).

6.2 Members' voluntary winding up

The sections relating to a members' winding up are s 256 (as amended by s 128 of the 1990 Act) and ss 258–64 CA 1963 (as amended by s 9 of the Companies (Amendment) Act 1982). Before a members' winding up can commence, a Declaration of Solvency must be filed. This Declaration must be made by the directors of the company or, where the company has more than two directors, by a majority of directors.

At a meeting of directors:

(a) The directors make a statutory declaration (sworn before a Commissioner for Oaths) to the effect that:

- they have made a full enquiry into the affairs of the company; and
- having made this enquiry they have formed the opinion that the company will be able to pay its debts in full in a period not exceeding 12 months.

The Declaration must be made within the 28 days immediately preceding the date of the passing of the Resolution for winding up the company and must be delivered to the Registrar of Companies for registration not later than 15 days after the passing of the Resolution to wind up. If these time limits are not observed and the requirements of s 128(2) of the Companies Act 1990 are not met and the resolution to wind up is passed, then the winding up will continue as a creditors' winding up. The liquidator can apply under s 280 CA 1963 for an order of the court to annul the resolution and recommence the procedure.

(b) The Declaration *must* include a statement of the company's assets and liabilities as at a date not more than three months before the making of the Declaration (s 9 of the Companies (Amendment) Act 1982).

Both the Declaration and the Statement are contained in Form No 12 of the Companies Office forms and there is an excellent label attached to the form, which sets out the steps to be taken.

(c) Section 256 CA 1963 (as amended by s 128 of the Companies Act 1990) provides that the Declaration of Solvency must be accompanied additionally by:

- a report made by an independent person; and
- a statement by the independent person that he has given and has not withdrawn his written consent to the issue of the Declaration with the report attached thereto;
- a copy of the Declaration attached to the notice issued by the company to convene the general meeting at which it is intended to propose the resolution to wind up.

  The independent person is either:

  - a person who is qualified to be the auditor of the company; or
  - the auditor of the company (s 256(3) CA 1963).

The report of the independent person shall state that in his opinion and to the best of his information and according to the explanations given to him:

- the opinion of the directors that the company will be able to pay its debts in full is reasonable; and
- the statement of the company's assets and liabilities is also reasonable (s 256(4) CA 1963).

There is an important proviso in s 128(8) CA 1963 that the court may, on the application of a liquidator, creditor or contributory, declare that any director who was a party to the Declaration of Solvency without having reasonable grounds for their opinion that the company be able to pay its debts in full, be personally liable for the debts of the company. The onus is on the director to prove he had reasonable grounds for his opinion.

The time limits imposed by these sections are mandatory, as pointed out by Costello J in the case of *Favon Investments Co Ltd (In Liquidation)* [1993] 1 IR 87, where he stated:

> …an application has been brought under section 280 of the Act of 1963 and orders are sought giving liberty to attach the report of the independent person (which had been omitted) to the directors' statutory Declaration of Solvency and an order directing the winding up to proceed as a members' voluntary winding up. I do not think that I have any jurisdiction to make such orders. The requirements of section 256 are perfectly clear and they are mandatory (p 90).

The resolution of the shareholders to wind up a company as a members' voluntary winding up is a special resolution, requiring a 75 per cent majority. Section 251(i) CA 1963 provides that a company may be wound up 'if the company resolves by special resolution that the company be wound up voluntarily' and s 256(ii) CA 1963 provides that where a Declaration has been made and delivered the winding up is referred to as a 'members' voluntary winding up'.

The following is a precedent notice convening an Extraordinary General Meeting (EGM):

Companies Acts 1963 to 2001

(Name of company) Limited

Notice is hereby given that an Extraordinary General Meeting of the above company will be held at *(location)* on the day of 200_ *(date)* for the purpose of considering and if thought fit passing the following special resolutions:

1. That the company be wound up voluntarily as a members' voluntary winding up and that *(proposed liquidator's name and address)* be appointed liquidator for the purposes of such winding up.
2. The meeting be authorised to fix the remuneration of (*name of liquidator*) and to empower him to distribute in specie (see *below)*.

Secretary.

Note:

A. There is sent with this Notice a copy of the Declaration of Solvency and the consent and report of the independent person.
B. Proxy Forms are attached.

From a practical point of view, the EGM to wind up cannot be called until after the Declaration of Solvency is sworn, as the notice convening the meeting must include a copy of the Declaration.

Section 258 CA 1963 provides that at the EGM two matters are dealt with:

(a) the passing of the resolution;
(b) the fixing of the remuneration of the liquidator (but this is optional).

The form of resolution as in the notice is as follows:

> That the company be wound up voluntarily as a members' voluntary winding up and that *(name and address of liquidator)* be appointed liquidator for the purposes of such winding up and that the remuneration of *(name of liquidator)* be fixed at (€) in addition to his costs, charges and expenses and that the liquidator be empowered to distribute the assets in specie.

The purpose of a distribution in specie is to enable a liquidator to distribute assets among different shareholders and such a distribution is made at a nominal stamp duty.

The effect of a failure to comply with the statutory requirements of s 256 CA 1963 is that the liquidation should continue as a creditors' voluntary winding up (s 256(11)). However, a liquidator may apply to the High Court within seven days of his nomination as liquidator or within seven days of the day on which he first became aware of the default, whichever is the later, for directions as to the manner in which the default is to be remedied (s 131(5) of the Companies Act 1990).

There are three points to note on the passing of the resolution:

(a) Within 14 days of the passing of the resolution, notice of the resolution must be given by advertisement in *Iris Oifigiúil*.
(b) All the powers of the directors cease, except 'so far as the company in general meeting (this is distinct from a creditors' winding up) or the liquidator sanctions the continuance thereof.
(c) If within 28 days after the advertisement of the resolution a creditor or creditors representing one-fifth in the number or value of the creditors apply to the court and prove to the court's satisfaction that the company will not be in a position to pay its debts within the time provided in the Declaration of Solvency, then the court may order that the liquidation should continue as a creditor's winding up. A copy of the order must be delivered within 21 days to the Registrar of Companies.

6.2.1 Other matters

If after his appointment the liquidator is of the opinion that the company will not be able to pay its debts in full within the period mentioned in the Declaration of Solvency, then under s 129 of the Companies Act 1990 the liquidator must take the following steps:

(a) Notice

- A creditors' meeting must be held within 14 days.
- A notice must be sent to creditors by post seven days before the meeting.
- The meeting must be advertised in *Iris Oifigiúil* and two daily newspapers at least 10 days before the meeting.
- The liquidator must furnish any creditor, prior to the meeting, with information that they may reasonably require, free of charge.

(b) Meeting

- A Statement of Affairs and list of creditors must be prepared by the liquidator and laid before the meeting.
- The liquidator must attend and preside at the meeting.

(c) Resolution

The creditors' meeting replaces the original meetings under s 266 CA 1963 and the winding up becomes a creditors' voluntary winding up and any appointment made or committee established by the creditors' meeting shall be deemed to have been made or established by that meeting.

(d) Other matters

The expenses of the members' liquidator may be referred to the court. This section was introduced largely to outlaw the effects of the decision in *Re Centrebind Ltd*

[1966] 3 All ER 880 where the members of a company, which was insolvent, could appoint their own liquidator without calling a creditors' meeting.

If the liquidation continues for a period in excess of one year the liquidator must, within three months of that year and each succeeding year, lay before a meeting of the members an account of his acts and dealings for that year.

Section 263 CA 1963 sets out in detail the requirements for the final meeting of the company which includes publishing the final notice in two daily newspapers. The form of notice is as follows:

IN THE MATTER OF THE COMPANIES ACTS 1963–2001
AND IN THE MATTER OF
[NAME OF COMPANY]
(IN VOLUNTARY LIQUIDATION)

Notice to Members of Final Meeting

NOTICE is hereby given pursuant to Sections 263 and 305 of the Companies Acts 1963 that a Meeting of the members of the above-named company will be held at *[address]* on [date] at *[time]* for the purpose of having an Account laid before them and to receive the Liquidator's report showing how the winding up of the company has been conducted and its property disposed of and of hearing any explanation that may be given by the Liquidator; and also to determine how the books and documents of the company shall be disposed of. Proxies to be used at the Meeting must be lodged with the Liquidator [name] at [address] not later than 4.00 in the afternoon of the day before the Meeting.

Dated the day of 200

____
[Name]

Liquidator
[Address]

6.3 Who may be appointed liquidator?

Anyone *other* than the following may be appointed as a liquidator:

(a) any person who is or has been an officer or servant of the company in the past 12 months;
(b) a body corporate–which appointment is void (s 300(a) CA 1963);
(c) except with the leave of the court a parent or spouse, sister, brother or child of an officer of the company;
(d) a partner or employee of an officer or servant of the company shall not be qualified for appointment as a liquidator (s 300(a) CA 1963, as inserted by s 146 of the Companies Act 1990).

If a liquidator becomes disqualified, as being in category (a), (c) or (d) above, then he must vacate his office on giving 14 days' notice to the court in a court winding up, the company in a members' voluntary winding up and the company and the creditors in a creditors' voluntary winding up (s 300A(3) CA 1963). Failure to give notice or acting while disqualified will leave the liquidator open to a fine. The various Institutes of the accountancy profession have also prohibited auditors of a company or members of the auditor's office from acting as liquidators of that company.

A liquidator may also be removed by the court 'on cause shown' (s 277(2) CA 1963).

The liquidator, when appointed, is a cross between a trustee and an agent. As an agent, he need only bring reasonable skill to his duties while his fiduciary obligation is primarily to the company and the creditors as a general body, but not the individual creditors. However, s 231(3) gives an aggrieved individual creditor, in a court winding up, the right to apply to the court and this right is extended to a voluntary winding up by s 280 CA 1963.

The company continues to exist on the appointment of the liquidator and accordingly the liquidator does not assume personal liability under contracts made by him in the company's name unless the contract provides otherwise or he acts negligently.

6.4 Functions of the liquidator

For the functions of the liquidator, see Chapter 2.

CHAPTER 7

CREDITORS' VOLUNTARY WINDING UP

Nicholas Comyn

7.1 When does a creditors' winding up take place?

A creditors' voluntary winding up takes place where either:

(a) no Declaration of Solvency has been filed (or this has been incorrectly filed); or
(b) where the company resolves at a general meeting that it cannot by reason of its liabilities continue its business, in accordance with s 251(l)(c) of the Companies Act 1963 (CA 1963).

Section 265 CA 1963 provides that 'Sections 266 and 273 shall apply in relation to a creditors' voluntary winding up'.

The term 'voluntary winding up' includes both a members' and a creditors' winding up (see Chapter 6). In each case, s 253 CA 1963 provides that 'a voluntary winding up' shall be deemed to commence at the time of the passing of the resolution for voluntary winding up (that is, the members' resolution). Section 266 CA 1963 sets out the steps to be taken to wind up as a creditors' voluntary winding up and provides for a statutory period (of 10 days) before the creditors' meeting can be called and during that period, often longer, the directors are faced with commercial problems, some of which are highlighted here.

7.2 What is the test of 'insolvency'?

The legal definition is still that set out by Kenny J in *Re Creation Printing Co Ltd, Crowley v Northern Bank Finance Corp Ltd* [1981] IR 40, namely 'being able to pay one's debts as they fall due'.

7.3 Can the company continue to perform existing contracts even though the company is insolvent?

Where it is for the benefit of the creditors, the company may complete or continue a contract but not otherwise. This follows the general principle of carrying on business for the benefit of the creditors after the liquidator is appointed (s 254 CA 1963).

7.4 What happens to employees?

The employees should be laid off unless they are essential to preserve the assets or to carry on any business for the 'benefit of the creditors'.

7.5 Assets—can creditors with reservation of title (ROT) remove their goods?

Even though the ROT clause may be valid, the directors should not let assets be removed as the liquidator has to adjudicate on claims, but creditors claiming ROT can identify their goods and request that they be stored and not sold pending the appointment of the liquidator.

7.6 Monies received

Once the directors are aware that the company is insolvent, and where they have decided to wind up the company, all monies received should be put in a separate account, in trust for the liquidator, as making any payment directly to a creditor or indirectly (for example to reduce a guarantee of a director) can leave the directors and the creditor exposed to fraudulent preference (s 286 CA 1963).

7.7 Steps to be taken

The steps to be taken by the directors to wind up as a creditors' voluntary winding up are set out ins 266 CA 1963:

(a) At the initial meeting of directors at which the decision is taken to wind up the company by reason of its liabilities the Secretary is directed to convene the necessary general meeting to pass an ordinary resolution (s 251(l)(c) CA 1963) and a meeting of creditors.

(b) Section 266(3) CA 1963 compels the directors to cause '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' to be presented to the meeting of the creditors. In general, this statement should be divided up into:

- assets specifically charged and their estimated realisable value;
- assets not specifically charged and their estimated realisable value;
- liabilities divided up as between secured creditors, preferential creditors, debenture holders and unsecured creditors;
- an estimate should be put in for the liquidator's fees or a note to say that the liquidator's fees have not been included; and
- the anticipated net dividend should also be inserted.

The list of creditors should as far as possible be brought up to date. It is generally good practice to note on the Statement of Affairs that some creditors claim a 'reservation of title' and to note the amount of such potential claim. A number of further matters arise in connection with the Statement:

- If an accountant is employed to help prepare the Statement and his fee is not paid before the company goes into liquidation then he is entitled to his fee only as an unsecured creditor after the appointment of the liquidator. However, it is possible to pay the accountant's fee in advance as a 'cost of the liquidation'.
- The Statement of Affairs is the directors' estimate of the financial situation of the company (viz s 266(3)(a) CA 1963).
- The directors must also appoint one of the directors to preside at the creditors' meeting.

- A list of creditors' names and addresses and amounts due must be attached to and circulated with the Statement of Affairs.
- The Statement of Affairs is 'presented at' the meeting of creditors, that is, on the day of the meeting.

(c) Section 266(l) CA 1963 next provides:

- Notice must be given *by post* to the creditors not less than 10 days before the date of a general meeting of the company and with every such notice the Proxy Form must be sent giving the creditors the right to appoint either:
  - the chairman of the meeting as his proxy; or
  - some other person to vote in his stead at the creditors' meeting. RSC Ord 74 r 77 provides that a general and special proxy must be sent with the notice although the special proxy is of no relevance to a creditors' meeting under this section.
- Notice of the creditors' meeting must be advertised once at least in *two daily* newspapers circulating in the district where either the registered office or the principal place of business of the company is situated, at least 10 days before the meeting (as inserted by s 130 of the Companies Act 1990).

7.8 The Form of General Proxy

GENERAL PROXY

IN THE MATTER OF *[Name of Company]* LIMITED AND IN THE MATTER OF THE COMPANIES ACTS 1963 TO 2001

I/We ______________________________

of ______________________________

a Creditor, hereby appoint (1) ______________________________

of ______________________________

or (failing him) (2) ______________________________

of ______________________________

to be my/our General Proxy to vote at the Meeting of the Creditors to be held in the above matter on day of 200 of at any adjournment thereof.

Dated this day of 200

Signed: ______________________________

It should be noted that:

(a) The person appointed general proxy may be the liquidator or if there is no liquidator the chairman of the meeting, or any such persons as the creditor may appoint. The Proxy Form should be altered accordingly.

(b) If a firm, the firm's trading name should be signed, and the words 'by A.B. a partner in the said firm' should be added. If the appointor is a corporation, then the form must be under its common Seal or under the hand of same duly authorised person in that behalf and the fact that the officer is so authorised must be so stated.

(c) The Proxy Form when signed must be lodged by the time and at the address stated for that purpose in the notice convening the meeting at which it is to be used.

(d) Section 266(l) CA 1963 provides that the meeting of the creditors must be held on the day of or the day following the general meeting of the company which is called to pass the Resolution to wind up. The following is a form of notice that typically appears in the newspaper:

Companies Acts 1963-2001

[Name of Company] Limited

NOTICE is hereby given pursuant to Section 266 of the Companies Act 1963 that a Meeting of the Creditors of the above named Company will be held at *[place]* on *[date]* at *[time]* for the purposes mentioned in Section 266 (as amended) and Section 267 of the said Act.

By Order of the Board

Secretary

This notice can also be used when sending out the Proxy Forms to the creditors with the addition of the words: 'Proxy Forms are enclosed with this Notice which should be completed as instructed, and returned to *[the registered office of the company]* not later than 4.30 pm on the day before the meeting.'

(e) The Resolution to wind up including the appointment of a liquidator is passed at the general meeting. This is an ordinary resolution (s 251(l)(c) CA 1963) and can be passed by a simple majority of those present in person or by proxy. The prior written consent of the liquidator to act must be obtained, otherwise his appointment is void (s 276A CA 1963 as substituted by s 133 of the Companies Act 1990). There is one important provision under s 266(5) CA 1963 which provides that in the event of the members' meeting being adjourned and the creditors' meeting taking place on the day or the next day then any resolution passed at the meeting of the creditors shall take effect as if it had been passed immediately after the passing of the Resolution at the adjourned meeting of the members.

The format of the Resolution of the company is:

Companies Acts 1963-2001

[Name of Company] LIMITED

It was resolved as an ordinary resolution that the Company cannot by reason of its liabilities continue its business and that it be wound up voluntarily and *[name of Liquidator]* of [address] be appointed Liquidator for the purposes of the winding up. It was noted that the Liquidator had given his prior written consent to act as Liquidator.

Once this resolution in general meeting is passed, the company is in liquidation.

7.9 Creditors' meeting

The creditors' meeting is the principle opportunity of the creditors to consider the final position of the company (the 'Statement of Affairs') and to quiz the director who is presiding at the meeting (s 266(3)(b) CA 1963) as to the figures and circumstances surrounding the Statement of Affairs.

The purpose of the creditors' meeting is therefore:

(a) to consider the Statement of Affairs;
(b) to appoint a liquidator other than that appointed by the company at the general meeting; and
(c) to nominate members to the Committee of Inspection.

These points will be dealt with in the general context of the conduct of the creditors' meeting, some being practical in nature.

The rules or regulations relating to the conduct of the creditors' meeting are contained in RSC Ord 74 rr 58–83 inclusive, but unfortunately these rules also apply to meetings of the creditors in a court winding up and can cause some anomalies (for example, the special and general proxy).

(a) It is important to ensure that a room is booked for the creditors' meeting. The notice convening the meeting must specify the place and time of the meeting (s 266(2) CA 1963) and this is a 'cost' of the liquidation. In the case of *Irish Systems Ltd* (High Court, unreported) a disenchanted creditor applied to the High Court to complain that the room in which the creditors' meeting was held was too small. His application to annul the meeting was refused, the message here is to be well prepared.
(b) Take names of creditors as they enter the room. Where a creditor is represented by a proxy or attending in his own right and where the value of the creditor's debt becomes relevant to the appointment of a liquidator it saves time if the creditors attending and their amounts are known before any vote is counted. It is also important to have ballot papers ready should there be a vote on the appointment of the liquidator.
(c) There are no strict rules as to the manner in which the creditors' meeting is conducted, but as a director must preside (s 266(3)(b) CA 1963) he or his solicitor should open the meeting, read the resolution passed at the members' meeting and set out the purposes for which the meeting is called and the conduct of the business of the meeting.
(d) A Statement of Affairs must be provided. Normally, before the Statement of Affairs is discussed, one of the directors will read a statement setting out the reasons why the company has failed and detailing steps to save it. The Statement of Affairs is the directors' responsibility (s 266(3)(1) CA 1963). Although, technically, there is no obligation to answer questions in relation to the Statement of Affairs, it is certainly implied, because:

    - the directors have a duty to 'lay' a full statement before the meeting;
    - there is an obligation on the director presiding to keep a record of the meeting (RSC Ord 74 r 73), and why be obliged to keep a record unless there are questions and answers to report?

    Conversely the director can only be obliged to answer questions relating to the Statement of Affairs, but typically such questions will relate firstly to the trading history of the company and secondly as to when the directors knew the company was insolvent. As a normal legal principle, the director presiding can refuse to answer questions that might incriminate him.

(e) Once the company in general meeting passes its resolution to wind up and appoint a liquidator the company is in liquidation and the liquidator has been appointed. If the creditors wish to appoint their own liquidator s 267(3) CA 1963 (as inserted by s 47 of the Company Law Enforcement Act 2001) provides that such appointment can be made by resolution of the majority, *in value,* of the creditors present personally or by proxy, which regularly leads to challenges on a proxy's right (particularly where it is the chairman) to vote. Some of the principles that have been established by the court are:

- Even though a proxy may not be completed strictly in accordance with the rules, the 'general wishes' of the creditors in admitting such proxies should be taken into account; see *Re M & R Electrical Ltd* (High Court, 30 July 1985, unreported), an *ex tempore* judgment of BarringtonJ.
- Employees who are owed arrears of wages are entitled to vote, even though they will be able to recover most of their statutory entitlements from the Redundancy Fund (see *In theMatter of Naiad Ltd t/a Metal Product Fasteners (In Voluntary Liquidation)* (High Court, 13 February 1995, unreported, McCracken J); this case also dealt with statutory notices and tests to remove a liquidator).
- Proxies used by directors in respect of loans due to them by the company which tipped the balance in favour of the company's appointed liquidator instead of the creditors' nominees were excluded by the court in an *ex tempore* judgment of Costello J *(Re Shannon Granary Ltd (In Voluntary Liquidation)* (High Court, 22 November 1990, unreported, Costello J). However, this was at the time when the creditors had to obtain a majority in number and value. Similarly, Costello J, in another *ex tempore* judgment, *Metro Express Ltd (In Voluntary Liquidation).,* excluded inter-company loans which tipped the balance in favour of the company's nominated liquidator.
- Finally, in relation to the right to vote (for example contingent creditors) or the amount a creditor is due (that is, where there is a dispute) RSC Ord 74 applies.

(f) The creditors are entitled to appoint to the Committee of Inspection not more than five persons and the company may at the general meeting at which the resolution to wind up is passed, or at a subsequent general meeting, appoint a maximum of three persons to the Committee (s 268(l) CA 1963). Section 268(2) gives the creditors the right to refuse to accept the persons appointed by the company.

If a solicitor is representing a creditor at a meeting of creditors he should:

- if he is the proxy holder, ensure it is properly completed and is returned to the registered office of the company in time;
- know the amount of the debt due and have in his possession a copy of the invoice or statement and be satisfied as to whether his client can claim ROT;
- make Companies Office searches to establish whether the company has been 'struck off' and to be familiar with the last set of accounts filed;
- be familiar with the voting rules at a creditors' meeting;

If a solicitor is representing the company, he will be more particularly advising the director who is presiding at the creditors' meeting and he should:

- have some knowledge of the Statement of Affairs;
- ensure the liquidator has consented to act;
- check that the notices have been advertised and proxies sent out;

- check the proxies returned to the company;
- ensure that a room has been booked and that copies of the Statement of Affairs and list of creditors are available at the door.

The liquidator on his appointment must notify the Companies Office within 14 days and in addition to filing notice of his appointment must lodge with the Companies Office a certified copy of the resolution of the creditors appointing him. The liquidator shall, on his appointment, exercise the powers given to a court liquidator and exercise the powers given under s 231(1)(d), (e) and (b) with the sanction of the Committee of Inspection or, where there is none, the creditors (s 276 CA 1963). However, the liquidator cannot, without the sanction of the court, exercise his powers as liquidator during the period from his appointment by the company until the holding of the creditors' meeting (s 131 of the Companies Act 1990), except for the purposes of:

- taking control of company assets;
- disposing of perishable goods or goods whose value is diminishing; or
- doing or taking all steps necessary to protect the company's assets.

Finally, it should be noted that s 274 CA 1963 provides that 'Sections 275 to 282 shall apply to every voluntary winding up, whether a members' or a creditors' winding up'.

CHAPTER 8

GENERAL CONCEPTS OF RECEIVERSHIPS

Bill Holohan

8.1 Introduction

Irish insolvency law is an ever-evolving area that has provided a fertile source for both judicial review and the enactment and subsequent review of statutory legislation. An examination of insolvency law in Ireland may be carried out under two broad headings: bankruptcy and corporate insolvency. These can be distinguished by the persons/entity to whom they apply, but are united by a common objective being that the trustee/assignee assumes responsibility for the distribution and settlement of the assets and liabilities of the bankrupt.

8.1.1 Bankruptcy

Bankruptcy is the insolvency procedure that is applicable to individuals. The classical definition of bankruptcy is considered to be a quotation from an English case in 1874 *(In Re Reiman* 20 Fed Cas 490):

> Bankruptcy is a law for the benefit and the relief of creditors and their debtors, in cases in which the latter are unable or unwilling to pay their debts.

Bankruptcy is governed by the Bankruptcy Act 1988, which came into operation on 1 January 1989 and which Act is complemented by the Rules of the Superior Courts (RSC). As stated above, bankruptcy applies only to debtors who are individuals.

8.1.2 Corporate insolvency

The insolvency procedure applicable to a company is termed 'corporate insolvency'. It is the latter with which this chapter is primarily concerned. Company insolvencies are governed by the Companies Acts 1963 (CA 1963) to 2001 and by RSC Ord 74. The test for insolvency is whether a company has the capacity to pay its debts as they become due. Four fundamental and formal insolvency or winding up procedures are applicable to companies. These procedures are:

(a) members' voluntary liquidation/creditors' voluntary liquidation;
(b) compulsory or court ordered liquidations;
(c) receivership;
(d) Examination (also known as Examinership).

This chapter covers only the third of these procedures, since the other areas are covered by other chapters. It is not intended to replace detailed textbooks or to go into the case law in any great detail; it is a practical working guide or introduction for the practitioner. Reference should be made to the textbooks for a detailed examination of the law.

8.2 Receiverships—a summary

Although receivership is merely a method of enforcing a security, it is in practice always treated as a form of insolvency procedure. What is a receiver? As his name implies, the receiver is the person who is granted the legal right to receive property belonging to others. Coupled with the right to receive, a person appointed as a 'receiver and manager' of a limited liability company has the power to manage and trade with the company's assets. A person appointed simply as a 'receiver' is appointed without a right to manage, but with the power to sell existing stocks or assets and in this case, the receiver's relevant powers would be set out in the debenture document.

Although there are different types of receiver in the context of a limited liability company, this chapter is primarily concerned with exploring the rights and duties of the most common type of receiver, that is, one who is appointed by a secured creditor (usually a lending institution), under the contractual powers granted by the company in a debenture/charge. This method of appointment is the most prevalent in the commercial world, and such a receiver can be termed a 'contractual receiver'. However, where there is no such contractual power afforded in the debenture, the creditor may petition to the court for the winding up of the company. The debenture is a contractual development, hence, all of the powers of the debenture-holder and of the receiver depend on this document, with the exception of a few statutory provisions.

8.2.1 What is a receiver?

There are a number of different types of receivers. We are primarily concerned here with one appointed under a debenture.

8.2.2 Court-appointed receivers

It is possible for a receiver to be appointed by the court in the following ways:

(a) pursuant to a specific statutory power, for example a receiver appointed pursuant to s 19 of the Conveyancing Act 1881 (which is the only relevant modern provision) who is appointed over lands with a view to collecting rents and profits. Receivers appointed pursuant to a statutory power can be termed 'statutory receivers'. This class of receiver does not play a very important role under the modern law of receivers;
(b) in its equitable jurisdiction pursuant to the Supreme Court of Judicature Act (Ireland) 1877;
(c) under the Rules of the Superior Courts.

In the latter instance, a charge is not necessary for the receiver's appointment. However, in all other instances outlined above, the appointment of the receiver arises in connection with a charge. Although the court is unlikely to be called upon by a debenture-holder who has an express power of appointment to appoint a receiver under its equitable jurisdiction, a certain event which may not have been covered by or which may not be within the scope of the debenture may justify an application being made to the court. For example, in *Angelis v Algemene Bank Nederland (Ireland) Ltd* (High Court, 4 June 1974, unreported) Kenny J said:

> It is not necessary to cite authority for the proposition that when assets charged by a debenture are in danger of seizure, a debenture-holder may immediately appoint a receiver.

In this case certain assets which were comprised in a floating charge had become vulnerable to execution at the hands of the sheriff and the debenture-holder had responded by appointing a receiver. Another example whereby the court's power to appoint a receiver under its equitable jurisdiction may need to be invoked occurs where the company had agreed to execute a debenture/charge but had never actually done so. In such instances, the court could appoint a receiver at the request of the intended debenture-holder. Just such a situation arose in the case of *Alexander Hull and Co Ltd v O'Carroll Kent and Co Ltd* (1955) 18 ILTR 70.

No statutory distinction is drawn in Ireland (as opposed to in England pursuant to the UK Insolvency Act 1986 Pt III) between an administrative receiver and a receiver. The law concerns itself with a receiver who is appointed by a secured creditor under a debenture containing a fixed and/or floating charge over all or most of the company's assets.

8.2.3 The governing law

Very little statute law covers receivers. Case law has mainly determined the rights, duties, powers and liabilities of receivers. As to statute law see:

(a) Pt VII, ss 314–23 CA 1963;
(b) Pts VI (ss 144–45) and VIII (ss 170–79) of the Companies Act 1990; and
(c) ss 52, 53, 55 and 58 of the Company Law Enforcement Act 2001.

8.3 How and when receivers are appointed

8.3.1 Introduction

In Ireland, the receiver is a person appointed by the holders of a debenture, which constitutes a charge over the undertaking and assets of a company incorporated under the provisions of the Companies Acts. He will usually, but not always, be an accountant. The restrictions on persons being appointed receiver are the prohibition on a body corporate acting as receiver under s 314 CA 1963 and the restrictions contained in s 315 CA 1963 (as amended by s 170 of the Companies Act 1990).

The receiver will usually be appointed because:

(a) the principal under a debenture is in arrears; or
(b) the interest under a debenture is in arrears; or
(c) some other event has happened by which, under the terms of the debenture, the security has become enforceable, for example a winding up order or because the security is in jeopardy.

As his name implies, the receiver is one who receives. He has the legal right to receive property belonging to others. Coupled with the right to receive, the receiver may be given power to carry on the business of a company and in this instance he is known as a 'receiver and manager'.

8.3.2 Status of the company

The receiver can only be appointed over assets which have been charged. The appointment of the receiver does not change the status of the company. Although the directors cease to control the assets over which the receiver has been appointed, their normal powers and duties continue in respect of other assets and liabilities of the company. Unlike a liquidation, a receivership will not bring to an end the life of the company. If, at the conclusion of the receivership, the receiver has a surplus on hand, he will normally pay or transfer the surplus to the company or to its liquidator if it is then in liquidation. If there are subsequent charges, it is considered that the holders should be notified before any return of assets to the company so that they can take action to safeguard their position, and indeed it may be unsafe for the receiver to pay the surplus to the company when he is on notice of a subsequent charge.

The receiver will be the agent of one of the parties to the debenture according to its terms. Normally he is stated to be the agent of the company over whose assets he is appointed. This means that the debenture-holder does not come under any personal liability for debts incurred in carrying on the business of the company by the receiver or for torts, negligence or omissions of duty in the course of the performance of the receiver's duties. However, under s 316 CA 1963 the receiver may become personally liable to persons contracting with him, except insofar as the contract otherwise provides, but he is entitled to be indemnified out of the company's assets.

8.3.3 Date of commencement of appointment

Receipt by the receiver of notification of his appointment is a condition precedent to the coming into effect of the appointment. The appointment commences on the date on which the receiver, having been handed the Deed of Appointment or otherwise informed of it, expressly or impliedly accepts the appointment.

8.4 Powers, duties and functions of receiver

The function of a receiver appointed by a debenture-holder is to take possession of the assets subject to the debenture-holder's charge. A receiver will usually then realise those assets and discharge the debt owing to the debenture-holder. However, a receiver may, depending of course upon the terms of both the security and his appointment, continue to operate the business with either a view to increasing the value of the company's assets, or alternatively, sell the business as a going concern or to sell part of the business whilst winding down the unprofitable part.

If a receiver is appointed on foot of a floating charge as distinct from a fixed charge, a receiver must first pay in full those creditors whose claims would be afforded priority in a winding up, that is, the preferential creditors.

A receiver and liquidator may act concurrently in respect of the same company but a liquidator is unable to deal with those assets under a receiver's control.

Regardless of whether the receiver is officially an agent of the company, his primary responsibility is to the debenture-holder. Essentially, the powers, duties and functions of a receiver can be listed as follows:

(a) to exercise care in disposing of company property (*McGowan v Cannon* [1983] ILRM 516; *Holohan v Friends Provident and Century Life Office* [1966] IR 1; *Casey v Irish Intercontinental Bank* [1979] IR 364; *Standard Chartered Bank v Walker* [1982] 3 All ER 938);
(b) to apply proceeds of sale in manner fixed by law;
(c) to satisfy notification requirements laid down in the Act;
(d) to take possession of, collect and get in the property charged by the debenture, and take all and any proceedings in the name of the company or otherwise as may be necessary for that purpose;
(e) to carry on or concur in the carrying on of the business where he is appointed receiver and manager;

(f) to raise money on the premises charged in priority to the debenture or otherwise, where he is given that power;
(g) to sell or concur in selling any of the property charged by the debenture and to use the company Seal for that purpose;
(h) to make arrangements or compromises which are in the interests of the debentureholder. The Debenture Deed should always be consulted to ensure that the receiver acts within his stated powers;
(i) to receive as agent of the company if so specified (and the receiver usually is so specified);
(j) to insure/repair;
(k) to employ agents and employees;
(l) to hive down part of the business;
(m) to furnish reports and accounts (s 321 CA 1963);
(n) to make arrangements or compromises, which are in the interests of the debentureholder.

The Debenture Deed should always be consulted to ensure that the receiver acts within his stated powers.

With regard to the receiver's duty to apply the proceeds of sale in the manner fixed by law, s 98 CA 1963 will require a receiver who is appointed by a debenture-holder and realises assets subject to a floating charge, to pay all preferential creditors before applying the proceeds to discharge the debts owed to the debenture-holder. If a company is in the course of being wound up, s 98 will not apply. However, the obligation to pay the preferential creditors continues if a liquidator is appointed prior to the receiver complying with the requirements under s 98. In the 1996 High Court case of *Re Manning Furniture Ltd* [1996] 1 ILRM 13 the court held that even though the proceeds of the floating charge were not used to discharge monies due under the debenture, the receiver was required to pay the preferential creditors out of any assets coming into his hands.

In contrast, where a receiver only realises the assets subject to a fixed charge as opposed to realising or taking into his possession the assets which are the subject of a floating charge, it would seem that he is not obliged to pay the preferential creditors under s 98 of the Act (see *United Bars Ltd v Revenue Commissioners* [1991] 1 IR 396).

8.4.1 Functions and powers of the receiver

In this section, the functions of the receiver as a receiver and manager appointed pursuant to a floating charge are considered, as well as the more important powers assumed by such a receiver.

Immediately upon his appointment, the receiver should ensure that the statutory provisions as to advertisement and notice to the Registrar of Companies of his appointment under s 317 CA 1963 are complied with. The debenture-holder will usually attend to these formalities.

A number of practical matters should be attended to by the receiver as soon as possible after his appointment. He should arrange insurance cover, notify the company's bank, solicitors, directors and secretary, suppliers, creditors and debtors, agents, employees and persons having property with the company of his appointment, and seek payment from debtors. He should ensure that all company stationery and invoices are overprinted with the words 'Receiver/Receiver and Manager appointed' or 'In Receivership'.

The powers of the receiver depend largely on the terms of the debenture under which he has been appointed and are supplemented by various statutory provisions affecting those powers and by implied powers. The debenture contains the express powers of the receiver appointed pursuant to that debenture.

8.4.1.1 Debenture Deed: to take possession

The first part of this power expresses what is in fact the main duty of the receiver and manager; that is, to take possession of the assets charged by the debenture so that they can be sold in order to pay off the debenture-holder and others entitled in priority to the debenture-holder (possibly a prior debenture-holder or, in the case of a floating charge, the preferential creditors). If anyone prevents the receiver from obtaining possession or interferes with his possession when obtained, proceedings can be taken to obtain possession or prevent interference. As a general rule, the receiver as such is not entitled to bring such proceedings in his own name, but he has the right to sue in the company's name even in the absence of an express power (see *M Wheeler and Co Ltd v Warren* [1928] Ch 840). The receiver should go into possession as quickly as possible after appointment and should seek to find out as much as he can about the business of the company to enable him to plan his strategy for the job which he has undertaken.

8.4.1.2 Debenture Deed: to carry on business

Unless expressly authorised, a receiver cannot carry on business and for that reason debentures almost invariably confer an express power to carry on the business of the company. Where there is such an express provision, then although the person appointed is termed simply a receiver, he is, in effect, a receiver and manager. Generally, the receiver has the power to carry on the business and he is given an express power to borrow money on the assets charged to the debenture-holder and in priority to that security. The power to borrow money can be vital if the receiver is to be able to carry on the business and thus enable outstanding contracts with high added value to be completed and a sale of the business as a going concern to be effected.

In carrying on the business, the receiver must bear in mind his primary responsibility to the debenture-holder and must ensure that he can achieve an adequate return on any business that he undertakes and that he does not depreciate the value of the assets over which he is receiver.

8.4.1.3 Debenture Deed: to sell

This is one of the common standard forms of express powers conferred on a receiver and manager and it is found in various forms; the debenture usually includes the power to convey the legal estate. The need for such a conveyancing power is a consequence of the nature of a floating charge. If a solicitor finds that a debenture does not grant the receiver an express power to convey in the name of or as attorney for the company, he may find it necessary to advise the debenture-holder to consider selling the property as mortgagee in possession.

8.4.1.4 Debenture Deed: to compromise

The final express power usually incorporated in the debenture implies the debentureholder's lack of confidence in the financial stability of the company which has granted the debenture.

Because of the financial problems leading to the appointment of a receiver, disputes with third parties are likely to arise and result in litigation. The receiver frequently inherits litigation based on disputes which arose prior to his appointment, and for this reason he is given an express power to make compromises or arrangements in the interest of the debenture-holder. An important factor in considering whether or not to compromise an action is the question of costs. In the case of *Bacal Contracting v Modern Engineering* [1980] 2 All ER 655 a successful defendant in an action taken by a company which later went into receivership obtained its costs against the receiver in the action from the date on which the company (being in receivership) went into liquidation. There is no set rule but the court has the discretion to award costs against the receiver as an expense in the receivership, although this would probably only happen in exceptional circumstances.

8.4.2 Implied powers

In addition to the express powers, the receiver, as agent of the company, has other implied powers, including those mentioned below.

8.4.2.1 To insure and repair

The receiver should invariably arrange blanket cover from the moment of his appointment over all the assets over which he is appointed, since the cover held by the company will frequently be quite inadequate.

8.4.2.2 To employ agents or employees

The power to carry on the business of the company gives the receiver an implied power to employ agents or employees for the purpose of carrying on or selling the business, although most well-drawn debentures avoid argument on the point by incorporating an express power, frequently in the following terms:

> To appoint managers, accountants, servants, workmen and agents for the aforesaid purposes upon such terms as to remuneration or otherwise as the receiver may determine.

8.4.2.3 To incorporate a subsidiary and sell assets to it

Many modern floating charges also empower the receiver to incorporate a subsidiary company and to sell the assets of the company to it. The 'hiving down' of a viable part of a business to a subsidiary company enables the purchaser in some cases to avail of taxation and stamp duty advantages. Hiving down will be discussed in Chapter 9.

8.4.3 Receiver's power of sale

The exercise of the power of sale by the receiver is the aspect of the receiver's duties most likely to bring the receiver into contact with solicitors other than his own legal adviser. The power of sale of a receiver has been equated to that of a mortgagee exercising his power of sale and in *Re B Johnson and Co (Builders) Ltd* [1955] All ER 775; [1955] Ch 634 it was stated that the receiver's power of sale is in effect that of a mortgagee. In other words, the same standards are expected of a receiver exercising his power of sale as are expected of a mortgagee exercising his power of sale. The receiver has a duty to act in good faith and in addition to that duty he also owes a duty of care in the conduct of the sale. That duty was established in *Cuckmore Brick Co Ltd v Mutual Finance Ltd* [1971] 2 All ER 633; [1971] Ch 949 and has been approved in a number of subsequent English decisions. It had been accepted in Ireland in the case of *Holohan v The Friends' Provident and Century Life Office* [1966] IR 1 as applying to mortgagees in possession exercising a power of sale, and by extension to others such as receivers.

The receiver, whether he carries on the business or not, will eventually need to sell the assets over which he has been appointed, as advantageously as possible. Section 316A CA 1963 (as inserted by s 172 of the 1990 (No 2) Act) provides that:

> A receiver, in selling property of a company, shall exercise all reasonable care to obtain the best price reasonably obtainable for the property as at the time of sale.

Those assets will typically include real property, stock in trade, goodwill and debtors. The method of sale may be by private treaty, tender or auction but in any event, the receiver should obtain professional advice on the most appropriate method and should obtain professional valuations of all assets being disposed of. The receiver must be cautious about disposing of assets for less than such valuation and he should obtain confirmation from a suitably qualified professional person that the price achieved by him is reasonable in the circumstances.

In the case of a sale of the business as a going concern the receiver's solicitors will draft an agreement for the sale of assets, the parties to which will be:

(a) the company as vendor;
(b) the receiver as the agent of the company; and
(c) the purchaser.

The form of such agreement differs only in minor respects from a sale by the company itself. For example, it will provide for a specific exclusion from liability for misrepresentation on the part of the receiver and will express the fact that he enters into the contract as agent for the company only and without personal liability; and due to the receiver's lack of knowledge of such matters it will specifically exclude all warranty as to title to assets which a purchaser would expect to receive in a normal commercial transaction. The price paid may reflect the absence of such warranty. The value of debtors purchased will also have to be substantially discounted. In some cases, the receiver will appoint the purchaser as his agent for collection of debts if he cannot achieve a reasonable cash offer for them.

The receiver will not normally be concerned with the provisions of the Sale of Goods and Supply of Services legislation, as he does not usually sell to a consumer. Similarly, he will usually escape liability under the Liability for Defective Products Act 1991 because goods sold by a receiver would not ordinarily be intended for private use or consumption. If real property is included in the sale, the agreement will incorporate the Standard Law Society conditions of sale. It is important to delete certain of the General Conditions from those Conditions of Sale and in particular, the warranty as to planning and the declaration relating to identity of the property as the receiver will have only limited knowledge of these matters. A special condition providing that if required by the purchaser the assurance to the purchaser will be executed by the charge-holder is frequently included in cases where the debenture-holder has a fixed charge. All debenture-holders, including those who appointed the receiver, would, in any case, be required to execute a discharge of their debentures. However, it is essential that the debenture under which the receiver sells is not released until after the date of the assurance to the purchaser where the receiver conveys as attorney for the company. In the case of subsequent debentures, consideration should be given to a sale by the mortgagee in possession rather than by the receiver, as a sale by the mortgagee will defeat the interests of puisne mortgagees whereas a sale by the receiver is subject to their interest.

8.4.4 Use of the Seal

The use of the company Seal by the receiver has been considered in the *Cork Shoe Company* case (*Industrial Development Authority v Moran* [1978] IR 159). KennyJ, in the course of his judgment in the Supreme Court in that case, commented as follows:

> I wish to point out that the power given to the receiver by Clause 10 is 'to carry any such sale into effect by deed in the name and on behalf of the company'. When a receiver is selling under such a clause, the more usual and better practice is for him to execute the deed of transfer by writing the name of the company and underneath this to write words that indicate that the name of the company has been written by the receiver as attorney of the company under the power of attorney given by the debenture. In addition, he should execute the deed in his own name. In that way he has the best of both worlds. The writing of the name of the company by the authority of the company given when it executed the debenture brings the case within the words of the debenture itself, and execution by the attorney personally gives the advantage of s 46 of the Conveyancing Act 1881.

It is advisable for a number of reasons, especially for purposes of taxation and stamp duty, that each asset be allocated a proportion of the purchase price in the sale agreement and it is preferable that this be agreed during the negotiations.

8.4.5 Absence of specified powers

The powers of the receiver are derived from the debenture under which the receiver is appointed and in the case of fixed charges from the Conveyancing Acts. The receiver will not have any power to carry on the business of the company if this power has not been given to him by the debenture. If the debenture is defective in this respect it may instead be necessary for the debenture-holder to apply to the court to appoint a liquidator. The receiver will not have any power of sale if such power is not in the debenture, as the Conveyancing Acts do not confer a power of sale on the receiver whose function under these Acts, as his name implies, is to receive the income of the mortgaged property. If the receiver has no power of sale and the debenture-holder still wishes to appoint a receiver, where the debenture-holder has a legal mortgage, the problem may be overcome if the debenture-holder sells the assets as mortgagee and the receiver does the necessary preparatory work leading up to the sale.

8.5 Receiver as agent of company/debenture-holder

The receiver is empowered to act as the company's agent but the relationship does not fall neatly within traditional agency rules and obligations. This is due to the fact that the relationship between receiver and company differs greatly from the usual agent/principal relationships in that the receiver may be bound by some of the company's obligations and in other instances may choose to repudiate those obligations (*Ardmore Studios (Ireland) Ltd v Lynch* [1965] IR 1). The difficulty, of course, arises as a result of the fact that the receiver is appointed (usually) by the debenture-holder and will, therefore, always pursue the debenture-holder's interests in relation to the company. Thus, the company is not in a position to instruct the receiver regarding the carrying out of his duties or on the exercise/ambit of his powers.

Even in instances whereby the debenture expressly provides that the receiver is the agent of the company, the court may still infer an agency relationship between debentureholder and receiver based on actions of the debenture-holder. A prime example of this occurred in the case of *American Express International Banking v Hurley* [1986] BCLC 52. In this case, a bank was the debenture-holder. The bank had directed the receiver to sell the assets at an undervalue, and in so doing had created a relationship of principal and agent between the bank and the receiver. Hence, the bank was held by the court to be liable to the guarantor for the company's debts.

8.6 Notification/publication

Receipt by the receiver of notification of his appointment is a condition precedent to the coming into effect of the appointment. Section 107 CA 1963 states that the debentureholder is primarily responsible for notification of the appointment which must be published within seven days in *Iris Oifigiuil* and one daily newspaper. In addition, the receiver must notify the company within 14 days of his appointment under s 319 CA 1963. Once the receiver has notified the company, it is under an obligation to submit a Statement of Affairs to the receiver within 14 days. Yet in practice, this obligation is rarely complied with.

Section 319(A) CA 1963 (as inserted by s 52(b) of the Company Law Enforcement Act 2001) requires that when the Registrar of Companies becomes aware of the appointment of a receiver, he must inform the Director of Corporate Enforcement of the appointment. The Registrar should 'become aware' by receiving a notice from the person appointing the receiver, as required by s 107 CA 1963.

Section 319(7) CA 1963 (as amended by s 52(a) of the 2001 Act) states that where a receiver ceases to act, his final return shall include a statement of his opinion as to whether or not the company is solvent and the Registrar of Companies is obliged to forward a copy of this documentation to the Director of Corporate Enforcement. This opinion will be relevant to the Director in considering whether to exercise his powers in respect of a company which is not liquidated following receivership, due to insufficiency of assets.

It is difficult to understand why the 2001 Act did not impose a requirement for direct notice to the Director, but it is to be presumed that in practice receivers will also notify the Director directly.

8.7 Effect of receiver's appointment

8.7.1 The company

The appointment of a receiver does not affect the legal status of a company. However, once the receiver is appointed all invoices, goods orders or business letters issued by or on behalf of the company must, pursuant to s 317(1) CA 1963, contain a statement stipulating that a receiver has been appointed. If the company, officer, liquidator and/or receiver defaults in satisfying this requirement, they may incur a fine pursuant to s 317(2) CA 1963.

In the event of a holder of a floating charge appointing a receiver over the entire undertaking and assets of the company, s 320 CA 1963 requires that the directors and secretary of the company or such other person as may be specified by the receiver, submit to the receiver within 14 days of his appointment a statement as to the affairs of the company.

Furthermore, a receivership is a temporary condition affecting a company which, unlike liquidation, does not necessarily lead to the company's dissolution. After a receiver has been discharged, the directors resume their normal functions in relation to all of the company's affairs, unless a liquidator has been appointed in the meantime.

Unlike a liquidation, a receivership will not bring to an end the life of the company. If at the conclusion of the receivership the receiver has a surplus on hand, he will normally pay or transfer the surplus to the company or to its liquidator if it is then in liquidation. If there are subsequent charges it is considered that the holders should be notified before any return of assets to the company so that they can take action to safeguard their position and indeed it may be unsafe for the receiver to pay the surplus to the company when he is on notice of a subsequent charge.

In addition, a receiver has the power to manage the company, that is, to continue the management of the business of the company. In practice, most receiverships do result in the dissolution of the company's business.

8.7.2 The directors

A director's powers regarding the company's assets are suspended upon the receiver's appointment, as at that time the receiver assumes controls over assets which are the subject of the charge. The director still remains in office and is permitted to exercise any power not conferred to the receiver.

In the event that a receiver is appointed regarding a specific asset only, a director's powers will only be suspended regarding that asset and will retain all other remaining powers. If, however, a receiver is appointed over all of the assets and undertakings of the company, the director's powers will obviously be significantly hindered, but the director will still retain the residual decision-making powers.

8.8 The receiver's position when appointed

8.8.1 Receiver's liability

The receiver will be the agent of one of the parties to the debenture according to its terms. Normally, he is stated to be the agent of the company over whose assets he is appointed, as this means that the debenture-holder does not come under any personal liability for debts incurred in carrying on the business of the company by the receiver or for torts, negligence or omissions of duty in the course of the performance of the receiver's duties. Under s 316 CA 1963, the receiver may become personally liable to persons contracting with him except insofar as the contract otherwise provides, but he is entitled to be indemnified out of the company's assets.

8.8.2 Receiver's qualification

Although the Companies Acts (s 314 CA 1963) do not prescribe any qualifications as a requisite for appointment as a receiver, they do prohibit the following persons from so acting:

(a) a body corporate;
(b) an employee or partner of an officer or servant (an officer or servant of the company in this context includes references to an auditor);
(c) a person who is an officer, auditor or servant of the company, or has been, within 12 months of the commencement of the receivership;

(d) an undischarged bankrupt (which, by virtue of the Company Law Enforcement Act 2001, is now defined to include a bankrupt under the laws of the State or elsewhere);
(e) a parent, spouse, brother, sister or child of an officer;
(f) anyone disqualified from acting as a receiver of the company's holding or subsidiary company or a subsidiary of its holding company.

Pursuant to s 315(2) CA 1963, if a receiver becomes disqualified, he must immediately vacate office and notify the company, the Registrar of Companies, the debenture-holder or court that he has vacated his office due to the disqualification. If a receiver fails to so vacate office after disqualification, he is committing a criminal offence, which, pursuant to s 315(5) CA 1963, is punishable by a fine.

8.8.3 Receiver's remuneration

Those receivers who are appointed by the court will be paid at the court-appointed rate whilst those receivers who are appointed by virtue of the debenture will have their rate of pay fixed by the terms of the debenture. However, the receiver's remuneration, even if fixed by the terms of the debenture, may be fixed by a liquidator, member or creditor of a company who applies to the court pursuant to s 318 CA 1963 (Re *City Car Sales Ltd (In Receivership and Liquidation)* [1995] 1 ILRM 221).

8.8.4 Resignation

When a receiver is appointed by the court, he may, pursuant to s 322C(2) CA 1963, only resign if the court grants its consent and subject to the terms laid down by the court. If the receiver fails to so comply with these notice provisions, he may be liable to a fine.

A receiver appointed under a debenture, however, may resign pursuant to s 322C(1) CA 1963, provided he has given one month's notice to the holders of floating charges over all or part of the company, the company itself or its liquidator, and the holders of all fixed charges over all or part of the company.

Additionally, pursuant to s 322A(1) CA 1963, the court has power to remove a receiver and appoint another, provided due cause is evinced. In the event that such proceedings take place, notice must be served on both the receiver and the person who appointed him at least seven days prior to the hearing. Both the receiver and the person who appointed him must be afforded a chance to appear and be heard at such proceedings under s 322A(2) CA 1963.

As mentioned above, s 52(a) of the 2001 Act provides, by way of amendment to s 319(7) CA 1963, that where a receiver ceases to act, his final return shall include a statement of his opinion as to whether or not the company is solvent and the Registrar of Companies is obliged to forward a copy of this documentation to the director.

8.9 Common insolvency principles

Several principles underpin Irish insolvency law and apply to both bankruptcies and liquidations:

(a) the *pari passu* rule;
(b) set off;
(c) priority

They are known collectively as the priority rules and are described in the Companies Acts and in other legislation and in the Rules of the Superior Courts. Legally, they have no application in receivership or examination but in practice, some of these principles are relevant and, in some cases, applied by analogy. *The pari passu* rule is the strongest underlying principle, whilst the latter two, being the rules of set off and priority respectively, provide exceptions to that rule. The principles are outlined below; for further detail, see Chapter 3.

8.9.1 The *pari passu* rule

The *pari passu* rule provides that all creditors, both generally speaking and within a particular class, should be treated equally with their debts abating on a pro rata basis where there is a shortfall of assets (s 275 CA 1963). That is, on a distribution, each debt is paid a similar proportion or percentage of the amount outstanding.

8.9.2 Proof of debt

In liquidation and bankruptcy, the onus of proof of an amount due lies on the creditor. The debts which may be proved in a liquidation are specified in s 283 CA 1963 and a similar provision is found in s 75 of the Bankruptcy Act 1988.

8.9.3 Set off

Rule 17 of the Proof of Debts Schedule to the Bankruptcy Act provides for set off. The set off rule applies in instances whereby there are mutual debts between the debtor and the creditor and thus, the debt of one may be set off against the debt of the other. The result of this is that only the balance would then need to be claimed (provided, of course, certain conditions apply). However, set off will only be permitted if the debt exists between the same parties in the same right.

8.9.4 Priority

The priority rule, which is subject to statutory obligations, imposes the payment of certain expenses or distribution of particular assets, in priority to all other debts. The rules as to priorities are common to bankruptcy and liquidations save only that a floating charge will not occur in bankruptcy (because an individual cannot create such a security) and there is no provision in the Bankruptcy Act 1988 for the recognition of deferred debts. For the application of priority rules to receivership and examination, see Chapter 3 (3.5.1).

8.9.5 Council Regulation (EC) No 1346/2000: the Cross Border Insolvency Regulation

As of 31 May 2002, Council Regulation (EC) No 1346/2000 (the Regulation) came into force. It is not proposed to deal with this topic in detail as it does not apply to receiverships, but it is worthy of detailed analysis in itself, and the following comments should be considered.

As a result of this Regulation, businesses trading throughout Europe that become insolvent are subject to a new framework of rules and procedures. Creditors in Europe will now be able to assert claims over a debtor's assets in insolvency proceedings in any other Member State. The Regulation enables Member States' insolvency officers to be recognised in any relevant court in the European Union and thus, an insolvency officer from one state will be able to pursue assets in another Member State. However, the effect of the Regulation in relation to bodies corporate is limited as it only applies to companies which are organised through a network of branches throughout Europe and hence does not cover subsidiaries which are separate corporate entities.

The Regulation creates a two-tier structure for insolvencies of companies across European jurisdictions. These are:

(a) 'main proceedings', which are brought in the country where the debtor has its 'centre of main interest'; and
(b) 'secondary proceedings', which may be instituted in other Member States in order to liquidate assets located in that Member State, provided of course that the debtor has an 'establishment' (which is defined as 'any place of operations where the debtor carries out non-transitory economic activities with human means and goods') within that Member State.

Main proceedings have universal scope. The law of the country in which the main proceedings are commenced is the applicable law governing the conduct of the insolvency proceedings. In addition, any judgment given in the country in which proceedings are instigated will then be recognised and can be enforced in other European countries without further formalities.

The Regulation was drafted in a bid to achieve harmonisation of insolvency laws across the EU. Harmonisation of insolvency laws was deemed necessary due to the increasing number of companies engaging in cross-border activities, which increased the potential for an insolvent debtor's estate to be spread throughout several jurisdictions. Prior to the implementation of the Regulation, cross-border insolvencies had been problematical, due to the conflicting approaches to the application of the insolvency laws of the various European Member States, which tended to view their insolvency laws as a matter of public policy It is too soon to determine whether the implementation of the Regulation has been successful in implementing its aim of improving management of cross-border insolvencies. Only time will tell.

The Regulation is expressed to apply to 'collective insolvency proceedings, which entail the partial or total divestment of a debtor and the appointment of a liquidator' (Article 1). The Annex to the Regulation stipulates the category of proceedings for each Member State which is included. In the case of Ireland, these are listed as meaning compulsory winding up, bankruptcy, administration in bankruptcy of the estates of persons dying insolvent, winding up by the court in bankruptcy of partnerships, creditors' voluntary winding up (with confirmation of the court), arrangements under the control of the court which involves the vesting of all or part of the property of the debtor in the Official Assignee for realisation and distribution, and company examinership. There is no statutory procedure for confirming members' voluntary winding up, so this remains outside the scope of the Regulation.

The definition of 'liquidator' is defined by Article 2 as 'any person or body whose function is to administer or liquidate assets of which the debtor has been divested or to supervise the administration of his affairs'. The Annex lists the persons or bodies so recognised for Ireland, and these include a liquidator, a provisional liquidator, the Official Assignee in Bankruptcy, a trustee in bankruptcy, or an Examiner, but not a receiver.

The rationale for the exclusion of receivership from the scope of the Regulation is that it was viewed as a method of enforcement of a creditor security rather than a 'collective insolvency proceeding', the concept of a receiver being unknown in most EU States, even though it is a very familiar one in common law countries, such as Ireland and the UK.

See Chapter 12 for more discussion of this Regulation.

CHAPTER 9

ADVISING PARTIES INVOLVED IN A RECEIVERSHIP

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9.1 Advising the various parties

This chapter is written as a guide for the solicitor advising parties involved in a receivership. Thus, the text is in part addressed to the acting solicitor. Some checklists are included in the text for ease of reference.

9.1.1 The existence and powers of the company

The first questions that the solicitor needs to ask himself are:

(a) Does the company exist?
(b) Can it borrow/create debentures?
(c) Was it incorporated prior to the creation of the mortgage/debenture?

Your first task as acting solicitor will be to advise on the validity of the receiver's appointment and what his powers are. If there is any flaw in his appointment, he will be unable to enforce any claims to priority over other parties interested in the property and he may incur liabilities as a trespasser. If his appointment is challenged it is for the receiver to justify it. Your duties will usually involve the following matters:

(a) check the company's Memorandum and Articles of Association to see that the company has the power to create the debenture;
(b) check that the debenture was duly sealed in accordance with the company's Articles of Association.

9.1.2 The existence and scope of the debenture

(a) Was it created after the company came into existence?
(b) Was it properly created, executed, sealed, stamped, registered, etc?
(c) Check in the Companies Office to see that the debenture was duly registered within the period of 21 days prescribed by s 99 Companies Act 1963 (CA 1963) or that the court under s 106 CA 1963 extended the time for registration.
(d) Check in the Companies Office to see that the date of incorporation of the company is earlier than the date of the debenture.
(e) Check the extent of the property captured by the debenture. Obviously, the receiver will not be able to collect the income from or realise assets not included within the scope of the debenture.

(f) Check the powers of the receiver. These are derived from the debenture under which the receiver is appointed and in the case of fixed charges the Conveyancing Acts. The receiver will not have any power to carry on the business of the company if this power has not been given to him in the debenture. If the debenture is defective in this respect it may instead be necessary for the debenture holder to apply to the court to appoint a liquidator. The receiver will not have any power of sale if such power is not in the debenture, as the Conveyancing Acts do not confer a power of sale on the receiver whose function under these Acts, as his name implies, is to receive the income of the mortgaged property. If the receiver has no power of sale and the debenture-holder still wishes to appoint a receiver, the problem may be overcome where the debenture-holder has a legal mortgage by the debenture-holder selling the assets as mortgagee with the receiver doing the necessary preparatory work leading up to the sale.

(g) Check that the debenture has been properly and adequately stamped.

(h) Check that an event of default has actually occurred which, under the terms of the debenture, enables the debenture-holder to appoint a receiver. The most common events are:

- Failure to repay monies due, or interest, following the sending of a written demand for payment by the debenture-holder to the company. The demand must have been made in accordance with the provisions for service of a demand in the debenture. If the demand has to be sent to the company's registered office, see that the demand has been sent to the current registered office at the date of the demand (which will not necessarily be the same address as that given in the debenture). The power to appoint can be validly exercised in such cases only if the demand is made prior to the appointment being communicated to the receiver.
- If the company passes a resolution to liquidate, a petition is presented, or an order is made to liquidate the company.
- If execution is levied against the company's property.
- If the company should cease to carry on its business.
- If the company should be in breach of any condition in the debenture.
- If a receiver should be appointed over any part of the assets of the company.
- If the company threatens to or actually ceases to trade.
- If any other debenture becomes enforceable against the company.
- If the company is unable to pay its debts.
- If the company's balance sheet discloses that the company's liabilities are in excess of its assets, including its uncalled capital.
- If the company reduces its capital.
- If the company, without the debenture-holder's consent, creates any mortgage or charge ranking in priority to or *pari passu* with the security created by the debenture.
- If circumstances occur which in the judgment of the debenture-holder render it necessary or desirable to appoint a receiver. This event might not be as safe a ground for making the appointment as, for instance, non-payment following a demand, as it might be possible for the company to challenge the validity of the appointment by trying to prove to the court that there were no such circumstances in existence or no reasonable grounds for arriving at the judgment made by the debenture-holder.

9.2 Advising the potential receiver

9.2.1 Eligibility

Will the nominee agree to act? One cannot assume that the person nominated by the debenture-holder as the receiver will agree to act. There may be many reasons why the first nominee of the debenture-holder would be unwilling to act: perhaps either because of some connection with the company (business or personal), or because they are one of the directors or one of the shareholders of the company. It is not unknown, in fact, for certain nominees to have held shares in companies in respect of which they were nominated as receiver. In addition, the nominee may be unwilling to act because of prior commitments. Accordingly, one should not automatically assume that the nominee will act. The nominee should be asked in writing whether he would be willing to accept the nomination and the debenture-holder should receive confirmation prior to the formal appointment and acceptance.

As to whether the nominee is eligible, see ss 314 and 315 CA 1963 (as amended). Section 314 provides that certain persons be excluded from eligibility. Section 315 (as amended by s 170 of the 1990 (No 2) Act) provides that none of the following qualify for appointment as receiver of the property of a company:

(a) a body corporate is not qualified for appointment as receiver of the property of the company;
(b) an undischarged bankrupt (which by virtue of the Company Law Enforcement Act 2001 is now defined to include bankrupts under the law of the State and other jurisdictions);
(c) a person who is or within 12 months prior to the commencement of the receivership has been a officer or servant of the company;
(d) a parent, spouse, brother, sister or child of an officer of the company;
(e) a person who is a partner of or in employment of an officer or servant of the company;
(f) a person who is not qualified by virtue of the subsection for appointment as receiver of the property of any other body corporate which is that company's subsidiary or holding company or a subsidiary of that company's holding company or would be so disqualified if the body corporate were a company.

An officer or servant of the company in this context includes reference to an auditor.

9.2.2 Debentures not providing for receivers

If the debenture does not contain provisions enabling the appointment of a receiver the mortgagee has only the rights of appointment of a receiver under s 19 of the Conveyancing Act 1881 when the mortgage is made by deed and the mortgage money has become due. Apart from express provisions in the mortgage deed, under s 24 of that Act the appointment cannot be made until the mortgagee has become entitled to exercise the statutory power of sale, that is, unless and until notice has been served on the mortgagor or one of several mortgagors requiring payment of the mortgage money default in payment of the money or any part thereof has been made for three months after service or unless and until some interest is in arrears and unpaid for two months after becoming due or there has been a breach of some provision contained in the mortgage deed or in the Act (other than the covenant for payment of the mortgagee money or interest).

If the mortgage is silent as regards appointment of a receiver and his powers, the receiver will have only the very limited powers conferred on him by the Conveyancing Acts. Under s 24 of the 1881 Act, the receiver is given power to demand and recover all the income of the property over which he is appointed receiver, by action, distress, or otherwise, in the name either of the mortgagor or of the mortgagee, to the full extent of the estate or interest which the mortgagor could dispose of, and to give effectual receipts for the same. This section also states that the receiver shall be deemed to be the agent of the mortgagor and that the mortgagor shall be solely responsible for the receiver's acts or defaults unless the mortgage deed otherwise provides. It further provides that the receiver shall, if so directed in writing by the mortgagee, insure and keep insured against loss or damage by fire, out of the money received by him, any buildings, effects or property comprised in the mortgage being of an insurable nature. The Conveyancing Acts do not authorise the appointment of a receiver in the case of a floating charge, nor can a receiver under these Acts be appointed of book debts comprised in a mortgage of a business.

9.2.3 Indemnity

It is obviously a good idea in every case, from the receiver's point of view, to get an indemnity from the debenture-holder who is appointing him. The indemnity should cover both the acts of the receiver in carrying out the receivership and any liabilities arising from the debenture under which he is appointed proving to be defective. There will be a special need for an indemnity in certain cases, for example:

(a) if a debenture is of recent creation, because of the risk of it (being a floating charge) becoming invalid or partly invalid under s 288 CA 1963 in the event of a winding up within 12 months of its creation, or (being either fixed or floating) because of the risk of it being invalid as a fraudulent preference of its creditors under s 286 in the event of commencement of a winding up within six months of its creation;
(b) if the company is already in liquidation or very likely to be put into liquidation, because the receiver will lose the protection of being the agent of the company from commencement of the winding up;
(c) if it is likely from the nature of the company's business that the receiver will be entering into contracts where it may be difficult to limit the receiver's statutory personal liability for contracts.

Institutional debenture-holders will usually be reluctant to give an indemnity and it may only be possible to obtain one where one of these special factors applies.

9.2.4 Receiver's fees/remuneration

Is remuneration for the receiver agreed in advance? The potential receiver should agree with the debenture-holder on the rate of remuneration to be paid to the receiver, if necessary by the debenture-holder, regardless of whether or not the receiver would be entitled or able to recover remuneration from the company. The appropriate analogy would be an agreement in relation to solicitor and client costs on an hourly basis as distinct from costs one would be entitled to recover on a party and party basis in litigation.

Section 318 CA 1963 provides statutory provisions enabling a court to fix the remuneration of a receiver. Section 318(1) CA 1963 provides that the court may, on an application made to it by the liquidator of a company or by any creditor or member of the company, by order, fix the amount to be paid by way of remuneration to any person who, under the powers contained in any instrument, has been appointed as receiver of the property of the company, notwithstanding that the remuneration of such receiver has been fixed by or under that instrument. Section 318(2) CA 1963 provides that the power of the court shall, where no previous order has been made in relation thereto:

(a) extend to fixing the remuneration for any period before the making of the order or the application therefor; and
(b) be exercisable notwithstanding that the receiver has died or ceased to act before the making of the order or the application therefor; and
(c) where the receiver has been paid or has retained for his remuneration for any period before the making of the order any amount in excess of that fixed by the court for that period, extend to requiring him or his personal representatives to account for the excess or such part thereof as may be specified in the order.

The power conferred under paragraph (c) above shall not be exercised by the court in relation to any period before the making of the application for the order unless, in the opinion of the court, there are special circumstances making it proper for the power to be so exercised. The court may also from time to time, on application by the liquidator, by any creditor or member of the company or by the receiver, vary or amend an order made by the court in relation to remuneration.

9.2.5 Appointment

Has a default occurred? Under the standard form of debenture, certain events are specified as giving the debenture-holder the right to appoint a receiver. These have already been mentioned above. Generally speaking, the provisions require that the company has been in breach of one or other of the provisions of the debenture. While a provision is usually incorporated providing that the debenture-holder may appoint a receiver if some event occurs or if circumstances occur which in the judgment of the debenture-holder render it necessary or desirable to appoint a receiver, it is generally preferable not to rely on such a provision for the appointment of a receiver, as it may be difficult to show that such circumstances or events objectively justify the appointment of a receiver.

If necessary, the court may also appoint a receiver under its equitable jurisdiction. It is unlikely to be called upon by a debenture-holder who has an express power of appointment but some event, which may not have been covered by or which may not be within the scope of the debenture, might justify an application being made to the court. For example, in *Angelis v Algemene Bank Nederland (Ireland) Ltd* (High Court, 4 June 1974, unreported), Kenny J said:

> It is not necessary to cite authority for the proposition that when assets charged by a debenture are in danger of seizure, a debenture-holder may immediately appoint a receiver.

In that case, certain assets which were comprised in a floating charge had become vulnerable to execution at the hands of the sheriff and the debenture-holder had responded by appointing a receiver.

In addition, for example, if the company agreed to execute a debenture/charge but had never actually done so, then the court could appoint a receiver at the request of the intended debenture-holder. This occurred in the case of *Alexander Hull and Co Ltd v O'Carroll Kent and Co Ltd* (1955) 18 ILTR 70.

9.2.6 The form of notice of appointment

There is no specified or prescribed form for the Deed of Appointment of a receiver. However, certain items should be included, and these are:

(a) the name of the company which issued the debenture;
(b) the name and address of the debenture-holder;
(c) the date of the relevant debenture under which the appointment is to be made;
(d) a recital that an event has occurred which gives rise to the exercise of the power of appointment. It is better not to specify a particular event in the actual Deed of Appointment;
(e) the name and address of the receiver;
(f) a recital that the receiver has agreed to accept the appointment;
(g) a statement that the receiver is appointed over the assets charged by the debenture or alternatively a statement that the receiver is appointed as receiver over certain specified assets.

If there are any requirements specified in the debenture as to the execution of the Deed of Appointment, then these should be followed. The Deed of Appointment would normally be under seal. If the debenture provides for the Deed of Appointment to be signed by or on behalf of the debenture-holder, then it does not need to be under seal. It is important, however, to ensure that the Deed is signed by an appropriate category of person to whom authority is given by the debenture. Preferably the Deed of Appointment should recite the capacity of the person signing the Deed of Appointment on behalf of the debentureholder.

It is not necessary for the Deed of Appointment to list out all of the powers of the receiver, as the Deed of Appointment cannot confer on a receiver a power that does not exist under the provisions of the debenture or under statute.

9.2.7 Acceptance by the receiver

If possible, the Deed of Appointment should also provide at the end of it for the signature by the receiver signifying his acceptance. Receipt by the receiver of the Deed of Appointment and acceptance is a condition precedent to its coming into effect. The appointment will commence on the date on which the receiver, having been handed the Deed of Appointment or otherwise informed of it, expressly or implicitly accepts the appointment.

9.2.8 Prior charge-holders

Any debenture-holder wishing to appoint a receiver will have to give consideration to charges which are registered in priority and in particular to the question of whether or not such charges/debentures would allow the earlier charge-holders/debenture-holders to appoint a receiver. If possible, the agreement, in writing, of the prior charge-holders to the appointment of a receiver should be obtained.

Notwithstanding the strict legal rights of prior charge-holders, it may also be possible on occasion to secure some form of inter-lender agreement between the charge-holders whereby they agree, in consideration of a later charge-holder agreeing to carry the cost of the receivership for the charge-holders, to rank *pari passu*.

9.2.9 Resources

Both the debenture-holder and the potential receiver should ensure that the receiver has sufficient resources available, in terms of manpower, etc, to effectively carry out the receivership. The amount of resources required will obviously depend on the nature and the scale of the operations carried on by the company. The potential receiver may be leaving himself open to an action at the hands of the company or the debenture-holder if he fails to exercise sufficient skill and expertise through lack of available resources, be it time, manpower or otherwise.

9.3 Advising contractors and suppliers

The receiver will require to examine all outstanding contracts of the company with its suppliers in arriving at his decision whether or not to carry on the business of the company. As the agent of the company, he can enforce an existing contract with the company but cannot be sued by the supplier should he decide not to complete the contract. The supplier would have the right to sue for breach of contract but would rank as an unsecured creditor only in respect of any award made in its favour. In the case of *Airline Airspace Ltd v Handley Page Ltd and Another* [1970] 1 All ER 29, Graham J was of the opinion that a receiver might disregard the contractual obligations of a company over which he was appointed if he could show that in order to fulfil the contractual obligations there would be benefit neither to the company nor to the debenture-holder. The receiver however does owe a duty to the company not to act recklessly in exposing it to unnecessary claims by his conduct.

The court held as follows:

> The receiver, within limit(s)…is in a better position than the company, qua current contracts…otherwise almost any unsecured creditor would be able to improve his position and prevent the receiver from carrying out, or at any rate carrying out as sensibly and as equitably as possible, the purpose for which he was appointed. It would not be inequitable for the receiver to prefer (one contractor) to other secured creditors, and it is in the best interests of all such creditors that he should be able to sell that part of (the company's) business which will constitute a viable unit in the way which will secure the highest price. If, in so doing, he does decline to take over (one) contract, he may, of course, render the (company) liable in damages and may also, to some extent, at any rate, damage their reputation as a trustworthy company which can be expected to honour its contracts. This, however…he is entitled to do, so long as the realisation of the net assets of the company …to the best advantage is not impaired.

This case involved a company in receivership which had one valuable asset, namely a design for a plane. The company had a contract with the plaintiffs whereby the plaintiffs were given the exclusive right to sell all aircraft of that design and were to be paid a commission for every aircraft sold. If the design were sold off to the hived down subsidiary, then the plaintiffs would no longer be able to exercise their rights. Accordingly, the plaintiff sought an injunction against the company and it was held that the receiver could not be prevented from carrying out his proposed cause of action on the grounds that a receiver ordinarily cannot be forced to cause the company to perform a pre-receivership contract.

The receiver is, pursuant to the provisions of s 316(2) CA 1963, deemed to be personally liable on any contract entered into by him unless he specifically excludes personal liability. He is entitled to an indemnity out of the assets of the company coming into his hands.

9.4 Advising the receiver when appointed

9.4.1 Deed of Appointment

As we have seen above, the Deed of Appointment does not have to be in any specific format. The particulars listed in section 9.2.6 above should be included and the requirements set out for valid execution should also be complied with.

9.4.2 Acceptance

Receipt by the receiver of notification of his appointment is a condition precedent to the coming into effect of the appointment. The appointment commences on the date on which the receiver, having been handed the Deed of Appointment or having otherwise been informed of it, expressly or impliedly accepts the appointment.

9.4.3 Publication

Notice of the receivership must be made by:

(a) publishing notice of the appointment in the prescribed form in newspaper/Iris *Oifigiúil* (s 107 CA 1963);
(b) giving notice to the company and its directors;
(c) all notepaper, invoices, letters, orders, statements and other documents must contain a statement as to receivership usually complied with by inserting 'In Receivership' in brackets after the name of the company.

Under s 107 CA 1963, a person who appoints a receiver must within seven days of the appointment:

(a) publish in one daily newspaper circulating in the district where the registered office of the company is situated a notice in the prescribed form; and
(b) deliver to the Register of Companies a notice in the prescribed form (Form No 53).

9.4.4 Notification

Under s 319 CA 1963, where a receiver of the whole or substantially the whole of the property of a company is appointed on behalf of the holders of any debentures secured by a floating charge, the receiver has to send notice to the company of his appointment. Section 319(2A) CA 1963 (as inserted by s 52(b) of the Company Law Enforcement Act 2001) requires that when the Registrar of Companies becomes aware of the appointment of a receiver, he shall inform the Director of Corporate Enforcement of the appointment. The Registrar should 'become aware' by receiving a notice from the person appointing the receiver, as required by s 107 CA 1963.

Under s 317 CA 1963, where a receiver has been appointed over the property of the company, every invoice, order for goods or business letter issued by or on behalf of the company or the receiver or the liquidator of the company, being a document on or in which the name of the company appears, must contain a statement that a receiver has been appointed. There is provision for a fine of €128 for an offence under this section. The section is normally complied with by inserting after the name of the company in brackets the words 'In Receivership'.

9.4.5 Insurance

As part of the general duty of care owed by a receiver to the company, the receiver should ensure that sufficient insurance is in place in respect of the assets of the company. The receiver should also examine the particular terms and conditions of the insurance policies to ensure that he would be regarded as the person entitled to receive the proceeds. It may well be that the receiver would be entitled to take possession of the assets of the company but would not be entitled to take possession of the proceeds of insurance policies in the event that such assets were destroyed by fire, etc. In such circumstances, the receiver ought to ensure, so far as possible, that his interest is noted on the policies, or, alternatively, should effect insurance in his name as well as that of the company.

In addition, the receiver should ensure that he has sufficient professional indemnity insurance to ensure indemnity in the event that any actions are brought against the receiver in relation to conduct of the receivership. This would be in addition to the indemnity which the receiver would have obtained from the debenture-holder.

9.4.6 Rivals

It is quite possible that more than one receiver could be appointed over the company's assets. It is possible that a number of charges/debentures could co-exist, providing for receivers to be appointed over different assets of the company. As stated in section 9.1.2 above, the appointment of a receiver over any part of the assets of the company is usually recited as one of the grounds on which a receiver may normally be appointed. If there is any conflict in respect of assets, then the first receiver appointed takes possession of the assets. For example, if there were two successive debentures, each of which included, say, the book debts of the company, the first receiver in time appointed would be entitled to collect the book debts, and the subsequent appointment of another receiver would not affect the powers of the first receiver.

Another potential rival to the receiver is a liquidator. Generally speaking, the appointment of a liquidator does not prevent the subsequent appointment of a receiver and the appointment of a receiver does not prevent the appointment of a liquidator. The appointment of a liquidator and its effects on the agency of the receiver vis à vis the company are dealt with in greater detail in section 9.7 below. Section 319 CA 1963 provides for certain obligations of disclosure on the part of the receiver. If necessary, these may also be enforced by the liquidator. Furthermore, s 322(1)(b) CA 1963 states that a liquidator, if appointed, may insist that the receiver account to him, the liquidator, for all receipts and payments and that he pay over the balance, if any, due.

9.4.7 Reservation of title

See the separate chapter on this subject in the *Commercial Law* book (Law Society of Ireland, 2001).

9.4.8 Resignation/removal

Resignation must be on notice to the court, liquidator, company and charge-holders: see s 322C CA 1963 (as inserted by s 177 of the 1990 (No 2) Act).

Section 315 CA 1963 prescribes who is qualified for appointment as receiver of a company. This is dealt with in greater detail above. However, if during the course of a receivership the receiver finds that were he now to be appointed as receiver to the company he would not be eligible, then s 315(2) requires him to vacate the office of receiver and give notice to the company, the Registrar of Companies, the debenture-holder or the court, depending on who appointed the receiver, of the fact that he has vacated the position of receiver, by reason of the fact that he would be disqualified if he were now to be appointed.

Section 322C CA 1963 (as inserted) now provides a procedure whereby the receiver may resign. It has been thought by some, up to the passing of the 1990 Act, that the resignation of a receiver might constitute a breach of contract as between the receiver and the debenture-holder under the terms negotiated between them, and on foot of the notice of appointment. However, s 322C (as inserted) specifically provides for a power of resignation and this can now be regarded as overriding any contractual provisions between the parties. The section provides that the receiver may resign, provided he has given one month's notice of his intention to resign to:

(a) the holders of floating charges over all or any part of the property of the company;
(b) the company or its liquidator; and
(c) the holders of any fixed charge over all or any part of the property of the company.

Section 322C(2) (as inserted) provides that, if the receiver is appointed by the court, he may only resign with the authority of the court and on such terms and conditions, if any, as may be imposed by the court.

9.4.9 Restriction/removal

The powers and functions of the receiver may be limited in whole or in part or the receiver may be removed. Under s 322B CA 1963 (as inserted by s 176 of the 1990 (No 2) Act), the liquidator of a company that has been wound up (other than by means of members' voluntary winding up) and in respect of which a receiver has been appointed, may apply to the court and the court may order that the receiver shall cease to act as such from a specified date or prohibit the appointment of any other receiver or may order that the receiver act only in respect of certain assets specified by the court. Such an order can be made on such terms and conditions as the court thinks fit and the court may subsequently rescind or amend any such order.

Also under s 322A CA 1963 (as inserted by s 175 of the 1990 (No 2) Act), the court may, on cause shown, remove a receiver and appoint another receiver.

9.5 Director of Corporate Enforcement

9.5.1 Notification

Section 319(2A) CA 1963 (as inserted by s 52(b) of the Company Law Enforcement Act 2001) is a requirement that when the Registrar of Companies becomes aware of the appointment of a receiver, he shall inform the Director of Corporate Enforcement of the appointment. The Registrar should 'become aware' by receiving a notice from the person appointing the receiver, as required by s 107 CA 1963.

Section 319(7) CA 1963 (as amended by s 52(a) of the 2001 Act) provides that where a receiver ceases to act, his final return shall include a statement of his opinion as to whether or not the company is solvent and the Registrar of Companies is obliged to forward a copy of this documentation to the Director. This opinion will be relevant to the Director in considering whether to exercise his powers in respect of a company which is not liquidated following receivership, due to insufficiency of assets.

It is difficult to understand why the 2001 Act did not impose a requirement for direct notice to the Director, but it is to be presumed that, in practice, receivers will also notify the Director directly.

9.5.2 Production of books and records

Section 53 of the 2001 Act allows the Director to seek production of the books and records of a receiver. The Director may, 'where he considers it necessary or appropriate', request the production of the receiver's books for examination, being either the books regarding a particular receivership or the books of all receiverships undertaken by that receiver, subject only to a limitation that any request may not relate to a receivership which ended more than six years prior to the request being made. The requirement for the Director to consider it 'necessary or appropriate' does not apply under s 57, which is the corresponding section dealing with liquidators. There is no corresponding section dealing with examiners.

The Director's request to the receiver must specify the reason why the request is being made. Where the request is made, the receiver is obliged to furnish the original books to the Director 'for examination', even though the case may be ongoing. The receiver is also obliged to answer 'any questions concerning the content of the books and the conduct of a particular receivership or receiverships, and give to the Director all assistance in the matter as the receiver is reasonably able to give'.

A question obviously arises as to whether the receiver must actually deliver the books to the Director at his offices (in Parnell Square, Dublin) or whether he can fulfil the requirement as to 'production' by making them available at the offices of the receiver. Where the matter is ongoing, and/or where the Director wishes to put questions to the receiver, the latter may not be an unreasonable position to adopt, particularly as the failure to comply with the request or answer a question is a criminal offence and the benefit of any doubt as to interpretation must be given to the receiver.

9.5.3 Disciplinary findings

Where the disciplinary committee of a prescribed professional body (being a body set up by the Minister under a statutory instrument) makes a finding that a member of a professional body has not maintained appropriate records or has reasonable grounds for suspecting that the member has committed an indictable offence under the Companies Acts in the course of a receivership (or liquidation), the professional body must report the matter to the Director forthwith, giving details of the finding, or, as the case may be, the alleged offence.

9.6 Advising creditors

Creditors can be broadly divided into five classes:

(a) secured creditors;
(b) special creditors;
(c) preferential creditors;
(d) unsecured creditors; and
(e) judgment creditors.

9.6.1 Secured creditors

Secured creditors are those creditors who have advanced monies to the company secured over the assets of the company. The debenture-holder who appointed the receiver would fall into this category, but the receiver must ensure by carrying out a Companies Office search that there are no other secured creditors with a charge ranking in priority to his own charge. If there are prior charges the rights of such debenture-holders must be recognised by the receiver, even though he has not been appointed by the debenture-holder concerned. There may also be a secured creditor with a second fixed charge ranking after the fixed charge for the debenture-holder but ahead of his floating charge. Again, the receiver must recognise the rights of such second fixed charge-holder.

9.6.2 Special creditors

Special creditors include hire purchase companies, landlords, public services, general rates, and persons holding liens. The hire purchase company's right to repossess its goods means that its claim is in a special position; the receiver must evaluate the equity held by the company under such agreements. In relation to landlords, if there are neither arrears of rent nor breaches of covenant the landlord is not entitled to terminate a lease upon the appointment of a receiver unless the lease specifically provides that he may do so. Although the receiver is not a party to the lease and not personally liable, he may have to pay rent with arrears and perform necessary obligations if he wishes to avoid forfeiture of the lease. He is not obliged to pay any rent if he considers it advantageous to allow the landlord to forfeit the property: *Hand v Blow* (1901) 2 Ch 721. Although a clause in a lease may provide that the landlord can terminate the lease upon the appointment of a receiver, the latter can usually negotiate with the landlord in order to remain in occupation or dispose of the unexpired term of the lease for the benefit of the debenture-holder. If there are arrears of rent the landlord has the right to distrain on any goods of the company remaining on the premises.

The public services, such as gas, electricity and water supply, are in a special position, as it is usual for the suppliers of such services to threaten to withhold further supplies unless their arrears are paid in full. A receiver is not a new customer with a statutory right to supply if he is acting as agent of the company, although a subsidiary is a new customer and one of the bonuses of hiving down is that, in principle, whatever the reluctance of the utilities may be, the subsidiary is entitled to a supply of gas or electricity. The receiver will usually be asked to give an undertaking to the utility company agreeing to pay arrears (and for the service used by the receiver) upon disposal of the company's assets.

Local authority rates are frequendy in arrears when a receiver is appointed. The receiver appointed is a new occupier and therefore not liable to pay arrears of rates except insofar as these are preferential (those which have become due and payable within one year before the date of appointment).

Frequently there will be claims for a lien raised by solicitors and others, and in all cases, the receiver should verify that the lien is valid and examine the conditions of contract incorporating such liens.

9.6.3 Preferential creditors

Section 98 CA 1963 provides that, on the appointment of a receiver on behalf of the holders of any denture secured by a floating charge or where a debenture-holder enters into possession of property subject to the charge, certain debts are to be paid as preferential. Those are the debts set out in s 285 CA 1963 (as amended from time to time).

9.6.4 Unsecured creditors

The prime duty of the receiver is to realise sufficient assets in order that a full settlement may be made to the debenture-holder and preferential creditors, and a receiver does not owe any duty to unsecured creditors. However, it is good practice for him to become aware of any claim for retention of title or set-off.

9.6.5 Judgment creditors

Where execution has been levied by a creditor before the receiver is appointed, the receiver should immediately give notice to the sheriff who has levied the execution. The receiver should claim the relevant assets as the title of the debenture-holder prevails over execution creditors who have not completed their execution at the time of the receiver's appointment. A Garnishee Order is similarly defeated by appointment of a receiver except to the extent of monies already paid to the creditor (*Carney v Back* [1906] 2 KB 746).

It is, therefore, important that the receiver notifies the sheriff as soon as he has been appointed, and thus secures the position of the company.

9.6.6 Difference in treatment

Creditors can be divided into five types, as to which see section 9.6. above. As to priorities see s 98 CA 1963. As between preferential and secured creditors see *United Bars Ltd (In Receivership), Walkinstown Inn Ltd (In Receivership) and Raymond Jackson, Plaintiff v Revenue Commissioners* [1991] IR 396 and *Eisc Teoranta (In Receivership and in Liquidation)* [1991] ILRM 760.

In the first case, Murphy J held that surplus monies should be paid to the company (and not to the preferential creditors in accordance with s 98) as he held that s 98 applied only to monies received from the realisation of assets subject to a floating charge and not assets subject to a fixed charge. Also as a general principle, he decided that monies received by a receiver on realising assets subject to a fixed charge, surplus to the sums due to the debenture-holder, were to be paid to the company rather than the preferential creditors.

In the second case, Lardiner J held that the duty created by s 98, which arose where a receiver was appointed on behalf of the holders of any debentures secured by floating charge, was not terminated or affected by a winding up order made subsequent to the appointment of a receiver and that the receiver did not in fact need to make any payment out of the assets which were the subject of the floating charge.

See also discussion under Advising contractors and suppliers' at 9.3 above.

From the creditors' side the following matters should be considered on the appointment of a receiver.

9.6.7 Reservation of title/unpaid seller

Do the terms of the unpaid seller's contract with the company provide for retention of title? If so, he should assert his right as soon as possible. If delivery of the goods supplied has not yet taken place, the creditor may be able to rely on the right of stoppage in transit under which the supplier gives instructions to the carrier to return the goods to him; clearly it is necessary to act very quickly in order to exercise this right which arises under s 44 of the Sale of Goods Act 1893.

The creditor should consider whether he can claim a set off in respect of monies due to the company in receivership.

If the receiver is continuing the business of the company, he may require continuing supplies from the company's previous suppliers. In that case, the creditor should ensure that he obtains written confirmation of orders signed by the receiver or an authorised member of his staff so that the receiver is liable personally to pay for any such continuing supplies made after the date of receivership.

9.7 Advising a liquidator appointed to the company

A floating charge created within 12 months prior to the commencement of a winding up is invalid as to any prior advances unless the company was solvent 'immediately' after the creation of the charge (see s 288 CA 1963). A company is solvent if it can pay its debts as they fall due (see s 286 CA 1963 as to fraudulent preference).

9.7.1 Effect of appointment on the receiver

Ordinarily the instrument creating the debenture confers on the holders or their trustees a right to appoint a 'receiver and manager'. A supervening liquidation will not affect their right to appoint. Indeed, that standard form of debenture specifies the presentation of a petition or a resolution for a voluntary liquidation as events which give rise to an immediate liability to repay all outstanding principal and interest and to a right to appoint a receiver and manager. Just as the event of liquidation does not prevent the appointment of a receiver, the appointment of a receiver does not prevent a liquidation.

The commencement of a winding up, in particular the appointment of a liquidator, may deter a potential receiver and manager from accepting a preferred appointment if he has reason to suspect that the charge under which his appointment would be made is in any way vulnerable. The charge may be a fraudulent preference or infringe the statutory provisions restricting the creation of floating charges within a certain period prior to a winding up. It may not have been registered or properly executed or there may be some other flaw.

9.7.2 Effect on receiver's agency

Usually the mortgage debenture provides that a receiver and manager appointed thereunder shall be the agent of the company. A compulsory winding up order automatically terminates that agency. Likewise, the commencement of a voluntary winding up, by the passing of a resolution to wind up, brings to an end the agency of a receiver and manager. As far as the receiver is concerned, although he retains his right to custody and control over the company's assets, the company whose agent he is no longer has full and free capacity to continue its business in terms of the objects in its memorandum. The company cannot authorise the receiver to do any act which it is unable to do itself, so that it cannot empower the receiver, after the date of the liquidation, to carry on its business so as to create debts provable against the unmortgaged assets of the company; but the receiver can still continue to exercise his powers in the name of the company, although the company is no longer liable for any debts which he may incur in so doing. The agency ends, but not the receivership, and the receiver is still in control. His position is peculiar and made more difficult. He cannot bind the company with fresh obligations. Acting, as he does, as a principal he will be personally liable in respect of contracts, albeit with the right to be indemnified out of the assets of the company. If, despite the termination of his agency, he purports to act in the name of the company, he may be held liable for breach of warranty or authority.

9.7.3 Effect on receiver's powers

While a compulsory winding up order or the commencement of a voluntary winding up brings to an end the agency of the receiver and manager, some of his powers survive the death of his agency. He may continue to carry on the company's business, although not so as to impose fresh liabilities on the company. He is, of course, entitled to take possession of the assets comprised in the debenture, and so that power remains. He may continue to get in and realise all the company's assets, both real and personal, comprised in the debenture. Again, he retains the power to continue proceedings in the name of the company in order to collect assets of the company comprised in the debenture. The termination of the authority of the receiver to act as agent of the company does not affect his power to hold or dispose of property comprised in the debenture.

Another power, which remains undisturbed by the event of liquidation, is the right of the receiver and manager to retain all documents needed to evidence the title of the debenture-holder. If those documents have found their way into the hands of the liquidator, they can be recovered.

9.7.4 Effect on receiver's duties

The receiver is subject to an obligation to deal with preferential creditors in accordance with s 98 CA 1963.

9.7.5 Effects on receivership of appointment of liquidator

The priority of charges registered will obviously also be relevant if one is acting not for the receiver but for a party who wishes to challenge the appointment of the receiver or the validity of the debenture under which the receiver is appointed, for example, the company itself or an unsecured creditor of the company or a liquidator of the company. Since the facts may, however, be difficult to check without winding up the company such person may also have to consider liquidating the company and this will definitely be necessary if one wishes to be able to invoke the provisions of s 288 CA 1963 (as amended) which provides:

> Where a company is being wound up, a floating charge on the undertaking or property of the company created within 12 months before the commencement of the winding up shall, unless it is proved that the company immediately after the creation of the charge was solvent, be invalid, except as to money actually advances or paid, or the actual price or value of goods or services sold or supplied, to the company at the time of or subsequently to the creation of, and in consideration for, the charge, together with interest on that amount at the rate of 5 per cent per annum.

For the purposes of s 288(1), the value of any goods or services sold or supplied by way of consideration for a floating charge is the amount in money which at the time they were sold or supplied could reasonably have been expected to be obtained for the goods or services, in the ordinary course of business, and on the same terms (apart from the consideration) as those on which they were sold or supplied to the company.

Where a floating charge on the undertaking or property of a company is created in favour of a connected person, s 288(1) shall apply to such a charge as if the period of 12 months mentioned in that subsection were a period of two years.

9.7.6 Connected persons

In this section 'a connected person' means a person who, at the time the transaction was made, was:

(a) a director of the company;
(b) a shadow director of the company;
(c) a person connected, within the meaning of s 26(1)(a) of the Companies Act 1990, with a director;
(d) a related company, within the meaning of s 140 of the Companies Act 1990; or
(e) any trustee of, or any surety or guarantor for the debt due to, any person described in paragraph (a), (b), (c) or (d).

This section does not avoid the debt itself so that the debenture-holder can still prove in the winding up as an unsecured creditor for a debt incurred before the floating charge was given to secure it, or for interest in excess of five per cent.

When a floating charge is invalidated by the company being wound up, the charge is invalidated for all purposes so that mortgagees and others may assert rights against property subject to the floating charge and thus prevent the liquidator from taking it for the benefit of the unsecured creditors of the company. See *Capital Finance Co Ltd v Stokes* [1968] IR 573.

9.7.7 Time of creation of the charge

It should be noted that the courts have liberally construed the requirement that the loan should be made at the time of or subsequently to the creation of the floating charge so as to uphold it in the company's liquidation. If a loan is made on the understanding that a floating charge will be given as security, the charge is taken as being created at the time the loan is made even though the debenture is not actually executed until some time after the lender advances his money, provided the company's promise to give the floating charge is unconditional (*Re Columbian Fireproofing Co Ltd* [1910] 2 LR 120; Re *FE Staunton (No 2)* [1929] 1 LR 180.

The section will not apply if the debenture-holder can prove that the company was solvent immediately after the creation of the charge. It has been held that a company is not solvent at the time unless it is able to pay its debts as they fall due: *Re Patrick and Lyon Ltd* [1933] Ch 7861. Therefore, the mere fact that the value of its assets exceeds its total liabilities does not necessary mean that the company is solvent.

9.7.8 Rule in *Clayton's Case*

Note the application of the rule in *Cloyton's Case* (1816) 1 Mer 572 if a company goes into liquidation within 12 months of the creation of a floating charge. All monies paid into the company's bank account after the floating charge is executed are deemed to have been appropriated to reduce the debt outstanding at the time of execution, and all subsequent drawings amount to new lendings secured by the charge. Therefore, if the amount so paid in equals or exceeds the debt outstanding at the time of execution, the charge will be fully effective. See *Re Thos Mortimer Ltd (1925)* [1965] 1 Ch 187 and *Re Yeovil Glove* [1965] Ch 148.

9.7.9 Fraudulent preference

Under the provisions of s 286 CA 1963, any mortgage, debenture or other act created or done within six months before commencement of its winding up which would in the case of an individual be void as a fraudulent preference in bankruptcy is likewise void in the event of the company being wound up, but there can be great difficulty in successfully invoking this section as it is necessary that the mortgage, debenture or other act was entered into with a view to preferring the mortgagee over other creditors.

However, it may now be easier for a liquidator to prove fraudulent preference than it has been in the past, in view of the decision in *Re FP and CH Matthers Ltd* [1982] 1 All ER 339. Here, the Court of Appeal held that a payment was made with a view to giving a creditor preference over the other creditors within the meaning of s 44 of the Bankruptcy Act 1914 if at the time of making the payment the debtor knew that he could not pay his debts as they arose and intended to pay one of his creditors in full ahead of the others; it was not sufficient for a debtor to genuinely believe that all the creditors would be paid three to six months in the future.

There is no fraudulent preference if the mortgage is not given voluntarily If the company pays a debt under the threat of legal proceedings, there is no preference, but a company cannot be said to discharge an obligation under the threat of legal proceedings when the obligation is owed to its own directors. Where the directors benefit from a transaction, the court is more willing to infer an improper motive. An improper motive was inferred when directors who had guaranteed the company's bank overdraft repaid it at a time when they knew the company was insolvent and when they had already stopped paying its current trading debts (*Re M Kushler Ltd* [1943] 2 Ch 481) and similarly a mortgage of the company's property which the directors gave to themselves as an indemnity against their liability under their guarantee of the company's overdraft was held to be a fraudulent preference (*Gaslight Improvement Co v Terrell* (1870) LR 10 EG 168).

The result of a transaction being held to be a fraudulent preference is that the liquidator may recover the money paid or property transferred to the creditor, or have any mortgage or charge given to him set aside. The money or property recovered is distributable among the creditors of the company generally and the holder of a floating charge on the company's undertaking has no prior charge on it.

Note: since the Companies Act 1990, it is open to a liquidator to apply under s 322 CA 1963 (as amended by s 176 of the Companies Act 1990) to limit or bring to an end a receivership. The liquidator can also seek the co-operation of the lender to have the receiver removed without the necessity for a court application.

9.8 Advising directors

9.8.1 Directors' Statement of Affairs

The provisions which govern the Statement of Affairs are ss 319–20 CA 1963. Section 319 CA 1963 requires the directors to submit a Statement of Affairs of the company, in the prescribed form, to the receiver within 14 days after the receipt by the company of notice of appointment of the receiver. Frequently, the directors will turn to their solicitor for advice in relation to completing such a statement and if they fail to complete it, they are liable to a fine. The values attributed to assets of the company should be modestly valued, as the statement would be filed in the Companies Office and would be available to creditors of the company in the event of a liquidation taking place. The directors are entitled to their costs for the preparation of the Statement of Affairs from the receiver.

The receiver, within two months of receipt of the Statement of Affairs, has to send a copy of it and of any comments he sees fit to make on it to the Registrar of Companies, to the company, to any trustees for the debenture-holders on whose behalf he was appointed, to the debenture-holders and to the court if he was appointed by the court.

Section 320 CA 1963 provides that the Statement of Affairs must show as at the date of the receiver's appointment particulars of the company's assets, debts and liabilities, names and residences of this creditors, and information about their securities. The Statement of Affairs is to be submitted by, and verified by affidavit of, one or more of the directors and by the secretary or by such other persons named in the section as a receiver may require. The receiver, out of his receipts, has to allow the reasonable costs and expenses incurred in preparing the Statement of Affairs.

9.8.2 Suspension of powers

Directors have no ongoing say in the business and are not removed. They are in effect in a limbo situation. In considering the effect of a receivership on the powers of directors, it is important to bear in mind the distinction between a receiver on the one hand, and a receiver and manager on the other. A receiver appointed over a specific property of the company has no power of management of the company's business and accordingly the management powers remain with the directors. A receiver and manager appointed under the terms of a floating charge has considerable powers of a management but, since a company cannot be managed by two different and conflicting managements, it is the management by the receiver which prevails. However, the appointment of a receiver and manager does not remove all the functions of the directors and they have some continuing powers and duties. For example, their statutory duties in relation to the preparation of annual accounts, the auditing of those accounts and calling of statutory meetings with shareholders, maintaining the Share Register and lodging of returns remain. Indeed, the directors can start proceedings in the name of the company without the receiver's consent, as happened in the case of *Newhart Developments Ltd v Co-operative Commercial Bank Ltd* [1978] QB 814 and a similar challenge was mounted in the *Irish Oil and Cake Mills Ltd* case in Ireland (High Court, 27 March 1984, unreported).

9.8.3 Proceedings

With the consent of the receiver, the directors may defend proceedings brought against the company. The receiver may in many cases have no interest in defending such proceedings as the plaintiff may be an unsecured creditor only and accordingly not of concern to the receiver.

9.9 Advising shareholders/guarantors

There is little or no effect on shareholders and guarantors. Their rights are unchallenged. Frequently the directors and/or the shareholders will have issued personal guarantees to the debenture-holder and it is very important to them that the receiver obtain the best possible price for the assets of the company so as to minimise their liability. The receiver's duty is to obtains the best price bearing in mind his liability to guarantors of the company and possibly even to ordinary creditors for negligent mishandling of a sale of the company's property. This liability has been acknowledged in the case of *Standard Charted Bank Ltd v Walker* [1982] 3 All ER 938. This case underlines the importance of the receiver obtaining professional advice to confirm the reasonableness of the price at which he proposes to sell the company's assets; if the receiver has a particular concern he is at liberty to apply to the High Court for directions pursuant to s 316 CA 1963.

9.10 Advising employees

The appointment of a receiver out of court by the debenture-holders does not terminate contracts of employment except where the continuation of the employment of some particular employee would be inconsistent with the receivership itself. For example, it has been held that the appointment of a full-time receiver would automatically terminate the contract of a managing director: *Griffiths v Secretary of State for Social Services* [1974] QB 468.

If the receiver proposes to sell any part of the company's business, he must abide by the provisions of the European Communities (Safeguarding of Employees' Rights on Transfer of Undertakings) Regulations 1980, SI 306/80, which implemented Council Directive (EEC) No 77/187 of 14 February 1977 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses (as amended). These require him, *inter alia,* to consult with and inform employees' representatives.

In addition, he is bound to observe the consultation and notification procedures prescribed by the Protection of Employment Act 1977, particularly if collective redundancies are anticipated. A receiver appointed out of court does not incur any personal responsibility for employees since, for example, if the receiver dismisses an employee he will be deemed as doing so as agent of the company except to the extent that he might have renewed the contract of employment or made a fresh one or has not disclaimed personal responsibility under s 316(2). Section 316(2) provides that a receiver of the property of a company is personally liable on any contract (including an employment contract) entered into by him in the performance of his functions, whether or not the contract is entered into by him in the name of the company or in his own name as receiver or otherwise, unless the contract specifically provides that he is not to be personally liable. The subsection also provides that the receiver is entitled to an indemnity out of the assets of the company in respect of that liability. A receiver who is appointed by the court is substituted as an employer and therefore becomes personally responsible and liable for all the usual consequences of a dismissal of an employee.

If the receiver is appointed under a debenture, this has no effect on the employees, as the receiver is the agent of the company. If the receiver is court-appointed, employees' contracts are terminated.

9.10.1 Receiver appointed under a debenture

If the receiver is appointed under a debenture, it does not affect the employees, as the receiver is the agent of the company. If court-appointed, contracts are terminated. The rights of employees are a matter of great importance both to the employees concerned and to the receiver. The receiver should decide as soon as possible whether he wishes to continue the employees' contract or dismiss them. Dismissal by a receiver amounts to redundancy, and the employee will seek the necessary forms from the receiver to enable him to obtain payment from the Redundancy Fund operated by the Minister for Labour (see the Protection of Employment (Employers' Insolvency) Act 1984). The receiver must be careful, if he continues the employment of the company's employees, that he does not take any action in relation to those contracts which would lead to the contract being deemed a new contract for which the receiver would be personally liable.

The general rule is that the appointment of a receiver who is the agent of the company does not of itself automatically terminate contracts of employment: *Re Foster Parks Ltd Indenture Trusts* [1966] 1 WLR 125. The rule also was applied in *Re Mack Trucks (Britain) Ltd* [1976] 1 All ER 977. This is in contrast to the position on the appointment of a liquidator. However, there are certain exceptions, for example, in the case of a sale or hiving down of the business or if the receiver enters into a new agreement with a particular employee which is inconsistent with the old agreement or where the continuation of the employee's services is inconsistent with the role and functions of the receiver.

9.10.2 Action against the receiver

One potential remedy that any dismissed employee should consider is his remedy for wrongful dismissal. If the dismissal amounts to a repudiation of his contract, there is a civil remedy in damages, although this remedy may be rather academic if the company is insolvent. However, the remedy can be of value if the receiver on his own personal responsibility has retained the employee and then wrongfully dismissed him, as the receiver can then be sued personally.

The question of whether an employee can take action for unfair dismissal, because he has been unfairly selected for redundancy or been dismissed as a result of a transfer of a business or because the company has failed to observe the statutory consultation periods, depends on whether the receiver can demonstrate that the dismissal was for 'economic, technical or organisational reasons entailing changes in the work-force'.

9.10.3 Preferential payments

Remuneration and other awards due to employees when a company goes into receivership have preferential status under s 285 CA 1963 and the Redundancy Payments Acts; preferential status is, however, limited to a maximum payment of £2,500 in respect of wages and holiday pay for each employee, plus their redundancy entitlement.

The best course for a receiver who wishes some or all of the employees to continue is to go on making payments of wages, salaries, etc, under their existing contracts. If he does not need their services, he should inform them that money is not available to continue payment of their remuneration and they should regard their employment contracts as terminated. This will reduce the risk of the receiver becoming personally liable for redundancy payments, unfair dismissal and other claims. If the receiver finds it essential to change any of the contracts of employment in ways that may amount to adopting them, to re-engage employees or to engage new employees, he should always try to do so as agent for the company and on basis that his personal liability is expressly excluded: see *Re Mack Trucks (Britain) Ltd,* cited above.

9.10.4 Continuity/transfer of employment.

It should be noted that the appointment of the receiver or even his personally entering into fresh contracts of employment with the employees does not of itself constitute a break in the continuity of employment for the purpose of calculating redundancy payments.

A purchaser of the business from the receiver will wish to know that the receiver has made all employees redundant prior to taking over the business to ensure that there is a break in service, so that the purchaser does not inherit lengthy periods of service giving rise to substantial redundancy payment claims in the future. Where the receiver has hived down the business of the company to a subsidiary company there will be a continuity of employment if the subsidiary company has adopted the contracts of employment. Such hive down operations are particularly subject to Council Directive (EEC) 77/187 (as amended) and to the Transfer of Undertakings (Protection of Employment) Regulations 1980 (SI 303/1980). The purpose of the regulations is to safeguard employees' rights in the event of a transfer of undertakings, businesses and parts of businesses. This is achieved by providing that on a relevant transfer of a business all the rights and obligations of employment contracts are automatically transferred.

9.11 Sale of the company/assets by a receiver

The power to sell is one of the standard powers conferred on a receiver (and manager). The need for a conveyancing power is a consequence of the nature of a floating charge. The full nature and extent of the power of sale is set out at 8.4.3 above under the title 'Receiver's powers of sale'. That section should be re-read at this point.

9.11.1 Hive down

It is possible that some portion of the company's business is viable and if that is the case then the receiver should consider selling off that part of the business by means of what is commonly referred to as a 'hive down'. Part or the entire successful/viable portion of the business would be transferred to a new company, which would be controlled by the receiver. The shares in the new company would then be sold in the expectation that a far better price would be obtained by this means rather than by a straightforward sale of the assets. Essentially the receiver would be selling a business rather than selling assets. It is not unusual to find that the purchasers of the shares in such circumstances would be former employees or executives of the company.

There are certain advantages to be gained by such a course of action. If the assets are transferred into a new company, which is controlled by the receiver and the trading is done by that company, then the receiver could not be held personally liable on any contracts entered into by that company in the course of the business. Those contracts would be binding on the hive down company and not on the receiver. The profitable assets of the company, along with tax losses, could be transferred into the new company, making it a very attractive purchase proposition. The hive down, unless it commences trading, will not have any debts of its own and will not be responsible for the old company's debts and liabilities. A case in point would be that *of Airline Airspace Ltd v Handley Page Ltd* [1970] 1 Ch 193. See 9.4.3 above for the facts of this case.

If the entire business of the company is hived down, then the employees of the company are treated as having been dismissed. If the hive down of the company's business is of only a part of the business, it depends on the circumstances whether particular employees' contracts have been determined. If employees are taken on by the hive down company, then under the European Communities (Safeguarding of Employees Rights on Transfer of Undertakings) Regulations 1980, the old company's rights and obligations regarding employees are transferred to the new company.

9.12 Checklists

Documentation required to be checked when checking the validity of appointment:

(a) **Memorandum and Articles of Association.**
Powers to borrow/give security?

(b) **Debentures.**
Creates the charge?

(c) **Minutes authorising securities.**

(d) Form C1.

(e) Certificate of registration.
Issued by registrar?

(f) Letter of demand.
Usual, before appointment of receiver. Valid demand? Precondition to appointment?

(g) The Debenture Deed.

Check the following:

- date of deed;
- stamp duty paid;
- registration date;
- nature of specific security;
- power to appoint receiver;
- circumstances when exercisable;
- nature of receiver's power.

9.12.1 Practical points to consider

Some practical points for consideration when advising the potential receiver are:

(a) scope of the proposed appointment;
(b) type of business involved and assets owed;
(c) other secured creditors, and whether there is any agreement between them;
(d) validity of appointment;
(e) reservation of title claims;
(f) hire purchase and/or leasing agreements;
(g) insurance arrangements;
(h) stock levels (particularly relevant if business is continuing);
(i) number of employees and whether they can/should be retained.

9.13 Some aspects of duties of care owed by debenture-holder or receiver

(a) Appointment of receiver:
Re Potters Oils Ltd (No 2) [1986] BCLC 98;
Shamji and Others v Johnson Matthey Bankers Ltd and Others [1986] BCLC 278.

(b) Supplying information:
McGowan v Cannon [1983] ILRM 516;
Irish Oil and Cake Mills Ltd and Another v Donnelly (March 1984, unreported, Costello J);
Gomba Holdings (UK) Ltd v Homan [1986] BCLC 331.

(c) Sale of property:
Cuckmore Brick Co Ltd v Mutual Finance Ltd [1971] 2 All ER 633.
Standard Chartered Bank Ltd v Walker [1982] 3 All ER 938.

9.14 Purchasing from liquidator or receiver

What special documents should be insisted upon when purchasing from a receiver or liquidator of a company? The proper standard of practice from a conveyancing point of view is set out in the following sections.

9.14.1 Liquidator

(a) Court liquidation:

- Official copy of winding up order of High Court.
- Ensure that court order contains appointment of liquidator. If not copy of order of such appointment should be obtained.
- Confirmation as to whether application made for order for sale. If so, obtain copy of such order.

(b) Creditors' liquidation:

- Copy of ordinary resolution of company as to winding up as filed in the Companies Office.
- Copy of resolution appointing liquidator.
- Copy of notice of appointment of liquidator with his endorsed acceptance of appointment as filed in the Companies Office.
- If directors are to be joined in sale, copy of authority of Committee of Inspection sanctioning the continuance of the powers of the directors (s 269(3) CA 1963).

(c) Members' liquidation:

- Copy of special resolution of company as to winding up as filed in the Companies Office.
- Copy of resolution of company appointing liquidator.
- Copy of notices of appointment of liquidator with his endorsed acceptance of appointment as filed in the Companies Office.
- If directors are joining in the sale, obtain copy of liquidator's authority sanctioning the continuance of the powers of directors (s 258(2) CA 1963).

9.14.2 Receiver

(a) Unregistered land:

- Satisfactory documentary evidence that the right to appoint receiver has arisen, for example that demand has been made but not met. Certified copy of appointment of receiver.

    - Original mortgage if all property in mortgage being released, or
    - Certified copy of mortgage if only partial release. A plain copy is never sufficient.

- Original release (and memorial) duly executed by bank and stamped (or cheque to cover it).

(b) Registered land:

- Satisfactory documentary evidence that the right to appoint receiver has arisen, for example that demand has been made but not met.
- Certified copy of appointment of receiver.

    - Original instrument creating charge is fully discharged.
    - Certified copy of instrument creating charge together with undertaking that original charge will be lodged in the Land Registry for the purpose of the dealing.

- Original deed of discharge duly executed by bank and stamped.
- Original certificate of charge either to be handed over or lodged in Land Registry depending on whether full or partial release.
- Letter addressed to Land Registry from party which originally lodged dealing in Land Registry that returnable documents should be sent to purchaser's solicitor on completion of dealing.

Other than those set out above, the normal requirements as to documentation and searches apply. It should be noted that where the mortgage or debenture affects lands other than the subject of the purchase, it is unnecessary to require an undertaking for production, safe custody or delivery of copies.

9.14.3 Execution of documents

As to the execution of documents the following rules apply:

(a) **Liquidator:**

The liquidator takes over the function of the directors and accordingly the execution of a Deed of Assurance by a company in liquidation should be effected by the affixing of the company Seal, which should be attested by the signature of the liquidator. The liquidator should also be joined in the Deed and executed as liquidator to confirm the sale.

(b) **Receiver:**

The receiver acts on behalf of the company and normally with the benefit of a power of attorney contained in the instrument under which he is appointed and signs the Deed of Assurance as attorney for the company.

One should check that the company is in receivership and that the required power to give a power of attorney exists and that such power of attorney was contained in the instrument under which the receiver is appointed. If any of the elements is missing, then the company and its directors must execute in the normal fashion, or the bank must convey as mortgagees.

CHAPTER 10

ALTERNATIVES TO WINDING UP, COMPANY VOLUNTARY ARRANGEMENTS AND EXAMINERSHIP AND OTHER FORMS OF RESCUE

Doug Smith

In this chapter, references to 'the Act' are references to the Companies (Amendment) Act 1990 (as amended by ss 180 and 181 of the Companies Act 1990 and as amended by the Companies (Amendment) (No 2) Act 1999). References to 'CA 1963' are references to the Companies Act 1963 (as amended).

10.1 Examinerships

10.1.1 Who may present a Petition

When advising a client who wishes to present a Petition for the appointment of an Examiner, the first thing which the solicitor must consider is whether or not that party has the requisite capacity to present a Petition under the Act. Section 3(1) of the Act provides that a Petition for the appointment of an Examiner under s 2 of the Act may be presented by:

(a) the company; or
(b) the directors of the company; or
(c) a creditor, including a contingent or prospective creditor (including an employee), of the company; or
(d) shareholders holding not less than one-tenth of shares carrying the power to vote at general meetings at the time of presentation of the Petition.

The above parties may present a Petition together or separately. Section 3(2) contains particular provisions dealing with insurers, banks and building societies which should be referred to if necessary. Section 3(5) provides that where a Petition is presented by a contingent or prospective creditor the court will not give the Petition a hearing until such time as security for costs is given.

10.1.2 The Petition

As soon as a Petition for the appointment of an Examiner is presented in the Central Office of the High Court the company is under protection pursuant to the Act. The extent of that protection is discussed below. Firstly, the nature and form of the Petition is dealt with here. Section 3(3) provides that a Petition shall nominate a person to be appointed Examiner. Section 3(3A) provides that the Petition shall be accompanied by the report of an independent accountant. In the absence of an independent accountant's report, an application to court for protection is necessary.

The Act provides that the independent accountant is somebody who is either the auditor of the company or a person who is qualified to be appointed as an Examiner of the company. In *Tuskar Resources plc* [2001] IR 668, the question of whether or not the independent accountant can then become the Examiner was considered by the court. It had been argued that an independent accountant would not be 'independent' if the purpose of his report was to determine whether he personally should or should not be appointed to the position of Examiner. Mr Justice McCracken indicated that:

> In view of the fact that the legislature did not take on itself to prohibit the independent accountant from acting as Examiner, I do not think that there is any statutory restriction on the court in so appointing him, although I can see there may be cases where it would be undesirable to do so.

Section 3(3B) of the Act details the fundamental requirements in respect of the contents of the report of the independent accountant. The report of the independent account must contain the following:

(a) the names and addresses of the officers of the company including shadow directors;
(b) the names of any other bodies corporate of which the directors of the company are directors;
(c) a statement of affairs of the company, which includes, where reasonably possible, the company's assets and liabilities (including contingent and prospective liabilities) as at the latest possible date and the names and addresses of its creditors, the securities held by them and the dates when such securities were given by the company;
(d) his opinion that any deficiency between the assets and liabilities has been satisfactorily accounted for or, if not, whether there is evidence of a substantial disappearance of property that is not adequately accounted for;
(e) his opinion as to whether the company, and the whole or any part of its undertaking, would have a reasonable prospect of survival as a going concern and a statement of the conditions necessary to ensure such survival, whether as regards the internal management and controls of the company or otherwise;
(f) his opinion as to whether the formulation, acceptance and confirmation of proposals for a compromise or scheme of arrangement would offer a reasonable prospect of the survival of the company, and the whole or any part of its undertaking, as a going concern;
(g) his opinion as to whether an attempt to continue the whole or any part of the undertaking would be likely to be more advantageous to the members and creditors as a whole than a winding up of the company;
(h) recommendations as to the course he thinks should be taken including, if warranted, draft proposals for a compromise or scheme of arrangement;
(i) his opinion as to whether further enquiries are warranted with a view to proceedings under ss 297 or 297A CA 1963;
(j) details of any funding requirements for the protection period and the source of those funds;
(k) his recommendations as to which pre-Petition liabilities should be paid;

(l) his opinion as to whether the Examiner would be assisted by a direction of the court in relation to the role or membership of any creditors' committee referred to in s 21 of the Act;
(m) anything else he considers relevant.

The report of the independent accountant is fundamental to the presentation of the Petition. Section 3A of the Act provides for interim protection pending the independent accountant's report for a period of 10 days, in exceptional circumstances outside the control of the petitioner. Thus, in circumstances where a Petition is presented in the absence of an independent accountant's report, the company is not under protection unless the court makes an order to that effect. This section provides that the court may make an order placing the company concerned under protection for such period as it thinks appropriate in order to allow for submission of the independent accountant's report. But this interim protection period shall expire not later than the tenth day after the making of the order unless that day falls on a Saturday, Sunday or Public Holiday, in which case it will expire on the first following day that is not a Saturday, Sunday or Public Holiday. It should be noted that the fact that a receiver stands appointed shall not, in itself, constitute exceptional circumstances outside the control of the petitioner. Section 3A(8) provides that any liabilities incurred by the company during this period of interim protection pending delivery of the independent accountant's report may not be the subject of a certificate under s 10(2) of the Act.

Order 75A r 4(3) of the Rules of the Superior Courts 1986 (hereinafter RSC) provides that the Petition shall comply with s 3(3) of the Act and shall also, insofar as applicable, comply with Form No 2 in Appendix M of the Rules.

Thus, the Petition must state the following:

(a) name and address of the petitioner;
(b) capacity of the petitioner;
(c) date of incorporation of the company in question;
(d) registered office of the company in question;
(e) nominal and paid-up share capital of the company in question;
(f) objects of the company in question.

In addition, s 2 of the Act provides that the Petition must show that:

(a) the company is or is likely to be unable to pay its debts;
(b) no resolution subsists for the winding up of the company;
(c) no order has been made for the winding up of the company.

10.1.3 Affidavit verifying contents of Petition

RSC Ord 75A r 4(3) provides that the Petition must be verified by affidavit. There is no particular form in the RSC for the verifying affidavit, but usually it would restate in more detail the contents of the Petition.

10.1.4 Duty to act in good faith

It is imperative that the Petition and verifying affidavit contain all matters which are material to the court's consideration of the application. In addition to the general obligation to act with utmost good faith in *ex parte* applications, s 4A of the Act contains a statutory duty to act in good faith. That section states as follows:

> The court may decline to hear a Petition…or, as the case may be, may decline to continue hearing such a Petition if it appears to the court that, in the preparation or presentation of the Petition or in the preparation of the report of the independent accountant, the petitioner or independent accountant:
>
> (a) has failed to disclose any information available to him which is material to the exercise by the court of its powers…; or
> (b) has in any other way failed to exercise utmost good faith.

10.1.5 Application for directions and the appointment of an Interim Examiner

RSC Ord 75A r 4(4) provides that a petitioner shall, on the same day as the presentation of the Petition, make an application to the court for directions. RSC Ord 75A r 5(1) provides that the court may make such order or orders as it thinks fit and may give such directions as it thinks fit. In particular, RSC Ord 75A r 5(1) indicates that the court may give directions as to the parties on whom the Petition should be served, the mode of service, the time for such service, the date for the hearing of the Petition (if different to that appointed by the Registrar) and whether the said Petition should be advertised and directions as to the mode of such advertising. RSC Ord 75A r 5(2) provides that the court may appoint any proposed Examiner as Interim Examiner with the same powers and duties in relation to the company until such time as the hearing of the Petition or such other adjourned date. In most cases the petitioner will apply for the appointment of an Interim Examiner. Generally, the reason for this is that the time period within which the Examiner must complete his task (70 days) (which may be extended by a further 30 days in certain circumstances) is relatively short and runs from the date of presentation of the Petition as opposed to the date of hearing of the Petition. Thus, it makes sense for the Examiner to begin his task as soon as possible.

10.1.6 The effect of presenting a petition

Section 5(1) of the Act provides that for a period of 70 days from the date of presentation of the Petition, which period may be extended by a further 30 days by s 18(3) of the Act, the company shall be deemed to be under protection. In essence, creditors are prevented from taking the type of action that we might normally expect.

Section 5(2) of the Act goes into some considerable detail in setting out the manner in which creditors' remedies are curtailed during the period of protection, as follows:

(a) no proceedings for the winding up of the company may be commenced or resolution for winding up passed in relation to that company and any resolution so passed shall be of no effect (even if a Petition for winding up has been presented or a meeting of members convened for the purpose of passing a resolution to wind up and appoint a liquidator to the company);
(b) no receiver may be appointed;
(c) no attachment, sequestration, distress or execution shall be put into force against the property or effects of the company, unless permitted by the Examiner;
(d) where any claim against the company is secured by a mortgage, charge, lien or other encumbrance or pledge, on or affecting the whole or any part of the property, effects or income of the company, no action may be taken to realise the whole or any part of that security, except where permitted by the Examiner;

(e) no steps may be taken to repossess goods in the company's possession under any hirepurchase agreement except where permitted by the Examiner. It should be noted that the definition of a 'hire-purchase agreement' includes a conditional sale agreement, a retention of title agreement and an agreement for the bailment of goods which is capable of subsisting for more than three months;
(f) where any third party (being any person other than the company) is liable to pay all or any part of the debts of the company none of the above-mentioned actions may be taken against that third party and no proceedings of any sort may be commenced against that party in respect of the debts of the company;
(g) no order pursuant to s 205 can be made by the court.

Previously, the Act provided that no set off between separate bank accounts of the company could be effected except with the consent of the Examiner. The Amendment Act of 1999 deletes this provision. Thus, it would seem logical that set off between separate bank accounts of a company is permitted, even though the company may be under protection.

In addition, no other proceedings in relation to the company may be commenced without leave of the court and subject to such terms as the court may wish to impose. Further, the court has discretion to make such order as it thinks proper in relation to any existing proceedings including an order staying such proceedings, upon the application of the Examiner.

10.1.7 The effect of presenting a Petition on a receiver

Where a receiver has been appointed to the company for a continuous period of at least three days prior to the presentation of the Petition, then the court may not hear a Petition for the appointment of an Examiner (s 3(6) of the Act). Where a receiver has been appointed for a period of less than three days and an Examiner is appointed, the court may make such order as it thinks fit including an order as to any or all of the following matters:

(a) that the receiver should cease to act from a date specified by the court;
(b) that the receiver shall, from a date specified by the court, act only in respect of certain assets specified by the court;
(c) directing the receiver to deliver all books, papers and other records, which relate to the property or undertaking of the company (or any part thereof) and are in his possession or control, to the Examiner within a period to be specified by the court;
(d) directing the receiver to give the Examiner full particulars of all his dealings with the property or undertaking of the company.

Section 98 CA 1963 provides that a receiver appointed on foot of a floating charge must discharge preferential payments as would be required in a winding up. Section 6A of the Act provides that the court may make an order restraining a receiver from making payments to preferential creditors in circumstances where an Examiner has been appointed or has not but in the opinion of the court may yet be appointed and where the making of such an order is likely to facilitate the survival of the company. Such an order may only be made where the preferential creditors are given an opportunity to be heard.

It should be noted that the Act is silent in relation to whether the three-day period mentioned above includes non-working days; and as insolvency assignments have a habit of arriving at 5 pm on a Thursday evening it should be presumed that non-working days are included in the calculation of this three-day period.

10.1.8 Effect of the appointment of an Examiner where a provisional liquidator stands appointed

Where a provisional liquidator stands appointed and the court makes an order appointing an Examiner, the court may make similar orders to those which it may make where a receiver stands appointed for a period of less than three days. However, in addition, the court may order that the provisional liquidator be appointed as Examiner.

10.1.9 Appointment

Section 2(2) of the Act (as amended by s 5 of the Companies (Amendment) (No 2) Act 1999) significantly changes the test which the court must apply in determining whether or not to appoint an Examiner pursuant to s 2 of the Act. The amended section provides as follows:

> The court shall not make an order under this section unless it is satisfied that there is *a reasonable prospect* of the survival of the company and the whole or any part of its undertaking as a going concern.

Previously, the court had considerably more discretion in arriving at its decision as to whether or not to appoint an Examiner. Mr Justice McCracken, in his decisions in relation to *Circle Network (Europe) Ltd* (15 February 2001, unreported, McCracken J) and *Tuskar Resources plc* considers at length the effect of the above amendment on the court's discretion in this regard. Consequently, the Petition must show evidence that there is a reasonable prospect of survival. Where the court appoints an Examiner, s 4 also gives the court jurisdiction to appoint the Examiner to be the Examiner of a related company. In these circumstances, the related company is also deemed to be under the protection of the court.

10.1.10 Notification of appointment

Section 12 of the Act sets out notification obligations in this regard, which are as follows:

(a) notice of the Petition must be delivered by the petitioner to the Registrar of Companies within three days of its presentation;
(b) notice of appointment as Examiner must be published by him in two daily newspapers within three days after appointment;
(c) notice of appointment as Examiner must be published by him in *Iris Oifigiúil* within 21 days after appointment;
(d) within three days after his appointment, the Examiner shall deliver a copy of the court order appointing him to the Registrar of Companies;
(e) where a company is under the protection of the court, every invoice, order for goods or business letter issued by or on behalf of the company shall include the words 'In Examination (under the Companies (Amendment) Act 1990)' immediately after the name of the company.

Failure to comply with these provisions is an offence and a person guilty of such an offence shall be liable to fines not exceeding the euro equivalent of £1,000 on summary conviction and the euro equivalent of £10,000 on conviction on indictment.

10.1.11 Examiner's powers

Section 7 of the Act enumerates some of the Examiner's powers as follows:

(a) the Examiner has the same rights and powers which an auditor has in relation to the supplying of information and co-operation;
(b) the Examiner has the power to convene, set the agenda for, and preside at meetings of the board of directors and general meetings and to propose motions or resolutions;
(c) the Examiner is entitled to reasonable notice of, to attend and be heard at all meetings of the board of directors and all general meetings.

Section 8 of the Act bestows considerable powers on an Examiner in relation to the production of documents and evidence by officers and agents of the company or a related company. These powers also extend to persons who are not officers or agents of the company. The Examiner may examine on oath, either by word of mouth or by written interrogatories any of the above. If any of the above persons refuse to produce such documents and evidence, refuse to attend before the Examiner, or refuse to answer questions put by the Examiner in relation to the affairs of the company, the Examiner may certify that refusal and the court may then enquire into the matter and make any order or direction it thinks fit.

Section 10 of the Act provides that the Examiner may certify liabilities of the company incurred during the protection period. Liabilities so certified shall be treated as expenses properly incurred under s 29(1) of the Act. Section 29(3A) of the Act provides that under any compromise or scheme of arrangement or in any receivership or winding-up, such expenses shall be paid in full and shall be paid before any other claim (including a claim secured by a floating charge), but after any claim secured by a mortgage, charge, lien or other encumbrance of a fixed nature or a pledge.

10.1.12 Directors' powers

The powers of directors survive both the presentation of a Petition for the appointment of an Examiner and the appointment of an Examiner. As such, the directors remain responsible for the day-to-day management of the company. This is in stark contrast to a liquidation where the directors' powers cease on the appointment of a liquidator. The principal task of the Examiner is to formulate a compromise or scheme of arrangement. However, in certain circumstances it may be undesirable to permit the incumbent directors to maintain their powers. Section 9 of the Act provides that the Examiner may apply to the court and if it is just and equitable to do so, the court may make an order that some or all of the functions or powers of the directors be transferred to the Examiner. Section 9(2) of the Act provides that the court is to have regard to the following matters in making such an order:

(a) that the affairs of the company are being conducted, or are likely to be conducted, in a manner which is calculated or likely to prejudice the interests of the company or of its employees or of its creditors as a whole;
(b) that it is expedient, for the purpose of preserving the assets of the company or of safeguarding the interests of the company or its employees or its creditors as a whole, that the carrying on of the business of the company by, or the exercise of the powers of, its directors and management should be curtailed or regulated in any particular respect;
(c) that the company, or its directors, have resolved that such an order should be sought;
(d) any other matter in relation to the company the court thinks relevant.

Thus, the circumstances in which the court may make an order pursuant to s 9 are extremely broad.

10.1.13 Members

The powers of the members a company under protection remain largely intact. Significantly, however, as mentioned previously, if the members pass a resolution to wind up the company, it will have no effect. In addition, members cannot obtain an order pursuant to s 205.

10.1.14 Contracts (pre-protection)

Section 7 (5A) of the Act provides that an Examiner may not repudiate a contract entered into by the company prior to the period during which the company is under protection. Section 7(5C) of the Act provides an exception to this rule in that an Examiner may avoid certain provisions of an agreement entered into by the company, in particular negative pledge clauses, if the Examiner is of the opinion that the provision would be likely to prejudice the survival of the company or the whole or any part of its undertaking as a going concern. If the Examiner is to evoke this provision he must serve a Notice on the other party or parties to the agreement informing them of that opinion.

Section 20 of the Act provides that a company may affirm or repudiate existing contracts.

10.1.15 Contracts (during protection)

Section 13(6) of the Act provides that an Examiner shall be personally liable on any contract entered into by him, in his own name or the name of the company, in the performance of his functions, unless the contract provides otherwise. But an examiner shall be entitled to a full indemnity out of the assets of the company in respect of such liability.

10.1.16 Restriction on payment of pre-Petition debts

The payment of pre-Petition debts is restricted by s 5A of the Act, which provides that no payment may be made by a company, during the period it is under the protection of the court, by way of satisfaction or discharge of the whole or part of the liability incurred by the company before the date of the presentation of the Petition. There are two circumstances where payments in respect of pre-Petition debts may be made: firstly, where the report of the independent accountant recommends that the whole or part of that liability should be discharged or satisfied, and secondly, where an application is made by the Examiner or any interested party for an order authorising the payment or discharge of the liability. In this regard, the court must be satisfied that failing to discharge or satisfy the debt would considerably reduce the prospects of the company, or the whole or any part of its undertaking, surviving as a going concern.

10.1.17 Meetings of creditors and members

Section 18 of the Act provides that the Examiner must formulate proposals for a compromise or scheme of arrangement as soon as is practicable after his appointment, and in any event within the time frame set out below. Section 22 of the Act sets out what the proposals should contain. Once he has formulated his proposals, the Examiner must convene and preside at such meetings of the members and creditors as he thinks proper and report back to the court on those proposals within 35 days of his appointment. Together with the Act, the Rules (RSC Ord 75A r 18) set out the manner in which these meetings are to be convened and run.

The number of meetings will depend on the different classes of members and creditors that are involved. For example, creditors may be broken down into secured and unsecured, contingent, preferential and so on. Members may also be divided into different classes according to the company's Articles of Association.

The meetings must be convened by notice in writing to each member of each class of member and creditor, giving not less than three days' notice. The proposals, together with a statement explaining the effect of the compromise or scheme of arrangement on the interested parties and forms of proxy (both special and general), should also be sent with the notice.

At the meetings, the Examiner puts forward his proposals for the consideration of those present either in person or by proxy. The Examiner will answer questions put to him in relation to the scheme of arrangement and the Examinership. Modifications to the scheme may be proposed, but will only be incorporated into the scheme with the consent of the Examiner.

The Examiner's proposals are then put to a vote. The proposals are deemed to be carried at a particular meeting if a majority in number holding a majority in value vote in favour of the proposals. Votes may be cast in person, by proxy or by a person authorised pursuant to s 139 CA 1963.

To be valid, a quorum must be present at each meeting. In the case of a members' meeting, at least two members must be present; in the case of a creditors' meeting, at least three creditors must be present.

The Examiner acts as chairman of the meetings and must arrange for minutes of the meetings to be kept. The chairman, like in creditors' meetings, may deal with the validity of proxies and votes.

The court is precluded from approving the Examiner's proposals unless at least one class of creditors whose interests would be impaired by the implementation of the proposals voted in favour of the proposals.

Section 23(4A) provides that an abstention shall not be construed as a vote against the proposals.

10.1.18 Guarantees

When acting for a creditor whose liability is secured by a guarantee, beware. Where that creditor wishes to enforce the guarantee, onerous notice provisions apply. In summary, the creditor must serve notice on the guarantor offering to transfer the creditor's rights to the guarantor to vote at the creditors' meetings on the proposals for a compromise or scheme of arrangement. Section 25A of the Act deals with this area. The notice provisions are as follows:

(a) where 14 days' notice is given of the creditors' meeting, the notice must be served on the guarantor at least 14 days before the meeting;
(b) where less than 14 days' notice is given of the creditors' meeting, the notice must be served by the creditor on the guarantor within 48 hours of having received his notice;
(c) the transfer notice must be in writing and must contain an offer to transfer to the guarantor the creditor's rights to vote in respect of proposals for a compromise or scheme of arrangement.

Clearly, failing to comply with the above notice provisions has very serious consequences for a creditor. When advising a creditor in relation to an Examinership, one of the first questions which must be asked is whether or not the liability is secured by a guarantee. If the liability is so secured then these provisions must be explained. If a compromise or scheme of arrangement is not entered into or does not take effect, a creditor may enforce a guarantee with leave of the court even if the creditor has failed to comply with these notice provisions.

10.1.19 Leases and hiring agreements

Section 25B of the Act provides that in relation to a lease in respect of land neither a compromise or scheme of arrangement nor modifications made by the court:

(a) can provide for a reduction in rent or other periodical payment or any extinguishment of the right of the lessor to such payments; or
(b) can provide for the non-exercise by the lessor of the right to recover possession, effect a forfeiture, otherwise enter on the land or to recover rent or other periodical payments or other relief for failure to comply with an obligation or covenant.

The above provisions also apply in relation to leases or hiring agreements in respect of property other than land where in the opinion of the court the property is of substantial value. Where a scheme purports to include such provisions they are deemed unfairly prejudicial pursuant to s 24(4)(c)(ii) of the Act and as such the court cannot confirm the proposal. The section does not define 'substantial value'. However, it does provide that in considering whether or not property is of substantial value the court shall have regard to the length of the unexpired term of the lease or hiring agreement. It will be interesting to see what other factors the court will consider in determining whether property is of substantial value.

10.1.20 Report to the court and confirmation of proposals

Section 18 of the Act provides that the Examiner is obliged to report to the court on the outcome of the meetings of members and creditors. Section 19 of the Act sets out what this report shall contain. The Examiner is obliged to report to the court within 35 days of his appointment or such further period as the court may allow, but s 5(1) of the Act provides that the company is under protection for a period of 70 days from the date of presentation of the Petition. The court may extend this 70-day period by a further 30 days. Thus the Examiner has 100 days, from the date of presentation of the Petition, to report to the court pursuant to s 18 of the Act. In practice, the Examiner will not be in a position to report to the court within the 35-day period stipulated and this will necessitate applications to the court for extensions subject to the maximum of 100 days mentioned above.

The Examiner is obliged to deliver a copy of his section 18 report to the company on the same day as he delivers it to the court. He is also obliged to supply a copy of the report to any interested party following written application but s 18(7) and (8) provide that the court may direct that parts of the report may be omitted.

Where the Examiner is unable to formulate proposals he may apply to the court for directions and the court may make such orders as it deems fit, including an order for the winding up of the company.

Pursuant to s 24, following delivery of the Examiner's report the court must set it down for consideration by the court. The company, the Examiner, and any creditor or member whose claim or interest would be impaired if the proposal were implemented, are entitled to attend and be heard. Section 22(5) provides that a creditor's claim against the company is impaired if he receives less in payment of his claim than the full amount at the date of presentation of the Petition. For a consideration of s 22(5) *see Jetmara Teoranta* [1992] 1 IR 147 and *Antigen Holdings Ltd* [2001] 4 IR 600. Section 22(6) sets out the grounds upon which the interest of a member of a company would be regarded as being impaired.

Section 24(4) provides that the court may *not* confirm the proposals:

(a) unless at least one class of creditors whose interests or claims would be impaired by implementation has accepted the proposals; or
(b) if their sole purpose is the avoidance of tax due; or
(c) unless the court is satisfied that the proposals are fair and equitable in relation to any class of members or creditors that has not accepted the proposals and whose interests would be impaired by them and that the proposals are not unfairly prejudicial to the interests of any interested party. For a consideration of what the court might regard as unfair and prejudicial see *Antigen Holdings Ltd and Jetmara Teoranta* (cited above) and see also *Holidair* (High Court, 6 May 1995, unreported, Costello J).

Section 25 provides that at the s 24 hearing a creditor or member whose interest or claim would be impaired by the proposals may object to their confirmation on any of the following grounds:

(a) where there was some material irregularity at or in relation to the members' or creditors' meetings; or
(b) acceptance of the proposals was obtained by improper means; or
(c) improper purpose; or
(d) unfair prejudice.

Where a party has voted in favour of the proposals, the grounds for objection are narrower. In these circumstances objections can only be made where:

(a) acceptance was obtained by improper means; or
(b) after voting to accept the proposals the objector became aware that the proposal had been put forward for an improper purpose.

Having heard objections, s 24(3) provides that the court may confirm the proposals (with or without modification) assuming there is no other reason why it would not. When confirming the proposals the court may make such orders for their implementation as it deems fit. The court must fix a date when the proposals come into effect but this date cannot be more than 21 days after the date of confirmation. Following their confirmation by the court the proposals become binding on the company, its members and its creditors.

Section 26 provides that the protection afforded to the company ceases when the compromise or scheme comes into effect or at any earlier date as the court may direct. The Examiner's appointment comes to an end when protection ceases.

Where the court does not confirm the proposals, it may make any order it deems fit including an order winding up the company.

10.1.21 Examiner's remuneration, costs and expenses and their priority

Section 29 provides that the remuneration, costs and expenses of the Examiner will be sanctioned by the court. RSC Ord 75A r 22 provides that an application for remuneration, costs and expenses shall be made *ex parte,* grounded on an Affidavit of the Examiner setting out a full account of the work carried out by him and a full account of the costs and expenses incurred by him and shall vouch same, and of the basis for the proposed remuneration which he is seeking to be paid. The Affidavit must also specify the use made by the Examiner of the company's staff and facilities as required under s 29(4). The court may also direct that the application be on notice. The court will, at the very least, scrutinise and in certain instances disallow remuneration, costs and expenses claimed by an Examiner. This can be seen in *Re Wogon's (Drogheda) Ltd (No 3)* (High Court, 9 February 1993, unreported, Costello J) and in *Re Clare Textiles Ltd* (High Court, 7 May 1992, unreported, CostelloJ).

If the Examinership is unsuccessful, the question of where the Examiner's remuneration, costs and expenses rank will come into sharp focus. Section 29(3) provides that the remuneration, costs and expenses of the Examiner which have been sanctioned by the court shall be paid before any other claim, secured or unsecured. Liabilities which have been certified by the Examiner are treated as expenses properly incurred by him and will rank before any other claim, including one secured by a floating charge, but will rank after a claim secured by a mortgage, charge, lien or other encumbrance of a fixed nature or a pledge. The definition of 'a claim' includes the costs, charges and expenses of winding up, including the remuneration of the liquidator.

10.2 Schemes of arrangement and compromises: sections 201-04 and 279 CA 1963

Prior to the implementation of the Examinership legislation in 1990, CA 1963 provided a mechanism whereby a company could propose a compromise or arrangement between itself and its members and creditors with the assistance of the court. This mechanism is very rarely used. It is clear from s 201 that these provisions apply where a company is in liquidation or where it is liable to be wound up. It also applies to a reorganisation of the share capital of a company.

In order to start this process it is necessary to apply to court for directions regarding the meetings of members and creditors or classes of both envisaged by s 201. It is not necessary to show that the company has a reasonable prospect of survival before the court will make orders pursuant to these provisions. Where such an application is made the court has wide discretion to stay or restrain proceedings against the company, on such terms and for such period as it thinks fit. This contrasts with the automatic protection afforded to a company under the Act where such protection is afforded to that company on proper presentation of a Petition in the Central Office under the Act. Lynch, Marshall and O'Ferrall (*Corporate Insolvency and Rescue,* 1996, Butterworths) suggest that a receiver may still be appointed notwithstanding an application pursuant to s 201 and that the court's discretion would not extend to preventing the appointment of a receiver by a charge-holder as it is not regarded as a process of the court. Conversely, an application could be made pursuant to s 201 even where a receiver stands appointed.

10.2.1 Approval of compromise or arrangement

Section 201 (3) provides that in order for the compromise or arrangement to be approved, it must be approved by a majority in number and three-fourths in value of the creditors or class of creditors or members or class of members present and voting in person or by proxy. Thus, the threshold for approval is far higher than in an Examinership. In addition, in order to be binding on the creditors and members or classes of members or creditors, it must be sanctioned by the court. It seems that the court has very broad discretion to either approve or reject a compromise or scheme.

10.2.2 Selecting classes of members and creditors and the position of the Revenue

One of the only cases dealing with the provisions under CA 1963 is *Pye (Ireland)* (High Court, 12 November 1984, unreported) (Supreme Court, 11 March 1985, unreported).

This case was mainly concerned with the manner in which the classes of members and creditors should be selected.

10.2.3 Revenue Commissioners' ability to compromise

A further issue which arose in the *Pye (Ireland)* case is whether or not the Revenue had power to compromise a preferential debt and it would appear that they do not. However, the Act specifically empowers the Revenue to compromise under the Examinership regime.

10.2.4 Examinership compared

Section 201 is rarely if ever used. Perhaps the principal reason for favouring the Examinership route is the immediate and extensive protection which is afforded once a Petition for appointment is presented. It would also appear that a receiver may still be appointed even though an application has been made pursuant to s 201. But s 201 is still an option where a receiver has been appointed whereas the appointment of an Examiner is not an option where a receiver stands appointed for three days. The threshold for approval is considerably higher under s 201. Even where the statutory majority required under s 201 is achieved, the court has very broad discretion to reject the arrangement, unlike the situation in Examinership. The position of Revenue debts also creates a problem. In the case of s 201, there is no third party responsible for putting together the rescue package. Generally speaking, creditors do not have faith in existing management and are more comfortable with the presence of an Examiner who is charged with the responsibility of putting together the proposals. In addition, the Examinership provisions are more extensive and certain. While the Examinership regime has a number of advantages over s 201, in rare cases the s 201 procedure may be the more appropriate one.

10.2.5 Section 279

Section 279(1) CA 1963 provides that:

> Any arrangement entered into between a company about to be, or in the course of being, wound up and its creditors shall, subject to the right of appeal under this section, be binding on the company if sanctioned by a special resolution and on the creditors if acceded to by three-fourths in number and value of the creditors.

Unlike s 201, this provision only applies where a company is about to be wound up or is in the course of being wound up. The court is not involved under this section unless there is an appeal by a dissatisfied creditor or contributory as provided for. It should be noted that this section does not afford the company any protection from its creditors.

CHAPTER 11

PERSONAL INSOLVENCY: BANKRUPTCY

Barry O'Neill

In this chapter, references to 'B Act 1988' are references to the Bankruptcy Act 1988 (as amended) and references to 'CA 1963' are references to the Companies Act 1963 (as amended).

11.1 Introduction

11.1.1 Definition of bankruptcy

The classic definition of bankruptcy is considered to be the quotation from an English case in 1874 (*Re Reiman* 20 Fed Cas 490):

> Bankruptcy is a law for the benefit and the relief of creditors and their debtors, in cases in which the latter are unable or unwilling to pay their debts.

Bankruptcy law applies only to debtors who are individuals. The main objects of bankruptcy legislation are:

(a) to secure equality of distribution and to prevent any one creditor obtaining an unfair advantage over the others;
(b) to protect bankrupts from vindictive creditors by freeing them from the balance of their debts where they are unable to pay them in full, and to help rehabilitate them;
(c) to protect creditors, not alone from debtors who prior to bankruptcy prefer one or more creditors to others but from the acts of fraudulent bankrupts;
(d) to punish fraudulent debtors.

The method of achieving these objectives is by the transfer of all assets to a trustee/assignee for the purpose of realisation and then the distribution of the proceeds of sale rateably among the creditors. Because the concept of limited liability is a much newer concept, there are quite a number of rules relating to liquidations which have their foundation in bankruptcy law.

11.1.1.1 History of Irish law in relation to bankruptcy

The Brehon law, which originated in the judgments of pagan Brehons, was recognised through most of Ireland until approximately 1600. It appears to have been the universal remedy by which rights were vindicated and wrongs redressed and constituted an important part of the law in Ireland for about 1,500 years. There are clear references to debtors and creditors, and the rights and obligations of both, in Brehon law.

The first Irish bankruptcy statute was in 1772 and was called An Act to prevent frauds committed by bankrupts'. Between 1772 and 1857 there were approximately 10 Irish statutes dealing with bankruptcy.

In 1857, the first of two important statutes dealing with bankruptcy was enacted. This was the Irish Bankrupt and Insolvent Act 1857 was enacted 'to consolidate and amend the laws related to bankruptcy and insolvency in Ireland'. By this Act, a bankruptcy court was established and the powers and procedures relating to that court were set out.

In 1872, the Bankruptcy (Ireland) Amendment Act became law. As its name implies, this Act amended the existing law, primarily by giving the court additional powers.

The B Act 1988 consolidates and modernises statute law relating to bankruptcy. It came into operation on 1 January 1989.

A number of recent Acts have contained bankruptcy provisions. These are primarily the Solicitors Acts and the Auctioneers and House Agents Acts.

11.1.1.2 'Acts' of bankruptcy

An act of bankruptcy is an act of default, voluntary or involuntary, committed by a debtor, which is either evidence of an intent to deprive creditors of their rights through fraudulent assignment or is an implication of insolvency. An act of bankruptcy *must* be committed and be proven to have been committed before the High Court will entertain any application to adjudicate a debtor bankrupt. Therefore, the proposed bankrupt must have committed one or more of the following 'acts' of bankruptcy:

(a) if, in the State or elsewhere, the debtor makes a conveyance or assignment of all or substantially all his property to a trustee(s) for the benefit of his creditors generally (s 7(1)(a) B Act 1988);

(b) if, in the State or elsewhere, the debtor makes a fraudulent conveyance, gift, delivery, or transfer of his property or any part of it (s 7(1)(b) B Act 1988): in a case in 1852, a fraudulent transfer of property was defined as follows:

- where the transfer has an immediate object to defeat creditors,
- where it is made with an objective of preventing equal distribution of the bankrupt's effects under his bankruptcy, which he knows must occur,
- where the transfer of property must necessarily in its results be known to the bankrupt to lead to the delay and disappointment of all his creditors except the particular individual to whom the transfer is made;

(c) if in the State or elsewhere, the debtor makes a conveyance or transfer of his property or any part of it, or creates a charge on it which would be deemed a fraudulent preference in a bankruptcy;

(d) if, with intent to defeat or delay his creditors:

- the debtor leaves the State, or
- being outside the State, remains outside the State,
- departs from his dwelling house,
- otherwise absents himself, evades his creditors (s 7(1)(d) B Act 1998);

(e) if the debtor files a Declaration of Insolvency in the High Court (s 7(1)(e) B Act 1988);

(f) if execution against him has been levied by the seizure of his goods under an order of any court or if a return of no goods has been made by the sheriff or county registrar whether by endorsement on the order or otherwise (s 7(1) B Act 1988);

(g) if the creditor presenting the petition has served upon the debtor in the prescribed manner a bankruptcy summons, and he does not within 14 days after service of the summons pay the sum referred to in the summons or secure or compound for it to the satisfaction of the creditor (s 7(1)(g) B Act 1988);

(h) where an order is made by the court directing that the deposit maintained in the High Court by an auctioneer shall not be released during a period, or where an order is made by the High Court directing that no banking company shall make any payment out of a bank account in the name of the auctioneer (Auctioneers and House Agents Act 1967);
(i) where a creditor obtains a judgment, order or decree against the holder of a banking licence and where the judgment relates to the payment of money due by the creditor in his capacity as a banker (s 28(1) Central Bank Act 1971).

It is important to note that in certain circumstances, the court can adjudicate bankrupt a debtor who tries but fails to carry through an arrangement with his creditors (s 105 B Act 1988).

The most common source of bankruptcy is where the debtor fails to pay his creditors having received a bankruptcy summons.

A bankruptcy summons will be issued by the High Court when:

(a) the debt is € 2,000 or more; and
(b) the debt is a liquidated sum; and
(c) the relevant notice (served under Superior Court Rules) has been served.

The creditor is entitled to present a petition if:

(a) the debt is € 2,000 or more; and
(b) the debt is a liquidated sum; and
(c) an act of bankruptcy has been committed within three months before the presentation of the petition, and the debtor

- is domiciled in the State or within a year before the date of the petition;
- has ordinarily resided in the State; or
- has had a dwelling house or place of business within the State; or
- has carried on a business in the State personally/by an agent/by a manager; or
- has been a member of a partnership which has carried on business in the State by means of a partner, agent or manager (s 11 B Act 1988).

11.2 Bankruptcy proceedings

11.2.1 The creditor’s position

As usual, full instructions should be obtained by the solicitor from the creditor to ensure that bankruptcy proceedings can be used against the debtor. The debt should be for a *liquidated* (or determined) sum. The creditor should be completely happy that the debtor cannot dispute the debt involved. The best way of avoiding any dispute regarding the debt is for the creditor to have already obtained a court judgment and to use the judgment as the basis for the bankruptcy proceedings.

Ultimately, if the debtor is adjudicated bankrupt, and appeals (or ‘shows cause’) against the (bankruptcy) order, it will be difficult to persuade the court that the debt is not due if another court has ordered that it is (due).

Instructions should be given as to the name, description and address of the person who will swear any affidavits in the case on behalf of the creditor.

Details of the procedure involved should be given to the creditor along with note of the *costs*.

The solicitor's expenses alone will involve stamp duty on many court documents and advertisements in national newspapers.

In the petition, the creditor undertakes to advertise and bear the expense of advertising. The petitioner must also *indemnify* the Official Assignee as to his costs, fees and expenses.

The solicitor should also discuss with his client the benefits of instituting the bankruptcy proceedings. If the creditor is only interested in collecting money which is due to him, then it is critical to ascertain whether or not the debtor has any money to pay the debt.

Admittedly, some clients will say that the threat of bankruptcy will ensure that the debtor will get the money one way or another but such optimistic clients should be warned that, in practice, sometimes the bankruptcy proceedings do not result in any payment of the debt and the costs of instituting the proceedings might be lost.

Great care should be taken where the client/creditor claims to have security for the repayment of his debt. Any creditor who holds security of any nature should be warned that ultimately he might be asked to *value his security* and adjudicate the debtor bankrupt for an unsecured amount.

In certain circumstances, a secured creditor could lose his security if he proceeds with the adjudication.

When a debtor has committed an act of bankruptcy, then the client has three months from the date of the committing of the act of bankruptcy to file the petition to adjudicate the debtor bankrupt (s 11(1)(c) B Act 1988).

The following is a basic checklist for solicitors taking instructions from a client who wishes to commence bankruptcy proceedings.

Full details of the debtor

(a) name;
(b) address;
(c) description;
(d) occupation.

Full details of the debt

(a) must be for a liquidated sum;
(b) ideally, a judgment should have been obtained;
(c) explain procedure to the client;
(d) time limits for the various stages;
(e) stamp duty involved;
(f) possible developments along the way;
(g) discuss question of costs with creditors;
(h) query whether bankruptcy proceedings are suitable to collect the debt;
(i) query whether client/creditor will accept a compromise payment;
(j) query whether client has any security for the debt;
(k) if client is a limited company, obtain name, address, description, etc, of the person representing the company who will swear affidavits, etc;
(l) discuss with client the effects of the bankruptcy on the debtor if the bankruptcy ultimately goes ahead;
(m) discuss interest upon judgment.

A judgment mortgage is not valid as against the property of a bankrupt until three months or more pass before the date of adjudication of the debtor as a bankrupt. This provision is contained in s 51 B Act 1988 and, incidentally, it has been incorporated in CA 1963 at s 284(2) in relation to the winding up of insolvent companies.

Note that the reference in s 284(2) CA 1963 to the 'filing of the petition' now reads as a reference to the date of adjudication (s 51(2) B Act 1988).

An important point is that the petitioning creditor gains no priority in relation to the payment of his debt if he makes the debtor bankrupt.

However, the costs of the petitioner are paid next after the costs, fees and expenses of the Official Assignee (s 12 B Act 1988).

In general, the preferential claims in a bankruptcy are similar to those in a liquidation or a receivership (s 81 B Act 1988).

11.2.2 The procedure

The Bankruptcy Act 1988 came into operation on 1 January 1989. The Act is complemented by the Rules of the Superior Courts, SI 79/89 (RSC).

The first step is sending a form of demand called 'Particulars of Demand and Notice Requiring Payment prior to the issue of a Bankruptcy Summons'. This form is sent to the debtor by ordinary post, although a posting voucher must be issued by An Post for production at a later stage. An affidavit of posting may be requested. This notice is to be found in RSC Form No 4.

The debtor has *four clear days* during which he can respond to the Particulars of Demand. If there is no response, then the creditor is entitled to proceed.

The next step is taken by having a bankruptcy summons issued and served on the debtor. The summons is issued by the court. The form of bankruptcy summons is found in RSC Form No 1.

To have a bankruptcy summons issued, you must first attend at the Examiner's office with the following papers:

(a) two copies of the Particulars of Demand (the posting voucher should be attached to one copy of the particulars);
(b) affidavit for bankruptcy summons sworn by the creditor (RSC Form No 5). This includes a statement that no form of execution has issued in respect of the debt and remains to be proceeded upon.

When the summons is issued, it must be served on the debtor. Service of a bankruptcy summons must be effected personally on the debtor.

The court can make an order providing for substituted service in circumstances where the court thinks fit.

The summons must be served within 28 days after it has been issued and a copy of the affidavit for bankruptcy summons must also be served. Within three days after the service, the summons server must endorse on the summons the day and the date of the service.

If the summons is not served within the 28-day period, then it is possible to apply to the court for an order seeking an extension of time. You will have to justify to the court why you are looking for the extension of time.

The time limit for payment under a bankruptcy summons is 14 days from the date of service.

After the summons has been served, the debtor can apply to the court to have the summons dismissed.

If the debtor is of the opinion that he does not owe the amount demanded, then he should instruct his solicitor to issue a notice of application to dismiss the debtor's summons (RSC Form No 7).

This form is accompanied by an affidavit in which the debtor states that he is not indebted to the creditor (RSC Form No 6). This affidavit must be filed within 14 days after service of the summons.

A date is fixed by the Examiner when the debtor's application will come before the court for determination.

If the debtor has not paid the debt within the time limit, then he will have committed an act of bankruptcy. This enables a creditor to file a Petition with the High Court within three months after the date of the act of bankruptcy taking place. The Petition asks the court to adjudicate the debtor bankrupt.

If the creditor decides to go ahead with the Petition then the following papers must be filed with the Examiner's office:

(a) Petition (RSC Form No 11). This document must be signed by the petitioner. Where the petitioner is a company it must be sealed by the company and signed by two directors or by one director and the secretary. The Seal and signature must themselves be witnessed. It must be signed first. It must include notice of the date for the hearing of the Petition. On the back of the Petition there is an affidavit verifying the details in the Petition (also RSC Form No 11);
(b) affidavit of proof of debt (RSC Form No 12). This must be signed in the normal way giving details of the debt due to the creditor. It is important to note that it must be signed in three places. The Examiner's office will then allocate a date for the hearing of the Petition. Then, a copy of the Petition is served on the debtor personally at least seven days before the hearing. An affidavit of service must be filed at least two days before the hearing of the Petition.

The original order of adjudication (RSC Form No 15) is filed on the Examiner's File once it has been signed by the bankruptcy judge.

The duplicate order of adjudication is given to the 'bankruptcy inspector' who is usually the first person to inform the bankrupt of his bankruptcy. The order of adjudication is served on the bankrupt by the bankruptcy inspector.

The duplicate order carries a note on the back which informs the bankrupt that he has three days from the service of the duplicate order to appeal against the validity of the bankruptcy. The court has power to extend this time to a maximum of 14 days.

The bankruptcy inspector is entitled to seize the goods of the bankrupt because by act of law at the time of the adjudication of the bankrupt all the bankrupt's assets become vested in the Official Assignee.

As mentioned, the bankrupt has three days or any extended time as the court thinks fit (not exceeding 14 days) from the service of the duplicate order of adjudication to appeal against the validity of the order (s 16 B Act 1988).

If no appeal is made, then the following documents must be produced to the Examiner's office:

(a) advertisement: this is a notice in which the date for the statutory sitting before the court is fixed. The solicitor for the petitioner is obliged to publish the notice in *Iris Oifigiúil* and in newspaper(s) at the direction of the court (RSC Form No 19);
(b) summons to bankrupt to attend public sittings (in duplicate): this summons is served on the bankrupt when the date for the statutory sitting has been fixed and if the bankrupt does not attend the sitting he is in contempt of court (Form 14).

In the case of an appeal by the bankrupt to have the bankruptcy upset, the application is started by issuing a notice (RSC Form No 16). The bankrupt must file this notice within three days from the date of service of the copy order of adjudication. The court may extend this period to a maximum of 14 days.

The Examiner sets a date for the first hearing of the application before the court. This is known as an application to show cause. On that date the bankrupt should indicate clearly to the court his reasons for trying to upset the bankruptcy and ultimately the court will decide on whether the bankrupt's application is valid or not.

When hearing the bankrupt's application to show cause:

(a) the court *shall* annul the bankruptcy if the bankrupt satisfies the court that the provisions of s 11 B Act 1988 have not been complied with (see section 11.2.1 above);
(b) in any other case, the court may:

- dismiss the application; or
- adjourn it on certain conditions (s 16 B Act 1988).

Very often the debtor cannot dispute any of the provisions of s 11 but he appeals to the court's equitable jurisdiction which allows the bankruptcy judge to make orders on the grounds of equity.

It is important to realise that while the bankrupt is appealing against his bankruptcy, he is still a bankrupt and the bankruptcy continues subject to any orders which the court might make by way of relief to the bankrupt. In particular, the court will probably restrain *publication* of the existence of the bankruptcy. However, the bankrupt is normally liable to the disabilities of bankruptcy such as not being able to trade or operate a bank account. Ultimately, if the court accepts the application of the bankrupt the bankruptcy will be annulled. If the bankrupt's application fails, then the bankruptcy proceeds in the usual way.

11.3 The debtor's position

Before anyone is adjudicated bankrupt, there is no doubt that he will have received many warnings. In fact, in a number of cases, the creditor will have obtained a judgment in one of the courts against the debtor and the debtor would have received independent warnings about the judgment.

As soon as the bankruptcy proceedings are threatened, the debtor should immediately approach the creditor who is threatening bankruptcy. This should be done because it is possible to remove the threat of bankruptcy by satisfying this creditor at this stage in the proceedings but, if the debtor is adjudicated bankrupt, then he must deal with *all* his creditors and the court will insist that all creditors have been satisfied before allowing the bankruptcy to be annulled.

If the money is available, then the debtor should pay the debt straight away, but in normal situations, it is advisable that a Statement of Affairs of the debtor be produced so that this can be handed to the creditor to disclose the true financial position of the debtor and to persuade the creditor to accept a realistic settlement.

This is also a good time to point out to the creditor that the return to him in financial terms in a bankruptcy is likely to be unsatisfactory. The realisation process can be slow, and because the petitioning creditor will gain no priority over the other creditors, the creditor may receive nothing at the end of the day and, by settling immediately, then the creditor is avoiding the very heavy costs involved in pursuing the adjudication.

Obviously the debtor should examine the amount claimed by the creditor and if there is any dispute about the figures, then this dispute should be communicated immediately to the creditor. If there is clear evidence of a dispute and this has been pointed out in writing to the creditor, it would be very unwise of the creditor to proceed further without first resolving the dispute. If a disputed debt is used as the basis for bankruptcy proceedings, the court will not look favourably on the creditor and will probably dismiss the bankruptcy summons and may award the costs against the creditor (see s 8 B Act 1988).

If the bankruptcy does take place, the debtor has the right to appeal, which has already been mentioned.

If none of the statutory reasons for appealing are available and therefore the debtor is relying on the equitable jurisdiction of the court, then it is essential that a detailed statement of affairs be produced from which the court will see clearly that the bankrupt has assets. It is also extremely helpful to give the court a programme of realisation of the assets with suggested values and timescales involved. If the court sees that the debtor may be able to discharge his debts in full within a reasonably short time, then it is likely that the court will give the debtor the time required.

Usually, the debtor's tax affairs will be in arrears. Because of this, the greatest delays arise when negotiations start with the relevant Inspector of Taxes to agree up-to-date figures.

If the appeal against the adjudication fails, then the court will allow the bankruptcy to proceed in the normal way, with publicity taking place (traditionally in two national newspapers and one local newspaper) and the bankrupt must co-operate with the Official Assignee/Trustee in every respect.

After 12 years, bankruptcy may be discharged.

11.4 After bankruptcy

11.4.1 Disabilities of a bankrupt

When a debtor is declared bankrupt, he immediately suffers some automatic disabilities:

(a) all assets (except some minor items: s 45 B Act 1988) vest automatically in the Official Assignee (s 44(1) B Act 1988);
(b) the debtor is not entitled to operate a bank account;
(c) under s 183 CA 1963, an undischarged bankrupt is prohibited from:

- acting as a director of any company;
- directly or indirectly taking part in the management of any company;
- being directly or indirectly concerned in the management of any company.

The section goes on to say that for the purpose of the section, the word 'company' includes an unregistered company and a company incorporated outside the State which has an established place of business with the State, and s 183A CA 1963 gives the Director of Corporate Enforcement powers relating to bankrupts. In addition:

(d) if an Official Liquidator is adjudicated bankrupt, his office is deemed to be vacated and he shall be deemed to have been removed as of the date of his adjudication (RSC Ord 74 r 42);
(e) an undischarged bankrupt cannot act as the receiver of a company (s 315 CA 1963);
(f) a bankrupt cannot be a trustee;
(g) a bankrupt cannot be a member of the Báil or Seanad (Electoral Act 1923);
(h) a bankrupt cannot be elected a county councillor;
(i) a bankrupt cannot be a member of a local authority.

11.4.2 Bankruptcy offences

In each of the following cases a bankrupt or an arranging debtor is deemed guilty of 'an offence':

(a) if he does not disclose to the court all his property;
(b) if he does not deliver up to the Official Assignee/Trustee all property which was in his custody or control;
(c) if he did not deliver to the Official Assignee/Trustee all books and papers relating to his estate;
(d) if he conceals any part of his property to the value of €650 or upwards or conceals any debt due to or from him;
(e) if he fraudulently removes any part of his property to the value of €650 upwards;
(f) if he fails to file or deliver a Statement of Affairs or makes any material omission in any statement relating to his affairs;
(g) if he knowingly fails to inform the Official Assignee/Trustee that a false debt had been proved;
(h) if he prevents the production of any book or papers affecting or relating to his estate;
(i) if he conceals, destroys, mutilates, falsifies any book or paper affecting or relating to his estate;
(j) if he makes or is privy to the making of any false entry in any book or paper affecting or relating to his estate;
(k) if he fraudulently parts with, alters or makes any omission in any document affecting or relating to his estate;
(l) if he attempts to account for any part of his property by fictitious losses or expenses;
(m) if he obtains by false representation or fraud any property on credit;
(n) if he obtains, under the false pretence of carrying on business, or if a trader dealing in the ordinary ways of his trade, any property on credit;
(o) if he pawns, pledges or disposes of any property which he has obtained on credit other than in the ordinary course of trade;
(p) if he is guilty of any false representation or fraud for the purpose of obtaining the consent of his creditors or any of them to an agreement with reference to his affairs or his bankruptcy.

The above provisions are to be found in s 123 B Act 1988. Where a person is guilty of an offence, he is liable:

(a) on summary conviction, to a fine not exceeding €650 or at the discretion of the court, to imprisonment for a term not exceeding 12 months or to both; or
(b) on conviction on indictment, to a fine not exceeding €2,500 or, at the discretion of the court, to imprisonment for a term not exceeding five years, or to both.

11.4.2.1 Note: adjudication: debtor's own petition

Where a debtor considers himself to be insolvent, and where he can prove that his estate will readily realise at least €2,000 he can petition the court for an order declaring him bankrupt (s 15 B Act 1988).

The debtor will also have to pay expenses such as stamp duty and advertising fees.

11.5 Winding up by a trustee

A bankrupt's estate may be wound up by either the Official Assignee or by a trustee (normally an accountant/insolvency practitioner).

If, at the statutory meeting before the court, three-fifths in number and value of the creditors present in court vote to have the estate of the bankrupt wound up by a trustee and a committee of inspection, then the trustee takes over from the Official Assignee and proceeds to wind up the affairs of the bankrupt similar to the way in which a liquidator winds up a company The trustee has all the powers of the Official Assignee. The trustee is appointed by the court and is subject to the control of the court.

11.6 Composition after bankruptcy

At any time after the commencement of his bankruptcy, the bankrupt can apply to the court for an order staying the realisation of his estate to enable him to make an 'offer of composition' to his creditors (s 38 B Act 1988). If the court accedes to this application, the bankrupt calls a meeting of his creditors to put the offer to them.

11.6.1 Creditors' meeting

The creditors' meeting takes place before the court (s 39 B Act 1988), and:

(a) the creditors must receive notice by post at least 10 days before the meeting;
(b) the notice must specify the precise offer;
(c) the notice must be inserted in *Iris Oifigiúil* at least 10 days before the meeting.

If three-fifths in number and value of the creditors who vote accept the offer, it is deemed to be accepted. The court must approve the offer. When the creditors have accepted it and the court has approved it, the offer is binding on all the creditors. A creditor for less than €125 cannot vote.

A composition may be payable:

(a) in cash; or
(b) by instalments (security must be given); or
(c) partly in cash and partly by instalments (again security must be given where the payments are to be by instalments).

11.7 Arrangements with creditors outside/prior to bankruptcy

11.7.1 Methods

There are two methods by which a debtor can make formal arrangements with his creditors:

(a) a private arrangement under the control of the court; or
(b) a private arrangement outside the court.

A private arrangement under the control of the court is governed by ss 87–109 B Act 1988. To start an arrangement under the control of the court, the debtor presents a petition supported by affidavit to the court setting out the reasons for his inability to pay his debts and requesting protection from actions/processes (including bankruptcy proceedings). An order for protection may be granted even if there is an execution order in the hands of the sheriff (s 89 B Act 1988).

When the protection order has been granted:

(a) the court will direct the debtor to hold a preliminary meeting of his creditors. The debtor must present a statement of his assets and liabilities to this meeting and keep a minute of the proceedings;
(b) the court will give a date for the private sitting of the court, which will take place after the preliminary meeting;
(c) the debtor must lodge with the Official Assignee a memorandum containing:
    - the date of the protection order,
    - his name and address,
    - the amount of his liabilities,
    - the amount of assets;
(d) a duplicate of the memorandum must be filed in the Central Office.

The debtor must file in the Official Assignee's office at least two days before the private sitting of the court:

(a) his Statement of Affairs incorporating his offer to creditors;
(b) a copy of the Statement of Assets and Liabilities presented to the creditors at the preliminary meeting; and
(c) the minutes of the preliminary meeting.

The creditors vote at the sitting of the court. If three-fifths in number and value vote in favour of the proposal, it is deemed accepted.

The court must approve of the 'accepted' offer. If it does, the offer is binding on all creditors.

A creditor for less than €125 is not entitled to vote.

The debtor must attend the sitting of the court.

A debtor who makes an offer to his creditors runs a high risk, because the court may adjudicate him bankrupt if:

(a) he does not file the relevant documents; or
(b) his offer is not accepted; or
(c) his proposal is annulled; or
(d) his affidavit (filed with Petition) is wilfully untrue, in that assets and liabilities have not been fully disclosed; or
(e) it appears that he does not wish to make a '*bonafide* arrangement with his creditors'; or
(f) his proposal is not reasonable; or
(g) he does not attend the private sitting before the court; or
(h) he fails to obey any order of the court; or
(i) he is 'party to any corrupt agreement with his creditors to secure the acceptance of his proposal'.

Such arrangements are very rare, due to the level of costs and risks as above. Note the similarity of this (old) concept to that of Examinership (for companies).

11.7.2 Arrangements outside court

In these cases, there is no involvement by the bankruptcy jurisdiction of the High Court. An arrangement made in this way is a matter of contract between the debtor and his creditors.

Normally, the debtor enters into a written agreement with all his creditors, the effect of which is as follows:

(a) the deed transfers the debtor's property (or most of it) to a trustee;
(b) the trustee agrees to dispose of all the property transferred to him and to hold the property/proceeds in trust for the purpose of paying:

- all costs and expenses of and incidental to the deed,
- preferential liabilities, as per bankruptcy rules,
- an agreed dividend to creditors,
- the surplus, if any, to be repaid to the debtor;

(c) the trustee is given power to:

- remunerate himself or any person employed by him and to pay the debtor any allowance he may think fit for services rendered,
- require a creditor to furnish particulars of the debt claimed,
- realise the assets in the method considered most appropriate;

(d) the debtor contracts with the trustee and with each creditor that:

- he will give all information concerning his estate and give all assistance to the trustee,
- he will not object in any way to the sale of any property;

(e) the debtor appoints the trustee to be his attorney so that deeds can be signed on behalf of the debtor;
(f) the creditors agree to release the debtor from all debts, claims and actions, etc (but this is usually done on the basis that it is without prejudice to any rights which the creditor may have against a guarantor).

The transfer of the property to the trustee is an *act of bankruptcy* and may lead to the debtor being adjudicated bankrupt at any time within three months after the signing of the trust deed. However, if a creditor agrees to join in the arrangement then that creditor is debarred from relying on the deed as an act of bankruptcy. The major difficulty of an arrangement of this type is that it requires the consent of *all* creditors. Any debtor trying to conclude an arrangement with his creditors requires detailed information about his financial affairs and the assistance of an accountant is essential.

11.8 Receivers and managers

Under s 73 B Act 1988 the court can appoint a receiver or a manager of the property or business of a debtor or any part of it. The Rules of the Superior Court provide that:

(a) after the presentation of a petition of bankruptcy or arrangement, the court may appoint a receiver and manager if sufficient grounds are set out in an affidavit filed by a creditor;
(b) a receiver must submit his accounts to the Official Assignee.

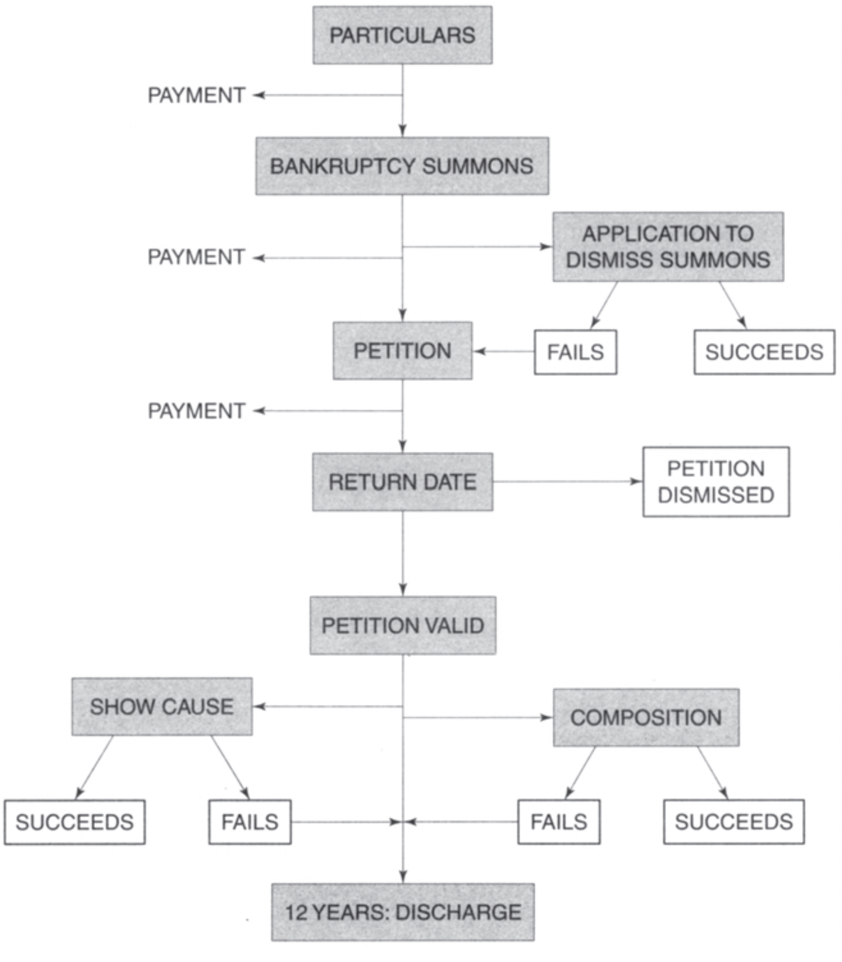
Appointments of receivers and managers in this way are very rare. When they take place, they are normally on the application of a mortgagee. The reasons given for the application to appoint a receiver and manager are primarily that it is in the interests of the creditors that the business of the bankrupt or the arranging debtor should be carried on for some time so as to effect a sale of the business as a going concern. In practice, the few cases which have arisen have involved hotels.

11.9 Estates of persons dying insolvent

The introduction of the Bankruptcy Act 1988 brought about changes relating to the estate of a person dying insolvent. Such estates may be wound up by the Official Assignee. A petition for the administration of the estate in this way may be presented to the court by:

(a) any creditor whose debt would have been sufficient to support a bankruptcy petition against the deceased if he had been alive; or
(b) the personal representative of the deceased.

On the hearing of the petition, the court may, unless it appears that there is a reasonable probability that the estate will be sufficient for the payment of the deceased's debts, make an order for the administration of the estate by the Official Assignee or, upon cause shown, dismiss the petition with or without costs (s 117 B Act 1988).



CHAPTER 12

INTERNATIONAL INSOLVENCY

Michael Quinn

12.1 Introduction

With the development of the global economy, one finds an increasing number of cases where issues arise as to the cross-border effect of insolvency proceedings. This chapter will briefly outline the issues that arise in such cases. The following topics will be discussed:

(a) the extraterritorial effect of Irish insolvency proceedings;
(b) the effect in Ireland of foreign insolvency proceedings;
(c) international efforts to streamline the conduct of insolvencies having cross-border effect.

12.2 Extraterritorial effect of Irish insolvency appointments and orders

The appointment of a liquidator will purport, on its face, to apply to *all* the affairs of a company. This would suggest that an Irish liquidator should be competent to take possession of and realise all the assets of the company, wherever situate. In practice this depends on whether the relevant authorities or third parties in other jurisdictions are willing to recognise the fact that the company is in liquidation and the status of the liquidator. It cannot be assumed, merely because he has been properly appointed under Irish company law, that his appointment will be recognised worldwide.

It is frequently the case that such a liquidator will succeed in realising foreign assets. For example, he may simply be able to send his own representatives abroad to take possession of moveable goods so that they are returned to the company's possession in Ireland and ultimately sold by him for the benefit of creditors. Foreign debtors may recognise his demand for payment and discharge their obligations by making full payment. More commonly, however, a liquidator finds that third parties in other jurisdictions disregard or ignore his appointment. If they are creditors, they may invoke 'self help' remedies, even if such remedies would be unlawful as against a liquidator, for example seizure of goods in part-payment of a debt, a practice which would only be permissible against a liquidator if the creditor had a valid retention of title clause.

Even if, as a practical matter, third parties can be persuaded to recognise the status of a liquidator, it will frequently be the case that governmental authorities or statutory authorities charged with maintaining public registers of interests in assets, such as immoveable property or intellectual property, may not be empowered to recognise an appointment unless in their own jurisdiction a court order has been made recognising the appointment or giving it local effect.

The extent of recognition varies in different jurisdictions. It is not within the scope of this book to state the laws of all other jurisdictions on this subject. It is, however, useful to summarise the two principal forms of procedure found in other jurisdictions where local courts are asked to assist, which are orders in aid and local winding up proceedings.

12.2.1 Orders in aid

An order in aid is an order of a local court giving effect in the relevant jurisdiction to the appointment and powers of a foreign liquidator, administrator, assignee or trustee. Such an order will generally facilitate such an office-holder to realise assets. In these cases, the order will frequently contain terms which in some way go towards protecting the interests of local creditors. An order in aid may also be granted so as to enable the liquidator to perform his investigative functions, such as exercising power to interview directors or officers, or to have them examined before a local court.

The concept of an order in aid is widely known in common law jurisdictions and some, notably England, have specific statutory provisions identifying the foreign jurisdictions whose liquidators or other such officers will be assisted by this procedure.

12.2.2 Local winding up proceedings

Some jurisdictions also have the concept of liquidating the affairs of a branch of a foreign corporation. This procedure involves the local court ordering a full liquidation of the company in the relevant jurisdiction. This procedure will not always facilitate the liquidation of the main company as it will generally mean the realisation of assets for the benefit of local creditors, with only the surplus, if any, being remitted to the 'main' liquidator.

12.2.3 Other issues

Because different jurisdictions throughout the world have different approaches to the recognition of foreign insolvency procedures, it is extremely difficult to predict the efficiency of an insolvency assignment having cross-border implications. A particularly difficult example is Examinership. Once a petition for the appointment of an Examiner is presented in the High Court, the company is deemed to be under the protection of the court, a concept known under the US equivalent Chapter Eleven procedure as the 'automatic stay'. Frequently the automatic stay is critical to the ongoing survival of the company on a going concern basis. However, if the company has a business and assets located in jurisdictions which will not recognise or give effect to the automatic stay, the ongoing survival of the company may be prejudiced by the actions of local creditors. Similarly, it will be necessary to know at the outset that if a scheme of arrangement is proposed and confirmed by order of the High Court, it can be rendered binding on all interested parties, including foreign creditors. As a matter of Irish law, such a scheme will bind all creditors regardless of their place of origin. However, it will still be a matter for the relevant foreign law as to whether creditors are precluded from disregarding the scheme and pursuing local remedies in their own jurisdictions.

The issues described above arise where the assets and activities of the company in other jurisdictions are those of the company itself, whether arising directly or through a branch. If the company has incorporated a subsidiary in other jurisdictions, as will commonly be the case, that subsidiary is a separate legal identity which is liable to be subject entirely to the insolvency procedures which govern companies in that jurisdiction. The interest and rights of a liquidator of a parent company are confined to those of a shareholder. This can mean in certain cases that the 'parent' liquidator would himself initiate steps to have the subsidiary company placed in liquidation under the relevant local laws. The principal continuing interest of the parent liquidator will be to await the remittance of any surplus from the local liquidator.

Finally, it is worth noting that the concept of a floating charge, common in Ireland and the UK, is not recognised in some jurisdictions. This means that a receiver appointed pursuant to such a charge will often not be recognised in other jurisdictions. This creates particular difficulties, and unfortunately has not been addressed by the new EU Insolvency Regulation discussed below.

12.3 Effect in Ireland of foreign insolvency proceedings

Many jurisdictions approach the issue of recognition of foreign insolvency proceedings from the point of view of reciprocity and orders in aid are sometimes granted in cases where the courts of the foreign State concerned also make such orders under a corresponding provision.

Section 250 CA 1963 provides that an order made by a court of any country recognised for the purposes of that section, and made for or in the course of winding up a company, may be enforced by the High Court in the same manner in all respects as if the order had been made by the High Court itself. Thus the court will recognise such a foreign order. The only country in respect of which the necessary ministerial order has been made for the purpose of this section is Great Britain and Northern Ireland.

As far as restructurings are concerned, s 36 of the Companies (Amendment) Act 1990 provides similarly that any order made by a court of any country recognised for the purpose of that section and made for or in the course of reorganisation or reconstruction of a company may be enforced by the High Court. No recognition order has yet been made under this section.

The nearest equivalent of these sections in the context of personal bankruptcies is s 142 B Act 1988 which expressly provides that the High Court and its officers may act in aid of any court in Northern Ireland, England and Wales, Scotland, the Isle of Man or the Channel Islands, at the request of such a court, in any bankruptcy matter before such court, and that the High Court shall have like jurisdiction and authority as in the case of a bankruptcy originating under its own original jurisdiction. Section 142 further provides that the Government may by order extend this provision to any other jurisdiction where the Government is satisfied that reciprocal facilities to that effect will be afforded by that jurisdiction.

Therefore, it will always be necessary to examine the particular rules which apply to any jurisdiction where a foreign insolvency office holder seeks to be recognised in this jurisdiction.

12.4 International rules on cross-border insolvencies

Historically, there has been very little harmonisation of insolvency law throughout Europe or worldwide. This is largely explained by the fact that although insolvency in many jurisdictions is largely a matter of company law, it is characterised also by principles based on other disciplines such as the laws of property and equity. Because the insolvency laws are not uniform, it has proved difficult to harmonise substantive laws. However, efforts have been made to establish a regime for the improved efficiency and effectiveness of the conduct of cross-border insolvencies in the European Union. The result of these efforts is contained in Council Regulation No 1346/2000 (the Regulation), which will be dealt with in further detail below.

The United Nations Commission on International Trade Law has adopted a UNCITRAL model on cross-border insolvency. The model law is designed to provide uniform legislative provisions to deal with cross-border insolvency and to promote the objectives of:

(a) co-operation between the courts and competent authorities involved in cases of crossborder insolvency;
(b) fair and efficient administration of cross-border insolvency that protects the interests of all creditors and other interested persons, including the debtors;
(c) protection and maximisation of the value of the debtors' assets;
(d) facilitation of the rescue of financially troubled businesses.

The model law has been adopted by only a small number of countries, which do not include Ireland. However, it is understood that the US and the UK will be adopting the UNCITRAL model law in the near future.

12.5 Council Regulation (EU) No 1346/2000 on Insolvency Proceedings

The entry into force of Council Regulation (EU) No 1346/2000 on 31 May 2002 brought an end to a prolonged vacuum in EU law relating to insolvency, marked by the absence of co-ordinated international regulation of insolvency proceedings.

The Brussels Convention on Jurisdiction of Courts and Enforcement of Judgments in Civil and Commercial Matters expressly excluded:

> bankruptcy, proceedings relating to the winding up of insolvent companies and other legal persons, judicial arrangements, compositions and analogous proceedings (Article 1).

A similar exclusion is contained in Regulation No 44/2001 on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters, which entered into force on 1 March 2002 (Article 1.2).

Several bi-party or multi-party Conventions have come into existence on this subject, principally between countries with close geographic, economic and financial ties, for example between Belgium and France, between Belgium and The Netherlands, between Germany and Austria, and between the Nordic States. Ireland was not a party to any of these Conventions.

The Regulation is not an attempt to harmonise substantive laws, but establishes a regime for the improved efficiency and effectiveness of the conduct of cross-border insolvencies. It does this by providing for cross-border recognition and enforcement of basic orders such as the appointment of liquidators and other insolvency office holders, and of remedies typically invoked in insolvency proceedings. It also establishes a regime for the management of asset realisation and the processing of creditor claims in multijurisdictional cases.

Whilst harmonisation is not the objective, the Regulation contains some important substantive provisions which achieve a form of limited harmonisation for individual cases by the mandatory application of the laws of the Member State in which insolvency proceedings are opened *(lex concursus)*.

12.6 Scope of the Regulation

The Regulation is expressed to apply to:

> collective insolvency proceedings, which entail the partial or total divestment of a debtor and the appointment of a liquidator (Article 1).

The Annex to the Regulation stipulates for each jurisdiction the category of proceedings which this includes. In the case of Ireland, these are listed as meaning compulsory winding up, bankruptcy, administration in bankruptcy of the estate of persons dying insolvent, winding up in bankruptcy of partnerships, creditors' voluntary winding up (with confirmation of a court), arrangements under the control of the court which involve the vesting of all or part of the property of the debtor in the official assignee for realisation and distribution, and company Examinership. Whilst the Regulation provides for 'creditors' voluntary winding up (with confirmation of a court)', the concept of voluntary liquidation in Ireland generally means, by definition, that there has been no court order. The Corporate Insolvency Regulations (SI 2002/333) establish a procedure whereby such a liquidator can apply to have his appointment confirmed by a certificate of the Master of the High Court.

The term 'liquidator' is defined as 'any person or body whose function is to administer or liquidate assets of which the debtor has been divested or to supervise the administration of his affairs' (Article 2). The Annex lists those persons for each Member State. In the case of Ireland, it means a liquidator, official assignee, trustee in bankruptcy, provisional liquidator or Examiner.

Receivership is also excluded from the Regulation. In Ireland and the United Kingdom receivership is frequently regarded as a form of insolvency practice. This is because the most common form of receivership in commercial practice is the receiver appointed under a modern bank debenture containing a floating charge over all the assets of the borrowing company. In truth, such an appointment is no more than the enforcement by one creditor of his security over defined assets and therefore is not a 'collective insolvency proceeding' such as the Regulation is intended to embrace. While such receiverships are common in Ireland and the United Kingdom, they are relatively unknown in many EU Member States. Thus their inclusion in the Regulation would have encountered some resistance and recognition might in certain Member States have been regarded as offensive to public policy. Recognition of such appointments can be problematic in some EU jurisdictions, and it is therefore disappointing that the opportunity was not taken to provide for recognition of the appointment of receivers out of court, with an appropriate saver to respect the laws of States which assert that such a concept would be contrary to constitutional rights or public policy or offensive to local rules concerning rights *in rem*.

The Regulation does not apply to insolvency proceedings concerning insurance undertakings, credit institutions or collective investment undertakings. Insurance undertakings are the subject of a separate Directive.

The Regulation is not retrospective. Therefore it only applies to insolvency proceedings opened after its entry into force on 31 May 2002. It expressly states that acts done by a debtor before that date shall continue to be governed by the law applicable to them at the time they were done (Article 43).

Where the Regulation uses the term 'debtor' this means the entity the subject of insolvency proceedings, whether it be a natural or legal person, corporate or non-corporate.

12.7 Jurisdiction

The cornerstone of the jurisdictional regime is established by Article 3. Article 3.1 provides that the courts of the Member State in which the centre of a debtor's main interests is situated shall have jurisdiction to open insolvency proceedings. This will be the main State for primary proceedings, or the 'State of the opening of proceedings'.

There is no conclusive definition of the centre of main interests. Article 3.1 states only that in the case of a company or legal person, the place of the registered office shall be presumed to be the centre of its main interests in the absence of proof to the contrary. This is a rebuttable presumption.

The only other guidance is to be found in paragraph (13) of the Preamble, which states that:

> The centre of main interests should correspond to the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties.

12.7.1 Territorial proceedings

Article 3.2 provides that where the centre of a debtor's main interest is situate within the territory of any Member State, the courts of another Member State have jurisdiction to open insolvency proceedings against that debtor if it possesses an establishment within the territory of that other Member State. The effect of such proceedings is restricted to the assets of the debtor located in the territory of the second Member State. These are therefore called 'territorial insolvency proceedings'. If proceedings have already opened in the main State, these 'territorial' proceedings will be 'secondary' and therefore subordinate to the 'main' proceedings.

The intention is that territorial insolvency proceedings will only be opened outside the 'main' State after the opening of main proceedings and thus will be 'secondary' to the main proceedings. There are, however, two circumstances in which territorial proceedings can be opened without insolvency proceedings opening in the main State (Article 3.4):

(a) where main insolvency proceedings cannot be opened because the conditions for doing so in the main State cannot be satisfied; and
(b) where territorial proceedings are requested by a creditor in the second Member State within which the debtor has the necessary establishment, or where the creditor's claim arises from the operation of that establishment.

The potential for abuse by the opening of insolvency proceedings in a multiplicity of jurisdictions, causing duplications of administrative expenses and loss of value for creditors generally, is addressed by the requirement that for the opening of any territorial proceedings, the debtor has an establishment within the relevant territory. The term 'establishment' is defined as 'any place of operations where the debtor carries out a non-transitory economic activity with human means and goods' (Article 2). This limits the scope for forum shopping, because the mere presence of assets, however great or small their value, in a Member State other than the main State, will not be sufficient to enable the courts of such a State to exercise insolvency jurisdiction on a territorial basis.

12.8 Recognition of insolvency proceedings

Chapter II establishes the rules for recognition of insolvency judgments. Any judgment opening insolvency proceedings handed down by a court of a Member State which has jurisdiction under the Regulation shall be recognised in all the other Member States from the time it becomes effective in the State of opening of the proceedings (Article 16). Thus the appointment of a liquidator shall be recognised in other Member States without any further formalities.

This extends also to not only the order appointing a liquidator, but also the powers of the liquidator, being the powers conferred on him by the laws of the main State.

The liquidator's appointment is evidenced by a certified copy of the original decision appointing him or any other certificate issued by the court which has jurisdiction. He may exercise all those powers which derive from his appointment, including the power to remove the debtor's assets from the territory of any Member State in which they are situate, subject to special rules concerning rights *in rem*. If territorial proceedings have been opened in another State or if asset preservation measures have been taken, the main liquidator must respect those proceedings in relation to the assets in that territory.

Article 21 provides for the publication by a liquidator of notice of his appointment in the Member State in which he has been appointed, and in any relevant Member State. The notice must state whether he is a 'main' liquidator or a 'territorial' liquidator.

Such publication is particularly important in the context of third parties honouring obligations to the debtor. Article 24 provides that where an obligation has been honoured in a Member State for the benefit of a debtor who is subject to insolvency proceedings opened in another Member State when it should in fact have been honoured for the benefit of the liquidator in those proceedings, the person honouring the obligation is deemed to have discharged the obligation only if he was unaware of the opening of the proceedings. If the obligation is honoured before the appointment has been advertised in the relevant Member State, it is presumed that the third party was unaware of the opening of the insolvency proceedings. If the appointment has first been advertised in that Member State, the third party is presumed to have been aware of the opening of the proceedings and the onus will fall on him to prove otherwise.

Recognition extends not only to judgments concerning the opening of insolvency proceedings and appointment of liquidators, but also to judgments concerning the course and closure of insolvency proceedings and compositions approved by the court. Such judgments may be enforced by the procedure described in Regulation No 44/2001 (relating to civil and commercial judgments generally).

12.8.1 Insolvency judgments

The rule of recognition, without further formalities, applies also to 'judgments deriving directly from the insolvency proceedings and which are closely linked with them, even if they were handed down by another court'.

This is a significant substantive provision which extends recognition and enforcement beyond such basic matters as a liquidator's appointment to substantive insolvency related judgments. This will include such matters as the asset swelling remedies, notably fraudulent preference challenges (s 286 CA 1963); invalidation of floating charges (s 288 CA 1963); the power of a liquidator to apply to the court for the return of assets improperly transferred by the company (s 139 of the Companies Act 1990); and the power of the court to order a company to contribute to the debts of a related company (s 140 of the Companies Act 1990) or to order the pooling of assets of related companies where both are in liquidation (s 141 of the Companies Act 1990). It will also extend to remedies affecting officers of the insolvent company, such as declarations of personal liability for the debts of the company grounded on fraudulent or reckless trading (s 297 CA 1963) or on failure to keep proper books of account of the company (s 204 of the Companies Act 1990); liability for misfeasance (s 298 CA 1963); and the power of the court to summons persons for examination before the court and to order the return of assets (s 245 CA 1963).

The limited ability to enforce many of these remedies against foreign parties or foreign resident directors (all being excluded from the Brussels Convention) has up to now confined the range of remedies available to liquidators. Thus the Regulation greatly improves this aspect of insolvency practice as far as EU resident parties and the recovery of assets within other Member States are concerned.

One would also expect that orders restricting the directors of an insolvent company from being appointed as directors or officers or being concerned in the management of a company unless they meet certain capital requirements or disqualifying directors absolutely from so acting (Pt VII of the Companies Act 1990) will be recognised and enforced under the Regulation on the grounds that such orders are judgments 'deriving directly from the insolvency proceedings and which are closely linked with them'.

The sanctions for a director having a restriction or disqualification order made include the fact that the Registrar of Companies in Ireland is required to maintain a register of persons subject to such orders. The court also has power to order that any consideration paid by a company for services performed by a person in breach of a restriction or disqualification order are recoverable by the company as a simple contract debt. If such a company is placed in insolvent liquidation within 12 months of such conduct, the court may declare the offending person personally liable for all the debts of the company incurred during the period while he was so acting (s 163 of the Companies Act 1990). All these remedies derive from and are so closely linked to insolvency proceedings that they should be recognised as falling within the scope of the Regulation.

There are some provisions of Irish company law which, although 'closely linked' with insolvency proceedings, are perhaps not 'deriving directly' from them. For example, s 251 of the Companies Act 1990 provides that certain of the provisions of the Companies Acts which previously only applied where a company was being wound up, may be applied where a company is insolvent but is not being wound up and the reason or principal reason why it is not being wound up is the insufficiency of its assets. The provisions which can be applied in such circumstances include the following:

(a) the power of the court to order the return of assets improperly or fraudulently transferred (s 139 of the Companies Act 1990);
(b) the power of the court to order a company to contribute to the debts of related companies (s 140 of the Companies Act 1990);
(c) criminal and civil liability of officers where the company's failure to keep proper books of account contributes to the inability of the company to pay its debts (ss 203 and 204 of the Companies Act 1990);
(d) the power of the court to order inspection of books and papers by creditors and contributories;
(e) the power of the court to summon persons for examination before the court and make orders for return of assets (s 245 CA 1963);
(f) power to arrest an absconding contributory (s 247 CA 1963);
(g) liability for fraudulent and reckless trading (s 297 CA 1963);
(h) liability of officers for misfeasance (s 298 CA 1963).

Section 251 of the 1990 Act is a far-reaching provision which has not yet been the subject of any judgments. Undoubtedly a judgment under this section would be 'closely linked' with insolvency proceedings. However, it is questionable whether in the absence of the opening of insolvency proceedings as defined in the Regulation they 'derive directly' from insolvency proceedings. They would seem, therefore, to be outside the scope of the Regulation. It must be anticipated that other provisions of company law or common law will fall in this category in various Member States.

12.9 *Lex concursus*

Article 4 declares that the law applicable to insolvency proceedings and their effects shall be that of the Member State within the territory in which such proceedings are opened, known as the 'State of opening of proceedings'. This is the concept of the *lex concursus*. It is one of the most important features of the Regulation in that it governs not only laws relating to procedural matters, but many of the substantive rules which affect the conduct of insolvency proceedings. Article 4 lists the principal matters. The most important are those concerning the ascertainment of assets and liabilities of the debtor, including:

(a) the treatment of assets acquired and liabilities incurred after the opening of the insolvency proceedings;
(b) the respective powers of the debtor and the liquidator;
(c) the conditions under which set offs may be invoked;
(d) the effects of insolvency proceedings on current contracts to which the debtor is a party;
(e) the effects of the proceedings brought by individual creditors (with the exception of law suits pending);
(f) the rules governing the lodging, verification and admission of claims;
(g) the rules governing the distribution of proceeds from the realisation of assets, the ranking of claims and the rights of creditors who have obtained partial satisfaction after the opening of insolvency proceedings by virtue of a right *in rem* or through a set off;
(h) rules concerning the costs and expenses incurred in the insolvency proceedings; and
(i) rules relating to the voidness and voidability or enforceability of legal acts detrimental to all the creditors.

This mandatory choice of law is the closest one finds to a harmonisation of laws, in that the *lex concursus* will govern all these issues in the liquidation of any one debtor company. By this rule, the Regulation will enable those who have dealings with a debtor whose centre of main interest is within the EU to know the substantive legal provisions by which their rights would be determined in the event of the debtor's insolvency.

12.9.1 Special choice of law

There are a number of special choice of law rules by way of exceptions to the principle of determination according to the *lex concursus*. These concern such matters as:

(a) rights *in rem* in respect of assets belonging to the debtor which are situated within the territory of another Member State at the time of the opening of the proceedings (Article 5);
(b) the right of creditors to claim set off where such is permitted by the laws governing the creditor's claim but perhaps not by the *lex concursus* (Article 6);
(c) the rights of the seller of goods under reservation of title and the rights of purchasers of goods (Article 7).

Issues concerning immoveable property are governed solely by the law of the Member State within which the property is situate *(lex situs)* (Article 8).

The effects of insolvency proceedings on parties to a payment system or settlement system or to a financial market are governed by the law of the Member State applicable to that system or market (Article 9). Issues concerning employment contracts are governed solely by the law of the Member State applicable to the contract of employment (Article 10). Issues concerning rights to immoveable property, a ship or an aircraft subject to registration in a public register are determined by the law of the Member State under the authority of which the register is kept (Article 11).

Whilst the *lex concursus* governs rules concerning voidness, voidability or unenforceability of acts detrimental to all creditors, this is subject to the exception that the *lex concursus* shall not apply where the person who benefited from an act detrimental to the creditors proves that the act is subject to the law of a Member State other than that of the State of opening of the proceedings and that law does not allow any means of challenging that act in the relevant case (Article 13). At one level, this exception seems to undermine the primacy of the *lex concursus* for certain very important substantive issues. It will remain to be seen how the courts of different Member States will interpret the requirement for this saver that there be 'no means of challenging' the relevant act. One must assume that this is not intended to permit other States to apply their own standards to transactions under scrutiny, but rather that it must be shown simply that their laws do not permit such a challenge in any circumstances whatsoever.

12.10 Secondary insolvency proceedings

Chapter III provides that the opening of proceedings in the debtor's centre of main interests will permit the opening in another Member State of secondary insolvency proceedings without the debtor's insolvency being examined in that other State. The secondary insolvency proceedings can only be opened in another State where the debtor has an establishment and they are territorial in effect. This means that they are restricted to the assets of the debtor situated in the territory of the second Member State.

Secondary insolvency proceedings under Chapter III must be 'winding up proceedings'. The definition of 'winding up proceedings' is more limited than 'insolvency proceedings'. Winding up proceedings are proceedings involving only the realisation of assets of the debtor. They do not include proceedings for a reorganisation. The Annex to the Regulation defines winding up proceedings and, in the case of Ireland, Examinership is excluded. In the case of the UK, both administration and voluntary arrangements under insolvency legislation are excluded.

Whilst primacy is given to the main proceedings, the law applicable to secondary proceedings is the law of the Member State within which those secondary proceedings are opened. This is most critical in such aspects as the priority and ranking of claims, the effects on contracts and the potential for challenge to transactions based on laws relating to such matters as voidable preferences. However, those laws of the 'second State' only apply in relation to the realisation and distribution of the assets within that State.

Secondary proceedings may be requested by a liquidator in the main proceedings or any other person or authority empowered to request the opening of insolvency proceedings under the law of the Member State within which the secondary proceedings are requested. Typically this would enable such proceedings to be commenced on the application of either the liquidator in the main proceedings or a creditor or other interested party in the relevant second State.

The Regulation imposes a system for communication and exchange of information between the 'main' liquidator and the 'secondary' liquidator. Article 31 provides that the liquidators shall be duty-bound to communicate information to each other and to co-operate with each other. They must immediately communicate any information which may be relevant to the other proceedings, in particular the progress made in lodging and verifying claims and all measures aimed at terminating the proceedings. The secondary liquidator must give the main liquidator an 'early opportunity of submitting proposals on the liquidation or the use of assets in the secondary proceedings'. The term 'proposals on the liquidation or the use of assets' is not defined, leaving significant scope for dispute as to what measures in a liquidation would fall within this article. Nor is any stipulation made as to what regard the secondary liquidator should give to such 'proposals'. One assumes that if it was intended that such proposals would be binding, the Regulation would have so provided. The provision at least establishes a system where a main liquidator who considered that the interests of creditors were prejudiced by any measures being taken might make an appropriate application to the court seised of the secondary proceedings, including application for a stay (see Article 33, discussed below).

The court which has opened secondary proceedings can stay the process of liquidation in those proceedings on the request of the main liquidator. In doing so it may require the main liquidator to take measures to guarantee the interests of creditors in the secondary proceedings. Such a stay can be rejected only if it is of manifestly no interest to the creditors in the main proceedings. A stay may be for a period of up to three months and can be extended for similar periods (Article 33).

A creditor may lodge his claim in the main proceedings and in any secondary proceedings. Each liquidator shall then lodge in the other proceedings claims which have already been lodged in his liquidation provided that doing so advances the interests of the creditors concerned. Each liquidator is empowered to participate in the other proceedings on the same basis as a creditor, in particular by attending creditors' meetings (Article 32).

Although secondary proceedings must be 'winding up' proceedings and therefore cannot be commenced as proceedings for a reorganisation or rescue plan, if the law governing the secondary proceedings permits the closure of such proceedings without liquidation of the debtor but by a rescue plan, composition or comparable measure, the main liquidator can propose such a measure. Closure of the secondary proceedings by such a measure can only become final with the consent of the main liquidator. If the main liquidator refuses his consent, the measure can become final only if the financial interests of the creditors in the main proceedings are not affected by the measure. It is difficult to envisage circumstances in which the main liquidator would withhold his consent unless the interests of the creditors in the main liquidation are impaired. In effect, therefore, the main liquidator enjoys a veto over any such plan.

Where the secondary proceedings result in a surplus after payment of all claims allowed under those proceedings, the second liquidator must transfer that surplus to the main liquidator.

12.11 Information and treatment of creditors

The Regulation establishes a procedural regime for the lodgment of claims and information to creditors and for equality of treatment of creditors generally.

Article 39 permits any creditor in a Member State other than the State of opening of the proceedings, including the tax authorities and social security authorities of Member States, to lodge claims in the insolvency proceedings.

This provision enshrines the basic principle of equality of treatment for creditors, regardless of their State of residence or business attachment. Most importantly, it overrides the widely practised exclusionary rule of private international law whereby the courts of one State refuse to enforce the revenue or other public laws of other sovereign States. The application of this rule has frequently meant, in the absence of particular conventions as between individual Member States, that foreign revenue claims have been denied the standing to lodge proof in insolvency proceedings. The new rule does not address the question of priorities and therefore the *lex concursus* will continue to govern the question of ranking of claims. For example, in Ireland only the debts to which s 285 CA 1963, as extended by numerous statutes, applies enjoy preferential status in a liquidation. This means that foreign revenue claims must now be admitted to proof, but are not within the category of claims to which preferential status attaches under s 285, in this case the *lex concursus*. Only an amendment to s 285 would alter this position.

Article 20 contains two important provisions to preserve the fundamental rule of equal treatment of creditors:

(a) Where, after the opening of insolvency proceedings in the State of the debtor's main centre of interests, a creditor obtains by any means total or partial satisfaction of his claim on assets of the debtor situated in the territory of another Member State, he must return those assets to the liquidator.
(b) Where a creditor obtains a dividend in the course of insolvency proceedings in any State, whether it be the primary or a secondary State, he can only share in dividends in other insolvency proceedings where creditors of the same ranking have, in those other proceedings, obtained an equivalent dividend.

12.11.1 Notification and submission of claims

As soon as insolvency proceedings are opened in a Member State, the court of that State or the liquidator must inform known creditors in other Member States. This notification must include time limits and other details concerning the lodgment of claims (Article 40). It can be given in one of the official languages of the State for the opening of the proceedings. The form must bear a heading 'Invitation to Lodge a Claim. Time Limits to be Observed' in all the official languages of the institutions of the EU. The creditor may then lodge the claim in the official language of his own State. However, the lodgment of his claim must bear the heading 'Lodgment of Claim' in one of the official languages of the State of opening of the proceedings. The creditor can be required to provide a full translation of its claim into the language of the State of opening of the proceedings.

12.12 Public policy

A Member State can refuse to recognise insolvency proceedings or judgments of another Member State where doing so would be 'manifestly contrary to that State's public policy, in particular its fundamental principles or the constitutional rights and liberties of the individual' (Article 26). As far as concerns recognition of the appointment of liquidators and the basic process of asset realisation and distributions to creditors, it is difficult to envisage, at least from an Irish point of view, measures which would offend public policy or the Constitution. However, one must anticipate that certain aspects of the investigative and enforcement process could face scrutiny under this Article, either under the Irish Constitution or similar fundamental laws in other Member States. For example, s 8 of the Companies (Amendment) Act 1990, which governs Examinership law and practice in Ireland, contained a provision to the effect that if an officer or agent of the company or other person refused to produce to the Examiner any book or document or answer any question put to him by the Examiner, the Examiner could certify that refusal to the court and the court would then conduct an enquiry and punish the offender in like manner as if he had been guilty of contempt of court. That provision was based on a similar provision of the Companies Act 1990, which was later held to be unconstitutional (*Desmond v Glackin (No 2)* [1993] 3 IR 67). Therefore, amending legislation in 1999 deleted the reference to contempt of court and provides that the court can 'make any order or direction it sees fit' (Companies (Amendment) (No 2) Act 1999). Similarly, s 297 CA 1963, which provides for personal liability of directors found party to fraudulent trading, was the subject of a constitutional challenge in 1997 (*O'Keefe v Ferris and Others* [1997] 3 IR 463 (SG)), albeit an unsuccessful challenge. Therefore one must expect that different mechanisms for enquiry and for compelling the provision of information originating in different Member States will encounter challenges from time to time against the fundamental laws in other Member States.

The Regulation does not refer to the European Convention on Human Rights. This raises the question of whether States which have incorporated the Convention into their domestic laws might contend that insofar as they have done so that Convention is a feature of their laws and policies against which foreign investigation or asset recovery measures might be tested. This would present a variety of issues perhaps not contemplated by the Regulation.

12.13 Conclusion

As a Regulation adopted by the EU Council, this measure has force of law effective from 31 May 2002. Several aspects of the Regulation will be problematic in practice. However, the fundamentals of the Regulation should improve the efficiency and effectiveness of cross-border insolvency proceedings. It will also widen the scope of the asset swelling and other remedies available to liquidators.

The Regulation only applies to branches of companies and other circumstances where the cross-border activities are not managed through subsidiary companies. Accordingly, there will be many 'group' cases where the administration of the insolvency will be conducted through the network of subsidiary companies as before.

CHAPTER 13

CONCLUSION

Michael Quinn

Although insolvency is recognised as a specialist area of law, in practice the insolvency lawyer must expect to encounter numerous different aspects of not only bankruptcy and company law, but also the laws of contract, property, trusts, securities and aspects of regulatory controls which apply to all sectors of industry.

Insolvency procedures are increasingly being recognised as a necessary and integral part of the framework for business laws generally and not as a necessary evil associated only with the closure of a business. Knowledge of insolvency principles and procedures equips the practitioner to identify solutions for retaining value for the business and assets of companies encountering financial difficulties. Similarly, he can advise creditors and other stakeholders on effective asset tracing and recovery measures.

Some aspects of recent reforms of Irish insolvency law are very progressive by contrast with other jurisdictions. For all its failings, the system of Examinership contains some critical features that are more advanced than similar systems in other jurisdictions. In the UK for example, the Enterprise Act 2002 introduces reforms which will limit the timetable for the administration process (which is the UK nearest equivalent of Examinership) so that it will be closer to the defined time frame which now applies in Ireland.

Other jurisdictions have varying forms of disqualification and other penalties for culpable directors of insolvent companies. However, the system of 'restriction' under s 150 of the Companies Act 1990, described in Chapter 4, whilst not without its faults, is unique in its focus on preventing the 'phoenix' syndrome by the particular capital requirements applying to future ventures for the directors concerned.

Reform of insolvency laws in other jurisdictions can still be informative. Again, the UK, our nearest neighbour, is introducing some very radical reforms in the Enterprise Act 2002. For example, it is intended that bankrupts will be discharged from bankruptcy automatically 12 months after their adjudication. At present a bankrupt in Ireland can remain in that legal status indefinitely, subject to his right to apply for discharge in certain circumstances. The Enterprise Act 2002 also contains some fundamental changes affecting priorities, including the proposed abolition of Crown preference, meaning in effect the abolition of preferential status for taxes. In parallel to this radical change is a proposal to abolish the right of the holder of floating charges to appoint receivers, and instead provide a right to enable them to move for the appointment of an administrator. Some of these changes will fundamentally alter the laws relating to priority, which in turn will affect business and lending practices.

There is an obvious need for consolidation of Irish company law, and the Company Law Review Group has made specific recommendations in this regard. This will benefit students of insolvency law, because at present the fundamentals are to be found in a range of separate statutes. In the meantime, this book serves as a basic introduction to insolvency law and practice. However, consolidation of company law will not limit the need for constant awareness of developments in other fields which impact on the conduct of insolvency.

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