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Corporate Recovery & Insolvency 2019

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A practical cross-border insight into corporate recovery and insolvency work

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Ireland

Michael Murphy

McCann FitzGerald

Grace Armstrong

1 Overview

1.1 Where would you place your jurisdiction on the spectrum of debtor to creditor-friendly jurisdictions?

Corporate insolvency and restructuring law in Ireland has developed to respond to the needs of both creditors and debtors by balancing the protection of both parties' rights. Our framework provides a broad range of flexible legislative remedies, with perhaps a marginal emphasis on the stability engendered by the protection of the rights of secured creditors. Where previously such secured creditors overwhelmingly comprised regulated financial institutions, with the recent advent of loan sales in the market, private institutions have become the holders of security and have frequently been involved in restructuring and enforcement actions. Where such proceedings come before the courts, the courts are mindful to ensure careful adherence to contractual and statutory rights, to ensure that debtors are protected notwithstanding that their obligations have been assigned to third parties.

Unsecured creditors do not enjoy priority in a winding up. However, retention of title clauses are valid as a matter of Irish law and may permit the unsecured creditor to recover goods supplied.

1.2 Does the legislative framework in your jurisdiction allow for informal work-outs, as well as formal restructuring and insolvency proceedings, and to what extent are each of these used in practice?

There are a comprehensive range of procedures available to an insolvent Irish company. These include liquidation, either following a court order or a shareholders' resolution, receivership (the appointment of a receiver by a secured creditor pursuant to contractual rights in a security document) and examinership, a court-managed restructuring procedure.

Examinership is a corporate rescue and restructuring procedure whereby an insolvent company is provided with court protection for a limited period to enable it to negotiate with creditors, seek new investment and write down its liabilities.

Irish company law also provides a mechanism for a company to reach a compromise with its creditors on a less structured basis than examinership and the recently revised company legislation reduced the number of court appearances required for such compromises. These scheme of arrangement provisions are very similar to the English scheme provisions. Until recently, such arrangements have not been widely availed of. However, there has been a noticeable focus on our scheme provisions.

Troubled companies will typically seek to resolve their financial difficulties through consensual discussion and agreement with creditors, whether documented by way of a formal standstill or settlement agreement. Failing such resolution, examinership, receivership and liquidation are commonly availed of under Irish law.

2 Key Issues to Consider When the Company is in Financial Difficulties

2.1 What duties and potential liabilities should the directors/managers have regard to when managing a company in financial difficulties? Is there a specific point at which a company must enter a restructuring or insolvency process?

When a company is insolvent, or close to insolvent, its directors owe fiduciary duties to the creditors of the company and not to its shareholders. Recent amendments to company law have codified directors' duties in a non-exhaustive list of formerly pre-existing common law (fiduciary), equitable and statutory duties. These include but are not limited to the duty to act honestly and responsibly and in good faith in the interests of the company, to act in accordance with the company's constitution and the law, not to use the company's property for his/her benefit, to avoid conflicts of interest and to exercise due skill, care and diligence.

The thrust of Irish company law sanctions against directors (which includes shadow and *de facto* directors) of an insolvent company is to penalise individuals who are recklessly incurring credit or who deplete the company's assets where the directors cannot, on any reasonable or objective basis, believe that the company will be able to operate as a going concern, or who were knowingly party to fraudulent trading. Personal liability may be imposed for all or part of the liabilities of the company. In addition, criminal sanctions may apply.

Directors of companies in insolvent liquidation are at risk of being subjected to restriction orders where they cannot show that they acted honestly and responsibly in relation to the affairs of the company. If restricted, a director is prevented from continuing to act as a director unless the company meets certain minimum paid up share capital requirements.

No specific mandatory triggers exist under Irish law for entry into restructuring or insolvency procedures. There are two tests for insolvency: the balance sheet test; and the cash flow test. If a company is considered to be insolvent under either of the above

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tests, its directors will need to keep their decision to continue to trade under constant review. The difficulty with applying the balance sheet test revolves around the valuation of the company's assets. This test can easily be triggered, particularly if the company has significant bank borrowings. It is therefore more important for directors to focus on the cash flow test in the short term while at the same time planning how to reduce the balance sheet deficit in the longer term.

2.2 Which other stakeholders may influence the company's situation? Are there any restrictions on the action that they can take against the company? For example, are there any special rules or regimes which apply to particular types of unsecured creditor (such as landlords, employees or creditors with retention of title arrangements) applicable to the laws of your jurisdiction? Are moratoria and stays on enforcement available?

Secured creditors, unsecured creditors and shareholders can directly influence the company's situation. An examinership is the only means by which a company in financial difficulty can obtain a moratorium from action by its creditors. An application for the appointment of an examiner can be made by the company itself, its directors, a creditor or member.

In an examinership, once a company has been placed under court protection, the creditors of the company (which term includes retention of title creditors and landlords) are prevented from taking any action to enforce their security or to take enforcement action of any kind against the company.

Secured creditors who apprehend a risk of examinership and wish to prevent the appointment of an examiner will typically move quickly to appoint a receiver. The appointment of a receiver is the main method by which a secured creditor will enforce its security. A court will refuse to hear a petition for examinership in relation to a company in respect of which a receiver has been appointed for a period of three continuous days prior to the date of presentation of the petition and a receiver will be removed if a petition for the appointment of an examiner is presented within three days of his appointment.

A winding up petition may be presented by the company itself, its creditors, any of its creditors or contributories, the Director of Corporate Enforcement and any person entitled to bring shareholder oppression proceedings. In every liquidation, a committee of inspection is typically appointed by creditors. The main duty of a committee is to oversee the activities of the liquidator and approve the liquidator's fees and expenses.

Shareholders who can show the affairs of the company are being conducted in a manner which is oppressive to their interests may apply to the court for relief.

2.3 In what circumstances are transactions entered into by a company in financial difficulties at risk of challenge? What remedies are available?

Certain transactions to which an insolvent company is party may be attacked by, among others, a liquidator appointed to the company and where such challenge is successful, the transactions may be set aside.

Where property is disposed of and it is possible to show that the effect of such disposal was to perpetrate a fraud on the company, its creditors or members, the court may direct the return of such property. There is no prescribed period within which an application must be brought.

Irish company law prohibits certain transactions where a company provides financial assistance in connection with the acquisition of shares in that company. Such transactions are voidable at the option of the company against a third party with notice and a breach of the legislation is a criminal offence. Directors are also restricted from entering transactions with the company except within certain specified conditions. In the event of a breach, such a transaction is voidable and a director may risk personal liability.

Transactions in favour of a creditor taking place within six months of the commencement of a winding up (or within two years if in favour of a connected person) made with a view to giving such creditor a preference are liable to be set aside.

Where a company is being wound up, a floating charge created within 12 months of the commencement of the winding up can in certain circumstances be declared invalid.

3 Restructuring Options

3.1 Is it possible to implement an informal work-out in your jurisdiction?

Informal work-outs as between debtors and creditors frequently occur. While creditors may be willing to provide standstill agreements during a period of negotiation, a company in financial difficulty will not be able to avail of immunity from suit during this period and will be vulnerable to actions by non-secured creditors, including the Revenue Commissioners. Accordingly, where a company perceives a significant threat of liquidation or receivership, but where it believes it has a reasonable prospect of survival, examinership may be a more viable option.

3.2 What formal rescue procedures are available in your jurisdiction to restructure the liabilities of distressed companies? Are debt-for-equity swaps and pre-packaged sales possible? To what extent can creditors and/or shareholders block such procedures or threaten action (including enforcement of security) to seek an advantage? Do your procedures allow you to cram-down dissenting stakeholders? Can you cram-down dissenting classes of stakeholder?

Examinership is the main rescue procedure for an insolvent company (or group of companies) which comprises three main components: new investment into the company; a forced write down of the company's current liabilities; and a "legal stay" or protection period which prevents any enforcement action being taken against the company for a period of up to a maximum of 100 days. During the period of examinership, no enforcement action can be taken by creditors, including secured creditors or against guarantors of the company's liabilities. Unless an existing shareholder is the investor, examinership will result in a change of ownership of the company. Existing shares will be cancelled and new shares will be issued to the proposed investor.

If an objecting party establishes that a company in examinership does not have a reasonable prospect of survival as a going concern or that the examiner's proposals for a scheme of arrangement are unfairly prejudicial, a court will not confirm the proposals. However, liquidation is the inevitable consequence of a failed examinership.

Debt-for-equity swaps and pre-packaged sales do occur, and while in practice the appointment of a receiver or examiner may take place on the basis that a pre-ordained outcome is to be implemented, there is no current legislative basis for a pre-packaged sale.

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3.3 What are the criteria for entry into each restructuring procedure?

The criteria for entry into examinership are threefold: the company is insolvent or likely to become insolvent; no resolution has been passed (nor has any order been made) to wind up the company; and there is a reasonable prospect of survival of the whole or part of the business as a going concern. An application for the appointment of an examiner must (save in exceptional circumstances) be accompanied by an independent expert's report, which verifies that the company has a reasonable prospect of survival as a going concern.

3.4 Who manages each process? Is there any court involvement?

An examinership is commenced by way of a petition to the High Court (or in certain circumstances, the Circuit Court) and the process is closely monitored by the court. The directors of the company remain in place and the company continues to trade, while the examiner analyses the company's finances, establishes which parts of the business can be rescued and negotiates with investors, creditors and shareholders to prepare proposals for a scheme of arrangement which, if implemented, will facilitate the company's survival. Once he has formulated his proposals, the examiner must convene meetings of each class of creditors who may vote in favour of or against the proposals. The examiner will then prepare a report which is filed in court. In order for a scheme to become binding on the members and creditors of a company, the court must make an order confirming the proposals. It may only do so if at least one class of impaired creditors has voted in favour of the proposals and the court will not approve a scheme if its purpose is to avoid tax or if it is unfairly prejudicial to any class of creditors.

3.5 What impact does each restructuring procedure have on existing contracts? Are the parties obliged to perform outstanding obligations? What protections are there for those who are forced to perform their outstanding obligations? Will termination and set-off provisions be upheld?

Examinership does not itself terminate contracts, albeit most contracts provide that examinership activates a right of termination. However, where a company is under the protection of the court, its creditors are prevented from exercising rights against the company, such as any claim for damages which may arise.

The company in examinership may, with the approval of the court, repudiate any contract under which some element of performance other than payment remains to be rendered by both parties. Any person who suffers loss as a result of the repudiation becomes an unsecured creditor in the examinership and the court may assess the value of his loss. This provision is frequently availed of by tenant companies to repudiate expensive leaseholds. The landlord becomes an unsecured creditor, the liability on him being discharged under the scheme.

The examiner may obtain court approval to dispose of property subject to a fixed or a floating charge on the basis that this would facilitate the survival of the company. The market value of the property sold must be accounted to the holder of the charge. The liabilities of a secured creditor can in certain circumstances be crammed down.

During an examinership, no proceedings may be commenced against guarantors or other third parties liable in respect of debts of the company. Particular rules govern the enforcement of guarantees in an examinership and certain steps must be taken by secured creditors to preserve their rights under the guarantees, thereby protecting the creditor's right to pursue the guarantor, even if the underlying debt is crammed down in the examinership.

During the examinership, the company must be able to fund itself and discharge all new liabilities incurred as they fall due. Further, the examiner's proposals should result in a more favourable outcome for the creditors than would be the case in a liquidation or receivership.

Set-off provisions will be upheld and can be applied, notwithstanding that a company is in examinership.

3.6 How is each restructuring process funded? Is any protection given to rescue financing?

The costs of an examinership can be significant and will be met out of the assets of the company. An examiner has the power to certify a liability at the time it is incurred if he forms the view that it is necessary for the survival of the company that the debt should be incurred. Such certification affords priority to any such liability over other creditor claims in the event of the subsequent liquidation of the company. No specific protection exists under Irish law for any new finance provided to a company by way of rescue funding.

4 Insolvency Procedures

4.1 What is/are the key insolvency procedure(s) available to wind up a company?

An insolvent company may be wound up by the Irish courts where, amongst other things, its members by special resolution have resolved that the company be wound up by the court or where the company is unable to pay its debts. The petition for a compulsory liquidation can be made by the company itself, any creditor(s) and/or, subject to some restrictions, any members. In limited circumstances, the Director of Corporate Enforcement (who has a supervisory role in respect of liquidations and insolvent companies), the Central Bank of Ireland and the Registrar of Companies may also petition for a compulsory liquidation of the company.

A company may also be placed in a creditors' voluntary liquidation where, amongst other things, the members by ordinary resolution resolve that the company cannot by reason of its liabilities continue its business and that it be wound up voluntarily.

The appointment of a receiver by a secured creditor pursuant to contractual rights contained in a security document is the main method by which a secured creditor enforces its security. However, receivership is not a process for the dissolution of a company.

4.2 On what grounds can a company be placed into each winding up procedure?

A company can be placed in compulsory liquidation by the court if the company is insolvent, or on just and equitable or public interest grounds. A creditors' voluntary liquidation may be initiated by the company in a general meeting, resolving that it cannot by reason of its liabilities continue its business, and that it be wound up as a creditors' voluntary liquidation. A company may be placed in a

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solvent liquidation if its directors are in a position to confirm that it will be in a position to meet its liabilities in full within a period of 12 months.

4.3 Who manages each winding up process? Is there any court involvement?

A liquidator is appointed to manage the realisation of the company's assets and distribution of claims. While compulsory liquidations were previously actively managed by the High Court, recent legislative change altered this position. A committee of inspection (comprising creditors of the company) may now be formed and the liquidator is obliged to report to the committee throughout the liquidation. The committee can authorise the exercise of certain powers and sanction payment of the liquidator's fees, costs and expenses.

The Director of Corporate Enforcement is tasked with ensuring compliance with company law and a liquidator is obliged to report to the Director in relation to the conduct of the directors of a company in liquidation.

Voluntary liquidations take place without court involvement. A solvent voluntary liquidation can be controlled by the company's shareholders, in contrast to an insolvent voluntary liquidation, which is managed by a liquidator but may be overseen by a committee of inspection, if such a committee is formed by the company's creditors. As in the case of a court liquidation, the committee can authorise the exercise of certain powers by the liquidator and sanction payment of the liquidator's fees, costs and expenses.

4.4 How are the creditors and/or shareholders able to influence each winding up process? Are there any restrictions on the action that they can take (including the enforcement of security)?

Typically, the liquidator is nominated by the petitioning creditor or the company, if it is initiating the winding up process. Following the appointment of a liquidator or a provisional liquidator, the leave of the court is required in order to commence or continue proceedings against the company.

The rights of secured creditors are unaffected by a liquidation, assuming such rights do not fall foul of any avoidance provisions and the secured creditor may elect to appoint a receiver or to allow the liquidator to realise its security and account to it for the proceeds. However, the claims of preferential claims will rank ahead of floating charge realisations.

4.5 What impact does each winding up procedure have on existing contracts? Are the parties obliged to perform outstanding obligations? Will termination and set-off provisions be upheld?

Contractual provisions which allow for termination of the contract on the entry by the company into an insolvency or restructuring process are common and are enforceable against a liquidator.

The liquidator may, with court approval, within 12 months after the commencement of the liquidation, disclaim any property of the company being wound up which consists of, amongst other things, (a) unprofitable contracts, or (b) any property which is unsaleable or not readily saleable by reason of its binding the possessor to the performance of any onerous act or to the payment of money. The liquidator's hand may be forced – any person interested in the property may require him to decide whether or not he will disclaim and if the liquidator wishes to disclaim in such circumstances, he must give notice within 28 days that he intends to apply to court to disclaim.

Under statutory insolvency set-off rules, set off of "mutual credits and debts" is permitted, but not mandatory. In addition, contractual set-off will survive insolvency and is enforceable against a liquidator.

4.6 What is the ranking of claims in each procedure, including the costs of the procedure?

The key principle of distribution of property of a company under Irish law is that claims, subject to certain exceptions, shall rank *pari passu*. Where a liquidator realises assets on behalf of a fixed charge holder, his costs and expenses in respect of such realisation will by agreement be retained out of such realisation. Once assets have been distributed to the holders of a fixed charge, super preferential creditors (comprising unpaid employee withholding tax), trust monies returned and following the application of set-off rights which may apply, the order of priorities in a liquidation are as follows:

(1) the costs and expenses of the liquidation;
(2) preferential creditors (comprising employee entitlements and unpaid taxes);
(3) floating charge holders;
(4) unsecured creditors; and
(5) members and contributories.

In the event of a liquidation following an examinership, the examiner's costs and expenses have priority over all over claims, including those of secured creditors. Any expenses certified by an examiner will rank in priority to a floating charge creditor.

The order of priority of claims in a receivership will be set out in the security document pursuant to which the receiver has been appointed.

4.7 Is it possible for the company to be revived in the future?

Where a company has been dissolved, the court may within a two-year period on an application being made by the liquidator or another interested party, make an order declaring the dissolution to have been void. It is also possible to apply for the annulment of a winding up order or resolution. In practice, both such applications are rare.

5 Tax

5.1 What are the tax risks which might apply to a restructuring or insolvency procedure?

The commencement of insolvency proceedings does not *per se* give rise to a tax liability; however, tax liabilities will continue to be incurred in the ordinary way in an insolvency or restructuring procedure, including, for example, corporation tax, VAT, employee withholding taxes, capital gains tax and stamp duty.

A liquidator or receiver will register for tax on their appointment and any pre-existing tax liabilities will be dealt with in the liquidation or receivership and are likely to have preferential status.

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In an examinership, liabilities to the Revenue Commissioners can be crammed down; however, the court will not confirm a scheme which is unfairly prejudicial to any creditor, including the Revenue. However, the write down of debt may trigger a capital gains tax liability or a VAT liability where VAT deductions have been claimed for the full value of invoices subsequently written down by the examiner's proposals. A liquidator appointed pursuant to a solvent voluntary liquidation will be obliged to obtain tax clearance before finalising the liquidation.

A key question is whether trade has ceased in a liquidation or a receivership. If a liquidator or receiver is simply realising trading assets, trade is likely to have ceased, in which case the income received is currently taxed as a post-cessation receipt at a corporation tax rate of 25%, as opposed to the standard rate of 12.5%.

6 Employees

6.1 What is the effect of each restructuring or insolvency procedure on employees? What claims would employees have and where do they rank?

In a receivership, the appointment of a receiver will not terminate employment contracts. However, a receiver may choose to terminate employment contracts and any claims by employees (for example, in respect of unpaid wages) which accrued prior to his appointment will have preferential status in the receivership.

Similarly, in an examinership, the appointment of the examiner will not terminate employment contracts as the business of the company will continue to be traded. Pre-existing claims by employees, including prospective or contingent claims, can be crammed down in the examiner's proposals.

In a liquidation, contracts of employment are generally terminated by the liquidator. Employee claims will typically rank as a preferential claim, ahead of floating charge creditors. Certain claims by employees (in respect of, for example, unpaid wages, holiday pay and redundancy payments up to certain thresholds) which cannot be met by the insolvent company will be paid out of a government-funded insolvency fund (the "**Fund**"). The Fund is then entitled to claim in the liquidation for all amounts paid to employees and will rank as a preferential creditor in the liquidation.

Where a transfer is effected or proposed to be effected of the business of the company in liquidation, the employees and the employers' liabilities to its employees may under specific legislation automatically transfer to the purchaser. The legislation provides certain exemptions for insolvency proceedings which may be applicable depending on the circumstances.

7 Cross-Border Issues

7.1 Can companies incorporated elsewhere use restructuring procedures or enter into insolvency proceedings in your jurisdiction?

By virtue of the Insolvency Regulation, subject to certain exclusions, where a foreign insolvent company (whether or not the insolvent company is Irish incorporated) has its "centre of main interests" ("**COMI**") in Ireland, "main proceedings" can only be instituted before an Irish court. Under the Insolvency Regulation, "main proceedings" have, subject as otherwise provided in the Regulation, universal scope and as such encompass all of the debtors' assets and creditors located in the EU (with the exception of Denmark). In the case of Ireland, main proceedings for the purposes of the Insolvency Regulation include compulsory winding up by the Irish court, examinership and creditors' voluntary winding up (with confirmation by the Irish court). Further, a foreign company incorporated in a country which is not subject to the provisions of the Insolvency Regulation may, in certain circumstances, be wound up by the Irish Court.

7.2 Is there scope for a restructuring or insolvency process commenced elsewhere to be recognised in your jurisdiction?

Ireland has not adopted the UNCITRAL Model Law on cross-border insolvency and domestic legislation does not contain a mechanism for the recognition of restructuring or insolvency processes commenced elsewhere. Where the proceedings are those to which the Insolvency Regulation applies, such proceedings will automatically be recognised in Ireland. Where the proceedings fall outside the scope of the Insolvency Regulation, the insolvency officeholder may apply to the High Court for recognition of the process under common law principles.

7.3 Do companies incorporated in your jurisdiction restructure or enter into insolvency proceedings in other jurisdictions? Is this common practice?

The range of remedies and procedures available under Irish law means that in practice this is rare.

8 Groups

8.1 How are groups of companies treated on the insolvency of one or more members? Is there scope for co-operation between officeholders?

Each Irish company will be dealt with as a separate legal entity and accordingly the assets and liabilities of a company in liquidation will not automatically be taken on by another group company. However, where two or more related companies are being wound up, and if a court is satisfied that it is just and equitable to do so, both companies may be wound up together as if they were one company. This is known as a pooling order.

In deciding whether it is just and equitable to make a pooling order, a court will have regard to (among other things): the extent to which any of the companies took part in the management of any of the other companies; the conduct of any of the companies towards the creditors of any of the other companies; 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 the extent to which the businesses of the companies have been intermingled.

An order will not be made simply because one company is related to another, or because the creditors of the company being wound up have relied on the fact that another company is or has been related to the first company.

Where an examiner is appointed to a company, either at the same time or later, an application may be made to appoint him to one or more related companies. The court must have regard to whether the

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appointment would facilitate the survival of the company or the related company or both and must be satisfied that there is a reasonable prospect of survival of the related company. The protection period of the related company is limited to the period available for the first company.

The recast EU regulation on Insolvency Proceedings contains a chapter on group insolvency proceedings, including provisions on cross-border cooperation of insolvency courts and insolvency practitioners from various insolvent group companies and a coordination procedure to afford a greater chance of rescuing the group as a whole, where possible. Insolvency practitioners can coordinate a joint restructuring plan and seek a stay of asset realisation measures.

9 Reform

9.1 Are there any other governmental proposals for reform of the corporate rescue and insolvency regime in your jurisdiction?

Irish company law was modernised in 2015, resulting in the consolidation of 12 acts into one, including all provisions which deal with corporate rescue and insolvency. Accordingly, substantive legislative reform is not anticipated. Irish insolvency law was also amended to incorporate so-called “Alternative A” contained in Article XI of the Aircraft Protocol to the Cape Town Convention. The most significant change arising from this is in examinership. In the event of an examinership of an airline or a company which owns or leases or has mortgaged aircraft under interests that fall within the scope of the Cape Town Convention, the examiner will have, at most, 60 days to cure all defaults and to agree to perform the company’s obligations in full. If he does not do that then he must deliver possession of the aircraft to the creditor at the end of the examinership or 60-day period, whichever is the earlier.

Ireland is party to the recast EU regulation on Insolvency Proceedings.

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Michael is Head of the Insolvency and Restructuring team. He has wide experience of advising in a number of significant restructurings, examinerships, receiverships and liquidations on behalf of all stakeholders including companies, directors, office holders, banks and other creditors. As well as advising when financial difficulties are identified, Michael advises on solvent reorganisations and on mitigating insolvency risk in transactions in the making.

Michael is a member of the Irish Society of Insolvency Practitioners and INSOL Europe. He has written and lectured extensively in the area of corporate recovery and insolvency.

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