

# Examinership A Review of Recent Developments



By Neil Hughes, FCA

The Zoe Group saga which dominated front pages over many months in the summer of 2009 brought Ireland's formal corporate recovery mechanism into sharp focus. Neil Hughes takes a look at what has been happening in the area of examinership.

Examination, or 'examinership' as it has become colloquially known, underwent formal legislative change in 1999. Today, as it approaches twenty years on the statute books, the practice of examinership is still evolving rapidly due to developments in case law.

It is clear that the 2009 decisions of Justice Clarke in refusing to confirm the high profile Laragan Developments scheme of arrangement, and the refusal of both Justice Kelly and Justice Clarke to appoint an examiner to the Zoe Group 'raised the bar' in relation to the process both from the point of view of the types of company that will qualify for examinership and also the types of scheme that will be approved by the High Court.

Perhaps the examinership process will never return to the 95% success rate enjoyed in the period 2004 to 2006. However, it was reported in the first week of 2010 that, following a drop in the success rate of examinership at the onset of recession in Ireland, a success rate of 75% was recorded overall for 2009. This recent improvement together with the more rigorous approach of the judiciary should be beneficial in the long run to restoring faith in all of the positive aspects of the examinership process: the protection of an insolvent trading business with a reasonable prospect of survival, thereby allowing it to continue to trade and restructure,

preserving employment, goodwill and work-in-progress (WIP), all the while delivering a better return to creditors than would be the case in a winding-up.

## Purpose of Examinership

Examinership is not an asset recovery exercise focused on maximising return. Rather, examinations have been responsible for the saving of many thousands of jobs in Ireland in the past number of years.

Clearly, a credible and robust formal recovery mechanism has a crucial role to play as the Irish economy suffers what may be a prolonged recession. In fact, in the now seminal Traffic Group Case in 2008, Justice Clarke stated:

*"It is clear that the principal focus of the legislation is to enable in an appropriate case, an enterprise to continue in existence for the benefit of the economy as a whole and, of equal, or indeed greater, importance to enable as many as possible of the jobs which may be at stake in such enterprise to be maintained for the benefit of the community in which the relevant employment is located. It is important both for the court and, indeed, for examiners, to keep in mind that such is the focus of the legislation."*

## Formal Developments: The Independent Accountant

The 1999 amendments to examinership legislation in Ireland introduced the Independent Accountants Report (IAR) which is now a necessary part of the proofs to appoint an examiner. In light of recent precedents it seems that the practice of a company's own firm of auditors preparing the IAR may become a thing of the past. In the period 1990 to 1999, the information in what is now the IAR was included in the first report of the examiner to the Court, i.e. a report prepared by someone who had no prior professional relationship with the company. Notwithstanding the provisions of the 1999 Act, a strong argument can always be made that the company's own accountancy/audit firm is not completely independent when it comes to the IAR. The reasons for this are clear: if the petition fails, at the very least that firm stands to lose their audit client and possibly whatever WIP they have accumulated in relation to ongoing work for the client. They therefore have a vested interest in the petition's outcome and could be easily perceived to be conflicted.

## SIP 19B

The Statement of Insolvency Practice 19B issued by the CCABI in January

2009 means the Independent Accountant now must approach the preparation of the IAR as a non-audit 'assurance engagement'. Essentially, the CCABI responded to criticisms by Justice Kelly in late 2008 of standard 'formulaic' type reports drawn from precedents in other cases and which offered no real insight into the company's true prospects for survival.

In practical terms, the SIP means that the preparation work required for the average report for even a small company has gone from one to two days' work to perhaps three to four days' work or even longer. The length of time taken to prepare the Vantive IAR was specifically questioned at the petition hearing. Further revisions to SIP19B are expected shortly.

## Funding of Schemes of Arrangement

Some of the most rapid developments in examinership have occurred in the funding of schemes of arrangement. The finding of fresh investment for the insolvent company is rightfully seen as a key part of the process.

Examinerships can also be funded from new borrowings such as invoice finance or the sale of non-core assets of the business.

Now, it is a brave examiner that will bring a scheme before the High Court without the necessary funds for the scheme safely squirreled away in their solicitor's client account. In fact, current practice is now requiring that a Designated Trust Account (DTA) be opened by the company or the examiner to ensure even greater certainty that the examinership dividends are ultimately paid out.

## The Costs of Examinership

The cost of the examinership process continues to vary widely depending on the complexity and size of the case involved. The only funds required up front to secure the appointment of an examiner are the cost of the IAR and the legal costs of the petition. These costs start at approximately €15,000 plus VAT.

The cost of the actual examinership itself will vary depending on the size of the company (or group of companies) and the time required to complete the work during the protection period. As a guideline, based on uncomplicated precedents in 2009 the cost for a straightforward case is likely to be at least €40,000. However, it is important to note that these funds are paid from new investment or borrowings as part of a scheme of arrangement. There is no requirement for costs of an examinership to be paid up front.

## Re-assurance for Secured Creditors

The judgement in November 2009 of Justice Clarke, confirming the scheme of arrangement in the Tony Gray & Sons Limited examinership will come as reassurance to the secured creditor community in Ireland. Because of the unusual circumstances that pertained in the case, the Court approved the examiner's proposals only because the Scheme provided for its fixed charge secured debt to be paid in full, including interest. The decision came after an unsecured creditor fought a four-hearing battle to overturn the scheme and have the company put into liquidation. Tony Gray & Sons Limited have been trading for fifty-one years, building and selling truck bodies outside Enfield in County Meath. The background to the case was that the company suffered a devastating fire and two break-ins in 2008 that led to the company becoming insolvent. I was appointed examiner in August 2009. The secured creditor was owed €1.4m by the company, secured with a fixed charge on the company premises at Hill of Down. However, the premises were only valued at €700,000.

The Scheme of Arrangement was funded by the proceeds of an insurance claim. No new funds were introduced by the shareholders or directors. The Scheme of Arrangement allowed for repayments to commence on half of the secured debt immediately, with a two year moratorium on capital and interest payments on the second half of the debt; with euribor interest only accruing for 24 months on the second

€700,000. However, critically, the full €1.4m bank debt was to become payable by the company with effect from January 2012.

In assessing the Scheme in the context of the unsecured creditor's objections, Justice Clarke was concerned that the written down creditors of the company were being unfairly prejudiced by the Scheme in light of the fact that the shareholders were to retain 100% of the company shares post-examination and no new funds were being invested. However, the Court ruled that because the full secured bank debt would 'kick in' in 2012, the shareholders were not unduly profiting from the preferential and unsecured creditor write-downs. Justice Clark went on to approve the Scheme of Arrangement on that basis.

In light of the recent upturn in the number of examinerships in Ireland (129 in the past three years), secured creditors have become increasingly nervous of just how far their rights can be compromised by the Courts in examinership cases. Notwithstanding the unusual circumstances of the Tony Gray & Sons case, secured creditors should gain comfort from the fact that the reason given by the Court for the confirmation of the Tony Gray & Sons Scheme was that the Scheme provided for the secured bank debt to be paid in full.

## Raising the Bar

A tightening of examinership practice that leads to increased success statistics and the raising of the bar for companies to both qualify for and successfully emerge from examination should in the long run help restore the confidence of Irish business people and secured creditors in all of the positive aspects of Ireland's formal corporate recovery process.

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