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COVID-19 AND EXAMINERSHIP – WHAT THE EXAMINER WANTS YOU TO KNOW

Following our articles on:

1. Emergency liquidity for businesses adversely affected by the economic impact of the COVID-19 Pandemic: https://www.dilloneustace.com/legal-updates/the-abc-and-de-of-emergency-liquidity-solutions;

2. Standstill Agreements as the first item out of the financial first aid kit: https://www.dilloneustace.com/legal-updates/running-to-standstill; and

3. Ireland's public sector lifeboat for SMEs and small mid-cap businesses: https://www.dilloneustace.com/legal-updates/liquid-spirit-government-guaranteed-working-capital-facilities-for-irish-smes-adversely-affected-by-the-covid-19-pandemic,

we turn to the main items for consideration by stakeholders in circumstances where examinership is the chosen mechanism for rehabilitation and long term recovery for a company in financial difficulty as a consequence of the Pandemic.

Testing times

In the current climate, it is unfortunately all too possible to imagine a business that has dealt with a severe business interruption by following the government's advice and has:

- lowered variable costs (while participating in the COVID-19 Wage Subsidy Scheme);

- delayed discretionary spending on replacing or improving assets, new projects and research and development;

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- extended its payables, getting as much credit, and as many concessions, as possible from its suppliers;
- expedited its receivables, persuading customers to pay on time or even early to maximise cash reserves;
- explored supply chain financing options in order to fund the acquisition of raw materials and unfinished goods out of the proceeds of future sales; and
- possibly applied for and obtained a government guaranteed working capital facility for SMEs adversely affected by the Covid-19 Pandemic or another form of emergency liquidity facility.

Nevertheless, the business may be unable to negotiate a standstill with all of its lenders and / or is dealing with landlords or other creditors that are unwilling or unable to reduce or defer monies due. The company may even be a defendant in litigation where a creditor / plaintiff is pushing to obtain judgment against the company to get the debt paid while it still considers there is a chance of full recovery.

In the middle of this mêlée with debtors, creditors and possibly Revenue as well, the company's Directors will be particularly concerned about personal liability for reckless trading under s.610 of the Companies Act 2014 (the **2014 Act**). Very broadly, the Directors can be made jointly and severally liable to contribute personally, potentially without limit, to the debts of the company where it is proven to the satisfaction of a court that, for example, they allowed the company to incur further indebtedness when they knew or ought to have known that their actions would cause a loss to creditors. Clearly Directors could find themselves on the horns of a dilemma when a calculated extension of further credit could be the only thing between the company's survival and total collapse. The examinership regime, originally introduced in 1990 and having seen a number of refinements since then, including under the 2014 Act, can be successfully utilised in circumstances such as these.

The rubric

Examinership is a process that can be used by a trading company in financial difficulty whereby, if successful, a court confirms a binding agreement with all creditors to pay back a percentage of their debt over an agreed timeline in satisfaction of their entire claims at the date the company enters the process. Examinership as a process is closer to the debtor-in-possession regime under Chapter 11 of the U.S. Federal Bankruptcy Code than the procedure of administration pursuant to Part II of the United Kingdom Insolvency Act 1986.

Examinership provides the company with protection from its creditors during the examinership period. This gives the company breathing space to allow an examiner put a survival plan together, which generally will include finding fresh investment. Changes were introduced in 2014 which provides that the Circuit Court has jurisdiction for examinerships of 'small companies' (as defined in the 2014 Act as amended by the Companies (Accounting) Act 2017) with the intent of making the process more accessible, in terms of the cost of the process, for SMEs. This result has been achieved, to a degree. However the specialised nature of the advice required, the number of applications to Court still required during the process and often the increase in amount of travel does mitigate against the level of reduction in costs that would have been hope for.

An examiner will be appointed only if the Court is satisfied that, although insolvent at the time the petition is presented, the evidence before it is that the company has a reasonable prospect of the survival and the whole or any part of its undertaking as a going concern. Paul McCann, Partner and insolvency practitioner at Grant Thornton has pointed out that "The company has to argue that its business or brand is something to save…there is no point, for example, in a manufacturer going into examinership when the market for the product it makes no longer exists".

The Court will be also be concerned with whether a group's, or certain of the company's subsidiaries, are a trading entity and that jobs will be saved. In the wake of the last recession in Ireland, the courts became "more and more reluctant…" to appoint examiners over troubled companies that were merely "…on life support with no prospect of survival." in the words of Mr Justice Kelly[1] when hearing (and famously dismissing) a petition in respect of the construction business of the Zoe Group in 2008.

The company must also demonstrate that it has enough cash to discharge key outgoings through the period of examinership. An increasing number of examinerships, especially for larger and multinational concerns, are 'prepackaged' with at least the tacit approval of creditors, investors and management prior to formally commencing the process. Prepacks also have the advantage of course that most, if not all, of the negotiation with interested parties has concluded, thereby mitigating the risk that an examiner will run out of time before being in a position to conclude a scheme that can be put to all creditors and then sanctioned by the Court.

Before and on the big day

For those outside the accountancy and legal professions, the procedure for examinership can seem document-heavy, formalistic and very detailed. Certainly the independent expert's report that should accompany an examinership petition, the various examiner's reports to the Court and the examiner's proposals to creditors are necessarily very detailed. However, the basic elements of the process can be boiled down to the following:

1) The filing of the petition, where accompanied by the independent expert's report, grants a company immediate protection from its creditors. Where the court is satisfied to appoint the examiner, he / she undertakes detailed examination of the company's business, assets, liabilities and undertaking;

2) Court protection lasts for up to 100 days (further in exceptional circumstances) and buys time for the examiner to come up with a rescue plan;

3) The examiner draws up proposals to put to the company's members and creditors in the form of a scheme of arrangement whereby the examiner's proposals will propose overall a better outcome for creditors than were the company to be put into liquidation;

4) The examiner sends out the scheme with an explanatory memorandum to the creditors (and members) with notices of the convening of the meetings for the various classes of creditors and members;

[1] Kelly J was also not convinced that the property market was going to improve at the time and therefore that the secured creditors would not do better by appointing receivers.

5) Meetings of the various classes of creditors and members are held where the examiner explains the proposals in the scheme;

6) The different classes of creditors and members vote on the examiner's proposed scheme;

7) Where at least one class of creditor whose claims are being impaired by the examiner's proposals votes, by a majority in number representing a majority in value, in favour of the examiner's scheme, then the examiner can proceed to put the scheme before the court for confirmation;

8) At the confirmation hearing, the company, and examiner may appear and be heard as well as any creditor or member whose claim or interest would be impaired. The Directors may also be heard. In confirming the examiner's scheme the court must be satisfied that the proposals are fair and equitable in relation to each class of member or creditor whose interest would be impaired and who voted against the proposals. The court must also be satisfied that the proposals are not unfairly prejudicial to the interest of any interested party;

9) Once confirmed by the court all creditors' claims are written down to what they are to get under the examiner's scheme regardless of whether they voted for or against the examiner's proposals.

Examiners are officers of the court in discharging their duties. As such the examiner has an ongoing duty to notify the court as soon as reasonably practicable if he/she forms the view at any point during the protection period that he/she will not be in a position to put a proposal to the court for confirmation such that protection be lifted. This will inevitably lead to an application to have the company put into liquidation in short order. Regardless of whether the examinership is before the Circuit Court or the High Court, only the High Court can make an order putting a company into liquidation.

Examinership success

As with the conditions that we mentioned that are commonly imposed in our article on standstill agreements, creditors of a company in examinership cannot take enforcement action during the protection period. The examiner's tool-kit to rehabilitate the company typically involves one or more of the following:

- injection of fresh equity capital by existing owners, new investors, management or some combination of them;
- disposal of non-core assets or subsidiaries for reasonably achievable sums over a realistic yet sufficiently tight timeframe; and / or
- availing of new, more affordable, 'work-out' borrowing facilities to tide the company over as it restructures.

In pulling these strategies together into a proposal for a scheme, the examiner needs to put before the court a survival plan that is sound based on a number of commercial considerations in addition to those directly concerning lenders and sponsors, including:

- Are the assets of the business easily sold, how long a remarketing period will be required, can they be sold as a job lot or must they be divided into parcels? Are there specialist brokers that can advise on the market for a particular asset class and what fees and commission will they charge?
- Are the assets of the company sufficient to justify the costs of examinership? Examinerships of large and complex businesses can be expensive.
- How flexible is the workforce, what are the costs of making changes with respect to numbers and length of service and how are key employees likely to react to transition envisioned by the examiner's scheme?
- Legal advice given on the regulatory position and legal liabilities of the company including licenses, environmental matters, key customer audits, planning permissions, etc.

Where the court has confirmed an examiner's proposal for a scheme of arrangement, what can the advantages be?

- Write downs of debts;
- Onerous leases of property and equipment can be re-negotiated or disclaimed by the company within the process;
- The company continues trading – an examiner's role involves actively engaging with management and stakeholders, in contrast to the unilateral role of a liquidator or receiver;
- Directors, as those most familiar with the company's business, suppliers, stakeholders, creditors and potential investors, will continue to have a management function during the examinership period, unless the court's directs otherwise;
- The process gives the company breathing space to be restructured;
- It avoids liquidation, while key suppliers, without whose support the company's survival would be seriously prejudiced, can have their liabilities discharged during the examinership period when certified by the examiner as having to be paid in priority;
- Protection from creditors – a receiver or liquidator cannot be appointed and goods kept free of claims or seizure by a creditor via the Sheriff or repossession by a lessor or supplier with a contract for retention of title; and
- While not a given, the potential for lower costs for small companies if the Circuit Court is used.

No retakes

For secured creditors, a borrower successfully navigating examinership could be regarded as a failure. Depending upon the terms of the examiner's scheme that is sanctioned by the court, a secured creditor's normally inalienable right to immediately to call in, deal with and directly receive proceeds from charged assets will not only be delayed, but may also be circumscribed.

However, an examiner may ultimately be unable to secure a new investor, a lifeline debt facility, the consent of the statutory minimum threshold of class of impaired creditors, court approval or any of them in time. In September 2009, following another period of great, albeit different, financial stress, it was estimated that for every three companies entering the examinership process, only one would come out of it successfully, with the other two placed in liquidation. One of the principal reasons for this was that many of the companies were property development companies and where the courts were not as optimistic as the petitioning companies about the prospects of the property market, which ultimately proved the courts to have been correct. Considerations at this time are different to then and arise primarily from cash flow challenges.

Contact someone with the past papers

There is a case to argue that businesses, creditors and insolvency practitioners have all learned from pre-GFC economics fraught with mismanagement facilitated by unfeasibly cheap credit. With better cash and risk management in the business community generally, one would expect a continued increase in the proportion of petitions for the appointment of an examiner to be made successfully, as well as companies placed in examinership avoiding having to be put into liquidation at a future point in time.

Examinership can prove to be a powerful tool for corporate rescue, though not an appropriate relief for all companies and all kinds of financial difficulty. A 2017 analysis by Vision-net.ie found that of the 420 companies that had an examiner appointed between 2007 and 2016, some 56 per cent of them now continued to trade successfully. In situations where procuring warranties and indemnities for a buyer of a stricken company from directors is problematic or of little real value, the comfort an examiner's forensic analysis can give could make all the difference to a sale going through.

Neither for the feint hearted nor those concerned only with the big picture, companies in financial difficulty considering the manifold advantages of examinership would be wise to consult experienced professionals at the earliest possible stage.

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