DEBT

Law guide - Debt, bankruptcy & liquidation

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with William J. Brennan & Co. Solicitors

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Bankruptcy

Introduction

Although bankruptcy can arise through unwise extravagant spending, it is more common for an individual to become bankrupt because their business or the business that they have guaranteed fails.

The bankruptcy process

Bankruptcy is a process that arises when a debtor is found to be unable to pay their debts from their own resources. A debtor may be unable to pay their debts if:

- they can pay their debts eventually but do not have sufficient resources to pay those debts which are due to be paid now
- taking a long-term view, they have insufficient resources to cover their liabilities

If a debtor is unable to pay their debts in either of these ways, they are declared to be 'insolvent' and susceptible to bankruptcy proceedings.

On the making of a bankruptcy order against them, the debtor becomes a bankrupt and their properties will vest in their trustee in bankruptcy and be distributed among their creditors.

Statutory demand to a company

If a debtor company fails to pay a debt within the time limit then insolvency proceedings may be started against the debtor company by the creditor. However, before a creditor can legitimately serve a bankruptcy petition upon a debtor, he must first serve a statutory demand upon the debtor for the outstanding debt.

Where the respondent is a company the statutory demand is normally served by sending it to the respondent's registered office address, as recorded at the Companies Registration Office, using ordinary prepaid post. It can also be served by registered post or in person.

Any document left at or sent by post to the place recorded by the Registrar of Companies as the registered office of a company is regarded as successful service of that document notwithstanding that the registered office may have been changed.

Recent changes in the area of bankruptcy

- The office of the official assignee in bankruptcy is now based in the Insolvency Service of Ireland (ISI).
- The duration of bankruptcy has been reduced from 12 years to three years since December 3rd 2013.

- Debtors must show that they have made reasonable efforts to avail of a Debt Settlement Arrangement or Personal Insolvency Arrangement in order to be eligible for bankruptcy.
- A person who is adjudicated bankrupt can publish the required notice on the ISI's website, free of charge, as an alternative to placing an advertisement in a newspaper.

Increasing the bankrupt's estate

The trustee in bankruptcy has a duty to creditors to increase the fund available for distribution to them and to do nothing that would diminish the money that is available.

Onerous property

A trustee in bankruptcy can disclaim onerous property, such as land burdened with onerous covenants or unprofitable contracts.

A disclaimer ends all the bankrupt's rights and liabilities in respect of the property in question and discharges the trustee from any personal responsibility for that property. Any person who suffers loss as a result of the disclaimer can claim for their loss from the bankrupt's estate.

To prevent a third party from having to wait a long time to find out whether a trustee intends to disclaim, any person who has an interest in property previously owned by the bankrupt is entitled to serve written notice on the trustee requiring them to disclaim the property within 28 days, failing which they lose the power to do so.

Disposals between the date of presentation of the petition and appointment of the trustee in bankruptcy

Any disposition by the bankrupt of their property between the date of the presentation of the petition and the appointment of the trustee in bankruptcy is void unless the court gives its consent or subsequently ratifies that disposition.

Undervalue transactions

If the bankrupt has made a gift or has received consideration significantly lower in value than the value they provided for the asset in the five year period prior to the petition and if the debtor was insolvent at the time of the transaction or became insolvent as a result of it, the trustee can apply to the court to have such a transaction set aside.

If the transaction took place within two years before the bankruptcy, there is no requirement that the debtor has to be insolvent at the time or as a result of the transaction.

Preferences

An arrangement is defined as a ‘preference’ if it places a creditor or surety in a position better than that in which they would otherwise have been, and further, that the debtor intended to do this.

The trustee in bankruptcy can make an application to set aside any 'preference' made within the six months prior to the petition, or within two years prior to the petition if the preference is made in favour of a person connected with the company.

The trustee has to show that the debtor was insolvent at the time or became insolvent as a result of the granting of the preference.

Transactions defrauding creditors

Where a transaction has been made at an under value for the purpose of making the debtor's property unavailable to pay the creditors, the trustee can apply to have such a transaction set aside.

The provision has no time-limit although the greater the time that has elapsed between the transaction and the bankruptcy, the weaker is the evidence that the purpose of the transaction was to avoid the asset in question being used to pay creditors.

Arrangements with debtor

Acknowledgement of debt

This is a short document signed by the person who owes money to another. It records the existence and amount of the debt and why it arose. It serves two very important purposes:

- It serves as a written and signed memorandum of the debt which will make it easier to prove the debt if it is disputed later. However, it must be emphasised that this is not a guarantee that a claim against a debtor will succeed.
- It serves to interrupt or suspend the effect of the Statute of Limitations Act 1957 (s.56) whereby a debt may become unenforceable after six years. The acknowledgement has the effect of restarting the clock and making the period of six years start afresh from the time the acknowledgement is signed.

Part payment of debt

It is up to the creditor to accept such payments. If the creditor does then they should be careful to accept such payments 'without prejudice'.

This means that you accept the part payment while reserving the right to commence court proceedings for recovery of the remainder of the debt if the debtor company neglects to pay in full.

Promissory notes

A promissory note is an unconditional promise in writing made by one person to another and signed by the person who makes the promise, the 'maker'. The person to whom the promise is made is called the 'payee'.

The maker promises to pay a specific amount of money on demand or at a fixed or determinable future time to:

- the bearer, being any person who is in possession of the promissory note
- a specified person

A promissory note is negotiable. This means that the note itself has a value and can be bought and sold. The payee, who receives the promissory note and is entitled to payment, may either claim payment or transfer their right to payment to someone else, the 'transferee'. If the promissory note is payable to the bearer, it is negotiated merely by delivery. If payable to a specific person or order, the promissory note is negotiated by endorsing the document in favour of some other person.

The promissory note is usually presented to the maker for payment. It is also presented to the person who has endorsed the promissory note, if applicable. If the note specifies a place for the note to be presented for payment, the person who requires payment must present the promissory note at that place. If the place specified is not appropriate for some reason, the note can be presented to the maker or the person who endorsed the note at an appropriate place.

Alternatives to bankruptcy

Personal Insolvency Act 2012

The Personal Insolvency Act became law in December 2012. The act is significant in that made available three new debt resolution processes to assist people with unsustainable debt in reaching an agreement with their creditors.

The structures put in place by the Personal Insolvency Act are:

Debt Relief Notice

This process allows for the write off of debt (generally unsecured and in some cases secured) up to €20,000, subject to a three year supervision period.

Debt Settlement Arrangement

A Debt Settlement Arrangement (DSA) provides for the agreed settlement of unsecured debt with one or more creditors over a period of five years, with a possible agreed extension to six years. It is vital that you make some repayments to your creditors in return for discount of your debts. It should be noted that this is a voluntary arrangement and you will have to get the support of creditors representing at least 65 % of your total debt.

Personal Insolvency Arrangement

A Personal Insolvency Arrangement (PIA) is an agreement that can be entered into for secured and unsecured debts. The amount of secured debt that can be included in a PIA is limited to €3,000,000. The difference between a PIA and a DSA is that it includes secured debt. A PIA must be agreed by the debtor and approved at a creditors' meeting by a qualified majority of creditors. In addition it must be processed by the ISI and approved by the Court. Under a PIA, a debtor's unsecured debts will be settled over a period of up to 6 years (extendable to 7 years in certain circumstances).

Arranging an insolvency agreement

As an alternative to a bankruptcy order, the debtor may attempt to make a voluntary arrangement with their creditors. To do this, the debtor has to find an insolvency practitioner who is willing to assist them in drawing up proposals and to supervise their implementation once they receive approval from the creditors. The insolvency practitioner is known as the debtor's nominee.

Once the debtor finds their nominee, they have to prepare a statement of affairs and apply to the court for an interim order to stop any other proceedings being taken against them while their creditors are considering the voluntary arrangements proposals.

While the interim order is in force, no bankruptcy petition can be presented or proceeded with, without the permission of the court. Further, no other proceedings can be commenced or continued against the debtor or their property.

The nominee would then prepare a report for the court, advising whether there are any realistic proposals to be made and whether it is worth calling a meeting of creditors.

If, at a meeting of creditors, three-quarters or more of the creditors in value approve the proposals, every ordinary unsecured creditor who had notice of the meeting and was entitled to attend and vote is bound by the decision of the meeting. Preferential and secured creditors are bound by the proposals only if they agree to it.

The nominee is responsible for supervising the implementation of the voluntary arrangement. If the debtor fails to comply with the arrangement or if it transpires that the creditors were persuaded to accept the proposal by means of false or misleading information, the nominee or creditor can petition for the debtor's bankruptcy.

Liquidation

Introduction

An insolvent company may be put into liquidation whereby all its assets are taken and shared between its creditors. Liquidation differs from bankruptcy in that at the end of the liquidation, the company ceases to exist.

There are also arrangements other than liquidation that enable a company to survive insolvency. The terms 'liquidation' and 'winding-up' are synonymous, both describing the process by which the existence of a company is brought to an end and its property administered for the benefit of its creditors and members.

There are three types of liquidation; compulsory, members' voluntary and creditors' voluntary liquidations.

Compulsory Winding Up

This type of liquidation occurs where creditors or members of the company petition the High Court to wind up the company. Where a creditor petitions the High Court to wind up a company, the court must determine that the company is insolvent and unable to pay its debts as they fall due. The other ground is where it is just and equitable to do so. When the court makes an order to wind-up the company an official liquidator is appointed who becomes its sole officer. The directors' power will cease on the appointment of the official liquidator.

Members Voluntary Winding Up

A members' voluntary winding up is a type of winding up which applies only to a solvent company. In order for this to happen a majority of the directors (where there is more than two) must make a statutory declaration that the company is solvent and able to pay its debts.

Creditors Voluntary Winding Up

The procedure for this type of liquidation is commenced by ordinary resolution of the shareholders. It is used in situations where companies are insolvent or where a declaration of solvency has not been sworn by the directors of the company. Sometimes it occurs where a members' voluntary winding up is converted to a creditors' voluntary winding up, where the company could not discharge its liabilities in full.

Distribution of assets

Introduction

On the compulsory or voluntary winding-up of a company, once the liquidator has details of all the company's debts, they must distribute such funds as they have realised in the proper order.

A creditor with security in the form of a fixed charge over the company's assets will usually enforce their security and will therefore not be paid by the liquidator.

If a sale of charged assets produces insufficient funds to discharge the debt, the creditor will prove for the balance in the liquidation as an ordinary unsecured creditor.

If the proceeds of sale are more than the sum owed to the creditor, they must pay over the excess to the liquidator for distribution among other creditors.

How is the money distributed?

The money realised from sale of the bankrupt's assets will be distributed in the following order:

1. **Expenses of winding-up:** This includes the cost of collecting the company's assets, the cost of the petition and the paying of the liquidator.
2. **Preferential creditors:** These are the same as the preferential creditors in bankruptcy.
3. **Creditors with floating charges:** Creditors who have secured the debts by way of a floating charge cannot enforce their security until all preferential creditors have been paid in full. This is so even if the floating charge crystallised before the commencement of liquidation.
4. **Ordinary unsecured creditors**
5. **Shareholders:** If there is any money remaining after paying all the previous categories of creditors in full, the members of the company can be repaid all or part of their capital investment in the company.

Alternatives to liquidation

Voluntary arrangement

A voluntary arrangement for a company is similar to a voluntary arrangement for an individual. Its aim is to avoid insolvency proceedings.

The directors must draw up proposals, assisted by an insolvency practitioner, who will report to the court as to whether meetings of members and creditors should be called to consider the proposals.

The arrangement is approved if a simple majority of members are in favour and more than three-quarters in value of the creditors (i.e. more than 75% of the debts owed) agree to it.

It will then bind any person who had notice of the meeting and was entitled to attend and vote, whether or not they actually did so. The rights of secured and preferential creditors are unaffected unless they agree to the voluntary arrangement.

Examination

The examination procedure is unique in this country and is a process designed to rescue companies that are in financial difficulties from insolvency**.**

A petition may be made to the High Court for the appointment of an examiner where a company is unable to pay its debts and has been not been wound up. Such a petition may be made by any of the following:

- the company
- the directors
- any secured or unsecured creditors
- shareholders representing 10% or more of the paid-up capital of the company

The main function of an examiner is to establish proposals for a compromise or a scheme of arrangement in respect of the company, its creditors and members and to report to the court on the viability of the company. These proposals will be put to the shareholders and creditors and will be deemed to be accepted by the creditors if passed by a majority in number and value of any class.

The examiner is required to arrange for particulars of his/her appointment to appear in Iris Oifigiul and in at least two daily newspapers circulating in the district in which the registered office of the company is situated.

The examiner should also, within three days of his/her appointment, deliver a copy, of the order appointing him/her, to the CRO.

Receivership

A receiver is usually appointed on foot of a debenture that creates a legal mortgage or charge, wherein the secured creditor is entitled to appoint a receiver for the purposes of taking possession of and realising the assets secured by the debenture.

A receiver is usually appointed when the company has defaulted under the terms of the debenture. Once appointed the receiver will take possession of the charged assets, realise those assets and discharge the debt owing to the debenture holder.

The powers and duties of a receiver will usually be specified in the debenture. Depending on the terms of his appointment a receiver may continue the business with a view to maximising the value of the company's asset or sell the business as a going concern.

Following the discharge of a receiver the directors are free to resume their normal functions, unless a liquidator has been appointed in the meantime.

A notice of appointment must be filed with the CRO within seven days of the appointment of the receiver and must be published in Iris Oifiguil and at least one daily newspaper circulating in the district where the company is situated.