



## High Court re-emphasises the purpose of examinership legislation

The High Court recently re-stated the purpose of the examinership process. Mr. Justice Clarke indicated that a court should lean in favour of confirming a scheme of arrangement where the enterprise is likely to be saved and, in particular, where all or a significant number of jobs will be saved notwithstanding a 'lack of candour' on the part of the petitioners.

### Background

In August 2007, an interim examiner was appointed to Traffic Group Limited and his appointment was subsequently confirmed.

On 28 November 2007, the examiner presented his section 18 report to the High Court which indicated that his proposals for a scheme of arrangement had been broadly supported by the various classes of creditors. However, the Revenue Commissioners opposed the scheme.

### Revenue objections to the scheme

It appears that no issues were raised by the Revenue Commissioners regarding the strict statutory requirements for court approval of the scheme and it was accepted that the company did have a real prospect of survival.

However, counsel on behalf of the Revenue Commissioners informed the court that, prior to the presentation of the petition, the company granted a charge over all of its assets to one of the banks. Until that point, the bank in question was an unsecured creditor although it did have the benefit of a guarantee from certain members of the directors' family which was supported by a lodgment held in a deposit account with the bank. Accordingly, the practical effect of the creation of the charge over the company's assets was to decrease the likelihood of the bank calling in the guarantee.





In addition to the creation of the charge, the company also reduced its liability to the bank by approximately €340,000 thereby effectively reducing the exposure of the guarantors. It was also submitted that those sums paid to the bank could constitute fraudulent preferences if the company was to go into liquidation thereby increasing the funds available for distribution to the Revenue Commissioners in a winding up.

While accepting that it was not a ground in itself to object to the scheme of arrangement, counsel on behalf of the Revenue Commissioners also highlighted the fact that the company's deficit was understated by a small but material amount in the petition and was an important factor in the overall consideration of the matter.

#### The court's decision

The court accepted that the actions of the petitioners in the period prior to and during the presentation of the petition are matters for consideration at the confirmation hearing and should include any failure to disclose information relevant to the company. In this regard, Mr. Justice Clarke indicated that there may be circumstances where the wrongful actions of those involved in the company are so serious that the court should refuse to confirm the scheme of arrangement.

However, he emphasised that the principal focus of the examinership legislation is to *'enable, in an appropriate case, an enterprise to continue in existence...and to enable as many as possible of the jobs ...to be maintained'*.

The court highlighted two important factual issues in this case. First, the petitioners provided an undertaking that they would not act as directors of the company for a period of 18 months which went some way to ensure that they would not benefit from the scheme of arrangement and survival of the company.

Second, although the bank in question had been granted a charge prior to the petition, under the terms of the scheme of arrangement, it was effectively being treated as an unsecured creditor and consequently no party benefited from the creation of the charge.

Accordingly, although the court was satisfied that there was a significant lack of candour on the part of the petitioners, the court made an order approving the scheme.

#### Comment

In circumstances where there has been any kind of wrongful action on the part of the petitioners but where it is likely that an undertaking can be saved and particularly where all or a significant number of the jobs can be saved, the following issues should be considered in drafting the scheme of arrangement:

- The extent to which a mechanism can be put in place to ensure that those guilty of the wrongful action do not benefit from the scheme of arrangement or the survival of the company;
- The extent to which the proposals can ensure that no creditor benefits to the detriment of another by reason of the wrongful action; and
- The extent to which, having regard to the wrongful action, the estimated outcome in a winding up could be more beneficial to one or more creditors of the company.

