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CHAPTER 5

Simplification: Creditor Protection

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5.1 The principle of creditor protection

5.1.1 The Review Group considers that one of the more important principles of company law is creditor protection. Legal protection stronger than that normally afforded to creditors of sole traders and individuals in partnership is particularly desirable where a company's members have limited liability.[1] The Group considered ways in which company law could be simplified while simultaneously improving creditor protection.

5.2 Validation procedures in creditor protection

5.2.1 The effectiveness of creditors' rights is related directly to a company's financial ability to meet its obligations. The Review Group believes stronger creditor protection may be achieved by measured and focused prohibitions which, where possible, are subject to validation procedures and occasionally *de minimis* exceptions. Current validation procedures are contained in s 60 of the 1963 Act,[2] s 256 of the 1963 Act[3] and s 34 of the 1990 Act.[4]

5.2.2 Section 60 of the 1963 Act sets out a validation procedure to be complied with in circumstances where a company seeks to provide financial assistance in connection with the purchase of shares. The creditor protection measures are:

(i) A majority of the company's directors make a statutory declaration stating, inter alia, that "the declarants have made a full inquiry into the affairs of the company and that, having done so, they have formed the opinion that the company, having carried out the transaction whereby such assistance is to be given, will be able to pay its debts in full as they become due";[5]

(ii) Any director who makes such a statutory declaration without having reasonable grounds for the opinion that the company, having carried out the transaction, will be able to pay its debts in full as they become due is liable to imprisonment for a period not exceeding 6 months or to a fine not exceeding £1,500 (€1,904.61) or to both.[6] In making the declaration, the directors need to be conscious that where a company is wound up within 12 months of the making of the statutory declaration and its debts are not paid in full, within 12 months after the commencement of the winding-up, it is "presumed until the contrary is shown that the director did not have reasonable grounds for his opinion".[7]

5.2.3 Section 34 of the 1990 Act (as inserted by s 78 of the 2001 Act) goes further. This validation procedure mitigates the effect of the s 31 prohibition on guarantees and the provision of security in connection with loans, quasi-loans and credit transactions by companies for directors of such companies and of their holding companies and persons connected with such directors. In addition to providing shareholder protection, s 34 contains measures designed to achieve creditor protection where companies propose to enter into a guarantee or provide security which would otherwise be prohibited by s 31 of the 1990 Act. These are:

(i) The directors are required to make a statutory declaration which states, inter alia, that they have made a full inquiry into the company's affairs and have formed the opinion that the company, having entered into the guarantee or provided the security, will be able to pay its debts in full as they become due;

(ii) A director who makes such a statutory declaration without having reasonable grounds for believing that the company, having entered into the guarantee or provided the security, will be able to pay its debts in full as they become due may be liable to a fine of up to £1,500 (€1904.61) or to imprisonment for a term of up to 12 months or to both. Moreover, where a company is wound up within 12 months of the making of the statutory declaration and its debts are not paid in full within 12 months after the commencement of

1 See the earlier discussion at 3.3.1 and 3.4.2.
2 As amended by s 89 of the 2001 Act.
3 As amended by s 128 of the 1990 Act.
4 As amended by s 78 of the 2001 Act.
5 1963 Act, s 60(4)(d).
6 See s 60(5) of the 1963 Act (fine increased by s 240(7) of the 1990 Act as inserted by s 104 of the 1999 (No 2) Act).
7 1963 Act, s 60(5).

the winding-up, "it shall be presumed until the contrary is shown that the director did not have reasonable grounds for his opinion."[8]

5.2.4 The fore going, apart from the penalties, are along identical lines to the s 60 validation procedure. However, the s 34 validation procedure contains some further measures, namely:

(i) The statutory declaration is required to specify the benefit which will accrue to the company by entering into such a guarantee or providing such security.[9]

(ii) The reasonableness of the statutory declaration is to be confirmed by an independent person (such as the company's auditor) who is required to state whether, in his opinion, the statutory declaration is reasonable.[10]

(iii) A director who makes the declaration may be declared by a court to be personally responsible for all or any of the company's debts if the declaration is made without reasonable grounds and the company is not able to subsequently pay its debts in full.[11]

(iv) The director or connected person and any other director who authorised the transaction or arrangement in contravention of s 31 may be liable to indemnify the company for any loss or damage resulting from the arrangement or transaction.[12]

5.2.5 Where a company proposes to have a voluntary members' winding-up, s 256 of the 1963 Act provides that certain creditor protection measures must be followed. These are:

(i) a majority of the directors make a statutory declaration to the effect that they have made a full inquiry into the affairs of the company and that having done so, they have formed the opinion that the company will be able to pay its debts in full within a period not exceeding 12 months from the commencement of the winding-up;[13]

(ii) where it is proved to the court that the company is unable to pay its debts, the court may declare that any director who was a party to the declaration (without having reasonable grounds for the opinion that the company would be able to pay its debts in full within the period specified in the declaration) shall be personally responsible, without limit, for such of the debts or liabilities of the company as the court may decide.[14] Furthermore, where a company's debts are not paid or provided for in full (within the period specified in the declaration) it is presumed, unless the contrary can be shown, that the director did not have reasonable grounds for his opinion;[15]

(iii) unlike other validation procedures, the declaration must include a statement of the company's assets and liabilities;[16]

(iv) as with the s 34 procedure, a report of an independent person (who may be the company's auditor) must be attached to the directors' statutory declaration.[17] The independent person must state in his report whether in his opinion and to the best of his information (and according to the explanations given to him), the opinion of the directors in the statutory declaration and the statement of the company's assets and liabilities are reasonable.[18]

8 1990 Act, 34(5)(b).
9 1990 Act, s 34(3)(e).
10 1990 Act, s 34(4).
11 1990 Act, s 34(5).
12 1990 Act, s 38(2).
13 1963 Act, s 256(1).
14 1963 Act, s 256(8).
15 1963 Act, s 256(9).
16 1963 Act, s 256(2)(b).
17 1963 Act, s 256(2)(c)).
18 1963 Act, s 256(4).

5.2.6 The Review Group believes that there is no justification for having two or more validation procedures and recommends there should be one validation procedure which is capable of being invoked in the case of a number of specific prohibitions. In summary, some or all of the validation procedures require:[19]

(i) a majority of the directors to make a statutory declaration;
(ii) the declaration states that a full inquiry has been undertaken by the directors into the affairs of the company, and having done so, the directors believe the company will be able to pay its debts in full within 12 months from the commencement of the company's winding-up (s 60 and s 34 providing no time limit but presuming if the debts are not paid in full within the 12 months, the directors did not have reasonable grounds for making their declaration);
(iii) in the case of s 60 and s 34, the purpose of the assistance or the security;
(iv) in the case of s 256, a statement of the company's assets and liabilities is incorporated in the declaration;
(v) in the case of s 34, the declaration must specify the benefit accruing to the company by entering into the proposed transaction;
(vi) in the case of s 256 and s 34, an independent person issues a report specifying that the opinion of the declarants is reasonable (and in the case of s 256, the statement of assets and liabilities is reasonable);
(vii) in the case of s 256 and s 34, the directors may be personally liable for the debts of the company if their opinion is not reasonable;
(viii) in the case of s 34, the directors may be required to indemnify the company for loss as a result of entering into a transaction not validated by the s 34 procedure;
(ix) in the case of s 60 and s 34, the directors may be liable to a fine or imprisonment if the section is breached.

5.2.7 The Review Group considered whether the measures, provided for in the validation procedures, were necessary or desirable. The Group weighed the protection (both preventative and remedial) afforded to creditors against a number of factors. These factors included:

(i) first, the potential liability for directors and the need on the one side to ensure directors or connected persons receive no benefit from a company's assets (other than where full value is given) and on the other side not to penalise directors who have approved of transactions honestly and reasonably, but unforeseen developments have triggered the collapse of the company without fault on the part of the directors. In this regard, the Review Group noted that, under the s 34 procedure, when a company's directors state that they have formed the opinion that the company "having entered into the guarantee or provided the security, will be able to pay its debts in full as they become due," it is not clear whether one is to assume that the guarantee has been called upon or the security realised. The Review Group believes what is important is that the company is solvent at the time the guarantee is entered into or security is provided. As there is no requirement to credit the benefit (direct or indirect) that accrues to the company[20] arising from the giving of the guarantee or provision of security, there should be no requirement to debit such contingent liabilities as if they had crystallised. The Group believes, it is impractical to expect declarations of solvency to be entirely open-ended and the opinion that a company is solvent should be confined to the time of entering into the transaction. The Review Group recommends that the directors' declaration specify that the company is solvent at the time of the creation of the security or guarantee to replace the statement that the company will be able to pay its debts in full as they become due;
(ii) second, the cost to and time incurred by companies being obliged to retain their auditors to verify the reasonableness of directors' statutory declarations and the possibility that Ireland's laws would be more stringent than those in other EU jurisdictions.

5.2.8 On balance, the Group concluded that the creditor protection principle necessitated the directors to make a considered decision and that the protections being provided by :

19 These procedures are in addition to a special resolution to be passed by the members of the company, with the right of 10 % of the shareholders to petition the court to restrain the implementation of the transaction.

20 See s 34(3)(e) of the 1990 Act.

(i) a majority of the directors making a declaration;
(ii) the declarants being satisfied that the company is solvent at the time of the declaration;
(iii) a statement of the company's assets and liabilities is incorporated into the declaration;
(iv) the benefit to the company is stated in the declaration (in the case of a winding-up, it will be to the effect that the directors intend the company to cease business, a continuation of which can be detrimental to the company); and
(v) the directors being personally responsible for the company's debts, where the declaration is made without reasonable grounds and the company is not subsequently able to pay its debts, if the court considers it just and equitable, and be liable to indemnify the company where the court considers it just and equitable and the director or a connected person has received a benefit from the transaction.

In addition a special resolution of the members should be required to validate the proposed transaction.

5.2.9 The Review Group had previously made an interim recommendation concerning the s 60 validation procedure which resulted in the enactment of s 89(a) and s 89(b) of the 2001 Act. The first provision enables a copy of the statutory declaration to be filed with the CRO within 21 days of the notice for the extraordinary general meeting (or the date of the special resolution if no meeting is called) rather than on the same day. The second provision enables the special resolution to be passed by written resolution if signed by all shareholders and if permitted by the relevant company's articles of association. The Group understands that these recommendations have already facilitated legal practitioners in implementing the s 60 validation procedure.

5.2.10 Bearing in mind the additional cost and delay in completing transactions, the Group considers the additional requirement of an independent person's report to be unnecessary in view of the other protective measures, particularly the directors' personal liability.

5.2.11 The Group believes that the disapplication of the requirement for an independent person's report in a voluntary members' winding-up will not result in abuse of that means of winding-up. In particular, the Group is satisfied that the provisions of s 131 of the 1990 Act operate to prevent the practice of "centrebinding". The Group is satisfied that the threat of personal liability is sufficient to deter the winding-up of insolvent companies using the members' voluntary winding-up procedure. The Group is also cognisant of the fact that it expects it will be asked to review the law relating to winding-up in its second work programme. Accordingly, the Group recommends the amendment of the validation requirements so that all validation procedures incorporate the safeguards set out in paragraph 5.2.8.

5.2.12 The Review Group recommends that the validation procedure under s 34 of the 1990 Act should continue to be capable only of validating guarantees and the provision of security in connection with loans, quasi-loans and credit transactions otherwise prohibited by s 31 of the 1990 Act. Thus, in respect of loans, quasi-loans and credit transactions the only exceptions to s 31 should continue to be ss 32, 36 and 37 of the 1990 Act.

5.2.13 The Review Group recommends that the breach of s 60 of the 1963 Act, s 31 of the 1990 Act and s 256 of the 1963 Act be an offence, modelled on s 40 of the 1990 Act and punishable in accordance with s 240 of the 1990 Act.

5.2.14 The Review Group recommends that the one validation procedure should be capable of being invoked in the case of the following existing creditor protection measures:

(i) the prohibition on the provision of financial assistance in connection with the purchase of shares (but subject to the exceptions listed below);[21]

21 See 5.4 below.

(ii) the prohibition on the entering into of guarantees and the provision of security in connection with loans, quasi-loans and credit transactions by companies for directors of such companies and of their holding companies and persons connected with such directors; and

(iii) the proposed members' voluntary winding up of the company.

5.3 Gifts and dispositions at an undervalue

5.3.1 As the controllers of property which is not their own, company directors are in a position analogous to that of trustees. Under company law, directors are subject to certain standards of behaviour. In exercising their powers (whether relating to the disposal of a company's assets or otherwise), directors are required to act *bona fide* and in the interests of the company.[22] Directors may not make a personal profit from their position[23] and directors may not cause companies to make gifts or dispose of property gratuitously or at an undervalue.[24] As the Supreme Court indicated in *Re Greendale Developments Limited*:[25]

> "it has been settled law since the decision in *Hutton v. West Cork Railway Co*[26] that a company cannot spend money or dispose of its property except for purposes which are reasonably incidental to the carrying on of the business of the company." [27]

It is a separate recommendation of the Review Group that the common law and equitable duties of directors be codified by statute.[28]

5.3.2 Until the 1990 Act, the legislature was content to rely upon these common law and equitable statements of directors' duties to govern corporate transactions and arrangements. Indeed, in relation to transactions and arrangements between companies and third parties, it is these general duties which apply to directors' dealings. In Part III of the 1990 Act the legislature recognises the greater likelihood of abuse of trust and position by directors in cases where their companies make loans and certain other transactions in their favour, or in favour of persons connected to them. There has been, since 1 February 1991,[29] a statutory prohibition (albeit subject to exceptions) on companies making or entering into loans, quasi-loans, credit transactions and guarantees and the provision of security for directors or persons connected with directors.

5.3.3 The Review Group considered whether a further, specific, statutory prohibition or restriction is required for gratuitous dispositions of a company's cash and assets to directors and persons connected with directors. A particular concern of the Review Group in relation to the abolition of the doctrine of *ultra vires* for a private company is the fact that the doctrine served a role in inhibiting gratuitous dispositions of corporate property, as seen in *Re Greendale Developments Limited*.[30] In that case, a disposition by a company in favour of its directors was found to be *ultra vires* and void. It was accepted that the company had obtained no benefit from the payments made by it. However, it is significant that in acknowledging there was no express object authorising gratuitous payments, Keane J said, were it otherwise, "different considerations might apply".[31]

5.3.4 There is no direct express statutory prohibition on a company providing a gift of real or personal property to a director although a company may not lend money to a director.[32] The Review Group considered and noted the effect of a number of statutory provisions which may apply to such a disposition. These include s 29 of the 1990

22 *Clark v. Workman* [1920] 1 IR 107.
23 *Bray v. Ford* [1896] AC 44 at 51.
24 *Daniels v. Daniels* [1978] Ch 406.
25 [1998] 1 IR 8.
26 [1883] 23 Ch D 654.
27 [1998] 1 IR 8 at 22.
28 See Chapter 11.
29 The commencement date of s 31 of the 1990 Act.
30 [1998] 1 IR 8.
31 *ibid*. at 23.
32 1990 Act, s31(1).

Act which requires the approval of a company's members for substantial property transactions between directors and their company. Of more relevance is s 139 of the 1990 Act which prohibits the improper transfer of assets where the effect is to perpetrate a fraud on the company, its members or creditors. The Group believes that the propriety of gratuitous dispositions by companies to directors must ultimately turn upon whether or not such dispositions are made *bona fide* and in the interests of the company as a whole. Each case will turn on its own facts. The Review Group does not believe it is either necessary or desirable to regulate gratuitous dispositions, as statutory prohibition would be likely to cause more difficulties that it would solve. As Bowen LJ said in *Hutton v. West Cork Railway Co*:[33]

> "The law does not say that there are to be no cakes and ale, but that there are to be no cakes and ale except such as are required for the benefit of the company...Charity has no business to sit at boards of directors qua charity. There is, however, a kind of charitable dealing which is for the interest of those who practise it, and to that extent and in that garb (I admit not a very philanthropic garb) charity may sit at the board, but for no other purpose."

5.3.5 The Group accepts that creditors (and shareholders) will have sufficient protection by the codification in statute of the common law duty that directors will have acted in breach of their duty if they do not act *bona fide* and in the interests of the company as a whole. The Group believes also that the new prominence of the duty, in statute, will be a significant deterrent to abuse.[34]

5.4 Maintenance of capital

5.4.1 Section 60(1) of the 1963 Act provides:

> subject to [certain exceptions including where the validation procedure is completed], it shall not be lawful for a company to give, whether directly or indirectly, and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase or subscription made or to be made by any person of or for any shares in the company, or, where the company is a subsidiary company, in its holding company.

5.4.2 The width of this prohibition means many transactions are caught and, thus, prohibited. The Review Group considers that a number of these, as set out below, should be exempt from the prohibition and, thus, from the requirement to be effected through a validation procedure.

5.4.3 The Group believes that where the financing of a share acquisition is validated in accordance with s 60, the subsequent refinancing should not require to be validated. A typical example is where a bank (or a syndicate of banks) lends money to a person who uses the funds to purchase the shares of a company. As security for that loan, the company (being acquired) and its subsidiaries guarantee the repayment of the loan and, as security for their guarantee, create fixed and floating charges over their respective assets. The giving of the guarantees and the charges can be effected only after the requirements of s 60(2) have been satisfied (a copy of the statutory declaration and notice of the special resolution being filed in the CRO). In practice, it will often happen that subsequently, say two to three years hence, the loan is refinanced with the same bank, or possibly a different bank. Because the new loan is being used partly to repay the outstanding indebtedness under the initial loan, a conservative but common legal view is that the s 60(2) procedure must be repeated for the re-financing notwithstanding that no new acquisition is taking place. This has little benefit to any interested party. Accordingly, the Review Group recommends that the refinancing of assistance previously validated be exempted from the prohibition and, thus, the procedural requirements of s 60.

5.4.4 The Review Group believes the avoidance of a re-validation of such transactions would facilitate refinancing by companies. In practice, such a refinancing is often on more advantageous terms, as to the cost of borrowing, than the initial financing and is thus for the benefit of the company, including its creditors. Completing the s 60 procedure on a refinancing provides little if any additional protection to creditors but adds to the cost of a refinancing.

33 [1883] 23 Ch D 654 at 673, applied by Murphy J in *Re Kill Inn Hotel Limited* (in liq), unreported, High Court, 16 September 1987.

34 See Chapter 11.

5.4.5 It is not unusual for companies and their subsidiaries to enter into extensive agreements with investors, which agreements will contain warranties and indemnities. In such circumstances, the company receives a benefit from the investment while giving the warranties and indemnities. Where companies have securities quoted on a stock exchange or securities market, it is not unusual for the companies themselves to give warranties to purchasers and underwriters for those securities. The Review Group recommends that to facilitate transactions in the normal course of a company's business of raising company capital, the s 60 prohibition should not apply to the giving by the company of warranties and indemnities for the purpose of or in connection with the subscription for its shares or the shares of its holding company. Similarly the Review Group recommends that the s 60 prohibition should not apply where securities of a company or of its holding company are, or are to be, afforded a trading facility on a stock exchange or securities market, for the purpose of or in connection with the purchase of its shares or the shares of its holding company.

5.4.6 It is not unusual for companies to pay a subscriber's advisory fees (e.g. legal and due diligence fees) in connection with an investment made in a company. The company obtains the benefit of the investment. The Review Group recommends that to facilitate a normal aspect of agreements raising funds for a company, the s 60 prohibition should not apply to the payment by a company of the fees of advisers to a subscriber for shares in the company in connection with the subscription.

5.4.7 Whenever a public company offers shares to the public or a listed company increases its listed share capital by 10% or more, the company is obliged to issue a prospectus and/or a listing particulars. Whenever a shareholder offers company shares to the public, that shareholder must procure the issue of a prospectus which can be issued by the shareholder or by the company. In the United States, such prospectuses must be issued by the company rather than by the shareholder. Whether the prospectus is issued by the company or the shareholder, there will be expense to a greater or lesser degree but it is in connection with supplementary regulation to which companies with quoted securities are subject. The Review Group recommends that the s 60 prohibition should not apply to the incurring of expense by a company to facilitate the admission to or continuance of a trading facility for securities of the company on a stock exchange or securities market, including the expenses associated with the preparation and filing of any documents required under the laws of any jurisdiction.

5.4.8 The Irish Takeover Panel Act 1997 and Rules made under that Act require, inter alia, that a relevant company must engage independent financial advisers where there is an approach to or offer made for the relevant company. A relevant company is an Irish-incorporated PLC whose shares are quoted on the Irish Stock Exchange, the London Stock Exchange, the New York Stock Exchange, NASDAQ, EASDAQ or the Neuer Markt.[35] The Review Group recommends that compliance with the Irish Takeover Panel Act (ITPA) should not create a breach of the Companies Acts. Accordingly, the payment by a relevant company or a subsidiary of a relevant company of fees and expenses to such advisers as must be retained by a relevant company within the meaning of and for the purposes of the ITPA should not be prohibited by s 60 of the 1963 Act.

5.4.9 It has become the prevalent market practice for PLCs to agree abort fees with an intending offeror, which become payable where the offeror is outbid by another offeror. In the UK, the Panel on Takeovers and Mergers approves such fees subject to their not exceeding 1% of the value of the offer. The Irish Takeover Panel has agreed these on a case by case basis, subject to the same 1% limit.[36] The Irish Takeover Panel's note[37] on their rule on inducement fees alludes to possible legal issues under s 60 of the 1963 Act. With a view to dispelling any question as to the applicability of s 60 to such fees, the Review Group recommends that the s 60 prohibition should not apply to the payment by a relevant company or a subsidiary of a relevant company, within the meaning of the ITPA, of an inducement fee to an offeror within the meaning of the ITPA, where the amount and preconditions to payment of that fee have been approved by the Irish Takeover Panel.

35 Irish Takeover Panel Act 1997, s 2; Irish Takeover Panel Act 1997 (Relevant Company) Regulations, 2001 (SI No 87 of 2001), Reg 3.

36 See Rule 21.2 of the Irish Takeover Panel Act 1997, Takeover Rules 2001, and notes on that rule.

37 Note 2 on Rule 21.2 of the Irish Takeover Panel Act 1997, Takeover Rules 2001.

5.5 Loss of share capital

5.5.1 Section 40 of the 1983 Act requires the directors of a company to convene an extraordinary general meeting (EGM) where the net assets of the company "are half or less of the amount of the company's called-up share capital".

5.5.2 This provision implemented Article 17 of the EC Second Company Law Directive which applied only to public companies limited by shares and public companies limited by guarantee and having a share capital.[38] Its implementation in the UK applies only to public companies.[39]

5.5.3 The Review Group considers that, in practice, the section is meaningless, at least with regard to private companies. When the EGM is held, inevitably the financial position of the company is noted and the company carries on business as before. There is no requirement to provide additional capital, for the very good reason that, particularly in the early stages, the company may simply be going through a development phase.

5.5.4 If the members at a specially convened EGM decide to take no action in the face of a need to do so, a creditor will have no remedy against the members. A creditor's remedy is more likely to be against the directors for reckless trading. Accordingly, the Review Group recommends that s 40 be repealed to the extent that private companies should not be required to convene and hold an EGM upon suffering a serious capital loss. Furthermore, the auditors, in their report, should not be required to state separately the net asset position of the company. However, the requirement should remain for public companies.

5.5.5 A consequence of the foregoing recommendation at 5.5.4 is that the requirement at s 193(4)(g) of the 1990 Act – that auditors must state in their audit report whether, in their opinion, there existed at the balance sheet date a situation which pursuant to s 40 of the 1983 Act would require the convening of an EGM of the company – should also be repealed for private companies. The Review Group is of the view that the requirement is not necessary, even in the case of public companies, and indeed causes confusion, particularly regarding multinational companies in Ireland. The Review Group recommends that the obligation be repealed for audit reports in respect of all companies.

5.6 Reduction of capital

5.6.1 The requirements in s 73 of the 1963 Act, dealing with the publication in connection with the reduction of share capital under s 72, while unwieldy, are considered to be appropriate. The reduction of share capital has to be sanctioned by the court[40] and to date the manner in which such reductions have been sanctioned is considered to be appropriate.

5.7 Memorandum and articles of association

5.7.1 It was noted that the recommendation elsewhere in the Report[41] to abolish, with some exceptions, the *ultra vires* rule for private companies should not have an adverse effect on creditors. Although one of the 19th century reasons for having the *ultra vires* rule was the protection of creditors,[42] this no longer effectively applies due to the preponderance of objects and powers in virtually all memoranda of association.[43] Indeed, in those cases

38 1997/91/EEC.

39 UK Companies Act 1980, s 34.

40 But in the case of a redenomination of share capital into the euro unit see s 26 of the Economic and Monetary Union Act 1998.

41 See Chapter 10.

42 See 10.1.4

43 Such as in *Re MJ Cummins Ltd, Barton v. The Governor and Company of the Bank of Ireland* [1939] IR 60; and in *Northern Bank Finance Corporation Ltd v. Quinn & Achates Investment Company* [1979] ILRM 221.

where the doctrine has applied it was invoked to avoid corporate contractual responsibilities to the detriment of a particular creditor.[44]

5.7.2 The reference in the memorandum and articles of association to *authorised* share capital was considered. It was noted that this was meaningless for creditor protection as it is the *issued* share capital which is of real relevance to creditors. Details of the issued share capital can be found from a search against a company in the CRO, which would highlight allotments and the amount of issued share capital specified in each annual return. It may, however, have relevance for shareholder protection and thus no recommendation is made with regard to the specification of the authorised share capital in a company's memorandum and articles of association.

5.8 Allotment of shares

5.8.1 The under capitalisation of companies is one of the causes of corporate failure. When persons choose to incorporate a company, one of the most important decisions is in what manner share capital or loan capital will be required to capitalise the company. Traditionally, members contributed capital to a company by subscribing for its shares. Save in the case of PLCs[45] (or other companies where the directors are the subject of a restriction order made under s 150 of the 1990 Act), there is no compulsory capitalisation of Irish companies. Capitalisation by way of share capital (as opposed to capitalisation through the provision of directors' or shareholders' loans) is preferable to creditors because the capital so contributed cannot be repaid[46] until all the company's creditors have received what is due to them by the company.

5.8.2 Today, it is more common for start-up capital to be provided by way of loans from shareholders or by way of bank finance. The Review Group does not believe the State should oblige companies to be capitalised[47] as this would have the effect of discouraging enterprise and hindering unnecessarily the development and particularly the commencement of businesses.

5.8.3 The Review Group considers, however, the State should ensure that adequate capitalisation of companies is facilitated by the removal of any obstacles which may exist to the capitalisation of companies through the issue of shares. It was noted that there is a 1% capital duty on the allotment of shares[48] which the Group, on balance, considers to be a disincentive to financing companies by the issue of equity share capital and which is, therefore, detrimental to creditor protection. The capital duty on share capital has encouraged the use of subordinated loans by companies (there being no stamp duty on subordinated loans). This duty has encouraged the use by some companies in the State, but also internationally,[49] of capital contributions (which in most circumstances are generally perceived to avoid the obligation to pay a 1% capital duty). The capital injection into a company by either of these methods is not as protective to creditors as share capital. This is because even subordinated loans may be repaid prior to the repayment of other debts, and although capital contributions should not be repaid prior to creditors being repaid, an early repayment of a capital contribution could not be excluded (this would depend upon the manner in which capital contributions are treated in the balance sheet of the recipient company).

5.8.4 The treatment by the State of issued share capital is out of line with other jurisdictions (including Northern Ireland). Although this point may be perceived by some as a fiscal issue, it is in fact a company law issue as the effect of this treatment is to weaken creditor protection. This arises from the desire to minimise the level of capital duty which serves as a disincentive to inject share capital into a company for the greater protection of creditors.

44 As highlighted by the Report of the Committee on Company Law Amendment (1945))(The Cohen Report).
45 1983 Act, s 10.
46 Otherwise than by court sanction pursuant to s 72 of the 1963 Act or Part XI of the 1990 Act.
47 Save where capitalisation is required for regulatory purposes such as licensed banks.
48 Stamp Duties Consolidation Act 1999.
49 See, for example the discussion of the nature and effect of capital contributions in the Privy Council decision in *Kellar v. Stanley William (Turks and Caicos Islands)* [2000] 2 BCLC 390.

5.8.5 The fact that this duty raised approximately €48 million in the year 2000[50] is an indication of the cost of incorporation for persons wishing to have sufficient equity capital. This is a cost which attacks the prudence of providing adequate share capital to meet the needs of the company and its creditors. There was some concern as to whether this issue was within the Review Group's terms of reference. The Group is mindful that taxation is essentially a policy matter for Government. However, for the reasons set out above, it is, on balance, considered that capital duty is a disincentive to creditor protection. Accordingly, the Review Group recommends that consideration be given to the abolition of capital duty on the issue of shares, albeit against the background of what is recognised to be a wider political and economic context.

5.9 Disclosure in the annual return

5.9.1 The Review Group noted that the requirement whereby a company is required to specify in its annual return the amount owing to creditors which is secured by charges requiring registration, pursuant to s 99 of the 1963 Act, is to be omitted from the new annual return form. In practice, it is believed, little attention has been given to completing this requirement accurately or possibly because of the lack of attention in its completion as a source of accurate information. While it may be useful to have such information, in practice, it has not proven to be so. The Review Group proposes to consider this further in its second work programme.

5.10 Annual accounts

5.10.1 The Review Group considered whether the requirements of the 1986 Act needed reforming to give more helpful information to creditors. Submissions were sought from certain credit agencies and in the absence of receipt of any submissions, whether from the credit agencies or from the public generally, it was considered not to make recommendations for changes to the form of accounts as set out in the 1986 Act. It was noted also that the Fourth and Seventh Company Law Directives are currently under review.

5.10.2 To give more up-to-date information to creditors, the Review Group recommends that annual accounts should be made up to a date not more than 6 months before the annual return date, rather than 9 months.[51] This should not prove to be a burdensome requirement as it applies already to listed companies.[52]

5.11 Debentures and series of debentures

5.11.1 Sections 91 to 97 of the 1963 Act deal with the register of debentures and provisions concerning the issue of debentures. In practice, the issue of debentures in the manner set out in the 1963 Act no longer applies and has been replaced by commercial paper, bond or note issues. These are usually, but not always, issued to the public where prospectus requirements would apply. The prospectus requirements are, however, for the benefit of investors rather than creditors. It is doubtful whether companies issuing short-term commercial paper privately through the inter-bank system actually enter the names of the holders of the commercial paper (strictly speaking, debenture holders) on a register as required by company law. In practice, banks issue short-term commercial paper on behalf of their corporate customers who are simply informed of the amount issued and the rate of interest applicable. Although ss 91 to 97 may be somewhat irrelevant, it is proposed that the Review Group should consider the issue in more depth in its second work programme with a view to recommending appropriate reform.

5.12 Charges

5.12.1 Section 99 of the 1963 Act requires particulars of certain charges to be delivered to the Registrar within 21 days of their creation. The Review Group noted that the Companies (No 2) Bill 1987[53] had proposed that the category

50 Source: The Revenue Commissioners.
51 See s 148(1) of the 1963 Act.
52 Irish Stock Exchange Listing Rules for Specialist Securities para 5.5
53 Which ultimately when amended became the 1990 Act.

of charges be extended to include shares and debts (other than book debts where registration is already required).[54] It had been proposed also in the 1987 Bill that each time there is an increase in a secured facility, a further form of particulars should be delivered to the Registrar. Both these provisions were dropped due to the perceived disruption for some companies in having security over shares or debts registered. An additional concern in relation to the second proposal was the increased cost and administration associated with further filings. While the Review Group sees merit in the concern, fixed charges on shares tend, in practice, to be registered as such charges include charges on dividends which are perceived could be deemed to be a book debt (a charge over which requires to be registered).[55] Registering all charges would give greater information to creditors as to prior secured creditors. The Group believes it is illogical to have a requirement to register some categories of charges but not others, as the secured creditor in each case has priority. However, EU developments on the registration or otherwise of charges need to be considered. Company law reform on the registration and priority of charges is to be considered in the Review Group's second programme.

5.13 Strike-off

5.13.1 The effect on creditors of a company being struck off was considered and it was noted that the Review Group's report on strike-off has dealt extensively with this.[56]

5.14 Investigations

5.14.1 No submissions have been received with regard to the right of creditors to instigate investigations in a company (the right is given to any creditor to apply to court to have an inspector appointed under s 7 of the 1990 Act). The Review Group considers that to date, as the appropriate Minister had instigated investigations where there seemed to be a perceived need, it was not recommended to make any change in this regard.

5.15 Priority of debts and winding-up

5.15.1 The priority of debts in a winding-up or receivership of a company, as set out in s 285 of the 1963 Act and other statutory provisions, was not considered. This is to be considered in the Review Group's second programme, together with the rules for advertising petitions, notices and location of creditors' meetings, proxies for creditors' meetings, committees of inspection and proof of debts.

54 See s 99(2)(e) of the 1963 Act.
55 *ibid.*
56 See Chapter 15.

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5.16 Summary of Recommendations

5.16 Summary of recommendations

- There should be a single validation procedure which can be carried out for validating what would otherwise be prohibited by s 60 of the 1963 Act, guarantees and the provision of security in connection with loans, quasi-loans and credit transactions, prohibited by s 31 of the 1990 Act, and s 256 of the 1963 Act. **(5.2.6/5.2.14)**

- The single validation procedure should require the majority of the directors to make a declaration in which it is stated that they are satisfied that the company is solvent at the time of the declaration. The declaration should incorporate a statement of the company's assets and liabilities and the benefit to the company in carrying out the transaction should be stated in the declaration. The directors should, if the court considers it just and equitable, be personally responsible for the company's debts where the declaration is made without reasonable grounds and the company is not subsequently able to pay its debts and they and persons connected to them should be liable to indemnify the company where they have received a benefit from the transaction. In addition, a special resolution of the members should be required to validate the proposed transaction. **(5.2.8)**

- The additional requirement of an independent person's report is unnecessary in validation procedures and should be dispensed with. **(5.2.10)**

- The validation procedure under s 34 of the 1990 Act should continue to be capable only of validating guarantees and the provision of security in connection with loans, quasi-loans and credit transactions. **(5.2.12)**

- The breach of s 60 of the 1963 Act, s 31 of the 1990 Act, and s 256 of the 1963 Act should be a criminal offence, modelled on s 40 of the 1990 Act and punishable in accordance with s 240 of the 1990 Act. **(5.2.13)**

- Gratuitous dispositions should be subject to the general duty that directors of companies can only act bona fide and in the interests of the company as a whole. **(5.3.4)**

- There should be no requirement to validate the refinancing of s 60 transactions which have been already validated. **(5.4.3)**

- The requirement under s 60 to validate the giving of warranties to purchasers and underwriters in connection with the purchase of shares should be repealed. (**5.4.5)**

- The requirement under s 60 to validate subscribers' advisory fees should be repealed. **(5.4.6)**

- The requirement under s 60 concerning the application of incurring of expense by a company to facilitate the admission to or continuance of a trading facility where shares on the stock exchange or securities market including expenses associated with the preparation of filing of any documents should be repealed. **(5.4.7)**

- Compliance by the company with the Irish Takeover Panel Act 1997 be exempt from the provisions of s 60 of the 1963 Act. (**5.4.7)**

- Section 60 of the 1963 Act should not apply to "abort fees" in connection with the offer of shares. **(5.4.9)**

- Section 40 of the 1983 Act (re: EGMs) should be repealed for private companies. **(5.5.4)**

- The obligation for auditors to state in their audit report whether, in their opinion, there existed at the balance sheet date a situation which would require the convening of an EGM of the company pursuant to s 40 of the 1983 Act should be repealed for audit reports in respect of all companies. **(5.5.5)**

- Consideration should be given to the abolition of duty of 1% on the issue of share capital. **(5.8.5)**

- Annual accounts should be made up to date no more than 6 months before the annual general meeting. **(5.10.2)**