Company Law Review Group

First Report

December 1994

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Chapter 1

Introduction

1.1 The Company Law Review Group was established in March 1994 by the Minister for Enterprise and Employment, Mr Ruairi Quinn, TD, to consider, as Phase I of its work, seven aspects of Irish Company Law and to make recommendations to the Minister by 30 November 1994.

1.2 A number of interested bodies were asked to make nominations for appointment to the Group. The Bar Council, the Consultative Committee of Accountancy Bodies - Ireland, the Incorporated Law Society, the Irish Association of Investment Managers, the Irish Bankers Federation, the Irish Business and Employers Confederation, the Irish Congress of Trade Unions, Irish Small and Medium Sized Enterprises, the Irish Stock Exchange, the Minister for Finance, the Revenue Commissioners and the Small Firms Association all made nominations for appointment which were accepted by the Minister. A list of the members of the Group is attached as Appendix 1. Also included in this Appendix is a list of the personnel forming the secretariat to the Group.

1.3 The seven areas set down for the first phase of the Group's work were

1. Companies (Amendment) Act, 1990 (the "Examinership" Act).
2. Part II of the Companies Act, 1990 ("Investigations").
3. Recommendations of the Ryan Commission on Financial Reporting.
4. Part V of the Companies Act, 1990 ("Insider Dealing").
5. The recommendations of the Small Businesses Task Force for changes in company law.
6. Chapter I of Part VII of the Companies Act, 1990 - provisions relating to restriction on directors.
7. The position of farmer creditors in the event of company liquidations.

1.4 Views of interested parties were sought through advertisements in the national press and through direct contact with bodies and individuals with particular interest in the areas being considered. Some forty eight submissions were received. Some bodies made separate submissions on different topics. A list of those who made submissions and the Phase I items covered in those submissions is given in Appendix 2.

1.5 A number of requests were received from individuals and bodies who wished to make oral submissions. Unfortunately time constraints did not allow us to respond positively to these requests.

1.6 The Group held its first meeting on 8 April, 1994 and met on a total of 19 occas including two full day meetings in November. The Group's last Phase I meeting was on 29 November, 1994. All the meetings took place in the Dublin Castle Confer Centre.

OTHER ISSUES

1.7 Many submissions raised issues which did not come within the scope of Phase the Group's work. Some of these other issues may be appropriate for the next phase. will bring all of these submissions to the attention of the Minister together with recommendations in relation to Phase II.

ACKNOWLEDGEMENTS

1.8 The Group wishes to thank all those who took the time to make submissions wh we found useful and informative. We would like to express our gratitude to the staf the Dublin Castle Conference Centre for their courtesy and attention. Finally, we ext our thanks to Mr Peter Baldwin, Secretary, and the other members of the secretariat their outstanding contribution without which the timetable set in our terms of referen could not have been met.

Chapter 2

Companies (Amendment) Act, 1990 - Court Protection and Examinership

2.1 The Companies (Amendment) Act, 1990 (referred to in this Chapter as "the Act") was enacted in highly publicised circumstances in August 1990.

2.2 The objective of the Act was stated at the time of its introduction to be the provision of a mechanism for the rescue and return to health of ailing but potentially viable companies. It provides that an application may be made to appoint an examiner to a company that is, or is likely to be, unable to pay its debts (as defined). The duties of the examiner are to examine the state of the company's affairs and report to the court thereon. Where the examiner considers that the whole or any part of the undertaking of the company is capable of survival and that an attempt to continue the whole or any part of the undertaking would be more advantageous to the members as a whole and the creditors as a whole than a winding up of the company, he/she must then formulate proposals for a compromise or scheme of arrangement. The court may, if certain conditions are met, confirm, or confirm subject to modification, the examiner's proposals in which case they become binding on all members and creditors. From the presentation of the petition for the appointment of the examiner the company is protected from its creditors.

2.3 Table 1 below gives an indication of the experience of the operation of the legislation to date. It must be emphasised that it is based solely on returns made to the Companies Registration Office and may not be comprehensive or fully accurate.

Table 1

	Total Application for Examinership	Examiner Appointed	Scheme of Arrangement	Subsequent Receiver/Liquidator (a) where Examiner appointed (b) where Scheme of Arrangement Agreed
Total	166	138	91	(a) 45 (b) 11
3 Largest Groups*	88	74	63	(a) 13 (b) 4
Excl 3 largest Groups	78	64	28	(a) 32 (b) 7

* The total number of companies in the three largest corporate groups are shown separately to indicate their significance as a component of the total figure.

2.4 Company failure is an inevitable feature of commercial life. Company law recognises this fact by providing for the orderly winding up of a company that has failed. However, a company that is encountering difficulties is not inevitably a complete failure. The company and the whole or part of its undertaking may have a viable and self sustaining future. In some instances that may be secured by the appointment of a receiver by the debenture holder. In other cases some other form of rescue process may be able to facilitate the survival of the company. Legislative support for company rescue exists in other jurisdictions and we have noted in particular the provisions in the United Kingdom, Australia and the USA. Company rescue, whether operating in a non-statutory voluntary process or under statute, should preferably be confined to the rescue of something that is viable and self sustaining. Attempts to maintain uneconomic units waste resources. In this Chapter, therefore, when we refer to viable companies we mean the company and that part of it that has a viable and self-sustaining future.

2.5 It has been argued that examinership is not necessary as the receivership process provides a mechanism whereby the viable element of a failing company and any related sustainable jobs can be sold on and preserved. We accept that many receiverships have maintained the viable core of failing companies and the associated jobs. This is not, however, the main focus of receivership which, in any case, is not available in the case of all companies.

2.6 Examinership, however, involves the impairment of the rights and interests of creditors and indeed competitors of the ailing firm. Creditors are not permitted to pursue their claims against the company during the course of the examinership and subsequently may have the level of their claim written down in a scheme of arrangement. Competitors of the ailing firm have to compete with a company that has benefitted, through the examinership process, from a reduction in its debts. Those trading with a firm that goes into examinership can find that contracts which had been freely negotiated with the protected firm are repudiated. The legislation has, therefore, significant potential for the impairment of normal commercial relationships.

2.7 In looking at the examinership legislation and its application to date we sought to identify the justification for setting aside, in the hope of securing the future of an ailing company, normal commercial rights and interests. Examinership involves a cost which has to be borne, principally by creditors but also by competitors. The justification for the introduction of the legislation must lie within the concept of the public interest - that the benefit accruing to a wider group justifies the impairment of the rights of others. It is noteworthy, in this regard, that the examiner will generally formulate proposals for a compromise or scheme of arrangement only where he/she is of the opinion that an "attempt to continue the whole or any part of the undertaking of the company would be likely to be more advantageous to the members as a whole, and to the creditors as a whole, than a winding-up of the company".

2.8 We experienced some difficulty in formulating a precise statement of the public interest justification for the examinership process with its associated impairment of the rights and interests of creditors and competitors. Yet, within the Group, and indeed in many of the submissions made to us, there is a belief that examinership, albeit in a modified form, is a useful mechanism which should be available in Irish company law.

That this view was expressed by bodies representing people whose interests had been impaired by the operation of the examinership legislation is worthy of particular note.

It is in this context that the Group approached its review of the examinership provisions.

2.9 It must, of course, be hoped that, in the normal course of events, companies would address their difficulties at an early date and if possible reach a voluntary accommodation with their creditors. If the company has a viable future such voluntary arrangements could result in the continuation of the company. If not, the winding up of the company is the likely appropriate route. The receivership process, on which we have already commented, is a further alternative in many cases. The common purpose is to focus on something worthwhile, the viable business which, depending on the circumstances, may or may not be capable of continuation within the existing company.

2.10 There may, however, be circumstances where the company has a viable future but where an accommodation cannot be reached voluntarily, for example where one creditor or group of creditors is blocking an arrangement which other creditors are willing to accept. Any assessment as to whether one could justify the imposition of a scheme of arrangement on the objecting creditors very much depends on the circumstances of the individual case. Factors such as the viability of the company, the level of impairment of the interests of different creditors and the level of support from creditors for the compromise all come into play in such an assessment.

2.11 In general terms, we consider that examinership might be justified in the case of ailing but potentially viable companies that have been unable to ensure their survival by voluntary arrangements with their creditors, but where the imposition of a scheme of arrangement might facilitate their survival without undue impairment of the interests of their creditors, their competitors or the commercial environment. Quite clearly, such a general description of circumstances in which examinership should be available is open to many interpretations and subjective judgements, particularly in relation to the viability of the company and the level of impairment to be suffered by its creditors and competitors. For example, it may be questionable whether examinership is appropriate if survival requires unwilling creditors effectively to be the major providers of equity to undercapitalised companies. Given the wide variety of situations that can exist it would be impossible to prescribe in legislation every precise set of circumstances where the examinership process would be appropriate. It is necessary to allow cases to be considered on their own merits.

2.12 It is essential, however, while allowing for consideration of the individual merits of each case, to set limits to the availability of examinership, to set parameters for the operation of the legislation and to provide checks and balances. It is these parameters which can focus on viability and limit the impairment of the interests of individual creditors and competitors. Many of the submissions made to us criticised the existing legislation arguing, in particular, that it does not give sufficient focus to viable companies and that it does not give sufficient protection to the interests of creditors. We accept the thrust of these particular criticisms and many of our recommendations relate to these issues.

FOCUS ON VIABLE COMPANIES

2.13 Under the existing legislation the court may in particular make an order for the appointment of an examiner if it considers that such order would be likely to facilitate the survival of the company, and the whole or any part of its undertaking, as a going concern. This has been interpreted to mean that the appointment of an examiner is appropriate where there is "some prospect" of such survival.

2.14 In our view, the present criteria for admission to the examinership process are not onerous enough. We recommend that the legislation be amended to require the court, before it appoints an examiner, to be satisfied that there is a "reasonable prospect" of the survival of the company and the whole or any part of its undertaking as a going concern. The purpose of examinership is to facilitate a company in overcoming temporary difficulties and allow for the continuation of the viable part of its undertaking. It should not be to postpone, at the expense of others, an inevitable failure. Requiring a reasonable prospect of survival would help focus the legislation on those for which it is most suitable and reduce the potential for damage to the interests of other parties.

2.15 To assist the court decide on whether a reasonable prospect for survival exists we recommend the introduction of a requirement that the petition for the appointment of the examiner be accompanied by a report of an "independent accountant". This report would include the information required at present to be included in the examiner's report under section 16 of the Act and would replace that report. In addition, the independent accountant's report should be required to indicate the extent of the funding required for trading during the examinership period and the source of that funding. In the absence of an outright prohibition on the payment of pre-petition debts the report should also indicate which pre-petition debts are to be paid. In this regard see paragraph 2.27 below. The independent accountant should be defined in legislation as an accountant who is qualified to be appointed as an examiner to the company or who is the company's auditor. The company's auditor could not, of course, be subsequently appointed as examiner and we appreciate that there are circumstances in which an auditor would not wish to accept the task of compiling the pre-petition report. Nevertheless we believe that the option to use the auditor for the preparation of the report should be available.

2.16 We appreciate that circumstances could unexpectedly arise where the survival of a company as a going concern is threatened but where an independent accountant's report is not completed or indeed even in the course of preparation. Such cases would, in our view, be rare and we would be concerned that any exemption to accommodate them could be used to circumvent the normal requirements. We do not favour any exemption from the requirement for the independent accountant's report which we consider should be available to the court in all applications. To cater for such exceptional cases we recommend that the court be allowed, if it is satisfied in certain respects, to grant the protection of the court for a maximum period of 10 days from the presentation of the petition to allow the independent accountant's report to be prepared. The actual question of the appointment of the examiner would be addressed on receipt of the independent accountant's report. If the report is not received within the specified period the protection of the court should cease. This facility should only be available where:

(i) the petitioners have satisfied the court that there were circumstances, outside their control, as to why a pre-petition report could not have been prepared in time to accompany the petition, and

(ii) the petitioners have satisfied the court that they could not reasonably have anticipated the circumstances referred to in (i).

2.17 We would, for example, consider it improbable that the appointment of a receiver would be cited as a reason why a pre-petition report could not be prepared. In the normal course there is likely to be a period of communication between the company and the debenture holder before the receiver is appointed. In these circumstances, we would consider that the appointment of a receiver might be reasonably anticipated by a company or its directors.

2.18 Where, exceptionally, a company is granted the protection of the court to allow an independent accountant's report to be prepared there should be no possibility of certification, by any interim examiner, of expenses incurred during this period. The sole concession in such cases should be the freeze on pre-petition debts while the independent accountant's report is prepared.

2.19 Compliance with the requirement for an independent accountant's report may be difficult or indeed impossible for creditors or members, who wish to present a petition, unless they have the co-operation of the company and its directors. Nevertheless, we do not favour any exemptions from the requirement to present such a report. We believe that, in practice, such difficulties would rarely arise as in the vast majority of cases the company or its directors are likely to be the petitioners. The necessity to ensure that the court has full information available to it, to enable it decide if an examiner should be appointed, in our view, outweighs the desirability of accommodating the small number of cases where such difficulties might arise.

2.20 The Minister for Enterprise and Employment and the Central Bank have particular rights of application in the case of insurance companies and financial institutions by virtue of their supervisory responsibilities. It may be desirable to ensure that they are in a position to secure a report from an independent accountant in the case of such companies.

2.21 It is important that the information on the basis of which the court takes its decision is as reliable as possible and that those preparing a report to accompany a petition for the appointment of an examiner act in good faith. We recommend that the legislation be amended to impose a specific duty on those persons presenting a petition and persons involved in the preparation of a report supporting such a petition (and in both cases their professional advisers) to exercise the utmost good faith and to disclose all relevant facts material to the exercise by the court of its discretion to appoint an examiner.

2.22 As the report of the independent accountant will replace the current 21 day report there should be a corresponding reduction in the timescale for examinership. The legislation should be amended accordingly to reduce the maximum time period for court protection.

RECEIVER IN SITU

2.23 At present, where a receiver stands appointed for three days the court cannot hear a petition for the appointment of an examiner. If our recommendation for a period of court protection in exceptional cases, to allow the preparation of an independent accountant's report, is accepted, there could be a period of up to 13 days after the appointment of a receiver during which he/she does not know whether an examiner will be appointed. It has been argued to us that this uncertainty poses difficulties for receivers. It has also been pointed out that the legislation makes no specific provision for the liabilities, costs and expenses of the receiver where an examiner is appointed. We note that section 6 of the Act allows the court to make any order it sees fit in relation to receivers and provisional liquidators. This flexibility may help solve some problems. Indeed we recommend that the court should be empowered to make such an order at any time from the presentation of the petition for the appointment of an examiner. This would give added flexibility to deal with difficulties arising for receivers. One difficulty that we consider should be addressed more specifically is the obligation on receivers under section 98 of the 1963 Act in relation to payments to preferential creditors. There may be circumstances where the appointment or potential appointment of an examiner could pose difficulties for receivers in complying with this requirement. Accordingly, we recommend that the court should be empowered to order, inter alia, the waiving of the requirement under that section.

2.24 We do not accept the suggestion that it should not be possible to appoint an examiner once a receiver has been appointed. This would give certain creditors a virtual veto over examinership appointments.

CREDITORS' INTERESTS

2.25 Creditors are the main sufferers in the examination process. Their rights and interests are impaired in many different ways by the existing legislation. They cannot enforce their debts or guarantees for those debts during the protection period. The value of their security may be eroded. If they are banks their normal right of set-off is restricted. Finally, the amounts owed to them can be written down in schemes of arrangement in which they have little say. In our view the legislation needs to be amended to give greater weight to the rights of creditors and to give them greater control over the outcome of the examinership process.

RIGHT TO BE HEARD AT PETITION HEARING

2.26 While the current legislation does not give creditors the right to be heard at the application stage, Rules of Court allow the court to adjourn the hearing until any party or parties which the court feels should be notified have been notified. In practice, we understand that the attendance of creditors is usual at the hearing for the appointment of the examiner (though not necessarily for the appointment of an interim examiner). We consider that the Act should be amended to give a right of hearing to creditors at the petition hearing. Their views would be of assistance to the court in deciding whether there was a reasonable prospect of survival particularly in the context of our recommendation below that creditor approval be required for any proposals for a compromise or scheme of arrangement.

PRE-PETITION DEBTS

2.27 The existing legislation prevents creditors from enforcing pre-petition debts. It does not however prevent company management from making payments in respect of those debts. This is open to abuse by allowing company management pay creditors of their choice. Management may be under pressure to pay essential suppliers (including labour) and thereby ensure continuity of supply. While there was a significant preference within the Group for the introduction of a prohibition on the payment of any pre-petition debt (in order to prevent such abuses and to ensure equity between creditors), there was a recognition that such a prohibition might prove impractical. As an alternative in the face of such impracticalities we recommend that only those pre-petition debts that are referred to in the funding statement accompanying the petition should be allowed to be paid. This would allow all creditors the opportunity to be heard in relation to the payment of pre-petition debts.

DEBTS INCURRED DURING EXAMINERSHIP

2.28 The ailing company continues to trade during the period of court protection. If the company trades at a loss during this period there is a further diminution of the position of pre-petition creditors. The Act allows an examiner to certify liabilities incurred during the protection period where they are essential to ensure the survival of the company as a going concern. These liabilities then rank with the examiner's own expenses ahead of all other liabilities. Furthermore judicial interpretation has indicated that assets already charged by fixed charge may, in certain circumstances, be used for the purposes of fresh borrowings. The potential for further losses by existing creditors is clear.

2.29 It has been suggested to us that companies should have to trade on a "cash basis" during examinership and that the position of pre-petition creditors should not be worsened during examinership. While we have some sympathy for the motives behind these suggestions, a requirement to trade on a cash basis would not accommodate businesses where seasonality is a factor and a general requirement not to worsen the position of pre-petition creditors would be difficult to enforce.

2.30 During the court protection period the company is allowed to continue to trade. This continued trading gives rise not only to liabilities which are directly those of the company but also to liabilities deriving from the collection of monies from others for transmission to the State in the form of PAYE, PRSI and VAT payments. We accept that these latter liabilities have a unique character and recommend that their payment during the protection period should be required.

2.31 A focus on more viable companies, the requirement to indicate in the pre-petition report how losses are to be funded and a reduced protection period should lessen the potential for further loss to pre-petition creditors. Nevertheless we believe that further protection needs to be given to secured creditors. The ability to secure debts on property is an important element in the financing of commercial activity in this country. Any doubt over the value of a security, in particular that of a fixed security, impacts on the availability and cost of credit to Irish business. To overcome potential problems in this area we recommend that the legislation be amended to provide that liabilities certified by the examiner should rank after the claims of fixed chargeholders although still ahead of floating charges. The examiner's own remuneration and costs referred to in section 29(1)

(but not expenses certified under section 10) should continue to rank ahead of all other claims.

2.32 In recommending greater protection for the interests of creditors we would be concerned if creditors could use devices such as negative pledges as effective vetoes on the examinership process. Accordingly, we recommend that the legislation be amended to allow the court to declare such pledges void if such voidance is necessary to allow the company obtain the funding necessary for the protection period.

GUARANTEES

2.33 Guarantees are another widely used arrangement which facilitates the granting of credit. Lenders, who might not otherwise grant credit, do so because of their assessment of the ability of the guarantor to discharge the debt should the debtor default. In effect, the loss occasioned by the failure of the debtor to discharge the debt falls to the account of the guarantor, not the immediate creditor. We see no reason to conclude that a different consequence should apply to the impairment of a creditor's claim under a court-approved compromise or scheme of arrangement in the examinership process and we recommend accordingly. Neither do we see any reason to conclude that a guarantor should be better placed than a creditor vis-a-vis a debtor company in examinership so that, for example, a guarantor could pursue a claim against the company in respect of the impairment after the scheme of arrangement. The alternative would, obviously, stultify the examinership process. Accordingly, we recommend that a guarantor should not have a right of subrogation in respect of the impairment. It follows that the guarantor is the person most immediately concerned with the impact of the compromise or scheme of arrangement. It would be reasonable, we believe, where creditors intend subsequently to enforce the guarantee, to require them to assign to the guarantor any rights to vote on a scheme of arrangement that are associated with the particular debt. We recommend that this be provided for in the legislation. We do not consider it unreasonable to freeze the enforcement of the guarantee while the original debtor company is under court protection.

BANKS' RIGHT OF SET-OFF

2.34 The Companies Act, 1990 introduced a number of amendments to the examinership legislation one of which prohibits set-off between separate bank accounts without the consent of the examiner. This treats bank creditors differently to other types of creditors. It could also result in a bank which is not a net creditor of a company involuntarily becoming a significant creditor. In examining this issue we considered whether a restriction on set-off should be extended to all creditors but were not in favour of such a measure. We also took account of views expressed by the Central Bank which indicated that the restriction has created difficulties in implementing internationally accepted practices of allowing offsets for capital adequacy purposes. We recommend that section 5(2)(h) of the Act (inserted by section 181 of the 1990 Act) be repealed thereby allowing banks to exercise the right of set-off.

" BIG TICKET" LEASING CREDITORS

2.35 One area of particular concern that was brought to the attention of the Group is the position of "big ticket" asset leasing arrangements. These arise particularly, but not exclusively, in the context of leasing activities carried on by companies operating from

the International Financial Services Centre (IFSC), Dublin, and Shannon Custom Free Airport in respect of major assets, such as aircraft, ships, etc.

2.36 It was suggested that there is a national interest in addressing the particular concerns raised, in that international lenders are reluctant to provide funding to leasing companies operating in the areas mentioned because of the potential impact of the provisions of sections 7(5) and 29(3) of the Act. We are satisfied that the recommendations we have made elsewhere in the Chapter, if implemented, will allay these concerns. However, if the necessary legislative changes cannot be made in the very near future, it has been represented to us that consideration should be given to introducing interim measures, if necessary restricted to the IFSC and Shannon zones, to ensure that any potential loss of or diminution in leasing business in these areas is avoided. We submit this request for consideration, in the knowledge that the precise manner in which the industry's concerns could be addressed can be discussed directly with the interests concerned.

2.37 The position of lessors in relation to future payments is somewhat uncertain under current legislation. It would be unreasonable, in our view, to require the lessor of an asset, particularly a substantial asset, such as an office block, to accept reduced payments for a future period. We believe that the legislation should be amended to preclude any possibility of a lessor being forced to take reduced payments in future in respect of a leased asset. The lessor should have the option to repossess the asset if the company cannot meet its obligations after the protection period.

CREDITOR APPROVAL FOR PROPOSALS FOR A COMPROMISE OR SCHEME OF ARRANGEMENT

2.38 At present, the only requirement relating to creditor approval for proposals for a compromise or scheme of arrangement is that one class of creditors, whose interests or claims would be impaired by implementation, has voted to accept it. We consider that this does not give sufficient recognition to the interests of creditors who, as we have already noted, are the main contributors to company rescue and whose goodwill will be most desirable, if not critical, to post rescue trading. In our opinion, the approval of a majority by value of creditors should be required before proposals for a compromise or scheme of arrangement are confirmed. We recommend that the legislation be amended accordingly. The introduction of such a requirement would not only be a more realistic reflection of the contribution of creditors but would be consistent with the focus on viable companies and a further encouragement for companies to tackle their difficulties seriously at an early date.

CREDITORS' COMMITTEES

2.39 The role of creditors' committees is not precisely defined in the legislation. We considered whether a more clearly defined and enhanced role for such committees should be provided by amendment to the legislation. We also considered whether secured creditors should have a right to be included on creditors' committees (the legislation gives the three largest unsecured creditors willing to serve such a right, subject to court directions otherwise). In the light of our recommendation that majority creditor approval be required for proposals for a compromise or scheme of arrangement and our recommendation relating to priority for fixed charges, we do not consider that the provisions relating to creditors' committees need amendment.

CLASSES OF CREDITOR

2.40 There is no definition in the legislation of the term "class" and we considered whether it would be useful to introduce such a definition. As the real significance of any such definition would arise in the approval of the proposals for a compromise or scheme of arrangement, we do not see that any such definition is necessary where the approval of a majority of creditors by value is to be required.

2.41 The above recommendations relating to creditors would, if implemented, give significantly increased recognition to their rights and interests in the examinership process.

APPROVAL OF MEMBERS

2.42 The existing provisions provide that proposals for a compromise or scheme of arrangement must be also approved by at least one class of members. In a situation where creditors are being asked to make concessions to ensure that the company survives we consider that there should be no requirement for approval by a class of members. While it could be argued that members should have some say where there is net equity in the company, such a criteria might be difficult to assess. On balance, we consider that there should be sufficient protection for members in the requirement that the proposals must not be unfairly prejudicial to the interests of any interested party.

REPUDIATION OF CONTRACTS, MANAGEMENT DURING COURT PROTECTION AND RECKLESS TRADING

2.43 It has been represented to us that the directors of the ailing company, who were responsible for the company while it got into difficulties, should be removed and that the examiner should be empowered to run the company. We do not agree with this suggestion. The purpose of the examiner is to investigate the affairs of the company and report to the court and he is required to do this within a very tight timescale. An examiner's ability to execute these responsibilities in time would be seriously impaired if he/she also had to run the company. Furthermore, the underlying objective of the survival of the company and its undertaking may not be best served by the removal of management for a period, however temporary. It may, of course, be in the interests of the survival of the company and the whole or part of its undertaking that there should be changes in the management of the company. The Act caters for this possibility in requiring the examiner to address the need for changes in the direction and management of the company in the proposals for a compromise or scheme of arrangement where he/she considers such changes necessary or desirable. In addition, during examinership the court can under section 9, to protect the interests of the company, employees or creditors, order that any or all of the powers of the directors shall be vested in the examiner.

2.44 The possibility of management engaging in reckless trading has also been raised as an issue. Section 297A of the 1963 Act, as inserted by section 138 of the Companies Act, 1990, provides for civil liability of officers of a company for fraudulent and reckless trading. Under this section, the court can make an officer of a company personally liable for all or any part of the company's debts or liabilities if it appears to the court that the officer was knowingly a party to reckless or fraudulent trading. The provisions relating to liability for reckless trading do not, however, apply in relation to the carrying on of the business during a period when the company is under the protection of the court. This

exemption was considered necessary because, under section 297A(2) of the 1963 Act, an officer is deemed to have been a party to reckless trading where he ought to have known that his actions or those of the company would cause loss to creditors or where he was a party to contracting a debt and did not honestly believe on reasonable grounds that the company would be able to pay the debt when it fell due for payment as well as all its other debts (taking into account the contingent and prospective liabilities).

2.45 While we understand the concerns expressed with regard to the exemption, we appreciate that it is necessary in the context of the definition of reckless trading. Furthermore, we note that protection is provided for creditors against the possibility of harmful actions by directors, not only by section 9, which allows the assignment of directors' powers to the examiner, but by section 7(5) which allows an examiner to halt, prevent or rectify acts, omissions, courses of conduct, decisions or contracts by or on behalf of the company which, in the examiner's opinion, are likely to be detrimental to the company, its members or creditors. In noting this "protective" aspect of section 7(5) we must also note that problems have arisen with its application which, we believe, require that it be amended.

2.46 The powers of an examiner under section 7(5) have been held by the courts to include a power to repudiate contracts even though they were entered into prior to the period of court protection. This provision, in its current form, clearly undermines the reliability of contracts entered into with Irish companies and could pose serious consequences for the financing of Irish industry. A person transacting business with an Irish company cannot be certain that an examiner subsequently appointed will not repudiate the contract. In our view the ability to repudiate a contract under section 7(5) should be confined to contracts entered into during the court protection period and we recommend that the legislation be amended accordingly. Those trading with a company in examinership should be aware of this fact as a result of the notification provisions of section 12 of the Act and can plan accordingly. Furthermore, the protective aspect of section 7(5) as a counterbalance to the exemption for directors from liability for reckless trading will not arise in relation to the pre-court protection period where the reckless trading provisions continue to apply.

SUBSEQUENT EXAMINERSHIPS

2.47 It has been suggested to us that examinership should not be available to a company on more than one occasion. We do not believe there should be any such prohibition. The court can consider each application for the appointment of an examiner on its merits and it can take the history of the company, including any previous examinership, into account. In any case, the company may have new owners, new management and the circumstances may be unrelated to those of the previous examinership.

TREATMENT OF WRITE DOWNS BY REVENUE AUTHORITIES

2.48 Though not specifically a company law issue, some of those who made submissions to us raised the question of the treatment by the revenue authorities of amounts written down in a scheme of arrangement. They argue that the practice of adjusting the company's tax liability to take account of these write downs is unfair in that it places the revenue authorities in a more advantageous position than other creditors. Apart from the fact that in many, if not most, cases there is no immediate tax liability, we note that the revenue

authorities' position in this is broadly neutral in that they grant corresponding bad debt allowances to the other creditors. We do not consider that an amendment to the legislation is required in this regard.

CHARGE

2.49 It has been represented that mortgage and charge are two different and distinct legal concepts. We recommend that the words "a charge" in section 5(2)(d) be amended to "a pledge, mortgage, charge or other encumbrance".

CO-OPERATIVE SOCIETIES

2.50 It has been suggested to us that co-operative societies, for example, agricultural co-operatives, should have the examinership process made available to them. While we appreciate that these bodies do not operate under the Companies Acts, we agree that the suggestion merits serious consideration and we recommend that it be explored.

CONSTITUTIONALITY

2.51 In paragraph 3.16 we refer to the Supreme Court's determinations in relation to the constitutionality of section 10, subsections (5) and (6), of the Companies Act, 1990 which relate to contempt of court arising in the course of investigations. As these provisions are mirrored in virtually identical terms in section 8, subsections (5) and (5A), of the Companies (Amendment) Act, 1990, we recommend that the latter sections be reviewed in the context of our recommendation on section 10 as aforesaid.

CONCLUSIONS AND RECOMMENDATIONS

- An amendment should be introduced requiring the court to be satisfied before it appoints an examiner that there is a reasonable prospect of the survival of the company and the whole or part of its undertaking. [Paragraph 2.14]

- The legislation should be amended to require a petition for the appointment of an examiner to be accompanied by a report of an independent accountant.[Paragraph 2.15]

- An independent accountant should be defined in legislation as an accountant who would be qualified to be appointed as an examiner to the company or who is the company's auditor. [Paragraph 2.15]

- The independent accountant's report should give the information at present required of an examiner under section 16 and should replace that report. It should also indicate the level of funding required for trading during the court protection period and the source of that funding. [Paragraph 2.15]

- There should be no exemption from the requirement to present an independent accountant's report but the court should be allowed to grant a 10 day period of court protection to facilitate the preparation of the report in specified exceptional circumstances. There should be no possibility of liabilities being certified by an interim examiner in this period. [Paragraphs 2.16 & 2.18]

- A duty should be imposed by legislation on those presenting a petition and their advisers to exercise the utmost good faith and disclose all relevant facts material to the exercise by the court of its discretion to appoint an examiner. [Paragraph 2.21]

- The maximum time period for court protection specified in the legislation should be reduced by 21 days to take account of the removal of the requirement for the examiner's report under section 16. [Paragraph 2.22]

- The power of the court to make an order in relation to a receiver or provisional liquidator should be extended to accommodate the period between the presentation of the petition and the decision on the appointment of the examiner. [Paragraph 2.23]

- The court should be empowered to make an order waiving a receiver's obligation to preferential creditors under section 98 of the 1963 Act if circumstances relating to the appointment of an examiner so warrant. [Paragraph 2.23]

- We recommend that the facility to appoint an examiner up to three days after the appointment of a receiver should be retained. [Paragraph 2.24]

- A creditor's right to be heard at the hearing of the petition for the appointment of an examiner should be specified in legislation. [Paragraph 2.26]

- In the face of practical difficulties in imposing a prohibition on payment of any pre-petition debt during the protection period, we recommend that only those pre-petition debts specified in the funding statement should be allowed to be paid. [Paragraph 2.27]

- There should be a requirement to make payment in respect of liabilities for PRSI, VAT and PAYE arising out of trading during the protection period. [Paragraph 2.30]

- Liabilities certified by the examiner should not rank ahead of fixed securities. The examiner's own remuneration and costs should continue to rank ahead of all other claims. [Paragraph 2.31]

- The legislation should allow the court to void negative pledges in certain circumstances. [Paragraph 2.32]

- The approval of a compromise or scheme of arrangement should not affect the creditor's rights under a third party guarantee. [Paragraph 2.33]

- A guarantor should not have a right of subrogation in respect of that part of the guaranteed debt impaired by the approved compromise or scheme of arrangement. [Paragraph 2.33]

- The legislation should require the assignment, by a creditor who intends to enforce a guarantee, to the guarantor of any rights to vote on a scheme of arrangement that are associated with the particular debt. [Paragraph 2.33]

- The prohibition on enforcement of guarantees by creditors during the protection period should be retained. [Paragraph 2.33]

- The restriction on the right of set-off between bank accounts should be repealed. [Paragraph 2.34]

- The special position of those involved in "Big Ticket" leasing in the IFSC and Shannon Custom Free Airport zones should be considered in the context of our recommendations for amendments to section 7(5) and section 29. [Paragraph 2.36]

- The legislation should be amended to preclude the possibility of lessors having to accept reduced repayments after the protection period. The lessor should have the option of repossessing the asset in such circumstances. [Paragraph 2.37]

- A requirement should be introduced that the approval of a majority by value of the creditors has to be obtained before the court can confirm proposals for a compromise or scheme of arrangement. [Paragraph 2.38]

- The requirement for the approval of a class of members for proposals for a compromise or scheme of arrangement should be removed. [Paragraph 2.42]

- The ability of an examiner to repudiate contracts under section 7(5) should be confined to contracts entered into during the protection period. [Paragraph 2.46]

- There should be no prohibition on a company undergoing examinership more than once. [Paragraph 2.47]

- The term "charge" in section 5(2)(d) should be amended to "a pledge, mortgage, charge or other encumbrance". [Paragraph 2.49]

- The possibility of making the examinership process available to co-operative societies should be seriously examined. [Paragraph 2.50]

- The wording of section 8, subsections (5) and (5A), of the Companies (Amendment) Act, 1990 should be reviewed in the context of changes in the wording of section 10, subsections (5) and (6), of the Companies Act, 1990. [Paragraph 2.51. See also Paragraph 3.16]

Chapter 3

Part II of the Companies Act, 1990 - Investigations

3.1 Part II of the Companies Act, 1990 (the Act) provides for the investigation of the affairs of companies, their ownership or control, or the ownership of shares and debentures. These provisions replaced the investigation provisions of the 1963 Act which had proved ineffective in the light of possible legal and constitutional difficulties.

3.2 The ability to conduct investigations into the affairs or ownership of companies is an important component of the company law framework. It provides a mechanism whereby evidence of wrongdoing, fraud and breaches of law can be obtained with a view to further proceedings. It can provide reassurance to interested parties in dispelling unfounded suggestions of misconduct and, by holding out the possibility of close scrutiny, can discourage such activities by those transacting business through the company vehicle.

3.3 Part II of the 1990 Act provides a variety of mechanisms whereby investigations can be carried out.

3.4 Under section 7 of the Act, the court may appoint one or more competent inspectors to investigate the affairs of a company in order to enquire into matters specified by the court and to report thereon as directed by the court. An application for the appointment of an inspector under this section may be made by the company, a director of the company, a creditor of the company or a specified minimum number of members.

3.5 Under section 8, the court may appoint an inspector to investigate the affairs of a company on the application of the Minister if the court is satisfied that there are, inter alia, circumstances suggesting fraud or unlawful activities or that members are not being given information that they might reasonably expect.

3.6 Under section 14 the Minister may appoint one or more competent inspectors to investigate and report on the membership of a company for the purpose of determining the true persons who are or have been financially interested in the success or failure (real or apparent) of the company or able to control or materially to influence the policy of the company. Section 15 permits the Minister to make the necessary enquiries without appointing an inspector.

3.7 Under section 19, the Minister or an authorised officer may require the production of books and documents of a company or other body corporate carrying on business in the State, if the Minister is of the opinion that specified circumstances exist such as it being necessary to determine if an investigation is warranted, its affairs are being conducted with intent to defraud or the body was formed for fraudulent or unlawful purposes.

3.8 The legislation also contains ancillary provisions relating to matters such as powers of inspectors, investigation of related companies, restrictions on shares or debentures,

savings for privileged information and the admissibility of evidence to the inspector and of his report in subsequent proceedings.

3.9 The investigations provisions in Part II have been used on six occasions, two involving the appointment of inspectors under section 8, two involving appointments under section 14 and a further two involving the appointment of authorised officers under section 19. A summary of these six uses of the legislation is contained in the Addendum to this Chapter.

3.10 Our remit is to examine the provisions of Part II and, whilst we have had regard to the experience of the use of these provisions, we have not concerned ourselves with the subject matter of the particular investigations.

3.11 Based on the experience to date, we consider that Part II of the Act has substantially proved to be capable of fulfilling the purpose for which it was enacted. A variety of suggestions for amendment were made to us which we consider below. While we recommend the introduction of some changes, our general view is that the provisions do not require any significant amendment.

APPOINTMENT OF INSPECTORS

3.12 It was suggested to us that all inspectors should be appointed by the Minister and that there is no need to involve the court. Underlying this suggestion is a belief that court decisions in judicial reviews relating to inspectors and their pursuance of their statutory duties and to the Beef Tribunal indicate that there would probably not be constitutional or legal difficulties with Ministerially appointed inspectors. While this may be the case, we do not favour any change. In our view the wide ranging nature of a section 8 investigation and the seriousness of the circumstances set out in that section make a court based process desirable. In relation to section 7, we believe that the court is the appropriate forum in which applications for the appointment of an inspector, from the interested parties listed in that section, should be considered. We are also satisfied, however, that the ability of the Minister to make appointments for the more focused investigations under sections 14 and 19 should be retained.

3.13 Suggestions were also made to us that civil servants and other Government officers should not be eligible for appointment as inspectors on the presumptions that they will not have the required degree of competence, that their employment makes them vulnerable to ministerial interference and/or they will be unable to retain confidentiality. We do not accept that there should be such presumptions and accordingly, do not recommend the introduction of such a prohibition. At the same time, we do not accept, as another submission suggested, that the court should be required to appoint a particular person nominated by the Minister or indeed by any other party. The court, in the case of appointments under sections 7 and 8, should continue to have the freedom to make the appointment as it sees fit in the particular circumstances of each case with the Minister making nominations for appointment under section 8.

PRODUCTION OF DOCUMENTS AND EVIDENCE

3.14 A number of recommendations were made to us that the ability of inspectors to access documents and evidence should be enhanced by a variety of amendments.

3.15 Section 10 imposes an obligation on officers and agents of the company (and where appropriate, related companies) and other persons "to give the inspectors all assistance in connection with the investigation which they are reasonably able to give". It has been put to us that additional wording should be included in this section to ensure that the subjective judgement of parties from whom assistance has been sought, as to what assistance they might reasonably give, does not result in difficulties for inspectors in accessing documents. A balance must be struck between affording too wide a power to the inspectors and an over reliance on the presumed co-operation of the respondent. While there is inevitably an element of judgement as to what information falls within the category of all assistance which they are reasonably able to give, it is open to the inspector to challenge in the courts the performance of persons under this section if he/she believes they have failed to comply with the section. We believe that the present wording of section 10 strikes the correct balance. We also believe that the section places a clear statutory duty on those to whom the inspector has directed requests for co-operation.

3.16 We are aware that the Supreme Court, on the grounds of constitutionality, has made determinations in relation to section 10, subsections (5) and (6). In the meantime, we understand that these provisions are capable of effective operation in practice, taking account of the Court's determinations. We nevertheless consider that any possible misconceptions about the standing of the subsections and consequent potential for confusion or misperception should be precluded by the earliest possible restatement of the provisions to reflect the decision of the Court.

3.17 As a further measure, to assist inspectors appointed under sections 7, 8 or 14, it has been suggested that companies and their agents such as banks and solicitors should be required to maintain documents for a minimum period of six years. There is, of course, a requirement under section 202 of the 1990 Act for books of account to be retained for a period of six years. We also note that it is common practice for solicitors and banks and others to maintain documents for such periods. We do not believe, however, that such a general requirement should be introduced without wide consultation and careful consideration of its implications for the transaction of business.

3.18 Section 9 allows an inspector, with the approval of the court, to investigate the affairs of another body corporate which is related to a company under investigation and to report thereon insofar as the results of the investigation into the other body corporate are relevant to the first investigation. In the case of a section 14 investigation into the ownership of a company, the approval can be given by the Minister. It has been pointed out that the term "related" restricts the application of this provision and that it would be preferable to allow the inspector to investigate any company or particular transactions of any company so far as he/she thinks the results of the investigation thereof are relevant to the original investigation. We believe that the provisions of section 9 are sufficiently wide and should not be amended in this regard. The definition of a related company in section 140(5) of the Act covers quite a wide range of commercial relationships. While in the context of an investigation of a company we consider it reasonable to allow for investigation of related bodies we do not consider it reasonable to allow the investigation, with all the associated implications for reputation, to be extended to a wider group of companies. Furthermore, the provisions of section 10 allow the inspector to require the production of documents and evidence concerning the affairs of the company under

investigation from any person and requires that person to give all assistance in connection with the investigation that they are reasonably able to give.

3.19 It has been submitted to us that section 14, which allows the investigation of company ownership, should be amended to allow the investigation of the ownership of any body corporate or unincorporated that conducted, or was connected with the conduct of, business in Ireland. In our view, the purpose of section 14 is properly focused on seeking to establish the true beneficial ownership or control of companies as defined under the Companies Acts. Where it is necessary, in discharging that function, to investigate involvement of bodies incorporated outside Ireland in the true ownership or control of the Irish company under investigation, it is possible to do so. We do not, accordingly, accept this recommendation for amendment to section 14. We make reference to international co-operation in investigations later in this Chapter.

3.20 A number of specific suggestions were made to us for the widening of the powers of the Minister or an authorised officer under section 19. Section 19 allows the Minister or an authorised officer to require the production of documents of certain companies and bodies corporate if the Minister considers that there are circumstances suggesting a need to determine whether an inspector should be appointed or that some specified improper activities are being conducted. It has been proposed that section 19 should be amended to allow the requisition of documents or information, pertaining to the affairs of the body under investigation in any way, which are held by any other person. It has been further recommended that section 19 should be amended to allow investigation of Irish bank accounts held by companies incorporated outside the State even though those bodies have not carried on any business in the State. We do not recommend that such amendments be introduced. The powers available under section 19 adequately facilitate what is but a preliminary investigation, which might lead on to further proceedings. We believe that appropriate limits have been set in the present legislation.

COSTS

3.21 Some concern has been expressed about the high level of costs associated with investigations. It is quite appropriate that there should be such concern where public funds are being expended. Under sections 7 and 8 the appointment of inspectors is a matter for the court, and we have recommended that this should continue to be the case. We note, however, that under section 7(4) the court, where it appoints an inspector under sections 7 or 8, may from time to time give directions to the inspector or otherwise with a view to ensuring that the investigation is carried out as quickly and as inexpensively as possible. We also note that section 13 allows the court to direct that any body corporate dealt with in the report of an inspector appointed by the court or the applicants for the investigation be made liable to the courts for the costs of the investigation; up to a maximum liability of £100,000 in the case of the applicants. It is of course also open to the Minister for Enterprise and Employment to consider the issue of costs in making applications for appointments under section 8 and in making appointments under sections 14 and 19. Indeed we note recent developments where civil servants have been employed in assisting an inspector operating under the aegis of the court. It has been represented to us that, in the case of section 14 investigations, there should be an analogous capability to that in section 13 for seeking to recoup the costs of the investigation. We consider that such a capability should be provided for in the legislation. Otherwise, we consider that the existing legislation adequately caters for the issue of costs.

3.22 The Department of Justice has expressed the view that the Minister for Enterprise and Employment and not the Minister for Justice should be the Minister responsible for defraying, in the first instance, the costs of section 7 and 8 investigations. It has separately been represented to us that the cost of investigations under section 7 should be borne, in the first instance, by the Minister for Justice as, in those cases, the appointments are made by the courts without the involvement of any other Minister. At the same time, it has been suggested that the Minister for Enterprise and Employment should, in the first instance, defray the costs of section 8 investigations where he/she is the applicant. We accept that there is some validity to these arguments. Nevertheless, we consider that this matter is more appropriately resolved inter departmentally and in advance of any amending legislation.

RECIPROCITY

3.23 Given the international dimension to modern commercial activity and the fact that serious fraud and malpractice characteristically know no national boundaries with devices such as offshore companies often featuring in arrangements there has been, and will inevitably continue to be, the need for inspectors appointed under Part II to seek co-operation of the authorities within other jurisdictions. It has been submitted that difficulties could arise for Irish inspectors if Irish legislation does not provide for reciprocal assistance. In principle, we support the introduction of provisions to allow for reciprocal assistance and international co-operation with statutory investigators from other countries. We recommend that the Minister for Enterprise and Employment explore the nature of such provisions in other jurisdictions with a view to identifying appropriate arrangements for inclusion in Irish company law.

RESTRICTION ON SHARES

3.24 Section 16 allows the Minister for Enterprise and Employment to issue a direction imposing restrictions on shares or debentures where there is a difficulty, in connection with an enquiry under section 14 or 15, in ascertaining the relevant facts about the shares or debentures. This power has been exercised in two instances to date, arising out of recommendations by inspectors appointed under section 14. In both instances we understand that the statutory restrictions are still in place. Each inspector reached a considered opinion in his statutory report, which, in both cases, was published by the Minister and was referred, inter alia, to the company in question.

3.25 The Act allows restrictions which will prevent the transfer of shares and debentures, the exercise of voting rights and the making of payment of any sums due from the company on those shares or debentures. The restriction on the making of payments of sums due from the company does, however, not apply in the case of liquidations. It has been argued that the thrust of this section could be overcome by putting the company into liquidation. We recommend that the potential for such abuse be removed by appropriate amendment.

3.26 It has been represented to us that the provisions of section 16(6) which provide for the lifting of the restrictions are unnecessarily narrow in that, except where the shares are sold with Ministerial or court approval, the restrictions may only be lifted if the Minister or the court is satisfied that the relevant facts about the shares have been disclosed to the company and that no unfair advantage has accrued to any person as a

result of the earlier failure to make that disclosure. There may be circumstances where the relevant facts have been disclosed to the inspector but where there is no need to require their disclosure to the company. Furthermore, the requirement that no unfair advantage has accrued to any person as a result of the earlier failure to disclose the true ownership, could be construed as requiring the Minister to maintain the restrictions in place and allow that matter to be determined in a court of law. In the context of the Minister having discretion to appoint the inspector, to impose the restrictions on shares and debentures and to publish the inspectors report we consider that it would be appropriate to allow the Minister the discretion to lift the restrictions under the sole condition that the relevant facts had been disclosed to the inspector and reported to the Minister.

MISCELLANEOUS

3.27 Section 19(3) allows for protection of a lien on books or documents where the Minister or an authorised officer requires the production of these from a person who appears to be in possession of them and claims a lien on them. It has been suggested to us that an equivalent provision be included in sections 10(1) and (2) and we recommend that such an amendment be made.

PRIVILEGE

3.28 It was suggested to us that inspectors should be granted absolute privilege in relation to the contents of their reports. We do not consider that this would be reasonable and believe that qualified privilege available to inspectors who act in good faith is sufficient.

ADMISSIBILITY AS EVIDENCE OF INSPECTORS' REPORTS

3.29 Under section 22 of the 1990 Act, an inspector's report is admissible as evidence in civil proceedings:

"(a) of the facts set out therein without further proof unless the contrary is shown, and

(b) of the opinion of the inspector in relation to any matter contained in the report.".

It was suggested to us that some limitation on the admissibility of an inspector's report as evidence may be desirable. We consider that the existing admissibility provisions are satisfactory and do not recommend any change.

CONCLUSIONS AND RECOMMENDATIONS

- Part II of the Companies Act,1990 has substantially proved capable of fulfilling the purpose for which it was enacted and does not require any significant amendment. [Paragraph 3.11]

- The present arrangements for appointments by the courts under sections 7 and 8 and by the Minister under sections 14 and 19 should be retained. [Paragraph 3.12]

- There should be no prohibition on the appointment of Government officials as inspectors. [Paragraph 3.13]

- No restrictions should be placed on the Court's discretion to make appointments under sections 7 and 8, with the benefit of nominations as appropriate in each case. [Paragraph 3.13]

- Section 10 needs to be restated to reflect the determinations by the courts in 1992 as to the unconstitutionality of certain elements thereof. [Paragraph 3.16]

- The ability to investigate "related" bodies corporate in section 9 should not be widened to cover bodies that are not related. [Paragraph 3.18]

- We do not favour extending the scope of section 14 to cover ownership of any body corporate or unincorporated that conducted or was connected with the conduct of business in Ireland. [Paragraph 3.19]

- The scope of documentation which can be required under section 19 is appropriately limited in the existing legislation. [Paragraph 3.20]

- We recommend that a statutory capability should be introduced to allow for the recovery of costs from appropriate sources for section 14 investigations along the same lines as in the existing section 13. [Paragraph 3.21]

- In principle we support the introduction of statutory arrangements to facilitate reciprocal assistance in investigations. The Minister for Enterprise and Employment should investigate the nature of such provisions in other jurisdictions. [Paragraph 3.23]

- Section 16(2) should be amended to apply the restriction on making payments due from the company on restricted shares or debentures to liquidation situations. [Paragraph 3.25]

- Section 16(6) should be amended to facilitate the lifting of restrictions even though the company has not been informed of the relevant facts about the shares or debentures. There should be a requirement that the relevant facts have been disclosed to the inspector and reported to the Minister. [Paragraph 3.26]

- A protection should be introduced in section 10(1) and (2) for a lien on books and documents similar to that in section 19(3). [Paragraph 3.27]

- We do not recommend the granting of absolute privilege to inspectors. [Paragraph 3.28]

- We do not recommend any change in the provisions governing admissibility of inspectors' reports as evidence in civil proceedings. [Paragraph 3.29]

Addendum to Chapter 3

On 12 and 26 September 1991, the Minister for Industry and Commerce appointed Maurice R Curran, solicitor, as Inspector under section 14 of the Companies Act, 1990, to investigate the true beneficial ownership of certain companies associated with Siúicre Éireann cpt and of certain debentures of Siuicre Eireann cpt. On foot of an interim report presented to the Minister on 22 October 1991, which was published and referred to the Director of Public Prosecutions, the Minister directed that a loan note issued by Siúicre Éireann cpt be subject to the restrictions imposed by section 16 of the Companies Act, 1990. The Inspector furnished his final report to the Minister on 4 December 1991. That report was also published and made available to the Director of Public Prosecutions. The section 16 restriction was maintained in force.

On 16 September 1991, the High Court, on the application of the Minister for Industry & Commerce, appointed Aidan G Barry, accountant and Ciaran P Foley, barrister, as Inspectors under section 8 of the Companies Act, 1990 to investigate the affairs of Siúicre Éireann cpt and certain related companies. The Inspectors furnished their final report to the Court on 25 February 1992. The report, together with two earlier interim reports previously withheld from publication, was published by order of the Court on 3 March 1992 and made available to the Director of Public Prosecutions, the Revenue Commissioners, the Department of Finance, the Central Bank and Greencore plc. The section 16 restriction to which reference is made above was maintained in force.

On 9 October 1991, the Minister for Industry and Commerce appointed John A Glackin, solicitor, as Inspector under section 14 of the Companies Act, 1990 to investigate the true beneficial ownership and control of Hoddle Investments Ltd and Chestvale Properties Ltd, arising from the purchase by Telecom Eireann of the former Johnston Mooney and O'Brien site at Ballsbridge, Dublin. The inquiry was instigated after an official investigation under the aegis of the then Minister for Tourism, Transport and Communications. The Inspector furnished an interim report to the Minister on 31 July 1992. The report was published and, on foot of that report, the Minister directed that certain shares be subject to the restrictions imposed by section 16 of the Companies Act, 1990. The Inspector's final report was received and published in July 1993 and referred to the Director of Public Prosecutions, the Minister for Transport, Energy and Communications, the Revenue Commissioners, the Department of Finance, the Central Bank, the Irish Stock Exchange and the Dail Select Committee on Enterprise and Economic Strategy. The section 16 statutory restriction was maintained in force.

On 4 December 1993, the Minister for Enterprise and Employment appointed Peter C Fisher, accountant, as an authorised officer under Section 19 of the Companies Act, 1990 to examine the books and documents of CountyGlen plc. The authorised officer's report was submitted to the Minister on 23 December 1993 and the Minister immediately applied to the High Court for the appointment of an inspector under section 8.

On 19 January 1994, the High Court, on the application of the Minister for Enterprise and Employment, appointed Frank Clarke, barrister, as Inspector under section 8 of the Companies Act, 1990 to enquire further into certain of the affairs of CountyGlen plc. The Inspector furnished an Interim Report to the Court on 15 July 1994, an abridged version of which was published by Order of the Court. After consideration of the report,

the Minister lodged a petition with the Court for the orderly winding-up of the company, and subsequently the company convened an EGM, under the Court's auspices. The Minister then withdrew the winding-up petition with costs being met by the company. The Inspector's final report was published by the Court on 17 October 1994, with the omission of confidential material which related to certain inquiries abroad. The report was referred to the Director of Public Prosecutions, and also to the company which had signified that it had instigated civil proceedings to recover monies. The Court ordered a further review of proceedings by January 1995.

On 7 October 1994 the Minister for Enterprise and Employment appointed Martin T Cosgrove, accountant, as an authorised officer under section 19 of the Companies Act, 1990 to examine the books and documents of certain companies involved in the operation of an enterprise known as the Clonmannon Retirement Home, Ashford, Co Wicklow. At time of writing, the inquiry had not concluded.

Chapter 4

Recommendations of the Ryan Commission and Related Issues

4.1 The Ryan Commission was established by the Institute of Chartered Accountants in Ireland (ICAI) to research the expectations of users of published financial statements and to put forward recommendations to reduce or eliminate the gap between what was expected and what was provided.

4.2 The report of the Commission which was presented to the ICAI in January 1992 contained some seventy recommendations. The implementation of most of the recommendations would not require addition or amendment to existing company law. These "non-legislative" recommendations call for action from the auditing profession, the accounting and auditing standards setting systems, the Stock Exchange and companies (principally PLCs and large private companies).

4.3 It is necessary, when examining the Ryan recommendations and related issues, to appreciate that the quality of financial reporting is but one of the many aspects of corporate governance. It is also necessary to appreciate that legislation governing the preparation, auditing and publication of financial statements in Ireland sits side by side with a self regulatory non-statutory environment which, in various ways, also governs the practice of the preparation of financial statements, their auditing and publication.

4.4 For example, while the Companies Acts set out the format of the balance sheet and profit and loss account, accounting standards set by a non-statutory system prescribe, subject to the overriding statutory requirement for a true and fair view, appropriate accounting treatment of financial information. Similarly, while the Companies Acts provide for the recognition of auditors by the Minister for Enterprise and Employment, auditing standards, set by a non-statutory system, guide auditors on how they should conduct an audit. Again, while the Companies Acts set out certain publication requirements, these are augmented, in the case of listed companies, by Stock Exchange obligations.

4.5 Accordingly, in considering the Ryan recommendations, we had regard to the combined effect of both the statutory and non-statutory provisions.

DIRECTORS' RESPONSIBILITIES

4.6 The Ryan Commission recommended that no change is needed or desirable in the legal responsibilities of directors in relation to the preparation and content of published financial statements. No case has been made to us for any change. While we consider that legislation governing the content of financial statements may need to be amended from time to time, we concur with the Ryan Commission recommendation that the responsibility for the preparation of those statements should remain with the directors. It is logical and proper that those responsible for the running of a company should be responsible for the preparation of the company's financial statements.

4.7 With a view to removing misunderstandings about the responsibilities of directors, the Ryan Commission recommended that all companies should be required by law to include a statement in their annual report of directors' responsibilities in relation to the preparation and content of financial statements. The Commission also made recommendations relating to the content of such statements.

4.8 In considering the Commission's recommendations in this area we noted a number of developments that have taken place since the Ryan Commission made its report.

4.9 Firstly, the Statement of Auditing Standards, SAS 600 - Auditors' Reports on Financial Statements, was issued in May 1993. This Statement of Auditing Standards established standards and provided guidance on the content of auditors' reports and identified, as one of the basic elements of such reports, a separate section with appropriate heading dealing with the respective responsibilities of directors (or equivalent persons) and auditors. The standard provides that auditors should distinguish between their responsibilities and those of directors by including in their report:

(i) a statement that the financial statements are the responsibility of the reporting entity's directors;

(ii) a reference to a description of those responsibilities when set out elsewhere in the financial statements or accompanying information; and

(iii) a statement that the auditors' responsibility is to express an opinion on the financial statements.

4.10 Where the financial statements or accompanying information (for example the directors' report) do not include an adequate description of the directors' relevant responsibilities, the SAS requires that the auditors' report include a description of those responsibilities.

4.11 Secondly, in 1993 the Irish Stock Exchange introduced a requirement for listed companies to indicate whether they had complied with the Cadbury Code of Best Practice. This code of best practice was developed, in the UK, by the Cadbury Committee on the Financial Aspects of Corporate Governance. The Cadbury Committee, which covered much of the same ground as the Ryan Commission, published its report in December 1992. It summarised its recommendations on the operation of boards of directors into a code of best practice which inter alia provided that "directors should explain their responsibility for preparing the accounts". The Cadbury Code was directed at the boards of directors of UK listed companies although other non listed companies were encouraged to aim to meet its requirements. We understand that it is now the practice among Irish listed companies and other major companies to incorporate a directors' responsibility statement in the company's financial statements.

4.12 It is clear therefore that current practice results in the inclusion of statements of directors' responsibilities either in companies' financial statements or in the report of the auditors on those statements. It was suggested to the Group by some interests that this practice should be strengthened by appropriate legislative provisions. Others argued against such legislation on the basis that it might restrict the development, through

decisions of the courts, in relation to directors' responsibilities. In the light of the developments outlined above, which effectively ensure that the financial statements of all Irish companies contain a statement of directors' responsibilities, and to avoid any possible problems of inappropriate limitation of such responsibilities, we consider that a responsibility statement should not be required by law other than in the circumstances of unaudited accounts. In Chapter 6 of this report we make recommendations for removal of the statutory audit in the case of certain companies with a turnover of £100,000 or less. In the absence of an auditor's report there is no certainty that the financial statements of such companies would contain a statement of directors' responsibilities. Accordingly, in Chapter 6, our recommendation on the removal of the statutory requirement for audit is accompanied by a recommendation for a statement of responsibilities by directors of those companies availing of the proposed exemption.

CONTENT OF FINANCIAL STATEMENTS

4.13 Responsibility for the preparation of a company's financial statements rests with the directors. In preparing those statements the directors must comply with the provisions of the Companies Acts governing the format and content of accounts. The overriding requirement is that the accounts should give a true and fair view. Detailed standards setting out accounting treatments have not been prescribed in law but have been left to the non-statutory accounting standards setting system. While there is no legislative recognition of accounting standards in this country there is a body of opinion that, in general, conformity with accounting standards would be a determining factor in assessing whether the true and fair view requirement has been met.

4.14 The generally applied accounting standards in this country are those set by the UK Accounting Standards Board (ASB) which contain suitable modifications to accommodate differing legislative and taxation provisions applicable in this country. These standards are promulgated in the United Kingdom by the ASB and in Ireland by the Institute of Chartered Accountants in Ireland (ICAI).

4.15 The ASB's predecessor, the Accounting Standards Committee (ASC), was a sub-committee of the Consultative Committee of Accountancy Bodies (CCAB) of which ICAI is one of six members. The ASC had to seek the advance approval of each of these six members for each of its pronouncements. This was generally a cumbersome system. The ASB, on the other hand, is independent of the CCAB members although it consults with them and with a wide range of other interested parties in the development of standards. The ICAI plays a major role in ensuring that appropriate modifications are contained in the standards to accommodate the different legal and taxation environment in this country. At the time of the establishment of the ASB the then Minister for Industry and Commerce indicated his preference for the retention of the link with the UK standards setting system. This was to ensure international acceptance of the financial reports of Irish companies thereby enhancing confidence in the Irish capital markets and facilitating inward investment. At the time, a sub-committee of CCAB-1 (Consultative Committee of Accountancy Bodies - Ireland) was established to examine accounting standards issues although each of the member bodies retains the right to submit individual views to the ASB on proposals for accounting standards.

4.16 The Ryan Commission expressed the view that there was no case for separate accounting standards for Ireland. This accorded with the view taken by the Minister for Industry and Commerce at the time of the establishment of the ASB and is one which we support. None of the submissions made to us on this matter recommend a separate accounting standards setting system. In addition to the reasons for this view given by the Ryan Commission (close economic links with the UK, internationalisation of standards, close links between professional bodies, dual listing of Irish companies) we consider that inward investment in Irish companies would be better served by the continuation of the existing arrangements.

4.17 The Ryan Commission expressed the opinion that accounting standards themselves should not be incorporated in law. We agree with this recommendation. Accounting standards are required to deal with an array of complex accounting issues. The speed with which such issues emerge and the rate of pace of change could not be dealt with adequately by legislation. The non-statutory accounting standards setting system is better equipped to respond in this fast changing environment. The separate question of legal backing for accounting standards is considered below.

4.18 The Ryan Commission identified a number of problems with the content of financial reports. As the Commission itself acknowledged, these are primarily matters to be dealt with by the standards setting system. In relation to accounting standards we considered that our main concern should be with the general effectiveness of the system rather than with the content of individual standards.

4.19 While concentrating on the system rather than the detail of individual standards, we note that the Accounting Standards Board has since addressed a number of areas where the Ryan Commission considered there were problems. Lack of attention to cash flow is the subject of Financial Reporting Standard 1 (Cash Flow Statements) which was issued in 1991 and over-emphasis on earnings per share is dealt with in Financial Reporting Standard 3 (Reporting Financial Performance) which was issued in 1992. The issue of emphasis on legal form rather than economic substance is tackled in FRS 5 on Reporting the Substance of Transactions which the Board issued earlier this year. The Ryan Commission also recommended that the Chairman's statement should contain a statement of the company's objectives and strategic plan, that financial statements should draw particular attention to features which make it vulnerable to changes in external circumstances, and that the chief executive's review should link the strategy to the company's detailed financial statements. In this regard we note that the ASB has addressed these issues in its statement of best practice "Operating and Financial Review". We agree that these matters are such as to be more appropriately dealt with in standards or statements of best practice rather than in legislation.

4.20 If a non-statutory system is to be accepted as the most appropriate way of dealing with standards then the central issue is whether the non-statutory system operates effectively. The work of the ASB to date and the indications of its future workload would suggest that it is effectively discharging the accounting standards setting function. This system should be kept under review to see that it continues to operate to a high standard.

4.21 The Ryan Commission recommended also that a supplementary statement by the Chairman covering events between the balance sheet date and the date of the AGM should

be filed with the annual returns in the Companies Registration Office. We understand the concern of the Commission that users should have available to them the most up to date information. It has been represented to us in submissions that this information is already in the public domain for public companies but that it would be an unreasonable burden for private companies. Our attention was also drawn to the Companies Acts' requirement that directors state in their report particulars of any important events affecting the company or any of its subsidiaries that have occurred since the end of the financial year. There is of course normally a period of time between the date of the directors' report and the date of the AGM. If, however, our recommendations made below in relation to the timeliness of filing of returns are accepted, the time period should be reduced. On balance, and in the context of improvements in the timeliness of filing returns, we consider that such a supplementary statement should not be required by law.

DIRECTORS' EMOLUMENTS

4.22 The Ryan Commission recommended that companies should state in their annual report the emoluments of the highest paid director and of the chairman and his deputy, together with the order of magnitude of the rewards of the other directors. Under the law at present companies are required to disclose only the total directors' emoluments. In making this recommendation the Ryan Commission pointed out that users of financial statements will want to relate performance not only to plans but also to rewards. It has been suggested to us that, in the context of board responsibility, the essential information is the total payable to the board. Within the Group there was a broad spectrum of opinion on this question ranging from support for complete transparency involving disclosure of emoluments of individual directors, through acceptance of the Ryan recommendation and on to disclosure of aggregate amounts for the whole board. There was general agreement within the group that, whether on an individual basis or in aggregate, **all** rewards to directors should be indicated. In this regard our attention was drawn to the best practice proposals of the Irish Association of Investment Managers which promote the disclosure of:

(i) directors' remuneration comprising all fees, salaries, pension contributions and other benefits and emoluments paid to directors,

(ii) aggregate figures for the performance element of the remuneration of executive directors stated separately,

(iii) information on share option schemes including size of the scheme, number of options outstanding, number of options held by individual directors and the range of exercise prices and applicable dates.

(All to be disclosed in the one section of the Annual Report.)

4.23 In our view the information set out above is the minimum acceptable for public limited companies. It should not, however, be left solely to best practice, but should be required by law of those companies. This would not of course prevent any company from making more detailed disclosures.

4.24 The Ryan Commission made a number of recommendations specifically relating to the issue of financial statements of listed companies.

4.25 The Commission recommended that interim and preliminary statements should include balance sheet information and should be reviewed and reported on by auditors. We note that these particular issues are under review by the Stock Exchange and the auditing profession in consultation with interested parties. There is no suggestion that these matters should be dealt with in company law and it would seem appropriate to deal with them in the above-mentioned consultative processes. The Commission also recommended that the Stock Exchange or other relevant authority should require the publication of the report of the auditors to the audit committee of a company if the company should collapse within twelve months of an unqualified audit report. There would be practical difficulties for the Stock Exchange in implementing this recommendation as the failed company would no longer be listed. We believe that the correspondence in question could be taken into account by liquidators and the executive unit recommended in Chapter 7 in assessing the performance of directors. In these circumstances, we do not think it necessary to require publication of the report to the audit committee.

AUDITING STANDARDS

4.26 In the same way as there is a non-statutory system for setting accounting standards, there is a non-statutory system for setting auditing standards. For the same reasons that we support non-statutory arrangements for setting accounting standards we consider that auditing standards should not be set in statute. Indeed, no recommendation has been made that they should. Auditing standards are set by the Auditing Practices Board (APB) which is a committee of the Consultative Committee of Accountancy Bodies (CCAB). The CCAB is a joint organisation of accountancy bodies in Ireland and the UK. While, unlike the ASB, the APB is accommodated within the professional bodies structures, a significant number of its members are non practitioners (including a non-voting nominee of the Minister for Enterprise and Employment). The CCAB bodies have undertaken to adopt the APB standards. The enforcement of auditing standards is effected, therefore, by the various professional bodies. These bodies also apply standards to their members in the areas of codes of conduct, independence and professional integrity. In addition, these self regulatory arrangements involve a system of disciplinary procedures.

4.27 As we have remarked in relation to the accounting standards setting system, it is important, in accepting a non-statutory system as more appropriate than legislation, to keep that system under review and to evaluate continuously its effectiveness. In the case of auditing, the ultimate responsibility for the assessment of the effectiveness of the non-statutory system rests with the Minister for Enterprise and Employment who has the statutory responsibility for granting recognition to auditors for the purposes of the Companies Acts. We note that the Minister has the responsibility and powers under legislation (Part X of the Companies Act, 1990) to monitor and impose conditions for recognition on auditors. The existing legislation, in our view, makes adequate provisions for the evaluation and review of the system. In practice, it would be hoped that there would be no need to avail of these powers and that the standards setting system and the professional bodies would ensure that all standards and codes operated to the highest level of quality.

4.28 While we have concentrated on the overall structure within which auditing standards are set rather than on the detail of those standards, we note that the Ryan Commission has made some recommendations in relation to the conduct of audit. These

recommendations cover areas such as engagement letters, reporting to management, internal controls and solvency (in the context of going concern). We also note that the Auditing Practices Board has issued exposure drafts of proposed standards covering all these areas. At the time of writing the final standards are not available. As with accounting standards we do not consider it appropriate that we should get involved in the detail of individual standards. The evidence is that issues are being addressed. It is important that the effectiveness with which they are addressed be reviewed continuously by the Minister in the context of the recognition process.

REPORTING OF FRAUD

4.29 The Ryan Commission recommended that, if the auditors discover or strongly suspect that a material fraud or illegal act has been committed, they should take legal advice and, if so advised, report to the Minister for Industry and Commerce after the client has been informed. Such a course of action would be generally consistent with the principles applied in the auditing profession's guidelines in this area. The general question of auditors reporting to third parties has, at the time of our examination of the recommendations of the Ryan Commission, been raised in the public domain in the context of the recommendation of the Tribunal of Enquiry into the Beef Processing Industry that the Finance Acts be amended to oblige auditors to report tax evasion to the Revenue Commissioners. While we do not propose to comment on the Beef Tribunal's recommendation we note that, like the Ryan recommendation, it brings to mind issues such as the role of the auditor, client confidentiality and public interest.

4.30 The role of the auditor is primarily to express an opinion on a company's financial statements and in particular to give an opinion as to whether those statements give a true and fair view. We do not believe that a requirement to report fraud to an appropriate authority would be inconsistent with this primary role. Undoubtedly, auditors, given the nature of their work, are more likely than most to uncover fraud. While there is professional guidance available to auditors in this area and at the time of our examination revised guidance is being prepared, there are, in our opinion, grounds for believing that a legal duty to report incidents of fraud or suspected fraud would be preferable and we recommend accordingly. Such a requirement would provide greater certainty as to the appropriate course of action to be taken. On balance it would ease the pressure on the auditor who because of a relationship with the company, its directors and management could have difficult decisions to make. Arguments can, of course, be advanced that the public interest may not be at issue and more particularly that the interest of the client company might, in some cases, be better served by non-disclosure. We do not accept that these arguments are of sufficient weight to counter the benefits of a legal duty to report in all material cases. We note also the recommendation in the Law Reform Commission Report on the Law Relating to Dishonesty (paragraph 37.9):

> *"Good internal auditing is the best bulwark against fraud and we would recommend that any auditor who discovers fraud or any form of criminal appropriation in a company's accounts should be required to report same to the Gardai. ".*

4.31 While the Law Reform Commission refers to both "internal" and "any" auditor, our recommendation relates to those referred to in the Ryan Commission

recommendation i.e auditors appointed under the Companies Acts. Internal auditors do not, of course, have any recognition in company law.

4.32 Understandably, auditors might question the fairness of imposing such a requirement solely on them. The question of imposing such a duty on the general public is broader than the company law issue and our own remit. We note, however, that the Report of the Government Advisory Committee on Fraud (1992) recommended that a clear legal duty should be established in law for all citizens to report reasonable suspicions of serious fraud.

4.33 Concerns have been expressed in relation to confidentiality, materiality, level of evidence required before reporting and the need for indemnification. While we recognise that these concerns are not without some validity we take comfort from the existence of general precedents e.g section 299 of the Companies Act, 1963, the Building Societies Act, 1989, the Central Bank Act, 1989, the Insurance Act, 1989, the Trustee Savings Bank Act, 1989 and sections 193 and 194 of the Companies Act, 1990.

LEGISLATIVE BACKING FOR ACCOUNTING STANDARDS

4.34 While the Ryan Commission did not favour setting out accounting standards in legislation, it did recommend that accounting standards should be recognised in law. The Commission envisaged that this recognition would be allied to a requirement for directors to state whether or not they have complied with the recognised standards and to give reasons for any material departures. We recommend that this proposal be implemented. The requirement for directors to give this information would be of significant benefit to the users of accounts and would encourage compliance with the standards. This recommendation found much support from those who submitted views to the Group. The standards to be recognised would be those promulgated by the ICAI. Should practical difficulties exist in defining standards as those promulgated by that body, which is only one of the accounting bodies recognised under the Companies Acts, we suggest that the accounting standards be defined to mean such statements of standards of accounting practice as issued by such body or bodies as may be prescribed by the Minister by regulation.

ESTABLISHMENT OF A FINANCIAL REPORTING REVIEW PANEL

4.35 The Ryan Commission recommended the establishment of a Review Panel which would examine material departures from accounting standards which result in financial statements not giving a true and fair view. The Review Panel would attempt to get directors to revise such accounts and if persuasion failed would have the power to take the directors to court to seek an order that such revisions be made and to have costs awarded against the directors. The Commission referred to the experience in the United Kingdom where such a panel had been established. We understand that the UK Financial Reporting Review Panel has been widely praised for its effectiveness in promoting high standards of financial reporting. At the time of writing the UK Panel has still not had to go to court and, where necessary, has been able to persuade companies to revise their accounts. It has been argued that much of the success of the UK Panel has been "below the waterline" and that the aversion of directors to the publicity surrounding examination by the Review Panel has had a significant deterrent effect in relation to departures from accounting standards.

4.36 The Review Panel in the UK is directed at public and large private companies. The Ryan Commission recommended that an Irish panel should examine the financial statements of all large quoted companies, semi State trading bodies, co-operatives and building societies, which had been qualified by their auditors, or where there had been a material departure from accounting standards or company legislation, or in which there was disagreement between auditors and the directors, or any other financial statements which they considered it desirable to do so. The Commission recommended that the Department of Industry and Commerce (now Enterprise and Employment), the Registrar of Companies, the Irish Stock Exchange and the Revenue Commissioners should be able to refer to the Panel any financial statements which they regarded as meriting examination.

4.37 Some of those who submitted views to us on this item considered that the small number of companies that would be involved in this country would not merit the establishment of a Review Panel. Others supported the establishment of a panel but recommended that it should deal only with listed companies and public interest companies. Others who supported the establishment of a panel were concerned that an expensive administrative structure be avoided.

4.38 The Ryan Commission itself did not elaborate in detail on the reasons for its recommendation. The view of the Dearing Committee in the UK, whose report gave rise to the establishment of the UK Review Panel, was that the responsibility for securing compliance with accounting standards cannot and should not be borne unaided by the auditing or even the wider accountancy profession. It has also been suggested to us that in a highly competitive environment Irish auditors find it difficult to resist the arguments of clients who wish to apply a particular interpretation of an accounting standard and it is argued that the existence of a Review Panel would greatly strengthen their position. The Ryan Commission, in referring to the need for legislative backing for accounting standards, quoted the Dearing Committee's observation that, given competitive pressures, "it would be idealistic to assume that all auditors at all times are unmindful of the risk of losing business". These arguments raise the question of auditor independence which is dealt with later in this Chapter in the context of other independence related recommendations of the Ryan Commission.

4.39 In considering the recommendation for the establishment of a Review Panel we were particularly mindful of the success which the UK Panel has had both in tackling instances of undesirable accounting practices and, in particular, as a deterrent against such practices. We accordingly recommend that provision be made in legislation for the operation of a Review Panel along the lines of that currently operating in the United Kingdom. We agree with those who have argued to us that an expensive administrative structure should be avoided. In this regard we consider that such a Panel should confine its attention to the more serious and material cases and we do not support the Ryan recommendation that the Panel should examine financial statements in which the statement of accounting policies is considered inadequate by any category of user. In our view, the Review Panel should be concerned with the financial statements of all quoted companies and all large companies that are required by company law to be returned to the Registrar of Companies. We would support in principle the inclusion of state companies within the remit of the Panel but recognise that decisions on their inclusion will have to take the specific legislation setting up each company into account. Company

law should provide for the voluntary revision of accounts by directors if they accept the view of the Review Panel. It should also allow the Review Panel to take the directors to court, if necessary, with a view to seeking an order for the revision of the accounts on the grounds that they do not comply with the Companies Acts. The possibility should exist for the imposition of costs, both of the legal proceedings and the issue of revised accounts, on the directors.

4.40 The Ryan Commission made other recommendations in relation to the membership and modus operandi of such a Panel. We do not consider it necessary or appropriate to provide for such details in legislation. Flexibility may be needed depending on the workload of the Panel, the requirement of independence, the need to avoid conflict of interest, and the need to have specific expertise available in particular cases. The experience of the operation of the UK Panel may prove useful in the consideration of such matters.

COSTS OF THE REVIEW PANEL

4.41 As already remarked, we do not envisage an expensive administrative structure. It will nevertheless be essential that the Review Panel is adequately financed. The Ryan Commission pointed out the difficulties in forecasting the level of funding needed. We appreciate these difficulties. The running costs will depend on the level of activity and the way in which the Panel and its operations are organised. Excluding legal costs, which could be substantial in the event of the Panel having to take a court action (although the legislation should enable the court to impose the costs on the directors involved), we believe that it would not be unreasonable to estimate the cost per case within the range of £5,000 to £10,000. Appropriate funding arrangements will also have to be made to cover the possibility of significant legal costs arising for the Irish Review Panel.

4.42 The Ryan Commission recommended that the Minister for Industry and Commerce (now Enterprise and Employment) should, in consultation with the professional bodies and the Irish Stock Exchange, determine how the Panel should be financed. We believe that the Review Panel should have the support, including the financial support, of the State, the auditing profession and the Stock Exchange. Support, including financial support, from other groups with an interest in the quality of financial reporting e.g. major institutional investors, is also desirable. The precise funding arrangements will need to be the subject of detailed examination and negotiations which we recommend should be held between the parties mentioned above.

AUDITOR INDEPENDENCE AND REGULATION OF AUDITORS

4.43 Independence is one of the essential attributes for effective auditing. Users of financial statements rely on the objectivity of the auditor whose report provides an assurance as to the veracity of the information contained in those statements. While, in law, the shareholders appoint the auditors, the significant role which is accorded to directors in practice can give rise to tensions in the relationship between the auditors and the preparers of the financial statements on which they are reporting i.e. the directors. The potential for such difficulties can be increased when the auditing firm is competing for non-audit business which the directors commission. It is of the utmost importance that the systems which grant recognition and supervise the activities of auditors ensure that auditor independence is protected. The Ryan Commission made a number of

recommendations that relate to the independence of auditors. The Commission recommended that the accountancy bodies should require that the maximum percentage of recurring gross fees of an auditing practice which can come from any one client should be five per cent. We support this recommendation for a five per cent limit insofar as PLCs and large private companies are concerned. While we appreciate that such a limitation is no guarantee of objectivity, we consider that it reduces the possibility of overdependence on any one client. To avoid practical difficulties for smaller auditing firms we recommend that the limit be ten per cent for companies other than PLCs and large private companies.

4.44 Existing company law requires that the remuneration and expenses of auditors be disclosed in a company's financial statements. The Ryan Commission recommended that the cost of any non-audit services provided to a company by its auditors or their associates should also be disclosed. We support the introduction in law of such a disclosure requirement. This would give greater transparency to the auditor/company relationship.

4.45 The Ryan Commission considered the possibility of a requirement for compulsory rotation of auditors but recommended against such a provision which it regarded as too mechanistic. The Cadbury Committee in the United Kingdom also recommended against compulsory rotation of auditors expressing a preference for rotation of audit partner instead. There are particular difficulties that could arise with compulsory rotation of auditors. For example, it has been pointed out that many large multinational firms prefer to have all their companies (including Irish subsidiaries) audited by the same auditors. Such a practice would be inhibited, in Ireland, by a requirement for rotation. Another factor is the loss of experience and good working relationships in the majority of cases where independence is not threatened. Accordingly, we recommend that the issue of auditor independence should be addressed, in the first instance, other than by compulsory rotation of auditors. We note and support the proposal for a requirement to rotate the audit partner.

4.46 Given the central value of independence to the role of the auditor, the maintenance of objectivity should be a core concern of the self-regulatory and recognition systems and the performance of auditors in this respect should be kept under continuous review.

4.47 We also support the view of the Ryan Commission that self-disciplinary procedures within the profession are to be preferred. It is important, however, that these procedures operate satisfactorily. We believe that the recognition process under the Companies Acts provides the Minister for Enterprise and Employment with the appropriate legislative powers to monitor and ensure that the self-disciplinary procedures operate effectively.

4.48 The Ryan Commission recommended that members of the recognised accountancy bodies should require their members who have been involved in out of court settlements to report their terms to the appropriate body. It also recommended that those bodies' investigation committees should list, in their annual reports, all out of court settlements and indicate those cases which had been (or would be) referred to disciplinary committees. We believe that it would be sufficient if the fact that an out of court settlement had been made was disclosed to the appropriate self-regulatory body. The self-regulatory body should indicate the number of such settlements notified to it in its annual report to the Minister and the number of those, if any, that have been referred to disciplinary committees. This would give the self-regulatory bodies details of their members who

were involved in such settlements and would give the Minister an overview of the incidence of such cases.

RETURN OF FINANCIAL STATEMENTS

4.49 The Ryan Commission made a number of recommendations relating to the return of financial statements to the Companies Registration Office. The Commission recommended that companies should be required to hold their annual general meeting within six months of the end of their financial year. We agree with this recommendation. The Commission went on to recommend that the annual return should be required to be filed within fourteen days of the AGM. In our opinion, thirty five days from the date of the annual general meeting would be a more realistic timescale and we recommend that the legislation be amended accordingly.

4.50 In order to assist the Registrar in determining when each company's financial statements are due to be filed, the Ryan Commission recommended that the Minister should introduce a form for notifying details of the company's accounting period. We consider that this information might be better disclosed in the form accompanying the annual return. Our preference would be to avoid the introduction of a further form. We also question whether those who default on the major requirement to make the annual return in time are likely to comply with a requirement to notify details of changes in the accounting period in a separate form.

4.51 The Ryan Commission recommend that additional resources be made available to the Registrar of Companies to enable any backlog of work to be cleared and to ensure that returns, once filed, are quickly available to the public. We fully support this recommendation. In doing so, we acknowledge that additional resources have been made available in recent times. Sufficient resources should be allocated to make filed information available quickly. Not to do so would be unfair to those companies who meet deadlines for the filing of information and to the users of that information - particularly in the context of the fees generated by these activities.

CONCLUSIONS AND RECOMMENDATIONS

- We concur with the recommendation of the Ryan Commission that no change is needed or desirable in the legal responsibilities of directors in relation to the preparation of published financial statements. [Paragraph 4.6]

- We consider that there is no need to require a directors' responsibility statement in law. Special provision would be needed for small private companies if they are to be exempted from the audit requirement . [Paragraph 4.12, see also Paragraphs 6.7 & 6.9]

- We concur with the view of the Ryan Commission that separate accounting standards are not needed for Ireland. [Paragraph 4.16]

- Accounting standards should not be incorporated in law. [Paragraph 4.17]

- The accounting standards setting system should be kept under review to ensure that it is operating satisfactorily. [Paragraph 4.20]

- We do not favour, as had been recommended by the Ryan Commission, the introduction of a statutory requirement that a statement from company chairmen covering events between balance sheet date and the date of the company's AGM be filed. [Paragraph 4.21]

- The minimum legal requirement for disclosure of directors' emoluments should be the aggregate of all rewards with individual share options separately disclosed. [Paragraph 4.23]

- We do not support the Ryan Commission recommendation that the Stock Exchange or other relevant authority should require the publication of the report of the auditors to the audit committee if the company collapses within twelve months of an unqualified audit report. [Paragraph 4.25]

- The auditing standards setting system should be kept under review by the Minister for Enterprise and Employment in the context of the recognition of auditors. [Paragraph 4.28]

- Auditors should be under a legal duty to report fraud or suspected fraud. [Paragraph 4.30]

- Accounting standards should be recognised in law. [Paragraph 4.34]

- Directors should be required to state whether they had complied with the recognised standards and to give reasons for any material departures. [Paragraph 4.34]

- Provision should be made in legislation for the operation of a Review Panel which would examine whether financial statements complied with the Companies Acts. [Paragraph 4.39]

- Provision should be made to facilitate the voluntary revision of financial statements by directors in order to comply with the Companies Acts. [Paragraph 4.39]

- The legislation should enable the Review Panel to take directors to court with a view to having financial statements revised to comply with the Companies Acts. [Paragraph 4.39]

- Legislation should provide for the imposition of the costs of the court case and the costs of the issue of revised accounts on the directors. [Paragraph 4.39]

- The Minister for Enterprise and Employment, the professional bodies, the Stock Exchange and other interested parties should discuss the funding of the Review Panel with a view to ensuring secure and satisfactory funding arrangements. [Paragraph 4.42]

- The accountancy bodies should require that the maximum percentage of gross fees of an auditing practice that can come from any one client should be five per cent in the case of public limited companies and large private companies and ten per cent for other companies. [Paragraph 4.43]

- There should be a legal requirement to disclose, in the company's financial statements, the cost of any non-audit services provided to a company by the auditors or their associates.[Paragraph 4.44]

- We support the introduction of a professional requirement for the rotation of audit partner. [Paragraph 4.45]

- We agree with the preference of the Ryan Commission for self-disciplinary procedures within the auditing profession. These must, however, operate satisfactorily and should be continuously reviewed by the Minister in the context of the recognition process. [Paragraph 4.47]

- Notification of out of court settlements by auditors should be made by them to their professional body and the accountancy bodies should state, in their annual reports to the Minister, the number of such settlements and the number of those cases, if any, that have been referred to disciplinary committees. [Paragraph 4.48]

- We agree with the recommendation of the Ryan Commission that companies should be required to hold their annual general meeting within six months of the end of their financial year. [Paragraph 4.49]

- We recommend that the annual return should be required to be filed within thirty five days from the date of the annual general meeting. [Paragraph 4.49]

- We support the recommendation of the Ryan Commission for the allocation of sufficient resources to the Companies Registration Office to enable financial information filed to be available for public inspection without delay. [Paragraph 4.51]

Chapter 5

Part V of the Companies Act, 1990 - Insider Dealing

5.1 Part V of the Companies Act, 1990 ("Part V") contains provisions for tackling insider dealing. Insider dealing is dealing in securities on the basis of information which is not generally available but if it were would be likely materially to affect the price of the securities. Part V provides for both civil remedies and criminal sanctions for insider dealing. It also implemented EC Directive 89/592/EEC on insider dealing which required Member States to introduce legislation to prohibit insider dealing.

5.2 The effectiveness of a securities market depends enormously on the confidence of investors in its integrity and fairness. One of the prime features of a fair market is, of course, equality of information among its participants. The possibility that some buyers and sellers of securities might be engaging in transactions on the basis of inside information damages investor confidence and the integrity of the market.

5.3 Part V makes it unlawful for a person who is or has been connected with a company in the preceding six months to deal in that company's securities if by reason of their connection with the company they have price sensitive information that is not generally available i.e. inside information. It also makes it unlawful for someone connected with a company to deal in the securities of another company if they have price sensitive information that is not generally available relating to a transaction involving the two companies. Furthermore, it is unlawful for a third party to deal in the securities if they get inside information from someone who is precluded from dealing by virtue of the aforementioned provisions.

5.4 Part V also prohibits a person who is precluded from dealing on the basis outlined in the preceding paragraph from causing or procuring another person to deal in the securities or from communicating the inside information to another person if they know or ought reasonably to know that the other person will use the information to deal (or to get another person to deal). Companies are prohibited from dealing if an officer of the company is precluded from dealing although there are some exemptions e.g. where the precluded person is not involved and the inside information has not been communicated. Dealers who have not offered advice can deal pursuant to specific instructions of a client.

5.5 Certain transactions are exempted from the prohibition on insider dealing:

- acquisition under a will or intestacy,
- acquisition pursuant to an employee profit sharing scheme,
- entering in good faith into specified transactions such as an obligation under an underwriting agreement.

5.6 There is also a provision whereby a person can deal "while not otherwise taking advantage" of inside information if they deal within a specific window period and if they comply with specific conditions. This exemption, which is provided for in section 108(10), is discussed further below in paragraph 5.15.

CIVIL LIABILITY

5.7 Section 109 provides that a person who deals (or causes another to deal) in contravention of the insider dealing prohibition may be made liable to compensate any other party to the transaction for loss sustained and to account to the company that issued or made available the securities for any profit accruing.

CRIMINAL SANCTIONS

5.8 Unlawful dealing is a criminal offence, and persons convicted of engaging in this practice are liable on summary conviction to a fine of £1,000 or imprisonment for not more than one year or both, or on conviction on indictment, to a fine of £200,000 or 10 years imprisonment or both.

ENFORCEMENT

5.9 The primary responsibility for overseeing the "criminal" provisions rests with the relevant authority of a recognised stock exchange. There is provision whereby an "authorised person", which includes the manager of a recognised exchange or persons nominated by a stock exchange and approved by the Minister, can investigate suspected cases of insider dealing. Where breaches are observed, the relevant authority is under an obligation to furnish a report in the matter to the Director of Public Prosecutions. There are also provisions whereby if unlawful dealings come to light in court proceedings, these can be brought to the attention of the relevant authority. Residual powers to enable the Minister to request a relevant authority to investigate suspected cases of unlawful dealing, where it appears no such investigations have taken place, are also conferred.

5.10 The legislation provides for co-operation between the stock exchanges of the EU Member States in relation to insider dealing. It also allows for the introduction of regulations by the Minister (now Minister for Enterprise and Employment) to overcome difficulties in bringing the provisions into operation. Two such sets of regulations have been introduced, one (S.I. No. 151 of 1991) relating to agreement to underwriting securities and the other (S.I. No.131 of 1992) which clarified that the provisions do not apply to dealings outside the State.

5.11 One of the major difficulties in relation to insider dealing legislation is enforcement. The possibility of insiders distancing themselves from transactions and the difficulty of proving an awareness of inside information can frustrate the policing of the prohibition on insider dealing. These are not of course valid reasons for rejecting the idea of insider dealing legislation. Rather they oblige those responsible for enforcement to equip themselves as best they can to execute their responsibilities. We note that the civil sanctions in Part V impose a further deterrent to insider dealing.

EXEMPTIONS

5.12 Many suggestions were made to us that particular types of transaction should be exempted from the provisions of Part V. The following types of activities appeared to be of particular concern:

- irrevocable undertakings in take-over situations,
- directors' recommendations on take-over bids,
- placings/new issues of shares,
- scrip dividends,
- bonus issues of shares,
- exercise of share options,
- sale by one director to another in possession of the same information,
- sale or gifting by director to family member,
- re-organisations of own holdings.

5.13 It was suggested that all "off market" transactions should be exempted and that this would solve most of the problems cited above. Off market in this connection means not on the exchange or not through a professional intermediary. In this regard it has been pointed out that the EC Directive on Insider Dealing gives Member States the option of not applying the provisions to off market transactions. The primary intention of insider dealing legislation is to protect the market. It has been argued to us that "caveat emptor" should apply in respect of dealing off market. We note the provisions of the EC Directive and indeed that such exemptions are allowed in other jurisdictions. It appears to us, however, that a person with inside information could relatively easily avoid the provisions of Part V if they only applied to market transactions. On balance our preference is for the retention of off market transactions within the scope of Part V although we recommend some exemptions. Where a person with inside information wishes to deal off market with someone else who is in possession of the same information we believe that they should be allowed to do so and we recommend that the legislation be amended accordingly. The person with whom they deal will, of course, be subject to the provisions of Part V until the information becomes generally available or is no longer price sensitive. We believe that the introduction of such an exemption would also facilitate some of the transactions listed above e.g. sales by one director to another, re-organisation of holdings.

5.14 We accept that allowing dealing between insiders with the same information will not solve all problems. We also agree that some of the cases listed in paragraph 5.12 above should be accommodated, for example directors' recommendations on take-over bids. It is also possible that circumstances other than those listed above could exist where it would be reasonable to allow someone with inside information to deal. We recommend that the legislation be amended to allow the Minister for Enterprise and Employment to

make regulations to allow such exemptions. While this is a more complex route to take than a general exemption from Part V for off market transactions we believe that it is better to confine the exemptions to specific circumstances. We do not propose to make recommendations on the precise content of such regulations which should be the subject of consultation with the Stock Exchange and other interested parties.

5.15 A further exemption is provided for in section 108(10) which provides that the prohibition on insider dealing does not preclude a person from dealing in securities if, "while not otherwise taking advantage" of his possession of inside information he complies with certain conditions. These conditions are that the person gives twenty one days notice to the Stock Exchange, that the dealing takes place within a period beginning seven days after the publication of interim or final results and ending fourteen days after such publication and that the Stock Exchange publishes the notice of intent to deal immediately on receipt. It has been represented to us that the wording of this sub-section is unclear. We agree. It is necessary, however, to be clear as to what the intention of the provision is to be before an improved wording can be determined. It would appear to us that the intention should be to allow dealing, within the window period and with the appropriate notification, if the purpose of the dealing is other than to take advantage of the inside information. In other words while the person might gain from the deal, he/she dealt for some other reason than to take advantage of inside information and would have done so even if he/she did not have the inside information. We recommend that the wording be amended to reflect this view.

UNCERTAINTY

5.16 Section 108(10) is not the only provision in relation to which there is uncertainty. It has been submitted to us that, as the definition of company in the Companies Acts refers only to companies registered under these Acts, the provisions of Part V may not apply to companies incorporated outside this jurisdiction whose shares are traded on the Irish Stock Exchange. While the definition of securities includes those "issued or proposed to be issued, whether in the State or otherwise", the definition of company would not seem to cover companies not incorporated in the State. Accordingly, we recommend that the legislation be amended to clarify that company shall include all bodies corporate whose shares are traded on the Irish Stock Exchange whether they are incorporated in the State or not.

5.17 A further uncertainty arises in relation to the territorial scope of the legislation. It has been suggested to us that a deal involving the securities of an Irish company could be executed outside the jurisdiction and would not be caught by the provisions of Part V. In all probability, if the share is traded on a stock exchange it will be covered by local insider dealing legislation. However, off market dealing is not, for example, covered by insider dealing legislation in Northern Ireland. It has also been suggested to us that dealing on the basis of tipping done outside the country is not covered by Part V. We recommend that the legislation be amended to cover, insofar as is possible and appropriate, attempts to circumvent Part V by conducting all or some part of the deal outside the jurisdiction. In this regard we note, for example, that under the Finance Acts certain instruments which relate to property in the State are liable to stamp duty wheresoever executed. In the case of market transactions regard should be had to the legislation governing trading on the markets of other countries in which Irish companies' shares are traded so that difficulties for those companies are avoided.

AUTHORISED PERSONS

5.18 An authorised person is a person, approved by the Minister, who is the manager of a recognised stock exchange or who has been nominated by a relevant authority of a recognised stock exchange. The role of an authorised person is to obtain the information which the relevant authority of a recognised stock exchange needs to fulfil its obligation to report to the Director of Public Prosecutions where it appears that a person has committed an offence under Part V. Under section 115(7) a relevant authority of a recognised exchange is not liable in respect of its functions under Part V unless the act or omission complained of was done in bad faith. No such immunity was, however, provided for the authorised persons. Notwithstanding the possibility that authorised persons would not be held liable in law unless they acted in bad faith we accept the suggestion made to us that the legislation should be amended to give authorised persons the same immunity as the relevant authority of the stock exchange and we recommend accordingly.

5.19 In Chapter 3 we refer to the Supreme Court decision which found the provisions of section 10, subsections (5) and (6), of the Companies Act, 1990, which provided for an offence of contempt of court for non-co-operation with an inspector, to be unconstitutional. We have recommended that an appropriate adjustment be made to reflect the reality of that decision. Part V contains provisions for an offence of contempt of court in the context of an authorised officer's enquiries. These provisions in Part V are different than those in Part II and may not need any amendment. Nevertheless, we recommend that the Part V provisions relating to contempt of court be reviewed in the context of the introduction of an adjustment to section 10.

CRIMINAL OFFENCE FOR CAUSING OR PROCURING OTHERS TO DEAL

5.20 Section 111 makes it an offence to deal in a manner declared unlawful in section 108. However it would not appear to make it an offence to breach the prohibition in section 108(4), on a person who is precluded from dealing, from causing or procuring any other person to deal. Nor would it appear to make it an offence to breach section 108(5) which prohibits the communication of inside information when the insider knows, or ought reasonably to know, that the person to whom he communicates the information will use it for dealing. We recommend that section 111 be amended to make it an offence to breach section 108(4) or section 108(5).

CONCLUSIONS AND RECOMMENDATIONS

- We recommend that off-market transactions should continue to be within the scope of Part V although we recommend that some exemptions be accommodated. [Paragraph 5.13]

- Part V should be amended to allow a person with insider information deal with another person who has the same information. [Paragraph 5.13]

- The Minister for Enterprise and Employment should be empowered by legislation to make regulations granting exemption from Part V in the case of specified off-market transactions. [Paragraph 5.14]

- Section 108 (10) should be amended to give greater certainty as to when the "window period" can be used. In our view it should be available to allow a person deal if there were reasons for dealing other than to take advantage of the inside information and where they would have dealt even if they did not have the inside information. [Paragraph 5.15]

- The term company should be defined for the purposes of Part V as including all bodies corporate whose shares are traded on the Irish Stock Exchange whether they are incorporated in the State or not. [Paragraph 5.16]

- We recommend that the legislation be amended to cover, insofar as is possible and appropriate, attempts to circumvent Part V by conducting all or some part of the deal outside the jurisdiction. In the case of market transactions regard should be had to the legislation governing trading on the markets of other countries in which Irish companies' shares are traded so that difficulties for those companies are avoided. [Paragraph 5.17]

- The immunity which is available to the relevant authority of the Stock Exchange should be extended to authorised persons. [Paragraph 5.18]

- The provisions of Part V relating to contempt of court should be reviewed, in the context of the introduction of an adjustment to section 10, as recommended in paragraph 3.16. [Paragraph 5.19]

- We recommend that section 111 be amended to make it an offence to breach section 108(4) or section 108(5). [Paragraph 5.20]

Chapter 6

Recommendations of the Task Force on Small Business for Changes in Company Law

6.1 The Task Force on Small Business was established in April 1993 to bring forward proposals to encourage new small enterprises, strengthen existing ones, and enable some to grow into large businesses. The Task Force presented its report in March 1994. The report is wide ranging and covers areas such as financing, taxation, labour legislation, training, marketing, support services for small business and company law. In the area of company law the Task Force recommended:

- that a new less onerous category of limited liability company be created to assist new companies in the first two years,
- that the statutory requirement for audit be removed for companies with an annual turnover below £100,000.

NEW CATEGORY OF LIMITED LIABILITY COMPANY

6.2 We understand that the Task Force on Small Business envisaged a new category of company primarily as a vehicle for granting exemptions, from a variety of statutory requirements, in the case of newly established businesses. The purpose would be to encourage the establishment of new businesses and assist them in their formative years. It would appear, however, that the statutory requirements that were of particular concern to the Task Force are not those imposed by company law but arise in other legislative areas e.g. labour law and taxation. We consider that exemptions from other legislation do not fall within the remit of the Company Law Review Group and should be examined in other fora on the merits of the individual proposals. Accordingly we have not addressed these issues in this report. We note however that they are being pursued by the Small Business and Services Division of the Department of Enterprise and Employment which has signalled its intention to introduce legislation where appropriate. This is in line with the recommendation of the Task Force on Small Business that a Small Business Act be enacted.

6.3 The Task Force made specific reference to company law provisions relating to company registration and audit. Their recommendations relating to the audit requirement are discussed below. In relation to registration the Task Force referred to ease of registration and limitation of total registration costs to £100. We recognise that improvements have been made in the ease with which companies can be registered. In particular, the introduction of the Company Incorporation (10 day) Scheme, under which registration within 10 days is guaranteed by the Companies Registration Office, has reduced the registration time. At present, however, this scheme is not available directly to the general public as it operates through solicitors and company formation agents. We recommend that, as a further improvement in the registration process, the 10 day system be made directly available to all who wish to register companies. This would involve the drafting of standard Memorandum and Articles of Association by the CRO for use by members of the public who wish to avail of the scheme. With regard to the costs of

registration we believe that the existing costs of approximately £170 are not excessive and we do not recommend any decrease.

6.4 The Task Force did not raise other specific points of detail in relation to company law. This would seem to support the view that company law does not impact onerously on a day to day basis on small companies. Nevertheless there is a perception that the volume of company law is intimidating for small companies and that its provisions are primarily relevant to the larger company. We believe that the general issue of whether company law could be amended or simplified in a way that would be materially helpful to small companies is worthy of examination. Such an examination would be a major task requiring a review of all company law provisions. Apart from consideration of amendments to and exemptions from existing company law such an examination could review the appropriateness of the company structure for small businesses and the accessibility of the legislation to those involved with small businesses. The type of examination proposed does not fall within the remit of this Group as part of Phase I of its work which, insofar as this item is concerned, is confined to the recommendations of the Task Force. We suggest, accordingly, that the application of company law to small companies be considered either in a future phase of the Company Law Review Group's work or by some other specially constituted advisory group. Consideration should also be given to whether any amendments or exemptions considered desirable for small companies should be made available to companies generally. We note that similar issues have been, or are being, examined in other jurisdictions. South Africa introduced a Close Corporations Act in 1985 as an alternative form for business ventures. The stated intention of that legislation was to provide a simple, less expensive and more flexible legal form for small enterprises. Australia has commenced a simplifications programme to overcome the unnecessary complexity of its corporations law. This programme will, in particular, look at the laws governing Australian proprietary companies. We further understand that the United Kingdom authorities have given some consideration to the application of company law to small businesses and we suggest that any future examination in this jurisdiction should take account of the experience of these and other jurisdictions.

REMOVAL OF THE STATUTORY AUDIT REQUIREMENT

6.5 The Task Force on Small Business recommended that the statutory requirement for audit should be removed in the case of small companies with an annual turnover of less than £100,000 (to be regularly adjusted in line with the consumer price index). The Task Force took the view that:

- the cost of audit is out of proportion to the benefit to such companies, customers, banks and other interested third parties,
- owner managers already have a day to day knowledge of the affairs of such companies so the assurance of audit is not necessary for them, and
- the value of abbreviated accounts to suppliers, banks and the Revenue Commissioners is limited by their content and timeliness of filing.

6.6 The principle of applying less rigorous financial reporting provisions in the case of smaller companies already exists in Irish and EU company law. The Companies

(Amendment) Act, 1986 allows directors of small private limited companies to draw up an abridged balance sheet and an abridged profit and loss account. In addition they need not file a profit and loss account or directors' report with their annual return. A small company, in the context of the 1986 Act, is defined in terms of meeting two out of three specified thresholds - turnover, balance sheet total and employee numbers. These concessions derive from the Fourth EC Company Law Directive which also permits exemptions from the audit requirement.

6.7 The recommendation of the Task Force for the removal of the statutory requirement for audit in the case of small companies was supported by the majority of those who made submissions to us on this matter. We consider that this recommendation should be accepted and that the statutory requirement for audit be removed for companies with a turnover of less that £100,000 which also meet the other thresholds for a small company under the Companies Acts. Provision should be made for regular review of the turnover limit. We do not consider that it would be practical or appropriate to make this exemption available to public companies. Furthermore, we recommend that it should not be granted to companies that are part of a group. It does not seem to us that these are the types of undertaking that the Task Force had in mind and making such an exemption available to groups could encourage avoidance by company restructuring. We have not examined in detail the position of companies operating within regulated sectors (e.g. insurance, banking etc.). It may be that few of these types of operation would meet the size criteria. In general, however, we consider that an exemption for these type of companies would be inappropriate for prudential and supervisory reasons.

6.8 In many of these small companies the shareholders and the directors will be the same people. There will, however, be cases where the shareholders will not be involved in the management of the company. These shareholders will, of course, continue to have available to them the annual accounts of the company. Nevertheless, some shareholders may wish to have the additional assurance of the statutory audit. We consider it reasonable to accommodate a balance between the rights of such shareholders and the benefits to the company (and to the other shareholders) of the availability of the exemption. Accordingly, we recommend that this balance be provided by enabling a minimum percentage of shareholders to have the right to require an audit. In our view, ten per cent of the voting rights would be an appropriate minimum.

6.9 The directors of small private limited companies will still have to ensure that proper books of account are kept and that annual accounts are drawn up and laid before the annual general meeting. These accounts will have to meet the requirements of the Companies Acts and will be subject to the overriding requirement to give a true and fair view. The directors will also have to meet the filing requirements of the Companies Acts. The responsibilities of directors in this regard, if not adverted to elsewhere in the accounts, are normally clarified in the auditor's report. In the absence of the auditor's report we recommend that directors of small private limited companies which avail of the exemption from audit be required by law to acknowledge these statutory responsibilities in a signed statement. This statement should also contain an affirmation by the directors that the company meets the size criteria for eligibility for the exemption. Appropriate penalties should be put in place to penalise and inhibit abuses of the exemption option.

SINGLE DIRECTOR

6.10 The Task Force on Small Business noted in its report that the Regulations implementing the 12th Directive on the single member company were being drafted at the time of the preparation of that report. The Regulations implementing the Directive have now come into force. The Directive and consequently the Regulations do not address the current general company law requirement of a minimum of two directors. It would appear to us that there is a prima facie case for the introduction of provision for one director only in single member companies. We recommend that the matter be examined further as part of Phase II of the Company Law Review Group's work.

CONCLUSIONS AND RECOMMENDATIONS

- We recommend that the availability of the 10 day incorporation system operated by the Companies Registration Office be extended directly to the general public. [Paragraph 6.3]

- We consider that the level of fee currently payable on registration is not excessive. [Paragraph 6.3]

- We recommend that the application of company law generally to small companies be examined either in a future phase of the work of the Company Law Review Group or by some other such group. [Paragraph 6.4]

- We recommend that the statutory requirement for audit be removed in the case of private limited companies which have a turnover of £100,000 or less and which also meet the Companies Acts' balance sheet and employee thresholds for a small company. Provision should be made for regular review of the thresholds. [Paragraph 6.7]

- We recommend that the exemption from audit should not be available to companies which are part of a group or to companies in a regulated sector. [Paragraph 6.7]

- We recommend that holders of shares carrying ten per cent or more of the voting rights should have the right to require an audit. [Paragraph 6.8]

- We recommend that directors of companies who avail of the exemption should be required to make a statement in their accounting documents setting out their statutory responsibilities in relation to accounts and certifying the eligibility to avail of the exemption. [Paragraph 6.9]

- We recommend that appropriate penalties should be provided for abuse of this exemption. [Paragraph 6.9]

- We recommend that the question of allowing a one director regime for single member companies should be examined as part of Phase II of the Company Law Review Group's work. [Paragraph 6.10]

Chapter 7

Chapter 1 of Part VII of the Companies Act, 1990 Restriction on Directors of Insolvent Companies

7.1 The provisions of Chapter 1 of Part VII of the 1990 Act were intended to be a major contribution to the solution of the problem which was generally referred to as the *Phoenix Syndrome* where companies were run into liquidation by their owner directors, who having liquidated them leaving substantial liabilities outstanding to creditors, then proceeded to establish new companies with which they could repeat the process.

7.2 The *Phoenix Syndrome* was seen to be a major problem which needed to be dealt with by the introduction of appropriate company law measures. Indeed, the seriousness with which the problem was viewed was exemplified by the inclusion in the original Companies (No.2) Bill, 1987 of proposals for the automatic restriction of all directors of companies going into insolvent liquidation from becoming a director of another company, without any limitation on the period of restriction, unless that other company met specified conditions. Arguments that such measures went too far and did not recognise the realities of honest business failure were accepted and revisions were made, as the Bill progressed through the Oireachtas, resulting in the current provisions of Chapter 1 of Part VII of the 1990 Act.

7.3 The current provisions essentially apply where

- it is proved to the court on the commencement of a winding up, or
- at any time during the course of a winding up it is certified by the liquidator, or it is otherwise proved, to the court

that a company is unable to pay its debts.

7.4 In these circumstances the court shall, unless it is satisfied in certain respects, declare that any person who was a director or shadow director of the company at the date of, or within twelve months prior to, the commencement of the winding up of the company shall not be involved as a director of or in the promotion or formation of any company unless that company meets specific requirements. The circumstances where the court can decide not to make a declaration are effectively where the person concerned has acted honestly and responsibly in the conduct of the affairs of the company. These provisions of Chapter 1 of Part VII apply, with necessary modifications, to a receiver in the case of a receivership as they apply to a liquidator in a winding up situation.

7.5 The effect of the court declaration is to prohibit the director from being appointed or acting as a director or secretary or being concerned or taking part in the promotion or formation of another company unless that company meets certain minimum capital requirements. In the case of a public limited company the minimum paid up capital required is £100,000. Otherwise the amount is £20,000. In addition to the minimum capital requirements there are other restrictions such as the prohibition on the other

company from granting loans to directors. The restricted person can apply for relief although such applications must be made within one year from the declaration of the restriction by the court.

7.6 Central to an examination of these provisions is the identification of the type of activity that needs to be tackled. It is then necessary to see how existing company law applies to such activities and what additions or amendments might improve the effectiveness of company law in tackling the problem. It should be noted that there are a wide range of company law provisions which impose obligations on directors and consequent penalties for breaches of those obligations. These range across matters such as to loans to directors, liquidation related activities, reporting requirements and fraud.

7.7 The main problem in *Phoenix Syndrome* situations is not what might be termed "honest" business failure to which no connotation of unlawfulness or wrongdoing should be attached. Such "honest" company failures are an unfortunate though inevitable feature of any market economy. Company law recognises this and provides for the orderly winding up of companies. The primary problem is those business failures which are the consequence of the deliberate actions of typically owner directors which are so designed as to enable them to benefit at the expense of creditors by using the protection of limited liability on the liquidation of their companies. The activities of these directors damage not only their own companies but other companies, their employees and the commercial environment generally. They inhibit entrepreneurial activity by placing additional obstacles in the way of others wishing to engage in business. There are sufficient difficulties and uncertainties in commercial life with which the honest entrepreneur has to contend without the additional hazard of the dishonest and irresponsible director. It is appropriate therefore that company law should discourage and provide protection from the activities of such directors.

7.8 The activities of these directors can be more specifically defined. We believe, in fact, that they would be substantially covered by the circumstances set out in section 160 of the 1990 Act which provides for disqualifications of certain persons from being appointed or acting as a director or other officer of a company or being involved in the promotion, formation or management of any company. Disqualification under this section would also prohibit the person from being appointed or acting as an auditor, receiver, liquidator or examiner. Section 160 provides for:

(i) automatic disqualification for five years or such other period as the court, on the application of the prosecutor, decides where a person has been *convicted on indictment of any indictable offence in relation to a company or involving fraud and dishonesty*, [section 160(1)]

(ii) disqualification for a period to be decided by the court where in any proceedings or on application the court is satisfied that:

(a) a person has been guilty (while an... officer of a company) of any *fraud in relation to the company, its members or creditors;* [section 160 (2)(a)] or

(b) a person has been guilty (while an...officer of a company) *of any breach of duty as such...officer;* [section 160 (2)(b)] or

(c) a declaration has been made under section 297A of the 1963 Act, (*which provides for civil liability for fraudulent or reckless trading*); [section 160(2)(c)] or

(d) the conduct of any person (as an ...officer of a company) *makes him unfit to be concerned in the management of a company;* [section 160(2)(d)] or

(e) in consequence of a report of an inspector under the Companies Acts *his conduct makes him unfit to be concerned in the management of a company;* [section 160(2)(e)] or

(f) *he has been persistently in default in relation to the relevant requirements* (which are defined in terms of delivery and return of documents to the registrar of companies) [section 160(2)(f)].

7.9 Applications to the court under section 160(2) (a) to (d) may be made by the Director of Public Prosecutions or, in certain circumstances, by any member, contributory, officer, employee, receiver, liquidator, examiner or creditor of the company. Where the application is made by a member, contributory, employee or creditor the court may require security for all or some of the costs of the application. An application under section 160(2)(e) may be made by the Director of Public Prosecutions and under 160 (2)(f) either by the Director or the Registrar of Companies. In addition the court may, of its own motion, in any proceedings, make a disqualification order under section 160(2)(a) to (f) and court means any court for these purposes other than for subparagraph (e) where it means the High Court.

7.10 We believe that section 160 provides a more adequate starting point for tackling *Phoenix Syndrome* directors. We believe that most such cases would be covered by one or more of the circumstances outlined in that section. We also consider that disqualification is a more appropriate consequence of such serious activities than restriction. The disqualification provisions in Irish company law are, in our view, primarily methods of providing protection for those involved in the commercial environment. In one UK case relating to disqualification of directors Browne Wikinson V.C is reported as stating:

> *"The primary purpose...is not to punish the individual but to protect the public against the future conduct of companies by persons whose past records as directors of insolvent companies have shown them to be a danger to creditors and others.".*

7.11 In accepting the primacy of the protective purpose, we note that the provisions have an obvious effect on the disqualified person and that in any particular case prosecutions under other provisions might be involved.

7.12 While we believe that disqualification is an appropriate level of protection for those more serious situations set out in section 160, we consider it reasonable to provide that

the court would have available to it the power to impose instead restrictions on directors in other cases where it seems to the court that a lesser form of protection would be more appropriate. Ultimately all cases will have to be considered on their own facts. There will, we believe, inevitably be cases where disqualification will not be possible to justify but where the acts or omissions of a director have been such as to warrant the provision of some lesser form of protection for creditors and other third parties. Accordingly, to accommodate such circumstances, we recommend below amendments to allow the court to impose restrictions in certain circumstances.

7.13 The most striking aspect of Chapter 1 of Part VII, which was commenced in 1991, was that it had not been used until recently. The fact that no liquidator or receiver had certified to a court that a company was unable to pay its debts with a view to activating the provisions would appear to have been due to the understandable concentration on returning as much as possible to creditors rather than having resources used up in a potentially costly legal action. The uncertainty on the part of liquidators and receivers as to what might happen after such certification is another likely factor in relation to the inaction under these provisions. Recently, it would appear, that the courts are requiring court appointed liquidators to address these provisions although it is not yet clear how the process will operate.

7.14 In examining section 160 and the use of the disqualification process as a basis for tackling Phoenix Syndrome directors, it is necessary to ensure that the provisions are properly activated and that problems of inaction, as occurred with the restriction provisions, are avoided. In this connection, we do not consider that any modifications are required in the circumstances set out in sections 160(1), 160(2)(a) or section 297A(1)(b) (of the 1963 Act), all of which are fraud related. However, we believe that the benefits to the system of ensuring action in the circumstances of section 160(2)(b) to (f) are such as to require the establishment within the Department of Enterprise and Employment of an adequately resourced executive unit which could make applications for disqualification of directors of companies in insolvent liquidation or receivership where there was reason to believe that these circumstances existed. We recommend the establishment of such an executive unit which should also be able to apply for disqualification of directors in cases of reckless trading.

7.15 Our recommendation that applications could be made by the executive unit in cases of reckless trading arises from our consideration of section 160(2)(c). This provision at present would allow an application for disqualification to be made where a declaration of personal responsibility was made under section 297A of the 1963 Act (inserted by section 138 of the 1990 Act) as a result of fraudulent or reckless trading. In the case of some companies there may be a reluctance to seek such declarations for example, because of a belief that the director has no assets. Nevertheless, it is recommended that the executive unit should be empowered to make an application for disqualification on the basis that the circumstances set out in section 297A(1)(a) existed. This is of particular relevance in the case of *Phoenix Syndrome* companies in that the circumstances set out in section 297A(1)(a) (being a party to carrying on the business of the compan[illegible] reckless manner) are, under section 297A(2), deemed to have existed if th[illegible]

(a) ...was a party to the carrying on of such busine[illegible] general knowledge, skill and experience that ma[illegible]

in his position, he ought to have known that his actions or those of the company would cause loss to the creditors of the company, or any of them, or

(b) ...was a party to the contracting of a debt by the company and did not honestly believe on reasonable grounds that the company would be able to pay the debt when it fell due for payment as well as all its other debts (taking into account the contingent and prospective liabilities).

7.16 We do not recommend that the rights of those other parties mentioned in section 160 to apply for disqualifications should be amended in any way although we recognise that the existence of an executive unit to whom liquidators and receivers would report would make applications from those other parties unlikely.

7.17 We believe that liquidators and receivers should have a central role to play in providing the information which would form the basis for action by the executive unit. We recommend that every liquidator and receiver should be required to report to the executive unit within six months of his appointment on whether he has reason to believe that circumstances set out in the relevant subparagraphs of section 160 or section 297A(1)(a) (of the 1963 Act) existed insofar as the directors of the company are concerned. There should be an ongoing requirement for the liquidator or receiver to report to the unit if at any time during the liquidation/receivership it appears to them that any such circumstances existed. The legislation should also contain ancillary provisions to enable the executive unit obtain all the information and documentation from the liquidator/receiver or other parties to enable it decide whether to take a case to court and to use as evidence in court. It is likely that in many such cases the liquidator/receiver would be called as witness. Given the need to focus limited resources we envisage, at this stage, that the executive unit will only be concerned with directors of companies in insolvent liquidation or receivership. The question of companies that cease to trade without going into liquidation has been represented to us as being a significant problem and another manifestation of the *Phoenix Syndrome*. This problem needs to be addressed as part of the effort to deal with dishonest and irresponsible directors. We recommend that it be considered as part of the next Phase of the Group's work.

7.18 We have recommended that the possibility to impose restrictions should remain as an option for the courts in circumstances that are not so grave as to warrant disqualification.

7.19 We believe that the lesser imposition of restriction should **not** be available where

- a person has been convicted on indictment any indictable offence in relation to a company, or involving fraud or dishonesty [section 160(1)], or
- the court is satisfied that a person has been guilty of fraud in the circumstances set out in section 160(2)(a), or
- where a declaration has been granted for civil liability for fraudulent or reckless trading under Section 297A of the 1963 Act [section 160(2)(c)], or

- where the court is satisfied, on application of the executive unit, that a director was knowingly a party to reckless trading (see paragraph 7.15).

The lesser imposition of restriction could not be justified in view of the seriousness of the circumstances that will have been established in these cases.

7.20 The power to impose restrictions should be available where the court is satisfied that

- the breach of duty as outlined in section 160(2)(b) was such as not to warrant disqualification but warranted restriction, or

- while the conduct of a person, as referred to in section 160(d) and (e), was not such as to make him unfit to be concerned in the management of a company, it was such as to warrant the restriction, or

- the persistent default referred to in section 160(2)(f) was not such as to warrant disqualification but warranted restriction.

7.21 In recommending the retention of restrictions we have in mind those restrictions that are referred to in the existing Part VII of the 1990 Act and summarised in paragraph 7.5 above. The provisions of that Part setting out when restrictions apply would be repealed with the new restriction capability being allied to the disqualification provisions. We believe that the ancillary provisions covering applications for relief, register of restricted persons and power to vary amounts should also be built in to the new provisions. With regard to relief from restriction it was suggested to us that the ability to seek relief should not, as it is under the current legislation, be confined to a period of one year from the declaration of restriction. We understand that one of the reasons for the current provisions was that other parties, who would be concerned with the case, may not be available with the passage of time to take part in the hearing of the application for relief. If our recommendation for the establishment of an executive unit within the Department of Enterprise and Employment is accepted, then it may be appropriate to extend the time period within which relief can be sought on the basis that the executive unit could be available to take part in such hearings. We recommend that this matter be reviewed in the light of the experience of the operation of the executive unit.

7.22 The amendments proposed would also shift the burden of proof from directors to the executive unit. This addresses what we believe are legitimate arguments from a number of interested parties that directors should not have to prove their "innocence" to avoid penalty. It also removes the need for any specific provisions to cater for those directors appointed by financial institutions, venture capital companies or investment fund managers (reference to the former two types of appointee in the context of the existing restrictions provisions are not, we believe, of particular use to those groups in any case).

7.23 We recognise that these recommendations have cost implications. It is not possible for us to quantify these costs in any precise way although the use of liquidators and receivers as information sources should assist in focusing efforts on those cases most deserving of attention. We do not envisage a large and costly bureaucracy and would hope that selective action would prove an effective deterrent. Nevertheless adequate resources will be needed to ensure the effectiveness of the executive unit.

CONCLUSIONS AND RECOMMENDATIONS

- Chapter 1 of Part VII was intended to tackle *Phoenix Syndrome* directors. We believe that the disqualification procedures in section 160 of that Act provide a more appropriate basis for dealing with such cases. [Paragraphs 7.8 & 7.10]
- The disqualification provisions in section 160 of the 1990 Act should be strengthened by enabling an adequately resourced executive unit, located within the Department of Enterprise and Employment, to apply for disqualification of directors of companies in insolvent liquidation or receivership. [Paragraph 7.14]
- The circumstances in which the executive unit could apply for disqualification would not include those involving fraud or dishonesty where the DPP would be involved but the executive unit could apply in cases of reckless trading. [Paragraphs 7.14 & 7.15]
- Liquidators and receivers should be required to report to the executive unit in such a way as to indicate cases where applications for disqualification or restriction would be appropriate. [Paragraph 7.17]
- The issue of companies that cease to trade without going into liquidation should be considered as part of the next Phase of the Company Law Review Group's work. [Paragraph 7.17]
- The court should be empowered to impose restrictions in specified circumstances where the less serious nature of the case would not warrant disqualification. [Paragraphs 7.18 & 7.20]
- Restriction should not be an option in specified cases of a more serious nature. [Paragraph 7.19]
- The restrictions should be the same as those set out in Chapter 1 of Part VII of the 1990 Act. The provisions of that Part setting out when restrictions apply would be repealed with the new restriction capability being allied to the disqualification provisions. Ancillary provisions such as notification to registrar and applications for relief would also be included in the new provisions. [Paragraph 7.21]
- We recommend that the length of time within which relief from restriction can be sought be reviewed in the light of the experience of the operation of the proposed executive unit. [Paragraph 7.21]
- The burden of proof under the new arrangements would shift from the directors to the executive unit. [Paragraph 7.22]

Chapter 8

The Position of Farmer Creditors in the Event of Company Liquidation

8.1 Farming interests for some time past have proposed that company law should provide specific preference to farmer creditors in a company liquidation situation on the basis that they are in a uniquely vulnerable position.

8.2 Points made in support of the proposal include:

- Farmers invariably operate as sole traders without the protection of limited liability.
- Farmers traditionally sell their produce on an informal basis abiding by the maxim that "a man's word is his bond".
- Retention of title is not a satisfactory solution since it requires documentation at time of sale and since the primary product is subsequently processed and intermingled.
- A significant portion of a farmer's annual produce may be sold to a single purchaser and in a single transaction.
- By reason of geographic concentration, the collapse of a single major buyer can spell disaster for an entire region reaching to thousands of individual farmers.
- The burden of risk in commercial transactions is inequitably distributed in that other parties have a greater capacity to secure their risk, e.g., by a fixed security, by irrevocable letter of credit, by in-depth credit risk investigation, by enforceable retention of title, by themselves having the benefit of limited liability, etc.

8.3 Possible solutions advanced in submissions made to us are:

- Monies owed to farmers for the supply of agricultural produce should rank as preferential debt in the event of liquidation of the debtor.
- Farmer creditors for the supply of agricultural produce should be deemed by law to have a first floating charge on the assets of the company debtor.
- In respect of the sale of primary agricultural produce, automatic retention of title should be recognised by law and retention of title claims should be exercisable on a group basis.

8.4 All who are engaged in commercial activity are affected to a greater or lesser extent by the fortunes of those with whom they trade. The failure of a major customer, supplier

or debtor can obviously have serious implications for those with whom they engage in business. Methods of protection against, or minimising, the inherent risks in doing business have developed over time. The ability to use these methods is conditioned by a number of factors particularly the relative commercial strengths of the buyer and seller and the nature of the goods being supplied. The protection obtained does not abolish the inherent risks of commercial activity. Rather it redistributes the burden of that risk.

PREFERENTIAL STATUS

8.5 We have been asked to consider extending preferential status to farmer creditors in a winding up. At present, the order of payment of creditors in a winding up is set out in the Companies Acts. In brief, credit secured by a pledge, mortgage or fixed charge, expenses of liquidation and pre-preferential creditors (employees PRSI contributions) rank in that order before preferential creditors, while floating charge-holders and unsecured creditors rank in that order after the preferential creditors.

8.6 Clearly the granting of a priority to a particular creditor may have an adverse impact on others. The Report of the Task Force on Small Business addresses this very issue in relation to section 115 of the Finance Act, 1986 in the following terms:

> *"In 1985, it was confirmed by the Supreme Court on appeal from the High Court that, with appropriate drafting, creditors could be given a fixed charge on the future book debts of a company (re Keenan Bros Ltd [1985] IR 401). The main practical consequence was that banks and other creditors who could otherwise have had a floating charge on such debts could, with the co-operation of the debtor and careful drafting, rank in front of the Revenue Commissioners by means of a fixed charge.*
>
> *The effects of the judgement were quickly addressed in the Finance Act 1986. Section 115 of the Act provides that, where the Revenue Commissioners are owed outstanding PAYE and VAT by a debtor, they may oblige another creditor of that debtor who is secured by a fixed charge on book debts to pay over all or part of whatever funds had been obtained from the debtor.".*

If farmer creditors are to be given a higher priority as preferential creditors, this may be at the expense of other creditors currently of similar or lower priority.

8.7 We have noted the points made in submissions to us in support of a special case for farmers. Whilst we recognise that farmers and suppliers of agricultural produce have particular problems, we also note that similar problems can occur in non-farming business and, to that extent, farmers are not in a unique position. We find great difficulty in determining any basis on which a particular priority should be assigned to farmer creditors.

8.8 We have taken particular note of the argument that the burden of risk in commercial transactions is inequitably distributed in that some parties have a greater capacity than others to secure their risk. The current situation and practices have, as mentioned earlier, developed over time and have been tested in the market-place. Nevertheless, it may be

that the relative preferences obtaining should be examined periodically in the light of market-place development. An examination along these lines would include a look at all winding up priorities including both fixed and floating charges and the position of unsecured creditors generally in relation to other creditors. Such an examination will require consultation with many interests since it will touch on diverse aspects of commercial life and on the interests of the Exchequer. It will also benefit from a study of developments in other jurisdictions. We note that work of a similar nature has been undertaken and steps smaller or greater implemented in other jurisdictions. We refer in particular to the US experience and the Cork Committee Report on Insolvency Law and Practice in the United Kingdom (Ref: Cmnd. 8558 - June 1982).

IRST FLOATING CHARGE

8.9 It has been submitted to us that a statutory first floating charge on the assets of the company in respect of monies owed for the supply of agricultural produce amounts to an automatic statutory retention of title with additional advantages. These are that the retention of title would not have to be expressed as a condition of every sale and there would be no requirement for the particular produce to be physically separated or identifiable in the exercise of the retention of title claim.

8.10 The proposal has the merit of simplicity but, again, would operate to shift the burden of risk to other parties. For that reason, we are unable to recommend that the proposal be accepted.

RETENTION OF TITLE

8.11 It has been suggested to us that legislation should be introduced to enhance the ability of farmers to use retention of title. At its simplest, a retention of title clause is intended to reserve title in the goods in the seller until the buyer pays for them. It thus affords to the supplier a level of protection against the failure of the buyer. Existing law provides that title to goods sold shall transfer to the buyer at such time as the parties to the contract intend it to be transferred. Retention of title requires to be incorporated in the contract of sale, usually by documentation. The subsequent exercise of the claim generally requires the ability to identify the specific goods.

8.12 It has been pointed out to us that the nature of the farming activity needs a simplified process of validating retention of title and that this may be accommodated by statutory recognition of automatic retention of title. It has also been pointed out that farmers have particular difficulty in identifying specific goods since, being primary products, they are likely to be intermingled and processed. We accept that the present law in relation to retention of title is complex and uncertain. Retention of title is not, however, peculiarly a company law matter and does not come within our remit. Indeed it has been the subject of detailed consideration leading to a report by the Law Reform Commission. We hesitate to make any recommendation which does not take account of the wider implications of change on the ways in which business is transacted generally.

INSURANCE

8.13 There may be ways outside the company law framework of addressing the concerns of the farming interests. One possibility that we considered is the development of an insurance or bonding arrangement whereby creditors could be insured against default by

buyers. It has been pointed out to us that whilst such a scheme operates in the United States, it may not be suitable here as it would impose a cost on farmers and on agricultural produce purchasers. However, since the cost will be in some relationship to the perceived risk, we feel that the concept is worth further consideration. We suggest that the farming interests work with the major agribusiness purchasers towards developing a cost effective insurance or bonding scheme.

CLUSIONS AND RECOMMENDATIONS

- We recommend that a full examination be undertaken of relative burdens of risk from third party business failure. [Paragraph 8.8]

- Pending the results of such an examination, we do not favour the introduction in law of preferential status to farmer creditors, a first floating charge facility or adjustments to the existing retention of title provisions. [Paragraphs 8.7, 8.9 & 8.10]

- We suggest that farmer interests and major corporate purchasers of agricultural produce jointly investigate the feasibility of a cost-effective insurance or bonding arrangement as cover against farmer creditor loss arising from company failure. [Paragraph 8.13]

APPENDIX 1

Mr James R Gallagher, FCA, (Chairman), Arthur Andersen

Mr James A Bardon, Director General, The Irish Bankers Federation

Mr Pat Burke, Principal, The Revenue Commissioners

Mr Des Cummins, Cummins Metal Recycling Limited

Mr Frank Cunneen, Chairman, Zeneca Ireland Limited

Ms Ann Fitzgerald, Secretary, Irish Association of Investment Managers

Mr John A Gleeson, Principal, Department of Enterprise and Employment

Mr Declan Hogan, Hogan and Associates

Mr Patrick Howard, Principal, Department of Finance

Mr William Johnston, Partner, Arthur Cox, Solicitors

Ms Gerardine Jones, Quotations Manager, The Irish Stock Exchange

Ms Fidelma Macken, B.L.

Mr Vincent Madigan, Principal, Department of Enterprise and Employment

Mr Declan O'Luanaigh, Pannell Kerr Foster

Mr Ciaran O'Mara, O'Mara & Company

Mr Paul Sweeney, Research Department, SIPTU

Secretariat: Mr Peter Baldwin, Secretary

Ms Brid Bannon and Ms Anne Sylvester, Assistant Secretaries

APPENDIX 2

List of Submissions Received on Phase I Topics

NAME	TOPIC						
	1	2	3	4	5	6	7
Ms P Barker, DCU			✓				
The Boardroom Centre						✓	
Dr John Breslin, UCD				✓			
Mr D Cahill, UCD				✓			
Consultative Committee of Accountancy Bodies - Ireland	✓	✓	✓		✓	✓	
Central Bank of Ireland	✓						
Chartered Institute of Management Accountants			✓		✓		
Craig Gardner	✓		✓		✓		✓
A Crowley, Crowleys - DFK							✓
Mr Maurice Curran, Mason, Hayes & Curran	✓	✓	✓	✓	✓	✓	✓
Deloitte & Touche	✓		✓			✓	✓
Department of Justice		✓					
Mr John Donnelly	✓						
Mr St John Dundon	✓						

NAME	TOPIC						
	1	2	3	4	5	6	7
Farrell Grant Sparks	✓						
Mr Peter Fisher, Department of Enterprise and Employment		✓					
Mr J A Glackin, Gerrard, Scallan & O'Brien		✓					
Harmac Court Management					✓		
Irish Business and Employers Confederation	✓		✓	✓	✓	✓	
Irish Creamery Milk Suppliers Association							✓
IDA Ireland	✓						
The Law Society	✓		✓	✓		✓	✓
Irish Farmers Association	✓		✓				✓
Institute of Chartered Accountants in Ireland			✓				
The Institute of Chartered Secretaries and Administrators			✓	✓	✓	✓	
Institute of Certified Public Accountants in Ireland	✓	✓	✓		✓	✓	
Institute of Directors in Ireland			✓			✓	
Irish Bankers Federation	✓						
Jefferson Smurfit Group plc				✓			
The Law Society	✓		✓	✓		✓	✓

NAME	TOPIC						
	1	2	3	4	5	6	7
ıe Lynch, UCC	✓	✓		✓	✓	✓	✓
n Nolan, Solicitor				✓		✓	
Trust Services Ltd					✓		
ıe Commissioners	✓					✓	
tewart, TCD		✓	✓	✓			
Kennedy Crowley	✓		✓	✓	✓	✓	
; na Gaeltachta	✓				✓	✓	
) Williams				✓			

I : Terms of Reference

1. - Companies (Amendment) Act, 1990 (the "Examinership Act")
2. - Part II, Companies Act, 1990 ("Investigations")
3. - Recommendations of the Ryan Commission
4. - Part V, Companies Act, 1990 ("Insider Dealing")
5. - Recommendations of the Task Force on Small Business
6. - Chapter I of Part VII of the Companies Act, 1990 - Restrictions on Directors
7. - The position of farmer creditors in the event of company liquidation

Minority Report

CHAPTER 2

Paragraph 2.27 - Pre-petition Debts

I believe that employees' wages, salaries and holiday pay as pre-petition debts should be specified in every funding statement as it will facilitate the orderly process of examinership. This should be provided for in law.

CHAPTER 4

Paragraphs 4.6 - 4.12 - Directors' Responsibility Statement

The primary purpose of the Directors' Responsibility Statement is to comply with a fundamental objective of financial statements, that of providing relevant information to users. Research has indicated a serious expectation gap between the users of financial statements and their authors. In particular, users are unaware that it is the responsibility of the directors (and not of the auditors) to safeguard the assets and prepare the financial statements. I believe that best practice may have developed among large entities to publish a responsibility statement which the directors sign, but best practice is not sufficient. The legal requirement for directors to state their responsibilities and to sign the statement in no way limits the potential for the courts or the legislature to extend or amend those responsibilities. Therefore, I believe that there is a need to require a Directors' Responsibility Statement in law, as was recommended by the Ryan Commission.

Paragraph 4.21 - Material Events After Balance Sheet Date

There should be a legal requirement that the company chairperson state if there has been any material event between signing off the balance sheet date and the date of the company's AGM. In my view it is particularly important to have this from large private companies.

Paragraphs 4.22 - 4.23 - Directors' Emoluments

The Ryan Commission recommended the disclosure of individual emoluments of directors and also those of senior management of companies. Disclosure of individual emoluments is consistent with the Review Group's recommendation to disclose individual share options. This is the practice in our major trading partners, the UK and US, and Irish companies operating in those jurisdictions disclose individual emoluments within bands, in those countries. This was also recommended in the Cadbury Report on Corporate Governance which stated that "*the overriding principle in respect of board remuneration is that of openness*". Irish companies' annual reports now have a section saying that they do not comply with this aspect of Cadbury because Irish company law does not require it. Shareholders should be entitled to a full and clear statement of directors' present and future benefits, and of how they have been determined. The legal requirement for the aggregate disclosure of directors is already practice. Stakeholders in companies should be able to judge the individual rewards to those charged with managing

the affairs of companies. I also favour the inclusion of emoluments waived by directors, details of compensation for loss of office and payment for contracts, if any, and payments to political parties.

Paragraph 4.49 - Filing of Returns

I believe that annual returns should be filed within fourteen days as was recommended by the Ryan Commission. Thirty five days is unnecessarily long.

Paul Sweeney,
SIPTU