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Overview of Corporate Restructuring and Recovery Options Available Under Irish Law - Part 1

by **Paul Dineen, Ruairí Mulrean, Richard Curran**

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As the novel coronavirus COVID-19 continues to disrupt economic activity in Ireland businesses are reviewing their corporate structures and funding arrangements to deal with the crisis. In this article, we outline the types of corporate restructuring options that are available under Irish law each of which will be discussed by us in greater detail in a series of subsequent articles.

We also discuss some topical areas such as a possible temporary suspension of corporate insolvency laws to allow directors of companies that were financially sound until the onset COVID-19 to continue to incur credit without the risk of being made personally liable for the company's debts should it subsequently be rendered insolvent.

Why Consider a Corporate Restructuring?

In the current difficult business environment, a company or group of companies might consider undertaking a corporate restructuring as a mechanism to ensure business continuity and survival beyond COVID-19, or to position the company as an attractive candidate for investment / funding or as a target for acquisition, merger or buyout, or to improve overall business efficiency (the Restructuring Goals). As any form of corporate restructuring generally comes with a financial cost, the various COVID-19 related financial support schemes being offered to Irish businesses by the government and semi-state bodies (discussed previously by us in Coronavirus: Financial Support for Irish Businesses) should be considered as a means of funding or part-funding the implementation of a corporate restructuring plan.

What Types of Corporate Restructuring Options are Available Under Irish Law?

The Companies Act 2014 (the 2014 Act) offers a range of restructuring options to Irish companies that could be considered with the aim of achieving one or all of the Restructuring Goals.

Such options are outlined below.

(i) Domestic Mergers, and Divisions -- Chapters 3 and 4, Part 9 of the 2014 Act

A domestic merger under the 2014 Act can take any of the following forms:

1. *Merger by Formation*. This is where two or more companies transfer all of their assets and liabilities into a newly formed company (NewCo) in exchange for the issue of shares in the NewCo to the

members of the transferor companies with or without cash payment. The transferor companies are then dissolved without going into liquidation.

2. *Merger by Absorption*. This is where the assets and liabilities of a wholly-owned subsidiary are transferred to its parent company and the subsidiary is then dissolved without going into liquidation.
3. *Merger by Acquisition*. This is where a company acquires all of the assets and liabilities of one or more companies in exchange for the issue of shares in the acquiring company to the members of the acquired companies, with or without cash payment. The acquired company is then dissolved without going into liquidation.

By way of example, a merger by absorption would be of benefit to a corporate group looking to save costs by consolidating and simplifying the structure of the group whereby an unprofitable or dormant subsidiary could be absorbed into its immediate parent company.

A division under the 2014 Act can take the following forms:

1. *Division by Acquisition*. This is where two or more companies acquire between them all the assets and liabilities of a company that is being divided and is dissolved without entering liquidation in exchange for issue of shares in one or more of the acquiring companies to the members of the divided company.
2. *Division by Formation*. This is where two or more new companies are formed in order to acquire between them all the assets and liabilities of a company that is being divided and dissolved without entering liquidation, in exchange for issue of shares in the companies being formed to the members of the divided company.

A division can be a useful restructuring mechanism as splitting the assets of a single company between independent business entities with lower-cost models can result in those assets being deployed with greater efficiency and, therefore, result in greater overall profitability.

Also, a division could be utilised to split off an unprofitable business line to better protect the survival of a more profitable and stable part of the company's business.

Notably, none of the merging companies in a domestic merger or companies involved in a division under Chapters 3 and 4, Part 9 of the 2014 Act can be a public limited company and one of the companies must be an LTD company (i.e. a private company limited by shares, registered under Part 2 of the 2014 Act).

Important Matters to Consider in Relation to Mergers and Divisions

It is important to note that in the context of the other processes referred to below, the merger and division regimes provided for in the 2014 Act are primarily available to solvent companies only. Furthermore, as these are forms of solvent restructurings, they are typically elective in nature, and therefore are not transactions that should be entered into without prior taxation advice so that they can, where possible, be undertaken in a tax neutral manner.

(ii) Liquidations -- Part 11 of the 2014 Act

The 2014 Act provides for two forms of liquidation that, in appropriate cases, can provide a useful framework for achieving a corporate restructuring those forms of liquidation being the members' voluntary liquidation (MVL) and the creditors' voluntary liquidation (CVL). An MVL is essentially a solvent liquidation with the CVL being an insolvent or nearly insolvent liquidation.

MVL: Possible Restructuring Options

In the context of restructuring options offered via an MVL, a liquidator during the course of an MVL is empowered under Section 601 of the 2014 Act to transfer company assets in exchange for the members of the company in liquidation receiving shares or participation rights in an existing or newly formed company to which the assets have been transferred.

CVL: Possible Restructuring Options

In the context of restructuring options offered via a CVL, Section 676 of the 2014 Act is a useful provision as it empowers a liquidator during the course of a CVL to agree a binding arrangement or compromise with the creditors and members of the company once passed by special resolution of the members and acceded to by 75% of the creditors. The main advantage here is that the liquidator could use Section 676 to implement an arrangement that involves making a compromise to sell the business assets to a third party, or possibly making a compromise with creditors that would ensure that the creditors would agree to the establishment a NewCo and take shares in same in exchange for writing off part or all of their debt.

(iii) Examinerships -- Part 10 of the 2014 Act

The examinership process is a court-based process overseen at all stages by either by the Circuit Court or the High Court.

When to Use?

A company can avail of the process when insolvent or likely to become insolvent and the Court must be convinced that the company has a 'reasonable prospect of survival as a going concern' subject to which it will make an order for the appointment of examiner. The company will then be afforded a 70-100 day statutory period of protection from debt enforcement actions while the examiner assesses its survival prospects and works to construct proposals for a scheme of arrangement or compromise between the company, its creditors and members. As such, examinership is principally a corporate insolvency process and we have previously discussed its merits and the merits of Schemes of Arrangement as a mechanism for restructuring company debt in an article on COVID-19: Restructuring of Company Debt.

A Viable Corporate Restructuring Option?

Some of the important factors that should be considered before contemplating an examinership include:

Possible Restructuring Outcomes

If considering examinership as a corporate restructuring option, it is important to keep in mind that the outcome of an examinership must result in the survival of the company as distinct from just the underlying business of the company or part of the underlying business. Business assets can be sold by the examiner as part of the scheme of arrangement but only in so far as this will facilitate the survival of the company. This can be contrasted with other forms of restructuring such as Schemes of Arrangement discussed below, where the outcome is more flexible to that of examinership e.g. viable business assets could be sold and hived off into a new entity with the original company being subsequently struck off using voluntarily strike-off procedure.

Costs

It is generally considered to be a difficult process for small-to-medium enterprises to access due to the costs involved in preparing the petition to the Court to appoint the examiner where a detailed independent accountant's report must be prepared and submitted. Further costs will be incurred by the examiner in making subsequent Court applications for directions on and sanction of the scheme of arrangement. A substantial influx of fresh capital investment is also nearly always a pre-requisite to any successful examinership.

Control

Control is also another major factor to consider in an examinership context, as while the existing directors will remain responsible for the day-to-day management of the company's affairs during the process this will be under the supervision of the examiner. The examiner also has the power to apply to the Court to displace directors who are being uncooperative and to take over the running of the company if doing so facilitates the company's survival.

(iv) Schemes of Arrangement -- Chapter 1, Part 9 of the 2014 Act

A Viable Corporate Restructuring Option?

The statutory Schemes of Arrangement (Schemes) regime was reformed under the 2014 Act, and it can be argued that this iteration of the regime positions it as a much more attractive restructuring option for Irish companies.

Some of the important factors that should be considered before contemplating a Scheme include:

Possible Restructuring Outcomes

The possible restructuring outcomes under the reformed statutory Schemes of Arrangement regime are broad ranging. In theory, a Scheme can be a compromise or an arrangement about anything that the company or group and its members or creditors (or any classes of members and creditors) may properly agree on among themselves. Some examples of the use of a Scheme in the context of restructuring include, the restructuring of insolvent company debt or capital structures, to implement a solvent group reorganisation involving a demerger or to implement a takeover.

A Scheme can also be implemented by a company when solvent or insolvent and, therefore, the Schemes regime offers management a real opportunity to take curative restructuring action when financial or operational challenges emerge. The proposals for a Scheme can also be prepared and put to the members and/or creditors on an initial informal basis, which should to preserve a level of goodwill between the parties.

Costs

One of the most interesting changes introduced under the 2014 Act was the reform of the Schemes regime into a more streamlined process. It is now a two-stage process. Stage one involves the construction of the proposals for a Scheme and the approval of the Scheme by the company's members and/or creditors. Stage two involves an application to the High Court for final review and sanction of the Scheme.

Previously, the board of directors had to prepare the Scheme proposals and apply to the High Court for an order granting them the powers to convene the meetings of members and/or creditors to vote on the Scheme. Two further court applications were also required for directions on notice and advertising of the Scheme and for a final sanction order. The statutory formalities governing Schemes are also now lighter and less complex with six provisions governing Schemes in the 2014 Act in contrast to 48 provisions governing to operation of an examinership.

The fact that the process has been simplified with less court involvement should allow the costs associated with constructing and executing a Scheme to be managed in a prudent fashion.

Control

Although some level of outside assistance from restructuring professionals will be necessary, the directors will ordinarily initiate and manage the process in parallel to continuing to run the day-to-day operations of the company.

(v) Pre-pack Receiverships -- Part 8 of the 2014 Act

Pre-pack Receiverships are essentially a form of traditional receivership that involve a pre-arranged sale of the business or assets (or both) of a company in receivership that completes either immediately upon the appointment of the receiver or shortly after the receiver is appointed.

A Viable Restructuring Option?

A Pre-Pack Receivership could be useful in the context of implementing a management buyout of the underlying business and/or assets where a company is in default or soon to be in default of its borrowing obligations to a major secured lender or by such a secured lender itself to sell the underlying business and/or assets. Therefore, it will only be an option if the cooperation of the relevant secured lender is obtained from the outset as a receiver in this context can only be appointed by fixed or floating charge

holder using its rights of appointment under a fixed or floating charge debenture. This should, however, not be too much of an impediment, as most Irish corporate lending arrangements typically include such rights.

(vi) Other Arrangements that could be considered to temporarily preserve business continuity

Temporary Standstill Arrangements

To provide some short-term breathing space until such a time as business activity begins to return to a normal level, the negotiation and implementation of temporary standstill arrangement could be considered. The essence of this kind of arrangement will be an agreed forbearance on repayments of debt owed to shareholders, as well as creditors such as banks, suppliers and rent payments to landlords. To be successful in implementing such an arrangement, the provision of information to the relevant creditors evidencing that the temporary forbearance will allow for the business to be preserved in the shorter term and that the business should be able to meet its payment obligations once business activity resumes to a normal level will be required.

Some of the major banks in Ireland are currently offering a three-month moratorium on repayments of business loans, which is in effect a form of temporary standstill arrangement.

Temporary Suspension of Corporate Insolvency Laws?

One related area that has been commented on elsewhere, to which it would be very useful for the Irish government to consider is whether it will adopt measures similar to those recently introduced by the UK and Australian governments to temporarily suspend corporate insolvency laws such as 'reckless trading'. Such a suspension would provide a level of comfort to directors of companies that are otherwise viable (but in financial difficulty due to COVID-19), that decisions taken to continue to trade during the pandemic and incur credit will not result in the directors incurring personal liability for all or part of the company's debts of the business or be restricted or disqualified should the company not survive and fall into liquidation.

Be Mindful of Directors' Duties

Irrespective of any governmental derogation from corporate insolvency laws, when making decisions in this uncertain business environment, directors should be even more mindful to observe the provisions relating to directors' duties set out in Chapter 2, Part 5 of the 2014 Act, such as the duty to act in good faith and in the best interests of the company. Importantly, directors should also bear in mind that the general duty to act in the best interests of the company is transformed into a general duty to act in the best interests of the company's creditors where the company is technically insolvent or is near insolvent.

Considerations

As noted in the introduction, we will be discussing in greater detail in a series of follow-on articles each of the corporate restructuring processes identified above to assist corporates considering a restructuring to select the appropriate option. We anticipate that many corporates in the current business environment will seek to consolidate their corporate structure to achieve cost savings, attract equity investment, plan for a refinancing or a sale.

Before considering implementing of any of the restructuring options discussed above, we would strongly recommend that you obtain specific legal, tax and accountancy advice in order to ensure the preferred option is suitable for achieving your particular Restructuring Goals.

For more information please contact Richard Curran at rcurran@lkshields.ie, Ruairi Mulrean at rmulrean@lkshields.ie or Paul Dineen at pdineen@lkshields.ie.

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About the Authors

Paul Dineen
Senior Associate

Paul has extensive experience across a wide range of corporate and commercial matters including mergers and acquisitions.

T: +353 1 638 5897 **E:** pdineen@lkshields.ie

Ruairí Mulrean
Partner

Ruairí practises in the areas of corporate law, mergers and acquisitions, corporate restructuring and insolvency.

T: + 353 1 638 5844 **E:** rmulrean@lkshields.ie

Richard Curran
Managing Partner

Richard has extensive experience in corporate finance transactions.

T: + 353 1 637 1514 **E:** rcurran@lkshields.ie