

## Goal 4 – Sanctioning Improper Conduct with respect to Insolvent Companies

### Introduction

The creditors and other stakeholders of insolvent companies suffer commercial damage when monies for goods and services are left unpaid. Because of public concern that some of the cases of corporate failure involved the directors acting dishonestly or irresponsibly and because such behaviour, where it occurred, was not being sanctioned in the past, the ODCE was established to supervise insolvent companies. The purpose of ODCE activity is to deter unscrupulous activity and encourage ethical and responsible business conduct at a time of serious difficulty in the company life cycle.

2004 was the second full year of operating the mandatory reporting regime for liquidators enshrined in section 56 of the Company Law Enforcement Act 2001. This accountability framework under the supervision of the ODCE and the High Court was introduced to raise corporate standards, reduce creditor risks and deter malpractice in the business environment.

In all, 1,309 (947 in 2003) liquidator reports were considered or received during the year in respect of insolvent companies. Of these, 623 (821 in 2003) were initial reports<sup>22</sup>, while the balance of 686 (126 in 2003) constituted further<sup>23</sup> or final<sup>24</sup> reports on company liquidations.

Decisions were issued in the case of 1,084 reports (630 in 2003) of which 529 (560 in 2003) constituted initial reports from liquidators, 268 were further reports, and 287 were final reports. The evaluation of such a large number of reports within prescribed statutory deadlines required a concerted effort by the Office to which many staff contributed. Many of the remaining

225 reports (317 in 2003) were received in the final quarter of 2004 and will be determined in 2005.

In examining these reports with respect to directors' conduct, the ODCE is particularly anxious to ensure that suspected fraud or misconduct is dealt with properly. In pursuing this objective, the Office has sought to ensure in particular that entrepreneurial endeavour is not inhibited by needlessly sanctioning persons who clearly showed that they behaved honestly and responsibly in the conduct of failed companies, even though losses may have ensued to others.

### Liquidation Trends

The following table shows the number of liquidations notified to the Companies Registration Office over the last five years.

Liquidations	2000	2001	2002	2003	2004
Creditors	324	415	378	369	268
Court	12	24	34	31	36
Members	581	589	720	942	795
<b>Total</b>	<b>917</b>	<b>1,028</b>	<b>1,132</b>	<b>1,342</b>	<b>1,109</b>

The 2004 figure of 278 voluntary creditor liquidations continues a trend of decline in the number of such insolvent companies being liquidated compared to previous years. However, this has been counterbalanced by a substantial rise in recent years in the number of solvent companies being liquidated. The ODCE welcomes the fact that a higher proportion of company stakeholders have been receiving full payment for their outstanding debt.

The ODCE would be concerned if the decline in the number of insolvent companies was caused by persons trying to evade the new accountability framework, and the Office will keep developments in the area under close scrutiny for the foreseeable future. Curbing any such tactics will of necessity be a continuing objective, in order to maintain the coherence and credibility of the improving conditions for corporate behaviour.

<sup>22</sup> An initial report is the first report received from a liquidator within six months of his appointment and in the majority of cases the decision to grant relief or not is made based on this report. In some cases 'relief at this time' is granted to facilitate further investigations by the liquidator.

<sup>23</sup> A further report is received from a liquidator usually after six months if 'relief at this time' was granted and after twelve months if a decision to grant relief or not has been made. In this way the ODCE monitors progress on an insolvent liquidation. As the principal decision on whether or not to relieve a liquidator

of their obligation to take restriction proceedings will have been made based on the initial report the majority of decisions for further reports will be 'relief'. The exception to this is when 'relief at this time' has previously been granted to facilitate further investigations by the liquidator.

<sup>24</sup> A final report is received from a liquidator four weeks prior to final meetings or final dissolution if the liquidation is a Court liquidation. This is a final monitoring exercise for the ODCE prior to dissolution of an insolvent company.

## Breakdown of Insolvent Companies in Liquidation by Economic Sector

Appendix 4.1 provides a breakdown by economic sector of the insolvent companies in liquidation by reference to the first reports received from liquidators in 2004. The construction, manufacturing, transport and wholesale and retail sectors continued to feature prominently in the companies in insolvent liquidation. The technology sector was less prominent than 2003 indicating improving economic conditions in the sector.

## Goal 4.1: Supervising Liquidators in the Proper Discharge of their Duties

The Director's supervisory functions with respect to liquidators (and receivers in certain circumstances) are founded in the following principal provisions of the Companies Acts:

- section 56 of the Company Law Enforcement Act 2001 which requires the liquidator of an insolvent company to report to the Director on the conduct of the company's directors and, unless relieved by the Director, to apply to the High Court for the restriction of all of the directors;
- section 57 of the 2001 Act which enables the Director to request for a stated reason any liquidator to produce his or her books for examination. The Director has a similar power with respect to receivers under section 323A of the Companies Act 1963 (as inserted by section 53 of the 2001 Act);
- section 58 of the 2001 Act which requires a prescribed professional body to report to the Director in any case where it has found that a member conducting a liquidation or receivership has not maintained appropriate records or where it has reasonable grounds for believing that the member, while so acting, has committed an indictable offence under the Companies Acts;
- section 299 of the Companies Act 1963 (as amended by section 51 of the 2001 Act) which obliges the liquidator of any company to report forthwith to the Director (and to the Director of

Public Prosecutions) any past or present officer or any member of the company who seems to the liquidator to be guilty of an offence in relation to the company for which he/she is criminally liable.

## Section 56 of the 2001 Act - Liquidator Performance

It is the ODCE's practice to identify the companies in liquidation that may be the subject of a reporting obligation. In undertaking this task, it gathers relevant information from the Companies Registration Office and monitors publications and other sources of information dealing with liquidations and the appointment of liquidators. In order to ensure that the required reports were received on time, the ODCE wrote to all relevant liquidators in 2004 advising them of their reporting obligations and reminded them one month in advance of the statutory deadline for receipt of their section 56 reports. The compliance rate for the production by liquidators of their first reports showed a welcome improvement to 97% in 2004 compared with 93% in 2003. Appendix 4.1.1 has the associated details.

The ODCE also continued during 2004 to issue Public Notices in which the reporting liquidators and the insolvent companies<sup>25</sup> subject to a section 56 report were identified on the ODCE website. The purpose of these regular updates is to enable interested parties to bring any matters of concern in relation to a specific insolvent company to the attention of the liquidator and the Office, so that these concerns can be taken into account in determining to what extent a liquidator should benefit from being relieved of the statutory obligation to apply to the High Court for the restriction of the company's directors.

In implementing its functions under section 56, the ODCE has necessarily tracked the performance by liquidators in complying with their legal obligations. In 2004, the Office found it necessary to correspond formally with liquidators who failed to submit reports on 81 occasions (71 in 2003) drawing to their attention that they were in default with regard to their statutory reporting obligations. In two cases, the Director had to resort to legal proceedings under section 371 of the Companies Act 1963 (as amended), resulting in High Court orders being made against both. The identities of

25 A copy of this information which is updated regularly is available at [www.odce.ie/Court Decisions/insolvency.asp](http://www.odce.ie/Court%20Decisions/insolvency.asp)

the liquidators in question are contained in **Appendix 3.3** of the Report.

The Director also corresponded with liquidators on 52 occasions in 2004 in respect of their failure to notify his Office that restriction applications had been taken where no relief had been granted. Late in 2004, four liquidators were issued with formal warnings that legal proceedings would be initiated against them should they continue to be in default in taking the necessary restriction applications.

The standard of liquidator reports received under section 56 continued to be mostly satisfactory in 2004. The Office will keep under review the issues arising from the section 56 reporting process, and we will develop appropriate responses to improve effectiveness in this area.

### Section 57 of the 2001 Act

In 2004, the Director made no requests for access to the books of liquidators (three in 2003).

### Section 58 of the 2001 Act

The prescribed professional bodies<sup>26</sup> made no reports in 2004 of suspected liquidator or receiver misconduct under this section (one report in respect of a liquidator was made in 2003).

### Section 299 of the 1963 Act

Two reports were received under section 299 in 2004 (one in 2003). All such reports are examined in detail by the Office given that they denote possible criminal liability.

## Illustration 4.1: Importance for Irish and EU Insolvency Law of the Liquidation of Eurofood IFSC Ltd. (In Voluntary Liquidation)

In late 2003, the major multinational food group, Parmalat, suffered a financial crisis within certain of its companies. A wholly-owned subsidiary in the group was an Irish company, Eurofood IFSC Ltd. ("Eurofood"). Its principal activity since incorporation in 1997 was the provision of financing facilities for other group companies.

There followed a series of conflicting legal decisions in the Irish and Italian Courts which had implications for the interpretation of the EU Regulation on Cross-Border Insolvency Proceedings<sup>27</sup> which was law throughout the EU since 31 May 2002, viz:

- on 27 January 2004, the High Court appointed a provisional liquidator to Eurofood under the Companies Acts;
- on 20 February, Eurofood was admitted to "extraordinary administration" under Italian law which the ODCE believes to be similar to examinership in Irish law;
- on 23 March, the High Court determined that Irish law ought to prevail and confirmed its appointment of a liquidator to Eurofood.

In a subsequent appeal of the High Court decision, the Supreme Court has found it necessary to seek preliminary rulings from the European Court of Justice on certain issues of European Law for the purpose of enabling it to give its ultimate judgment.

The Director participated in the High Court and Supreme Court proceedings and is also one of the parties who has filed Written Observations with the European Court of Justice. While the complexities of this litigation is best understood by considering the judgments of the Irish Courts<sup>28</sup>, the key issues from the Director's perspective are:

- the extent to which companies whose "centre of main interests" is apparently located in Ireland can nonetheless fall to be wound up under the laws and regulatory structures of other EU Member States and
- the consideration of the circumstances in which it is permissible under the EU Regulation for the courts of one Member State to refuse to recognise insolvency proceedings opened in another Member State, where the effects of that recognition would be manifestly contrary to the latter State's public policy and in particular its fundamental principles or the constitutional rights and liberties of the individual.

The issues involved are both complicated and novel and have potential implications for our present legal understanding of the effect of the registration of companies in Ireland and in other EU States. It is thought likely that the matter will be dealt with by way of an oral hearing before the European Court of Justice, but owing to the large number of cases pending before that Court, no date for a hearing has yet been fixed.

<sup>26</sup> Under the Company Law Enforcement Act 2001 (Section 58) Regulations 2002 (S.I. 544 of 2002), the following professional bodies are prescribed:

- the Institute of Chartered Accountants in Ireland;
- the Institute of Certified Public Accountants in Ireland;
- the Association of Chartered Certified Accountants;
- the Institute of Incorporated Public Accountants Ltd;
- the Law Society of Ireland;

- the Institute of Taxation in Ireland;
- the Chartered Institute of Management Accountants.

<sup>27</sup> Council Regulation (EC) No 1346/2002 of 29 May 2000 on insolvency proceedings.

<sup>28</sup> See [www.odce.ie/court/insolvency.asp](http://www.odce.ie/court/insolvency.asp) for copies of the High Court and Supreme Court judgements.

## Effect of Pooling Order on Reporting Obligation

During 2004, the High Court, on the application of a liquidator, made a pooling order under section 141 of the Companies Act 1990 ordering that the liquidation of two companies should be undertaken as if they were the one company. The liquidator sought advice from this Office on whether one or two section 56 reports were applicable. It was decided that as both companies had the same liquidator and having regard to the terms of the Court order, only one report was applicable.

## Eurofood IFSC Limited (In Voluntary Liquidation)

The decision of the High Court to assert its jurisdiction to order the liquidation of this company has given rise to legal dispute with the Italian Courts. The Supreme Court has sought preliminary rulings from the European Court of Justice on a number of issues which have considerable implications for Irish and EU insolvency law. The Director participated during 2004 in the High Court and Supreme Court proceedings and has filed Written Observations with the European Court of Justice. A synopsis of the issues pertaining to this case is included in the accompanying **Illustration 4.1**.

## Goal 4.2: Assessing Directors' Conduct in Insolvent Liquidation Situations

The Director considers relieving liquidators of the statutory obligation to apply to the High Court for the restriction of a director, where the liquidator makes a clear and unambiguous statement in the section 56 report that the company director has demonstrated that he or she acted honestly and responsibly in relation to the conduct of the company's affairs. The liquidator is expected to provide details in the report of the factors that support that opinion or any other opinion which they may express.

29 Full Relief was granted in cases where the ODCE was satisfied, on the basis of information provided by the liquidator or otherwise, that all of the directors of the insolvent company had satisfactorily demonstrated that they had acted honestly and responsibly in the conduct of the company's affairs.

30 Relief was not granted in cases where the ODCE was satisfied, on the basis of information provided by the liquidator or otherwise, that none of the directors of the insolvent company had satisfactorily demonstrated that they had acted honestly and responsibly in the conduct of the company's affairs.

## ODCE Relief Decisions

As indicated in **Appendix 4.1.1**, the ODCE determined a total of 1,084 liquidator reports in 2004, of which 529 were first reports. In these 529 cases, the relief decisions in 2004 (relative to 2003) were of the following character:

Decision Type	2003	%	2004	%
Full relief <sup>29</sup>	294	53%	357	67%
No relief <sup>30</sup>	199	36%	93	18%
Relief at this time <sup>31</sup>	34	6%	53	10%
Partial relief <sup>32</sup>	25	4%	21	4%
Other decisions	8	1%	5	1%
Totals	560	100%	529	100%

Complete lists of the companies in respect of which full relief or relief at this time were granted in 2004 are contained in **Appendices 4.2.1** and **4.2.2** respectively.

The increase in the Office's 'full relief' decisions and a similar reduction in the proportion of 'no relief' cases can mainly be attributed to more responsible conduct by the directors of recently insolvent companies and to a greater familiarity by liquidators and the ODCE with the standards being applied by the High Court in determining what constitutes honest and responsible behaviour by directors. What is notable is that in 2003, all directors in more than one in three of these insolvent companies found themselves facing restriction proceedings. In 2004, this figure had halved to about one in six companies. This improvement suggests that directors are now more attentive to their duties with respect to creditors and other stakeholders because of the impact of the reporting regime.

Decisions of 'no relief' or 'partial relief' by the ODCE do not of course constitute a finding in relation to the honesty or responsibility of the directors concerned, and it would be improper for any such inference or imputation to be drawn. It is a matter for the High Court (having heard the liquidator's evidence and the explanations of company directors) to determine if a

31 Relief 'at this time' was granted in cases where the ODCE was satisfied that the liquidator needed more time to investigate properly the circumstances giving rise to the company's demise. The ODCE requires such liquidators to submit a second report, after which a fresh decision is made on relief.

32 Partial relief was granted in circumstances where the ODCE was satisfied, on the basis of information provided by the liquidator or otherwise, that some but not all of the directors of the insolvent company had satisfactorily demonstrated that they had acted honestly and responsibly in the conduct of the company's affairs.

restriction declaration should be made in the case of any particular company director.

## Tracking Court Decisions on the Restriction Applications

Where the ODCE decides not to grant relief, the legal obligation on the liquidator to commence restriction proceedings is confirmed. The effect of the ODCE's relief decisions in 2004 was that more than 200 company directors (relative to 500 in 2003) faced being called to account before the High Court for their stewardship of an insolvent company. As the Director is not a Notice Party to liquidator restriction applications, it can be some time before the ODCE receives definitive information on the completion of the Court proceedings and on the outcome of those proceedings. For the purpose of this Report, the Office has attempted, via a combination of Court notifications to the CRO (where restrictions declarations have been

made) and feedback from liquidators (particularly those cases where no restriction was imposed), to produce an initial review of the incidence of Court restrictions relative to the ODCE relief decisions.

During 2004, the High Court reached decisions in 141 cases where no relief or partial relief had previously been decided by the ODCE, with the remaining cases pending before the Court or yet to be initiated. In respect of the 141 cases heard, the High Court has restricted one or more directors in 109 cases, representing 77% of the total. No restriction orders were made in respect of the remaining 32 cases or 23% of the total. In terms of individual directors, there were 198 directors<sup>33</sup> restricted (representing 69% of this total) and one director disqualified. No restrictions were made in respect of 87 directors representing 31% of the total.

It is noteworthy that of the 217 persons who were restricted by the High Court during 2004, 198 of

### Illustration 4.2.1: Company/Director Transactions as discussed in *Re XNET Information Systems Ltd. (in voluntary liquidation) Stafford v Higgins & Others*<sup>34</sup>

A restriction order was made in respect of two directors of a company who obtained loans of company assets as a method of refinancing the purchase of assets which were to be used by the company. In the judgement on this case, the High Court highlighted that:

- a company and its directors are separate legal entities;
- directors must disclose their interests in contracts;
- determination of irresponsibility is independent of dishonesty or bad motive;
- loans of company assets may breach section 31 of the Companies Act 1990.

In particular, the Court stated: "I have concluded that I cannot accept that directors of a company, even those who do not take specific legal advice, could be regarded as acting responsibly in entering into significant financial transactions which were, in essence, financial transactions between the Company and themselves without either bringing those matters to the attention of their fellow directors or obtaining formal board approval.

Every director must be deemed to know and appreciate the distinction between the Company as a separate legal person and themselves as individuals. Further, it appears

to me that directors must be deemed to be aware of obligations which they have not only to the Company and its shareholders but also to creditors and others dealing with the Company. Further, directors must be assumed to know, at least in a general way, of their obligations under the Companies Act. Section 194 of the Companies Act, 1963 provides:

'(1) It shall be the duty of a director of a company who is in any way, whether directly or indirectly, interested in a contract or proposed contract with the company to declare the nature of his interest at a meeting of the directors of the company.'

This obligation to disclose and, thereby, bring to one's fellow directors a potential conflict of interest may properly be regarded as principles of good governance and sound commercial probity and proper standards in commercial dealings. The board of directors of a company is responsible for managing the affairs of the company. It appears to me that, independently of any specific legislative requirement, a person who is a director of a company must be aware or ought to be aware and understand that if he or she proposes to enter into a contract with the company that the full board of directors should be made aware of the fact that he or she, a fellow director, is interested in the contract and asked to approve the contract."

<sup>33</sup> Where an individual is restricted, s/he may only act as the director or secretary of a company for a period of five years thereafter if that company meets certain minimum capitalisation requirements. In the case of a private company, a minimum called up share capital of €63,487 is required. In the case of a public limited company, the corresponding figure is €317,435. Moreover, the called up share capital must be fully paid for in cash. Restriction permits individuals to

continue to avail of the benefits of limited liability. However if a restricted person breaches the capitalisation conditions, s/he may potentially be convicted of an indictable offence, fined and disqualified for five years.

<sup>34</sup> [2004] IEHC 82 (6 May 2004) Finlay Geoghegan J.



these were a direct result of the obligation placed on liquidators under section 56 of the Company Law Enforcement Act 2001. Of the 19 restrictions not related to the section 56 process, two of these evolved from distinct ODCE enforcement actions. This means that only 17 persons were restricted during 2004 unrelated to ODCE enforcement activity.

Appendices 4.2.3 and 4.2.4 to this Report outline, in relation to restriction proceedings which concluded before the High Court in 2004, the outcome of the cases where restrictions were made and were not made respectively. The Register of Restricted Persons which is maintained by the Companies Registration Office records 479 restricted directors at end-2004. The full list of persons that currently stand restricted is available from the Companies Registration Office or at their website [www.cro.ie](http://www.cro.ie).

Two of the issues dealt with by the High Court in 2004 in its decisions concerned:

- company/director transactions and the duties of directors and
- the respective responsibilities of executive and non-executive directors in insolvent situations.

The accompanying **Illustrations 4.2.1** and **4.2.2** provide useful information on the approach of the High Court to these circumstances.

### Tracking Directors seeking Relief from their Restriction

Section 152 of the Companies Act 1990 allows a restricted director to seek relief within 12 months of being restricted either in whole or in part. Such an application must be notified to the liquidator of the company that gave rise to the restriction. In 2004, a number of restricted persons applied for relief without having made any moves to abide by the restriction conditions. When this Office indicated that we would be opposing the relief application, the application was

## Illustration 4.2.2: Duties of Executive and Non-Executive Directors as discussed in *Re RMF (Ireland) Limited (in voluntary liquidation) Kavanagh v. Riedler & Others*<sup>35</sup>

In addressing the respective duties of executive and non-executive directors (NEDs) in this case, the High Court indicated that even if the distinction was not expressly recognised in the Companies Acts, it was well established in commercial life. It therefore felt impelled to recognise the distinction in considering whether a person has acted responsibly while acting as a director of a company.

According to the Court, the first test in considering the responsibility of a NED is to consider the conduct “in relation to any such particular agreement or purpose” for which he or she had been appointed, especially if the appointment was made with a view to bringing certain expertise to the board. Therefore if a person is appointed as an advisory NED and has no managerial function, the Court will limit its consideration to those functions of the NED appropriate to that role.

However, merely because a person is appointed to bring expertise does not mean that they can escape responsibility as -

“Each individual director owes duties to the company

(i) to inform himself about its affairs and

(ii) to join with his co-directors in supervising and controlling them.”<sup>36</sup>

While the Court recognised that directors may collectively delegate to executives or management certain functions, “such delegation does not absolve the directors from their obligation of ultimate supervision.”

However, the Court added that a NED is required to act when the occasion arises and to take such steps as are necessary to address the matter:

“In considering whether a non-executive director has acted responsibly for the purposes of s. 150 of the Act of 1990 it appears to me that the courts should also recognise that, in general, a non-executive director is entitled both to rely upon information provided by his fellow executive directors and to rely upon the executive directors carrying out what might be considered to be normal executive or management functions. There may be factual circumstances which will put a non-executive director on notice that he should not continue to rely either upon information provided or upon executive duties being properly performed and require further action from him or her.”<sup>37</sup>

<sup>35</sup> [2004] IEHC 334 (27 May 2004).

<sup>36</sup> Numbering added for emphasis

<sup>37</sup> Underlining added for emphasis

withdrawn, and the ODCE is considering at present if the individuals in question should now be prosecuted for their defaults. We will obviously continue to keep an eye on these types of cases, so as to ensure that applications for relief in respect of restrictions (and disqualifications) are fully justified to the High Court.

### Tracking Directors not abiding by their Restriction Conditions

As indicated earlier under Goal 3, ODCE investigations have confirmed that there are a number of restricted individuals acting in breach of the statutory requirements, and at year-end, we secured a first conviction and disqualification against a restricted director for continuing to act as a director or secretary in a company which did not comply with the capitalisation requirements. Two further such prosecutions are ongoing at year-end.

## Goal 4.3: Sanctioning Fraudulent or Abusive Behaviour

### Unliquidated Insolvent Companies

The Director is conscious that the directors of insolvent companies may be tempted to cease trading without a formal liquidation as a means of evading their responsibilities to the company's creditors and other stakeholders and avoiding the implicit threat of restriction which arises in a liquidation situation. The 2004 results indicating declining numbers of directors going before the High Court means that company directors have nothing to fear from the section 56 process if they behaved honestly and responsibly in conducting the business of the insolvent company and cooperated fully with the liquidator in the discharge of his/her duties.

Having successfully improved behaviour in the area of liquidations, the Office focused attention in 2004 on cases involving the conduct of directors of some insolvent companies that are not in liquidation. In the interests of fair play, the ODCE clearly wants to see the same discipline of good conduct apply to all insolvent companies, not just those that are placed in liquidation. The orderly winding up of insolvent companies should be the normal response to insolvency rather than the abandoning of the company and its creditors.

The ODCE is aware that some directors are evading accountability for their actions and omissions, whether by accident or design, by refraining from placing their companies in liquidation. Having ceased trading, these companies will usually end up being dissolved by the Registrar of Companies for failing to file annual returns. The law now provides that the directors of dissolved insolvent companies are at risk of disqualification<sup>38</sup>.

Disqualification typically gives rise to greater personal consequences for irresponsible directors than a restriction flowing from the liquidation of an insolvent company. The identity of both disqualified and restricted individuals is available online from the CRO's public register at [www.cro.ie](http://www.cro.ie), and all businesses should be mindful that the CRO is a useful source of credit risk information.

In 2004, the ODCE focused greater attention on the phenomenon of unliquidated insolvent companies. The areas of activity included:

- companies with outstanding registered judgements which have ceased trading. The Director secured a five-year restriction from the High Court against a director of one such company in 2004. Correspondence has issued to the directors of a number of other similar companies, and in the absence of satisfactory replies, restriction proceedings will also be brought against all of their directors;
- companies which are the subject of complaint to the Office. Following the examination of documents and information seized under search warrant in one case, the Director has recently launched disqualification proceedings against two directors of the company in question;
- companies which have been struck off the Register of Companies for failing to file annual returns. As indicated earlier in Goal 3, the ODCE secured from the High Court during 2004 the disqualification of one company director for two years and the restriction of a fellow director for five years. While this was the first case of its type to come to a decision, proceedings in another five such cases were before the High Court at end-2004.

<sup>38</sup> If disqualified by the High Court, a person is prohibited from being appointed or acting as an auditor, director or other officer, receiver, liquidator or examiner and from being in any way, whether directly or indirectly, concerned in or part of the

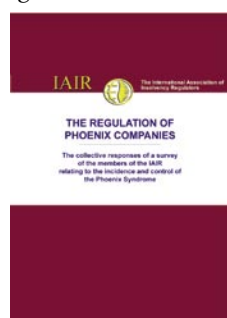
promotion, formation or management of any company or any society registered under the Industrial and Provident Societies Acts. A disqualified person who breaches the Court order is liable to be convicted and disqualified for ten years.

Companies may also fail to be liquidated following the conclusion of a receivership, and the Director has also been given the ability to monitor unliquidated insolvent companies in these circumstances. Specifically, a receiver appointed pursuant to a floating charge over the whole or substantially the whole of the property of the company is now required<sup>39</sup> to state his or her opinion as to whether or not the company is solvent at the end of the receivership, and this information is made available to the ODCE via the receiver's notification to the Registrar of Companies. In 2004, the Director received 24 such notifications confirming an insolvent situation in the company. This latter group of companies are forming part of the Director's overall examination of the problem of unliquidated insolvent companies.

## Research on Phoenix Companies

At the request of the International Association of Insolvency Regulators (IAIR) of which the ODCE is a member, the Director and his staff completed an international research project into the phenomenon of phoenix companies in 2004. The research drew on the collective experience of IAIR members and found *inter alia* that phoenix companies were particularly prevalent in the clothing, construction, hospitality and transport sectors. There was general agreement that the primary victims of phoenix activity are the tax authorities (who are the primary creditor) and the legitimate competitors of the phoenix company (who are prejudiced by the resulting unfair competition). It was also acknowledged that other creditors, such as service providers, consumers and employees, also tend to suffer losses if their services are not required by the phoenix entity.

While the comparative study did not identify any 'big idea' which would eliminate the problem, it was encouraging that many jurisdictions (including Ireland) appeared to possess many of the legal instruments that had been successfully deployed in other jurisdictions to contain the problem. The research will therefore prove valuable in helping regulators in particular to refine the measures, practices and procedures necessary to tackle successfully the phoenix phenomenon.



The Report on Regulation of Phoenix Companies

The Director remains anxious to detect any such activity in the State, so that he can act to minimise its disruptive impact on genuine businesses. A copy of the Report entitled 'The Regulation of Phoenix Companies' is available at [www.insolvencyreg.org](http://www.insolvencyreg.org).

## Conclusion

As a result of the regime of mandatory reporting introduced for the liquidators of insolvent companies a little over two years ago, the ODCE has received reports on more than 1,200 insolvent companies. Following our examination of the liquidators' recommendations in these reports, we have determined that the directors of more than 300 of these companies should defend their behaviour in High Court proceedings for restriction. As a result of proceedings concluded to date, the High Court has deemed it appropriate to restrict about 500 directors for irresponsible conduct in the management of their failed companies.

As the primary legal sanction for irresponsible behaviour in insolvent companies, restriction has been increasingly applied by the High Court in the last two years. Disqualification is a more serious civil penalty, which can be imposed for misconduct with respect to both solvent and insolvent companies. Both orders are primarily made in order to protect the interests of potential future creditors in company commercial affairs. A disqualification application is a useful complementary option to those of restriction and criminal prosecution, and the ODCE plans to make more use of this measure in the future in order to sanction suspected misconduct and alert the market to past misbehaviour.

The result of ODCE's initial work (in tandem with that of liquidators and the Courts) is that the market is becoming a potentially safer place for the development of companies, at least in terms of making information available to the market on past misbehaviours and safeguarding genuine business from the ravages and uncertainties of unscrupulous business conduct. This Office would therefore encourage all directors who are unfortunate enough to have been restricted or disqualified to take the necessary action to comply with the law. If they fail to do so, the ODCE will consider bringing them before the Courts again, and our experience to date is that the Courts do not have much sympathy for defendants who default on orders made by the High Court.

<sup>39</sup> Section 319 of the Companies Act 1963 (as amended by section 52 of the Company Law Enforcement Act 2001).