

EXAMINERSHIP IN PRACTICE

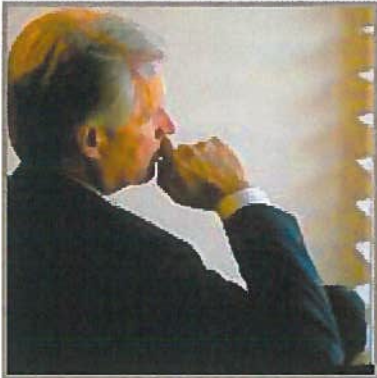
AVEHICLE FOR CORPORATE RECOVERY

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Examinership in Practice:
A Vehicle for Corporate Recovery

Given the non-exhaustive content of this booklet a company's management should seek detailed advices from experienced corporate recovery professionals at the very earliest stage of their deliberations.

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“In grave difficulties, and with little hope,
the boldest measures are the safest”

King Charles I, 1635

What is Examinership?



Examinership is a process whereby the protection of the Court is obtained to assist the survival of a company. It is quite a technical procedure and is not widely used. Essentially it allows a company to restructure with the approval of the High Court. The process usually results in creditor balances being reduced, while intangible assets of the company are protected, investment is obtained and in the short term at least, directors retain control.

Examinership is an option available to an insolvent company that enables it to explore all opportunities to provide for its survival. It is a management friendly process that is inclusive of customers, creditors, suppliers and staff.

1 *Introduction*



The appointment of an examiner to companies in difficulty became possible following the emergency enactment of the Companies Act 1990. The examinership provisions arose as a result of the imminent collapse of the Goodman Group of companies, with the attendant catastrophic effect this would have had on the Irish beef industry in particular, and the spin-off effects it would have had on the economy as a whole with its agricultural basis at that time.

The Irish legislation reflects the pro-active self-help provisions of U.S. Chapter 11 type protection afforded to companies. In this regard it is distinguished from the rather more onerous administration provisions of U.K. company law.

The activities of a company under the protection of the High Court are subject to the scrutiny of a High Court Judge.

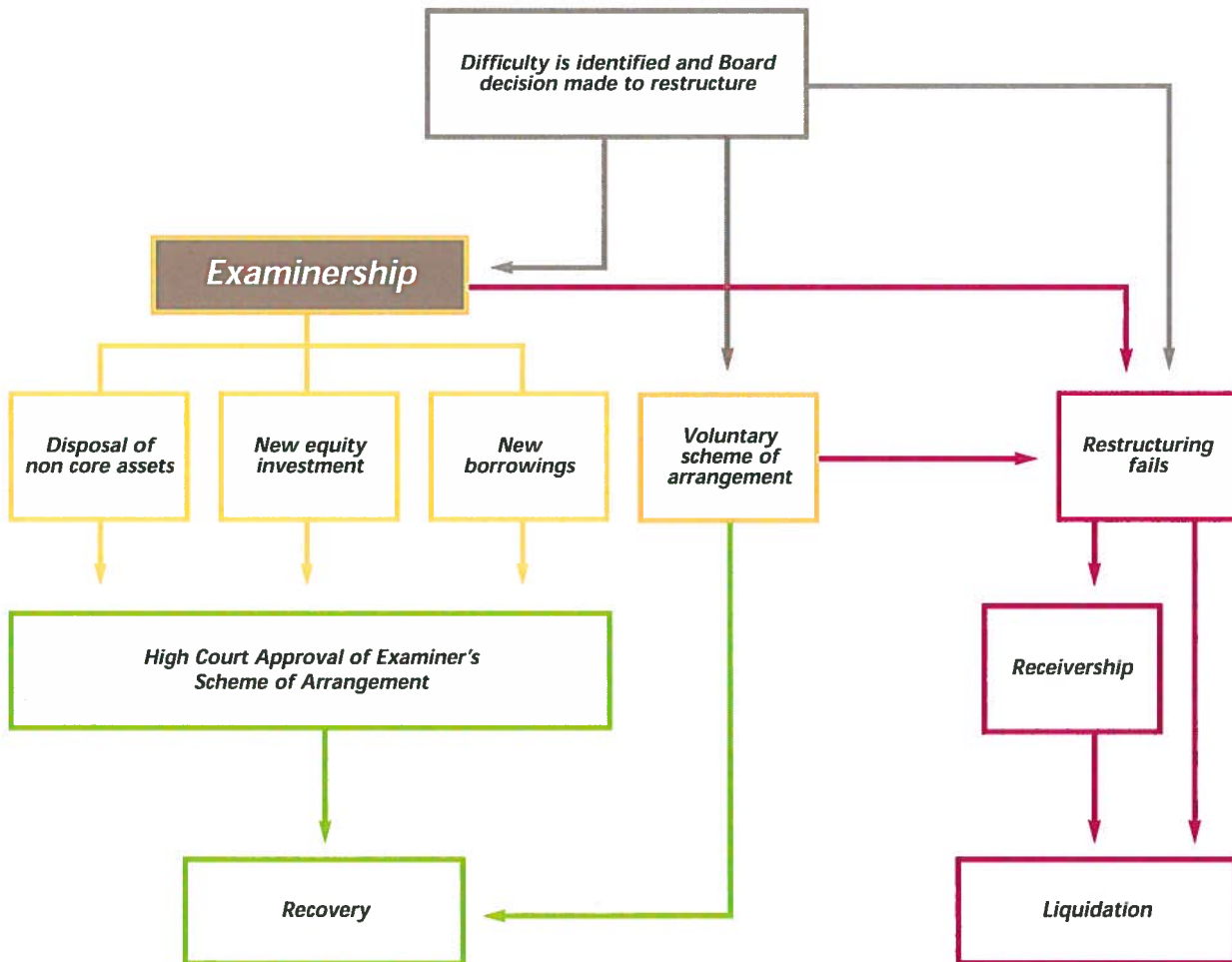
The system is almost self-regulating because with few accountants and solicitors operating within the area, their integrity as officers of the Court is of paramount importance. Where the assigned Judge finds that the highest standards have not been met by the company or the examiner or that there has been any failure by petitioners for the protection of the court to disclose all material facts the Courts have been unequivocal about removing the company from the protection formerly afforded to it.

At the very outset, this analysis does not purport to set out an exhaustive statement of the law or practice in examinerships, insolvency or corporate recovery.

It is meant to highlight certain circumstances whereby the owners and management of companies should consider the appointment of an examiner as potentially a positive step for both the company and its creditors, following a period of difficult trading conditions.

Introduction continued

The following diagram illustrates where examinership can fit into the corporate recovery process:



2 *Examinership - An Alternative*



In the very short term, the appointment of an examiner to a company provides breathing space for the company, where normal corporate recovery measures are not available. The immediate advantage is the protection of the Court for the company against its creditors thereby enabling it to continue to trade and to attract investment on more favourable terms than would be the case where the threat of the immediate demise of the company is the only alternative.

In the medium to long term, the examinership process facilitates the company's restructuring by making provision for investment and the sanction of the High Court to a scheme of arrangement with the creditors of the company.

The Start:

How is an Examiner Appointed?

CANDIDATES FOR EXAMINERSHIP

There are two criteria for determining whether a company is a candidate for examinership; the first being satisfying the tests set out in the Companies Acts, the second being commercial considerations.



STATUTORY PROVISIONS

At the outset, the company must be insolvent and unable to pay its debts in order to have an examiner appointed. It must also be able to demonstrate that it has a reasonable prospect of survival. In addition, no examiner can be appointed to a company if an official liquidator has been appointed, or where a receiver has been acting for a period longer than three days.

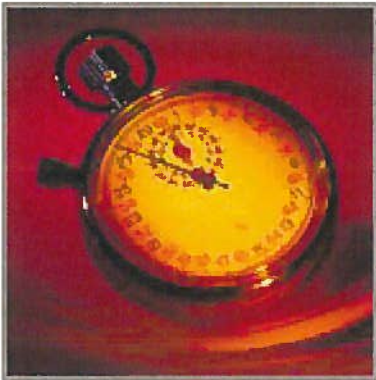
The statutory requirements can be summarised as follows:

1. The company commissions an independent accountant's report. This report must contain certain specific information; most importantly that the company has a 'reasonable prospect of survival' as a going concern provided the examinership is successful, and in particular that the likely result of the process would be more advantageous to the creditors than a winding up.

Further expansion on this crucial 'reasonable prospect of survival' point is required from the independent accountant. Normally their report will point out that the company must secure investment sufficient to facilitate a compromise with its creditors, or scheme of arrangement, in order to be capable of survival.

2. The independent accountant must confirm that there is no deficiency in the finances of the company that is not satisfactorily accounted for and that the company has sufficient funds to trade throughout the period of protection.
3. The independent accountant must supply the Court with the necessary cash flow projections and statements of affairs to vouch the conclusions drawn in his report.

Normally the directors or shareholders of a company petition the High Court to have an examiner appointed. However creditors of the company, both actual and contingent (including the company's employees) may also do so. In practice it is rare for creditors of the company to have enough information about the affairs of the company to successfully petition to have an examiner appointed.



COMMERCIAL CONSIDERATIONS

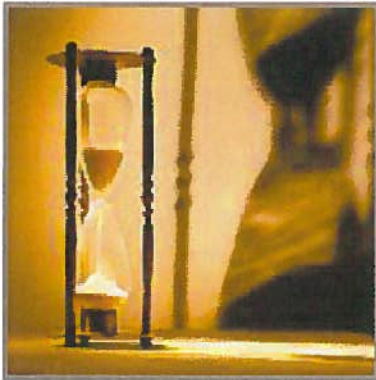
Whether the company is likely to attract investment is the key factor having regard to the examinership option. Among the questions that should be considered to determine whether the company is likely to attract investment and is a candidate for examinership are as follows:

- Is the company likely to survive in whole or in part as a going concern, or is the company 'terminally insolvent'?
- What are the assets of the company?
- What are the liabilities of the company and how are these liabilities secured?
- Are the assets of the company easily sold?
- Are the assets of the company sufficiently large to justify the costs of examinership?
- What is the staffing position of the company (number of staff and length of service) and what will their reaction be to the likely changes following examinership?
- What is the regulatory position of the company including licenses, environmental matters, key customer audits, planning permissions, etc.
- What is the level of outside investment required to put together a scheme of arrangement to be put to the creditors?

The process to petition to have an examiner appointed is a rigorous one and care must be taken to ensure that all of the statutory tests are met. In addition it can be a costly exercise and the company must be prepared to commit resources to discharge the costs associated with it.

The Middle:

What is the Role of the Examiner?



THE PROTECTION PERIOD

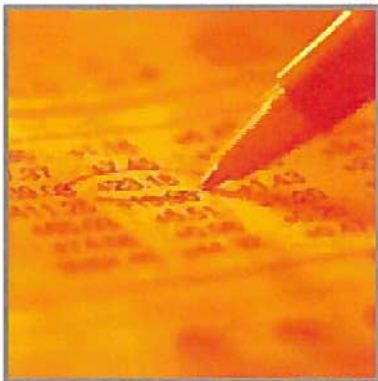
The protection of the Court is offered for a period of 70 days, which can be extended by application to the High Court to 100 days and further in exceptional circumstances. Typically the examiner assumes his role at a time of crisis and of great uncertainty for the company, its creditors and employees.

The statutory duty of the examiner is set out in the Companies Acts. It is to conduct an examination of the company's affairs with a view to formulating proposals for a scheme of arrangement, for presentation to meetings of the company's shareholders and creditors, for the ultimate approval of the Court.

Although independent of the directors, in practice however, a significant amount of the examiner's time will be dedicated to working with the directors of the company to restore confidence in the company and its trade where this has been lost.

To enable a company to trade in the protection period the examiner must successfully manage an inclusive process involving the company's key customers, suppliers, management and staff. The process is inclusive of all aspects of the company's business and is 'management friendly' and in that regard must be distinguished from the unilateral nature of receivership and liquidation.

The Role of the Examiner - continued



The examiner will also immediately communicate with all creditors, customers and staff to explain the process and its effect on the company's ongoing operations.

Certain creditors and staff will often react badly to the news of an examiner's appointment. It is common for disgruntled creditors with claims for retention of title to move to repossess their property. The company resists these claims with the protection afforded by the Court, thus forming a sound platform for the examiner to sell assets and/or attract investment to provide for the survival of the company.

A key power of the examiner is to 'certify' ongoing expenses of suppliers, with the effect that should these suppliers continue to supply the company on credit during the protection period, their post-petition certified accounts will enjoy priority over all other creditors except a fixed charge holder, should the examinership process prove unsuccessful and the company be wound up.

The examiner must carefully monitor the cash flow of the company throughout the protection period to ensure the company trades in accordance with the projections furnished to the Court at the petition stage.

It is important to note that although the examiner has a right to access all books and records of the company and a right to attend all board meetings, the examiner does not usually usurp the executive function of the board of directors. For example, it is unusual for the examiner to become a signatory on the company's bank account.

The End:

How does a Company Successfully Emerge from Examinership?



THE FORMULATION OF A SCHEME OF ARRANGEMENT

In order for the Scheme of Arrangement (“the Scheme”) to be successful the examiner must persuade at least one class of creditors to accept the Scheme before it can be brought before the High Court for approval.

In addition he must ensure that all creditors within a class are treated the same way. The formulation of the scheme will usually cause some degree of discontent in at least one of the classes of creditors identified by the examiner.

The first task of the examiner is to divide the body of creditors into different classes. The formulation of the Scheme is the examiner’s attempt to share out a limited fund usually following some form of investment, between competing claims of different classes of creditors.

The typical Scheme will involve a secured creditor receiving all of the funds owing to them, but sometimes by way of instalments and at times will involve some writing off of interest. The preferential creditors will usually receive a substantial dividend on foot of their liabilities whereas the unsecured creditors will generally receive much less.

The key to having the examiners proposals for a Scheme approved by the creditors is to formulate and present the Scheme in such a way that it is clear that the creditors will secure a more advantageous outcome for themselves by endorsing the examiners proposals, than would be the case should the company be wound up.

How does a Company Successfully Emerge from Examinership - continued



A central part of the process is for the examiner to predict the likely attitude of the different classes of creditors to his proposals and formulate the Scheme accordingly. It is often the case that those creditors who vote against the examiner's proposals feel that they have been unfairly prejudiced by the Scheme and that they would be in a more favourable position if the company went into liquidation.

Following the formulation of the Scheme it must be put to the vote of both a meeting of shareholders and creditors. Once the shareholders and creditors meetings have considered and voted on the Scheme the examiner must revert to the Court with a report on the outcome of the meetings and any modifications of the proposals adopted at the meetings.

This report is designed to indicate to the Court the views of the various classes of the company's creditors. Obviously the Court will be inclined to approve a Scheme where it enjoys considerable support.

An examiner is permitted to formulate only those proposals which make it likely that the company will survive as a going concern, in whole or in part.

3 The Advantages of Examinership



ADVANTAGES FOR THE COMPANY

Promoters retain control

A liquidation or receivership is marked by the director's immediate loss of control of the company.

In the majority of cases the promoters of a company are personally and financially linked with the company and most will do what they can to help ensure that the effect of the insolvency of the company will be mitigated to the extent possible on the staff, the customers, the suppliers to the company and indeed themselves.

In addition normally the promoters of the company are the people most familiar with the company, likely investors, industry colleagues and other companies that may be interested in the opportunities presented by the examinership.

The process facilitates the promoters mining their knowledge of the industry to find a party to invest and thereby reduce the effect of the situation on those least able to protect themselves.

Protection of the company during the process

An obvious advantage of examinership for a company is the avoidance of numerous risks for the company, in particular:

- A receiver cannot be appointed by the company's debenture holder while under the protection of the Court;
- A petition cannot be presented to the High Court to have an official liquidator appointed;
- No goods may be seized or claimed by any creditor through the Sheriff, no goods held under a lease or a hire purchase agreement may be repossessed by the leasing company and no goods the subject of retention of title can be repossessed without the consent of the examiner;
- No other proceedings may be commenced against the company without the consent of the Court;
- Personal guarantees cannot be enforced during the examinership process. In certain circumstances, a personal guarantee may not be valid following the approval of the High Court of the examiner's proposals for a scheme of arrangement.



Company Maintains Intangible Assets

In an increasingly regulated market often one of the most difficult things for growing companies to achieve, are the regulatory approvals appropriate to the particular industry sector. Delays in granting approvals, planning permission, licenses etc., can often frustrate a company's ability to expand or to take advantage of market conditions.

Once certain approvals are obtained, however they remain assets of the company, of use only to the company and are not transferable to third parties.

In addition to formal approvals required by statute, in many circumstances particular industries have further due diligence and key performance indicators between supplier and customer that extend beyond statutory requirements.

Typically for example, retailers that are large volume purchasers of items that may be prone to product liability claims will carry out research about manufacturing processes of supplier companies so as to ensure that the manufacturers supplying them do not expose them to third party claims. In these circumstances, vital supplier certification will issue to the manufacturer by the retailer.

The approved supplier certification is a non-transferable asset of the company and usually survives the examinership process intact, even following third party investment in the company. When presented with a company under the protection of the Court, an investor has an opportunity to avail of the 'upside' of that company: it's licenses, customer audits, etc; while avoiding the downside: the company's historical debt, which is discharged in the scheme of arrangement.

In addition to the above as the company in examinership normally cannot fully cease to trade the company has the opportunity to retain:

- the customer base and existing contracts;
- the goodwill;
- key staff;
- management.



ADVANTAGES FOR CREDITORS

Maximisation of the value of assets and goodwill

The value of assets of a company on a winding up as opposed to on a going concern basis is fundamentally undermined by the very fact the company is in liquidation. Unless a company has significant unsecured assets the reality is that unsecured creditors are more often than not unlikely to receive anything from a company that has gone into liquidation.

Probability of dividend

A successful examinership will always mean some form of dividend to the unsecured creditors and in practice the examiner will prove that the dividend is better than could be expected on a winding up. Accordingly where it is appropriate, even irate unsecured creditors should encourage companies entering the process.

Opportunity to continue to trade

Many creditors will support a company in examinership and vote for an examiner's proposals for a scheme of arrangement, in the hope that future trade with the company may recoup some of the money lost from the circumstances that gave rise to the appointment of the examiner.

4

The Disadvantages of Examinership



DISADVANTAGES FOR CREDITORS

Disadvantages for secured creditors

In the normal course a secured creditor will be able to rely on their security to recover any money owed by the company. Where an examiner is appointed however, their normally unassailable security can in certain circumstances be compromised by the Court's approval of a scheme of arrangement.

Should the scheme of arrangement not be approved and the examinership not succeed, the costs and expenses of the examiner also rank in priority to the security held by a charge holder and must be discharged in priority to the charge holder on the liquidation of the company.

Disadvantages for unsecured creditors

Where an examiner is appointed to a company and fails to secure investment in the company or the sale of assets to enable it to survive, the dividend to an unsecured creditor in the liquidation will also be reduced as the costs and expenses of the examinership will be paid out of the assets of the company.

5

Conclusion *A Vehicle For Corporate Recovery*



For a company in financial difficulties, examinership provides:

- Time;
- Protection from creditors;
- A framework to agree a compromise with creditors.

Examinership is often the last throw of the dice for companies in difficulty. It is not an appropriate relief for all companies and is not appropriate in many situations.

It is possible that due to its technical nature the procedure is not very popular, but it is a very useful weapon in the armoury of the company in financial difficulties; the director seeking to protect their personal interests, the creditor seeking to maximise his return or the investor seeking reduced risk in their investment.

In investment situations where procuring warranties and indemnities from directors is problematic, an examiner may provide the certainty required to facilitate investment.

Given the advantages to all parties connected to a company in financial difficulty that comes through examinership successfully, it is a matter that should be considered with advice from experienced professionals at the earliest possible time.

