



Examinership: a process of saving jobs while taking care of creditors' interests

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Introduction

According to the EU Commission, it is estimated that 200,000 companies become insolvent in the EU each year (or 600 a day), resulting in 1.7 million direct job losses every year. The EU Commission suggests that a significant percentage of companies and related jobs can be saved with the implementation of preventive procedures. As a result, in November 2016 the EU Commission issued a proposal for a Directive to promote early restructuring to support growth and protect jobs. The Directive is expected to be enacted within the next two to three years.

However, a concept aiming to support growth and protect jobs has been used with success for many years in various EU countries. An example of this is the concept of Examinership, which is used in Ireland. Following Ireland's example, Cyprus introduced the concept of Examinership into its legal system in 2015, using the Irish model as a basis.

The aim of this report is to set out the basic steps involved in the process of Examinership and point out some key parameters that need to be present in order for Examinership to be successful.

Overview

Examinership applies to insolvent companies and provides a period of protection to the company. During this period the creditors are prohibited from bringing any action against the company. The creditors, together with the company, are expected to try and reach a compromise with regards to the debts and obligations of the company.

An Examiner is appointed to assess the affairs of the company and formulate proposals for its survival. The proposals must not put the creditors as a whole in a worse position compared to their current position in case of liquidation. An important aspect is that the company has the right to continue to trade during Examinership.

Purpose of Examinership

The main purpose of the whole process is to examine the prospects for the survival of an insolvent company. The primary objectives pursued are the continuation of the business of the company and saving as many job positions as possible.

According to Clarke J. in *Re Traffic Group Ltd*:

The purpose of Examinership is "... to enable, in an appropriate case an enterprise to continue in existence for the benefit of the economy as a whole and, of equal or indeed greater importance, to enable as many as possible of the jobs which might be at stake in such enterprise to be maintained for the benefit of the community in which the relevant employment was located".

The Examinership process

Starting the process

The process starts with a petition to the court for the appointment of an Examiner. The company is placed under the court's protection for an initial period of four months, from the date the petition is presented. The period can be extended for another two months if necessary. The examiner's objective is to assess the company's affairs and examine whether it is possible to rescue the company. If the examiner believes that a rescue is possible, then he must prepare a rescue plan towards this purpose.



Court's protection

The effect and scope of protection allowed to the company results in an automatic stay of any creditors' actions and also protects the guarantors of the obligations of the company, since the creditors cannot turn against them. In addition, no petition for the winding-up of the company can be brought and no receiver can be appointed. Finally, no claim can be filed at a court against the company without a leave from the court.

Presenting a court petition

The court petition for the initiation of the process can be presented by:

- a) Any member or members of the company holding at least 10% of the voting share capital;
- b) A guarantor of the obligations of the company;
- c) Creditors of the company;
- d) The company itself.

Appointment of an Examiner

The following conditions must apply for the appointment of an Examiner:

- a) The company must be unable to pay its debts;
- b) No resolutions for the winding-up of the company must have been passed;
- c) No order by court must have been made for the winding-up of the company;
- d) No receiver must have been appointed during the last 30 days preceding the petition;
- e) There should be reasonable prospect of survival.

It is important to note that the Examiner should be a natural person who is a licensed insolvency practitioner. George Z. Georgiou & Associates LLC has licensed insolvency practitioners as part of the Firm. In the following two sections the conditions regarding the inability of the company to pay its debts and the reasonable prospect of survival will be analysed in more detail.

Unable to pay its debts

Under the concept of Examinership, a company is considered "unable to pay its debts" if it cannot pay them as they fall due. Thus, if a company has a debt obligation which will be due and payable in a certain number of years, it should be in a position to pay it at the time it is due. If, at a given time, a company is not in a position to pay a debt which has not yet become due, it is not considered "unable to pay its debts".

Another possibility where the company will be unable to pay its debts is when the value of its assets is less than the value of its liabilities. Also, if a creditor to which the company owes a sum in excess of €5000 and who has made a written demand to the company for payment, but the company has not satisfied such a demand, it will be deemed as inability on the part of the company to pay its debts.

Finally, the company will be considered as unable to pay its debts if a judgment or another court order was obtained by a creditor against the company and courts, which remained unsettled.

Reasonable prospect of survival

The court, in order to allow the company to enter into Examinership, must be satisfied among others that there is reasonable prospect of survival. For this purpose, the petition to the court must be accompanied by an independent expert's report who is usually prepared by the company's auditor or an independent insolvency practitioner. The report contains the expert's opinion as to whether there is reasonable prospect of survival which must be based on evidence.

The expert is also expected to provide (among others) opinions and recommendations on the following:

- Whether continuance of the company as a going concern will leave stakeholders and creditors as a whole better off compared to liquidation;
- Whether the formulation of proposals for compromise with the company's creditors will facilitate such survival



The court has discretion to either approve the appointment of an examiner or reject it regardless of the statements in the expert's report.

As Justice Kelly in *Vantive Holdings Ltd v Companies Acts (2009)* stated:

"... I have the greatest reservations about the projections on which the independent accountant has relied in forming his opinion. They appear to me to be lacking in reality given the extraordinary collapse that has occurred and the lack of any indication of the revival of the fortunes in the property market. The valuations in question are out of date and can hardly be described as truly independent. I am not satisfied that the petitioners have discharged the onus of proof of showing that there is reasonable prospect of the survival of the company"

Duties and powers of the Examiner

When the appointment of an Examiner is approved by the court, the Examiner will undertake the main duty to examine the company's affairs and, if considered appropriate, to develop a rescue plan (also known as a "scheme of arrangement") for approval.

In order to fulfil his duties, the Examiner will be entrusted with the following powers:

- The Examiner has the same rights and powers as those of the auditors of the company. These powers enable the Examiner to formulate proposals for the survival of the company. During the period of Examinership the directors of the company maintain control;
 - However, the Examiner may have the powers of the directors vested in him by order of the court if this is considered to be in the best interests of the company. These will include management and borrowing powers.
- Convene and attend any general meetings or directors' meetings;
- Prevent the company from acting in a manner in relation to its assets, if the Examiner is of the opinion that this is likely to be detrimental to the company;
- To dispose of charged property with the approval of the court;
 - Even if charged property is disposed, the holder of the charge, (i.e. the person for whose benefit the company's property is charged) must maintain its priority compared to other persons who are not holders of any charge;
 - In case of disposal of a fixed charge the net proceeds of the disposal will be paid firstly towards the discharge of the obligation, so the company is secured by the charge, and if there is any excess amount, it can be used towards other liabilities of the company.

Expenses of Examinership

Certain liabilities incurred during the Examinership process may be considered as "properly incurred" by the Examiner. This will usually be the case with expenses that will contribute to the company's survival during the period in which the company is under the process of Examinership. Examples of these expenses include utilities, salaries and supply of raw materials.

Such liabilities, even though incurred after the petition for Examinership, will be paid in preference to certain other creditors. These liabilities may well be contested before the court by any person who does not agree with the preferential status of these liabilities, thus the examiner must be in position to justify that those liabilities were properly incurred and that they were necessary for the company's survival.

Overriding of contracts

The Examiner has the power to stop, prevent or rectify any actual or proposed act, omission, course of conduct, decision, contract or any term of a contract which were created before the appointment of the Examiner, if he is of the opinion that any of these is or may be detrimental to the prospects of survival of the company.

Any person suffering loss, under certain circumstances may apply to the court to consider whether the Examiner's proposed action to override the contract or any term contained in the contract was necessary under the circumstances.



Scheme of arrangement

It is the duty of the Examiner to develop a plan for the survival of the company also known as a scheme of arrangement. The scheme of arrangement contains the proposals of the Examiner as to how the company could survive.

The proposals must:

- Specify each class of members and creditors;
- Specify classes of members and creditors whose interests will be impaired by the proposals and classes whose interests will not;
- Treat each member within each class equally;
- Provide for the implementation of the proposals;
- Specify whether changes should be made to the management of the company;
- Include other matters that the Examiner deems appropriate;

Approval of the proposals

The preparation of the scheme of arrangement by the Examiner, must be sanctioned by the court. However, before reaching the stage of court sanctioning there are some other steps to be undertaken by the Examiner:

- The Examiner may convene meetings of members and creditors and may appoint a committee of creditors;
- During the meetings the proposals are discussed and are either approved, rejected or subject to modifications;
- The proposals must be approved by the majority in value of the creditors represented at the meeting.
- The Examiner prepares a report describing the outcome of the members and creditors meetings as well as the Examiner's proposals;

Confirmation by court

After the above procedure is concluded the proposals will be put before the court for approval.

The court will examine whether the proposals are just and equitable having regard to the survival of the company as a going concern, saving of job positions and not to put creditors in a worse position than in the case of the company's liquidation.

The court will confirm the proposals if:

- At least a class of creditors whose interests are impaired by the implementation of the proposals accepts the proposals;
and
- The proposals are just and equitable towards any class of creditors or members that has not accepted the proposals and whose interests are impaired by the implementation;
and
- The proposals do not affect in an adverse and unfair manner the interests of any interested party;

Once confirmed by the court, the proposals become binding upon the various parties affected by them.

Right to object

Any member or creditor whose interests would be impaired by the proposals may object to the court on any of the following:

- There was some material irregularity in either the creditors or members' meetings;
- Acceptance of proposals was obtained through improper means;
- The proposals were put forward for some improper purpose;
- The proposals unfairly prejudice the interests of the objector.



For a successful outcome

There are some requirements that need to be present for the Examinership to be successful. The most important are:

- The company must have sufficient cash flow that will enable it to cover running expenses during Examinership;
- The classes of creditors affected by the Examinership must be willing to accept a compromise and cooperate with the Examiner;
- External investments for the funding of the proposals must be obtained.

Where the above requirements are present, there is a higher possibility for a successful outcome of the Examinership.

Recent example

Given that, there are not any cases yet in Cyprus in which the process of Examinership was put in practice, we provide a recent example from Ireland, where the process of Examinership was applied with great success. This is the case of Debenhams Retail Ireland Ltd. The key points are:

- A scheme of arrangement was approved by the vast majority of creditors and by the court in August 2016;
- Unsecured creditors will receive 5% of total amount owed to them compared to nil in case of liquidation;
- The company secured significant cost savings under the scheme that allow it to continue to trade;
- Cost saving proposals were accepted by employees' unions;
- Agreements with landlords were reached;
- Parent company agreed to invest in the form of a loan;
- No compulsory redundancies, only voluntary.

Following the Examinership, the company announced profits for 2016 of €19 million compared to loss of €5.8 million the previous year. The company managed to reduce its costs and increase its revenues. The number of staff employed fell by 127 but 1508 persons are currently employed by the company. According to a note by the directors attached to the financial statements, the company has reasonable resources to enable it to continue for the foreseeable future.

Conclusion

The Irish model of Examinership has proved successful and has contributed towards the survival of many companies as well as jobs. The Cypriot model of Examinership, which is based on the Irish model, can prove to be a very helpful tool in the hands of any party interested in the survival of a company and the saving of jobs.

Provided that creditors cooperate and external funding for proposals is available, it should be expected that the outcome of Examinership for a company is successful.



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