INTRODUCTION

1. In the current environment, clients are naturally concerned about borrowings and the extent to which they are personally exposed in relation to those borrowings and how much they could potentially lose. Aileen's paper deals with advising clients on asset protection in the backdrop of exposure to borrowings. The purpose of this paper is to look at insolvency and particularly, how the insolvency procedures limit an individual's ability to deal with their assets both prior to the invocation of the insolvency procedures and during the insolvency procedure. The main focus of the paper is on the bankruptcy procedure and on specific issues raised in Aileen's paper in particular:

    (a) bankruptcy procedures
    (b) family home
    (c) secured creditors/charged assets and priority on distribution
    (d) setting aside pre-bankruptcy transactions

2. Insolvency law concerns mainly collective procedures whereby a debtor's assets are administered for the benefit of all its creditors. There are a wide range of legal collection and enforcement mechanisms available to an individual creditor in seeking to enforce his debt against a debtor. The characteristic of the bankruptcy method is that it is a group collection procedure, the principle object of which is to make the insolvent person's assets available to his creditors. The bankruptcy regime is regulated by the **Bankruptcy Act, 1988** (hereafter referred to as "the 1988 Act") and **Order 76 of the Rules of the Superior Court**. (**For further discussion of bankruptcy see Bankruptcy Law, Forde and Simms and Bankruptcy Law and Practice in Ireland, Sanfey and Holohan**). While there had been relatively little activity in the bankruptcy area in the past decade, the question is whether the current state of the economy will mark an increase in activity in this area.

3. Mindful of the use of corporate vehicles, the position on liquidation is also briefly discussed. The main method for dealing with insolvent companies is the liquidation procedures (**see ITI Seminar on Examinerships, Receiverships and Liquidations: Legal and Taxation Aspects (September 2009) (McGuire and Fitzgerald)** for a full discussion on

company liquidation and other insolvency procedures). While the focus of this paper is on individuals and bankruptcy, there is a short section on company liquidations and some specific issues including

(a) liquidation procedures

(b) personal liability for directors and directors loans

(b) personal guarantees.

BANKRUPTCY

4. Most commercial businesses are carried on through companies with a separate legal personality and usually with limited liability such as to afford the promoters of the business protection from bankruptcy in the event of the enterprise going wrong. However there is an exposure to bankruptcy for the promoter/shareholders in a case where the company's liabilities are secured by the owner's personal guarantee. It is very common, particularly in the case of small family owned companies that the banks will insist on personal guarantees in respect of the company borrowings. Furthermore there are a number of professions such as barristers, solicitors and accountants who cannot carry on a business. It is also possible that a non-trader can be made bankrupt in circumstances where that person borrowed to finance consumer expenditure.

5. The main objectives of bankruptcy legislation are as follows **(*Bankruptcy Law Committee Report (the Budd Report) para 1.13.1*):**

(a) To secure the equal distribution of assets of a debtor and to prevent any one creditor obtaining an unfair advantage over the others.

(b) To protect bankrupt from creditors by freeing them from the balance of the debts where they are unable to pay them in full and to help rehabilitate them.

(c) To protect creditors, not alone from debtors who prior to the bankruptcy prefer one or more creditors to others, but from the actions of fraudulent bankrupts.

(d) To punish fraudulent debtors.

6. The bankruptcy process aims to reduce the costs of uncoordinated action on the part of a debtor's many creditors. The legislation seeks to balance the interests of the creditors against the protection of debtors. The fact that debtor protection is one of the number of objectives does not mean that the Bankruptcy Act is a debtors charter. Other jurisdictions tend to be more in favour of debtor protection than in this jurisdiction.

7. There are a number of special situations to which special rules apply in relation to bankruptcy. Where a bankruptcy has intra EU impact it is governed by the EU Regulation 1346/2000 on insolvency proceedings (see below). There are also special rules in relation to the bankruptcy of partnerships, the bankruptcy of a deceased's estate and in relation to an employer. These special rules are beyond the scope of this paper.

Procedures

8. The following are the basic steps in the bankruptcy process:

(a) Arrangements:

In order to avoid bankruptcy a debtor may try to seek a settlement with all of his creditors which can be ruled on by the Court and in which case can avoid a bankruptcy scenario.

(b) Petition of Bankruptcy:

Where the debtor cannot or refuses to pay his debts the creditor can petition the Court to have him adjudicated bankrupt where the Petition is granted, the debtors property become vested in either the Official Assignee or alternatively the Creditor's Trustee.

(c) Vesting property

Following the vesting the Official Assignee takes over the management of the debtor's assets and proceeds to realise them. One of the main functions of the assignee or trustee is to investigate the bankrupt in relation to his affairs and to his dealings with his assets which may lead to proceedings in relation to setting aside certain transfers on the grounds that they were fraudulent conveyances or fraudulent preferences, voluntary settlements or improvident dispositions (see later).

(d) Proving debts

This step focuses on the creditors who are required to “prove their debts” which is a formal procedure for establishing that such money is due and owing. Following that, once the costs of bankruptcy have been paid and certain preferred creditors are paid, the remaining balance is distributed amongst the general creditors on a pro-rata basis. In the exceptional case that a surplus arises, that surplus is returned to the bankrupt.

(e) Discharge

If all the creditors are paid in full the bankrupt will be discharged from bankruptcy which entitles him to conduct his business without being effected by the restrictions contained in the act. However, after realising his entire estate if he succeeds in paying his creditors more than 50% in the euro, the Court may order his discharge provided that his preferential creditors are paid in full and in all the circumstances it is reasonable and proper that he should be discharged. The effect of discharge is that he is no longer liable for the debts he incurred prior to being adjudicated a bankrupt.

Bankruptcy petition

9. Where a debtor cannot or refuses to pay his debts his creditor can petition the Court to have him adjudicated bankrupt. The first step in the procedure to have a person declared bankrupt starts with the presentation of a petition to the High Court. A creditor petitioning the High Court is not required to pursue all or any of the other legal options for collection or enforcement available to him.

10. The petition is usually presented by one of the creditors however it is sometimes presented by the debtor himself. The debtor may seek to petition for his own bankruptcy on the basis that it is a method by which he is protected for a period of time which may enable him to come to an arrangement with his creditors and thus avoid having a creditor petition for bankruptcy. Alternatively it may be attractive to the debtor to secure an arrangement whereby his debtors are paid off and he is then discharged from bankruptcy and from his unpaid debts accrued prior to the adjudication of

bankruptcy. There are significant effects of being adjudicated bankrupt and a debtor petitioning for his own bankruptcy must be mindful of these effects (see below). There are of course many other downsides for a debtor pursuing this course of action, for example, the publicity, embarrassment and the inconvenience of such procedure.

11. It may be possible to avoid the bankruptcy process where the debtor and all of his creditors come to an arrangement for the payment of the debts and the discharge of the bankrupt without pursuing the bankruptcy option. There may be business or personal reasons for the creditor to prefer this course of action. Further, the arrangement will secure the prompt payment of the debt and may secure a substantial part of that debt. There are drawbacks for the creditors in agreeing to an arrangement. Firstly, the creditor may be agreeing to a somewhat smaller amount then he would receive under the bankruptcy process. Secondly, without the bankruptcy process there is no investigation into the bankrupt debtor's affairs.

12. As a prerequisite to presenting a High Court petition, the petitioner must be able to point to an act of bankruptcy that occurred within three months prior to the presentation of the petition. It is important to note that an act of bankruptcy does not necessarily mean that the debtor is insolvent. As a corollary the fact that a debtor is insolvent does not necessarily mean that he has committed an act of bankruptcy. The acts of bankruptcy are set out in the 1988 Act (***Section 7 of the 1988 Act***)

13. The most common act of bankruptcy relied on by a petitioning creditor is where the creditor serves a bankruptcy summons (formally known as a debtor summons) on the debtor in a prescribed manner and the debtor does not within fourteen days after service of the summons pay the sum referred to in the summons or secure more compound for it to the satisfaction of the creditor. The creditor must apply to Court for the summons which will only be issued if he can satisfy the Court on a number of matters (**Section 8 of the 1988 Act**):

    (a) a notice in the prescribed form has been served on the debtor;
    (b) the debtor presently owes at least €1,900;
    (c) the debt is a liquidated sum.

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14. It is the practice of the High Court to also require a return of nulla bona in addition to the statutory requirements. In **Harrahill v EC unreported, High Court (Dunne J) 21 July 2008 and ex tempore Supreme Court 20 February 2009** concerned an application for liberty to issue and serve a bankruptcy summons. The case challenged the High Court practice of requiring a return of *nulla bona*. Mr Harrahill, the Collector General applied for liberty to issue and serve a bankruptcy summons in respect of outstanding judgments for unpaid tax against the defendant. In this case the Collector General had not executed the order and consequently there was no return of *nulla bona*. The Collector General challenged the requirement of a return of *nulla bona* as a pre-condition to a successful application to issue and serve a bankruptcy summons.

15. The High Court refused the application and it was appealed to the Supreme Court. The High Court (Dunne J) held that the court has discretion in whether to issue a bankruptcy summons. The return of *nulla bona* is not an absolute pre-requisite for the issue of a bankruptcy summons. If the applicant demonstrates a good reason for the absence of the return of nulla bona then there is nothing to stop the Court in an appropriate case from issuing a bankruptcy summons. However, in this particular case, the applicant did not proffer any good reason for the absence of a return of *nulla bona*. In those circumstances, the Court held that it was not appropriate to issue a bankruptcy summons without the return of *nulla bona.*

16. Geoghegan J in the Supreme Court held that the existing practice of requiring the return of nulla bona was inappropriate and conflicted with the 1988 Act and the Rules of the Superior Courts. In particular, the practice effectively renders the bankruptcy summons procedure redundant in that a nulla bona is an act of bankruptcy in itself. The Court held that there should be no rule of practice that required a *nulla bona* and remitted the matter to the High Court to be reconsidered. It would seem to follow from that decision that a petitioning creditor is not required to have judgment before applying to court for liberty to issue and serve a bankruptcy summons.

17. Where a person petitions to have himself adjudicated bankrupt, the presentation of the petition is deemed to be a declaration of insolvency and thus constitutes an act of bankruptcy. The Court has discretion to refuse the petition for bankruptcy by a debtor if it constitutes an abuse of process on the basis of the facts in the case however it has been held that just because a debtor is trying to protect himself and save himself this does not in itself constitute an abuse of process.

18. In the case of a petitioning creditor, an act of bankruptcy includes *inter alia* fraudulent conveyances and fraudulent preferences (see below).

Effects of adjudication as a bankrupt

19. The effects of adjudication are set out by ***Sanfey and Holohan (pg 52-3)*** as follows:

(a) All property belonging to the bankrupt at the date of his adjudication automatically vests in the Official Assignee for the benefit of his creditors with certain exceptions.

(b) All property (except certain payments in respect of personal injury loss) acquired by the bankrupt subsequent to his adjudication vests in the Official Assignee if and when the Official Assignee claims it. The bankrupt has an obligation to notify the Official Assignee of all after acquired property and the failure to do so is an offence.

(c) The bankrupt's salary or income is liable to be attached in favour of the Official Assignee under court order and the court will decide on the portion to be paid to the Official Assignee having regard to the family responsibilities and personal situation of the bankrupt. The court may also vary such orders having regard to any changes in the family situation of the bankrupt.

(d) A bankrupt cannot act as a director or take part or be concerned in the management of a company without leave of the court.

(e) If a bankrupt obtains credit of £500 (€634.87) or more without disclosing his status as a bankrupt or if he trades under a name other than that which he was made bankrupt, he commits a criminal offence.

(f) A bankrupt may be liable to be prosecuted for various types of criminal offences as specified in the act.

(g) A bankrupt is not entitled to hold elected representative office and if he holds such office and is adjudicated bankrupt, he ceases to hold office.

20. The effects of being adjudicated bankrupt are draconian and very serious for a debtor.

Property automatically vests

21. On being adjudicated a bankrupt, and from that date, all the bankrupt's property vests in the Official Assignee subject to certain exceptions and qualifications. For the purposes of the 1988 Act property is widely defined as including "*money, goods, things in action, land and every description of property, whether real or personal and where situated in the State or elsewhere; also, obligations, easements and every description of estate, interest and profit, present or future, vested or contingent, arising out of or incidents to property as above defined" (**Section 3 of the 1988 Act**)* The effect is that the bankrupt is divested of all his property and his property is very widely defined.

22. The Official Assignee does not acquire title to property which belongs to a third party. Therefore, the Official Assignee does not acquire title to, for example, goods held under a hire purchase agreement or under a retention of title clause. Similarly, where a debtor has mortgaged property the assignee does not acquire title to that property except to the extent of the bankrupt's equity of redemption. Trust property can give rise to issues concerning who actually owns the trust property. These issues arise where any of the parties to a trust, settlor, the trustee of a trust, or a beneficiary under a trust, is adjudicated bankrupt (see Aileen Keogan's paper).

23. Co-ownership is common in the case of certain types of property, for example, the family home and joint banks accounts. The bankrupt's share of any property held as tenants in common automatically vests in the Official Assignee. The bankrupt's share in a joint tenancy is severed and automatically vests in the Official Assignee (see also Aileen Keogan's paper).

24. Certain essentials or necessities required by the bankrupt and his family to live on do not vest in the Official Assignee. These are *"such articles of clothing, household furniture, bedding, tools or equipment of his trade or occupation or other like necessaries for him, his wife, children or dependent relatives residing with him…."* (***Section 45(1) of the 1988 Act***) The bankrupt is entitled to select which of these items he wants but cannot retain more then €3,100 worth of items unless otherwise permitted by the Court.

25. **CASE STUDY** – If Joe is adjudicated bankrupt, the Official Assignee can have recourse to *inter alia* the shares in Construct Ireland Ltd. If Construct Ireland Ltd is liquidated, Joe may be exposed to personal liability:
(1) to the extent that he provided personal guarantees in respect of the company's borrowings,
(2) to the extent that he owed money to the company by way of a director's loan, and
(3) if he is found to have been involved in reckless or fraudulent trading.

After acquired property may be claimed

26. Property acquired after adjudication including a bankrupt's future earnings do not automatically vest in the Assignee (***Section 44(5) of the 1988 Act***). The Official Assignee may apply to Court for directions regarding the earnings which are defined as *"any salary, income, monument or pension"* which he is entitled to receive whether as employee or self employed person (**Section 65 of the 1988 Act**). In making any such order the Court will have regard to the bankrupt's family responsibilities and personal situation. There is some authority that a bankrupt can retain sufficient earnings to maintain himself and his family in reasonable comfort (***Re Walter [1929] 1 Ch 649***). In relation to such property acquired after the adjudication, the property does not vest in the Assignee automatically. It only vests when the Assignee claims it and the purpose of this is to protect any person dealing *bona fide* and for value with the bankrupt (***Section 44 of the 1988 Act***).

27. **CASE STUDY** – If Joe is adjudicated bankrupt, then the Official Assignee may claim his future income as an electrician if it is necessary to satisfy his debts. In any application, the Court will take into account Joe and his family's needs

before making such an order. It would seem that he can retain sufficient earnings to maintain himself and his dependents in reasonable comfort.

Bringing bankruptcy to an end

28. The usual procedure for bringing a bankruptcy to an end is an order discharging the bankrupt to free him from pre-adjudication and provable liability.

29. Discharge will also be ordered where all the creditors have consented, provided that provision has been made to defray the expenses, fees and costs in bankruptcy as well as the preferential debts. In other words, the creditors have consented to the discharge and waived their outstanding claims against the debtor. The Court has discretion to discharge the bankrupt where:

    (1) the bankrupt has made full disclosure of any after acquired property, and
    (2) the Court is satisfied that it is reasonable and proper to order the discharge in the circumstances.

    A further condition is that either the creditors have been paid at least 50c in the euro by the Assignee or Trustee or alternatively a bankruptcy has been in existence for more then twelve years. The principle effect of discharge is the debtor is no longer liable in respect of all his debts and liabilities which could have been proved in bankruptcy.

EU insolvency

30. Both personal bankruptcy procedures and liquidation procedures fall under the EU Regulation on insolvency proceedings (***Council Regulation 1346/2000***). The effect of this is that in the case of debtor having business interests in a number of EU countries, the insolvency proceedings may only be commenced in the country of the debtor's "*centre of main interest*" (***Article 1(1)***).

31. **Re Eurofood (IFSC) Ltd [2004] 4 I.R. 370, [2006] ECR 1-000** is an Irish case and is the first case to deal with the interpretation by the ECJ of the EU Insolvency Directive. The insolvency proceedings commenced in Ireland by

way of the presentation of a winding up petition and the appointment of a provisional liquidator to a subsidiary of an Italian head-quartered Parmalat group. Following that there was an attempt to commence insolvency proceedings in Italy.

32. The ECJ decided inter alia that:
(1) a member state being asked to open 'main proceedings' must consider whether it has jurisdiction to do so,
(2) the appointment of a provisional liquidator constituted the opening of insolvency proceedings, and
(3) in this case the centre of main interests of the Irish subsidiary was Ireland rather than Italy where its parent was based.

BANKRUPTCY – SPECIFIC ISSUES

Family home

33. Aileen's paper refers to the impact of bankruptcy on assets such as the impact on joint assets. There are a number of specific issues that this paper addresses in relation to the impact of bankruptcy on assets.
(1) the impact on the family home,
(2) the treatment of secured creditors, and
(3) the distribution of the estate of the bankrupt.

34. It is very common that the most substantial asset of a bankrupt is the family home. There are special provisions in relation to realising the family home for the purposes of the official administrating the estate. In order to dispose of it, prior sanction of the Court is required and any disposition of the family home without such sanction is void (**for further discussion see The Bar Council, Bankruptcy Law Paper, Sanfey and Farrelly (3 April 2009**).

35. Once adjudication takes place, the property interests including the family home vest in the Official Assignee. If the bankrupt is the sole owner of the property, that property vests in the Official Assignee. Once the spouse's legal and beneficial interest in the family home is established, the Official Assignee is faced with the prospect of realising a share of an asset which he co-owns

with the spouse. Unless the consent of the spouse is forthcoming the Official Assignee will require an order for sale in lieu of partition under the ***Partition Acts, 1868 to 1876***.

36. The prior sanction of the Court is required before there is a disposition of the family home. There is no requirement for consent on the part of the spouse. ***Section 61, Ss(4)*** provides that:

> "*notwithstanding any provision to the contrary contained in Ss(3), no disposition on property or bankrupt, arranging debtor or person dying insolvent, which comprises of the family home within the meaning of the Family Home Protection Act, 1976, shall be made without the prior sanction of the court, and any disposition made without such sanction shall be void*.

37. If the Court has wide discretion to determine whether the home should be sold or whether to order the postponement of the sale, the factors pertaining to the exercise of the discretion are set out in **section 61, Ss (5)** as follows:

> *"on an application by the Official Assignee under this section for an order for the sale of a family home, the Court, notwithstanding anything contained in this or any enactment, shall have power to order postponement of the sale of the family home having regard to the interests of the creditors and of the spouse and dependents of the bankrupt as well to all the circumstances of the case".*

38. This necessitates an application to Court and the Court has discretion in relation to ordering a sale. In making an order for sale the Court has discretion to take certain matters into account including whether to require a postponement of the sale and if so for what length of time. There is no set length of time but in general a short stay would be normal in order to facilitate the bankrupt and his family making preparations for a move to another home.

39. Once adjudicated bankrupt, the spouse cannot initiate family law proceedings against the Official Assignee. If such proceedings are in being at the date of adjudication, they cannot proceed insofar as they relate to the bankrupt's property which includes the family home. However, if prior to adjudication, the

Court orders that the family home or other assets be transferred in the course of family law proceedings, then those transfers will be effective to transfer ownership to the spouse and cannot be set aside by the statutory provisions discussed below (see Setting aside pre-bankruptcy transactions).

40. ***In Re Duffy, a bankrupt,*** the Court postponed the sale for two months. ***In Re Hickey, a bankrupt,*** the order for sale was postponed until the children of the bankrupt attained the age of majority, which in that case was for a period of 5 years. In ***Rubotham (Official Assignee) v Young unreported decision of the High Court dated the 23rd of May 1995*** the Court granted a stay of four months in circumstances where the children were of full age and the proceedings did not come on for seven years post adjudication. In ***Rubotham (Official Assignee) v Duddy*****, unreported decision of the High Court dated the 1st of May 1996,** a stay of ten years was put on the sale while the bankrupt's spouse was ill, of 66 years of age and had lived in the house for 48 years. In that case the value of the house was well in excess of the debts and would have facilitated the repayment of the debt together with interest in recourse.

41. **CASE STUDY** – if Joe were to be adjudicated bankrupt, then his share of the family home would vest automatically in the Official Assignee. The Official Assignee will be required to apply for the Court's direction in relation to the sale of the family home. In giving directions, the Court will take into account the circumstances of the family and is likely to stay the sale for sufficient time to allow the family to make alternative arrangements particularly where there are two children involved.

Secured creditors/charged assets

42. Generally, a secured creditor will not have recourse to bankruptcy proceedings as he ordinarily should be able to rely on his security to recover his debt. Insofar as the security is not sufficient to meet the debt outstanding, the creditor will be unsecured for the balance of the debt. As an unsecured creditor, the creditor can of course resort to the usual creditor remedies including bankruptcy proceedings. The occasion of bankruptcy of a debtor has only a limited impact on the ability of a secured creditor to realise his security.

43. For the purposes of the 1988 Act, a secured creditor is defined as *"any creditor holding any mortgage, charge or lien on the debtor's estate or any part thereof as security for a debt due to him"* (**Section 3(1)**). To obtain payment from the bankrupt's estate, creditors must prove their debts. This is a formal procedure for establishing that the bankrupt is indebted to the person in question and the amount of that liability. The traditional rule is that secured creditors cannot prove for the entire debt and at the same time realise their security. Therefore, in bankruptcy proceedings, the secured creditor has a number of options. The secured creditor can stay outside the bankruptcy entirely and rely on his security and not submit any proof. Alternatively, the secured creditor can realise his security and prove for the balance. The secured creditor can value his security and prove for the balance after deducting the proceeds of the realisation. The Court will not readily interfere with the valuation provided by the creditor. There are statutory safeguards which minimise the risk of creditors submitting incorrect valuations e.g. the Official Assignee is given the option to redeem the security at the value assigned to it by the creditor or can put the security up for sale. Finally, the secured creditor may waive his security for the benefit of the general creditors and prove for the entirety of his debt.

44. A secured creditor is obliged to disclose his security in a petition for bankruptcy.

Distribution to creditors

45. Various categories of creditors are treated differently. It is only the general creditors who rank equally in the division of assets. The priority of distribution is similar to that arising on liquidation on an insolvent company. As noted above, the powers of a secured creditor to realise their security is largely unaffected by the debtor becoming bankrupt (**Section 136(2) of the 1988 Act**). This applies to fixed or floating charge holders. However, in the case of individuals as opposed to companies, while it is technically possible to create a floating charge, in practice it is rarely done. The petitioning creditor does not by virtue of the petition achieve any priority on the bankruptcy. This is an important point for the creditor to bear in mind when deciding whether to petition for bankruptcy. There may not be any assets or sufficient assets available in the bankrupt's estate to meet all the claims including the claim of

the petitioning creditor. Therefore, before embarking on the process, it is important to establish whether the debtor has any money. Sometimes a petitioning creditor will commence or threaten bankruptcy proceedings to try to secure payment. However, sometimes bankruptcy proceedings do not result in any payment of the debt and the creditor may also lose the costs of instituting the proceedings.

46. Before any of the bankrupt's debts can be paid, the costs of administering the estate must be covered. **Section 80 of the 1988 Act** provides that *"the expenses, fees and costs of the bankruptcy shall be payable in priority to the liabilities of the bankrupt in such order as may be prescribed"*. There are no precise rules as to priority other than a petitioning creditor's taxed costs should be paid immediately after other administrative costs.

47. Again, similar to a company liquidation, statutory priority is afforded to Revenue debts. Priority is given to certain Revenue debts namely "assessed taxes" being one year's taxes assessed on the bankrupt up to the 5th of April before the date of adjudication with unpaid employment contributions under the Social Welfare Acts having "super-preferential" status. Therefore, if the bankrupt is a trader, the Revenue is usually the most significant creditor with the result that there may be little or nothing left for the unsecured creditors.

48. Once secured and preferential debts are discharged, the ordinary unsecured creditors are paid provided they have proved their debts. Those creditors are paid *pro rata*. In the unusual case of there being a surplus after payment of all debts, the surplus is transferred to the bankrupt.

Setting aside pre-bankruptcy transactions

49. Aileen's paper focuses on asset protection. The paper noted that asset protection concerns arise in certain situations including situations where there is a potential of insolvency based on existing borrowings, personal guarantees or trading as a sole unincorporated trader. It was highlighted that in these situations the client will wish to divest himself of his good assets so that they are not available to satisfy claims by creditors and at the same time the client will wish to retain control over the assets for his use and enjoyment and/or retain as much control over those assets as possible. In particular, Aileen's

paper looks at transfers to a company owned by the transferor, to a trust set up for that purpose, to the spouse of the transferor and to the children of the transferor.

50. The key concern for clients in transferring assets for asset protection purposes is the wide-ranging statutory provisions that fetter the client's ability to transfer assets successfully. These provisions provide that certain transfers or dealings in assets can be set aside by the Court in certain circumstances. This renders the transfer ineffective as the result of the set-aside is to bring the assets back into the estate for distribution amongst the client's creditors. The other principle feature of these statutory provisions is that they provide a measure of protection for the *bona fide* purchaser for valuable consideration.

51. There are a number of ways in which the bankrupt's dealings in his property can be set aside. The effect of setting aside the transactions is to increase the assets available to the Official Assignee in satisfying the bankrupt's creditors. The Official Assignee has the power to apply to the Court to:

(a) Disclaim onerous property or contracts (**Section 56 of the 1988 Act**).
(b) Set aside Fraudulent conveyances (**Section 10 of the Conveyancing Act, 1634)**.
(c) Set aside Fraudulent preferences (**Section 57 of the 1988 Act**).
(d) Set aside Voluntary settlements (**Section 59 of the 1988 Act**).
(e) Set aside Improvident transactions (**Section 58 of the 1988 Act**).

52. Similarly, on the liquidation of a company, the liquidator has similar powers to apply to Court to set aside certain transactions. The liquidator can apply to Court to:

(a) Disclaim onerous property or contracts (**Section 290 of the Companies Act 1963**).
(b) Set aside Improper transfers/fraudulent conveyances/dispositions (**Section 139 Companies Act 1963**)
(c) Set aside Fraudulent preferences (**Section 286 Companies Act 1963**).

Disclaim onerous contracts or property

53. The Official Assignee has the power to disclaim onerous property or contracts. This power may be used where the bankrupt's estate includes property or obligations which constitute a substantial drain on the resources of the estate. The power is regulated by the Court; the Official Assignee can apply to Court to divest the estate of such obligations thereby reducing the drain on its resources and increasing the value in the estate. The effect of the disclaimer is to extinguish the rights and obligations of the bankrupt in the property and to extinguish the liability of the Official Assignee in relation to the property. However, there is some measure of protection for the other party to the contract/transaction. The power to disclaim shall not, except in so far as is necessary for the purpose of releasing the bankrupt and his property and the Official Assignee from liability, affect the rights and liabilities of that other person.

54. The property and interests which are capable of being disclaimed include *"land of any tenure burdened with onerous covenant, of shares or stock in companies of unprofitable contracts or of any other property which is unsaleable or not readily saleable by reason of its binding the possessor thereof to the performance of any onerous act or to the payment of any sum of money"* (***Section 56(1) of the 1988 Act***). There are certain time limits for the application to be made; the Official Assignee must apply to disclaim within 12 months of the adjudication or, if later, on becoming aware of the existence of such property (subject to extension by the Court).

55. A similar provision applies to companies in liquidation irrespective of whether the company is solvent or insolvent (***Section 290 Companies Act 1963***).

56. The court, in deciding whether to grant the application, balances the position of the Estate and the persons who are affected by disclaiming it. In ***Re: Madeley Homecare Limited [1983} NI 1*** a company held a premises under a 15 year lease. This lease was guaranteed by two guarantors who agreed to pay all the losses arising from the company's failure to perform the covenants on the lease. The company went into insolvent liquidation. The Liquidator applied to disclaim the lease on the ground that it was unprofitable. The lessor opposed the application submitting that such a disclaimer would determine the

lease and free the guarantors from further liability leaving him to his proof in liquidation for any injury he might incur. The Court refused the application to disclaim on the basis that *inter alia:*

(1) the test to apply in such an application was to balance the advantages and disadvantages of the disclaimer to be gained by the liquidator in the liquidation of the company and by the persons affected by the disclaimer (in this case the lessor).

(2) the applicant liquidator failed to discharge the onus of showing that disclaiming would be more advantageous; *prima facie* that the assets available to the liquidator would be less at risk from claims by the guarantor if the disclaimer were refused than from claims by the lessor if the disclaimer were allowed.

(3) a disclaimer should not be allowed where it would destroy the lessor's claims against a solvent guarantor.

57. The disclaimer is most commonly used in the case of leasehold property which is no longer needed and which carries with it a high rental obligation and possibly significant repairing and other obligations. As a result of the obligations, the leasehold property which is no longer needed cannot be sold. In this case, the leasehold property is a drain on the bankrupt's estate. If the leasehold property is disclaimed, this releases the estate from the ongoing obligations arising under the leasehold property. This is subject to the landlord's entitlement to prove for his financial loss associated with the repudiation of the lease.

Fraudulent Conveyances/dispositions

58. It is a fundamental principle of bankruptcy law that where a debtor transfers property to a third party with object of defeating or hindering his creditors and is subsequently adjudicated bankrupt; the Courts can intervene and set aside that transfer. The basis for setting aside such transfers is ***Section 10 of the Conveyancing Act, 1634.*** This power to set aside a transfer is not limited to bankruptcy situations; the Courts can set aside any transaction where there was an intention to delay, hinder or defraud creditors. For example, the fraudulent conveyance provisions may be invoked to set aside the transfer of property if it is done to frustrate a creditor who is attempting to enforce his security over the property, for example, a creditor who is in the process of

obtaining a judgment mortgage. It is not essential that the transferor of the property be insolvent at the time of the transaction although fraudulent intent is more readily inferred in a case where he is insolvent.

59. This provision has been recast in **Section 74(3) of the Land and Conveyancing Act 2009** which comes into effect on 1st December 2009. The purpose of the new section is to replace the complicated and uncertain provisions governing fraudulent dispositions contained in *inter alia* **Section 10 of the Conveyancing Act 1634**. Section 10 is to be replaced by Section 74(3) which provides that any conveyance of property made with the intention of defrauding a creditor or other person is voidable by any person thereby prejudiced. However, there are two savers:
(1) to protect a purchase in good faith, for valuable consideration without notice of the fraudulent intention, and
(2) to ensure that there is no affect on other bankruptcy laws, i.e. the new section does not affect the operation of Sections 57 to 59 of the 1988 Act (i.e. fraudulent preferences, improvident transactions and voluntary settlements respectively) (see below Improper Transfers (Section 139 Companies Act 1963).

60. A fraudulent conveyance is an act of bankruptcy and so a petition for bankruptcy may be brought by a creditor on the basis of that fraudulent conveyance, provided it occurs within three months of the presentation of the petition.

61. The concept of fraud in this context is not the classic concept of fraud found in the tort of deceit. Instead is a concept referable to the disponer having an intention of prejudicing his creditors by putting the asset beyond their reach. In other words he is not acting in an honest fashion in the context of the relationship of debtor and creditor.

62. It has been noted by ***Palles CB*** in ***re: Moroney 21 LR IR Ch 27 [1887]*** that:

> *"… to bring a conveyance within the Statute, first, it must be fraudulent; secondly the class of fraud must be an intent to delay, hinder or defraud creditors. Whether a particular conveyance be within this description it may depend on an infinite variety of*

circumstances and consideration. … the object of the statute was to protect the rights of creditors as against the property of their debtors. It was no part of its object to regulate the rights of credits inter se, or to entitle them to an equal distribution of that property."

63. In the case of voluntary dispositions, that requisite intention may be readily inferred (***Lloyds Bank v Mircan [1973] 3 ALL ER 757 at 759***). While the Courts more readily strike down voluntary transfers, the fraudulent conveyance can also include other transfers for consideration. In the case of transfer for valuable consideration the law does not require that the consideration be adequate. However even if valuable consideration is paid, the transfer may still be susceptible to being set aside if the transferee was privy to the intention to delay or defeat the transferor's creditors. There is protection for the *bona fide* transferee for value and without notice who cannot be deprived of his property. This was noted in the case of ***Brice v Flemming [1930] IR 376*** where Meredith J. stated *"…where there is a bona fide purchase for valuable consideration the transaction cannot be impeached… unless the purchaser is shown to have been privy to the Vendor's intention".*

64. There are a number of indicia of fraud (for the purposes of a fraudulent conveyance) and in an appropriate case the Court may well infer that there is a fraudulent conveyance in such circumstances:

(a) if the debtor disposes of all or virtually all of his property;
(b) where following the transfer by the debtor the property remains in his possession;
(c) if the property is disposed of just prior to the creditor seeking to enforce judgement;
(d) where the transferor reserves some interest in the transferred property;
(e) where the terms of sale give the vendor power of revocation;
(f) where there are false statements in the instrument of transfer;
(g) where the consideration is inadequate then; as regards the deficiency, the transfer may be regarded a voluntary;
(h) where the transferor and transferee are closely related.

65. **CASE STUDY** – If Joe transfers his share of the family home to Mary, this transfer may be open to challenge as a fraudulent conveyance. Whether it is successfully challenged will depend on the circumstances. In this case, if the transfer is a voluntary transfer then it is more likely that a fraudulent conveyance will be inferred than in a case where consideration is received. If it is regarded as a fraudulent conveyance, it constitutes an act of bankruptcy. This means that a creditor may present a petition to the High Court predicated on the transfer as an act of bankruptcy. For this reason it is difficult to take the family home out of the estate in the case of bankruptcy by transferring it to the spouse (see Family Home above).

Fraudulent preference

66. It is a fundamental principal of bankruptcy that all creditors are treated equally and share *pari passu* in the estate of the bankrupt. The Official Assignee has the power to apply to set aside certain transfers of property where those transfers constitute fraudulent preferences (***Section 57 of the 1988 Act***). A similar provision applies to companies (see below, Fraudulent preferences Section 286 Companies Act 1963).

67. Broadly, transfers of property by a person unable to pay his debts as they become due in favour of any creditor and made with a view to giving such creditor a preference over the other creditors are liable to be set aside where the transfers occur within six months of the debtor being adjudicated bankrupt. Unlike the jurisdiction to set aside fraudulent conveyances, this jurisdiction can only be invoked in the course of bankruptcy proceedings and is limited to transfers occurring within the six months prior to adjudication. Again, there is protection for any person who acquired title to the property in good faith and for valuable consideration.

68. A fraudulent preference is an act of bankruptcy and so a petition for bankruptcy may be brought by a creditor on the basis of that fraudulent preference provided it occurs within three months of the presentation of the petition.

69. Again the term fraud is not used in its traditional sense. What are targeted in this case are dispositions of property to one creditor or to just some creditors

in circumstances where it is unfair that those creditors should secure an advantage at the expense of other creditors. The underlying policy of bankruptcy law is that all creditors should be treated equally and should share *pari passu* in the estate. Unless there was good reason for paying one or some of the creditors or otherwise giving them advantage over the generality of the creditors, the Court will hold that the disposition was unfair and accordingly voidable.

70. The key to this section is that the debtor's predominant intention when transferring his property to the creditor in question was to prefer that creditor (see below re pre-liquidation transactions). It may be the case that the debtor was under such pressure to prefer the creditor or pay over the amount owing, that pressure is sufficient to negate any intention to prefer. This will of course depend on the circumstances. The pressure must be genuine and not just an excuse for preferring that creditor. This type of pressure may well be borne on a trader by his key trade suppliers whereby he is forced to clear his indebtedness to them in order to secure further supplies where those supplies are the lifeblood of the business. In such case it will be very difficult to show that there was an intention to prefer insofar as the pressure to pay and retain supplies to the business negated any intention to prefer that creditor. The fact that the transaction was carried out in the ordinary course of business is a strong indication that the debtors intention was not simply to prefer but rather to maintain the supplies to the business and maintain supplies to the trade and thus to stay in business.

71. **CASE STUDY** – Joe discovers that Patrick has paid down a substantial amount of some of his other debts in relation to other developments. Joe suspects that Patrick has cashflow difficulties now. Joe is worried that his cashflow difficulties may cause problems for Patrick in serving the debt on Site 3 which will have a knock on effect on Joe (as it is assumed they are jointly and severally liable for the debt). It would seem that Patrick has preferred one or some of his creditors over his debt on Site 3. If this constitutes a fraudulent preference, then it is an act of bankruptcy and as such may ground a petition for bankruptcy by Joe. If Patrick is adjudicated bankrupt, then the transfers may be set aside as fraudulent preferences. This would increase the estate available for his creditors. However, the estate may

not be sufficient to meet all the claims. Joe is a co-owner and may be forced into a sale to meet the debt.

Voluntary settlement

72. Another long standing principal of bankruptcy is that where a person is made bankrupt and prior to that adjudication he makes certain gifts of his property, the Court can set aside those gifts in favour of his general creditors. The underlying principal is that the donee of the property should not benefit at the creditors' expense. In this case there is no need to establish *scienter* of any kind. There are two exceptions to this:
(1) transactions which are entered into in good faith and for valuable consideration, and
(2) certain marriage settlements (***section 59 of the 1988 Act***). Again there is protection for a *bona fide* purchaser for value without notice who obtains title from the transferee.

73. There are two aspects to this. Firstly, any gratuitous settlement of property made by the bankrupt within two years of the adjudication can be set aside regardless of the debtor's actual financial circumstances at the time of the transfer Therefore all voluntary dispositions, except certain marriage settlements can be avoided where they are made within that time.

74. A transfer made between two and five years of the adjudication may be avoided only if the bankrupt was insolvent at that time of the transfer. Therefore in case of voluntary transfers made between two and five years of the adjudication, except for certain marriage settlements they can be set aside unless the transferee or persons claiming through him proves that the debtor was solvent at the time. In the case of an exception for a transaction made in good faith and for valuable consideration it is important to note that while the Courts will not insist on an equivalence of consideration they tend to strike down exchanges where what is given by the debtor bears no reasonable relationship to what is received in return.

75. **CASE STUDY** – If Joe transfers his share of the family home to Mary, this transfer may be open to challenge as a voluntary settlement. If Joe is

adjudicated bankrupt then, any transfer of the family home to Mary in the two years prior to that date is liable to be set aside irrespective of Joe's state of solvency at the time. If the transfer of the family home to Mary occurred more than two years and less than five years before the date of adjudication, then the transfer may be set aside unless it can be shown by Mary that Joe was solvent at the time of that transfer. If Mary obtained the house from Joe and then sold the house to a third party John, then the Official Assignee would not be entitled to take the house from John provided that John was a *bona fide* purchaser for value without notice of Joe's financial circumstances.

Improvident transactions

76. Bankruptcy law also make provision for the set aside for improvident transactions which occur just prior to the adjudication (***Section 58 of the 1988 Act***). The purpose of this provision is to set side any dealings with the debtors property which, in the circumstances, the Court deems to be improper. The section deals with transactions which occurred within three months of the adjudication and must have been preceded by an act of bankruptcy. There is provision for the protection of third party purchasers who acquired the property in good faith and for valuable consideration. Broadly, this applies to a transaction occurring after an act of bankruptcy and within 3 months of adjudication, where as a result of that transaction, property is sold at substantially less than market value or the transaction results in a substantial reduction in the value of the estate. It is for the Court to decide, on the basis of the facts, whether the transaction in question should be set aside. The Court will not invalidate a transaction if:

(1) the other party to the transaction had no notice that the debtor committed an act of bankruptcy by making the transfer, and
(2) the transaction was *bona fide.* Furthermore, if the transaction was set aside by the Court then the third party title cannot be adversely effected provided he acquired it in good faith and for valuable consideration.

77. **CASE STUDY** – If Joe decided to sell his share of Site 3 to Patrick, he should exercise care in relation to the sale to ensure that it is not later challenged as an improvident transaction. The timing of that sale would be important if it

occurred after an act of bankruptcy, and within three months of the date of adjudication it may be open to scrutiny by the Courts. In those circumstances, Joe should be in a position to show that the sale to Patrick achieved the best price obtainable. It would be difficult to show this if Patrick was the only person to whom the property was offered for sale.

Pre-liquidation transactions

Fraudulent preferences

78. ***Section 286 Companies Act, 1963*** provides for the set aside of a fraudulent preference in the case of companies. This section provides that, any conveyance, transfer or other act in relation to property, made or done by or against, the company which is unable to pay its debts as they fall due in favour of any creditor and done with a view to giving such creditor a preference over the other creditors, is deemed to be a fraudulent preference if it takes place within six months of the winding up of the company. The time period is extended to two years in the case of a connected person e.g. directors, shadow directors.

79. In the case of a company, the Courts may infer an intention to prefer where a company's directors have given personal guarantees in respect of the company's debts, and shortly before winding up, the company arrangements are made to pay off the guaranteed debt. The Courts may invalidate payments made or securities given by a company where in consequence thereof the directors are no longer exposed under their guarantees for the company's debts or other obligations.

Improper/fraudulent transfers

80. **Section 139 of the Companies Act, 1990** deals with the improper/fraudulent transfer of assets. Where, on the application of a liquidator, creditor etc., a company which is being wound up, and it can be shown to the satisfaction of the Court that any property of the company was disposed of by way of conveyance, transfer etc. and the effect of such disposal was to perpetrate a fraud on the company, its creditors or members, the Court may if it deems it just and equitable to do so, order any person who appears to have control of

such property or the proceeds of sale thereof, to deliver it to the liquidator on such terms or conditions as the Court sees fit. It is important to note that the position of bona fide purchasers for value without notice is protected. ***McCann & Courtney***[1] note that Section 139 is intended to replace ***Section 10 of the Conveyancing Act, 1634*** (see above) and enables the liquidator to set aside transfers of company assets where the assets are put beyond the reach of creditors and thus defrauding them.

81. The case of ***La Chatelaine Thudicom Limited (unreported decision of the High Court (Murphy J.) 2008 IEHC 349)*** was the first decision on the *scienter* to prove a fraudulent transfer under Section 139. In this case, the director of the company had permitted a creditor to remove cash and stock from the company's premises just before the Company went into insolvent liquidation. The High Court found that the removal of the company's assets was a fraudulent transfer on the basis the effect of the transaction was to perpetrate a fraud on the company. The effect of the transfer was that the assets were taken out of reach of the creditors, and that the company was deprived of assets to which it was lawfully entitled. There is no requirement to prove fraudulent intent on the part of the transferor. Therefore to set aside such a transaction the liquidator did not have to prove that the company intended to defraud its creditors. He has a low evidential burden of establishing that the actual effect of the disposition has been to defraud creditors i.e. that the assets were taken out of the reach of its creditors. The Court held that the transfer was a fraudulent transfer for the purposes of Section 139.

82. The Court held that the transfer was not a fraudulent preference under Section 286 Companies Act 1963 on the basis that the necessary intention – the dominant intention to prefer the transferee of the assets – had not been made out. In that case the court accepted the evidence of a director of a company and found that there was no dominant intention to prefer the transferee of the assets over the other creditors and found that there was no fraudulent preference on the facts.

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[1] Companies Act, 1963 to 2006 Tottel, 2007 at p1256

83. In the case of fraudulent preference, the onus of proof is on the liquidator to establish that the dominant intention of the transferor is to prefer one creditor over the other (***Curran Construction Company Limited v Bank of Ireland Finance Limited [1976] ILRM 175***). However, proof can be problematic and the Court is permitted to infer that such an intention exists from the facts of the case. The case of **Station Motors Ltd v AIB [1985] IR 756** concerned bank account payments prior to the company going into insolvent liquidation. The controller of the company did not give evidence. The Court held that it was permitted to draw inferences of an intention to prefer the transferee from the surrounding circumstances. Of particular importance was the fact that the director/controller of the company was a guarantor of a bank overdraft. While the bank was the direct beneficiary of the cash transfers to the bank, the controller was an indirect beneficiary in that it reduces his liability under the guarantee. The court focused on this "strong element of personal advantage" for the controller of the company in holding that the transfers to the bank constituted a fraudulent preference.

LIQUIDATION

Procedures

84. There are two types of liquidation, the first is a Court supervised process ("High Court Liquidation") which usually commences with the winding up petition presented under ***Section 213 of the Companies Act, 1963***. The most common basis for presenting a petition is where the company is unable to meet its debts as they fall due and the petition is presented by one of its creditors. The other type of liquidation is a voluntary liquidation; in the case of insolvency, a creditors voluntary liquidation. The liquidation is voluntary in the sense that it is commenced by creditors where the company is insolvent. The liquidator is then appointed by the creditors at a creditors meeting in the case of a creditors voluntary winding up.

85. The purpose of a liquidation is to bring the company to an end by distributing the assets of the company, paying the liabilities of the company and winding the company up.

86. The principle function of the liquidator is to collect the assets and distribute them *pari passu* among the creditors, subject always to the payment of the preferential debts. The creditors are ranked as follows:

(i) secured creditors under fixed charges;

(ii) all costs, charges and expenses properly incurred in the winding up;

(iii) remuneration and expenses of the liquidator;

(vi) employee deductions in relation to PRSI (super preferential);

(v) preferential creditors (certain Revenue debts and employee entitlements);

(vi) floating charges;

(vii) unsecured creditors;

(viii) shareholders.

87. Revenue is a preferential creditor in respect of certain pre-liquidation assessed taxes (***Section 285 and Section 98 of the Companies Act, 1965***). Revenue is the preferential creditor in respect of maximum of one year of assessed taxes under each tax head. Interest on overdue tax is also included. Employee PRSI contributions are super preferential in that they rank above Revenue debts. However post liquidation debts do not have a preferential status and fall to be dealt with as an unsecured creditor.

88. In the case of personal guarantees, the directors/shareholders of a company will be personally liable for the debts of the company which have been guaranteed. Further, in certain cases, in liquidation, the shareholders/directors can be held liable for the debts of the company.

Personal Liability for Directors

89. On a winding up, where the company is unable to pay its debts, the Court may declare certain directors to be personally liable (with or without limit) in certain cases.

90. Essentially petitioning the Court to wind up a company is an effective way of submitting the actions of directors to the scrutiny of the Courts and this is particularly important for creditors where there are concerns in relation to fraudulent and reckless trading.

91. In certain cases a director may be personally liable without limit for the debts of a company where it appears that while he was an officer of the company he was knowingly a party to the carrying on of the business of the company in a reckless manner (**Section 297A CA 1963**).

92. In tandem with that, there is also provision for the imposition of criminal liability on persons found guilty of fraudulent trading i.e. where the person was knowingly a party to the carrying on of any business of the company with intent to defraud its creditors or for any fraudulent purpose (**Section 297 CA 1963**).

Loans to directors

93. In addition, there is provision for fixing directors with personal liability where the company is owed money by its directors. It is important to ensure that such accounts are examined in order to ensure that there are no balances outstanding by the directors to the company. Directors may be exposed to personal liability and prosecution where there are loans or credit arrangements in place with the company in contravention of **Section 31 Companies Act 1990**.

94. Keane (**Keane, Company Law (3rd Edition)**) comments on the position prior to the introduction of the prohibitions in the 1990 Act saying that the principal victims of the gap in the law were the creditors of private limited companies who frequently found, when the company got into financial difficulties, that it had made loans to its directors with no sensible commercial basis.

95. **Section 31 CA 1990** contains a prohibition on loans to directors and connected parties which extends to *inter alia* "quasi-loans" to a director of the company and also prohibits a company from *"enter[ing] into a credit transaction as creditor for such a director…"* (**Section 31 (1)(a) and (b) CA 1990**). The prohibition is eased somewhat by a number of exemptions which include:

(1) Arrangements below a certain value,

(2) intra-group transactions, and

(3) loans to cover reasonable expenses, and

(4) loans in the ordinary course of business.

96. Certain arrangements are exempt where that arrangement and the total of all such arrangements (all prohibited loans) together amount to less than 10% of the company's relevant assets (**Section 32 CA 1990**). The company's relevant assets are the company's net assets determined by reference to the accounts prepared and laid in accordance with **Section 148 CA 1963** in respect of the last preceding financial year in respect of which such accounts were so laid or alternatively the called-up share capital where no accounts have been prepared and laid before that time (**Section 29(2) CA 1990**).

97. Where the directors become aware of a "situation" whereby the arrangements come to exceed the 10% threshold, they have a duty to take action to rectify the situation. The legislation acknowledges this can happen for any reason but primarily because the value of the relevant assets has fallen. The directors are under a duty to amend the arrangements to bring them below the 10% threshold. They have two months in which to amend the arrangements otherwise the arrangements are voidable (subject to certain exceptions where the arrangements cannot by law be avoided) by the company (**Section 33 CA 1990**).

98. There are a number of sanctions and the exposure to sanction depends on whether the company is solvent or not. There is provision for criminal sanction for breach of the prohibition in Section 31 (**Section 40 CA 1990**). The offence is committed in two scenarios:

    a) By an officer of the company who permits or authorises a company to enter "*knowingly or having reasonable cause to believe"* that the company was thereby contravening Section 31 or
    b) Any person who procures a company to enter "*knowingly or having reasonable cause to believe*" that the company was thereby contravening Section 31 – in theory this is very broad and could extend to professional advisers.

99. The maximum penalty is €1,269 and/or 12 months imprisonment on summary conviction or €12,697 and/or 5 years imprisonment (**Section 240 CA 1990**). This exposure to criminal sanction is very serious and means that a person

suspected of a breach may be arrested without warrant and detained for up to 12 hours under the Criminal Justice Act 1984.

100. Where a company enters into an arrangement which is in contravention of Section 31, a number of civil consequences ensue. Firstly, the arrangements are voidable (subject to certain exceptions) by the company. Secondly, the directors involved and those who authorised the arrangements are liable to account for any gain and to indemnify for loss or damage. Thirdly, the directors can be fixed with personal liability. There is a let out for certain directors not directly involved in the arrangements.

101. In relation to fixing the directors with personal liability, the Court must be satisfied that loans to/credit arrangements with directors have either contributed materially to the company's inability to pay its debts or has substantially impeded the orderly winding up thereof. The Court is obliged to take into account whether and to what extent any outstanding liabilities arising under the arrangements were discharged prior to the commencement of the winding up. Further in deciding on the extent of personal liability, the Court is obliged to "*have particular regard*" to the extent to which the arrangement in question either contributed materially to the company's inability to pay its debts or substantially impeded the orderly winding up of the company. This suggests the Court is obliged to engage in a proportional approach to the imposition of personal liability. Where a company is in insolvent liquidation and has a material sum owed to it by a director, it is difficult to see how this does not contribute in a material way to the company's inability to pay its debts at least to the extent of the underlying debt.

102. **CASE STUDY** – Construct Ireland Ltd built the houses on Site 3. However, Construct Ireland received some but not full payment from Joe and Patrick in respect of the building work. Therefore, there is a balance outstanding on the director's loan account in respect of Joe's debt.

103. In this case, the supply of goods and services in the course of carrying on the construction and development of the units tends to fall within the third limb of the definition – credit sales. Once the value of the outstanding debt reaches 10% of the net relevant assets, the arrangements are in breach of the prohibition on loans to directors. Joe should rectify this as a matter of urgency.

Personal Guarantees

104. It is common for the directors or owners of a small company to provide security for the company's liabilities in the form of personal guarantees. Frequently, the guarantees given were unlimited such that the lender had full recourse to the debtor's personal assets. Currently there are many examples of the banks seeking to rely on such personal guarantee. This has occurred in circumstances where the value of the underlying security is less than the liabilities secured thereon and therefore the banks have sought to rely on the personal security entered into by the owners/directors of those companies. Ordinarily a secured creditor would recover what is owed to him through his security. However where the security is not sufficient to discharge the debt the balance is regarded as an unsecured debt. It is in relation to this unsecured debt he may well petition for the debtor's bankruptcy.

105. Issues can arise where personal guarantees are signed by both spouses. For example, the Family Home Protection Act 1976 protects the non-owning spouse by providing that the prior consent in writing of the non-owning spouse is required prior to the conveyance of an interest in the family home. Therefore, any conveyance of the family home by the owning spouse, without the prior written consent of the non-owning spouse is void.

106. The question has arisen in a number of cases as to the obligations of the financial institutions/lenders in obtaining guarantees and whether the spouse can defend against the invoking of a guarantee in certain circumstances specifically where the guarantees were signed without legal advice.

107. In **Ulster Bank v Fitzgerald unreported, High Court (O'Donovan J) 9 November 2001** the plaintiff bank was seeking judgment for sums due and owing including sums due from a company owned by the Defendant husband and guaranteed by the Defendant husband and wife. The Defendant wife claimed that guarantees given by her husband were not enforceable against her on the grounds that she had no financial interest in the guarantees and that she had been persuaded to execute the guarantees as a result of the undue influence exercised over her by her husband of which the Plaintiff bank were aware or deemed to have been aware. The Bank official gave evidence that the defendants were not present together on the occasions when the

guarantees were executed. Before executing the guarantees he had explained to each of them the meaning of the guarantees and the reason why they were required by the Plaintiff bank. He told the Plaintiff wife that she could obtain legal advice on the guarantees but she signed the guarantees on the spot.

108. The Court accepted that the Defendant husband exercised inordinate pressure and the Defendant wife felt she had no option but to sign. However, the Court found there was no evidence that the bank officials had any inkling of the fact that the Defendant wife may have been acting under the influence of her Husband and not acting under her own free will. It held the bank was not under any obligation to take any special steps to ensure that she obtained independent legal advice. The Court did not accept that the wife did not have a financial stake in the business for which the guarantees were given as she and her family relied on the income generated by it. In that case it was noted that there was no direct threat to the family home.

109. In the English case of **Royal Bank of Scotland v Etridge (No 2)(2002) 2 AC 773** it was held that a financial institution was deemed to be on notice of the husband's undue influence where the wife provided security for a loan to a company in which she had no interest and prima facie was not to her advantage. In those circumstances, certain obligations were imposed on the financial institution arising out of that notice. Lord Nicholls stated *"...the furthest a bank can be expected to go is to take reasonable steps to satisfy itself that the wife has had brought home to her in a meaningful way, the practical implications of the proposed transaction".*

Dearbhla Cunningham BL

26th November 2009

Section 7 of the Bankruptcy Act 1988

(a) if in the State or elsewhere he makes a conveyance or assignment of all or substantially all of his property to a trustee or trustees for the benefit of his creditors generally;

(b) if in the State or elsewhere he makes a fraudulent conveyance, gift, delivery or transfer of his property or any part thereof;

(c) if in the State or elsewhere he makes any conveyance or transfer of his property or any part thereof, or creates any charge thereon, which would under this or any other Act be void as a fraudulent preference if he were adjudicated bankrupt;

(d) if with intent to defeat or delay his creditors he leaves the State or being out of the State remains out of the State or departs from his dwelling-house or otherwise absents himself or evades his creditors;

(e) if he files in the Court a declaration of insolvency;

(f) if execution against him has been levied by the seizure of his goods under an order of any court or if a return of no goods has been made by the sheriff or county registrar whether by endorsement on the order or otherwise;

(g) if the creditor presenting a petition has served upon the debtor in the prescribed manner a bankruptcy summons, and he does not within fourteen days after service of the summons pay the sum referred to in the summons or secure or compound for it to the satisfaction of the creditor.

(2) A debtor also commits an act of bankruptcy if he fails to comply with a debtor's summons served pursuant to section 21 (6) of the Bankruptcy (Ireland) Amendment Act, 1872, within the appropriate time thereunder, and section 8 (6) of this Act shall apply to such debtor's summons.

Section 56 Bankruptcy Act 1988

Disclaimer of onerous property.

56 --
(1) Subject to subsections (2) and (5), where any of the property (other than after-acquired property) of a bankrupt consists of land of any tenure burdened with onerous covenants, of shares or stock in companies, of unprofitable contracts, or of any other property which is unsaleable or not readily saleable by reason of its binding the possessor thereof to the performance of any onerous act or to the payment of any sum of money, the Official Assignee, notwithstanding that he has endeavoured to sell or has taken possession of the property or exercised any act of ownership in relation thereto, may, with the leave of the Court and subject to the provisions of this section, by writing signed by him, at any time within twelve months after the date of

adjudication or such extended period as may be allowed by the Court, disclaim the property.

(2) Where any such property as aforesaid has not come to the knowledge of the Official Assignee within one month after the date of the adjudication, the power under this section of disclaiming the property may be exercised at any time within twelve months after he has become aware thereof or such extended period as may be allowed by the Court.

(3) The disclaimer shall operate to determine, as from the date of disclaimer, the rights, interests and liabilities of the bankrupt and his property in or in respect of the property disclaimed, and shall also discharge the Official Assignee from all personal liability in respect of the property disclaimed as from the date when the property vested in him, but shall not, except so far as is necessary for the purpose of releasing the bankrupt and his property and the Official Assignee from liability, affect the rights or liabilities of any other person.

(4) The Court, before or on granting leave to disclaim, may require the Official Assignee to give such notices to persons interested and impose such terms as a condition of granting leave, and make such other order in the matter as the Court thinks just.

(5) The Official Assignee shall not be entitled to disclaim any property under this section in any case where an application in writing has been made to him by any persons interested in the property requiring him to decide whether he will or will not disclaim, and the Official Assignee has not, within a period of twenty-eight days after the receipt of the application or such further period as may be allowed by the Court, given notice to the applicant that he intends to apply to the Court for leave to disclaim; and, in the case of a contract, if the Official Assignee, after such application as aforesaid, does not within the said period or extended period disclaim the contract, he shall be deemed to have adopted it.

(6) The Court may, on the application of any person who is, as against the Official Assignee, entitled to the benefit or subject to the burden of a contract made with the bankrupt, make an order rescinding the contract on such terms as to payment by or to either party of damages for the non-performance of the contract, or otherwise as the Court thinks just, and any damages payable under the order to any such person shall he deemed to be a debt proved and admitted in the bankruptcy.

(7) Subject to subsection (8), the Court may, on an application by any person who either claims any interest in any disclaimed property or is under any liability not discharged by this Act in respect of any disclaimed property and on hearing any such persons as it thinks fit, make an order for the vesting of the property in or the delivery of the property to any person entitled thereto, or to whom it may seem just that the property should be delivered by way of compensation for such liability as aforesaid, or a trustee for him, and on such terms as the Court may think just, and on any such vesting order being made, the property comprised therein shall vest accordingly in the person therein named in that behalf without any conveyance or assignment for the purpose.

(8) Where the property disclaimed is of a leasehold nature, the Court shall not make a vesting order in favour of any person claiming under the bankrupt, whether as under-lessee or as mortgagee by demise, except upon the terms of making that person—

> (a) subject to the same liabilities and obligations as those to which the bankrupt was subject under the lease in respect of the property at the date of the adjudication; or
> (b) if the Court thinks fit, subject only to the same liabilities and obligations as if the lease had been assigned to that person at that date; and in either event (if the case so requires), as if the lease had comprised only the property comprised in the vesting order, and any mortgagee or under-lessee declining to accept a vesting order upon such terms shall be excluded from all interest in and security upon the property and, if there is no person claiming under the bankrupt who is willing to accept an order upon such terms, the Court shall have power to vest the estate and interest of the bankrupt in the property in any person liable either personally or in a representative character, and either alone or jointly with the bankrupt, to perform the lessee's covenants in the lease, freed and discharged from all estates, encumbrances and interests created therein by the bankrupt.

(9) Any person damaged by the operation of a disclaimer under this section shall be deemed to be a creditor of the bankrupt to the amount of the damages, and may accordingly prove the amount as a debt in the bankruptcy.

Section 57 Bankruptcy Act 1988

Avoidance of fraudulent preferences.

57.—
(1) Every conveyance or transfer of property or charge made thereon, every payment made, every obligation incurred and every judicial proceeding taken or suffered by any person unable to pay his debts as they become due from his own money in favour of any creditor or of any person in trust for any creditor, with a view to giving such creditor, or any surety or guarantor for the debt due to such creditor, a preference over the other creditors, shall, if the person making, incurring, taking or suffering the same is adjudicated bankrupt within six months after the date of making, incurring, taking or suffering the same, be deemed fraudulent and void as against the Official Assignee; but this section shall not affect the rights of any person making title in good faith and for valuable consideration f through or under a creditor of the bankrupt.

(2)

(*a*) Where a person is adjudicated bankrupt and anything made or done is void under *subsection (1)* or was void under the corresponding provisions of the law in force immediately before the commencement of this Act as a fraudulent preference of a person interested in property mortgaged or charged to secure the bankrupt's debt, then (without prejudice to any rights or liabilities arising apart from this section) the person preferred shall be subject to the same liabilities and shall have the same rights as if he had undertaken to be personally liable as surety for the debt to the extent of the charge on the property or the value of his interest, whichever is the less.

(*b*) The value of the said person's interest shall be determined as at the date of the transaction constituting the fraudulent preference, and shall be determined as if the interest were free of all encumbrances other than those to which the charge for the bankrupt's debt was then subject.

(*c*) On any application made to the Court in relation to any payment on the ground that the payment was a fraudulent preference of a surety or guarantor, the Court shall have jurisdiction to determine any questions relating to the payment arising between the person to whom the payment was made and the surety or guarantor, and to grant relief in respect thereof notwithstanding that it is not necessary so to do for the purposes of the bankruptcy, and for that purpose may give leave to bring in the surety or guarantor as a third party as in the case of an action for the recovery of the sum paid.

(*d*) *Paragraph (c)* shall apply, with the necessary modifications, in relation to transactions other than the payment of money as it applies to payments.

Section 58 Bankruptcy Act 1988

Avoidance of certain transactions.

58.—
(1) If within three months before he is adjudicated bankrupt a debtor commits an act of bankruptcy and thereafter either sells any of his property at a price which, in the opinion of the Court, is substantially below its market value or enters into or is a party to any other transaction which, in the opinion of the Court, has the effect of substantially reducing the sum available for distribution to the creditors, such transaction shall be void as against the Official Assignee, unless the transaction was *bona fide* entered into and the other party had not at the time of the transaction notice of any prior act of bankruptcy committed by the bankrupt.

(2) *Subsection (1)* shall not affect the rights of any person making title in good faith and for valuable consideration through or under a person (other than the bankrupt) who is party to a transaction mentioned therein.

(3) *Subsection (1)* shall not apply to any transaction mentioned in *section 57 (1)* or *59*.

Section 59 Bankruptcy Act 1988

Avoidance of certain settlements.

59.—
(1) Any settlement of property, not being a settlement made before and in consideration of marriage, or made in favour of a purchaser or incumbrancer in good faith and for valuable consideration, shall—

> (*a*) if the settlor is adjudicated bankrupt within two years after the date of the settlement, be void as against the Official Assignee, and
>
> (*b*) if the settlor is adjudicated bankrupt at any subsequent time within five years after the date of the settlement, be void as against the Official Assignee unless the parties claiming under the settlement prove that the settlor was, at the time of making the settlement, able to pay all his debt without the aid of the property comprised in the settlement and that the interest of the settlor in such property passed to the trustee of such settlement on the execution thereof

(2) A covenant or contract made by any person (in this section called the settlor) in consideration of his or her marriage, either for the future payment of money for the benefit of the settlor's spouse or children, or for the future settlement, on or for the settlor's spouse or children, of property wherein the settlor had not at the date of the marriage any estate or interest, whether vested or contingent, in possession or remainder, shall, if the settlor is adjudicated bankrupt and the covenant or contract has not been executed at the date of the adjudication, be void as against the Official Assignee, except so far as it enables the persons entitled under the covenant or contract to claim for dividend in the settlor's bankruptcy under or in respect of the covenant or contract, but any such claim to dividend shall be postponed until all the claims of the other creditors for valuable consideration in money or money's worth have been satisfied.

(3) Any payment of money (not being payment of premiums on policy of life assurance) or any transfer of property made by the settlor in pursuance of a covenant or contract to which *subsection (2)* applies shall be void as against the

Official Assignee in the settlor's bankruptcy, unless the persons to whom the payment or transfer was made prove that:

(*a*) the payment or transfer was made more than two years before the date of the adjudication of the settlor, or

(*b*) at the date of the payment or transfer, the settlor was able to pay all his debts without the aid of the money so paid or the property so transferred, or

(*c*) the payment or transfer was made in pursuance of a covenant or contract to pay or transfer money or property expected to come to the settlor from or on the death of a particular person named in the covenant or contract, and was made within three months after the money or property came into the possession or under the control of the settlor;

but, in the event of any such payment or transfer being declared void, the persons to whom it was made shall be entitled to claim for dividend under or in respect of the covenant or contract in like manner as if it had not been executed at the date of the adjudication.

(4) In this section "settlement" includes any conveyance or transfer of property.

Section 61 Bankruptcy Act 1988

Functions of Official Assignee in bankruptcy and vesting arrangements.

61.—
(1) This section applies to every bankruptcy matter and vesting arrangement.

(2) The functions of the Official Assignee are to get in and realise the property, to ascertain the debts and liabilities and to distribute the assets in accordance with the provisions of this Act.

(3) In the performance of his functions the Official Assignee shall, in particular, have power—

(*a*) to sell the property by public auction or private contract, with power to transfer the whole thereof to any person or to sell the same in lots and for the purpose of selling land to carry out such sale by fee farm grant, sub fee farm grant, lease, sub-lease or otherwise and to sell any rent reserved on any such grant or any reversion expectant upon the determination of any such lease,

(*b*) to make any compromise or arrangement with creditors or persons claiming to be creditors or having or alleging themselves to have any claim present or future, certain or contingent, ascertained or sounding only in damages whereby the bankrupt or arranging debtor may be rendered liable,

(*c*) to compromise all debts and liabilities capable of resulting in debts and all claims, present or future, certain or contingent, ascertained or sounding only in damages, subsisting or supposed to subsist between the bankrupt or arranging debtor and any debtor and all questions in any way relating to or affecting the assets or the proceedings on such terms as may be agreed

and take any security for the discharge of any debt, liability or claim, and give a complete discharge in respect thereof,

(*d*) to institute, continue or defend any proceedings relating to the property,

(*e*) to refer any dispute concerning the property to arbitration under the terms of section 11 of the Arbitration Act, 1954 ,

(*f*) to mortgage or pledge any property to raise any money requisite,

(*g*) to take out in his official name without being required to give security, letters of administration to any estate on the administration of which the bankrupt or arranging debtor would benefit,

(*h*) to agree a sum for costs where the Court so directs or where he considers that the amount which would be allowed on taxation would not exceed £1,000,

(*i*) to agree the charges of accountants, auctioneers, brokers and other persons,

(*j*) to ascertain and certify to the Court the amount due in respect of a mortgage debt and the due priority thereof with power to the Court to vary such certificate,

(*k*) to draw out of the account referred to in *section 84 (1)* any sum not exceeding £100 by way of indemnity in respect of costs incurred by him.

(4) Notwithstanding any provision to the contrary contained in *subsection (3)*, no disposition of property of a bankrupt, arranging debtor or person dying insolvent, which comprises a family home within the meaning of the Family Home Protection Act, 1976 , shall be made without the prior sanction of the Court, and any disposition made without such sanction shall be void.

(5) On an application by the Official Assignee under this section for an order for the sale of a family home, the Court, notwithstanding anything contained in this or any other enactment, shall have power to order postponement of the sale of the family home having regard to the interests of the creditors and of the spouse and dependants of the bankrupt as well as to all the circumstances of the case.

(6) The Official Assignee may in case of doubt or difficulty seek the directions of the Court in connection with the affairs of any bankrupt or arranging debtor.

(7) The exercise by the Official Assignee of the powers conferred by this section shall be subject to the control of the Court, and any creditor or other person who in the opinion of the Court has an interest may apply to the Court in relation to the exercise or proposed exercise of those powers.

(8) The powers and functions conferred on the Official Assignee by this section may be exercised and performed—

(*a*) in the case of an adjudication founded on a petition of a debtor, on adjudication,

(*b*) in the case of an adjudication founded on a petition by a creditor, on the expiration of the time for showing cause,

(*c*) in the case of a vesting arrangement, on approval of the proposal by the Court.

Section 286 CA 1963

Fraudulent preference.

286.—
(1) Subject to subsection (2), any conveyance, mortgage, delivery of goods, payment, execution or other act relating to property made or done by or against a company within 6 months before the commencement of its winding up which, had it been made or done by or against an individual within 6 months before the presentation of a bankruptcy petition on which he is adjudged a bankrupt, would be deemed in his bankruptcy a fraudulent preference, shall in the event of the company being wound up be deemed a fraudulent preference of its creditors and be invalid accordingly.

(2) In relation to things made or done before the operative date, subsection (1) shall have effect with the substitution, for references to 6 months, of references to 3 months.

(3) Any conveyance or assignment by a company of all its property to trustees for the benefit of all its creditors shall be void to all intents.

Section 290 CA 1963

Disclaimer of onerous property in case of company being wound up.

290.—
(1) Subject to subsections (2) and (5), where any part of the property of a company which is being wound up consists of land of any tenure burdened with onerous covenants, of shares or stock in companies, of unprofitable contracts, or of any other property which is unsaleable or not readily saleable by reason of its binding the possessor thereof to the performance of any onerous act or to the payment of any sum of money, the liquidator of the company, notwithstanding that he has endeavoured to sell or has taken possession of the property or exercised any act of ownership in relation thereto, may, with the leave of the court and subject to the provisions of this section, by writing signed by him, at any time within 12 months after the commencement of the winding up or such extended period as may be allowed by the court, disclaim the property.

(2) Where any such property as aforesaid has not come to the knowledge of the liquidator within one month after the commencement of the winding up, the power under this section of disclaiming the property may he exercised at any time within 12 ninths after he has become aware thereof or such extended period as may be allowed by the court.

(3) The disclaimer shall operate to determine, as from the date of disclaimer, the rights, interests and liabilities of the company, and the property of the company, in or in respect of the property disclaimed, but shall not, except so far as is necessary for the purpose of releasing the company and the property of the company from liability, affect the rights or liabilities of any other person.

(4) The court, before or on granting leave to disclaim, may require such notices to be given to persons interested and impose such terms as a condition of granting leave, and make such other order in the matter as the court thinks just.

(5)The liquidator shall not be entitled to disclaim any property under this section in any case where an application in writing has been made to him by any persons interested in the property requiring him to decide whether he will or will not disclaim, and the liquidator has not, within a period of 28 days after the receipt of the application or such further period as may be allowed by the court, given notice to the applicant that he intends to apply to the court for leave to disclaim.

(6) The court may, on the application of any person who is, as against the liquidator, entitled to the benefit or subject to the burden of a contract made with the company, make an order rescinding the contract on such terms as to payment by or to either party of damages for the non-performance of the contract, or otherwise as the court thinks just, and any damages payable under the order to any such person shall be deemed to be a debt proved and admitted in the winding up.

(7) Subject to subsection (8), the court may, on an application by any person who either claims any interest in any disclaimed property or is under any liability not discharged by this Act in respect of any disclaimed property and on hearing any such persons as it thinks fit, make an order for the vesting of the property in or the delivery of the property to any person entitled thereto, or to whom it may seem just that the property should be delivered by way of compensation for such liability as aforesaid, or a trustee for him, and on such terms as the court may think just, and on any such vesting order being made, the property comprised therein shall vest accordingly in the person therein named in that behalf without any conveyance or assignment for the purpose.

(8) Where the property disclaimed is of a leasehold nature, the court shall not make a vesting order in favour of any person claiming under the company, whether as under-lessee or as mortgagee by demise, except upon the terms of making that person—

> (*a*) subject to the same liabilities and obligations as those to which the company was subject under the lease in respect of the property at the commencement of the winding up; or
>
> (*b*) if the court thinks fit, subject only to the same liabilities and obligations as if the lease had been assigned to that person at that date;

and in either event (if the case so requires), as if the lease had comprised only the property comprised in the vesting order, and any mortgagee or under-lessee declining to accept a vesting order upon such terms shall be excluded from all interest in and security upon the property, and, if there is no person claiming under the company who is willing to accept an order upon such terms, the court shall have power to vest the estate and interest of the company in the property in any person liable either personally or in a representative character, and either alone or jointly with the company, to perform the lessee's covenants in the lease, freed and discharged from all estates, encumbrances and interests created therein by the company.

(9) Any person damaged by the operation of a disclaimer under this section shall be deemed to be a creditor of the company to the amount of the damages, and may accordingly prove the amount as a debt in the winding up.

Section 139 CA 1990

Power of the court to order the return of assets which have been improperly transferred.

139.—
(1) Where, on the application of a liquidator, creditor or contributory of a company which is being wound up, it can be shown to the satisfaction of the court that—

> (*a*) any property of the company of any kind whatsoever was disposed of either by way of conveyance, transfer, mortgage, security, loan, or in any way whatsoever whether by act or omission, direct or indirect, and
>
> (*b*) the effect of such disposal was to perpetrate a fraud on the company, its creditors or members, the court may, if it deems it just and equitable to do so, order any person who appears to have the use, control or possession of such property or the proceeds of the sale or development thereof to deliver it or pay a sum in respect of it to the liquidator on such terms or conditions as the court sees fit.

(2) *Subsection (1)* shall not apply to any conveyance, mortgage, delivery of goods, payment, execution or other act relating to property made or done by or against a company to which section 286 (1) of the Principal Act applies.

(3) In deciding whether it is just and equitable to make an order under this section, the court shall have regard to the rights of persons who have *bona fide* and for value acquired an interest in the property the subject of the application.