COURSE: CERTIFICATE IN CREDIT MANAGEMENT
SUBJECT: LAW
MODULE 2

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Introduction

In the last module, we saw that the origins of Irish law were historical, and in fact some of the ancient principles of law still apply today. Business Law also dates back some considerable time, and again as for other areas of law, we have inherited a considerable amount of legislation from our period of English rule and many of these statutes are still applicable today. However, there have been major changes in the last 40 years or so, particularly as a result of our entry into the EEC, now the European Union. Many of these changes relate to Company Law, so much so that it is widely accepted that our membership of the EU has had a profound influence on the course of Company Law in Ireland today.

Company law is defined by some as 'Law of Persons', however, I think it is more correctly categorised under Business Law. Small private limited companies account for the majority of businesses operating in Ireland, so they are a key feature in Irish commercial activity. Small to Medium companies (SMEs) are also the largest group of employers in Ireland. Companies are regulated by various instruments of law, including statutory legislation, contract law, common law and equity, and also European Union law in its various forms. The various Companies Acts form the basis of company law in general and would be considered to represent primary company law in Ireland, while the other sources are supplementary.

In this module we cover several areas of Business Law, however, Company Law is by far the most important. For this reason, much of this module is taken up with Company Law whereas the other areas in this unit have only been outlined. In your role as a credit professional it is important that you have a really good understanding of Company Law, as many of your customers will fall into the category of private limited company. But it is also important to understand this from the point of view of the company you are employed in. Even if you are engaged in the area of consumer credit, it is likely that your customer base will include small private limited companies, so a study of this area of law will also benefit you. We will be covering the Sale of Goods Acts in the next module and that will also benefit everyone as a consumer and some as providers of consumer credit.

In addition to Company Law, as outlined above, we will also examine the areas of Credit and Security, which includes mortgages and other charges. We will consider the enforcement procedures in cases where we pursue a debt through the legal channels. Hire Purchase and Leasing Agreements are also very prevalent in business today, and nowadays in particular there is a tendency for companies not to invest in fixed assets at all. Consequently, the Balance Sheet for most companies today is totally focussed on current assets and current liabilities, so agreements for leasing have become much more important. We will also take a brief look at the Consumer Credit Act 1995, insofar as it relates to these types of agreements. It is beyond the scope of this course to go into detail in this area of law, however, if you are involved in consumer credit, it is recommended that you familiarise yourself with the main aspects of this legislation together with a review of the 2007 Act. You will also find some useful information in our next module which deals with the Sale of Goods Acts.

Finally, in this module we will look at negotiable instruments, particularly from the perspective of accepting payment of a debt. How secure is the form of payment you

are agreeing to? For example, if you accept a cheque in payment of a debt, what are the duties of the bankers, and do they owe any duty to the Payee, or is all the legal protection in favour of the Payer? The brief section on negotiable instruments should provide answers to these and other questions.

Although the notes included here on Company Law are fairly comprehensive, due to the short duration of our course they have of necessity had to be significantly reduced. I have endeavoured to include all the areas that would be of most interest to students of this course. The principal area of company law I have omitted or just briefly referred to is the area of Shares, Share Capital, and Capital Maintenance, and I included just a brief outline of debentures under Credit and Security.

As with all other topics, if you have a particular interest in this area, then you could read up on any of the topics included here, or use the internet to research any particular item or case. The area on enforcement procedures is no more than a brief outline, designed to introduce this topic to you. If you intend to pursue a debt through legal channels, you must still seek legal advice on the best course of action. You will be better informed, but unfortunately not an expert – yet!

COMPANY LAW

History & Background

The development of companies in both Ireland and England was very similar due to the historical links between the two countries. Early companies however bear very little resemblance to the modern registered company today. In the early days of company law, companies were created by Royal Charter and can be traced back to the 14th century in relation to trading by merchant adventurers. The concept of limited liability did not exist and accordingly the members of the company could be held liable in full for all of its debts. The Royal College of Surgeons is an example of such a company.

The Limited Liability Act was introduced in 1855, establishing the concept of limited liability of members for debts of the company, and also provided that companies had to end their name with the word 'Limited' or 'Teoranta' for those operating in the Irish language; Ltd or Teo for short respectively. This Act, combined with the earlier Joint Stock Companies Act in 1844 and later the Companies (Consolidation) Act in 1908, the Companies Act 1913 and the Companies (Particulars as to Directors) Act 1917, together formed the basis of company law in Ireland for the first half of the last century. Since then, the most important legislative enactment has been the Companies Act, 1963 which was based on the recommendations of the Report of the Company Law Reform Committee (1958). It is the single largest statute enacted by Dail Eireann. This Act was modified in 1977 with the new Companies Amendment Act and again in 1982, 1983 and 1986. A far more radical Companies Amendment Act and Companies Act were introduced in 1990 and again this was further modified in 1999. Two new acts were introduced in 2001 and 2003, the Company Law Enforcement Act and the Companies (Auditing & Accounting) Act. Other Acts have been enacted in 2005, 2006 and more recently, two new Acts in 2009. New legislation will be introduced on an ongoing basis, reflecting the ever changing business environment in which companies operate.

It was the 1990 Act which had the most powerful impact on Irish commercial activity in general. This Act placed new responsibilities on directors of limited companies and for the first time in history, company directors were to be held personally liable for non-compliance with statutory legislation. All limited companies are required to file an annual return within a specified time frame with the Companies Registration Office (CRO) and there are considerable penalties for non-compliance or for late returns.

Prior to the 1990 legislation, Irish companies, particularly the small companies which represent the majority of Irish companies, had an indifferent attitude to record keeping in general, and many of them had an adverse reaction to the requirement to disclose financial information in relation to their businesses. Despite the fact that they enjoyed limited liability in relation to the debts of the company, they objected to the general public having access to what they considered to be their 'private' information regarding the business. Consequently, many firms failed to file the required returns.

In addition to the negative attitude of many directors of small companies, there was also at the time the added problem of the number of companies registered as limited companies. There were in excess of 200,000 companies registered, but it was soon discovered that many of these companies were not in fact trading. The problem was that from the 1963 Act up to the 1990 Act, many business people registered companies, not to set up in business, but for other reasons such as to protect a particular name. A name once registered cannot subsequently be registered by anyone else. Other reasons included attempts to protect a market sector by registering the name of a UK or American competitor in order to try to prevent them setting up an Irish company with the same name. In the early days of company formation, it was relatively easy and cheap to set up a company. The share capital requirement was nominal, and for the two compulsory directors, only IR£1 was required from each. Many business people also registered companies with a view to selling them on for profit at some time in the future.

Hence these companies became known as 'shelf' companies and many were later purchased for a fee by entrepreneurs setting up in business who preferred not to go through the hassle of setting up a company from scratch and who also wanted a 'quick' start in business. All that needed to happen was to register a change of directors and secretary and sometimes a change in the memorandum or articles of association. The early days of the 1990 legislation were thus hindered by the sheer volume of non-compliant companies.

In 1999, The CRO began a rigorous campaign to 'round up' defaulting companies and to 'weed out' non-trading companies. They were aided in this process by the provisions of the Companies (Amendment) (No.2) Act 1999, which amended the law on examinerships and which also gave power to the CRO to 'strike off' non-compliant companies. They began their campaign by issuing notices to all registered companies who had not filed a return advising the directors that if they failed to file a return within a specified time, then the company would be 'struck off' the register. The problem was exacerbated by the fact that these notices were sent out to the registered address of each company, but in many cases, because there were so many shelf companies, the address was often just an office which was used at the time of registering the company. Consequently, many companies never received the notices.

This was a period of intense anxiety for creditors, particularly unsecured creditors, as many of the debtors on their books were suddenly struck off, resulting in many companies trading with 'unregistered' companies. The big 'clean up' which occurred in the late 1990s resulted in thousands of companies being struck off, which in turn resulted in many unsuspecting creditors continuing to issue invoices to 'non-existent' companies.

Because of the backlog this operation inevitably created, coupled with the volume of companies which tied up precious resources, the information that should have been available to interested parties, including trade creditors/suppliers, was invariably out of date and therefore of little use. By the time the financial information from the returns became available, many of the companies had changed significantly, some had even gone out of business while others were found to be have been insolvent during the period creditors were trading with them and extending credit in good faith. In

many cases the information was a year old, and a year earlier many suppliers had unwittingly continued to supply products and services and to provide credit facilities as they were completely unaware of the situation.

Eventually however, with the aid of a good computer system, and the fact that all of the 'dead wood' had been cleared out, the CRO caught up and information filed became available much earlier. In addition, many genuine company directors, having been made aware of the consequences of their non-compliance, were given the opportunity to have their company re-instated and to file all missing returns together to bring them up to date. This amnesty was availed of by thousands of companies at this time.

Today, the CRO is a very useful source of information on any registered company, and its data bank is maintained as up to date as possible.

In addition to the various Companies Acts, another very important piece of legislation was introduced in 2001. This was the Company Law Enforcement Act. The purpose of this act was to ensure that all registered companies complied with the legislation as laid down in the various Companies Acts, and to achieve this aim, the Office of the Director of Corporate Enforcement (ODCE) was established. This division includes staff qualified in a variety of professions, such as accountants, garda officers, private investigators, tax inspectors, solicitors, barristers and a host of other highly qualified personnel who together have a wealth of experience in business and law enforcement. This division was to have a major impact on areas of business such as reckless trading, fraudulent trading, non-compliance with statutory obligations etc, and it is as a direct result of their efforts that many company directors have been prosecuted for such offences.

As a result of all of the activities of both the CRO and the ODCE, combined with the significant legislation enacted in recent years, the business environment within which we operate today has become much more stable. For the first time, creditors have access to good reliable information regarding any companies with which they wish to do business, and in particular to whom they may extend significant amounts of credit. Business people themselves have finally come to realise that they cannot enjoy the benefits of limited liability without disclosing important financial information to their prospective creditors. Auditors are responsible for ensuring that proper records are kept and more and more, company directors are happy to discuss their financial status with creditors in an effort to reassure them that they are a 'good' risk. This is to be welcomed in the commercial world, as the chaos which ensued prior to the introduction of the legislation and the development of the ODCE only served to break down the trust which has to exist between supplier and customer if there is to be a good steady trading relationship.

The areas of law covered in this section are of tremendous importance to the credit professional today. Here more than in any other area of law, it will be demonstrated how legislation, or the law of the land, can play a very supportive role in the area of credit. The roles of directors, accountants and auditors are more clearly defined and the role of the new ODCE provides a very reliable monitoring service. The majority of offences relate to finance in one way or another and also to a general disregard of financial obligations by some business owners. While the ODCE cannot pursue your

unpaid debt, it can force owners to comply with legislation and therefore to ‘smarten up’ their act.

Companies and Company Law in Ireland

Most companies are established in order to engage in some industrial or commercial enterprise; the vast majority of companies are run in order to make profits for their members. However, some companies are established for non-commercial or non-profit purposes. With regard to commercial activities, individual business persons may choose to conduct their businesses either in their own names as “sole traders” or under the auspices of registered companies in which they own all or virtually all the shares. Where a number of persons wish to engage in a business in common, they have the choice of either forming a partnership or a registered company. However, if a considerable number of persons are involved, the partnership option is not available to them. Among the principle advantages of the sole trader and the partnership forms are that they do not need any special formalities or expenditures to be established. One becomes a sole trader simply by trading on one’s own behalf; the mere fact of doing business in common with others with a view to making a profit constitutes a partnership. At present there are around 200,000 Irish registered companies and in recent years, approximately 300 new companies were being registered every week.

In the present climate however, this trend has reversed and now unfortunately there are more companies closing down than there are starting up. The strain of the recession on companies is evidenced by an average of five companies per day going into liquidation, the majority due to insolvency. The figures for companies involved in examinership or receivership are also increasing alarmingly. Despite the recession however, all companies must follow very strict procedures where insolvency or liquidation is involved, and this is one of the benefits of having good company legislation in place. Directors can no longer just walk away, leaving unpaid debts with their creditors. That is not to say that there is any better chance of creditors being paid, particularly unsecured creditors, but it does mean that directors are accountable and they can be punished in law. It is hoped that this will be a deterrent to directors who might be careless or even reckless in running up debts for a company.

Sources of Company Law

Up to 1963 there were a number of companies Acts in operation, but most of them were repealed and consolidated into the Companies Act 1963. This Act is a major piece of legislation, representing the biggest single Act enacted by Dail Eireann. It contains 399 sections and is known as the ‘Principal’ Act. It formed the basis of company law in Ireland and has been amended on several occasions, particularly since our entry into the European Economic Community (EEC) in 1973.

Table of Statutes

There has been a vast amount of legislation in the area of company law enacted over the years, the following table is a brief outline and description of the main sources of Company Law in Ireland today:

- Companies Act 1963 – known as the 'Principal' Act, it is the foundation of modern company law in Ireland, and almost all issues are covered in its 399 sections.
- Companies (Amendment) Act 1977 – simplifies certain activities on the Stock Exchange
- Companies (Amendment) Act 1982 – inserts certain amendments into the principal act.
- Companies (Amendment) Act 1983 – introduces the modern public limited company. The act also deals with financial issues, such as the amount of share capital that a company can issue, and includes the provision that a private limited company cannot invite the public to buy its shares
- Companies (Amendment) Act 1986 – deals largely with company accounts and reports and introduces the requirement for companies to file financial statements with the Registrar of Companies
- Companies(Amendment) Act 1990 – a one issue act with creates the role of the examiner
- Companies Act 1990 – this deals largely with personnel of a company; directors, secretaries and auditors. Establishes legal duties and responsibilities of officers of companies and strengthens the regulations governing them
- Companies (Amendment) (No. 1) Act 1999 – a short act dealing with stabilisation matters for securities sales
- Companies (Amendment) (No.2) Act 1999 – amended the law on examinerships and removed the statutory audit requirement for small companies
- Company Law Enforcement Act 2001 – establishes the Director of Corporate Enforcement and amends the law on investigations. It also established the Company Law Review Group on a permanent statutory basis
- Companies (Auditing and Accounting) Act 2003 – this act establishes the Irish Auditing and Accounting Supervisory Authority and strengthens the regulation of company auditors

Collectively, these acts are cited as the Companies Acts 1963 – 2003 and are construed together as one act, representative of Company Law in Ireland. There are also numerous pieces of delegated legislation in force under the various acts, all primarily concerned with the regulation of companies and officers.

In line with the above legislation, there is also EU legislation in the form of directives issued to member states. There are many company law directives in force in Ireland as Acts or delegated legislation. These directives are part of the EU programme of harmonisation of company law throughout the European Union, and it could be said that the increased volume of new company legislation since 1973, when Ireland joined the then EEC, is as a direct result of such directives being implemented.

Recent Developments

The Investment Funds, Companies and Miscellaneous Provisions Act 2005 – provides greater flexibility to the funds industry without sacrificing appropriate controls, while

the Investment Funds, Companies and Miscellaneous Provisions Act 2006 includes, among other things, an increase of audit exemption thresholds.

In 2007, the Company Law Review Group presented a report on the Companies Consolidation and Reform Bill with a view to replacing thirteen Companies Acts and numerous statutory instruments with a single piece of legislation. This legislation is expected to simplify many of the existing procedures for setting up and running a company, while ensuring that creditors and shareholders retain good legal protection. One of the proposals is to replace the current memorandum and articles of association with a single document and to provide for single-director private companies. It is also proposed to extend the powers of the Director of Corporate Enforcement to include the power to petition to wind up a company.

The following two Acts represent the most recent legislation:

- The Companies (Amendment) Act 2009 and
- The Companies (Miscellaneous Provisions) Act 2009

The Company Law Review Group are continuing the process of reviewing all company legislation, with a view to making any changes necessary to bring Company Law in Ireland up to date and in line with other European member states.

The Company Law Review Group (CLRG)

Prior to the 2001 Act, working groups on company law had produced reports at the request of the Minister for Enterprise, Trade and Employment. Under Section 68 of this Act, the duties of the CLRG are outlined as follows:

The CLRG shall monitor, review and advise the Minister on matters concerning:

- The implementation, amendment and consolidation of the Companies Acts
- The introduction of new legislation relating to the operation of companies and commercial practices in Ireland
- The rules of the Superior Courts and case law judgements, insofar as they relate to the Companies Acts
- The approach to issues arising from the State’s membership of the European Union, insofar as they affect the operation of the Companies Acts
- International developments in Company Law, insofar as they may provide lessons for improved State practice, and
- Other related matters, including issues submitted by the Minister to the CLRG for consideration

The members of the CLRG are appointed by the Minister. The Minister must consult with the CLRG at least every two years to determine a work programme. The CLRG must report to the Minister every year.

In addition to all statutory legislation, there is also an abundance of case law or precedent in existence, which is also a very useful source of company law. Probably the most famous case is ***Salomon v Salomon & Co. Ltd (1897)*** which established that a person who forms a company and the company itself are separate legal entities.

Company law is classified as civil public law, although there are some criminal elements such as insider dealing. There is always going to be some overlap between Company Law and other areas of law, such as:

- Contract law – contracts are the cornerstone of commercial activity, consequently, companies engaged in commercial activity will enter into contracts on a daily basis
- The common law and equity – the foundation of contract law
- Tort law - where a civil wrong may have been committed
- Criminal law – where a wrong committed is a criminal offence

A full list of offences and indictable offences can be found on the website of the Office of the Director of Corporate Enforcement (ODCE).

Company Forms

A company is an association of one or more persons, formed for a business purpose. There are different types of companies, the most important of which is the company limited by shares and registered under the Companies Acts 1963 – 2009. A company must be distinguished from other forms of business entities, such as sole traders and partnerships.

A sole trader is simply an individual, usually an entrepreneur, professional or tradesman, who sets up his or her own business and operates as a single owner of the business. There are many such sole traders in Ireland and they tend to remain small, but if the business grows significantly, many will go on to incorporate the business as a company. A partnership is defined as an association of two or more parties carrying on a business in common with a view to a profit. In Ireland, many partnerships can be found in the legal and accounting professions, where two or more merge their respective businesses to enable them to develop and strengthen the business as a whole.

The characteristics and features of a registered company are quite different to the other forms of business, and these differences can best be understood by contrasting them.

Contrast between a Registered Company and a Sole Trader/Partnership:

(1) Legally Separate from Owners:

The registered company has a legal identity that is entirely distinct from that of its owners. A sole trader's business is part of his own property and its obligations and debts are also that trader's own personal liabilities. A partnership is merely an association of the individual partners; its assets and liabilities are in law those of its members. A registered company, by contrast, exists in law entirely separate from its members or shareholders; company property belongs to it and not to the shareholders and the shareholders are not directly answerable for the company's liabilities. A company could be described as a legal person, having the legal right to sue in its own name, or be sued. It can own property and any other assets, and can incur debts and other liabilities in its own name.

This important principle was established in the case **Salomon v Salomon & Co. Limited [1897].** Mr. Salomon ran a successful leather business as a sole trader, but was persuaded by members of his family to incorporate the business. He sold the business to the newly incorporated company for the sum of £30,000 which was satisfied by the issuing to him of 20,000 £1 shares in the company. The balance of the sale price was satisfied by the creation of a floating charge (debenture) in favour of Mr. Salomon in the sum of £10,000 covering all assets of the company. After serious financial trouble, the company was wound up and the liquidator applied to Court to have Mr. Salomon personally liable for the company's debts, as he was the major shareholder.

On the first two hearings Mr. Salomon, as major shareholder, was held to be personally liable for the company's liabilities. However, on appeal to the House of Lords (UK), Mr. Salomon's contentions succeeded. It was held that Mr. Salomon was a separate person capable of incurring a valid debt to the company and accordingly would not be held liable for the debts of the company. This is probably the most significant decision ever made in relation to company law. It is commonly known as the 'Salomon Principal'.

Company property is held in the company's name and legal proceedings are brought by or against the company in its own name. The separate legal personality of companies, therefore, enables business persons to segregate their own private affairs from their business.

A company once it is incorporated is a distinct legal entity separate from its members. A 'veil' therefore separates the company from its members from the date of incorporation. The decision in the Salomon case constitutes the normal principle applied by the courts in the majority of cases. However, there are a number of exceptions to this principle of separate legal personality, and in each of the following instances, the veil of incorporation is said to be lifted:

1. Where a director or other officer of the company was knowingly a party to the carrying on of the business of the company in a reckless manner.
2. Where any person was knowingly a party to the carrying on of any business of the company with intent to defraud.
3. Where the company is the subsidiary of another company i.e. where the majority of the company's shares are owned by another company.
4. Where the company is set up for a fraudulent, illegal or improper purpose.

In such cases, the courts will lift the **corporate veil** in order to look at the realities of the situation, beyond the separate legal entity of the company. This could be done in order to make a holding company liable for the debts of its subsidiary or to render members liable for the debts of the company itself, or in situations where the court feels that the veil of incorporation has been abused in some unacceptable manner by persons involved in the company.

(2) Limited Liability:

"Limited liability" results from separate legal entity. It means that a company's owners' (i.e. the shareholders or members) liability for debts incurred by their

company that it cannot pay, is subject to a limit or ceiling; those owners cannot be held personally responsible for those debts beyond that limit. In any particular company the limit is one the owners agreed to when establishing the company or when they acquired shares in it. Where a company is limited by shares, a member of the company, in the winding up of the company, is liable only for any amount that remains unpaid on his shares at that time. In a company limited by guarantee, the member is liable only to the full extent of his guarantee. Thus, the members do not have to pay an amount equal to the full debts of the company. Their liability is limited, and any liability is to the company and not directly to the company's creditors.

This is in direct contrast to an unlimited liability company, where the members guarantee the debts of the company without any limitation. In the case of sole traders or partnerships, the owners are personally liable for all debts incurred during the course of their business. Thus, their own personal assets are always at risk, and if the business failed and they could not afford to repay their debts from the proceeds of the business, they can be personally sued by the creditors.

In a limited company, if the shares are fully paid, the shareholders cannot then be held personally responsible for their company's debts; the shareholder's liability is limited to the amount remaining unpaid on their shares only.

This method of separating business persons' and investors' personal wealth from the fortunes of their enterprises is designed to encourage them to take business risks, without which a capitalist economy and society would stagnate. This is particularly important in a declining economy when entrepreneurship becomes vital. Without some protection in law, the entrepreneurs may not be willing to take the necessary risks. It is not a blanket protection however, and company directors must follow very strict procedures to ensure that they comply with all legislation. Any non-compliance could result in the corporate veil being lifted, as described above, and the directors subsequently being held personally liable.

For example, under Section 36 of the Companies Act 1963, a shareholder who knows that the company is carrying on business with less than the statutory minimum membership for more than six months is severally liable for the debts of the company contracted during that time.

(3) Transferable Shares:

A registered company is comprised of members or shareholders. If any shareholder wishes to liquidate his or her investment in the company, all they need do is to sell their shares to another. This transaction can be carried out quite easily; it does not require the assistance of a qualified lawyer and, more importantly, causes no disruption to the running of the business. On the other hand, a sole trader who wishes to dispose of his business must execute conveyances and other elaborate contracts to that end. And as a general rule, a partnership must come to an end whenever any one partner retires. The transferable share in a registered company is an administratively simple way of attracting further investment in the company. All that needs to be done is for the company seeking more capital to allot additional shares in return for cash or other assets to those willing to invest in it. Effectively, the company does not move or

change, but shares can be moved around frequently. This greatly enhances the stability of a properly registered company, making the company more secure in the long term.

(4) Continuous Existence:

When a sole trader dies his business comes to an end; it may be sold off to satisfy claims by the estate or it may be transferred to another party under the deceased's will. On the death of any partner generally the partnership is automatically dissolved. A company, by contrast, never dies but continues in existence until it is wound up. Therefore, the business is not disrupted to any like extent when the principal shareholder dies as when the sole trader or a partner dies. In the case of a registered company, the business continues to remain in the same ownership and it is only the company's shares that change hands. This continuous existence, or perpetual succession, further enhances the long term prospects of the company and can attract good investment if and when it is required for the development or growth of the business. In essence, the 'company' does not change, but ownership of it can change over and over throughout its existence. There are several registered companies in existence today that have been around for more than one hundred years.

Types of Registered Companies:

The formation of companies in Ireland is a relatively straightforward process compared to the situation which prevailed under old legislation in the past. When a business is being incorporated, there are several choices to be made. The company can be limited or unlimited, public or private, under any combination of these categories depending on the circumstances and personal preferences of the owners.

Limited Company:

One of the main reasons why persons choose to do business through the vehicle of registered companies is to obtain the privilege of limited liability. By this is meant that, if the business fails, the owners of the limited company are not personally responsible for all of its unpaid liabilities (examined above). Consequently, this is the choice of the majority.

Unlimited Company:

It is not surprising that there are comparatively few unlimited companies, since their members can be held liable without limit for the company's debts. There are, nevertheless, some advantages in having the unlimited form. For example, these companies are exempted from many of the Companies Acts' disclosure requirements and accordingly provide their members with greater secrecy about their affairs. Consequently, some business owners, particularly family businesses, prefer to remain unlimited as this protects their privacy. There are several private unlimited companies in the retail sector for example, because of the sensitivity of information such as pricing policy and margins. Companies choose this option in order to conceal this information from competitors.

Private Company:

A company may be registered as either a private or a public company. The normal private company is the one-person or the small family trading concern, although some major firms are private also. The principal advantages of being private are that, provided the company is small or medium-sized, a comparatively restricted amount of information about the company's financial and trading position need be disclosed to the public through the Companies Registration Office (CRO).

In order to form a private company, there must be a minimum of one or two members; and the articles of association must provide for the following: that, apart from employees/shareholders, its membership shall not exceed fifty (amended to ninety-nine), that the transfer of its shares is subject to some restriction and that the public should not be invited to subscribe for shares in it.

Public Company:

A new kind of company, the public limited company, or "p.l.c." for short, was inaugurated by the Companies Act 1983. In order to be a public company with limited liability (p.l.c.) a number of requirements, designed principally to protect creditors from being victims of under-capitalisation and over-trading, must be satisfied. For example, the company must have a minimum authorised share capital of at least €38,092 and at least one-quarter of the nominal amount must have been paid up on its issued share capital *(Section 28 Companies Amendment Act 1983).*

Public companies may be listed or unlisted. A listed company is a public company, the shares of which are bought and sold on the stock exchange. Only a small percentage of PLCs are listed companies, the others are referred to as unlisted.

Group Companies

In a group of companies, a holding company will hold shares in a number of subsidiaries. A company may wish to separate its areas of business for management or administration reasons. In other cases, a holding company, sometimes referred to as a 'parent' company, may be based in one country and hold shares in subsidiaries in other countries. Ireland has a significant number of such companies in operation, where the parent company is based, for example, in the UK or the USA, and the subsidiaries of those companies are registered and based in Ireland. There are some also where the holding company is based in Ireland.

Memorandum of Association:

Every registered company must have a memorandum and articles of association. This document is the company's fundamental law and may be amended only in the circumstances and in the manner as provided by the various Companies Acts.

The memorandum must state the following:

1. The company's name
2. Its objects
3. A limited liability clause which states that the liability of the members is limited
4. A capital clause which states the amount of the nominal capital and the number, division and amount of each share
5. An association clause which gives the name, address and occupation of each subscriber, in addition to the number of shares taken

Company Name

Under the CA 1963, the company name must end with 'limited' or 'public limited company' (plc), or the Irish equivalent. The only exception to this rule is in the case of any non-profit company such as a charity, when an exemption is given. It is an offence for anybody other than a plc to trade under a name which ends in plc. And if it is a private limited company, the name must end in Limited or Ltd for short, or the Irish equivalent Teoranta or Teo. No company name can be duplicated and in fact, a name might be refused by the Registrar if it is too similar to another. There are also some restrictions set out in the CA 1963 with regard to 'undesirable' names.

If your debtors' ledger contains companies, you must ensure that you have the ***correct legal title*** on any documentation for each company. Failure to do so could result in proceedings being commenced with either the wrong company or a non-existent company, causing any action to be dismissed.

Guinness Ltd., Smithwick and Sons of Kilkenny v Kilkenny Brewing Company Ltd (1999). The defendants were ordered to change their company name because of the likelihood of confusion with 'Kilkenny Irish beer' which is brewed by the plaintiffs.

Under Section 114 of the CA 1963, a company must display its name at its office or place of business, on all business letters and notices, and on cheques, invoices and receipts. Failure to do so may lead to the lifting of the 'corporate veil'.

Durham Fancy Goods v Michael Jackson (Fancy Goods) Ltd (1968)
The defendants endorsed a cheque made out to M. Jackson (Fancy Goods) Ltd.
Held: The plaintiffs had accepted an incorrect version of the name and therefore could not rely on Section 114.

A company must also have a company seal engraved with its name in legible characters.

The name of a company can by changed by special resolution and with the approval of the Registrar of Companies. Companies thus changed should notify their creditors accordingly, however, it is a known fact that some fail to do so or fail to ensure that their creditors have received such notice. This can present a major problem for creditors.

A sample case where a change of name occurred will help to illustrate this point. A registered company was trading for several years and the owners decided to sell the

company in order to retire. The new owners continued trading with suppliers, but unknown to the suppliers, they had actually dissolved the old company and incorporated a new company with a name very similar to the old one. The difference was so slight that creditors did not notice and accepted cheques from the new company believing them to be drawn on the old company.

They traded for 12 months with Company B, believing it to be Company A. They only became aware of their mistake when the company was put into liquidation at the end of this period. The statement of affairs showed a deficit of over €1m, so unsecured creditors would be paid nothing. Shocked creditors at the subsequent creditors' meeting discovered that they had been trading with a new company that had little or no assets. The most substantial asset, the premises which the old company owned, remained with the old company 12 months prior, and in fact had been sold to a property management company – with the same directors as the new company. This illustrates the consequences, albeit uncommon, of providing credit to the wrong company.

It should be a matter of regular 'housekeeping' that you periodically check your debtor accounts to ensure that you are trading with the correct legal entity. Keeping copies of cheques on file is a good way to keep an eye on customers for any changes. If you notice anything, it would be good practice to have a chat with the customer or investigate further if a change is fundamental.

Company Objects

The memorandum of association must state what the company's 'objects' are, in other words, what it is intended that the company shall do. A company cannot act outside its objects by virtue of the **ultra vires rule.** This rule means that any activities by the company acting outside its objects are automatically void. Frequently, companies have their objects expressed in very broad and general terms to avoid this eventuality. However, in those circumstances the court will only have regard to the main objects of the company. Any powers exercised by the company must have the effect of advancing the main objects of the company. For example, most companies would include in their objects the power to hire and fire, buy and sell, write cheques or borrow money. Companies have both expressed and implied powers.

If a company set out as one of its main objects that it builds houses, then it cannot subsequently build factories as that would be outside the objects and therefore any contracts entered into to build factories would be considered ultra vires (beyond the powers of) the company. So the company would broaden its main objects to allow it more flexibility.
If a contract is ultra vires the company, it cannot be ratified by the company.
The effect of the ultra vires doctrine is to prevent a third party dealing with the company from suing on a contract if that contract is not made within the company's power. The harshness of this rule has been modified by Section 8 of the Companies Act 1963 which provides that a third party dealing with the company who is not "actually aware" that an act is ultra vires is entitled to rely on the transaction. If a contract has been examined by a professional such as a solicitor, the company cannot subsequently rely on Section 8 as it could not then claim it was not actually aware that the transaction was ultra vires.

Introduction Ltd v National Provincial Bank (1970) – A company changed from tourism to pig breeding. Subsequent borrowing was ultra vires and therefore could not be enforced by the lender.

Re Frederick Inns Ltd (in liquidation) (1994) - €1.5m had to be returned by the Revenue Commissioners to the liquidator because it had been paid by a holding company on behalf of ten of its subsidiary companies, but it did not have the power to do so (i.e. there was nothing in its memorandum of association to allow it).

The Ultra Vires Rule
An ultra vires contract is void and unenforceable by a company.
A third party may enforce the contract under Section 8, CA 1963, and Article 6, EC Regulations 1973, but only if it can be proven that they were totally unaware that the contract was outside the objects of the company.

It is possible to alter the memorandum of association of a company. This can be done by special resolution. The clauses which can be altered are; the name clause, the objects clause, the capital clause and the limited liability clause.

Articles of Association:

The second major document needed to form a registered company is the articles of association, which may be regarded as the company's byelaws, or internal rules and regulations; the rules that set down in detail how the company is to be run and managed on a daily basis. The Companies Act 1963 contains a model set of articles and most companies in fact adopt these for their articles, either in their entirety or subject to some alterations.
In the case of any conflict between what is contained in the memorandum and what is contained in the articles, then the memorandum will prevail as that is the more important document.

Once the articles are registered, they are deemed to create a legally binding contract between the shareholders and the company.

The articles of association may also be altered by a special resolution.

Accounts, Audit and Disclosure of Information:

Maintenance of Accounts
One of the principal techniques used by the Companies Acts to safeguard investors and persons who deal with companies is the compulsory disclosure of information. In exchange for the privilege of separate legal personality and limited liability, registered companies are required to disclose certain facts about themselves to the general public, usually via the Companies Registration Office (CRO). Additional information must be made available to their shareholders and debenture-holders. However, because requiring companies, especially small companies, to disclose extensive financial information could make them vulnerable to competitors, small and medium-

sized companies (SMEs) are not obliged to disclose as much information as large companies and Plcs.

Section 202 of the Companies Act 1990 requires that all registered companies keep proper books of account which must be kept on a "continuous and consistent basis". Among the matters for which accounts must be kept are assets and liabilities, day-to-day receipts and expenditures, purchases and sales, services provided and stocks held, together with records of stocktaking. These books must be kept by the company for at least six years after any event to which they relate occurred. These books must give "a true and fair view of the state of affairs of the company". Any director of the company who does not take reasonable steps to secure compliance with these statutory requirements commits a criminal offence.

In addition to keeping proper records, all companies are required by law to file an annual return with the CRO. The time-frame allowed is within nine months of the financial year end at which the accounts have been prepared. It is the responsibility of the company secretary to ensure that all returns are filed at the correct time.

In the case of SMEs, they are only required to file abridged accounts.
A company is defined as small or medium relative to its turnover, number of employees and balance sheet value, and changes from time to time. The current criteria is:

A Small Private Company is one which satisfies two of three conditions:

- Turnover not exceeding €3.8m
- Average number of employees less than 50
- Balance Sheet Total less than €1.9m

A small company which satisfies the above criteria for two consecutive years is not required to file a Profit & Loss Account and files only an abridged Balance Sheet and certain notes to the accounts. This significantly reduces the level of financial analysis required.

A Medium Company must satisfy two of three conditions:

- Turnover not exceeding €7.6m
- Average number of employees less than 250
- Balance Sheet Total less than €15.2m

A medium company does not have to file a Trading Account, i.e. details of turnover, cost of sales and margin. The accounts they are required to file start with Gross Profit only. This enables them to keep sensitive information from competitors.

A Large Private Company is any company which does not fall within either of the above two categories. A large company does not have any concessions from publication.

Audit:

Every company must appoint an auditor or auditors, with the exception of those SMEs outlined above, whose principal task is to examine the company's accounts and to make an auditor's report on them. The auditors are appointed by a resolution of the

annual general meeting. In order to ensure that the auditor is professionally competent to do the job, is independent and honest, the law sets down rigorous qualifications which must be met. As is the case with company directors, auditors can be removed from office quite easily – an ordinary resolution of the company is sufficient. How much the auditors are to be paid for their services is controlled by the shareholders and is fixed either at the Annual General Meeting or in such manner as that meeting determines.

A register of auditors is maintained by the Companies Registration Office and contains the names and addresses of persons or firms who have been notified to them as qualified for appointment as auditors of a company. It is a criminal offence for an auditor to conduct an audit if he is not registered.

In order to carry out their task, the auditors are given extensive powers to obtain books and records and to demand information. Failure to provide, within two days of the request, any information or explanation being sought is an offence, except where it was not reasonably possible to comply. Giving false or misleading information to the auditors is an offence where that is done knowingly or recklessly.

Being appointed by the company, the auditor's primary duty is to it and to make the auditors' report. That requires them to audit the company's books and records. The Companies Act 1990 places them "under a general duty to carry out such audit with professional integrity". Where proper books are not being kept by the company, the 1990 Act requires the auditors to notify the company promptly of that fact. They must also notify the Registrar of Companies to that effect unless, within seven days, the matter has been rectified.

Recent Changes

The criteria for small to medium companies have recently been changed, as outlined above. This is aimed at cutting down on the 'red tape' and the onerous task of filing information for small firms which, more often than not, do not have the resources to maintain such a high level of record keeping etc. Certain private limited companies that satisfy the necessary criteria may avail of an exemption of the statutory requirement to have an audit. To qualify, the company's turnover must be below the maximum level for this category for two consecutive financial years. Small to medium sized companies are defined by legislation and the criteria may be changed from time to time, in line with current economic conditions. All companies must still keep proper books of accounts, and these can be inspected at any time by an Inspector of Taxes, but SMEs are now saved the expense of engaging external auditors to complete a full audit. This is to be welcomed for small firms in general, as the audits carried out in the past were exactly the same as those carried out for larger companies with much greater resources and usually more shareholders to be reported to.

Many small companies have taken the decision to continue having a full audit, or a less detailed audit, as they see this as an external independent check on the financial performance of the company. When an audit is carried out, the auditors will sign a report for the company stating that the accounts represent a true and fair view of the company's financial position, and this report can be a very valuable document to present to creditors, suppliers and other interested parties. It provides more security

than management accounts alone, as it represents an independent check on all the activities of the company and also means that all assets have been properly examined, such as a review of the stock take carried out, to ensure that everything is in order. Without a statutory audit, the risk associated with extending credit to companies is considered to be higher. However, a review of the company's financial statements filed at the CRO can still provide a substantial amount of information and details to support a proposed credit line.

Companies Registration Office (CRO)

The Companies Registration Office (CRO) is the statutory authority for registering new companies in the Republic of Ireland. It is the central State office dealing with practical aspects of company law, such as the incorporation of new companies and the filing of annual returns. The Office also registers business names. A business name is a trading name which differs from the names of the persons or the company who owns the business.

The CRO has a number of core functions:

- Incorporation of companies and the registration of business names
- Receipt and registration of post-incorporation documents
- Enforcement of the Companies Acts in relation to the filing obligations of companies
- Making information available to the public

Companies, and to a lesser extent business names, have an obligation under law to file certain accounts with the CRO, as outlined above. These documents include;

- Changes of registration office
- Changes of company officers
- Changes to a registered company name, or a number of other changes which affect the company

Companies are also required to file annual returns and in most cases they must also file annual accounts which should be annexed to the returns. The CRO also keeps details of mortgages and charges imposed on companies

Unfortunately, not all companies comply with their obligations to file documents. The CRO can take a number of measures to deal with companies who fail to file their annual returns, including prosecution of the company or directors, or striking the company off the register. Companies who fail to file may be struck off the register, and in such cases, the protection of limited liability no longer exists and individuals can be held personally liable for any debts incurred after the strike off. Also, the assets of such companies will become the property of the State. While it is usually possible to reinstate companies which have been struck off, this can be a very expensive process. Companies wishing to avoid such an action need to ensure that their annual returns are filed on time.

In the period 1999 to 2007, several thousand companies were struck off the register, some of which were later reinstated. In 2008, a total of 5,804 companies were struck off for the failure to file annual returns and 122 companies were prosecuted. The programme of enforcement is ongoing.

Almost all of the information filed with the CRO is available for public inspection, usually for a small fee. Certain vital information, such as company name and registered office address, may be checked free of charge on the web search facility, which can be found at www.cro.ie . A more detailed report of any company is available by ordering a company printout or a copy of any document filed. This can also be obtained using web search facility – a small charge applies for copies/printouts. Some basic statistics are available in the annual report which is attached to the return.

The web search also includes a facility to carry out a search for disqualified or restricted persons – ie company officers who have either been disqualified or restricted because of an offence under the Companies Acts.

The CRO also maintains a register of auditors which contains the names and addresses of persons or firms who have been notified to them as being qualified for appointment as auditors of a company (as outlined under Audit above). The CRO must also be notified when a liquidator is appointed and the CRO then notifies the ODCE of the appointment.

Office of the Director of Corporate Enforcement

This new office of Government was brought into being by the enactment of the Company Law Enforcement Act 2001. This legislation was finally passed after many years of lobbying and research, and in particular as a result of the work carried out by the Working Group on Company Law Compliance and Enforcement, the Company Law Review Group, and also the findings of the McCracken Tribunal which occurred at around the same time. The Government had expressed concern over abuse of Company Law and in particular it had become apparent that this abuse would affect the integrity of the system of company regulation in Ireland. The view was expressed that if Ireland was to maintain its reputation as a place to do business there had to be greater compliance.

In 1999 there were two new Companies (Amendments) Acts, one of which extended the power of the Companies Registration Office (CRO) to strike companies off the register (see introduction). Warning notices had been sent to companies that had not filed a return for 1999, asking that any outstanding returns including the return for 1999 be filed. Up to 7,000 warning notices per week were being sent out by the CRO at this time. The process of sending out notices followed by statutory strike-off continued until all companies registered in Ireland that had not filed an annual return up to a date during 1999, had had notices issued to the registered address of the company.

The CLE Act was the next step forward in ensuring continued and better compliance with all company legislation. It does not take over any functions of the CRO, but is considered to be complementary to their role in regulating companies in Ireland. One of the roles of the Company Law Review Group was to simplify the operation of the combined Companies Acts, to enhance corporate governance and to encourage commercial stability, and the 2001 Act added weight to this function.

Today, the level of compliance in Ireland has improved greatly, due primarily to the increased activity of the CRO and easy access to forms which need to be filed and are now available on their website www.cro.ie , combined with the activities of the ODCE who offer support and encouragement to companies and who have gone a long way in re-educating company officers in general.

In the present era of openness and transparency, the focus is very much on those advising, managing or running companies, and the ODCE has a very important role to play.

The ODCE mission statement gives a very clear picture as to its purpose;
'The mission of the Office of the Director of Corporate Enforcement is to improve the compliance environment for corporate activity in the Irish economy'.

Mr. Paul Appleby, the first Director of Corporate Enforcement, was appointed in November 2001 and is legally responsible for:

- Encouraging compliance with company law
- Investigating and enforcing suspected breaches of the legislation

It is important to note that the CRO remains responsible for:

- Filing obligations
- Bringing non-compliant companies and officers to court
- Collecting and making publicly available up-to-date information on companies registered in Ireland

The Director of Corporate Enforcement took over from the Minister for Enterprise, Trade and Employment in the investigation and prosecution role. His main legal powers are:

- Initiation of fact finding investigations
- Supervision of companies in official and voluntary liquidation and of unliquidated companies
- The restriction and disqualification of directors and other company officers
- The supervision of liquidators and receivers in the discharge of their functions under the Companies Acts
- The regulation of undischarged bankrupts acting as company officers
- Prosecution of persons for suspected breaches of the Companies Acts

The office has a compliment of professional and administrative staff and investigations carried out have resulted in the successful prosecution of directors and officers of some of the companies found to be in breach of the law.

The role of the ODCE however is primarily to encourage compliance, rather than to catch people out. Their website – www.odce.ie – contains a lot of very useful information about the main responsibilities of companies, company directors, secretaries, auditors, creditors, liquidators, receivers and examiners. They play a very supportive role in the legal compliance of companies and the people involved in the running of these companies.

The fact finding company investigatory powers of the Director originate in the Companies Act 1963, amended by the 1990 Act, which made provision for investigatory powers to be exercised by the Minister for Enterprise, Trade and Employment. The 2001 Act transferred those powers to the Director.

In addition, the Director may apply to the High Court to appoint inspectors, but must first satisfy the court that:-

- There is intent to defraud creditors or creditors of any other person or otherwise for a fraudulent or unlawful purpose or in an unlawful manner or in a manner unfairly prejudicial to some of its members or that any actual or proposed act or omission of the company is or would be prejudicial, or that it was formed for any fraudulent or unlawful purpose; or
- Persons connected with its formation or management of its affairs have in connection herewith been guilty of fraud, misfeasance or other misconduct towards it or its members; or
- Members have not been given all the information relating to its affairs, which they might reasonably expect.

The 2001 Act specifically states that the Director can have appointed as one or more of the inspectors, an officer or officers of the Director, which conceivably include a member of the Garda Siochana.

The activities which can be carried out by the ODCE are varied and are still evolving, as this office is still considered to be in its 'infancy'. However, the main activities and powers may be summed up as follows:-

- Fact finding company investigations
- The appointment of inspectors
- Investigations of ownership of a company
- Power to require information regarding shares or debentures
- Power to impose restrictions on shares or debentures
- Power to conduct a private examination of documents
- Assisting overseas company law authorities
- Search warrants to enter and search premises and to obtain information from the officers of the company on site
- Taking whatever steps are necessary in order to preserve or prevent interference with material information
- Restriction and disqualification of directors
- Supervision of companies in official and voluntary liquidation and of unliquidated insolvent companies
- Reporting criminal offences
- Power to investigate companies found to be insolvent, but not in liquidation
- Restraining movement of assets
- Supervision of liquidators and receivers
- Regulation of undischarged bankrupts
- Power to prosecute
- Power to obtain evidence from auditors

This list is not exhaustive but includes the main activities of the ODCE at this point in time.

The key goals of the Office are cited by the Director as follows:-

Goal 1	Encouraging compliance with the Companies Acts
Goal 2	Uncovering suspected breaches of Company Law
Goal 3	Prosecuting detected breaches of Company Law
Goal 4	Sanctioning improper conduct relating to insolvent companies
Goal 5	Ensuring quality customer service

In addition to these specific goals, the ODCE is seen as an agency that helps company officers to comply with their legal obligations, with a particular emphasis on the importance of informing and educating company directors and other parties about their duties and powers under the Companies Acts. It discourages misconduct by those who may be tempted not to comply and it pursues those who may have breached their duties and obligations under the law.

The Director has both civil and criminal enforcement powers. He may prosecute company law offences summarily in the District Court and to date, the Office has secured more than 300 convictions against some 120 companies. They deal with approximately 1,700 cases each year.

Among the convictions are:-

- Persons acting as directors in breach of High Court disqualification or restriction orders
- Persons acting as auditors of companies while not qualified to so act
- Companies and directors for failing to keep proper accounting records
- Directors for providing false information or for falsifying company documents

In total, there have been 80 persons disqualified in recent years for serious abuse of their company law responsibilities, and over 900 directors restricted since 2003, where the company was insolvent and the directors failed to satisfy the High Court that they had acted honestly in the twelve months prior to the winding up of the company.

The role of the Director is limited to the Companies Acts. He is not the primary regulator of companies in sectors of the economy that are not registered under the provisions of the Companies Acts. The ODCE also does not police internal company rules. This is the role of the official auditor of a company.

Despite the fact that the Office has only been in operation since late 2001, it has been hugely successful in delivering significant results in improving market conduct and in reducing the consequential risk of financial loss for business and other company stakeholders.

Advantages to Creditors

Before the ODCE came into being, a creditor may have found that some of their customers were not complying with company legislation. For example, if they tried to get a copy of the debtor's annual return, where the debtor was a limited company, but found that it was not filed. Or if they did obtain a copy but found that there was a deficit in net current assets or even a negative net worth. Prior to 2001 there was not a

lot that a creditor could do. Now, however, the creditor can file a complaint with the ODCE and this complaint will be investigated by the Office in due course.

The ODCE works on cases where, for example, annual returns have not been filed, or where a company's return shows it to be technically insolvent. This is what is called the 'bank' of investigations to be carried out by the Office. They work their way randomly through many thousands of companies that fall into this category on an ongoing basis. However, if they receive a specific complaint, or if a non-compliance is brought to their attention, then this will take precedence and will be investigated first.

Presently, a creditor can report a non-compliant debtor, and although the ODCE will not carry out an investigation with regard to the unpaid debt, they will force the company either to comply with legislation and bring their affairs back in line, or alternatively, they may force the winding up of the company. This would at least bring closure and a liquidator could be appointed to try to generate some funds from the disposal of any assets. This is preferable to the situation that prevailed in the past, where directors just walked away and invariably went about setting up another company shortly afterwards, with no penalties for the unpaid debts they left behind, and no satisfaction for any of the unsecured creditors, and quite often the secured creditors also.

Creditors

Creditors are not without power in law, and the ODCE has a booklet available which outlines the various powers and duties of creditors.

A creditor of a company is defined as a person or company to whom the company owes a debt. There are two types of creditor; secured and unsecured.

Secured Creditors

A secured creditor is defined as a person or company whose debt is secured on one or more of the company's assets, such as property. If, for example, a company borrows money from a bank or other financial institution to purchase a building, the lender will ask for the title deeds to the building as security in case the company cannot repay the loan on the agreed basis. Some suppliers who would normally be unsecured creditors apply to the courts for a charge over a company's assets in cases where there is a substantial amount of debt involved or if there is a significant amount overdue. This has the effect of moving those creditors up in rank in the event of liquidation of the company.

Unsecured Creditors

An unsecured creditor is one whose debt is not secured on any of the company's assets. If the company cannot pay all of its debts, unsecured creditors will only recover payment if there are any funds remaining after the secured creditors have been paid.

Powers of Creditors

The most significant power that Creditors have under the Companies Acts is to seek to have a company liquidated. Creditors have various powers to address defaults in the operation of a company, such as;

- Power to appoint a liquidator
- Power to appoint a receiver
- Power to seek the appointment of an examiner
- Power to seek judgments in respect of debts owed
- Power where default exists
- Power to seek an investigation of the company
- Power where a company is not in liquidation
- Power to seek the restoration of the company to the Registrar of Companies

Duties of Creditors

The most important duty of Creditors under the Companies Acts is to protect their own interests. At least once a year, creditors should satisfy themselves that companies are able to pay for the goods and services being provided to them. For example, creditors can check out a company's state of affairs by viewing their annual returns filed in the CRO, before they decide if they want to do business or, more importantly, extend credit to that company. A regular credit check could prevent financial loss and avoid the need for creditors to consider taking legal action to protect their interests.

In the current climate, where in recent years many companies obtained credit freely from financial institutions, there is now a very sharp restriction of credit causing hardship for the companies who came to rely on a certain level of available credit for working capital. Many SMEs have been forced to cease trading as a result, and this has involved many, many redundancies. But for the moment at least, company legislation is designed to protect the creditor, and many have made the decision to adopt a protectionist policy in regard to extending credit. Many fear that if they had to take legal action in pursuance of a debt, they would be found to have been negligent in their duty to take reasonable care that a debtor had the ability to repay any credit extended to the company. There is a great amount of protection for consumers under specific consumer legislation, however, trade creditors do not enjoy the same level of protection. The business sector is obliged under law to take reasonable precautions to protect their own interests.

Judgments

When a company does not pay a debt, the creditor can seek a Court Judgment against the company. Once this judgment is secured, the creditor can engage a public official, known as a sheriff, to try to recover the debt. The creditor can also seek to register the judgment in the High Court. Once a judgment is registered, it will be published in a number of different publications and will also be available on a number of websites where searches can retrieve the details for any member of the public. The poor publicity associated with this can often make it difficult for the company to get credit from a bank or other suppliers while the debt remains unpaid. For this reason,

sometimes notice to the company that you intend to take this action can sometimes prompt the company to settle the account.

Unliquidated Insolvent Companies

This class of debtor has in the past been a bone of contention for many creditors. In the past, before all the new legislation of recent years, there was very little a company or individual could do if a company was insolvent but had ceased to trade and had not been officially liquidated. This left a lot of unfinished business, for both secured and unsecured creditors, and also denied them the opportunity to carry out a full investigation into the activities of the company and the whereabouts of any assets still owned by the company.

Now, when a creditor notices the first signs of problems with a company, they have a few choices. If they are aware that the directors or officers of the company have not complied with any legislation, they could consider filing a complaint with the ODCE. The ODCE could then carry out investigations of the company if there was sufficient evidence that an offence may have been committed. Quite often, notifying the ODCE of any warning signs can be just the signal needed to take action before it is too late. If the guilty parties can be brought to justice before they abscond, there is a much better chance that the creditors will salvage something.

Alternatively, when a company cannot not pay a debt due to insolvency, the creditor can sometimes apply to the High Court to:-

- Order a related company to contribute to the assets of the company
- Order that company assets that were improperly taken from the company be returned to it
- Make a director personally responsible for the companies debts if they are guilty of fraudulent or reckless trading
- Make a director personally responsible if the company has not kept proper books
- Assess what damages a director should pay if they have done wrong
- Question the officers of the company on oath about the company's business
- Inspect the books and papers of the company
- Have a director, a shadow director, secretary or other officer of a company arrested and have their books, papers and personal property seized
- Restore a struck off company to the Register

In the case of a company struck off the register, that company ceases to exist, so creditors wishing to take legal action against it must first get the company restored to the register. They can apply to the Circuit Court for an order directing that this be done.

In addition to all of the above, creditors can also apply to the High Court for one or more inspectors to be appointed to investigate and report on the affairs of the company.

The complaint procedures and forms are available on the website of the ODCE.

Winding Up of a Company:

Companies go out of existence through the formal process of being wound up or put into liquidation; these two terms mean the same thing. The winding up of a company is the process whereby the assets of a company are collected and realised, the resulting proceeds are applied in discharging all its debts and liabilities, and any balance which remains after paying the costs and expenses of the winding up is distributed among the members according to their rights and interests. A liquidator is appointed in order to carry out the winding up. There are three types of winding up of a company:

1. Member's Voluntary winding up of a company.
2. Creditors' Voluntary winding up of a company.
3. Involuntary winding up of a company (Compulsory winding up).

(1) Member's Voluntary Winding Up:

There are numerous reasons why shareholders may wish to wind up a company e.g. they may be dissatisfied with the way in which it is being run; they may be unable to raise the additional funds it needs to stay in business; or they may wish to liquidate their investment in it and there is no ready market for their shares.

In order for members themselves voluntarily to wind up their company, a majority of the directors must make a statutory declaration that, upon having made full inquiry, they are of the opinion that the company will be able to pay its debts in full within at least 12 months from when the winding up commences. This declaration must be accompanied by a report of an "independent person" stating that the directors' opinion regarding the company's solvency is reasonable. All that then is required is a special resolution of the company (three-quarters majority of the shareholders) to wind itself up.

A voluntary winding up commences from the time the resolution to wind up is passed. The company must then cease to carry on business except in so far as is necessary to facilitate the liquidation. ***A liquidator must be appointed by the shareholders***, who may fix his remuneration. When the company's assets have been collected and the creditors and shareholders are paid off, the liquidator must call a publicly advertised general meeting and provide it with an account of the winding up.

(2) Creditors' Voluntary Winding Up:

A creditors' voluntary winding up will arise either on the conversion of a member's voluntary winding up or where the members in general meeting resolve that the company cannot by reason of its liabilities continue its business, and that it be wound up voluntarily. The essential features of a creditor's voluntary winding up is the absence of a declaration of solvency and that the winding up is brought about usually, not by the creditors, but by the members themselves, usually on the advice of the directors.

Where there is an internal decision to wind up the company on the grounds that it is insolvent the directors of the company should convene two meetings, one of the members of the company, and one of the creditors. The purpose of the members' general meeting is to pass an ordinary resolution that the company cannot, by reason of its liabilities, continue its business and that it be wound up voluntarily. From the date of this resolution, the voluntary winding up of the company is deemed to commence. The company should cease to carry on its business.

At this meeting the ***members may nominate a liquidator*** for the purpose of winding up the affairs and distributing the assets of the company. However, if the ***creditors nominate a different liquidator***, their nominee will prevail as the company's liquidator.

The purposes of the creditors' meeting are:
(1) To consider the statement of affairs prepared by the directors;
(2) To consider the appointment of the liquidator appointed by the members and replace him if desired;
(3) To appoint a committee of inspection.

The committee of inspection has a number of functions including the fixing of the liquidator's remuneration, determining whether the liquidator should continue the business of the company and determining whether the powers of the directors should continue.
On an application being made either by a company's members or creditors, prior to the completion of the voluntary winding up, the court may order that the creditors' voluntary winding up be converted into an involuntary winding up.

(3) Involuntary or *Compulsory* Winding Up:

An involuntary winding up will arise where the High Court is petitioned to have a company compulsorily wound up. The grounds on which the High Court can order a company to be wound up are set out in Section 213 of the Companies Act 1963. The most frequently used grounds are:

1. The company is unable to pay its debts (the most common ground)
2. A shareholder is being treated in an oppressive manner or his interests are being disregarded
3. The company has not traded for a year or did not commence trading within one year of incorporation

In the case of the company being unable to pay its debts, one of the following conditions must be satisfied:

(a) The company owes money on foot of a court order and is unable to pay that judgement or;
(b) A creditor has not been paid a debt of €1,270 or more within three weeks (21 days) of demanding it in writing.

Section 215 of the 1963 Act states who may petition to have a company wound up, namely the company, any creditor, the Minister and any member.

Section 49 of the Company Law Enforcement Act 2001 inserted a new section into the 1963 Act which gives the court the power to order the ODCE to inspect the books of a company in liquidation.

The procedure involved in an involuntary winding up starts with the person who wishes to have the company wound up petitioning the High Court. The petition must be served on the company at its registered office and must be advertised in two national newspapers. The company is entitled to challenge the petition. If ***the court*** makes an order winding up the company, it ***appoints a liquidator***, called the "official liquidator" to carry out the winding up. There is no requirement in the Companies Acts that the liquidators have any qualification, but those appointed are almost always accountants. Persons connected with the company are disqualified from acting as liquidators.

Liquidators

A liquidator is defined as a person who conducts a liquidation or winding-up of a company. Once appointed, the liquidator must notify the Registrar of Companies who in turn will notify the ODCE. Regardless of the type of liquidation, a liquidator's general function is the same in every situation, it is only the appointment of a liquidator that varies.

The principal ***duties*** of the liquidator are as follows:

1. To take possession of the company's assets and protect them;
2. To make out a list of the debtors and creditors of the company;
3. To have disputed cases adjudicated upon by the courts;
4. To sell the assets of the company;
5. To pay off the debts of the company in their order of priority.

The liquidator has the following ***powers***, some of which can only be exercised with the consent of the High Court:

1. To sell any property of the company;
2. To execute deeds, receipts and other documents;
3. To carry on the company's business so far as may be necessary for its beneficial winding up;
4. To bring or defend legal proceedings;
5. To employ a solicitor;
6. To borrow money on the security of the company's property;
7. To disclaim onerous property i.e. to abandon property charged with mortgages and other charges to an extent that it is not possible to sell it.

Priority of Debts

The following is the priority of debts that applies when there is not enough money made from the winding up to pay all the creditors:

1. The liquidator's fees and expenses;

2. Secured creditors i.e. creditors whose debt is secured by a charge over the company's property. These creditors are paid out of the charged property. In this category, fixed charges are paid before floating charges.
3. Taxes and wages due, including holiday pay and redundancy payments, and personal injury compensation due to employees. These creditors rank equally amongst themselves.
4. All other unsecured creditors, ranking equally amongst themselves.

The first categories are collectively known as 'preferential' creditors. (See note on case ***Station Motors Ltd v AIB*** below)

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The effect of a class of creditors ranking equally amongst themselves is that where the amount left to pay that class is not enough to totally discharge all the debts of that class, the total amount left is divided between the creditors in the class equally and each creditor receives a percentage of his debt e.g. if one million euro is owed to persons in class 3 and there is only 500K euro available to pay them, each creditor in that class will receive 50c for each euro. In such a situation, members of class 4 receive nothing.

Notable Cases:

Re Murph's Restaurant Ltd (1979) Ire

Two shareholder directors removed the third from the company after their personal relationships soured. In response, the third man sought to wind up the company on the grounds of oppression under Section 205 (1963).

Held: It was just and equitable to lift the corporate veil and wind up the company, because the removal of the third man damaged a relationship based on 'mutual trust and confidence' which was more akin to a partnership than a company.

Point of law: **Grounds for Compulsory Liquidation**

Station Motors Ltd v AIB (1985) Ire

A company's overdraft with AIB was personally guaranteed by two directors. Three months later the company went into creditors' voluntary liquidation. Prior to the liquidation, almost half of the overdraft had been repaid. The liquidator argued that these payments were a fraudulent preference.

Held: The pre-liquidation repayment of the overdraft was done to prefer AIB directly and the guarantors indirectly. This transaction was set aside by the liquidator and AIB had to repay the money to the company.

Point of Law: **Fraudulent Preference**

Re Kelly's Carpetdrome Ltd (1987) Ire

A supermarket ceased trading and its stock was taken over by Kelly's Carpetdrome, which had the same directors. All the supermarket's creditors were paid prior to it being liquidated except the Revenue Commissioners. Money was transferred from Carpetdrome to other companies controlled by the directors. When it became apparent that the Revenue Commissioners were about to seek monies owed to them, the stock of Carpetdrome was transferred to another company controlled by the same men – Kelly's Carpet Drive-In Ltd, and all Carpetdrome's debts were paid except the

Revenue Commissioners. Carpetdrome went into liquidation owing large sums to the Revenue Commissioners. The liquidator discovered falsification and destruction of records within the company.
Held: The directors had acted deliberately to defraud the Revenue Commissioners and were made personally liable for the debts of Carpetdrome.
Point of Law: **Fraudulent Trading.**

Examinerships:

The winding up of companies that could not pay their debts led to many companies being liquidated that could have been saved. The Companies (No. 1) Act 1990 introduced the concept of examinerships.

An examiner can be appointed where the following three conditions are met:
(1) The company is, or is likely to be, unable to pay its debts; and
(2) The company is not in the process of being wound up; and
(3) The court is satisfied that there is a 'reasonable prospect' of the survival of the company and the whole or any part of its undertaking as a going concern.

The application for the appointment of the examiner is made by petition to the High Court. It can be made by the company, the directors, a creditor, or a shareholder who holds at least one-quarter of the voting shares. The application has to be accompanied by a financial report of an independent accountant qualified to be an auditor of a company. The report must state that he thinks that the company has a prospect of survival as a going concern and must set out proposals to save the company. The petition must nominate a person to be appointed an examiner.

Like a liquidator, an examiner is not required to have any qualification but in practice is almost always an accountant. The examiner must be independent of the company. If an examiner is appointed the company is put under the protection of the court for a period of 70 days, which can be extended by up to 10 days. Unlike a winding up, the directors retain control of the company and the examiner has powers similar to that of the chairman of the board of directors.
The following are the effects on creditors of appointing an examiner:
(1) No winding up of the company can be started, whether voluntary or involuntary;
(2) No secured creditor can take steps to realise his security without the consent of the examiner;
(3) Goods belonging to the company which are subject to hire purchase agreements, retention of title clauses etc. cannot be repossessed;
(4) No legal proceedings can be taken against any person liable for the company's debts, such as a guarantor;
(5) No other proceedings against the company can be taken without the leave of the High Court and the Court may stay such proceedings on the application of the examiner.

One of the examiner's main functions is to formulate a compromise or scheme of arrangement with the creditors whereby they agree to settle their claims against the company for less than they are worth. The classes of creditors are the same as those for determining the priority of debts. Each class of creditors has to accept the proposals in a creditor's meeting. Where at least one class of creditors accepts the

proposals, the examiner can put them before the High Court for approval. If the court confirms the proposals they are binding on all creditors and any other person that could be affected by them.

If the examinership fails, the court protection will be lifted and the company can be put into liquidation.

Re Hefferon Kearns Ltd (1993) Ire
The defendants were directors in a building company and held 85% of the shares. The company was involved in three major contracts, two of which were for companies in which the directors also held shares. The company got into financial difficulties and an examiner was appointed. The examiner sought to make the directors personally liable for the company's debts due to reckless trading. It was argued that the director's behaviour leading to the examinership was reckless.
The High Court held that the directors had not traded recklessly, for the reasons outlined below:
In this case, the following important points of law were laid down:

- It is not necessary to prove fraud in an action for reckless trading
- The reckless trading legislation does not impose collective responsibility on the board of directors; thus the case has to be proven against each separate director based on their conduct.
- For a director to be 'knowingly' involved in reckless trading, he must have been a party to carrying on business in a manner which he knew very well involved a serious and obvious risk of loss or damage to others, and ignored that risk, because he did not care whether such others suffered loss or damage, or because his own selfish desire overrode any concern which he ought to have had for others.
- Thus, the law requires knowledge or imputed knowledge that a director's actions would cause loss to creditors, so that worry or uncertainty about the company's ability to pay was not sufficient to create liability.

Held: To prove reckless trading, the directors must know of an obvious and serious risk of loss or damage to others, and ignore this risk, or be careless and indifferent to the consequences. Worry or uncertainty is not the same as knowledge.
Point of Law: **Reckless Trading**

Debentures

The term 'debenture' is not a technical one; there is no precise legal definition of the term, however, in simple terms, it is the equivalent of a loan. The term 'debenture' signifies an instrument or document creating or acknowledging indebtedness of a company of some permanence. Debentures issued by companies often possess several of the following characteristics: they are one of a series of debentures; they provide for repayment of a principal sum on a named date or on a specified event occurring; they provide for payment of interest on the debt and they contain a charge on the company's property securing the debt.

There are a great variety of kinds of debenture e.g. a debenture may be a single one or may form part of a series; it may be secured or unsecured. Many debentures are instruments given to a single creditor who is owed money by the company. But

debentures are generally issued in a series of debenture stock and are transferable in much the same way as shares. Public companies occasionally make prospective offers to the public to apply for debenture stock. Such debenture stock is a portion of some large debenture, which can be transferred in fractional amounts and which can be consolidated into larger holdings. With debenture stock, sums are advanced to the company by numerous persons, but those sums comprise a single loan fund, the lenders being issued with stock certificates evidencing the fractional amount of that fund which is theirs. Where debentures are issued in a series ranking equally, every company is required to keep a register of debenture-holders containing their names and addresses, and stating the amounts held by each of them.

Many debentures stipulate a time within which they must be redeemed. However, **perpetual** or irredeemable debentures are redeemable only in the event of the company being wound up or on some other very grave default by the company. **Convertible** debentures are ones which entitle the owner thereof, on or after a certain date or on some contingency occurring to convert the debenture into shares in the company.

Usually the interest to be paid to debenture-holders is payable every year as a fixed percentage of the capital sum. Debentures or debenture stock, the holders of which are registered with the company, are transferable in the same way as shares i.e. by executing a proper instrument of transfer or by vesting in another person by operation of law, as on the debenture-holder's death.

Receivers

One of the ways in which creditors can enforce their security is by having a receiver of any charged assets appointed. Debentures given by companies often authorise the debenture-holder to appoint a receiver in the event of default and the like. At times receivership is used not simply as a means of reimbursing creditors but more as a device for reorganising insolvent companies, so as to salvage their viable parts for the benefit of those involved.

The courts have an inherent power to appoint a receiver over charged assets. Usually the debenture itself will authorise the creditor to appoint a receiver: the creditor can then designate someone as receiver once the conditions for exercising the power are satisfied, without ever resorting to the courts. The vast majority of company receiverships take this form and the designated grounds for making an appointment are almost identical in most debentures. A body corporate cannot be a receiver of company's property nor can persons who were closely connected with the company's management. The court determines the court-appointed receiver's remuneration and if agreement cannot be reached in relation to the remuneration of a receiver appointed by a creditor, an application can be made to the courts. A receiver may be removed by the court for "cause shown". Provided he gives one month's notice to the debenture-holder and the company, a receiver appointed under a debenture may resign. A court-appointed receiver may only resign on such terms as the court fixes.

Appointment of a receiver operates to suspend the company's powers and director's authority in relation to the assets covered by the receivership. However, the directors retain some powers e.g. a receiver cannot prevent the directors from authorising

proceedings against a creditor for breach of contract in wrongfully putting the company into receivership.

A receiver's function is to do everything necessary to realise the security. Particular powers to this end may be set out in the order of the court, or in the debenture and the instrument, under which he was appointed e.g. to sue in the company's name. Receivers may apply to the courts for directions about any aspect of their functions. A receiver has the power to dispose of the assets that were charged. Receivers cannot be held liable on contracts existing with the company at the time of their appointment.

Receivers appointed by the court are officers of the court and are not agents of any person. Receivers appointed by debenture-holders are agents for those who appointed them. However, instruments of appointment frequently designate them as agents of the company, so that the appointing creditor cannot then be held responsible for their wrongs.

CREDIT AND SECURITY

1. Mortgages:

A mortgage is the transfer of rights of ownership on the understanding that they are to be re-conveyed or released in the event of the obligation being performed. The party who transfers the property is known as the mortgagor (e.g. person who takes out a mortgage to buy a house) and the party who obtains the security interest is known as the mortgagee (e.g. bank or other financial institution). Mortgages are the most common form of proprietary security (security on property).

The right to release the rights of ownership back to the mortgagor is known as the **equitable right to redeem**. Equity regards a mortgage as nothing more than a transfer of property as security for the performance of an obligation (paying back the mortgage). Notwithstanding the estate which has vested in the mortgagee (bank), as a matter of substance the mortgagor (person taking out the mortgage) is treated as retaining valuable rights in respect of the property. These are collectively known as the '**equity of redemption**' and include the equitable right to redeem.

Because the extent of the mortgagee's rights is limited by the monetary claim which the mortgage secures, it is possible to quantify or value the equity of redemption. For instance, if a house worth €100,000 is mortgaged in order to secure a loan of €80,000, in the event of it being sold because of the mortgagor's default, the mortgagee's rights over the proceeds of sale would be limited to the outstanding amount of the loan, interest payable to date and any costs which he has incurred. The mortgagor would be entitled to any balance remaining. Accordingly, the difference between the value of a property and the mortgage affecting it is colloquially known as the 'equity'. The equity of redemption arises as soon as the mortgage is created and constitutes an equitable interest in the property which may be conveyed *inter vivos* or pass on death.

In the creation of mortgages, a distinction is made between **Unregistered** Land (land ownership which is not registered although the Registry of Deeds may reveal certain dealings in relation to the land) and **Registered** Land (land ownership registered under the Registration of Title Act 1964 and which system is administered by the Land Registry). At present, approximately 85 per cent of land in the State is registered. Land in urban areas is generally unregistered because complex pyramid titles make it very difficult and expensive to present an accurate picture of ownership for the purposes of securing initial registration.

A distinction is also made between **legal** mortgages (created by deed or grant in relation to **unregistered** land and by charging **registered** land with the payment of a sum of money in the Land Registry) and **equitable** mortgages (e.g. depositing title deeds with a bank or financial institution in relation to **unregistered** land or depositing a land certificate in relation to **registered** land).

2. Pledges:

A right of security over property may be described as possessory if the creditor is entitled to retain physical possession until the debt is discharged. The pledging or pawning of goods is a familiar example of such security arising by agreement. Ownership of the chattel (property/good) remains with the pledgor (the debtor), even though the pledgee (the creditor) has custody of it. The rights of the pledgee extend beyond merely holding on to the chattel until he is paid. He is entitled to sell the chattel in the event of non-payment and pass a good title to the purchaser without having to seek a court order. A pledge is sometimes explained in terms of the pledgor retaining general property in the item pledged, while the pledgee obtains special property. However, strictly speaking the pledgee does not obtain any proprietary interest in the subject matter. The transaction is merely a bailment by way of security and the pledgee's right to sell the bailed goods is derived from an authority implicitly conferred by the pledgor.

3. Charges:

A charge is a form of proprietary security which gives rise to some of the incidents of a mortgage, but not all of them. Hence it is sometimes said that while every mortgage is a charge, not every charge is a mortgage. Although a charge confers an interest over or in respect of the subject matter, unlike a mortgage it does not transfer property or confer any estate or interest in that subject matter and does not confer a right to possession. The distinction is evident from the remedies which are available for the enforcement of the securities. Because a charge is nothing more than the appropriation of specific property to the discharge of a debt or other obligation, the rights of the chargeant (the person in whose favour the charge was created) are limited to the realisation through an application to the court for an order of sale or the appointment of a receiver.

While these remedies are likewise at the disposal of a mortgagee, he can also take possession of the land and provided that the mortgage was created by deed, invoke the statutory remedies provided for in the Conveyancing Acts 1881-1991 which allow him to sell the land or appoint a receiver without having to obtain a court order. A written contract which provides that certain property is to constitute security for a particular debt is sufficient in the eyes of equity to give rise to a charge.

Floating Charges:

There are two principal categories of company charge, the fixed charge and the floating charge. The former is a charge on a specific identifiable item of property e.g. on land or property, machinery, motor vehicles etc. A floating charge, by contrast, is a charge on a designated category or categories of assets but their actual constituent elements are continually changing e.g. company stock in trade, raw materials and debtors (current) and although these items are subject to the charge, the company is permitted to use and even dispose of them in the ordinary course of business and replace them with new stock, new debtors etc. The great advantage of the floating charge over a specific security is that the company which grants a floating charge remains relatively free to deal with the charged assets until it defaults and a receiver is

appointed or some other crystallising event occurs (converting the floating charge into a fixed charge).

Lenders may not be so enthusiastic about such floating charges because of the freedom that the company may have to dispose of the charged assets; also because these charges rank in priority after any fixed assets and after the State's and company employees' statutorily preferred debts and also current assets may not obtain anything like their book value in a sale when the lender seeks to enforce the security. Moreover, a floating charge given within twelve months of a company being wound up is invalid if the company was insolvent at the time the charge was created.

Floating charges possess three basic features:

1. Until they "crystallise" the charge does not fasten or attach to any specific property of the company but, instead, floats over whatever category of assets are charged;

2. Until crystallisation, the company is able to transfer the charged assets, whether by way of sale or as security, so as to confer on a third party a good title against the creditor who is secured by the charge;

3. In the event of the charge crystallising, such as when the company defaults and a receiver is appointed, the charge then ceases to float and becomes converted into a specific charge over the category of assets in question, and in all respects takes on the attributes of a specific charge over those assets.

Crystallisation of a floating charge means the charge ceases to float over the assets in question and is converted into a fixed charge over those assets described as security. After crystallisation, the company is no longer free to deal with those assets in the course of its business and the holder of the charge becomes entitled to have those assets sold off in order to be reimbursed from their proceeds.

Impact on Unsecured Creditors

The effect of a company having any charges on its assets is very significant for creditors of that company. For example, if a creditor is supplying another company with products for resale, and that company has a floating charge on its stock, then in the event of a liquidation, the secured creditor, ie the one that holds the charge, will be ranked higher and may receive all or most of the proceeds from the sale of this asset. Similarly, if a company provides credit to another company in a supply chain, and that company has a floating charge over its debtors, then again the unsecured creditor may receive no payment from the proceeds in a case where the liquidator appointed collects the debts for the liquidated company. The proceeds in this case will again go to the holder of the charge, usually a financial institution, but occasionally another major supplier.

4. Liens:

Generally speaking, the term 'lien' is used to describe a non-consensual right of security against property. However, it is not uncommon to find the terms of a

contract providing for the exercise of a lien. Both the common law and equity recognise liens as arising in certain defined circumstances:

Common Law Liens: In certain cases, where a person is already in possession of another's asset, the common law will permit him to remain in possession until he is paid by the latter. It is immaterial that there is no express term in the contract between the parties providing for such a right. Repairers of chattels, such as car mechanics, frequently invoke this right. Similarly, a solicitor can assert a lien over any documents belonging to a client (e.g. title deeds) which happen to be in his custody.

One drawback of a common law lien is that it persists only as long as the creditor has custody of the asset. If the creditor gives up possession he cannot subsequently demand its return from the debtor. Possession must have been obtained lawfully e.g. a person cannot exercise a lien over something which he has stolen. Furthermore, unlike a pledge, a possessory lien does not give the creditor the right to dispose of the property and use the proceeds to discharge the debt. The creditor must hope that the inconvenience of being denied possession will act as a sufficient incentive for the debtor to perform his obligation.

Equitable Lien: An equitable lien arises automatically by virtue of the rules of equity unless excluded by agreement. It is like a charge in that it appropriates specific property as security for the discharge of a particular monetary obligation. It is not dependant on the creditor having possession of the property. The person entitled to the lien can apply to the court for an order that the charged property should be sold so that he can be paid out of the proceeds of sale. Equitable liens usually arise in the context of contracts for the sale of land. Even if a vendor has conveyed the land to the purchaser and given up possession, he will have a lien over the land which constitutes the subject matter of the contract in respect of the part of the purchase price which has not been paid by the purchaser. Conversely, if a contract falls through without default on the part of the purchaser, he will be entitled to a lien to secure the return of money paid e.g. deposit.

5. Guarantees:

A guarantee is an undertaking to answer for another's default. It is thus an accessory or secondary obligation which requires the default of the principal debtor in order to render the guarantor liable to action. The guarantor is not liable for any amount in excess of that recoverable from the principal debtor. Moreover, if the contract with the principal debtor is void or unenforceable, the contract of guarantee is likewise void or unenforceable.

Guarantees may take one of two forms: fixed or discrete guarantees (fixed-sum credit in which the amount of financial accommodation to be provided is determined at the outset) and continuing guarantees (the debtor is given a facility on which he can draw at leisure, the relationship between the parties is intended to be of indeterminate duration and the agreement contemplates a flow of dealings).

Where the guarantee was given at the request of the debtor, the guarantor has an implied contractual right to be indemnified by the debtor against liabilities (money actually paid) he incurs. Where the guarantee was given at the request of the creditor, a guarantor who discharges the debt he has guaranteed is entitled to step into the shoes of the creditor and take over by **subrogation** all the creditor's rights against the debtor in respect of the debt and all the securities held by the creditor for payment of the debt.

Since the guarantor's liability is limited to that of the principal debt, it follows that he is discharged if the guaranteed debt is paid or released or if the liability to pay is extinguished by operation of law. Where there are two or more guarantors of the same obligation who are liable for the same amount then, unless otherwise agreed between them, their burden is to be shared equally, and if one pays more than his share he is entitled to recover the excess in an equitable action for contribution.

Enforcement Procedures for Civil Debt

Introduction

In the Enforcement of Judgements in respect of Civil Debt, the process of Enforcement follows judgement and non-payment on foot of that judgement. In every case it is important to assess the options open to you as the Creditor. It can be very difficult to assess the financial position of the Debtor, and act accordingly. A decision may be made not to pursue the amount owed by the Debtor, as he/she does not have adequate funds to do so. Equally, there may be a good cause of action open to you as the Creditor, resulting in a judgement that will realise most if not all of the debt. A lot will depend upon whether the Debtor is able to pay, possesses sufficient assets, or has a business reputation they wish to preserve.

There are a number of options available to the Creditor and each one should be explored as a possibility while at all times bearing in mind the costs of bringing the action. Some avenues of approach are inexpensive and have immediate impact, such as Registration. However, this makes a judgement public, and this may alert other Creditors and cause them to pursue what they are owed by the Debtor. Bankruptcy and Liquidation procedures are expensive and time consuming but may be the only way of forcing a reluctant but financially secure debtor to pay off their debt.

It should also be noted that the length of time it takes to obtain a judgement and to have it registered varies considerably. In Dublin it can take more than 6 months, because of the enormous volumes being processed. Outside Dublin however this period can be much lower. If it is possible to pursue in a court outside Dublin then this could be an advantage. This is possible if a company has a registered office outside the capital, or trades in some other area. The cost also varies, but a fair estimate of the total cost of this procedure should be available from a solicitor. Lower courts incur lower costs in general. Pursuing a debt of €5,000 would cost less than a debt of €20,000 as the lower debt will be processed in the District Court, while the higher debt will be processed in the Circuit Court.

Registered judgements can be viewed online or alternatively can be monitored through a weekly publication of judgements, such as Experian Gazette or Stubbs Gazette.

THE EXAMINATION PROCEDURE

Enforcement of Court Orders Acts, 1926 and 1940 (Courts No 2 Act 1986)

There are a number of points to note:

1. This procedure is available against individuals only, not against companies.
2. It is a form of enforcement applicable to any amount outstanding.
3. Only the District Court has jurisdiction, i.e. the proceedings cannot be started in the Circuit or High Court.

4. The moving party is the Creditor and the defending party is the Debtor.
5. The proceedings must be taken in the area where the Debtor resides.

Before initiating any legal proceedings for recovery of a debt, a creditor must be very careful to check out any alternative actions. If it is at all possible to come to an arrange with a debtor, then this is preferable to taking legal action which can be costly and may only produce the same results, i.e. an arrangement or an agreed payment schedule.

Forms Required

1. Statutory Declaration to Accompany Application for Summons (Form 53.2). This document must be sworn by the Creditor or a competent person on their behalf.
2. Summons for Attendance of Debtor (Form 53.1). This must be completed in duplicate. This is to be lodged with the District Court Clerk. In some District Court areas, one will have to apply to Court for the Summons for Attendance of Debtors, while in others you just lodge the forms with the District Court Clerk and the Summons for Attendance will be returned with the Court date endorsed on it.

Procedure

The Summons for Attendance is to be served on the Debtor at least 21 days prior to the Court date. If the Summons is returned then an application for substituted service should be made. When service has been affected and at least 4 days before the Court date, the Original Summons is to be lodged with the District Court Clerk along with a Statutory Declaration of Service. This is used to prove that service was affected and that the Debtor is on Notice of Application for the Summons.

The Summons for Attendance of the Debtor shall, in addition to requiring the attendance of the Debtor at Court for an assessment of means, requires the Debtor to complete, detach and lodge with the Clerk the Statement of Means (Form 53.3 Form SC). The Creditor or its Solicitor shall be entitled on payment of the prescribed fee to inspect and take copies of the Statement of Means any time after it has been lodged. On the Court date the Creditor is to produce the following:

- The Judgement on which the Creditor relies or other evidence of the original debt owed to the Creditor.
- A Certificate of Amount Due (Form 53.4 Schedule SC) signed by the Creditor setting out the amount outstanding at the date of the Certificate. A copy of the certificate is to be furnished to the Debtor prior to the date on which the examination is due to take place.
- Evidence that the Debtor is ordinarily resident in the Court area where the examination is taking place.

On the Court date, the Creditor applies for an Instalment Order. Here the Debtor is examined as to means, and then a set sum is to be repaid over a specified period of time, e.g. €40 per month for 48 months. Often debtors will not have made or filed a Statement of Means, and will have to be cross-examined. If the debtor fails to appear, then application is made for an Instalment Order if appropriate. An application can be made for the payment of a one-off lump sum.

INSTALMENT ORDER PROCEDURE

Here the Instalment Order (Form 53.4 Schedule C) is lodged in duplicate with the District Court Clerk. On being signed by the Clerk, it is returned to the Creditor for service on the Debtor. The Order is to be served by registered post and a note should be made of the dates upon which the instalments will be due to be paid by the Debtor. If the Instalment Order is obeyed by the Debtor, then the Creditor should monitor the means of the Debtor. In the event that the Debtor's means improve, then an application for a Variation Order should be made. Here the District Court Clerk will re-enter the proceedings, and apply to the Court for an increase in instalments. However, it is unlikely that the Order will be varied unless it is felt that the circumstances warrant it.

COMMITAL ORDER PROCEDURE

If the Debtor fails to pay off the debt through the Instalment Order procedure, an application can be made for a Committal Order. This is an Order committing the debtor to prison for failure to pay off the debt. This process is activated through the lodgement of a Summons on Application for Arrest and Imprisonment (Form 53.8), in duplicate, at the District Court Office. The original Instalment Order will have to be produced, with an endorsement of service, which is the proof that the Debtor was served with the Instalment Order. The Clerk will fill in the date for the hearing and return the Summons to the Creditor, and then has to serve the document on the Debtor by registered post.

As above, at least 4 days prior to the Court date the Summons is to be filed with an endorsement of service with the District Court Clerk. On the hearing date the Creditor or their representative will have to be present in Court. Evidence must be given about:

- The number of instalments outstanding,
- The amount of each instalment, and
- The total amount outstanding.

The Court will have to be informed of the date of service of the Committal Order. If the Debtor is not in Court, then an Order will be made for their imprisonment. If the Debtor appears then no Order will be made for imprisonment, unless there is wilful failure and neglect on the part of the Debtor. The Judge may well treat the process as a Variation Application and the Judge may substitute a lower figure in regard to the instalments, or adjourn indefinitely or to a specific date in order to see whether or not the Debtor's circumstances improve. If the Committal Order is made, then the following have to be lodged with the District Court Clerk:

1. Form 53.9-Order for Arrest and Imprisonment.
2. Form 53.10-Warrant to Enforce Order for Arrest and Imprisonment.

The Clerk forwards the Warrant (Form 53.12) to the Gardai and they then enforce it. If any payments are accepted from the Debtor this will be considered to a waiver of

the right to enforce the Order. It should be noted that imprisonment of the Debtor does not operate as satisfaction or cancellation of the debt.

POWERS OF THE SHERIFF

The Sheriff's Office can assist in the enforcement of a judgement and the collection of the debt owed to the Creditor. The Sheriff can seize all moveable goods subject to the limitation that the necessary wearing apparel, bedding and tools & implements of trade up to a specified value are exempt (S. 7 Enforcement of Court Orders Act 1926). Nothing can be taken in execution of the debt that cannot be sold. A leasehold can be seized, unless it is subject to a legal mortgage. Goods may be sold 48 hours after seizure, and may be sold by auction, tender, or private proposal. The Sheriff has the right to break into premises, and there will be no action against him provided:

- He makes reasonable efforts to enter peaceably and without violence; and
- He has reasonable grounds for believing there are goods of the Debtor on the premises.

The Sheriff has the right to summon a posse through the Warrant of Posse Comitatus. Usually the Gardai will be summoned to enforce the warrant. If a third party lays a claim on the goods seized by the Sheriff, then the latter will issue Interpleader Proceedings. Any delay on the part of the Third Party will result in immediate judgement for the Sheriff's Office. It should be noted that the Sheriff is an Officer of the Court when enforcing a judgement. However, if he acts on instructions to seize a specific asset, he then becomes an agent of the Creditor. If the Sheriff is guilty of any wrongdoing, then the Creditor will be held to be liable in a claim for damages.

SMALL CLAIMS COURT

The purpose of the Small Claims Court is to process consumer claims without recourse to a solicitor. To be eligible the consumer must have bought the goods/services for private use from a party selling them in the course of business. This procedure includes minor damage and rent deposits but is not available for use by one business owner against another.

The Small Claims Registrar will deal with consumer claims in relation to goods or services up to a value specified by law. Initially this was IR£1,000, converted to €1,267 in 2001, so it is really only intended for very small claims and in cases where unspecified damages are not likely to arise. Claims in respect of accidents/personal claims or for recovery of payments under a loan or hire purchase agreement are excluded but claims in respect of goods bought on credit are included. A claim may be made for bad workmanship as well as faulty goods, but **NOT** in respect of debts or personal injuries.

A claim in the Small Claims Court is made on the relevant application form, **Form 53A.1**, which is to be submitted along with the requisite fee. This is to be lodged with the Small Claims Registrar, who will then forward a copy of the form to the

respondent. If the respondent disputes the claim, or makes a counterclaim, the Registrar will then pass on to the applicant a copy of the lodged response.

The Registrar may then interview both parties together to resolve the dispute. This meeting is usually informal and held in private. If an agreement is not possible, then the Registrar will fix a date, time and location for a hearing of the claim by a District Court Judge. The date and time of the hearing and the address of the Courthouse will be sent to both parties by post.

If the claim is uncontested by the respondent, then he will notify the Registrar's office by returning the **"Acceptance of Liability Form"**. In the event that within fifteen days of receipt of a copy of the initial claim the respondent does not reply then the claim will be automatically treated as undisputed. The District Court will make an Order in favour of the applicant for payment, which is to be made within a specified period of time. In the event that payment is not forthcoming, then steps can be taken to have the Order executed by the Sheriff. This will cost a further fee, although it will be refunded if the Sheriff successfully executes the Court Order.

Hearing of the Claim

In the event that the claim proceeds to a hearing, the attendance of the applicant at Court is required. He will need to bring with him copies of the relevant documentation e.g. letters, receipts and invoices. The applicant will be required to swear an oath and be open to cross-examination in relation to the claim. If the applicant requires a solicitor to be present then the costs of legal representation will have to be met by him, even if he is successful. This is also the case in respect of any witnesses called on his behalf in regard to the claim. However, if a witness is called and refuses to attend, a summons will be issued by the Registrar, who will also arrange for its service on the witness. In the course of the hearing of the claim in court, the Registrar will outline the alleged facts, any counterclaim, and call the applicant to give evidence before the Judge. The respondent will be able to put their case to the court in response to the claim.

If the claim is resolved in favour of the applicant, the respondent will be notified of the decision and be permitted four (4) weeks to pay the amount awarded by the court. Failure to pay will result in the execution of the Order of the Court by the Sheriff, referred to earlier.

JUDGEMENT MORTGAGE

If the Debtor has property then it may be possible to attach a judgement mortgage to the property in question, either through a decree or judgement of the Courts. The first step is to ascertain whether or not the property is actually owned by the Debtor, which can be done through a search in the Land Registry or the Registry of Deeds. It may

not be in the debtor's own name, and may be registered under a Company or a different spelling of the Debtor's surname. It is crucial to have the right Debtor and correct property before undertaking a Judgement Mortgage procedure. In addition, one should check to ensure that there are not any other judgement mortgages registered on the property. If there are, then this may reduce the value of a property on a sale.

The procedure is that a Judgement Mortgage should be prepared in duplicate, and lodged in the Court Office where the original judgement against the debtor was obtained, e.g. the District Court Office. The original affidavit will be retained on file, and a copy returned to the Creditor. That copy is then lodged with either the Land Registry or Registry of Deeds, depending on where the property was registered. If it is registered in the Land Registry then a photocopy of the Judgement Mortgage will suffice. However, for Registry of Deeds it must be on judicature paper as well.

HIRE PURCHASE AND LEASING

In a hire purchase arrangement, a person is not buying the item in question but rather "hiring" it with an "option" to purchase on the completion of the hiring payments. Normally, the customer is "buying" the goods from the shop owner. However, often finance companies are involved in hire purchase arrangements because the trader offering the hire purchase facilities is not in a position to finance the sale of the item by way of hire purchase, as the instalments can last over a period of three to five years. The finance company steps in and basically agrees to buy the item from the trader and then lets the item on hire purchase to the hirer who was initially the customer of the trader. Approximately 50% of the total of hire purchase agreements are made in this way.

Ownership:

In a hire purchase agreement possession of the goods will not pass to the customer immediately, but the property in the goods (or the ownership) will remain with the finance company.

There are two elements in a hire purchase transaction:

(a) Goods are **"bailed"** i.e. delivered to the possession of the hirer for his use;
(b) The hirer has an **"option to purchase"** the goods when he has completed payment of a number of instalments which represent the cash price plus a charge for credit.

Advantages of Hire Purchase:

(a) The trader sells goods to a financial institution and is therefore sure of being paid.

(b) The financial institution is being repaid the price of the goods together with interest on those goods by the hirer. It also has the security of having title to the goods and this means that it can recover the goods if the hirer defaults.

(c) The hirer has the use and enjoyment of the goods while he is making repayments and when all repayments have been made, he will have an option to purchase the goods.

The hire purchase agreement provides that when all instalments due have been paid, the hirer will have the option to purchase the goods. At that stage, the property in the goods will pass to the hirer. The hirer may terminate the agreement if he wishes. On payment of the sums due, ownership in the goods will pass to the hirer automatically and the contract then becomes a contract for the sale of goods. Until such an option is exercised by the hirer, he may not transfer the goods with a good title to a third party,

even if that third party is unaware of the hire purchase agreement which the hirer has with the finance company.

It is necessary to distinguish between a hire purchase agreement and a **credit sale** agreement. In the case of a hire purchase agreement, the property in the goods *may* pass at some future date whereas in a credit sale agreement the property in the goods passes as soon as the contract is made. Because the property in the goods passes under a credit sale agreement when the contract is made, the buyer becomes the owner and the goods cannot be recovered by the seller unless there is a reservation of title clause. The only remedy available to the seller is to sue the buyer for any balance outstanding.

The law in relation to Hire Purchase is regulated by the Consumer Credit Act 1995.

Leasing Agreements:

Leasing agreements are similar to hire purchase agreements in a number of ways. Leasing agreements involve a bailment or hire; however, the hirer acquires no option to purchase the goods. Thus, a hire purchase agreement differs from a leasing agreement in that under a hire purchase contract the hirer may acquire legal title by exercising an option to purchase the asset upon fulfilment of certain conditions (normally the payment of an agreed number of instalments). In the Republic of Ireland, there is normally no provision in a lease contract for legal title to the leased asset to pass to the lessee.

Leasing agreements take a number of forms, the most common of which are:

(1) **A Finance Lease:** is a lease that transfers substantially all the risks and rewards of ownership of an asset to the lessee. A finance lease usually provides payment by a lessee to a lessor of the full cost of the asset together with a return on the finance provided by the lessor. The lessee has substantially all the risks and rewards associated with the ownership of an asset, other than legal title.

(2) **An Operating Lease:** is a lease other than a finance lease. In an operating lease, the lessor undertakes to maintain and to insure the goods. It is normal in the case of operating leases that the agreed leasing period is usually shorter than the expected useful life of the goods. Furthermore, the total of the lease rentals received will not normally cover the original capital cost of the items leased; thus, when the lease period has expired, they are normally sold off by the owners to an independent party.

Currently, almost all types of non-consumable goods may be acquired by way of leasing including electrical goods, office equipment, motor vehicles etc.

A lease agreement is not a contract of sale as no property in the goods passes, or is intended to pass, to the persons acquiring the goods. As in hire purchase agreements, leasing agreements are bailments of goods for reward (a bailment of goods is a delivery of possession of them to another for some purpose).

Consumer Credit Act 1995:

The Consumer Credit Act 1995 came into effect on the 31st of July 1995 to give effect to an EU Council Directive. The Act consolidated, revised and extended the law relating to consumer credit, hire purchase and money lending. It repealed the Moneylenders Acts 1900 - 1989, and provided for the amendment and extension of the Pawnbrokers Act 1964. It also repealed the Hire Purchase Acts 1946 – 1980. The revised provisions only apply where the hirer is a consumer.

Section 2 of the Consumer Credit Act 1995 contains certain relevant definitions:

Consumer: A natural person acting outside his trade, business or profession.

Consumer Hire Agreement: An agreement of more than three months duration for the bailment (defined as delivery of a thing to another person for a limited purpose) of goods to a hirer under which the property in the goods remain with the owner.

Credit: Includes deferred payment, cash loan or any other form of financial accommodation.

Credit Agreement: An agreement whereby a creditor grants or promises to grant to a customer a credit in the form of a deferred payment, a cash loan or other similar financial accommodation.

Hirer: A consumer who takes, intends to take or has taken, goods from an owner under a hire purchase agreement or a consumer hire agreement in return for periodical payment.

Hire Purchase Agreement: An agreement for the bailment of goods under which the hirer may buy the goods or under which the property in the goods will, if the terms in the agreement are complied with, pass to the hirer in return for periodical payments; and where, by virtue of two or more agreements, none of which by itself constitutes a hire purchase agreement, there is a bailment of goods and either the hirer may buy the goods, or the property therein will, if the terms of the agreements are complied with, pass to the hirer, the agreements shall be treated for the purpose of this Act as a single agreement made at the time when the last agreement was made.

Hire Purchase Agreements:

Section 57 – There is a statutory requirement to state, ***in writing*** to the prospective owner, the cash price of the goods.

Section 58 – provides for the contents of a hire purchase agreement:

The agreement shall be ***in writing*** and signed by the hirer. The hirer must receive a copy of the agreement within 10 days and he must also be furnished with a copy of any contract of guarantee relating to the agreement, as must the guarantor. The agreement shall contain a statement of:

(a) The hire purchase price.
(b) The cash price of the goods.
(c) The amount of each of the instalments by which the hire purchase price is to be paid.
(d) The date upon which each instalment is payable.
(e) The number of instalments.
(f) The names and addresses of all the parties to the agreement at the time of its making.
(g) Penalties for failure to comply with the agreement.

The words "Hire Purchase Agreement" shall appear predominantly on the document.

Section 59 – The owner shall not be entitled to enforce the agreement unless Sections 57 and 58 have been followed:

Henry Forde & Son (Finance) v Forde (1986)

A hire purchase agreement was signed by the defendant hirer in November 1979. It was sent to him with the owner's name typewritten on it within 7 days. The agreement was not signed by the owner until 1982.

Held – the requirements of the Hire Purchase Acts had not been satisfied because no memorandum had been signed by or on behalf of the owner and the typewritten name on the memorandum did not constitute a signature. However, the court exercised its discretionary power to dispense with these requirements. The owner was entitled to enforce the agreement.

Section 63 - The hirer may terminate the agreement. However, he must then either purchase the goods or return them, having taken reasonable care of the goods while in his possession.

Section 64 – the owner may only recover the goods by legal proceedings.

The hirer has certain obligations:

(a) To take reasonable care of the goods.
(b) To give information as to the whereabouts of the goods.

The owner also has certain obligations:

(a) The goods must correspond with the description.
(b) There is an implied condition that the goods be of merchantable quality and fit for purpose
(c) There is an implied condition that the goods will correspond to the sample.

A hire purchase agreement that excludes all or any of the statutorily implied conditions may be void or unenforceable. The additional protection applies where the hirer deals as a consumer.

An Bord Iascaigh Mhara v Scallon (1973)

The defendant concluded a hire purchase agreement with the plaintiffs for a fishing boat. The trawling equipment on the boat was not sufficiently powerful for normal trawling. The defendant defaulted in his payments and when the plaintiffs sued for arrears, he counter-claimed for damages for breaches of the implied terms regarding (i) merchantable quality and (ii) fitness for purpose.

Held – the defendant failed on the first contention on the basis that the boat was fit for all purposes other than trawling. He succeeded, however, in his second contention in that there is an implied condition that the goods supplied are reasonably fit for their intended purpose and they were not.

Consumer Hire Agreements:

Section 84 – Requires that consumer hire agreements and related contracts of guarantee shall be made in writing, signed by the hirer and a copy shall be given to him within 10 days and a copy of the guarantee to the guarantor.

Section 85 – A consumer hire agreement shall contain a statement of:

(a) The cash price of the goods to which the agreement relates.
(b) The amount of each instalment to be paid by the hirer under the agreement.
(c) The date upon which the each instalment is payable.
(d) The number of instalments and total amount payable.
(e) Any additional costs to be paid.
(f) The cost of any early termination by the hirer of the agreement.
(g) The names and addresses of all parties to the agreement at the time of its making.
(h) Penalties if the hirer fails to comply with the terms of the agreement.

It must be possible to identify the goods from the agreement.
There shall be a prominent notice within the agreement that the goods remain the property of the owner.
The agreement shall clearly be called "A Consumer Hire Agreement".
The owner shall not be able to enforce the consumer hire agreement unless these conditions have been fulfilled.
The hirer has a duty to take reasonable care of the goods and to give information about the whereabouts of the goods.

It is important to note that any hire purchase, leasing, or credit sale agreement must be in writing, unlike the majority of contracts which can be in any form. Failure to provide written evidence of any such agreement would render the contract unenforceable.

NEGOTIABLE INSTRUMENTS

A negotiable instrument is a contractual document which contains an undertaking to pay money. Negotiable instruments are widely accepted as a substitute for cash. They secure the payment of money, since they entitle the holder to payment of the sum appearing on the face of the document. The most common forms of negotiable instruments are bills of exchange, cheques and promissory notes.

The essential feature of negotiable instruments is that of **negotiability** i.e. that quality which enables a third party to obtain a good title to the instrument from a party whose title is defective. The general rule of law is that the true owner of an item of property is the only person capable of transferring to anyone else an indisputable legal title to that property. For example, if X acquires an item of property from Y but Y was not the true owner of it, then X is not the true owner either. This rule is embodied in the Latin phrase "**nemo dat quod non habet**" (you cannot give what you do not have) and this principle is recognised in law. This means that if a person's property is stolen and subsequently sold to a third party, the true owner is entitled to have his property returned, if located. The third party has no legal right to the property, even though he may have paid a fair price for it in good faith. But this principle does not apply to negotiable instruments, and it is this feature that makes them a very flexible instrument in commercial activities.

Currency, in all forms, has always been excepted from this rule. If X gives Y coins or Irish bank notes in settlement of some obligation then the money is Y's absolutely unless Y actually knew when he was given it that the money did not belong to X. It is not necessary to enquire into the previous history of coins or bank notes. If currency could not be handled with freedom from doubt about its ownership then it would cease to be useful as a means of settling debts.

The business community has customarily treated certain types of documents evidencing an entitlement to receive money as being free from doubt. Such documents are said to be **negotiable**. A person who acquires a negotiable instrument **for value** and **in good faith** is entitled to ignore all previous claims to the document i.e. such a person may disregard any previous unlawful dealings such as the stealing of the document and take good title.

Characteristics of Negotiable Instruments:

(1) Title to the instrument can pass by mere delivery (together with, in certain circumstances, the endorsement of the transferor).

(2) Notice of the transfer need not be given to the person on whom the instrument is drawn.

(3) The transferee is entitled to sue on the instrument in his own name.

(4) A bone fide purchaser for value without notice can take the instrument free from a defect in the title. (see note above explaining this feature)

(5) The instrument will be recognised as negotiable either by custom (e.g. bank notes) or statute (e.g. bills of exchange under the Bills of Exchange Act 1882).

Negotiable Instruments include:

1. Bills of exchange
2. Cheques
3. Promissory notes
4. Debentures payable to bearer
5. Share warrants
6. Banker's drafts

They do not include postal orders or money orders.

BILLS OF EXCHANGE:

A bill of exchange is defined in Section 3(1) of the Bills of Exchange Act 1882:

"An unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand, or at a fixed or determinable future time, a sum certain in money, to, or to the order of, a specific person, or to bearer".

Nowadays, cheques are the most common kind of bill of exchange and the original bills of exchange are rarely used. Cheques, however, only became widely used in the 20th century. The Bills of Exchange Act 1882 is mainly concerned with a different kind of financial document which is nowadays only used in international trade.

The person/company who issues a bill of exchange is known as the **drawer**.
The person/company/institution that is required to pay out on foot of the bill of exchange is known as the **drawee**.
The person/company to whom payment is to be made is known as the **payee.**

Unconditional Order: A bill of exchange must be phrased imperatively i.e. it must be an order to pay. If a document is conditional on some event occurring e.g. the receipt of goods, it is not a bill of exchange. It may, however, be accompanied by words of courtesy or politeness, for example, the use of the words "please pay" is permissible.

In writing: A bill of exchange must be in writing. The term "writing" includes print or typing. Although a bill of exchange written with an ordinary lead pencil is valid, payment may be refused in practice, because of the ease of alteration, until the confirmation of the drawer is obtained.

Addressed from One Person to Another: The word 'person' includes legal persons e.g. a company.

Signed by the Drawer: The requirement of a signature is interpreted liberally. Apart from ordinary signature, the initials or mark of the drawer, or a stamped signature, will satisfy the statutory definition.

A person is only liable on a bill of exchange if it has been signed by him as drawer, acceptor or endorser or by his agent duly authorised. For example, the holder of a cheque which the drawee bank refuses to pay has no claim against the bank which has not signed it, though he usually has against the drawer since he has signed it.

A signature which is a forgery has no legal effect i.e. the bill is treated as if there were a blank space where the forged signature is written.

To Pay on Demand or at a Fixed or Determinable Future Time: A bill is payable on demand if it states that payment is to be made on demand or at sight or on presentation. If no time is expressed, the demand for payment must be made within a reasonable time. In the case of cheques, a reasonable time period has become, by custom, to be considered at six months.

A Sum Certain in Money: The order contained in a bill of exchange must be in respect of a monetary obligation. Although the sum payable may be expressed in figures only, it is preferable in order to prevent alteration that it should also be specified in words.

To or to the Order of a Specified Person or to Bearer: The payee, in a bill of exchange which is not a bearer bill (bill expressed to be payable to the bearer), must be identifiable with reasonable certainty.

Liability of the Parties to a Bill of Exchange:

A person is not liable on a bill as drawer, endorser or acceptor if that person had not signed the bill. In the case where a bill has been signed on behalf of a person, that person will not be liable unless he has authorised the other person to sign on his behalf.

Liability of Drawer:

The drawer is the party who issues a bill ordering payment. He has primary liability, pending acceptance of the bill. The drawer engages that on presentment (i.e. presenting of the bill for payment) the bill will be accepted and paid according to its tenor and if it is dishonoured then he undertakes to compensate the holder.

Liability of Drawee:

The drawee is the person to whom the order contained in a bill of exchange is directed. A drawee as such has no liability as a party to a bill. A drawee that accepts a bill becomes an acceptor, and he thereby incurs primary liability on the bill under Section 54 of the Bills of Exchange Act.

Liability of Payee:

If a payee indorses a bill he engages that on due presentment the bill will be accepted and paid according to its tenor and if the bill is dishonoured he will compensate the holder or subsequent endorser.

CHEQUES:

The provisions of the Bills of Exchange Act 1882 also apply to cheques:

Section 73 of the Bills of Exchange Act 1882 defines a cheque as a bill of exchange drawn on a banker payable on demand.

The principal characteristics of a cheque are:

- A cheque is always drawn on a banker.
- A cheque is payable on demand.
- A cheque is always for a sum certain.
- A banker does not accept a cheque and so if it is dishonoured, he does not have any obligations to the drawee.
- A banker must honour a cheque if it appears to be in order and is presented to him in the ordinary course of business and the drawer has sufficient funds to meet it (or is within agreed overdraft limits).
- A cheque must be presented within a reasonable time period for encashment (custom has dictated that this term is within six months of the date of the cheque).
- Cheques may be crossed, bills of exchange cannot.

Crossing of Cheques:

The purpose of crossing a cheque is to make fraud more difficult and to ensure that a cheque can only be cashed through a bank. Since a bank may not pay a crossed cheque over the counter, but only credit it to the customer's account, the crossing of a cheque will make fraud more difficult.

There are four different methods of crossing cheques:

(a) General:

A general crossing consists of two parallel lines across a cheque, with or without the words "and company" or any abbreviation thereof. A general crossing indicates that the cheque can only be paid through a banker.

(b) Special:

Here the name of the banker is inserted within the two parallel lines. The cheque is then only payable through the specific banker named.

(c) Not Negotiable:

If the words “not negotiable” are written across the face of the cheque, either with or without the name of a banker, then the person receiving the cheque cannot receive a better title than that which the person giving it had.

(d) Account Payee Only:

If these words are written across the cheque then it is a notification to the bankers that the proceeds of the cheque must be paid into the account of the person named on the cheque.

PROMISSORY NOTES:

A promissory note is an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money to, or to the order of, a specified person or to bearer.

Differences between Promissory Notes and Bills of Exchange:

1. The basic difference between a bill of exchange and a promissory note is that the former contains an “order” to pay whereas the latter contains a “promise” to pay.
2. Whereas a bill of exchange had three parties to it: the drawer, the drawee and the payee, a promissory note has only two parties. The two parties to a promissory note are the promissor or the maker, and the promissee.
3. It is usually necessary to present a bill of exchange for payment, however, a promissory note does not have to be presented in order to make a promissor liable on it.
4. A promissory note is not complete until it is delivered to the payee, whereas a bill of exchange is complete when it has been drawn up and signed.
5. A promissory note does not require acceptance.

Creative Press Limited –v- Harman & Another (1973)

The Plaintiff company sued the Defendants on foot of a promissory note drawn up in the following terms:

“We, GS Harman & Annette Harman, jointly and severally promise to pay the Creative Press Limited on or before the first day of November 1970 the sum of £2,000 for value received”.

The Defendants claimed that this was not a promise to pay “on demand or a fixed or determinable future date” on the ground that the words “on or before” introduced an uncertainty or contingency into the time for payment.

Held – there was a definite obligation to pay on the note at a fixed date. Accordingly, the wording complied with the statutory definition of a promissory note.

The Relationship of Banker and Customer

The relationship between banker and customer is extremely important in business today, and in fact a good relationship can greatly improve a company's chances of survival in constantly changing economic and market conditions. On the other hand, a bad relationship can hinder the efforts of a company to develop and grow in strength and competitive positioning. The legal relationship is a simple contractual relationship of debtor and creditor where the bank is the debtor and the customer is the creditor. This relationship is not a fiduciary one – a fiduciary relationship exists where there is trust and confidence between the parties. In those circumstances the law insists that no undue advantage is gained by one party over the other. But this law does not apply to the relationship between banker and customer.

Duties of a Banker

A banker owes a contractual duty to take reasonable care in his or her conduct of the customer's account. A banker owes a duty to pay cheques properly drawn on the customer's account, provided that the account has sufficient funds or is within the permitted overdraft limits agreed with the bank. This duty is owed to the customer and not to any other party.

Dublin Port & Docks Board v Bank of Ireland (1976)
A drawer drew cheques on his bank in favour of the plaintiffs. At that time, his account was in credit, however, when the cheques were presented for payment, there were insufficient funds in the drawer's account and the bank refused to honour the cheques. The plaintiffs sued for amounts owing to them.
Held: The banker was completely entitled to refuse to honour the cheques, since it owed no duty to the payee, but to the customer alone.

The duty and authority of a banker to pay a cheque drawn on the bank is terminated in a number of ways, such as:

- The customer may countermand the payment – a banker will be liable for wrongly paying a countermanded cheque.
- The banker's duty is terminated by notice of the death or insanity of the customer.

Bank of Ireland v Hussey (1965) – The banker was unable to recover from a payee sums of money paid on cheques the day before the banker's authority to honour cheques was withdrawn due to the drawer's mental illness.

The banker's duty is also terminated on notice of the presentation of a bankruptcy petition, or a petition for the liquidation of a company.

The relationship between banker and customer is confidential. The banker must not divulge any information relating to the customer which the banker discovers while acting in the capacity of banker. The Banker's Books Evidence Act 1897 provides that a court may make an order authorising a party to litigation to inspect, and take

copies of, entries in the books of a bank. The Finance Act 1983 gives the High Court wide powers to force a banker to reveal the affairs of a customer and in addition, under certain circumstances, vests a discretion to freeze the bank account of a customer, who is a taxpayer.

The duty to maintain secrecy also ends where disclosure is in the public interest, or in the interest of the bank, such as when the bank sues a customer for payment of an overdraft or other debts owed.

A customer may also agree to overrule the bank's duty by giving their permission for a third party to obtain a reference from the bank. In such cases, this permission can be expressed or implied. When an individual completes and signs a credit application, either on his own behalf or on behalf of a company, he or she may be required to give a bank reference and will be asked to sign a statement giving the creditor permission to request such a reference from their bankers. This request is presented by the creditor's bank to the customer's bank.

The legal implications of bank references is an issue concerning Tort Law and is dealt with in detail in that module under Negligence.

A bank has no authority to pay a cheque, and if it does so, may not debit the customer's account if:

- Its authority has been terminated in any of the ways outlined above
- The apparent signature of the drawer has been, or appears to be, forged
- The cheque is void for material alteration

Because banks process huge volumes of cheques every day, there is no possible was that each cheque could be given the careful scrutiny that would pick up every possible alteration or apparent alteration. Therefore, both the paying bank and the collecting bank are given statutory protection against liability, subject to certain conditions.

Protection of the paying bank:
A paying bank is deemed to have paid a cheque in due course, that is, to the person entitled, in spite of any forged, unauthorised or irregular endorsement, or the absence of any endorsement, provided he pays:

- In good faith and
- In the ordinary course of business

A payment is said to be made in good faith if it is made honestly, whether or not it has been made negligently.
A payment is made in the ordinary course of business as long as normal banking procedures are followed, even if there was negligence in doing this. A payment outside banking hours, or a payment to a suspicious person not known to the bank, could be not be classified as being made in the normal course of business, and therefore statutory protection against liability could not be provided.

Protection of the collecting bank:
A collecting bank is protected from liability where he receives payment for a customer who has no title, or a defective title, provided he acts:

- In good faith and
- Without negligence

Negligence by a collecting bank has been established in cases where:

- An account was opened for a previously unknown customer without proper enquiry
- Payment was obtained for a customer of a cheque for an abnormally large amount in relation to his circumstances
- Payment was obtained for a customer of a cheque drawn by his employer in favour of a third party
- Payment was obtained for a customer of a cheque drawn by him as agent for a third party but payable to himself

Protection of a Customer

In addition to the above situations concerning negligence, if a bank fails to obey the specific instructions of a crossed cheque and makes payment in a manner other than that demanded, this may leave the bank open to an action by the drawer. This can protect the customer from possible fraud by a third party.

Similarly, if the bank account of a company or partnership, or a joint account, requires two signatures, and the bank has been given the correct mandate, but a cheque is nonetheless paid with only one signature, then the bank may also be open to an action.

Traders also have some protection in law in cases where a bank ***wrongly*** refuses to honour a cheque. For example, when a cheque is 'returned to drawer' because of insufficient funds, when there were actually sufficient funds in the account at the time the cheque was presented. In such cases, the trader can claim damages, without proof of actual loss, for breach of contract. A private customer can only claim nominal damages, unless they can prove actual loss.

Clearance of Cheques

It is important to note that it is only cleared funds that are available, so the ledger account may show a credit balance while the cleared balance could in fact be negative or overdrawn. Every bank maintains two running balances for each customer, the ledger balance and the cleared balance, or 'available' funds. The difference between the two amounts to the sum of the third party cheques lodged and credited to the customer's account by the collecting bank but not yet cleared by the paying bank.

It is the time that the cheque is presented to the paying bank that is important. This is the time that the account is checked for available funds. The period of time it takes for a cheque to clear varies between banks and also depends on whether the cheque is lodged to the same bank as the drawer, in which case it is usually one day for clearing. Where both banks are the same but different branches, it is usually two days, but if the cheques is drawn on a totally different bank, and then depending on which two banks are involved, the clearing time can be as long as 7 working days.

Because of this timing issue, banks have been able to legitimately refuse to honour cheques that were good on the day they were issued, but not on the day they were presented. For example, if a business owner died and the bank was notified on the day of his death, but a cheque had been issued a week prior to his death and lodged on that day, this cheque would most definitely be returned. A bank can also recall such a cheque, even if it appears that it has been cleared

Duties of a Customer

The customer owes a duty towards the bank to take reasonable care in drawing cheques so as to guard against alterations. The giving of a blank cheque, signed by the customer, is not a prudent practice and the customer may have to compensate the bank for any negligence in this regard. Cheques should also be clearly written using ink and not pencil and should be appropriately crossed when necessary.

Customers should also ensure that the bank has the correct mandate with samples of all signatures, particularly in the case of companies where different combinations may be required.

Customers must also notify the bank without delay if they are aware of, or suspect, any forgeries.

Cheques must be kept in a secure place at all times. While this is not a legal requirement, it could be used in evidence if a stolen cheque was subsequently paid out by a bank, and may constitute contributory negligence on the part of the customer.

The torts of defamation, negligence and negligent misstatement arise in relation to bankers and customers duties. This is covered in more detail under Tort Law.