



Regulatory Impact Analysis	
Title of legislation	General Scheme for the Companies (Small Companies Administrative Rescue Process and Miscellaneous Provisions) Bill 2021
Department	Department of Enterprise, Trade and Employment
Date	xx May 2021
Related publications	Public consultation Public consultation report General Scheme
Available to view or download at:	xxxxxxxxxx
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## 1. Policy Context

### 1.1 Background

The Department of Enterprise, Trade and Employment continues to receive proposed amendments to the Companies Act 2014 intended to support companies mitigate the impact that Covid-19 continues to have on the normal operation of business. The crisis has put significant strain on companies financially which is evident from the statistics outlining the level of uptake on Government supports as well as unemployment figures. This position is also supported by the economic data and projections provided by the Central Bank, considered at 1.2 below.

Since April 2020, the Department working with the Company Law Review Group (CLRG) has been considering the feasibility of such proposals and drafting potential amendments to the Companies Act for consideration. The role of the CLRG as set out in the Companies Act is to advise the Minister on all matters pertaining to company law in the public interest, seeking to promote enterprise, facilitate commerce, simplify the operation of the Act, enhance corporate governance and encourage commercial probity. Membership of the CLRG is wide and representative of a broad range of stakeholders who are company law experts of employer and employee representatives, public bodies and professional practitioners.

In anticipation of a potential and significant increase of insolvencies arising as a result of the pandemic, and in line with commitments contained in the Programme for Government, on 8 July 2020, the Tánaiste wrote to the Chairperson of the CLRG requesting that it examine the issue of rescue for the SME sector.

The CLRG submitted its report in October 2020<sup>1</sup> and recommended a summary rescue process which would be a stand-alone process separate from the examinership process, but which would mirror key elements of the examinership legislation.

Such a process would:

- be designed for “small” and micro companies (as defined by the Companies Act 2014) which represent 98% of companies in Ireland,
- be commenced by resolution of directors rather than by application to Court,
- be concluded within a shorter period than examinership,
- be overseen and assisted by insolvency practitioners,
- provide that the rescue plan be passed by a simple majority in value of creditors,
- provide for format of cross class cram down of debts designed to reduce costs,
- not require application to Court for approval of rescue plan (provided no creditor objections), and
- have safeguards against irresponsible and dishonest director behaviour.

Following the conclusion of the CLRG’s work, further analysis by the Department and consideration by the Tánaiste and Minister, the CLRG’s recommendations were developed from an operational and policy perspective to form the basis of what is now the General Scheme for the Companies (Small Company Administrative Rescue Process) Bill 2021. The SCARP builds on the existing policy of examinership while reducing court oversight and concluding within a shorter timeframe thus resulting in a cheaper and more cost-efficient option for small and micro companies.

Having regard to the urgency of the proposed legislation to assist viable companies remain in business as supports are phased out, proposals have been considered within a compressed timeframe. Notwithstanding the significant work done by the Department to develop the proposals, the Department is mindful that the introduction of any new legislation can give rise to unintended consequences.

Thus, in developing the policy, the Department has adopted a number of mitigation strategies - early engagement with the Attorney General’s Office and relevant stakeholders during drafting of the General Scheme for example - to reduce the risk of unintended consequences. On balance, the Department considers the Bill to be an appropriate regulatory response to the unprecedented challenges currently faced by small and micro enterprises.

## **1.2 Economic Outlook**

Preliminary CSO National Accounts data indicate that Irish GDP grew by 3.4% last year, boosted by a strong export performance, largely due to a surge in pharmaceutical exports, and continued strength in the IT sector. However, Modified Domestic Demand, a more appropriate indicator of domestic economic activity, paints a considerably less positive picture, with activity contracting by 5.4% as a result of the pandemic. Output declined in all sectors of the domestic economy in 2020, with the largest declines in sectors with a high dependence on social contact including the arts, hotels, bars

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<sup>1</sup> <http://www.clrg.org/clrg/publications/the-company-law-review-group-s-special-report-on-the-rescue-of-small-business.pdf>

and restaurants and high-street retailers.<sup>2</sup> This is particularly relevant to small and micro enterprises with 78% operating in sectors moderately or highly affected by the pandemic.<sup>3</sup> The Stability Programme Update<sup>4</sup> estimates that Modified Domestic Demand will increase by 2.6% this year, before recovering more significantly to growth of 7.4% in 2022.

Over 200,000 Irish enterprises operate in sectors with direct or intermediate levels of exposure to the economic impact of the pandemic. Research conducted by the Central Bank at the onset of the pandemic estimated a three-month SME liquidity shortfall of between €2.4 and €5.7 billion due to the crisis. Restrictions have persisted beyond this point and financial shortfalls are likely to have expanded beyond the Central Bank's initial estimates. A recently published survey by the Central Bank and ESRI has found that almost a quarter of SMEs could be vulnerable to liquidation when insolvency criteria normalise. Half of SMEs are estimated to hold 5% or less of annual turnover in reserve, with a quarter of SMEs holding less than 1%.

The cumulative effect of government supports, loan payment breaks, forbearance from creditors, and pre-existing financial buffers have likely held back insolvency levels with commentators suggesting a number of 'zombie' companies who have not formally entered into insolvency but have permanently ceased trading. Government support to date has largely focused on the immediate liquidity crisis faced by firms, but as the crisis has persisted for more than a year it has evolved into a solvency crisis for some enterprises in particularly hard-hit sectors. Analysis undertaken by the Department of Enterprise, Trade and Employment indicates that when the economy reopens, these firms may not be in a position to take on further debt or source adequate equity injections, which will likely lead to higher reported insolvency rates. While insolvency rates remained largely static in 2020, figures for Q1 2021 have shown a notable increase in the number of insolvent firms. Previous analysis by the World Bank<sup>5</sup> indicates that it took 13 quarters from the onset of the financial crisis in 2007 before OECD countries reached a peak of insolvent liquidations, which suggests higher insolvency rates are likely to persist for some time due to the time lag associated with recessionary events.

The State's comprehensive policy response to the crisis has proven successful in mitigating the immediate impacts of Covid-19 on the small company sector. However, as supports are rolled back e.g. CRSS and EWSS, the existing financial weaknesses across small companies are likely to be amplified and further exposed. An efficient insolvency regime will play an important role in the reallocation of resources across the economy as it becomes clear that the business models of some firms are no longer viable. This has potentially significant consequences for the 788,000 workers employed in small and micro enterprises and for the wider economy.

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<sup>2</sup> [Quarterly Bulletin - Q2 2021 \(centralbank.ie\)](https://www.centralbank.ie/quarterly-bulletin/q2-2021)

<sup>3</sup> SME liquidity needs during the Covid-19 shock, Central Bank of Ireland - [https://www.centralbank.ie/docs/default-source/publications/financial-stability-notes/no-2-sme-liquidity-needs-during-the-covid-19-shock-\(mcgeever-mcquinn-and-myers\).pdf?sfvrsn=6](https://www.centralbank.ie/docs/default-source/publications/financial-stability-notes/no-2-sme-liquidity-needs-during-the-covid-19-shock-(mcgeever-mcquinn-and-myers).pdf?sfvrsn=6)

<sup>4</sup> [gov.ie - Minister Donohoe publishes Stability Programme Update 2021 \(www.gov.ie\)](https://www.gov.ie/publications/2021/03/minister-donohoe-publishes-stability-programme-update-2021)

<sup>5</sup> The World Bank Group "The Calm Before the Storm: Early Evidence on Business Insolvency Filings After the onset of Covid-19"

### **1.3 International Approach**

The Department considered restructuring processes provided for in other jurisdictions, namely New Zealand, the U.S.A and the Netherlands, when developing the proposals.

Each jurisdiction provides for processes with unique characteristics of varying applicability and comparability in an Irish context. New Zealand, for example, provides for a debt warehousing process, solely for the Covid period, while the U.S.A developed a “light” version of their own Chapter 11 bankruptcy model. The Netherlands only recently introduced the “W.H.O.A” process and as such there is a lack of analysis available as to the success or otherwise of the model pending a further bedding down period and increase of use. The Department did not consider that such processes were in keeping with the recommendations of the CLRG or existing well-established policy with regard to examinership. Furthermore, deviating extensively from the well-understood examinership model would add complexity, require training and development for practitioners ahead of uptake, and jeopardise the targeted delivery timeframe. Most importantly from a policy perspective, examinership is internationally well regarded and Ireland is seen as a leader in the area of corporate rescue. The Department therefore considered it more prudent to build on our existing, and successful, domestic model.

The World Bank has also provided commentary which indicates that there is no consensus on an optimal insolvency model specifically suitable for SMEs emerging from the pandemic response globally.

The Department therefore considers that the Small Companies Administrative Rescue Process Bill offers an appropriate bespoke solution which takes into account Ireland’s existing and well-established insolvency framework.

## **2. Policy Objective of the Proposal**

The policy objective of the proposal is to provide a cost-efficient option for viable but insolvent small companies. It seeks to pre-empt issues arising from Covid-19 in respect of insolvency as we move into a stabilisation phase of the pandemic response and as companies transition off Government supports to normal operations. The General Scheme progresses commitments contained in the Programme for Government to simplify and improve examinership laws in response to the Covid-19 crisis. The proposal also addresses what has long been considered a pre-existing barrier of access to corporate rescue and restructuring for smaller companies.

While Ireland’s existing rescue process, examinership, is internationally recognised as a successful tool for restructuring in its own right, the associated costs mean that this important process may often be beyond the reach of small and micro companies. Such companies employ in the region of 788,000 workers and it is a Government priority to provide a rescue framework capable of supporting their future viability. Discussions with practitioners on the Company Law Review Group indicate costs ranging from €80,000 - €120,000 for the average examinership, while SCARP is estimated to cost in the region of €20,000 - €50,000, dependent on creditor engagement and the number of court applications required by a particular company.

Business representatives have called for a process akin to examinership, but appropriately nuanced to meet the unique requirements of small and micro enterprises. Previous attempts were made to open up the examinership process to such companies by amending the Companies Act 2014 to allow small and micro companies to initiate examinership in the Circuit Court rather than the High Court. This was intended to reduce associated costs thus making examinership a viable alternative to winding up for such companies. However, the amendment did not result in a corresponding increase in use. Therefore, provision of a separate process is justified.

Given the impact the crisis continues to have on the liquidity of companies, it is reasonable to anticipate an increase in winding up petitions. The General Scheme seeks to mitigate this with a view to protecting otherwise viable companies and preserving employment.

### 3. Policy Options

1. Do nothing
2. Enact legislative measures

### 4. Identification and Description of Options

Option	Benefits	Impacts
<b>1. Do nothing</b>	<ul style="list-style-type: none"> <li>No State intervention required.</li> </ul>	<ul style="list-style-type: none"> <li>Potential for significant increase in insolvencies and liquidations across circa 200,000 companies employing 788,000 workers.</li> <li>Potential for substantial job losses across small and micro companies operating in sectors with high levels of exposure to pandemic related impacts.</li> </ul>
<b>2. Enact legislative measures</b>	<ul style="list-style-type: none"> <li>Potential increased facilitation of rescue plans for small companies.</li> <li>Potential reduction in the number of insolvencies and liquidations arising as a result of Covid-19.</li> <li>Potential preservation of employment across small and micro company sector.</li> </ul>	<ul style="list-style-type: none"> <li>An additional and tailored option available to viable small companies assisting their rescue resulting in job retention, and other economic and societal benefits.</li> <li>The introduction of any new legislation may result in unintended consequences. This is particularly true of legislation developed within a compressed period of time.. However, the Department has adopted a number of mitigation strategies to reduce the risk of unintended consequences.</li> </ul>

Option	Benefits	Impacts
		<ul style="list-style-type: none"> <li>• Potential for legal challenge. While the Department has worked closely with the Office of the Attorney General in drafting the General Scheme and will continue to do so when engaging with Parliamentary Counsel to finalise drafting, there is potential for legal challenge. SCARP removes the requirement for Court intervention at the beginning of the process and at the approval stage of the process in certain circumstances. In examinership, it is the Court’s supervisory function and oversight role which ensures the process is compatible with the Constitution and in particular with regard to property rights. However, the Department is satisfied on the basis of engagement with Advisory Counsel to date, that the process is constitutionally robust with sufficient safeguards incorporated into the process for the benefit of creditors.</li> <li>• Likelihood of success – there is no evidence to give an indication as to the level of demand for the process. However, a less costly insolvency model is proposed which would suggest higher uptake among eligible companies than under examinership.</li> <li>• Potential threat to the economy if numerous companies artificially continue to exist being propped up by state supports and by utilising SCARP, without any real liquidity to pay off external funds. However, the Department considers that the viability test provided for in the Bill and that the process is built on creditor engagement go a substantial way towards mitigating this risk.</li> </ul>

## **5. Impact Analysis**

### **a. National Competitiveness (incl. employment)**

The proposal seeks to preserve employment and support the survival of companies which were viable prior to Covid-19. It provides an additional rescue option for companies and as such contributes to a supportive and well-rounded legislative framework for business.

### **b. Socially excluded or vulnerable groups including gender equality, poverty, people with disabilities and rural communities**

This proposal is not envisaged to have any adverse impact on socially excluded or vulnerable groups including gender equality, poverty, people with disabilities and rural communities.

### **c. The environment**

This proposal is not expected to have an impact on the environment.

### **d. Significant policy change in an economic market including impacts on competition and consumers**

This proposal does not reflect a significant policy change in an economic market and as such there is no impact on competition or consumers envisaged.

### **e. North-South, East-West relations**

The proposal does not impact North-South, East-West relations.

### **f. The rights of citizens/human rights**

This proposal could be interpreted as an interference with an individual's property rights as guaranteed by the Constitution. However, the Department has engaged with the Attorney General's Office in this regard and is satisfied that the proposal is constitutionally robust with sufficient safeguards incorporated into the process for the benefit of creditors.

### **g. Compliance burden on third parties e.g. citizens and business**

The proposal reduces the compliance burden on third parties, i.e. small and micro companies, by providing for a more flexible and administrative form of examinership/corporate rescue process.

## **6. Consultation**

The Department has consulted with the Attorney General's Office in relation to specific issues arising during the development of the General Scheme and has had extensive engagement with the Company Law Review Group and other stakeholders. A public consultation also took place to inform development of the General Scheme. The Department received 17 responses to the consultation from a mixture of representative groups, individuals and insolvency practitioners. A copy of the Department's public consultation response is being made available on the Department's website.

## **7. Enforcement and Compliance**

The General Scheme provides various enforcement and compliance provisions in relation to failure to comply with filing, notice and information obligations. Such provisions are in keeping with the existing provisions of the Companies Act 2014 with regard to other insolvency and rescue processes. There are additional safeguards included in the General Scheme to reflect the potential risks associated with reduced court oversight.

## **8. Review**

The legislation will be periodically reviewed and a post-enactment report completed. Furthermore, it will be re-examined in the context of Ireland's transposition of the Preventive Restructuring Directive to determine whether amendments are required to achieve further alignment with the mandatory elements of the Directive.

## **9. Publication**

The Department intends to publish both the General Scheme and Regulatory Impact Analysis on its website.