ODCE Submission to the Business Regulation Forum

14 June 2006

The Office of the Director of Corporate Enforcement (ODCE) is pleased to respond to the request by the Business Regulation Forum for a submission on the subject of regulatory issues as they impact on business costs and market efficiency. Consistent with the Forum's request in relation to the content of submissions, this deals with the following particular matters:

1) The Role and Impact of the ODCE;
2) The ODCE's Graduated Approach to its Regulatory Responsibilities;
3) Specific Suggestions for Regulatory Change.

The Role and Impact of the ODCE

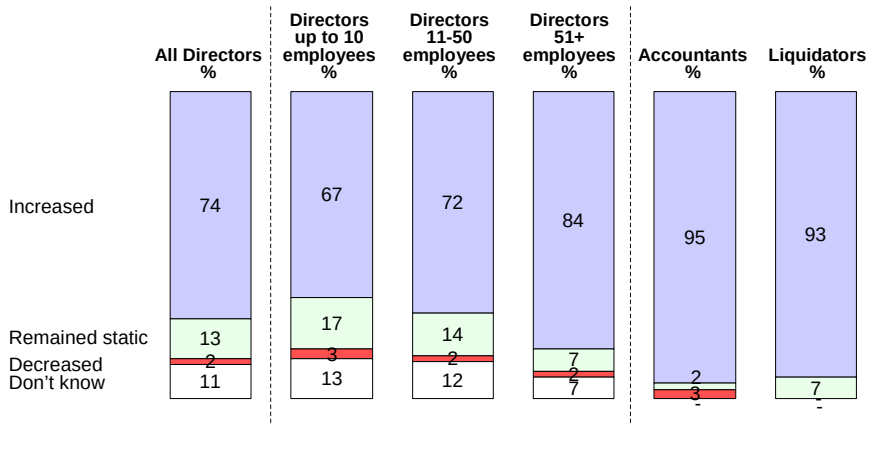
The ODCE was established in late 2001 following the enactment of the Company Law Enforcement Act 2001. The Director, Mr Paul Appleby, is charged with:

- encouraging compliance with the Companies Acts, and
- bringing to account those who disregard their obligations under company law.

The Companies Acts contain a balanced legal framework of rights and duties which are distributed among company directors, investors, creditors and other stakeholders. The purpose of the Acts is to establish a fair and reliable basis for the conduct of commercial and social relations via companies. The role of the ODCE is to ensure as far as possible that the public interest as expressed in the law is achieved in practice.

In terms of impact, the ODCE has been successful in contributing to a changed compliance environment. The Office's Annual Report for 2005 includes the results of market research commissioned from Millward Brown IMS in late 2005. This showed that 74% of directors believe that company law compliance has improved over the last five years. The equivalent figure for accountants and liquidators was close to 95%. **Illustration 1.2.1** from the Report contains further information on these results.

Illustration 1.2.1 - Movement in Compliance Levels



Q. In your opinion, have levels of compliance with Company Law in Ireland increased, decreased, or remained static over the past 5 years?

In terms of outputs, the ODCE has achieved significant results since its establishment in:

- promoting compliance through advocacy, guidance and other means;
- detecting company law breaches by way of auditor, public and other reporting;
- enforcing detected breaches of the law in appropriate cases;
- sanctioning improper conduct with respect to insolvent companies and
- providing quality services to the Office's customers.

A summary of these outputs for the 2002-2005 period is contained in **Appendix 1** to this Submission. Overall, the recent Millward Brown IMS market research has also indicated that 68% of company directors rate the ODCE as an effective organisation.

A concrete example of the improved market discipline now prevailing and of the attendant benefits for business is provided in the ODCE's recent Annual Report (page 30). The 21% drop in the number of insolvent liquidations between 2001 and 2005 has been offset by a 47% rise in the number of solvent companies being liquidated. Clearly, it is welcome that a higher proportion of company creditors and other stakeholders have been receiving full payment for their outstanding liabilities since 2002 when the insolvency regime in the 2001 Act came into force. We believe that this regime is encouraging company directors to wind up failing businesses in good time. This is leading to improved business practices and better protection for company stakeholders.

The ODCE's Graduated Approach to its Regulatory Responsibilities

The ODCE takes a graduated approach to its regulatory responsibilities. It actively informs and encourages company stakeholders to adhere to their obligations. When developing primary guidance material, the Office consults with and involves business and professional bodies in its preparation as a matter of standard practice.

Where an allegation of misconduct arises, the Office is selective in determining if a complaint will be investigated. Some complaints are more appropriately addressed by other parties, including on occasion the complainant by way of civil legal proceedings. Where it does decide to become involved, the Office determines its appropriate response by reference to the circumstances of the case. Various ODCE responses are employed to address reported concerns, and consistent with its legal functions and powers, these efforts are directed to-

- securing voluntary compliance;
- obtaining administrative rectification of evident defaults;
- empowering company stakeholders to resolve their own difficulties;
- directing the taking of remedial action by the defaulting party;
- encouraging future compliance;
- seeking remedial orders from the Courts;
- seeking enforcement sanctions.

The ODCE's latest Annual Report contains illustrations of the employment of these options in 2005[1]. A consequence of this graduated approach is that only a small fraction of cases reported to the Office result in the taking of legal action against the defaulting companies, company directors or other parties. At the same time, the quality of the future compliance environment will be influenced by the extent to which serious misconduct or regular disregard of the law is seen to be appropriately sanctioned in the present. The Director considers his Office's overall approach to be broadly consistent with the criteria for better regulation set out in the White Paper "Regulating Better".

Specific Suggestions for Regulatory Change

Laws and regulations with respect to business define the ground rules and boundaries for the operation of corporate activity in the market. Where feasible, these rules should enhance the power of the market to achieve positive ends in the public interest. Where necessary, these rules should also permit effective intervention to assess, correct or restrain the conduct of market actors for positive public ends.

Achieving the right balance in these areas is affected by many things, including the ability of legislation and regulators to respond to changing market developments and the ability of legislators to discern the public interest in addressing the demands of sectoral interests for change. In the former case, the regulatory compliance burden may be excessive until the required changes are made, while there is a danger in the latter instance that the burden may be too light if legislators fail to identify and uphold the public interest.

The ODCE's remit is confined to the Companies Acts, and it will be no surprise then if our suggestions are confined to matters in this general field. The Forum is no doubt aware of the work of the Company Law Review Group which is developing a Consolidated Companies Bill which should assist in simplifying and modernising Irish company law in the near future. Notwithstanding our participation in this work, the following discrete themes and general proposals are offered for consideration.

<u>Need for Greater Transparency</u>

Company stakeholders need access to up-to-date corporate information in order to enable them to assess risk in their conduct of commercial and social relations. Information deficits are clearly not conducive to sound commercial decision-making. Yet company law grants regulatory concessions on the filing of up-to-date financial information with the Companies Registration Office (CRO). Certain companies are permitted to file no accounts or only abridged accounts. Abridged accounts involve the preparation of an altered set of statements which add cost and involve an unnecessary layer of bureaucracy for smaller companies, while the "benefits" are in fact a reduction in the quantity and quality of company information disclosed to other company stakeholders. This reduces stakeholders' ability to make rational commercial decisions in their own interest and in the interests of the improved operation of the market.

[1] See in particular the Illustrations in the text which discusses the results under Goals 2, 3 and 4. A copy of the Report is available on the ODCE website at http://www.odce.ie/.

Accordingly, the filing of abridged information should be dispensed with and other regulatory concessions reviewed. It is the view of the ODCE that the law should provide generally that complete company profit and loss/income and expenditure accounts and balance sheets should be filed annually with the CRO, regardless of whether the company's accounts are audited. This is a 'win-win' situation where not only would the compliance burden be reduced by eliminating the preparation of abridged accounts but the operation of the market as a whole would benefit from the improved market transparency.

The adoption of such a proposal is particularly desirable following the recent decision to raise the audit exemption threshold which will directly alleviate regulatory burdens at company level. When implemented however, the absence of an audit will reduce the quality of information publicly available in the market, because some 90% of Irish companies will then be potentially eligible for audit exemption. Accordingly, it would seem necessary in the public interest that more complete financial information on company performance should be required to be filed in the CRO even if the information is unaudited, in order to help compensate for any decline in information quality.

Similarly, it is imperative that the companies which claim audit exemption are only those that are entitled to it. For reasons of transparency and equity, a simple inquiry mechanism should be available to enable the ODCE to establish a company's entitlement in any case of doubt.

In a similar field, two international peer reviews of Ireland by the Council of Europe and the OECD in 2005 were critical of the limited ability of the Irish Authorities to access information on the beneficial ownership and control of companies. The OECD review in particular urged that the requisite information should always be internally recorded by companies and made available in the public interest to competent authorities on request in order to combat money laundering and terrorist financing. The regulatory burden of complying with such a provision within companies would be minimal while the public benefit would potentially be very significant.

Access to Legal Remedies

One of the weaknesses of company law in Ireland from the perspective of many ordinary stakeholders is that notwithstanding the availability of many legal remedies, they are often of little practical value for cost reasons. Often the remedies can only be secured following the making of costly applications to the High Court. The likely cost/benefit ratio of such applications is particularly disproportionate for small and medium sized companies.

It is desirable therefore that particular remedies under the Companies Acts, which at present can be granted only by the High Court, should—in appropriate cases—be capable of being dealt with also at District and/or Circuit Court level. For instance, the District Court could be given jurisdiction to determine certain minor classes of applications, such as a shareholder's exercise of his/her statutory right to compel an inspection of certain books and records of a company or perhaps an application by a company for an order extending the time within which it must deliver its annual return to the CRO. Likewise, the Circuit Court should possibly be given jurisdiction to deal with certain applications under Section 205 of the Companies Act 1963 (the principal

statutory remedy for the resolution of minority shareholders' disputes), particularly in cases involving minority shareholdings of moderate value in small or medium sized companies.

Section 2 of the Companies Act 1963 already permits courts (other than the High Court) to be prescribed by regulation to handle company law issues. Accordingly, the implementation of such an initiative can be achieved by secondary legislation and would allow individual stakeholders to assert their rights and pursue their grievances in a far more cost-effective manner. Access to the District and Circuit Courts would therefore reduce regulatory burdens for smaller companies in particular.

Consent Procedures in Lieu of Disqualification and Restriction Orders

Regulators often share with the regulated some frustration with the limitations of the law and a desire to change it in order to ease compliance and enforcement. One current example of an inappropriate regulatory burden which is equally shared by regulators and the regulated is the requirement that all proceedings for restriction and disqualification proceedings must be determined in the High Court. A considerable amount of unnecessary time and legal expense is spent in prosecuting proceedings to which directors are not opposed. In the case of company liquidations, the expense involved is reducing the return to creditors from the assets of the liquidation. These financial and regulatory burdens could be easily removed by the adoption of a consent procedure such as applies in the UK. Experience there suggests that over 80% of disqualifications are achieved with the consent of the party involved. The effect of a consent is that it has the same legal status as that of a High Court Order.

A consent procedure has already attracted the support of the Company Law Review Group in the context of the forthcoming Consolidation Bill, but the ODCE is of the view that this and similar regulatory burdens should be addressed as they arise. The ODCE believes in this case that the early introduction of such a provision would see a significant majority of disqualification and restriction applications disposed of in the public interest without the need for expensive confirmatory Court proceedings.

Conclusion

The Director hopes that the above comments contribute value to the work of the Business Regulation Forum. In summary:

- the proposals above for improved market transparency are primarily designed to enhance the quality of commercial decision-making and thereby improve competitiveness;
- those proposals recommending improved access to the law will empower companies to better defend their commercial interests on a more cost-effective basis than is possible at present, and
- the proposal on consent procedures in lieu of disqualification and restriction orders will eliminate unnecessary legal cost in many cases to the benefit of the creditors of failed companies.

If we can be of further assistance, please get in touch.

Office of the Director of Corporate Enforcement
14 June 2006

Appendix 1

ODCE Performance 2002 - 2005

	2002	2003	2004	2005	Total
Compliance Goal					
Office Publications	10	9	7	7	33
Presentations, Articles, Press Releases	43	80	74	63	260
Detection Goal					
Public Complaints and Auditor Reports	620	1,950	1,956	2,373	6,899
Cases Determined	426	1,406	1,577	2,111	5,520
Insolvency Goal					
Initial Liquidator Reports	300	525	362	327	1,514
Initial Reports Determined	4	560	529	317	1,410
Enforcement Goal					
Court Proceedings Initiated	19	71	41	50	181
Court Orders / Judgments Secured	35	109	122	144	410
Convictions	14	43	66	49	172
Disqualifications	0	1	3	21	25
Restrictions (via liquidators primarily)	0	153	198	137	488
Customer Services Goal					
Website Visits	42,000	75,600	116,800	178,900	413,300