Department of Business Studies
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The opinions and perceptions of insolvency practitioners in relation to the reform of the bankruptcy act 1988

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Abstract

The current economic crisis has had a damaging effect on businesses. Many directors and sole traders have found their debts accumulate to an unmanageable level as a result. Considering the large amounts of money in question these cases will ultimately lead to personal bankruptcy under the Bankruptcy Act 1988. However, this legislation was enacted in a time when very little credit was extended to individuals. Many commentators believe there is a need to reform this legislation. It is criticised for being outdated and irrelevant in this credit society.

This thesis explores current bankruptcy legislation in order to find out why there is a need for reform. It discusses the issues surrounding the current legislation, which is largely unused by over indebted individuals. Furthermore, it discovers whether the legislation proposed by the Law Reform Commission provides the solution to these current issues and if not, what provisions would be suitable. As the proposed legislation is more lenient on the debtor, this thesis will also explore whether this will create any issues.

The results, based on interviews with eight insolvency practitioners, reveal there is indeed an urgent need to reform this legislation. It is punitive, unfair and restricts bankrupts from re-entering the business community and contributing to the economy. At a time when entrepreneurship is vital in Ireland's road to recovery, this is a fundamental flaw with the BA 1988. The findings also found that the interviewees believe the proposed law is suitable for the most part but, at times unrealistic and in need of some minor adjustments. The proposed Bill is not expected to be published until 2012 and when this will be enacted is uncertain.

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Abbreviations

BA 1988	Bankruptcy Act 1988
LRC	Law Reform Commission
CA 1963	Companies Act 1963
C(A) 1990	Companies Amendments Act 1990
OECD	Organisation for Economic Co-Operation and Development
INSOL	International Association of Restructuring, Insolvency and Bankruptcy Professionals
EC	European Commission
BAPCPA	Bankruptcy Abuse Preventation and Consumer Protection
ISIP	Irish Society of Insolvency Practitioners

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Chapter 1: Introduction

1.1 Introduction

The ongoing recession has highlighted serious and fundamental flaws in the Irish business and banking sectors regarding the ways in which business in Ireland is financed. The easing of restrictions to credit, created an environment where businesses were actively encouraged to amass significant amounts of debt, which if economic commentators such as McWilliams (2010) are to be believed, will ultimately have to be resolved through the bankruptcy courts. The recession has had a detrimental effect on businesses as they do not have the same access to credit they once enjoyed, leaving them unable to pay their debts. As a result of this, there were 2,900 insolvencies in 2009 and 2010 (Finfacts 2011). Throughout the course of liquidation, limited liability protects directors from personal exposure to the debts of the company but in some instances this is not the case. Directors may become personally liable for the debts of the company if they have breached the companies act or have signed personal guarantees. Furthermore, as a sole trader is not protected by limited liability he will be personally liable for the debts of the business. Considering the large monetary values involved, it is likely that many such cases will result in bankruptcy.

Bankruptcy is a commonly used yet misunderstood term. The term bankruptcy is generally used to describe any individual who is unable to pay their debts but this is not the case. To be "bankrupt" an individual must be declared so by the High Court and go through bankruptcy procedures set out in the Bankruptcy Act (BA) 1988. This law is twenty three years old and it was enacted pre Celtic tiger when there was very little credit extended to people and very few owned a credit card. Now in these recessionary times, when people are struggling to keep up with debt repayments, it has become an urgent issue. The Law Reform Commission (LRC) 2010 have made proposals to update this legislation and many including Baxter (2011), Holohan (2010), Fine Gael (2010), Joyce (2003, 2009) and Stafford (2006) have written articles surrounding this issue.

This thesis will explore the issues with current Irish bankruptcy legislation in order to find if there is a need for reform. The BA 1988 has been accused of having an adverse effect on entrepreneurship for a number of reasons including restricting bankrupts from re-entering the business community sometimes for the rest of their lives. Taking into account the important contribution businesses make to our economy these issues will be given particular consideration. Furthermore, this thesis will explore whether the legislation proposed by the LRC provides the solution to these issues and if not, what would be more suitable alternatives.

In order to explore Irish bankruptcy legislation, emphasis will be placed on those who have become bankrupt due to business debt. Cases involving directors and sole traders have a greater degree of complexity attached considering the large amounts of money that could be in question, in comparison to individual with personal debt. If the LRC's recommendations are implemented there will be a non judicial system in place to deal with those who have consumer debt, excluding them from bankruptcy legislation. However, it can be expected that complex cases involving business debt will be dealt with in court under bankruptcy legislation. For this reason, directors and sole traders will be focused on in order to explore bankruptcy legislation in this country. For ease of reference, this thesis will refer to the bankrupt as a male considering this reflects the reality here in Ireland where 93% of active bankrupts are males (Holohan and Sanfey 2010).

1.2 Research questions

This thesis aims to answer the following questions:

1. What is the relevant legislation regarding cases where directors or sole traders become bankrupt as a result of their business debts?
2. Why is there a need for reform of the BA 1988?
3. Is the legislation proposed by the LRC appropriate and if not, what would be more suitable alternatives?
4. Are there any drawbacks associated with the proposed legislation?

In order to answer these research questions, the remainder of this thesis is structured as follows: chapter two sets out the similarities and differences between insolvency, liquidation and bankruptcy. These terms are core to this topic and for this reason it is important to clarify what they mean. In addition, chapter two will also provide a background to the legal framework that is applicable to the bankruptcy of directors and sole traders. It will outline the instances when a company director may face personal bankruptcy under the Companies Act (CA) 1963 and also the Companies Amendments Act [C(A)] 1990. In addition to this, the BA 1988 will be outlined. Finally, chapter two will identify the arguments in favour of reform. These arguments are based on the current issues with bankruptcy legislation in Ireland. How the proposed legislation intends to deal with these issues will also be discussed throughout this section.

Chapter three outlines the methodology which was applied for conducting the primary research. Semi structured interviews were chosen and in this chapter the reasons and justifications for this method have been described. In addition, an explanation for each question asked is given in order to clearly link these questions to the research objectives. Finally, a brief over view of the procedures used to analysis the data will be described.

Chapter four will present the findings from the semi structured interviews with eight insolvency practitioners. Furthermore, it will provide an interpretation of this information in order to answer the research questions outlined above.

Chapter five discusses both the findings of the secondary and primary research in order to link these results back to the research questions.

Finally, chapter six will provide an overall conclusion to this thesis. Additionally, areas for further research will be identified.

1.3 Contributions of this study

This study will first and foremost be of benefit to the business studies students at Letterkenny Institute of Technology. It will provide an insight into Irish bankruptcy legislation, a topic which is not explored on any syllabus at this institute. It may also inspire students to choose this as the topic for their thesis in the future when further developments have taken place regarding the reform. It may also provide such students with an insight into the issues which existed pre reform in order to draw comparisons. This study may also benefit those who find themselves unable to pay their debts by helping them to understand more about the process. Finally, this study may be of some interest to any individual who is considering a career in this area.

1.4 Limitations of this study

The intention of this study is to provide an insight into the complex topic of bankruptcy by highlighting the issues with the current legislation and also discussing the proposals made by the LRC in relation to the reform. This is a small scale research project which conducted eight interviews and therefore the findings and results are not conclusive.

Chapter 2: Literature Review

2.1 Introduction

This chapter outlines the literature which exists regarding the reform of the BA 1988. The differences and similarities between the terms insolvency, liquidation and bankruptcy will be explained in order to clarify exactly what they mean. This will be followed by a brief description of the relevant legal framework which surrounds this topic. There will be a review of the published issues with the current legislation and also the proposals made by the LRC in relation to a reform. Finally, the consequences of introducing more lenient legislation will be outlined.

2.2 Insolvency, Liquidation and Bankruptcy

There are common misconceptions regarding the meaning of these three terms so it is important to clarify and differentiate between them. Insolvency occurs when a company or an individual cannot pay their debts as they fall due. In other words their liabilities outweigh their assets. Personal insolvency is not defined in law rather the BA 1988 defines acts of bankruptcy. S.214 of the CA 1963 states a company is insolvent if it is unable to pay a debt exceeding £50, owing for three weeks or if the debts of the company outweigh its assets. When a business becomes insolvent the owner is personally responsible for the business debts. When a company is insolvent it can be put into liquidation, meaning the company will be wound up and closed down. Liquidation can be likened to bankruptcy but applies only to companies. The main purpose of liquidation is to realise all of the assets of the company and in accordance with S.285 of the CA 1963, distribute the proceeds amongst the creditors in order of priority, paying out any remaining surplus to the members. S.225 of the CA 1963, states a liquidator is appointed for the purpose of conducting the proceedings in winding up a company. Liquidation may result in personal bankruptcy for the company directors.

Bankruptcy law applies only to individuals. This legislation was designed to deal with both debtors who are unwilling to pay, these are referred to as the “cant pays” and

those who are unable to pay, referred to as the "wont pays". The standard definition of bankruptcy is considered to be a quote from an English case in 1874

> "Bankruptcy is a law for the benefit and the relief of creditors and their debtors, in cases in which the latter are unable or unwilling to pay their debts" *(*Reiman Fed Cas 1874)

Bankruptcy is a generic term, which covers a wide range of over indebted individuals including company directors and sole traders who may find themselves responsible for the debts of their business regardless of whether the company is incorporated or not. The reason why personal bankruptcy law applies to businesses, and not just to individuals, is because when a firm is not limited by liability, its debts are personal liabilities of the firm's owner, the sole trader. A sole trader can become a director by incorporating their firm into a company. When a firm is incorporated limited liability applies, therefore the directors are not legally responsible for the firm's debts. However limited liability will not always apply to directors who have breached company law or signed personal guarantees leaving them personally liable for the companies' debts.

2.3 Directors and Bankruptcy

There is a perception that limited liability will apply to all directors of companies but this is not always the case. As mentioned previously limited liability will not always protect the directors. They may invest all their savings in the company or take out personal loans in an attempt to try and save the company. Furthermore, if a personal guarantee has been signed or if they have breached the company's acts by repaying a debt as a fraudulent preference, trading recklessly or fraudulently or failing to maintain proper books of account.

Personal debt and savings

When a business is failing the directors may invest all their saving and also take out personal loans in order to try to rescue the company. If insolvency and closure occur regardless, this means that along with being personally responsible for the personal loans, they will also have lost their regular income from the company and may face bankruptcy as a result.

This situation was seen in the case of the construction company P Elliot. The key directors had personal loans for tens of millions of Euros with the Bank of Scotland as a result of trying to save their company, which went into receivership in May of this year Now these directors may be facing bankruptcy as it is unlikely they will be able to repay this debt. (Daly 2011).

Personal Guarantee

A personal guarantee is a guarantee from an individual in relation to a business loan. If the business is unable to repay, the onus is on the individual to take on the debt. Directors may have signed these guarantees in order to secure finance for the business when the assets of the company were inadequate. Personal guarantees had become a common business practice during the boom years. This was very much so the case in the construction industry where suppliers such as "chadwicks" had personal guarantee clauses written into all of their contracts. In addition to this, if a company had leases of any sort these contracts always included some form of personal guarantee (Leydon 2011). Now in the recession, these guarantees have become a real issue. Mc Donagh (2011), the CEO of Nama, stated that every developer involved in the first transfer of assets to Nama had been involved in a personal guarantee. In total approximately 60% of their loans had a personal guarantee attached.

This situation is best illustrated in the cases of Sean Quinn and Bernard McNamera. Anglo Irish Bank is pursuing Sean Quinn and members of his family for €2.8b worth of loans for which they provided personal guarantees (Curran 2011). As a result of this, a Swedish court has approved the appointment of a bankruptcy receiver to the Quinn's companies (Noonan 2011). Similarly, Bernard McNamara provided many personal guarantees which have been estimated at €300m (McCaughren 2011). There has been a petition issued against McNamara in order to declare him bankrupt (Hartnett 2010).

Given the economic crisis and especially the collapse of the construction sector, it is widely recognised by leading economist Kelly (2010) and Broderick (2011) that there are many others in a similar position. These individuals do not have the assets to

cover these personal guarantees and this will ultimately lead to bankruptcy (Maguire 2011).

Companies Act 1963-2009

S.297 of the CA 1963 introduced the concept of making a director personally liable for the debts of their company. The liquidator is required to examine the actions of directors throughout the liquidation. The legislature has created a number of charges or actions which can be brought against the directors who have abused their position within the company (McConville 2008).

Fraudulent preference

S.218 of the CA 1963 states, when the winding up of a company commences, any sale of company property or preferential payment is void, unless the court directs otherwise. If a preferential payment is made to a creditor who holds a personal guarantee from a director this is called fraudulent preference. Under S.286 of the CA 1963, the director can be held personally liable for the debt as the payment will be held as void by the court. This can also be seen as fraudulent or reckless trading as the director has continued to trade after the commencement of the winding up (McConville 2008).

Fraudulent or reckless trading

Under S.56 of the Company Law Enforcement Act 2001, the liquidator of an insolvent company must send a S.56 report to the Director of Corporate Enforcement. In this report the liquidator must comment on the behavior of the directors and give an opinion as to whether or not they acted honestly and responsibly in relation to their business affairs (Taite 2008). Under S.297 of the CA 1963, if the directors are found to have acted fraudulently or recklessly in the carrying on of the company business, this will impose personal liability for the debts of the company on the directors (Mc Conville 2008).

Reckless in relation to the directors knowledge, experience and skill that may reasonable be expected of a person in their position, that they should have known their actions or those of the company would cause loss to a creditor, or if they contracted a debt and they did not honestly believe the company would be able to repay it (Mc Conville 2008). An example of this could be if a company is in financial difficulties and continues to trade unless they have a reasonable expectation that they can afford to do so. S.297 of the CA 1963 states fraudulent trading is found to occur where it appears that the business of the company has been carried on with the intention to defraud creditors or any other person.

Failure to Maintain Proper Accounts

Under S.204 of the C(A)A 1990, if there has been a failure to keep proper books of account, the court may hold the directors personally liable for the company's debts if it considers that such failure: has contributed to the company's inability to pay its debts, or has resulted in uncertainty as to the assets and liabilities of the company, or has obstructed the timely winding-up of the company (Callanan 2007).

These sections of the Companies Acts were largely unused throughout the boom years as many companies in financial difficulties were able to obtain easy access to credit in order to remain in business. Now in the current economic climate business failure has increased and as a result so has investigations by liquidators. Naturally, this has led to an increase in the amount of directors who are expected to be found guilty of the above offences. Under S.150 of the CA 1963, directors who have been found guilty of the above crimes can be restricted, for a period of up to fifteen years from re-entering the business community or in more serious cases, be disqualified. For example, David Drumm, the former Anglo Irish Bank chief executive is wanted by the Director of Corporate Enforcement, the Gardai and the Chartered Accountants Regulatory Board for questioning about his alleged fraudulent activities at the bank (Phelan 2011, Ryan 2011 and Carswell 2011). Furthermore, investigations are on going into his colleague Sean Fitzpatrick's, activities (Keane 2011) who was declared bankrupt last year (Carolan 2010). The current Irish bankruptcy system would impose severe penalties on such individuals regardless of whether they are found to have become bankrupt

through no fault of their own or fraudulently. This will be explored in more detail below.

2.4 Personal Bankruptcy Legislation- Bankruptcy Act 1988

To be adjudicated bankrupt the debtor must owe at least €1900 and have committed an act of bankruptcy. A creditor can force their debtor into bankruptcy however, the debtor may also decide to become bankrupt voluntarily. In 2009, 2 of the 17 bankruptcies were voluntary (Holohan and Sanfey 2010). Once a debtor is adjudicated bankrupt, he is required to hand over all his assets and property, including the family home, to the Official Assignee. He will be allowed to retain such articles of clothing, furniture, household and tools of trade to the value of €2,500 (O'Grady 2011). There are many restrictions which apply to a bankrupt up until such a time as they are discharged.

Official Assignee- Christopher Lehane

Once an individual is adjudicated bankrupt all their property must vest in the Official Assignee. Under S.61 of the BA 1988, the role of the official assignee is to realise the bankrupt's assets and distribute them among the creditors in order of preference. The family home must also vest in the Official Assignee even if it is co-owned. In addition, any property which is acquired by the bankrupt post adjudication must also vest in the Official Assignee (Holohan and Sanfey 2010).

Acts of Bankruptcy

These are defined in S.7 (1) of the BA 1988. There are nine acts of bankruptcy, the most commonly seen are:

S.7(1) (f) which provides that a debtor has committed an act of bankruptcy when a court order has been issued against the debtor in respect of an unpaid debt and the sheriff has been unable to seize goods sufficient to adequately cover the debt and;

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

S.7 (1) (g) which provides that when a bankruptcy summons remains unpaid after 14 days the debtor will have committed an act of bankruptcy

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

After the debtor has been adjudicated bankrupt the creditors are required to lodge their claims for unpaid debts with the Official Assignee. These claims will then be categorised.

Categories of Debt

There are two types of debt. Preferential debts include rates, taxes and amounts due to employees. These are all set out in S.81. Non preferential debts are all other claims including loans of any type (EC 2005).

Restrictions

Under S.129 of the BA 1988 a bankrupt is not entitled to apply for credit over €650 without informing the lender of their status. Under S.183 of the CA 1963 a bankrupt is prohibited from acting as a company director or from being in any way concerned with the management of a company. Furthermore, a bankrupt cannot practice as a solicitor (S.50 of the solicitors act 1954), be elected a member of parliament (S.51 of the Electoral Act 1923) or may not leave the jurisdiction without the leave of the court (S.124 of BA 1988). S. 72 of the BA 1988 states the court can order for the bankrupts post to be re-directed to the Official Assignee. Once a bankrupt is discharged all restrictions no longer apply. The EC (2005) suggest that a discharged bankrupt will have difficulty getting credit.

Discharge

Under S.85, the bankrupt will remain so until they are discharged. There is no automatic discharge period in Irish bankruptcy legislation. An undischarged bankrupt will remain so even after death (Maguire 2011). If the debtor repays all their debts or all their preferential debts and 50% of their non-preferential they can apply to the High Court to be discharged. If they have failed to do this and have remained bankrupt for a period of twelve years or more they may also apply to be discharged.

This twelve year period is referred to as conditional discharge. This is the longest period of any EU country, where the average is five years (Keily 2009). Considering the cost of the High Court many do not return to the court to be discharged. As a result, bankruptcies have lasted up to twenty five years or even for the remainder of the debtor's life (Laffoy J in Grace vs. Ireland and the Attorney General 2007).

2.5 Issues with Irish bankruptcy legislation

The bankruptcy legislation is rarely used by over indebted individuals. In 2009, 17 were declared bankrupt, this figure increasing to 29 in 2010 (Collins 2011) and to date in 2011, 16 individuals have been declared bankrupt (Examiners Office 2011). The possible reasons for these low figures will now be explored.

The core argument of this paper is that there is a need to reform the BA 1988. Baxter (2011) and Joyce, senior policy researcher with the Free Legal Aid Centre's (Kennedy 2008), states all parties concerned are convinced of the need for reform. Reifner *et al.* (2003) stated that Irish bankruptcy legislation should not even be called an insolvency procedure due to the fact it is rarely used and is very expensive. The EC in its second chance paper (2007) scored all European countries bankruptcy systems based on their treatment of bankrupts, Austria came out on top with 7 points, and the UK received 5. Meanwhile Ireland received 2 but this was wrongly based on the assumption that after 12years there is an automatic discharge (Holohan and Sanfey 2010).

Leading commentators on bankruptcy such as O'Neill (2011), Brown (2011), Richard Clarke (2011) and Holohan (2011) have highlighted issues with current bankruptcy legislation such as the discouragement of entrepreneurship by imposing a lengthy discharge period, the payment of preferential debts before discharge, high legal costs and not distinguishing between culpable and non culpable debtors. If these issues are dealt with by making this law more debtor friendly, it could have a lasting impact on the economy as it may encourage abuse of the system and it may also increase the cost of debt. It is important the correct balance is found, on one hand too strict bankruptcy laws could deter individuals from using bankruptcy as soon as they are in financial difficulties when they are merely delaying the inevitable. On the other hand, lenient laws could mean the writing off of millions of euro's worth of debt, as a result

of fresh start policy bankruptcy legislation which allows bankrupts to start a fresh with a clean slate. Many accounting and insolvency professionals in Ireland have published their positions on the need for a reform of the BA 1988. Baxter (2010) discusses the urgent need for reform in this country. He asks

"Why were over 74,000 individuals in England and Wales declared bankrupt last year, yet in Ireland the equivalent was only 17?" (Baxter 2010: 7)

However, the numbers of registered judgements against debtors who have not repaid their debts have increased. In 2009 there were 5,557 judgements to the value of €376.4m, this increased to 7,447 judgements valued at €1.18b in 2010 (Mulligan 2011). The Law Reform Commission LRC (2009) compared this low figure of 17 Irish bankrupts in 2009 with Northern Ireland reporting that there were 1237 bankrupts in the same period. The LRC (2010) indicate that the current system serves little purpose and does not provide any benefit to Irish society. According to Djankov *et al.* (2008) the main test of whether bankruptcy law is effective in achieving its objectives is the amount of individuals who use the procedure.

2.5.1 Discouragement of Entrepreneurship

Peng *et al* (2009) states that when entrepreneurs know that they will not be given a second chance if their company becomes insolvent, this acts as a deterrent to them starting a new business in the first place. White (2010) agrees stating that debtor friendly bankruptcy legislation makes self-employment more attractive to risk averse individuals. This can be justified by research conducted by Cumming and Armour (2008) which found that, bankruptcy laws are the most important contributor to high levels of self-employment and the possibility of households owning businesses is 35% higher if they live where there is debtor friendly laws (Berkowitz and White 2004). Gallop (2009) states that 49% of individuals would not start up a business for fear of the consequences of bankruptcy.

In order to combat this, the European Commission EC (2011) in their second chance report, encouraged member states to adapt fresh start approaches to bankruptcy legislation by reducing the stigma attached and as a result creating a more supportive environment for businesses at risk and a more favourable climate towards

entrepreneurship. They have taken the stance that business closure and bankruptcy are something which is natural and that bankruptcy should be treated as a rehabilitation process in order to allow the entrepreneur to re enter the business world. Instead of this, current bankruptcy legislation in Ireland is based on a "philosophy of punishment" (LRC 2009:164) and is considered to be "anti entrepreneurial" (ISME Fielding 2011: 7 and Daly 2010a: 1).

Encouraging entrepreneurship through bankruptcy law reform has been the subject of work undertaken by the LRC (2010). In order to achieve this they have recommended more debtor friendly legislation. Firstly they propose the introduction of an automatic discharge. They also recommend the abolishment of the stipulation that all preferential debts must be paid before the bankrupt is discharged. Furthermore, they propose that culpable and non culpable bankrupts be distinguished between in order to ensure honest bankrupts are released back into the business community and culpable bankrupts are restricted from doing so. The Organisation for Economic Co-Operation and Development OECD (2003), Second Chance Report (2011), Kok (2004), Ekanem and Wyer (2007), Dybvad (2011), Schror (2006) and Stam *et al.* (2006) find that those who have been declared bankrupt have learned from their mistakes and are generally more successful second time round. Examples of such bankrupts include Walt Disney, Henry Ford, H.J Heinz (Holohan 2011), Alan Sugar and Simon Cowell (Daly 2009). In addition to this, failure allows society to learn which entrepreneurial endeavours do not provide economic growth (Hoetker and Agarwal 2007, Second Chance Report 2011, Knott and Posen 2005, McGrath 1999, Lee *et al.* 2007, and Peng *et al.* 2010).

Length of Discharge Period

The Irish discharge period is based on recommendations made by the Budd Committee in 1972, a group set up in 1962 to put forward proposals for the now BA 1988. They stated that bankrupts should not be discharged for as long as possible "as most bankruptcies are brought about by either gross negligence, incompetence, sharp practice or petty fraud" (Budd Report 1972: 170). However, evidence drawn from the second chance report (2011) states bankruptcies which involve fraud are as low as 3-6% and so this assumption could be called into question. The Civil Miscellaneous Provision Bill (2010) included an automatic discharge period of twenty years. The

Civil Miscellaneous Bill (2011) goes further and shortens the automatic discharge period to twelve years while introduces a conditional discharge period of five years. This would effectively mean that three hundred bankrupts would be discharged (Coulter 2011). Fielding, president of the Irish Small and Medium Enterprise Organisation, Mc Evoy, president of the Institute of Certified Accountants, Talbot, chief executive of Chambers Ireland and Blackwell, director general of the Free Legal Aid Centres all welcome the introduction of an automatic discharge period yet they agree it is still too long (O'Halloran 2011). O'Grady (2011) agrees describing this as merely an interim measure and of little practical impact, especially as this discharge period is still considerably longer than in other jurisdictions. To date neither bill has been brought into law. The LRC (2010) and the International Association of Restructuring, Insolvency and Bankruptcy Professionals INSOL (2001) recommend that distinguishing between culpable and non culpable debtors would still protect the business community with strict sanctions for those who have acted wrongfully.

The LRC (2010) recommends an automatic discharge period of three years. This will allow honest bankrupts back into the business community sooner, increasing entrepreneurial activity (Lee *et al* 2010).

No distinction between culpable and non-culpable bankrupts

Under the BA 1988 all the restrictions detailed above relate to both culpable and non-culpable bankrupts. This exhibits the laws policy of viewing bankrupts as untrustworthy, dishonest and/ or incapable. The second chance report (2011) states that only fraudulent and criminal behaviour such as breaches of the Companies Acts, should be punished. The reality of bankruptcy and business failure is a normal part of economic life but public opinion does continue to make a strong connection between business failure and fraud (LRC 2010). This lack of a distinction is now being challenged by a team of lawyers as they see it as a constitutional flaw in the current system. They believe that the courts should be given discretion when penalising the bankrupt based on their particular case (Kennedy 2011).

Additionally, the LRC (2010) have recommended that a procedure be put in place where dishonest bankrupts are restricted from going back into business. In addition to

this, criminal and civil offences will be put in place against dishonest bankrupts. However, prosecutions against white collar crime in Ireland have been described as "pathetic" (Webb and McBride 2011: 5) and so this punishment could be called into question. Finally, they proposed that the bankrupt may be required to pay towards their debts after discharge for a period of five years. It is important that if this system is implemented, it is adequately monitored as the payment of debts after discharge has been ineffective in the US according to White (2010). She finds that bankrupts are likely to work less after being discharged from bankruptcy if their earnings are subject to the repayment of debt.

Honest bankrupts would not be subjected to these punishments and restrictions. This means that honest bankrupts will be allowed back into the business community after discharge. This will have the effect of encouraging entrepreneurship as those bankrupts who acted honestly will be allowed back into the business community in order to contribute to the economy.

Preferential Debts as a condition for discharge

Under the BA 1988, bankrupts must pay all preferential debts before they can be discharged. This condition is almost never met (LRC 2010). The LRC (2010) recommends that S.85 (4) of the BA1988 be abolished. This section states that all expenses, fees, costs and preferential payments must be paid before the debtor is discharged. They have also recommended that revenue debts should be no longer given preferential status. Tax debts associated with business failure could be vast depending on the size of the firm. In the US, tax debts must be paid before the debtor can be discharged from bankruptcy. This is to prevent bankruptcy processes from being used as a form of tax avoidance (Wood 1995). In addition, it has been argued that the revenue is an involuntary creditor and therefore should be given preference over all other voluntary creditors (Day 2000). However, the revenue do have additional powers and authority other creditors do not have the benefit of, for example, the imposition of penalties and high interest rates, and the power to investigate and remove records (Revenue 2010). On the other hand, in the UK since 1986, tax preference has been abolished entirely. This is to ensure the fair distribution of assets among the creditors equally (Cork Report 1982). The fair distribution of

assets among creditors is essential and the loss to the revenue if they are not a preferential creditor is disproportionate to the loss of a small business creditor, considering the financial difficulties SME's are facing in this economic crisis. In addition to this, the revenue will receive extra corporation tax from the creditors who receive more as a result of the revenue not having a preferential status.

High Costs

Irish bankruptcy procedures are expensive considering the numerous court appearances that are necessary (LRC 2009). It is likely to cost tens of thousands of Euros (Hauser 2010), the Official Assignee alone can cost €6350 and over. Furthermore, if a creditor has petitioned to have the debtor declared bankrupt, they must provide an indemnity to cover the fees of the Official Assignee, often at great expense (Holohan and Sanfey 2010). It has been found by Lee *et al* (2010) that the cost of bankruptcy in Ireland is approximately 9% of the estate. The costs associated with bankruptcy include; payment of the High Court petition proceedings, the fees of the Official Assignee including any stamp duty on realised assets and the payment of preferential creditors (Holohan 2010). The LRC (2010) propose the reduction of costs and to make the bankruptcy system more accessible to debtors although they do not specify how this could be achieved. The current limit for other civil matters in the High Court is €38092.14 and over. In the LRC (2010a) paper on Court Reform, they recommend this limit be increased to €100,000. Therefore, cases involving large amounts of debt will still need to be held in the High Court. This does not follow the recommendations of the second chance report (2007) and INSOL (2001) which state that all individuals should have access to bankruptcy and therefore cost should not be a prohibitive factor.

The costs of bankruptcy could also affect the credit flow in society. White and Fan (2003) found that if the cost of bankruptcy is high, entrepreneurs borrow less and avoid bankruptcy even when in financial difficulties. Furthermore, Lee et al. (2007), Peng et al. (2010), Cumming and Armour (2008) and Halliday and Carruthers (2007) find that lowering the cost of bankruptcy lowers the entry barriers to becoming self employed and makes it a more attractive option. Entrepreneurship is a very important element in Ireland's road to recovery and reducing the costs of bankruptcy might

indeed encourage more self employment. High bankruptcy costs "can cause sluggish economic growth" (Mason 2005: 1523). In other words, high bankruptcy costs may provide over indebted individuals with an incentive to delay filing for bankruptcy which can reduce the amount which could be distributed among creditors.

2.6 Effect on Credit Flow

The relationship between credit and bankruptcy legislation has not been considered by the LRC (2010) in their final recommendations paper. This is an important factor considering the current economic climate. Ihle (2011) reports that, for the first quarter of 2011, 48% of small businesses who applied for credit were refused. Many academics have found a direct relationship between the flow of credit and bankruptcy laws including Broadie *et al.* (2007) and Choi and Phan (2006). Funchal (2007), Lee *et al*., (2007), Bebchuk (2002), and Kahl (2002) studied the impact of an increase in debtors protection when such levels are low and found that by increasing the level of debtor protection in bankruptcy, firms cost of debt increased and that there is a decrease in the flow of credit. Berkowitz and White (2004) find that the rejection rate for credit in the US in states where bankruptcy laws are more debtor friendly is 30%. Djankov *et al* (2008), using a larger sample of countries, concluded that more creditor protection is associated with broader credit market. It is important that the balance is right, bankruptcy law needs to encourage entrepreneurship through more debtor friendly laws and yet, it also needs to encourage a steady credit flow as directors and sole traders need access to credit in order to operate and trade.

2.7 Abuse of the system

Some American economists have argued that too many people took unfair advantage of the bankruptcy system because of their lenient laws (Adkisson and McFerrin 2005, White 1991). Weller *et al* (2010) stated that bankruptcy in the US no longer carried an adverse stigma and that many filings were "bankruptcies of convenience." (Weller *et al* 2010:1) In 2005 the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) was implemented. Abuse of the current Irish bankruptcy system would not seem to be a factor due to the severe penalties imposed and low levels of individuals using this system. The LRC (2010) propose a more lenient system towards

debtors and is expecting the number of bankrupts to increase to 3,680 per annum. Fay *et al* (2003) found that as the number of bankruptcies increase, the level of stigma associated with it decreases as the public become more familiar with the process. Although this stigma needs to be reduced here in Ireland, it is important that bankruptcy still carries some stigma in order to prevent abuse. According to White (1991) if bankruptcy laws are too lenient, then many individuals will take on too much debt only to be relieved of it at the expense of society.

2.8 Conclusion

It has been established that there is a need for a reform of the BA 1988. The literature review highlighted the many negative aspects of the current legislation placing emphasis on research outcomes produced by agencies such as the LRC (2010). The LRC (2010) outlined many issues with the current legislation which discourages entrepreneurship. These include the discharge period, the amount of preferential debts, not distinguishing between culpable and non-culpable bankrupts and the high costs. They have recommended these issues be dealt with by introducing an automatic discharge period, abolishing preferential debts, differentiating between culpable and non-culpable bankrupts and finally reducing the costs associated with the process.

The need for a balanced approach to bankruptcy legislation was also considered. It is important that bankruptcy legislation on the one hand encourages entrepreneurship, while on the other hand discourages abuse and does not affect the flow of credit. This is an essential balance which is important to strike considering the effect these issues could have on economic growth.

Chapter 3: Methodology

3.1 Introduction

This chapter will outline the methodology that was applied in order to find; why there is a need to reform the BA 1988, are the proposals put forward by the LRC appropriate and are there any issues with the introduction of more debtor friendly legislation. Firstly, the chosen data collection method, semi structured interviews, will be explained and justified in order to clearly demonstrate why this method was chosen. This is followed by an explanation regarding the interview questions asked and a profile of the interviewees. Finally, a brief description of the data analysis method adapted will be given and also a description of the limitations associated with this type of methodology.

3.2 Data Collection Method Adopted

In order to gather primary data for this thesis, semi structured in depth interviews were chosen as the data collection method. This method was chosen because it allows for an interpretive philosophy to be adopted. This philosophy allows for a flexible approach to be taken when collecting the data (Saunders *et al.* 2009) and is best suited to this type of thesis as it takes into account the changing business environment. This is particularly important as the information regarding the reform of the BA 1988 is constantly changing and new developments can be expected at any stage. Additionally, considering the issues to be dealt with are complex in nature, this philosophy facilities the understanding of how and why. It allows for the details of the situation to be understood and the reality working behind them (Remenyi *et al.* 2003). By adopting this approach to the data collection, rich insights can be gained into the issues with the current legislation and whether the proposals of the Law Reform Commission are appropriate to deal with these issues.

Semi structured interviews are a valuable means of conducting exploratory research. This type of research is suitable where flexibility and adaptability is a must. It will allow for the changing of direction if new data appears which reveals new insights (Saunders *et al* 2009). Furthermore, as the research surrounds the opinions and perceptions of insolvency practitioners regarding the reform of this legislation, the

data to be collected is subjective and qualitative. Using semi structured interviews means that the questions can be open-ended and the flow in which they are asked can be flexible so that questions could be added or omitted as necessary (Hair *et al.* 2007). This will help to ensure all the necessary information is gathered. As each individual has their own unique opinion this also needed to be catered for in the data collection method chosen. The flexibility of this type of interview allowed the interviewees to fully express their own opinions on the current legislation and the reform, and explain why they felt this way.

3.3 Interview Themes

From the outset it was taken into account that these are high profile busy professionals so it was essential that the questions were kept to a minimum to ensure only 30 minutes of their time was taken up. It was important not to ask the interviewees to name or give any specifics regarding any cases which they described as this would have had an adverse effect on the interview process. Specifics about cases were not necessary for this thesis and so it was ensured that such questions were avoided.

The interviewees were asked to give their opinions on the current and proposed legislation in order to answer the research questions. To ensure all issues addressed in the literature review were covered in the interview, the interviewees were all asked to comment on the same issues. Additionally they were offered the chance to add any other issues they felt had been missed but were important. The discouragement of entrepreneurship was the overarching theme as this is the main reason for the reform of the bankruptcy legislation. By asking interviewees whether or not the current legislation discouraged entrepreneurship shows whether this is a valid reason for a reform of this legislation.

The next issue addressed was the discharge period. This is the most controversial issue with the current legislation and so it was important to understand what was the insolvency practitioners opinion on this. Also, it sought to find whether they felt that the proposed three year automatic discharge period was more appropriate in the current times.

In order to find out what are the current issues with having preferential classes of creditors and having the payment of these as a condition of discharge the interviewees were asked to express their views. This aimed to highlight what would be the consequence of removing preferential debts as proposed by the LRC, and also whether this was likely in the current economic climate.

If the proposals of the LRC are implemented, culpable and non-culpable bankrupts will be distinguished between. Interviewees were asked to give their opinions on this in order to find if these proposals are practical and realistic and if not what would more suitable alternatives be.

Another major criticism of the bankruptcy process is that it is expensive. There is not much published data on the costs associated with bankruptcy and so the insolvency practitioners were asked to give an average figure. As a solution to this issue, the LRC have proposed the introduction of a non-judicial system. It was also suggested to the interviewees that the process could be removed from the High Court as this might reduce costs. It was also suggested to the interviewees that in order to reduce the costs, the proceedings should be taken out of the High Court and a non-judicial process set up. Interviewees were asked to express their opinions on these alternatives in order to see if these would be suitable and appropriate.

Much literature exists in America that suggests if bankruptcy laws are relaxed they will be abused and as a result the flow of credit will reduce as creditors are less likely to receive as much in a bankruptcy situation. As the credit flow in Ireland is already an issue, interviewees were asked did they feel this would become an issue here as it did in America.

3.4 Profile of the interviewees

In order to enhance the quality of the findings and discussion section, each interviewee was asked for their permission to attribute their names to their individual opinions. The interviewees were chosen because of their high profile presence in the area of bankruptcy and so it was felt that it would not be appropriate to anonymise

their contributions to this thesis. All interviewees gave their permission except for one. This individual will be referred to as Anon.

Interviews were conducted with the following insolvency practitioners:
Bill Holohan of Holohan Solicitors has worked with bankruptcy for 25 years and he is regarded as the main authority on this subject in Ireland. He has recently published the second edition of his book, *Bankruptcy Law and Practice in Ireland*. He is a member of the Irish Society of Insolvency Practitioners ISIP and regularly presents with the Law Reform Commission in regards to reform.

Declan Black of Mason, Hayes and Curran works with complex insolvency matters resolving disputes between the parties in question. He is also a course tutor in insolvency for the Law Society of Ireland.

Barry O'Neill of Eugene F Collins is a consultant on insolvency matters for the Law Society's Education Programme and a contributing author to *Insolvency Law* published by the Law Society of Ireland. He is one of the compilers of the Combined Companies Acts 1963-1990. Mr. O'Neill is Chairman of the Law Reform Committee of the Irish Society of Insolvency Practitioners (ISIP).

Sean Kelly of Farrell, Grant and Sparks is the director of insolvency at this firm and has written many articles on bankruptcy for the Sunday Business Post. He also has many years' experience working with insolvency and bankruptcy in the UK.

Michael Leydon of Kavanagh Fennell has over 13years of insolvency experience. He regularly writes articles on bankruptcy for insolvencyjournal.ie. He is also a Member of the ISIP and the Law Reform Committee of the ISIP.

Jim Stafford of Friel Stafford was interviewed over the phone. Mr Stafford is the founding member of this firm and deals specifically with business debt. He has lectured and written widely on insolvency matters. He is also a member of the ISIP.

Madeline Murray was also interviewed over the phone. Ms. Murray is the senior manager at Deloitte in Cork. She deals with both corporate and personal insolvencies

and is a member of both the ISIP and also the UK's Insolvency Practitioners Association.

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3.5 Data Analysis

In order to analysis the data collected, the interviews were firstly transcribed. They were then categorised according to the issues addressed in the question. This allowed for the rearrangement and analysis of the data systematically and rigorously (Blaxter *et al.* 2006).. Here, unnecessary data was removed to ensure that the data remaining was linked specifically to the research questions. This allowed the data to be presented in a more manageable and comprehensible form. The final step taken was to reorganise the information in order to recognise relationships and patterns. Examples of these relationships and patterns included how many interviewees agreed with the fact the BA 1988 discourages entrepreneurship. Additionally, did the reason given by the interviewees for their responses agree or disagree with the literature. This allowed for conclusions to be drawn and also for the identification of instances where it would not be possible to draw such conclusions, if there was more than one different suggestion put forward or where there was conflicting opinions.

3.6 Limitations of the Research

As with all research, there were limitations associated with this methodology. As all interviewees chosen were high profile professionals it was necessary due to their busy schedules, to conduct two of the interviews over the phone. This was a limitation considering face to face interviews have been found to produce more credible results as the personal contact allows for trust to be built. This trust can be difficult to achieve over the phone and may have resulted in the reluctance of the interviewees to divulge too much information (Saunders *et al.* 2009). Additionally, the time constraints of this research resulted in a limited time period within which interviews could be conducted. As a result, it was not possible to interview all concerned stakeholders.

3.7 Conclusion

Semi structured interviews were the chosen data collection method as this research aims to discover the opinions and perceptions of insolvency practitioners. This research is interpretive and exploratory as the method used is flexible and takes into account the changing business environment which bankruptcy is a part of. Eight interviews were conducted with high profile insolvency practitioners. The findings of these will be presented in chapter four.

Chapter 4: Findings

4.1 Introduction

This chapter outlines the findings of the primary research. In order to establish why there is a need to reform this legislation all issues identified in the literature will be further explored. Furthermore, this chapter discloses the opinions and perceptions of insolvency practitioners as to whether the proposed legislation is appropriate and if not what they believe to be more appropriate alternatives. Finally, it will outline the opinions and perceptions of the interviewees with regards the introduction of lenient bankruptcy laws.

4.2 Entrepreneurship

The general consensus from the interviewees was that current bankruptcy legislation discourages entrepreneurship as it prevents bankrupts from re-entering the business community. However, all interviewees felt that entrepreneurs do not think of the possibility of bankruptcy from the outset and in the majority of cases do not even know the consequences of bankruptcy.

O'Neill believes bankruptcy in Ireland is not a relief process as it should be, but a punishment, as it sometimes never allows the bankrupt back into the business community. Holohan uses the metaphor of a "lobster pot" to describe the Irish bankruptcy process; once you get into it, it is nearly impossible to get out of. In comparison to this, he uses the analogy of a "car wash" to describe the UK system. You go in and you come out clean after a year but without the car, this leaves you free to buy another car. Holohan also refers to the EC second chance report which states that bankrupts are more successful second time round having learnt from their mistakes. He also refers to the fact here in Ireland there is still a "Dickensian" approach to bankruptcy.

There were many anti-entrepreneurial issues highlighted in the literature review, these include; the discharge period, the lack of a distinction between culpable and non-culpable bankrupts, the payment of preferential debts before discharge and the high costs of proceedings. All interviewees were asked to comment on each of these issues

in order to establish what exactly the issues with the current legislation are and what are their opinions and perceptions regarding the reformed legislation and its appropriateness.

Discharge period

All interviewees agreed that the current conditional discharge period of twelve years is too long. Leydon calls it "ridiculous" while O'Neill describes it as "a punishment". O'Neill further explained that the twelve year discharge period was an idea of the Budd Committee in the 1960's so even in 1988 it was out dated. The idea was to ensure bankrupts were not allowed to re-enter the business community for as long as possible as it was believed bankruptcies were brought about by fraud or sharp practices. However this could be called into question as, Holohan explains that in twenty five years he has only dealt with five bankrupts who have had an element of fraud. Instead, he believes in general bankrupts tend to be "unlucky, stupid or both" and he is sure each one of them would have learned from their mistakes.

When asked what a more suitable period would be, all interviewees agreed that the three year automatic discharge proposed by the LRC was appropriate. There was consensus among the interviewees that this period would allow the bankrupt back into the business community in a more appropriate length of time. Additionally, they felt that a shorter period would be unsuitable and they all made reference to the fact the UK's one year discharge period is too short. Furthermore, Anon states that a three year period has been successful in Australia. Kelly and O'Neill furthered the argument for a three year discharge by stating that this will be ample time for the estate to be realised whereas in the UK, the estate will likely not be fully realised before the bankrupt is discharged. A three year discharge would result in the creditors receiving their monies before the bankrupt is automatically discharged.

The government of 2007 made a commitment at European level to introduce an automatic discharge period of three years but as of yet this has not materialised. However, there have been two provisions in relation to this in the Civil Miscellaneous Bills of 2010 and 2011, introducing an automatic discharge of twenty years and twelve years respectively. To date neither of these Bills has been brought into law. Many reasons for the reluctance of the government to honour the commitment that

was given in 2007 has been put forward by the interviewees. Holohan believes this is because the government do not want to be seen to be facilitating "the Galway tent brigade" by supporting debt forgiveness. This could be described as a form of clientelism. Black agrees, making reference to the fact that a short discharge period may be viewed as "politically unappealing" for the current government. Leydon explains debt forgiveness is inevitable because of the substantial debts that many individuals have amassed. Leydon believes the government do not want to admit this yet as they would be viewed by the public as effectively writing off the debts of the rich and famous, instead, they want to keep up the pretence that they will chase everyone for as long as they can. He adds that as a result, the reformed bankruptcy legislation is not expected to be published for at least ten or twelve months and that it may not be enacted for another four years. He also adds that this is effectively a waste of everyone's time, money and effort and it would be much better if the government would fast track this reform and allow these individuals to get on with their lives.

This introduces a political dimension to bankruptcy as it would appear that the government are more concerned about their image than introducing new effective bankruptcy legislation. This highlights the fact that perhaps the reason why this reform has not taken place to date is due to political motivations.

Culpable and non-culpable

The majority of interviewees agreed there should be a distinction made between culpable and non-culpable bankrupts. They agreed with the LRC's proposal to restrict culpable bankrupts similar to the restriction imposed on directors under the companies' acts. Leydon and Black add to this by stating the discharge period should depend upon how the debt arose, whether it was fraudulently, recklessly or both. However, Leydon believes that a five year restriction period would be appropriate. Stafford and Black also add there should be penalties where the bankrupt does not co-operate with the proceedings. Black suggests discharge should be dependent on co-operation. However, Murray although agreeing, feels that it would be "impossible, timely and costly" to make a distinction. She explains it is difficult to prove an individual has acted fraudulently or recklessly. Recklessness has a very broad definition which can be interpreted in many different ways. Furthermore, she adds

that the number of successful cases brought against directors on either of these grounds is quite low.

Kelly, O'Neill and Anon disagreed with the LRC's proposals. They believe that all bankrupts should be treated the same under bankruptcy legislation, regardless. They explained criminal matters should be held in the criminal courts and civil matters in the civil courts as otherwise this would complicate the process further. If fraud or recklessness is the reason for the bankruptcy, these matters should be dealt with separately, in the criminal courts. However, in response to this suggestion, Black refers to the lack of white collar prosecutions in this country and feels that this factor should be considered by the legislator.

This highlights a lack of consensus among insolvency practitioners with regard to the LRC's proposal.

In relation to the payment of debts after discharge by culpable bankrupts, all interviewees felt this was not realistic and unlikely to be successful if implemented. Holohan makes reference to the fact there is currently a provision in the BA 1988 which allows the Official Assignee to attach a repayment to the bankrupts earnings, however, in recent times he has not chosen to do so, as bankrupts in general do not earn much after they have been declared so. Additionally, Leydon stated that he believes bankrupts will be deterred from working if their wages are garnished by debts owed; especially considering how reasonable social welfare payments are. In addition to this, Kelly feels that as these are 'culpable bankrupts' they are more likely to avoid any repayment of debt where possible.

This shows that it is possible of culpable bankrupts to avoid such repayments. It also highlights that if this is enacted it may not be used considering the Official Assignee has chosen not to use the current provision.

Preferential debts

All interviewees agreed that the condition which states preferential debts must be paid before discharge is the main constraint preventing bankrupts from being discharged. They stated this is the reason why many bankruptcies last beyond twelve years.

Holohan described a case where a client of his has now remained in bankruptcy for thirty years as a result of this condition. He approached Holohan recently and asked him was this constitutional. Holohan believes it is not however, to bring a constitutional case to court this would cost at least €50,000. Murray believes going forward this condition is not realistic considering the amount of revenue debts businesses are accumulating prior to bankruptcy. Anon adds that this is the reason why many travel to the UK in order to be declared bankrupt as there are no preferential debts recognised in their system. In order to address this issue, the LRC propose the removal of all preferential debts. As they have proposed an automatic discharge period of three years this would also ensure bankrupts would be discharged regardless of the preferential debts that is owed. The general consensus among the interviewees was that the removal of preferential debts would in theory be a fairer way of dividing out the estate however; in reality they do not think it will be implemented. Holohan, Kelly, O'Neill and Stafford felt that this is unlikely to happen as ultimately the final decision rests with the government. Considering the current economic climate they are unlikely to change the revenues preferential status.

Stafford and Black believe that if preferential debts were removed, bankruptcy would be open to abuse as it could become very attractive as a form of tax avoidance. Leydon feels that this would mean more creditors would be involved in the process, in turn creating more work for the Official Assignee when dividing out the estate, therefore increasing the costs of the process.

Kelly points out that as a result of their preferential status the revenue "are slow" to chase their insolvent debtors as they can accumulate interest and penalties on these debts, in the knowledge these must all be paid before discharge.

This also demonstrates the political dimension to bankruptcy as the government would again appear to be using their powers to ensure the revenue receives payment before other creditors. It also highlights the revenues inefficiencies regarding the collection of taxes as it would appear they are content with the fact that significant amounts of interest and penalties are accumulating on these unpaid taxes at the expense of the other creditors.

Costs of bankruptcy

All interviewees agreed that the costs of bankruptcy are too high. Leydon stated that the cheapest Official Assignee costs he has experienced have been €10,000 while on average it is approximately €35,000. As a result of these high costs, Anon and Holohan state that the majority of bankrupts cannot afford representation and therefore have no option but to represent themselves in the High Court.

Black believes that because the courts insist on an "incredible technical" process this drives up costs. This process is "technical" because the examiner's office of the High Court supervises the Official Assignee. Holohan explains that this effectively means one court official is supervising another which makes for a slower, more expensive process with too much red tape. Holohan also explains this is because up until 1924 the Official Assignee was essentially one of the creditors which they had nominated. This Official Assignee worked under the supervision of the courts and this provision was never removed from the 1988 act. Furthermore, where counsel is involved this makes the process more expensive.

All interviewees agreed that in order to reduce these costs, bankruptcy procedures should be moved out of the High Court. Holohan makes reference to the fact that there used to be a bankruptcy court in Cork until the early 1960's and so there is no reason why other courts could not hold such cases. He states that from time to time bankruptcy can involve complex legal issues but more often than not it would be more suitable to have cases heard in the Circuit Court as it would be less expensive overall. Murray feels that as the amount of cases are potentially going to be high; the lower courts will need to be involved in order to ensure an efficient process. Leydon agrees describing the current process as "inefficient" due to how busy the High court is and this will become a real issue if bankruptcies increase from 29 (2010) to the thousand or so expected (Holohan, Black and Leydon).

Leydon suggests that in order to determine which court the bankruptcy is held in, the level of debt could be used as an indicator. He feels that if the level of debt is quite low then it can be assumed the case will be less complex and there is likely to be no

fraud or recklessness involved as these factor are generally associated with substantial debt. Black takes a different perspective, although he believes the High Court involvement is unnecessary, he also feels that the judges in the Circuit Court are not equipped and competent enough in commercial matters in order to deal with such cases. In response to this, Holohan and O'Neill feel this may reflect the current situation but with some time to prepare they have no doubt these judges would be capable.

In order to further reduce costs, Kelly feels the Official Assignee should have less involvement in the process. As the Official Assignee is a public servant, Kelly feels that this results in a "drawn out and quite tedious" process, adding to the costs. The Official Assignee is in charge of realising the assets and distributing this among the creditors. Kelly suggests that there should be a system similar to that in the UK where insolvency practitioners play more of a role. In relation to this, Leydon explains there is a growing concern about insolvency practitioners being more involved in the process as these are professionals who are concerned about their fees creating a conflict of interests (Leydon).

To substantially reduce the costs, the LRC have proposed the introduction of a non-judicial system. However, all interviewees agreed that cases involving business debt would be more suited to the legal system as these cases tend to be more complex. O'Neill believes that cases involving company directors need a sense of authority and seriousness and this can only be found in the High Court.

This shows that the current legislation is too bureaucratic and includes unnecessary provisions making the process more expensive with no real added benefits. It also highlights the pressure that the High Court will come under if the numbers of bankruptcies increase and the need for the circuit court to be involved in this process. Furthermore, it shows that insolvency practitioners are eager to become more involved in the process.

4.3 Bankruptcy as an option

All interviewees felt that bankruptcy is no longer viewed as an option by over indebted individuals or their creditors due to its punitive nature and also as the costs associated with it are too high.

Leydon , Black and Holohan state that for a creditor to put their debtor into bankruptcy, they would need to apply to the court and the costs of this would be at least €7000. Holohan feels this is disproportionate when compared to the statutory minimum of €1900 debt needed to start bankruptcy proceedings. This figure was also suggested by the Budd Committee in the 1960's when the equivalent in Irish punt would have bought you a small house (Holohan). As a result, Kelly, Black, Holohan, O'Neill and Leydon agree that currently creditors are not forcing their debtors into bankruptcy, instead they are getting court judgement mortgages against them as this has proven to be a more effective method for the creditor to receive what they are owed. This effectively prohibits the debtor selling an asset without sharing the proceeds with the creditor. This is because it is too expensive for the creditor to force the individual into bankruptcy and they may not receive the debt they are owed if the debtor is a "can't pay".

Black makes the point that in addition to reforming the BA 1988, a law should be introduced which enables the creditors to fully understand the amount of assets the debtor has. This would ensure the creditors could easily distinguish between the "cant pays" and the "wont pays". In other words, that the creditor would know from the outset whether the debtor had the funds and was merely refusing to pay, this type of individual is referred to as a "won't pay", or if the debtor could not afford to pay, this type of individual is referred to as a "can't pay". He believes that the most effective way to achieve this would be to implement a system whereby after a successful judgement has been brought against the debtor, their financial institutions will be obliged to hand over to the creditors all their financial information. The current system of requesting the debtor to fill out a statement of net worth, allows for the hiding of assets. Black further explains the most effective way to establish how much money an individual has is to examine their bank statements. If the creditor was

satisfied that the debtor was a "cant pay" they would not force them into bankruptcy. Holohan and O'Neill also refer to this stating that there is no point putting an individual into bankruptcy if they have no assets to be realised. Leydon reiterates this point by stating that the creditors do not and will not force individuals into bankruptcy as it is an additional cost to them and if the debtor is a "can't pay" it would be effectively a waste of time and money. This situation is unlikely to change after the reform, instead Leydon believes voluntary bankrupts will become the norm.

This has shown that the statutory limit of €1900 is out-dated as it has not been changed for twenty three years. It has also been identified that there is a gap in the system which gives bankrupts the opportunity to conceal the true value of their estate. As a result of this, the system does not support creditors because of the costs and lack of information available to them from the outset.

4.4 Lenient laws

It has been suggested that the introduction of more lenient bankruptcy laws could have an adverse effect on credit flow and may also attract abuse by individuals trying to alleviate their debts.

Effect on credit flow

Stafford and Murray were the only interviewees that did believe credit flow would be affected if more lenient laws are implemented. Leydon and Black do not feel that it will make the situation any worse than it already is, as individuals are already finding it difficult to obtain credit in the current economic climate. However, Leydon believes that creditors are likely to become more vigilant about the contracts signed regarding the issue of goods; more retention of titles is likely to be seen and also shorter credit limits. Holohan believes that this is an issue in the US because of the high rate of bankruptcies, 0.5% of total population. The reason for high levels of bankruptcies in the US stems from their culture as they view the process as a "learning curve". Ireland's culture regarding bankruptcy differs greatly as there is much stigma attached to this topic. O'Neill and Kelly state Ireland is a conservative country and for this reason credit flow will not become an issue. After the reform,

Holohan, Black and Leydon expect the bankruptcy figures will reach the thousands while Kelly and O'Neill believe it may only reach 1000.

If Ireland's percentage of bankrupts increased to a level similar to that of 0.5% in the US, this would equate to 23,350 Irish bankrupts, however this is unlikely considering the general consensus among the interviewees that the figures expected is significantly lower than this. It has been identified that stricter terms and conditions will become the norm among creditors.

Abuse of the system

Interviewees were divided as to whether more lenient legislation would encourage abuse of the system. O'Neill, Stafford, Holohan and Murray do not believe that the laws will be relaxed enough for the system to be abused. They also believe individuals will be deterred from abusing the system as discharged bankrupts have great difficulty obtaining loans, mortgages and any type of credit. On the other hand, Kelly, Anon, Black and Leydon believe wherever a law is relaxed it is to be anticipated that a limited number of individuals will try to abuse the system. Anon adds that the benefits of introducing lenient bankruptcy legislation will bring benefits which will far outweigh this minor drawback. This identifies that all interviewees agreed that this will not become a serious issue after reform.

4.5 Conclusion

This chapter has highlighted the opinions and perceptions of the interviewees regarding the issues with the current legislation. Although, there is a general consensus among the interviewees that a reform is necessary, there are some conflicting opinions on the provisions that the new Bill should include. Finally, it showed that there are not expected to be any issues with the introduction of more lenient legislation.

Chapter 5: Discussion

5.1 Introduction

This chapter will link the findings from both the primary and secondary research in order to discuss the overall outcomes and to form a perspective on the research findings.

5.2 Entrepreneurship

The literature found that at a time when Ireland needs entrepreneurs in business to help grow the economy, the current bankruptcy legislation discourages this by firstly, deterring individuals from entering business and secondly, by preventing bankrupts from re-entering the business community (LRC 2009, Daly 2010, ISME Fielding 2011 and Holohan 2011).

The primary and secondary research finds that bankruptcy legislation acts as a "complete bar" (Holohan) by locking individuals in and preventing them from re-entering the business community (LRC 2010). Holohan describes the system as a "lobster pot". Irish legislation effectively gives entrepreneurs one opportunity and does not give them the chance to learn from their mistakes. However, it has been found that bankrupts are more successful second time round (OECD 2003, Second Chance Report 2011, Kok 2004, Ekanem and Wyer 2007, Dybvad 2011, Schror 2006 and Stam *et al.* 2006).

However the interviewees disagreed with the literature put forward by Peng *et al.* (2009), White (2010) and Gallop (2009) as they believe entrepreneurs do not think about the possibility of bankruptcy from the outset and in the majority of cases do not even know the consequences of bankruptcy. Perhaps a reason for the difference in opinion is that the interviewees only interact with those who took the risk and became entrepreneurs. The research outlined in the literature included a more diverse population as they included both self-employed individuals and also those who choose not to go into business.

Both the literature and the primary research found that the current bankruptcy legislation is anti-entrepreneurial for the following reasons; the discharge period, the lack of a distinction between culpable and non-culpable bankrupts, the payment of preferential debts before discharge and the high costs associated with the process.

Discharge

The discharge period was the most significant issue identified with the current legislation in both the primary and secondary research. The twelve year period was based on an assumption made by the Budd Committee in the 1960's that all bankruptcies were as a result of sharp practices or fraud. Even if this was the case fifty years ago, this has no presentence in to-days business environment. Additionally, evidence drawn from the second chance report (2007) states that only 3-6% of bankruptcies across in the EU have some element of fraud. This position is further argued by Holohan as he states that in twenty five years he has only experienced five bankruptcy cases with an element of fraud.

There is a general consensus among the interviewees and the authors reviewed that an automatic discharge period needs to be introduced. It was agreed by all interviewees that the period of three years proposed by the LRC would be appropriate. This would allow honest bankrupts back into business in a more suitable length of time.

According to the primary and secondary research a three year automatic discharge period is a very important contributing factor to making this legislation more entrepreneurial. This begs the question as to why it has not been implemented already. Holohan, Black and Leydon suggest that perhaps the government do not want to be seen supporting debt forgiveness which may favor the "Galway tent brigade". The primary research found that the delay in the reform of bankruptcy legislation may be politically motivated and as a result, further damaging the economy. This can be seen as the government have failed to live up to the promise that was made four years ago. Additionally, this is evident considering the fact that each of the civil miscellaneous bills did not include an automatic discharge period of three years but instead twelve years.

Culpable and non-culpable

The secondary research established that the LRC proposed a distinction should be made between culpable and non-culpable bankrupts. This is to ensure that culpable bankrupts are punished accordingly while also ensuring that honest bankrupts are released back into the business community.

Five of the interviewees agreed with the secondary research to restrict these individuals similar to the restrictions imposed on directors in the companies' acts. This view is supported also by the second chance report (2011) as it states that business failure is a normal part of economic life and non-culpable bankrupts should not be punished for this.

The remaining interviewees disagree with the secondary research as they suggest no distinction should be made under bankruptcy legislation. They feel that the LRC's proposal of an automatic three year discharge should apply to all bankrupts, whether they are culpable or non-culpable. Additionally they feel that if the bankruptcy is as a result of criminal dealings then this should be dealt with in the criminal courts. However, the effectiveness of this could be called into question as Webb, McBride (2011) and Black refers to the fact there are very few "white collar" prosecutions in this country. Furthermore, the literature suggests that the current legislation may be unconstitutional as it is soon to be challenged by a team of lawyers (Kennedy 2011).

In relation to garnishing culpable bankrupt's income after discharge, all interviewees felt this is unrealistic. Holohan made reference to the fact that this provision exists in the current legislation and is unused. Leydon and Kelly agree with the literature as they feel that this condition will deter these individuals from working (White 2010).

It is important that which ever route is taken on this issue, the outcome results in the protection of the business community from culpable bankrupts while also encouraging its success by allowing honest bankrupts to re-enter sooner in order to contribute to the economy.

Preferential debt

All interviewees and authors reviewed agreed that the condition which states preferential debts must be paid before discharge is the main reason preventing bankrupts from being discharged under the current legislation. The LRC have proposed to remove this stipulation as this condition is almost never met. However, the government has included a conditional discharge in both Civil Miscellaneous Bills. The latter Bill included a conditional discharge period of five years which is unlikely to be met considering the LRC (2010) state that the current twelve year conditional discharge is rarely fulfilled.

The general consensus among the interviewees was that the removal of preferential classes of creditors, especially the revenue, is unlikely. Arguments for and against the removal of the revenues preference were put forward in both the literature and by the interviewees. On the one hand, if the revenues preference was dropped this may leave bankruptcy open to abuse by individuals trying to avoid the payment of tax (Wood 1995, Black and Stafford). However, Kelly, Anon, Black and Leydon explain that some abuse is inevitable wherever a law is relaxed and this should not be a deterrent to creating a more supportive business environment.

On the other hand, the secondary research suggested that if this condition remains it is unfair towards other creditors as they may be forced to write off potential large debts as there is likely to be little or no money remaining after revenue has been paid. This is not an ideal situation, especially in the current climate.

The government is using their powers to ensure the revenue remains a preferential creditor while other creditors will suffer the consequences being forced to write off potentially significant amounts of debt. The effect that this would have on a small creditor is disproportionate compared to the effect it would have on the revenue. Additionally, if the revenue were to lose their preference this may be an incentive for them to collect taxes on a timelier basis.

Costs

The primary and secondary research agreed that the costs of the bankruptcy process are too high. However, the secondary research findings did not offer any suggestions as to how these costs could be reduced for those with business debts. The LRC did propose a non-judicial system but all interviewees agreed that this system is geared at those with consumer debts and therefore irrelevant to this research. There was consensus among the interviewees that bankruptcy proceedings should be held in the Circuit Court with appeals being referred to the High Court where necessary in order to reduce the costs. Holohan and O'Neill suggested however that training of the Circuit Court judges would be essential to ensure this process is effective. Additionally, it was suggested by Kelly that the Official Assignee's involvement in the process should be reduced as this is also another contributing factor to the costs of the process. However, there is an element of bias as all interviewees are insolvency practitioners and these are the professionals who would benefit the most from a reduction in the involvement of the Official Assignee. However, this may be a valid argument as if the numbers of bankrupts reach the thousands as expected, it could be questionable whether one individual, the Official Assignee, would be able to continue realising all assets for distribution among creditors due to time and resource constraints.

5.3 Bankruptcy as an option

The secondary research describes how unused and ineffective the current bankruptcy legislation is. Djankov *et al.* (2008) states the main test of how effective bankruptcy legislation is at achieving its objectives is to look the amount of individuals who use the system. Considering only 29 individuals were declared bankrupt in in 2010 (Collins 2011), this demonstrates the ineffectiveness of this legislation.

The literature found that debtors rarely enter bankruptcy voluntarily as it is too punitive and difficult to get out off. Holohan and Sanfey (2010) found that in 2009 there were only 2 voluntary bankruptcies out of a total 17.

The primary and secondary research also found that creditors are obtaining court judgements against their debtors rather than force them into bankruptcy. The literature

found that there were 7,447 judgements in 2010 (Mulligan 2010) while the primary research revealed that the majority of these cases were judgement mortgages. The primary research found that the reason for this is due to the high costs associated with forcing a debtor into bankruptcy. Additionally, the primary research suggested that another reason why creditors are reluctant to force their debtors into bankruptcy is because they would be unaware from the outset whether the debtor was a "can't pay" or a "won't pay". Black suggests that legislation should be put in place in order to ensure creditors are fully informed of their debtor's financial position from the outset by granting them permission to view their debtor's bank records rather than the current system of requiring the debtor to fill out a statement of net worth. Holohan states that there is no point chasing a debtor who has no money. Bankruptcy is effectively an assets liquidation process, if there are no assets it is more punitive on creditors as they would have the added expense of forcing the debtor into bankruptcy.

Under the current system it has been suggested that debtors are capable of hiding assets from their creditors. This has been over looked by the LRC and to date there has been no mention of introducing such legislation. This demonstrates the current systems lack of support for creditors and this may remain an issue after the reform. Leydon supports this view by stating that after reform it is can be expected that voluntary bankruptcies will increase however, it is likely creditors will still not be forcing their debtors into banrkruptcy.

5.4 Lenient laws

The literature did suggest some issues may arise if the bankruptcy legislation is relaxed as proposed. These include an adverse effect on credit flow, as creditors can expect to receive less in a bankruptcy situation and also that the system may be open to abuse.

Credit Flow

The literature review revealed a direct relationship between credit flow and bankruptcy legislation in the US (Broadie et al. 2007, Choi and Phan 2006, Funchal 2007, Lee *et al*., 2007, Bebchuk 2002, and Kahl 2002). This could become an issue with the introduction of more lenient legislation as these will increase the numbers of bankrupts. However, the majority of interviewees disagree with the literature as they

do not think relaxing the bankruptcy legislation would affect credit flow as it is not expected that the bankruptcy figures will increase to a level where this would become an issue. All literature on this topic is American where bankruptcy levels in 2010 were 0.5% of the total population. If the bankruptcy figures increase in Ireland as expected to a maximum of 3000, this merely translates into 0.06% of total population. Instead, the general consensus was that there will be shorter credit limits and stricter contracts which stipulate retention of title.

Abuse

Adkisson and McFerrin (2005) and White (1991) found that making bankruptcy laws more lenient leaves the system open to abuse. The primary research found that half of the interviewees do not believe this will become an issue as they feel the law will not be relaxed enough for the system to attract abuse. However, the remaining interviewees believe that wherever a law is relaxed it is likely to attract abuse. Some abuse may be expected however according to Anon, the benefits of introducing a more lenient bankruptcy system far outweigh this drawback. Additionally, it is vital that the legislation is designed with this issue in mind in order to ensure individuals are deterred from taking advantage of this process to alleviate their debts

5.5 Conclusion

This chapter linked the primary and secondary research in order to discuss the findings. It has been found that there is a general consensus among the interviewees and the literature reviewed that a three year automatic discharge period is most appropriate. There was a difference in opinion in relation to the removal of preferential debts however; there was a general consensus that the government may be reluctant to remove the revenues preference. Additionally, there was mixed responses in relation to the punishment which should apply to culpable bankrupts. Five of the interviewees agreed with the LRC's proposal to restrict these individuals under bankruptcy legislation however, the remaining interviewees disagreed with this as they felt no distinction should be made between bankrupts under bankruptcy legislation. All interviewees disagreed with the LRC's proposal to force culpable bankrupts to pay towards their debts after discharge as they felt this was unrealistic.

In relation to the costs associated with the process, both the primary and secondary research found that these are too high. In order to reduce these costs it was suggested that the bankruptcy process should be held in the Circuit Court. Finally, the majority of interviewees disagreed with the literature which stated lenient bankruptcy laws may have an adverse effect on credit flow as they do not believe bankruptcies will increase to a level where this would become a problem. There were different opinions offered regarding whether the system would be open to abuse as it is difficult to predict what the likely outcome of this would be.

Chapter 6: Conclusion

6.1 Overall Conclusion

Bankruptcy is supposed to be a relief process for both the creditors and the bankrupt however; the findings of both the primary and secondary research contradict this. Many issues with the current legislation have been identified however the most significant issue is the discouragement of entrepreneurship. The BA 1988 has been found to discourage entrepreneurship as it effectively locks individuals into bankruptcy, sometimes for the remainder of their lives. The reason for this is because the BA 1988 does not have an automatic discharge period; instead the twelve year discharge is merely conditional. The most severe condition which must be met in order to be discharged is the payment of preferential debts. As these stipulations apply to both culpable and non-culpable bankrupts, the business community is starved of honest bankrupts who have learnt from their mistakes and are generally more successful second time round.

As the costs of this process are so high this has effectively acted as a deterrent towards creditors forcing their debtors into bankruptcy. Additionally, the severe punishments have deterred debtors from applying for a voluntary bankruptcy. As a result, this process has remained largely unused in recent times.

In relation to the suitability of the LRC's proposals, the majority of interviewees believed these would be appropriate however some conflicting opinions were identified. The primary and secondary research found that the LRC's proposal of a three year automatic discharge period would be suitable as it would allow the bankrupt to re-enter the business community after a more appropriate length of time. However, there were some conflicting opinions in relation to the LRC's proposal to punish culpable bankrupts.

All interviewees felt that the LRC's proposal to force culpable bankrupts to pay towards their debts after discharge was unrealistic and unlikely to be used if introduced. Instead, the majority of interviewees believed that culpable bankrupts should be restricted from re-entering the business community with disqualifications where necessary.

The majority of interviewees agreed with the LRC's proposal to abolish all preferential debts as they felt this would ensure a fairer distribution of the estate however; all interviewees agreed that this is unlikely to be introduced as the government will not wish to remove the revenue preference. In order to reduce the costs associated with the process the LRC's proposal of a non-judicial system was found to be unsuitable for those with business debts, instead the general consensus among the interviewees was that this process should be held in the Circuit Court with appeals to the High Court.

Finally, the interviewees disagreed with the literature as they felt that there would be no adverse effect on credit flow with the introduction of more lenient bankruptcy legislation, instead they felt that stricter contracts and shorter credit limits will become more common. The interviewees were divided on whether they felt the system would be abused as it is difficult to predict what the outcome will be.

6.2 Recommendations of further study

Many areas of further study have been identified, including; the issue of white collar prosecutions in this country. An investigation into this area may shed some light on why the prosecution levels are so low, especially in comparison to other countries such as the US. This research could also help identify whether culpable and non-culpable bankrupts should be distinguished between under bankruptcy legislation or whether this punishment should be left solely to the Director of Public Prosecutions.

After the new legislation has been enacted research could be conducted in order to find if the issues identified with the current legislation have been resolved and if the new legislation has created the desired supportive entrepreneurial environment. Additionally, after the new legislation has been enacted an investigation into whether credit flow was adversely effected or whether the system is being abused would shed more light on this area as currently it is difficult to predict the expected outcome.

A political dimension to bankruptcy legislation was introduced in the thesis in relation to shortening the discharge period and also the removal of the revenues preferential

debt status. This issue needs further research in order to conclude that there is in fact a political dimension and what effect this is having on creditors and the bankrupt.

This thesis also introduced the possible need for a system where creditors would be aware from the outset about the financial position of their creditors. More research is needed in order to find what benefits could be reaped from such a system.

In the UK insolvency practitioners play a more important role in the bankruptcy process as they are in charge of realising the assets and distributing the estate. Here in Ireland this role is undertaken by the Official Assignee. Research should be conducted in order to establish which system is more effective and efficient.

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