



Client Update

In the matter of Birchport Limited (under the protection of the Court) and in the matter of the Companies (Amendment) Act, 1990

Interests of secured creditors unaffected by recent case.

(January 2009)

The recent High Court ruling in relation to a company called Birchport Ltd seems to have become a source of some worry in banking circles due to media reports that it is somehow an authority for the proposition that a bank can be forced to write down the value of commercial loans secured against companies' assets, and to continue as lender to the company, as part of the examinership process.

It has always been the case in examinerships that a creditor's secured debt is assessed at the value of the secured assets. In the past this generally meant that a secured creditor would get repaid its debt in full, as the value of the secured assets would have almost inevitably exceeded the value of the debt. The principal reason that this has now become an issue of some interest and debate is because of the recent fall in property values.

BACKGROUND

Birchport owned a leasehold interest in a pub, which (coupled with personal guarantees of the directors) formed part of the bank's security. In the face of a Revenue Commissioners' petition to have the company wound up, Birchport applied to have an examiner appointed. The value of the leasehold interest had roughly halved since the time of the granting of the bank loan. In addition, Birchport's debts included substantial rent arrears, which would have had to be discharged before the leasehold could be sold, thereby further reducing the value of the leasehold to the bank. As a consequence, if the company went into liquidation (or receivership) the bank would have been unable to recover the full amount of its debt upon realisation of the secured asset (the leasehold interest). The balance of its debt would inevitably have been unsecured.

The scheme in the *Birchport* case allowed for the bank to be repaid the current value of the secured asset on a staged basis, and for it to receive a dividend on the balance the same in percentage terms as other unsecured creditors. The scheme was approved by the High Court. It should, however, be noted that this was an agreed negotiated solution which was reached with the bank in question. The bank preserved its right to pursue the guarantors in respect of the shortfall in the event of default under the terms of the new facility, and retained its security over the leasehold premises.

WHEN IS IT POSSIBLE TO WRITE DOWN BANK DEBT THROUGH THE EXAMINERSHIP PROCESS?

It is undoubtedly difficult at present to attract fresh investment capital and formulate a successful scheme of arrangement where a company has substantial property interests. In some cases, it may be sufficient for the bank's debt to be rescheduled. However, in a falling property market with secured borrowings often in excess of short-term realisable value, banks tend to favour the appointment of a receiver. A write-down of the debt may not be attractive to a bank in circumstances where values appear lower in the short-term than they may be when capital becomes more freely available.

The examinership legislation permits the court to approve a scheme of arrangement which writes down the debts of each class of creditor (including secured creditors) if it is fair and equitable and is not unfairly prejudicial to the interests of any interested party. A creditor would be in a position to show that they had been unfairly prejudiced if they could show that they would be better off were the

company to go into receivership or liquidation. In practice, therefore, it is only possible for an examiner to succeed in writing down the debt of a secured lender in circumstances where the lender is either paid the written down sum (which is equivalent to current market value) immediately, or agrees to the examiner's proposal.

CONCLUSION

In *Birchport*, the bank took part in the examinership process and used it so as to best protect its position. The alternative was that it would have been forced to realise its security and to try to sell the leasehold interest in the current, depressed, market, and to rely on the personal guarantees of the directors in respect of the shortfall. Instead it agreed a current value in respect of the leasehold interest and rescheduled this part of the debt, and it also received a dividend on the balance of its loan to the company.

Birchport is therefore not authority for the proposition that a secured debt may be written down and a bank forced to stay in for a fixed period for the reduced amount in all cases. An unsuccessful examinership will almost invariably end in liquidation, and clearly creditors will always assess their position against that backdrop.

The publicity generated by the Birchport decision, although misleading, is likely to lead to a greater focus on the position of secured creditors in examinerships.

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