



Small Company Administrative Rescue Process

KPMG Turnaround & Restructuring



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01 Overview

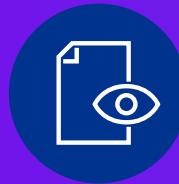
The Companies (Rescue Process for Small and Micro Companies) Act 2021 (the “Act”) was signed into law by the President on 22 July 2021. The Act provides for a new rescue process, exclusively for small and micro companies only.

What is SCARP?

The Small Company Administrative Rescue Process (“SCARP”) has been introduced to provide a quicker and more affordable restructuring option to small and micro businesses in Ireland, who are facing insolvency.

SCARP is based on the key components of the examinership process, but will be a more streamlined and quicker process without Court involvement.

Over the years there have been calls for a formal rescue process to deal with small companies and these calls have increased since the onset of the COVID-19 pandemic. With the difficulties faced by many sectors which comprise small and micro companies, SCARP may be a suitable restructuring mechanism to allow such companies to continue to trade and avoid closure.

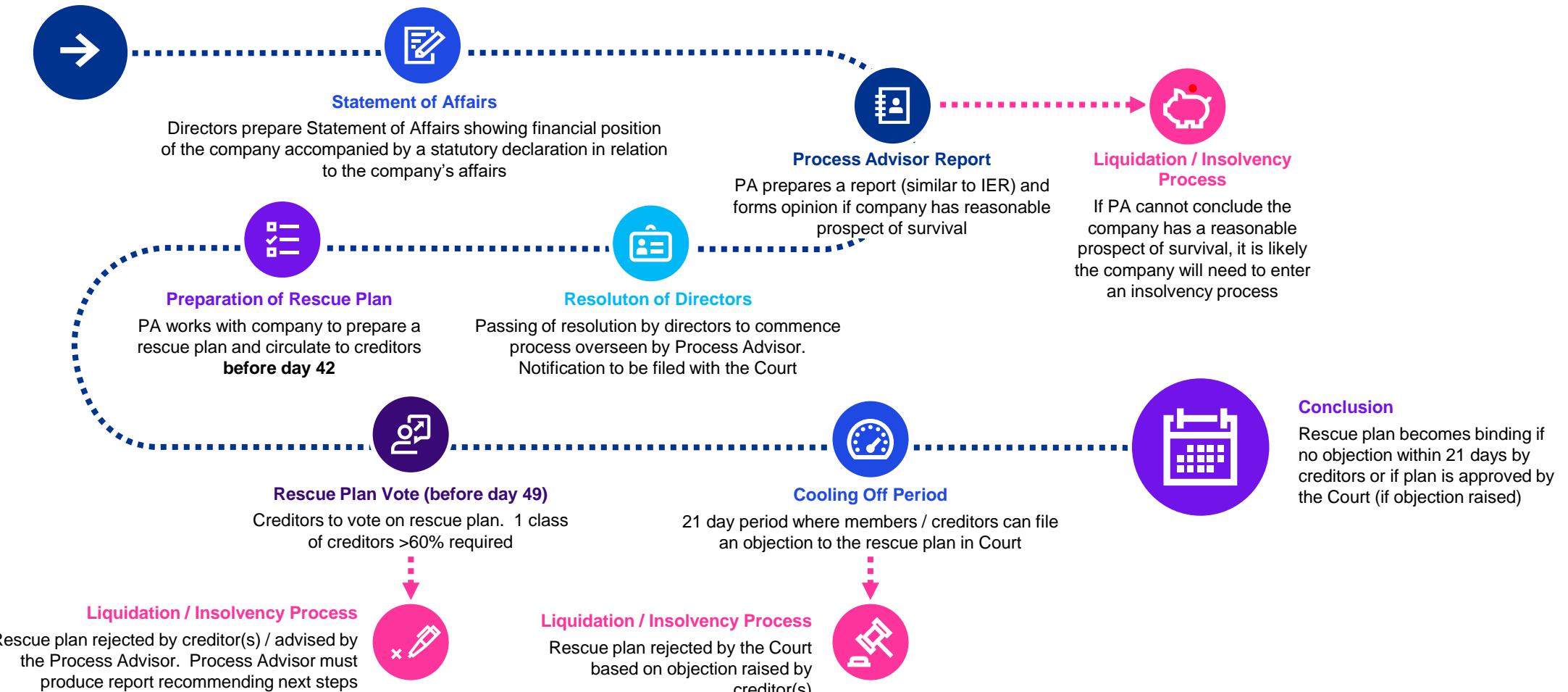


Summary of SCARP

An illustration of SCARP is shown overleaf, but the process essentially involves the following steps:

- The directors prepare a statement of affairs detailing the financial position of the company and make a statutory declaration that they have made a full inquiry into the affairs of the company.
- The directors must obtain a report from an insolvency practitioner (Process Advisor), which includes the Process Advisor's opinion on whether a rescue plan (“rescue plan”) provides a reasonable prospect of survival of the company.
- Within 7 days of receiving the Process Advisor's report, the directors pass a resolution appointing the same Process Advisor and commencing SCARP. Within 2 days of his / her appointment the Process Advisor is required to file a notice with the CRO of the appointment and also advertise a notice in Iris Oifigiul.
- The Process Advisor notifies all creditors within 5 days of his / her appointment and requests submission of claims.
- The Process Advisor has 42 days to form a rescue plan to propose to the company's creditors, ultimately restructuring the company's debt and saving the company from insolvency.
- The Process Advisor holds meetings of the various classes of creditors and members to present the rescue plan, and hold a vote for its approval. These meetings must be held within 49 days of the commencement of SCARP.
- The rescue plan is approved by creditors when approved by 60 per cent in number, representing a majority in value of at least one class of impaired creditors at the creditors' meetings. The approved rescue plan can provide for the write-down of liabilities across all classes of creditors.
- A creditor or member has 21 days to object to the rescue plan. If an objection is raised, the Process Advisor must seek the Court's approval of the rescue plan.
- If no objection to the rescue plan is filed within the 21 days, the rescue plan becomes binding on all members and creditors, without the need for a court application.

02 SCARP Roadmap



03 SCARP v Examinership

Key Features	SCARP	Examinership
“Small” & “Micro” Companies Only	<ul style="list-style-type: none"> ▪ Turnover < €12m ▪ Balance Sheet < €6m ▪ Employees < 50 ▪ Company must meet 2 of the above criteria to be a small / micro company 	<ul style="list-style-type: none"> ▪ Available to all companies
Commencement	<ul style="list-style-type: none"> ▪ Commenced by way of directors' resolution ▪ Report prepared by “Process Advisor” (Insolvency Practitioner) ▪ Process Advisor is also appointed to formulate the rescue plan (rescue plan) ▪ No Court application required, but Process Advisor required to notify the Court of his / her appointment 	<ul style="list-style-type: none"> ▪ Commenced by application to Court ▪ Application supported by Independent Expert's Report ▪ Independent Expert is not appointed Examiner. Alternative Insolvency Practitioner must be Examiner
Impact on Creditors	<ul style="list-style-type: none"> ▪ No automatic stay on creditor enforcement action ▪ Court protection can be obtained by application to Court by the Process Advisor ▪ Process cannot be commenced by a creditor 	<ul style="list-style-type: none"> ▪ Court protection on appointment of Examiner
Approval of rescue plan	<ul style="list-style-type: none"> ▪ > 60% in number and majority of value, of impaired class of creditor approves rescue plan ▪ 70 day process, rescue plan vote by day 49, then creditors have 21 days to object (“cooling off period”) ▪ Cross cram down of debt allowed ▪ If objection is raised in Court, rescue plan is brought to Court for approval 	<ul style="list-style-type: none"> ▪ > 50% in number and majority of value, of impaired class of creditor approves rescue plan ▪ Creditor can challenge scheme in Court if deemed unfairly prejudicial etc
Onerous contracts	<ul style="list-style-type: none"> ▪ Repudiation of onerous contracts possible, through administrative process or application to Court (same as examinership) 	<ul style="list-style-type: none"> ▪ Repudiation of onerous contracts possible, but requires application to Court
State Creditors	<ul style="list-style-type: none"> ▪ Revenue Commissioners and the DEASP creditors can request to be excluded from a rescue plan based on “statutory reasons” e.g. poor tax compliance by the company. 	<ul style="list-style-type: none"> ▪ No exclusion mechanism available for creditors ▪ Creditors are given the opportunity to vote on the rescue plan and can challenge in Court
CEA / DPP Reporting Obligations	<ul style="list-style-type: none"> ▪ Process Advisor is required to report certain offences by officers of the company to the CEA / DPP. Subject to the same restriction / disqualification process under the Companies Act 2014. ▪ Process Advisor is required to provide a report to the ODCE (and also the company, its employees and file with the relevant Court) on the rescue plan and the outcome of the process. 	<ul style="list-style-type: none"> ▪ No reporting obligations

04 Key Considerations

SCARP has some clear differences to examinership which must be considered by companies when planning for SCARP or assessing its suitability as a restructuring option.

Excludable Creditors

Certain liabilities owed to state bodies can be excluded from SCARP.

State bodies such as the Revenue Commissioners and the Department of Employment Affairs & Social Protection have the ability to be excluded from a rescue plan proposed by the Process Advisor.

This could present a challenge to the company's future viability if it cannot agree a write down of debts owing to these creditors.

The relevant creditor must notify the Process Advisor within 14 days of receiving notice of the Process Advisor's appointment, if it wishes to be excluded from the rescue plan.

There must be sufficient grounds for opting out by the creditor.

Those grounds include:

- Company has failed at any time to comply with a requirement relating to tax under the Companies Act 2014 or other legislation.
- The Revenue Commissioners are conducting an audit or an intervention.
- The company is party to an appeal in relation to a tax obligation under the Companies Act 2014 or other legislation.

If no request to be excluded is made, the debt will be included in the rescue plan.



Fail to Prepare, Prepare to Fail

SCARP is designed to be a faster and more streamlined process when compared to examinership in order to keep costs to minimum. While that is to be welcomed, there is a lot to be delivered within a very short timeframe.

A company should undertake careful planning well in advance of entering SCARP to ensure the Process Advisor can hit the ground running and quickly propose a fair and equitable rescue plan for all creditors.

Companies should at a minimum have the following:

1. Up to date financial accounts and supporting books and records.
2. Detailed financial projections based on the board and management's view on what cram down of debt is required, and how they expect the business to perform post SCARP.
3. Financial projections must have detailed underlying assumptions.
4. Detailed position on each creditor and the company's recent interaction, and credit terms.
5. Which creditors are critical to be paid during SCARP to ensure the business can continue to operate while the Process Advisor prepares and proposes the rescue plan to creditors.
6. Identify management's view on which conditions are necessary for survival.



Investment

Due to the short nature of the process, it may be difficult to obtain timely external investment.

Therefore, the continued cooperation of creditors and secured lenders is essential for the process to succeed.

If external investment is required, investment options would need to be explored in advance of SCARP commencing, and would form part of a company's planning for SCARP, and ultimately form part of the rescue plan proposal to the creditors.



04 Key Considerations



Creditors' Interests

SCARP is designed to protect the interests of all creditors regardless of their class / ranking.

Unlike examinership, no Court protection is granted to the company entering SCARP i.e. creditors can take enforcement action / legal proceedings against a company during SCARP. However, the Process Advisor, the company or its directors may apply to court for a stay on proceedings or to restrain further proceedings against the company for a certain period.

Creditors can reject a rescue plan at the relevant meeting of the creditors. If the rescue plan is approved by one impaired class of creditor, The Process Advisor must seek Court approval of the rescue plan if an objection to the plan is raised by a creditor during the 21 day cooling off period.

This offers a protection to creditors by allowing a challenge to a proposed rescue plan. If an objection is raised, it should be able to demonstrate that the proposed rescue plan does not present a better alternative than a liquidation scenario.



Transparency with Creditors

It is essential for the Process Advisor and the company to be open / transparent about the company's issues / financial difficulties, and also how it expects to emerge from SCARP.

Creditors who are sceptical / were about to initiate legal proceedings against the company for the recovery of their debt, would need to be convinced not to take any action while SCARP is underway.

A Process Advisor can apply to Court for protection against any legal proceedings / enforcement action, but this will add costs to the SCARP, and the efficiency / lower cost of SCARP could be quickly lost.

Also, if the benefits to the creditor of approving the rescue plan over a liquidation scenario are not clear, it increases the likelihood of the creditor rejecting the plan at a creditors' meeting or subsequently lodging an objection to an approved rescue plan to the Court. If such an objection is raised the rescue plan will need to be sanctioned by the Court, again adding more cost to the process.

Clear and transparent communication with creditors should lead to a smoother and cheaper process.



Affordability

SCARP is clearly designed to be a cheaper alternative to examinership, involving a much quicker process and more administrative process with less Court involvement.

The same person will act as Process Advisor and produce a report to support the company entering SCARP, unlike examinership where the Independent Expert and Examiner are separate individuals.

However as already explained, SCARP could become a more expensive process if Court protection is required or if the Process Advisor is required to apply for Court approval of a rescue plan as a result of a creditor objection.

Therefore, careful planning in advance of SCARP and full transparency with creditors will be an essential ingredient of exiting SCARP successfully.

04 Key Considerations



Onerous Contracts

The Process Adviser may, repudiate an onerous contract such as a lease where the repudiation is necessary for the survival of the company as a going concern. A Court application will be required for the repudiation of any onerous contracts, similarly to examinership.

The Process Advisor must put the contracting party on notice setting out *inter alia*, the basis for the repudiation, repudiation proposal and allow the contracting party an opportunity to respond with a counter proposal.

The contracting party has not being less than 10 days to respond to Process Advisor's repudiation proposal. After considering any counter proposal, the Process Advisor will notify the contracting party of:

The proposed repudiation forming part of the rescue plan;

- Repudiation will take effect on the date on which the rescue plan effective date;
- Loss / damages value determined by the Process Advisor;
- Contracting party's right to participate in the creditors meeting; and
- Contracting party's right to object to the repudiation or the determination of loss / damage if rescue plan is approved by the Court.



CEA Obligations

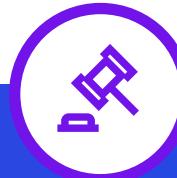
As is likely due to the lack of Court oversight compared to examinership, the Process Advisor will be subject to the same reporting requirements as a Liquidator.

Company directors will be subject to the existing restriction and disqualification regime provided for under the Companies Act 2014. Similarly to receiverships and examinerships the Corporate Enforcement Authority will also have the power to examine books and investigate, where appropriate.

It will be a criminal offence for directors if they provide false or misleading information during SCARP.

A director's conduct will be important, in particular how they react to any possible failure of SCARP, and the subsequent steps they took in relation to the affairs of the company once SCARP ended.

Within 49 days of his / her appointment the Process Advisor is obliged to provide a report on the rescue plan, the outcome of the members and creditors meetings, a list of creditors and liabilities, a breakdown of the Process Advisor's remuneration and the Process Advisor's recommendations. The CEA will be provided with a copy of this report along with the company, its employees, the Court and other interested parties (where requested).



Jurisdiction

The Process Advisor is required to determine whether any legal proceedings should be brought in the Circuit Court or the High Court.

As highlighted throughout this paper, SCARP is designed to be a quicker and more affordable rescue / restructuring process for small and micro companies. The Process Advisor will need to be mindful of minimising costs and therefore would be expected to bring any proceedings through the Circuit Court. Upon his / her appointment the Process Advisor will need to confirm the relevant Court jurisdiction when notifying the relevant stakeholders of the commencement of the process.

The Process Advisor will need to demonstrate why any legal proceedings are being brought through the High Court. The High Court can refer the matter back to the Circuit Court.

05 State Creditors - Exclusion Challenge

As debts owed to certain creditors can be excluded from a rescue plan, it is important to consider the potential position adopted by the most likely impacted creditor, the Revenue Commissioners.

The Revenue Commissioners

It is reported that the Revenue Commissioners are expected to outline its position on the SCARP and how it will support the process.

The Revenue will be impacted by SCARP given the high level of warehoused tax liabilities (recently stated in Dáil Éireann to be circa €1bn), so it will be important for companies to carefully consider proposals to Revenue and its likely preferential creditor status.

Given the highly influential role Revenue will play in certain SCARPs, it is important to consider how the Revenue may assess the merits of a rescue plan.

Dealing with Challenge

As part of its SCARP planning, companies should anticipate what the reaction of the Revenue Commissioners / DEASP, and how best to approach the outstanding debt with the Process Advisor.

It is likely that these creditors will form part / all of the preferential class of creditors so their cooperation / approval of the rescue plan would greatly assist a successful exit from SCARP.

It is critical the company is up to date with its tax and statutory obligations, and it would be helpful if it could demonstrate constructive dialogue / communications with the relevant creditors.

Revenue will be very important in many SCARPs as they will also typically act as proxy holder of other state creditors, therefore increasing their influence / vote value on rescue plans.

The key requirements to obtain the support of a rescue plan from the Revenue Commissioners, should form the basis of a well structured rescue plan proposed by Process Advisors.



Likely Position

- ✓ Tax compliance history is key. Support will be difficult to obtain if there is a history of late filing of tax returns, longstanding tax arrears, missed tax arrears instalment payments and poor tax audit outcomes.
- ✓ Is the rescue plan the best option for creditors? Or is liquidation / receivership the best outcome?
- ✓ Is the business viable? Are the issues longstanding or temporary?
- ✓ Conduct of the directors in the lead up to SCARP. Has accurate and reliable financial information been provided to creditors?
- ✓ Other compliance issues such as late filing of annual returns and financial accounts could be viewed negatively.
- ✓ Proposed rescue plans should be properly structured, well thought out and supported by detailed projections showing the outcome in a going concern and liquidation scenario.

06 How Can We Help

Largest Restructuring Practice

Our Restructuring practice is the largest in Ireland comprising 3 partners, more than 120 staff across 4 offices in Dublin, Cork, Galway and Belfast.



Preliminary Meetings

Preliminary discussions / meetings to discuss the company's suitability for SCARP and the likelihood of a successful outcome. If SCARP is not suitable, we can explore other restructuring options for the company.



Planning & Preparation

We will advise and assist companies with critical advanced planning and preparation before entering SCARP.



As highlighted throughout this paper, SCARP will have a better chance of succeeding if careful planning is completed in advance.



Act as Process Advisor

We are qualified and licensed insolvency practitioners who will act as Process Advisor, aiming to deliver an optimal outcome for the company, its creditors and other key stakeholders.



Expert Advice to Creditors

We can advise creditors of companies on the suitability and fairness of proposed rescue plans, including assistance with a challenge to the rescue plan if necessary



Quality delivery

As Ireland's largest Restructuring practice, we have collectively worked on some of the largest and most complex restructuring appointments / projects.



Our specialist expertise combined with a strong management team will ensure the highest service delivery.



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