PREFERENTIAL CREDITOR STATUS IN IRISH CORPORATE INSOLVENCY LAW: A NEED FOR MORE PRIORITIES?

Abstract: This article evaluates whether there is a need for further priorities within current preferential debts under Irish corporate insolvency law. In acknowledging the choices facing the legislature when attempting to achieve distributive justice, the article reflects on the reality of insolvency and whether according preferential status to creditors is as significant in practice as might be imagined. The article reviews arguments regarding preferential ranking of the Revenue Commissioners as creditors in insolvency. In light of recent proposals in the UK, the article scrutinises claims to preference of other unsecured creditors, such as prepayment consumers and, in particular, SME traders.

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Introduction

Even in the specific context of corporate insolvency, the order of priority to creditors' claims in the distribution of payments in a company's winding-up tends to be accepted as a fact of life in law and practice.[1] There is little consideration as to why preferences enjoyed by certain creditors are still justified relative to the legitimate claims of other creditors.[2] From time to time, there have been analyses of the value arguments for and against the abolition of the Revenue Commissioners' preferential status under Irish law. Rather than concentrating on removing one group's preference, there are no similar assessments of the reasons for according other classes of creditors a preferential position in the statutory ranking of creditors' claims. A discussion of this nature is overdue in Ireland – especially in light of recent developments in the United Kingdom relating to draft legislation enabling partial reintroduction of the Crown preference in insolvency and to proposals for preferential treatment of prepaying consumers' claims.

This article commences by providing an overview of the current statutory preferences under Irish corporate insolvency law. The article highlights how legislation – rather than the judiciary – has proven to be the means by which the implementation of distributive

[1] In Irish case law, the basis for the statutory priority of claims in distribution in liquidation was summarised by Laffoy J in *Re Greendale Developments Ltd.* [1997] 3 IR 540, 547: 'The winding-up process is the process of the administration of the assets of the company, their collection, realisation and distribution in discharge of the liabilities of the company to the creditors and of the entitlements of its contributories in accordance with the scheme of priorities provided in the Companies Acts'.

[2] Examples of academic studies on the preferential status of creditors generally include: Susan Cantlie, 'Preferred Priority in Bankruptcy' in Jacob Ziegel (ed) *Current Developments in International and Comparative Corporate Insolvency Law* (Clarendon Press 1994); Andrew Keay and Peter Walton, 'Preferential Debts: An Empirical Study' (1999) 3 Insolvency Lawyer 112; Rizwaan Mokal, 'Priority as Pathology: The *Pari Passu* Myth' (2001) Cambridge Law Journal 581; Barbara Morgan, 'Should the Sovereign Be Paid First? A Comparative International Analysis of the Priority of Tax Claims in Bankruptcy' (2000) 74 American Bankruptcy Law Journal 461; Morris Shanker, 'The Worthier Creditors (and a Cheer for the King)' (1976) 1 Canadian Business Law Journal 341; Christopher Symes, *Statutory Priorities in Corporate Insolvency Law: An Analysis of Preferred Creditor Status* (Ashgate Publishing 2008); and Jacob Ziegel, 'Preferences and Priorities in Insolvency Law: Is There a Solution?' (1995) 39 St Louis University Law Journal 793. In the Irish context, there has been consideration of statutory priorities in: Company Law Reform Committee, *Report of the Company Law Reform Committee* (Stationery Office 1958); Bankruptcy Law Committee, *Report of the Bankruptcy Law Committee* (Stationery Office 1972); Company Law Review Group (CLRG), *First Report* (1994), Chapter 8; available at: <http://www.clrg.org/publications> accessed 22 July 2019; CLRG, *Annual Report 2007*; available at: <http://www.clrg.org/publications> accessed 22 July 2019; Law Reform Commission (LRC), *Personal Debt Management and Debt Enforcement* (LRC 100-2010); and in the textbooks of Irene Lynch Fannon and Gerard Murphy, *Corporate Insolvency Law and Rescue* (2nd edn, Bloomsbury Professional 2012) and Mary Donnelly, *The Law of Credit and Security* (2nd edn, Round Hall 2015).

justice in insolvency is attempted. Given that contentious choices must be made at some stage as to who gets what in a distribution scenario, the article proceeds to evaluate the rationale for preferential claims, as epitomised by those of taxation authorities. As opposed to simply repeating the old arguments favouring and resisting Revenue preference, the article illustrates how such arguments can easily extend to other creditors' situations. In view of proposals raised by the UK's Law Commission, the possibility of increased protection for prepaying consumers should equally merit attention in an Irish setting. By comparison with prepaying consumers, the article contends that there is a persuasive case to be made for a preference for small- and medium-sized enterprises (SMEs) as vulnerable, unsecured trade creditors. This is particularly so considering the prevailing impetus in government policy in recent years to foster the growth of such businesses.

By weighing the factors involved in various creditors' priorities, the article concludes by almost inevitably recognising the one stark, but obvious, reality of insolvency – that there will invariably be not enough funds to satisfy all creditors' demands. Whilst any measure to establish a new preference should be vindicated and grounded in available evidence through liquidation data, it does give rise to the somewhat self-defeating question as to whether preferential status really matters all that much. Is it essentially a circular policy debate instead of one focused on the practicalities, that is, the recoveries to be yielded by creditors in typical corporate insolvency cases? The realisation and distribution of the assets of an insolvent estate may appear to be a perfect arena for attracting arguments and counter-arguments from different interests clamouring to have their claims elevated higher up the queue for payment in liquidation. Proponents of distributive justice within corporate insolvency can all too often forget that a company ultimately reaches an end point of winding-up for a reason. This article submits that priority status remains important in maintaining orderly distributions. However, it must be seriously doubted as to whether the addition of any new priorities would produce real benefits for those classes of creditors. Where exactly can the line be drawn in the creation of new preferences?

Current preferential claims in Irish law

In the distribution of proceeds under Irish corporate insolvency law, secured creditors, as fixed charge-holders, are able to enforce on their security outside of a debtor company's winding-up proceedings. The remuneration, costs and expenses of liquidators and examiners (where sanctioned by court) then take priority. Otherwise, a sizeable list of debts that 'shall be paid in priority to all other debts'[3] in a corporate winding-up is set out under section 621 of the Companies Act 2014 (hereinafter, the '2014 Act'). These preferential debts include rates and taxation claims over a 12-month period prior to the 'relevant date'. The date in question is the day of appointment of a provisional liquidator to a company, or, where no such appointment is made, the day on which the company is ordered to be wound up, or, where neither of the above apply, the passing of a resolution for the company's winding-up.[4] The taxes encompass local rates, Value Added Tax and local property taxes.[5] The next category of preferential debts in the legislation are those of employees' unpaid wages or salaries (including by commission), up to a €10,000 limit and up to four months before the relevant date.[6] Accrued holiday pay entitlements also have

3 2014 Act, s. 621(2).
4 2014 Act, s. 621(1).
5 2014 Act, ss. 621(2)(a)(i)–(vi).
6 2014 Act, s. 621(2)(b). An exception to these limits is provided for under section 621(5) in the case of farm labourers employed on the basis of a lump sum being payable.

preferential status.[7] Contributions payable to employees under the Social Welfare Acts within the 12-month window prior to the date of commencement of liquidation are stipulated as preferential debts.[8] Preference is further expanded to damages owed to employees arising from work-related accidents,[9] to all sums due to employees under any scheme or arrangement for payment during absence due to ill-health,[10] and to any payments due pursuant to a scheme or arrangement for superannuation benefits to employees.[11]

Upon distribution in a winding-up, preferential debts rank equally, which, as elaborated upon in the next section, could be viewed as a rather incongruous application of the *pari passu* principle. If there are insufficient funds with which to pay all preferential creditors, claims are to abate in equal proportions.[12] The preferential debts listed within the 2014 Act occupy a place above the claims of floating charge holders.[13] Other secured creditors are entitled to enforce on their security and remove those assets from the available proceeds for distribution among the remaining creditors. Moreover, the 'crystallisation' of a floating charge into a fixed charge, upon certain triggering events specified in the borrowing debenture, will also have the effect of extracting assets from the funds to be distributed.[14]

The possibility of reforms

Employees' interests have assumed an almost sacrosanct position, as exemplified in practice by 'super-preferential' payment of employees' contributions towards social insurance benefits.[15] By contrast, the preferential position of the Revenue Commissioners has been a source of attention (if not outright criticism from some quarters) over the years. It must be acknowledged that there is scant evidence at present of a policy change on Revenue preference. As Mary Donnelly observes, there seems to be little legislative appetite for the abolition of a preference which expressly operates in favour of the State.[16] A reasonably thorough revisiting of the question of removing Revenue's preferential status was contained in the Company Law Review Group (CLRG)'s Annual Report 2007.[17] No recommendations for reform were advanced. Furthermore, the idea of introducing new preferential categories was not readily embraced in previous decades. A notable instance was the CLRG's refusal in 1994 to recommend a preferential status for farmer creditors. The CLRG recognised that there were 'particular problems' facing farmers and agricultural suppliers but not to the degree that farmers were in a 'unique position' to necessitate a preferential ranking among creditors in liquidation. It was instead suggested that farmers and major corporate purchasers of produce take it upon themselves to jointly investigate the feasibility of cost-effective insurance or bonding arrangements which could serve to mitigate losses.[18]

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7 2014 Act, s. 621(2)(c).
8 2014 Act, s. 621(2)(d).
9 2014 Act, s. 621(2)(e).
10 2014 Act, s. 621(2)(f).
11 2014 Act, s. 621(2)(g).
12 2014 Act, s. 621(7)(a).
13 2014 Act, s. 621(7)(b).
14 See *Re JD Brian (in liquidation)* [2015] IESC 62, and, on the further implications of crystallisation of floating charges for other creditors' claims, see Irene Lynch Fannon, 'The Floating Charge Debate: The Path to Clarity' (2015) 22 Commercial Law Practitioner 187.
15 Section 19 of the Social Welfare (Consolidation) Act 2005 made provision for such a class of 'super-preferential' debts and amended the equivalent provision in section 16(2)(b) in Social Welfare (Consolidation) Act 1993.
16 Donnelly (n 2) para. 23-56.
17 CLRG 2007 (n 2).
18 CLRG 1994 (n 2).

Even if a comprehensive re-appraisal of creditors' priorities may be welcome at this point, the Irish inaction on preferential status in insolvency curiously runs counter to not only the continuing patterns in other jurisdictions but also to the conclusions of the Cox Report (Report of the Company Law Reform Committee) and the Report of the Bankruptcy Law Committee, as far back as 1958 and 1972 respectively.[19] While the Cox Report recommended the abolition of State preferences, the Bankruptcy Law Committee reasoned that all preferential payments ought to be abolished in the area of personal bankruptcy. It is worth contemplating why there could have been a gradual loss of interest and enthusiasm for such absolute approaches towards the equal treatment of all classes of creditors.

Difficult choices: seeking distributive justice in insolvency

It is not surprising that laws regulating distribution in insolvency have long been studied as a convenient microcosm for broader debates concerning fairness and efficiency in the distribution of wealth. After all, the 'distributional question' is at the essence of insolvency since 'one of the most important decisions the law has to make is to establish which creditors are not paid, which creditors are paid, and to what extent they are paid'.[20] José Garrido maintains that distribution is integral to insolvency as 'it was the main reason for its birth and it continues to be at the heart of that proceeding'.[21] When formulating an appropriate legal framework in relation to insolvency, it is difficult to dispute Elizabeth Warren's perspective that '[t]he distributional issues of bankruptcy must be resolved at every step' and '[t]here is no way to escape them'.[22] Amidst proposals for the reform of Article 9 of the Uniform Commercial Code in the United States, there was an attendant rise in scholarship preoccupied with achieving greater fairness in corporate bankruptcy procedures.[23] For the likes of Warren, issues of distributive justice do not deviate from the inherent objectives of insolvency processes but instead comprise the core function of insolvency as a 'scheme designed to distribute the costs amongst those at risk'.[24]

Such sentiments were resonant in the UK's Cork Committee Report in 1982 when it recommended the removal of the Crown's preference in insolvency because 'the existence of preferential debt militates against the principle of *pari passu* distribution and operates to the detriment of ordinary unsecured creditors…' The Cork Report held that no debt should be granted priority 'unless this can be justified by reference to principles of fairness and equity which would be likely to command general public acceptance'.[25] Raising a sword of *pari passu* against the creation of statutory preferences may well be a futile exercise. Creditor preferences are an intrinsic feature of insolvency systems across the globe. As Rizwaan Mokal incisively recognises, it is not the equal ranking of all creditors within *pari passu* distribution but, in fact, the differing priorities of creditors' claims that seems to represent the rule of insolvency. Mokal encourages insolvency scholarship to tear itself away from the perception that 'the "equality" principle occupies the centre of the

[19] Company Law Reform Committee (n 2); Bankruptcy Law Committee (n 2).
[20] José Garrido, 'The Distributional Question in Insolvency: Comparative Aspects' (1998) International Insolvency Review 25, 25.
[21] ibid, 52.
[22] Elizabeth Warren, 'Bankruptcy Policy' (1987) 54 University of Chicago Law Review 775, 810.
[23] See, for example, Lucian Bebchuk and Jesse Fried, 'The Uneasy Case for the Priority of Secured Claims in Bankruptcy' (1996) 105 Yale Law Journal 857; Lynn LoPucki, 'The Unsecured Creditor's Bargain' (1994) 80 Virginia Law Review 1887; Warren (n 22); Elizabeth Warren, 'Making Policy with Imperfect Information: The Article 9 Full Priority Debates' (1997) 82 Cornell Law Review 1373.
[24] Warren (n 22), 790.
[25] Report of the Insolvency Law Review Committee (Cork Committee), *Insolvency Law and Practice* (Cmnd 8558. 1982), para. 1398.

insolvency law universe'.[26] A further paradox noted by Mokal is how some commentators could surmise preferential treatment to be both an exception and an application of *pari passu* whereby preferential claims rank equally among themselves,[27] as is the case under the Irish 2014 Act.

This should not be taken to mean either that the law's promotion of distributive justice is diminished by an erosion of *pari passu*. On the contrary, 'departures from the strong version of *pari passu*' and the introduction of preferences can be conceded to allow for 'prior private bargains be adjusted in the public interest or in pursuit of democratically established policies...'[28] As David Milman reflects, '[i]n the end, one suspects that the *pari passu* rule has been adopted by the courts as a convenient 'fall back' position that avoids the necessity of making difficult choices where the legislature has failed to take the initiative'.[29] A call has to be made somewhere along the line when trying to apply principles of 'desert' and to distinguish which parties are specifically more deserving of substantive protection. The priority engendered by preferential status derives from operation of law and not from a contractual bargain.[30] For the law to make choices between the claims of unsecured creditors, legislative direction may be the most suitable way of avoiding burdens being imposed on the courts.[31]

A task for legislation

The fact that the onus is not upon the courts to determine which unsecured creditors are more worthy than others of preferential payment in liquidation cases should be of some relief to the Irish judiciary. As Christopher Frost identifies, insolvency leads to 'polycentric' problems whereby the societal costs of a company failure involve many possible outcomes, each affecting differing actors.[32] Indeed, the wider repercussions of corporate insolvency can carry a community dimension in affecting livelihoods as well as the social fabric of localities and regions.[33] In citing work of Lon Fuller,[34] Frost stresses that an insolvency must lead to decisions affecting a broad range of constituencies far beyond the 'private' interests associated with a given company. At the best of times, the judicial role is primarily directed towards dispute resolution and the immediate parties to a dispute (albeit varying in the scale of complexity). Having elicited information from the parties, determinations are based on adjudicative facts. A company insolvency and the consequent polycentric problems frustrate any straightforward approach. Trade-offs will be required in deciding between competing values and disparate interests.[35] It could be just as well for the Irish courts that it is legislation which grasps this nettle as to the extent to which preferential status is warranted. The trouble then lies in ascertaining exactly which creditors possess legitimate grounds for elevated priority.

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26 Mokal (n 2), 590.

27 ibid, 584.

28 Vanessa Finch and David Milman, *Corporate Insolvency Law: Perspectives and Principles* (3rd edn, Cambridge University Press 2017) 512.

29 David Milman, 'Priority Rights on Corporate Insolvency' in Alison Clarke (ed), *Current Issues in Insolvency Law* (Stevens & Sons 1991) 57.

30 A point reiterated by Lynch Fannon and Murphy (n 2), [8.81].

31 Finch and Milman (n 28), 513.

32 Christopher Frost, 'Bankruptcy Redistributive Policies and the Limits of the Judicial Process' (1995) 74 North Carolina Law Review 75, 124.

33 See Karen Gross, 'Taking Community Interests into Account in bankruptcy: An Essay' (1994) 72 Washington University Law Quarterly 1031; and Karen Gross, *Failure and Forgiveness: Rebalancing the Bankruptcy System* (Yale University Press 1997).

34 Lon Fuller, 'The Forms and Limits of Adjudication' (1978) 92 Harvard Law Review 353.

35 Frost (n 32), 125.

The rationale for priority of tax claims

The central purpose of legislation in setting creditors' priorities could explain why Revenue continues to hold a pre-eminent position. If governments possess the law-making powers, it must always be anticipated that priority of payment will be constructed in their favour.[36] The apparent benefits for the wider public interest in maintaining State preference in insolvency distribution cannot be discounted. In what could be regarded as a duty to the community at large, tax authorities are seen as acting as agents for the public and not in the expectation of profit.[37] By fulfilling their obligations, the burden of a debtor's unpaid tax bill is prevented from being loaded upon other taxpayers.[38] For (unsecured) State creditors such as Revenue, there is no choice in extending credit when a tax liability falls due and it can be justified in contributing towards rendering governmental services which are required by not only that individual debtor but by every other taxpayer.[39] As accepted by the CLRG when reviewing the issue of preferential payments, Revenue constitute an involuntary creditor in not being able to choose customers through any sort of risk assessment. In many instances, Revenue will have to seek out companies which commence trading without being tax–registered.[40] Revenue can even be exploited as a lender 'of last resort' by struggling companies that are inclined to ignore tax demands but still strive to meet payments to suppliers or other creditors for the sake of keeping their businesses afloat.[41]

The subject of Revenue preference should be all the more relevant in light of very recent moves in the UK to partially reintroduce Crown preference through certain tax debts in insolvency. Following the recommendations of the Cork Report, Crown preference for all taxation claims was eventually abolished in England and Wales through the Enterprise Act 2002.[42] At the time of writing, the reform measures are integrated within the draft Finance Bill 2019-20. The draft legislation provides for priority to payment of the 'indirect' taxes which a company collects from employees and customers 'in trust', to be transferred to HMRC. These include PAYE income tax, VAT, employee National Insurance Contributions and Construction Industry Scheme deductions. 'Direct' taxes such as corporation and capital gains tax are not to be designated as preferential. If adopted, the rules are proposed to come into effect from 6 April, 2020.[43] A cynical outlook on the proposal could be that it is merely another contingency for the UK Exchequer in preparation for a potential post-Brexit economic fallout. Nonetheless, the restoration of a preference for only indirect taxes being held on behalf of tax authorities is commensurate with similar recommendations of the CLRG in Ireland over 10 years ago,[44] and with the

36 Symes (n 2), 157.
37 See Cantlie (n 2), 441.
38 See Morgan (n 2), 463.
39 Shanker (n 2).
40 CLRG, *Second Report* (CLRG 2002-2003) <http://www.clrg.org/publications> accessed 22 July 2019.
41 CLRG 2007 (n 2), para. 7.4.5.
42 Enterprise Act 2002, s.251. Section 252 of the 2002 Act provided for the ring-fenced 'prescribed part' of insolvent companies' net property to be made available for satisfaction of unsecured debts. As the upper limit of the prescribed part has also recently been increased to £800,000 (from £600,000), a partially reintroduced Crown preference should especially adversely impact on floating charge holders. See further Caroline Sumner, 'The Unwelcome Return of Crown Preference in Corporate Insolvencies' (2019) 2 Corporate Rescue and Insolvency 72. The introduction of the 2002 Act was regarded by Donnelly (n 2), para. 23-55, to have 'came in the context of a broader re-shifting of the policy balance in favour of corporate rescue and a less penal response to personal bankruptcy'. See also Insolvency Service/DTI White Paper, *Insolvency: A Second Chance* (Cmnd 5234, 2001).
43 For the draft legislative documents, see: <https://www.gov.uk/government/collections/finance-bill-2019-20> accessed 22 July 2019.
44 See CLRG 2007 (n 2), para. 7.4.12

approach espoused in jurisdictions such as Canada by retaining priority for withholding taxes.[45]

The difficulties of Revenue preference

It does seem unlikely that an Irish legislature will be brave enough any time soon to commit to a full abolition of all tax priorities in insolvency, as was the case in Australia[46] and in Germany.[47] However, a reduced preference for only the taxes that are collected and held by debtors for subsequent payment to Revenue could be a sufficient compromise. It could, at least, enhance the possibility of improved returns for unsecured creditors lacking in preferential privileges. It should be borne in mind that Revenue is clearly not as helpless as being an 'involuntary' creditor might connote. For a start, Revenue has an armoury of potent enforcement mechanisms at its disposal by virtue of the Taxes Consolidation Act 1997, including deductions through notices of attachment, interest charges and penalties.[48] Furthermore, Revenue's preferential status could conceivably result in 'perverse incentives' whereby Revenue is more motivated to push for a premature liquidation of a company than acquiesce in supporting a rescue process.[49] Yet, this can regularly be an advantage in instances of inefficient businesses. Unlike small trade suppliers, Revenue may be the only creditor with the wherewithal to petition the High Court for winding-up orders.

A related difficulty is the prospect of the 'lazy tax collector'[50] and that Revenue might not be proactive in chasing up debtors for outstanding sums owed when content in the knowledge that Revenue claims are endowed with preference upon a debtor's liquidation. It was a risk discerned by the Law Reform Commission (LRC), which, in 2010, recommended that Revenue debts should no longer be given preferential status in bankruptcy. For the LRC, Revenue exercise a certain amount of business discretion in collection practices and could passively permit a liability to accumulate which would accordingly be to the detriment of other creditors dealing with that debtor company. Suppliers could not be aware of the confidential tax circumstances of the company.[51] Another comfort for Revenue may be that government has the deeper pockets to withstand any losses and that its debts are diversified across the populace. Even if this may not be the most apt gauge of a creditor's vulnerability,[52] it does underscore how tax debts are 'conceptually different' to the claims of other 'non-consensual' creditors.[53]

Proposals for increased protection of prepayment consumers

The precarious nature of a prepaying consumer's entitlements upon the insolvency of a retailer was under focus lately in the UK due to the Law Commission's proposals for increased protection of these creditors.[54] Among a range of recommendations, the Law Commission proposed that certain consumer claims be given preferential status in insolvency. An applicable claimant should be a consumer as defined by relevant statute.[55] A

45 See further Morgan (n 2), and Symes (n 2).
46 Corporations Act 2009 (Australia). The legislation came into effect following the recommendations of the Harmer Report (Law Reform Commission of Australia, *A General Insolvency Inquiry* (Report No. 45)).
47 *Insolvenzordnung*, v. 5.10.1994 (BGBI. I S.2866)
48 Taxes Consolidation Act 1997, s. 1002.
49 See Lynch Fannon and Murphy (n 2), [8.83].
50 Shanker (n 2), 348-9.
51 LRC (n 2), para. 3.92.
52 CLRG 2007 (n 2), para. 7.4.9.
53 Cantlie (n 2), 423.
54 Law Commission, *Consumer Prepayments on Retailer Insolvency* (Law Commission No. 368, 2016).
55 Consumer Rights Act 2015, s. 3(2): 'an individual acting for purposes that are wholly or mainly outside that individual's trade, business, craft or profession'.

claimant should have prepaid for goods and services which were not received in exchange for payment. The payment would be worth £250 or more and should have been made during a six month period in advance of insolvency. A consumer eligible for preferential treatment would also have to be unable to avail of existing statutory protection,[56] of chargeback remedies on a card payment, or of any trust, insurance or bond taken out.[57] In December 2018, the UK Government issued a response in which it decided against pursuing the specific recommendation for a preferential position, ranking after employees but ahead of floating charge holders.[58] Although the alternative measures selected for implementation are beyond the scope of this article, an analysis of the viability of a preference for consumer prepayments does, of itself, stimulate interest in this jurisdiction and Irish commentators have expressed the hope that "it will not take a major retailer collapse before it is considered seriously'.[59] Much of the drive for the proposals in the UK stemmed from the notorious *Farepak* administration case,[60] in which consumers stood to lose an average of £400 each having participated in a Christmas savings scheme of monthly contributions.[61]

Different from the rest?

Regardless of the sympathy that prepaying consumers naturally prompt,[62] only one-third of respondents to the Law Commission's original consultation endorsed a limited preferential status for prepayment consumers in insolvency.[63] It reinforces empirical findings from almost 20 years before which indicated a similar lack of support for a consumer preference within creditors' statutory priorities.[64] A key reason for the opposition among practitioners, at any rate, is the sheer quantity of small-value claims that would have to be parsed through in a typical insolvency and which are likely to be especially prevalent in cases in the retail sector. Although this was a factor which influenced the Law Commission's placing of a limit of £250 or over for any proposed preferential claim,[65] it is highly probable that a prepaying consumer preference would exacerbate delays and costs in proceedings. Aside from a putative lack of familiarity with the law or with business practice, it is uncertain whether consumers' circumstances are decidedly unique from any other unsecured or involuntary creditor. The 'equality of misery' causes hardship for all unsecured classes. As Kayode Akintola asserts, most unsecured creditors are incapable of assessing the risks of doing business with a given debtor. The impact of debtor insolvency should more severely hit trade creditors as they 'have more at stake than prepaying consumers do'.[66] Relative to the amounts that prepaying consumers could expect to lose, small suppliers' very livelihoods are threatened when a major client enters liquidation and leaves debts unpaid

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56 For example, under section 75 of the Consumer Credit Act 1974.

57 Law Commission (n 54), Recommendations 4a and 4b at para. 8.109.

58 Department of Business, Energy and Industrial Strategy, *Law Commission Report on Consumer Prepayments on Retailer Insolvency* (2018) <https://www.gov.uk/government/publications/consumer-prepayments-on-retailer-insolvency-government-response-to-the-law-commission-report > accessed 22 July 2019.

59 G Brian Hutchinson (Editorial), 'The Challenges of Making Preferential Creditors of Consumers Who Have Prepaid' (2016) 23 Commercial Law Practitioner 226, 227.

60 *Re Farepak Foods and Gifts Ltd. (in administration)* [2006] EWHC 3272 (Ch).

61 See Law Commission (n 54), para. 4.4.

62 See Alec Samuels, 'Prepayments: The Lost Consumer Deposits' (1987) Journal of Business Law 30, where it is noted that there is a very personal element of grievance and distress in losses suffered by prepaying consumer and that a consumer does not expect to run the risks that businesses might when dealing with a retailer.

63 31 responses were received and 10 were in favour of limited preferential treatment for consumers. 16 were against the proposal and five were undecided: Law Commission, 'Consumer Prepayments on Retailer Insolvency: Summary of Responses to Consultation Paper' (2015) <http://www.lawcom.gov.uk/project/consumer-prepayments-on-retailer-insolvency/ > accessed 22 July 2019.

64 Keay and Walton (n 2), 116.

65 See Law Commission (n 54), para. 8.42.

66 Kayode Akintola, 'The Proposed Preferential Priority of Prepaying Consumers: A Fair Pack of Insolvency Recommendations?' (2019) Journal of Business Law 1, 4.

with little or nothing to be yielded in distribution. If there is no sufficiently special motive for guaranteeing consumers a preferential status, is there more that could be said in the interests of the SME trade creditor were changes to be implemented by statute?

Making a case for SMEs as trade creditors

SMEs[67] have been at the centre of an array of policy supports and initiatives in Ireland, particularly in the aftermath of the economic crisis. It attests to a clear recognition of how decisive the growth of SMEs is to the future prospects of the entire economy. SMEs comprise approximately 99.8 per cent of the active enterprises in Ireland, contributing to employment of some 850,000 people.[68] Legal reforms have also been instigated, purportedly to bolster the accessibility of necessary procedures to SMEs, as exemplified by measures establishing Circuit Court examinership.[69] At a European level, a cognisance of SMEs is further demonstrated in the recently enacted Preventive Restructuring Directive (awaiting transposition under Irish law).[70] For instance, the Directive places a requirement on EU Member States to ensure that creditor class formation in voting on company restructuring plans protects claims of vulnerable creditors such as small suppliers.[71] Given that such legislative provisions explicitly make a distinction between smaller traders and other classes, granting a preferential status to SME creditors in insolvency distribution might not be an altogether illogical next step.

There is a profound obstacle to advocating for a preference for SME trade creditors over other claims. Trade credit practices imply that those creditors constitute 'voluntary' unsecured creditors, unlike the 'involuntary' claims of Revenue and employees. However, it must be queried as to whether SMEs are truly capable of 'adjusting' to their subordination in the hierarchy of creditors' claims. Are all SMEs fully aware of the consequences of entering into certain transactions and are freely assuming the consequent risks of non-payment or debtor insolvency?

Commercial practices and the notion of the 'adjusting' creditor

Competitive pressures impair SMEs' ability to vary the terms by which unsecured credit is extended. When a trader is faced with competition from similar businesses, there is restricted scope for any negotiation of specialised supply agreements. In such competitive markets, taking a decision to adjust supply terms by charging a higher interest rate could be counter-productive and could culminate in a business losing clients. Vanessa Finch and David Milman convey the predicament confronting SMEs in this respect when presenting the example of a supplier of tiles for roofing work who is considering changing the terms

67 Small- and medium-sized enterprises have a broad definition in accordance with the European Commission Recommendation 2003/61/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, [2003] OJ L 124/36. SMEs cover businesses which employ no more than 250 persons with an annual turnover not exceeding €50 million and/or an annual balance sheet total not exceeding €43 million.
68 See Central Statistics Office, 'Business Demography 2017' (CS0) <https://www.cso.ie/en/releasesandpublications/er/bd/businessdemography2017/> accessed 22 July 2019; and the European Commission, 'Small Business Act Fact Sheet for Ireland, 2018 (European Commission) <https://ec.europa.eu/growth/smes/business-friendly-environment/performance-review_en> accessed 22 July 2019.
69 See Jonathan McCarthy, 'Challenges in Finding the Right Approach to SME Rescue: The Example of Reforms to the Irish Examinership Process' (2019) 32 Insolvency Intelligence 43.
70 Directive (EU) 2019/123 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 [2019] OJEU L 172/18.
71 Article 9(4).

on which credit is being offered. The supplier anticipates that competing businesses, which are less informed or cavalier, could react by offering new terms to customers that aim to undercut the supplier. The supplier will therefore feel that terms simply cannot be adjusted because to do so would result in a loss of trade and a waste of resources by completing assessments of clients' creditworthiness.[72]

Economic literature frequently depicts unsecured trade credit as possessing informational advantages in relation to the businesses that suppliers are dealing with.[73] When suppliers increase their familiarity with a market, they also learn to be aware of any possible changes to a client's capacity to repay. Through this apparent advantage of information acquisition, suppliers can cut off future supply of goods and services if there is a reduced chance of payment. As John Armour argues, this counters an assumption that unsecured trade creditors are limited in their ability to adjust in line with a debtor's creditworthiness. [74] For Armour, there is ample evidence to show that trade creditors tend to adjust the amounts of credit advanced to particular debtors even though the same terms will apply for all credit being extended by a trader.[75] The import of the argument is that SMEs can diversify their risks. SMEs are not tied to a single debtor. However, this perspective may fail to suitably account for the competitive realities for SME suppliers.

Small-scale suppliers can become highly reliant on lucrative customers, for better or for worse. The choice of alternative customers might not be plentiful if a market is competitive. Credit control practices and due diligence can be a challenge to rigorously uphold in such conditions. Suppliers can lack bargaining power in demanding cash on delivery. As Jacob Ziegel notes, trade creditors are regularly unable to adequately protect themselves either because there are not enough customers to enable businesses to spread the risk around or because the creditors lack the resources to enforce specialised credit control.[76] There are deficiencies to retention of title (ROT) clauses when these quasi-security devices cannot apply in practice, such as with perishable goods, or where the supplied goods cannot be identifiable so as to reserve ownership.[77] As a protective measure, retention of title clauses may be only 'a poor man's secured loan'[78] if it is simply not practicable for suppliers to take security over a client's assets.

Contrary to the supposed informational advantages enjoyed by SME trade creditors, the dearth of information available to unsecured creditors generally is a prominent aspect of Lynn LoPucki's strident criticism of the implications of priority rules in insolvency.[79] In LoPucki's view, irrespective of the numbers of sophisticated repeat players that are accustomed to balancing probabilities of loss and non-repayment, markets are constantly assimilating vulnerable newcomers that are not well-informed. The outcome is that '[w]ith a constant flow of new suckers and poor information flows, there is no a priori reason why the markets for unsecured credit cannot persistently underestimate the risk, resulting in a permanent subsidy to borrowers'.[80] Even though there may always be a significant portion

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72 Finch and Milman (n 28), 82.
73 See Mitchell Petersen and Raghuram Rajan, 'Trade Credit: Theories and Evidence' (1997) 10 Review of Financial Studies 661.
74 John Armour, 'Should We Redistribute in Insolvency?' in Joshua Getzler and Jennifer Payne (eds), *Company Charges: Spectrum and Beyond* (Oxford University Press 2006) 215.
75 ibid.
76 Ziegel (n 2), 803.
77 On ROT clauses generally, see further Fidelma White, *Commercial Law* (2nd edn, Round Hall 2012) 313–323.
78 John Hudson, 'The Case Against Secured Lending' (1995) 15 International Review of Law and Economics 47, 51.
79 LoPucki (n 23).
80 LoPucki (n 23), 1956.

of younger suppliers that are less adept with a particular market, LoPucki's 'parable of the pit' is a grimly thought-provoking reflection on the innate risks and, indeed, inequities of the insolvency process. A town (the secured creditors) gets permission to dig a large pit in the middle of a nearby highway (commerce) without placing any warning signs whatsoever. Cars begin to fall into the pit, the occupants (unsecured creditors) killed and the town takes their valuables. LoPucki envisages that economists would proceed to defend this situation since, firstly, the public should now be aware of the pit after such events, and, secondly, users of the highway should deserve to suffer the consequences of their ignorance so as to provide an incentive for others to learn.[81] Even if experienced traders develop an understanding of the harsh consequences, later market entrants cannot be presumed to share the same acumen.

Evaluating the feasibility of an SME preference

The plight of the unsecured trade creditor and the prospect of some differential treatment for such claims has been emphasised even since the classic *Salomon* judgment.[82] In his judgment, Lord MacNaghten stated that:

> I have long thought, and I believe some of your Lordships also think, that the ordinary trade creditors of a trading company ought to have a preferential claim on the assets in liquidation in respect of debts incurred within a certain limited time before the winding-up. But that is not the law at present. Everybody knows that when there is a winding-up debenture-holders generally step in and sweep off everything; and a great scandal it is.[83]

Accomplishing a feasible compromise is elusive. As critically examined in Christopher Symes' 'divination' on the issue, a preferential status for small businesses could not be sustained, principally because there are just too many of these creditors to justify it.[84] Symes applies a number of criteria in determining the case for a small business priority, generally revolving around informational knowledge, voluntariness in accepting the risks of being unsecured and the capacity to exit arrangements or to adjust to a demoted position in the hierarchy of creditors' claims. Although some of Symes' conclusions can be disputed by points set out above, it is undeniable that there are many individual situations in which trade creditors find themselves and this undermines the potential for any generalised class claim. As Finch describes it, questions of creditor vulnerability pertain to a variety of such matters as 'the type of transaction involved, the pattern of risk spreading, the mode of payment, the market traditions, the levels of competition in the sector, the quality of information on suppliers that is available and the rate of turnover of business in the sector'.[85]

As an intermediate option, specialised solutions could be proposed like that previously forwarded by Milman whereby precedence be attached to creditors owed small sums (below £750).[86] This essentially foretold the comparable proposals of the Law Commission with regard to prepayment consumer claims. As with the flaws of the Law Commission recommendations, Milman acknowledged that a measure of this type would complicate life

81 LoPucki (n 23), 1956-7.
82 *Salomon v. Salomon and Co. Ltd.* [1897] AC 22.
83 *Salomon v. Salomon and Co. Ltd.* [1897] AC 22, 52.
84 Symes (n 2), 228-9.
85 Vanessa Finch, 'Is *Pari Passu* Passé?' [2000] Insolvency Lawyer 194, 210.
86 Milman (n 29).

for insolvency practitioners and add to transaction costs in having to identify and extract the smaller-value debts for payment.[87] Nonetheless, it was asserted that this would 'surely be an acceptable price to pay for improving the quality of distributive justice dispensed by English law'.[88] While being a laudable suggestion in catering to smaller claims, concentrating only on the size of the debt may offer little clues as whether a creditor is so vulnerable as to necessitate such prioritised treatment.[89]

Enough to go around? The reality of insolvency

In spite of all of the arguments and conjecture concerning the value judgements relating to creditor preferences, there is an unavoidably cruel reality associated with corporate insolvency. There are minimal proceeds to emanate in typical winding-up cases. Any grand endeavour at achieving a semblance of distributive justice will always be struck by the fact that there simply may not be the money there to be distributed. The negligible amounts that are at stake in liquidation was evident from empirical findings produced over the course of the author's own doctoral research on Irish proceedings.[90] This research indicated that the proceeds often only suffice to discharge liquidators' fees and expenses. Payments to preferential creditors are therefore restricted. Dividends of any amount for unsecured creditors are rare. When unsecured creditors do receive a return, it is generally anything up to 10c in the euro. The substantial proportion of companies that are liquidated are small-scale businesses. The bulk of their assets could be leased and are reclaimed upon commencement of a winding-up, thereby removing this property from distribution.

The desirability of comprehensive statistics and data on the average recoveries in liquidation is a recurring subject for academics and practitioners.[91] Informed decision-making as to the creation of new creditor preferences should be bolstered by having reference to statistical information, such as liquidators' reports on payments or empirical surveys of insolvency practitioners.[92] However, the figures which are available from our nearest neighbours disclose the same bleak findings for unsecured creditors. In 2010, the UK's Office of Fair Trading released statistics indicating that unsecured creditors receive payment in approximately 20 per cent of insolvencies and that the average return ratio is a paltry 4 per cent.[93] Surveys of floating charge realisations for the purposes of distributions to unsecured creditors under the prescribed part[94] have evinced that only 95 prescribed part funds were set aside from a sample size of 704. Of the 95, the average return to unsecured creditors was 7p in the pound.[95]

87 Milman (n 29), 78.
88 ibid.
89 Finch (n 85), 209.
90 The author's empirical research consisted of qualitative interviews with 19 leading insolvency practitioners in Ireland along with further interviews with representatives of small business organisations and business advisors.
91 For example, see Richard Tarling, 'The Absence of Insolvency Data' (2013) 34 Insolvency Lawyer 234.
92 For an explanation of future directions of research on statutory priorities, see Symes (n 2), Chapter 10. On the relevance of data in supporting policy decision-making, see Morgan (n 2), 506-7.
93 Office of Fair Trading, *The Market for Corporate Insolvency Practitioners: A Market Study* (2010), para. 4.58, <https://webarchive.nationalarchives.gov.uk/20140402172033/http://oft.gov.uk/shared_oft/reports/Insolvency/oft1245> accessed 22 July 2019.
94 See footnote 42.
95 Kayode Akintola, 'The Prescribed Part for Unsecured Creditors: A Pithy Review' (2017) 30 Insolvency Intelligence 55, 57. For the likely lack of change to these patterns after the recent increase in the cap of the prescribed part in the UK, see Kayode Akintola, 'The Prescribed Part for Unsecured Creditors: A Further Review' (2019) 32 Insolvency Intelligence 67.

There is an undoubted consistency to empirical findings that have been acquired on the limited recoveries in insolvency outcomes. A data set of English company liquidations between 1998 and 2005 revealed that even preferential creditors yielded mean returns of only between 17.2 and 19.3 per cent of what they were owed. In the same study, unsecured creditors were found to have been paid a mean of between a meagre 4.8 and 7.7 per cent of the sums owed to them.[96] In relation to other processes in the UK such as administration and administrative receivership, empirical research was conducted by Sandra Frisby on over 2000 companies entering such procedures between November 2004 and May 2006. It was recorded that preferential creditors received 11.2 per cent in payments of debts owed to them at the time of publication. The average return to unsecured creditors was 3.3 per cent and, in 28.9 per cases, there was no dividend whatsoever for unsecured creditors.[97] As disappointing an outcome which that represents for unsecured creditors, it even marks a slightly improved result on the (pre-Enterprise Act 2002) finding obtained by Andrew Keay and Peter Walton where the majority (85 per cent) of insolvency practitioner respondents to their survey confirmed that dividends were paid to unsecured creditors in 30 per cent or less of liquidation cases.[98]

It has become a 'self-evident truth' of insolvency by now that unsecured creditors will get little or nothing out of proceedings.[99] It is all the more striking when the claims of unsecured suppliers of goods and services tend to be substantially greater in value than those of secured creditors and, yet, stand to recoup trivial sums.[100] However, as borne out by the available statistics, preferential creditors usually have little to be pleased about either. Ziegel's empirical study showed that preferential creditors (excluding the bankruptcy trustees) recovered 17.8 per cent in bankruptcy distributions compared with an average recovery of 5 per cent for unsecured creditors.[101] Rather than it being understood to be perennial exploitation of unsecured creditors, the very nature of insolvency itself curtails the possibility of genuinely fair results when there are so few funds as it is for the relevant parties. As obvious as it may be, it remains worth recalling that, 'as the law must choose who is to be paid from a limited supply of funds in the insolvent estate, insolvency law can never satisfy all creditors'.[102]

Side-effects of interfering with the pecking-order

A move to award preferential status to a class of creditors would inevitably generate a reaction from other stakeholders in insolvency. It is an eventuality which was recognised by the Law Commission in the UK in its proposals for prepayment consumer protection when stating that '[a]ny change to the hierarchy to promote one group would necessarily have an impact on those further down the line'.[103] Swapping around the rungs of the ladder of creditors' priorities risks arousing the antipathy of one particularly powerful class of creditors. If the claims of, say, trade creditors were to be granted a rank above floating charges, banks especially might regard this as a threat to their bargained-for entitlements. There could be consequences for the credit market as financial institutions might look to compensate for any prospective loss of their priority to repayment. These creditors could

[96] Régis Blazy and Nirjhar Nigam, 'Corporate Insolvency Procedures in England: The Uneasy Case for Liquidations' (2019) 47 European Journal of Law and Economics 89.
[97] Sandra Frisby, *Report to the Insolvency Service: Insolvency Outcomes* (Insolvency Service 2006).
[98] Keay and Walton (n 2).
[99] Akintola (n 66), 12.
[100] See the findings of the study presented in Ziegel (n 2) in which the accumulated claims of unsecured trade creditors amounted to about 50 per cent more than the total claims of secured creditors in the sample.
[101] ibid.
[102] Symes (n 2), 260.
[103] Law Commission (n 54), para. 8.37.

be hesitant to advance loans to businesses, such as those very SMEs for whom, ironically, a preference in insolvency would have been intended to be of most benefit.

The choices made as to which parties warrant statutory preferences can be fraught with political influence. For example, the preferential categorisation under Irish law of such claimants as employees is fundamentally a politically-motivated decision.[104] The pragmatism entailed when legislators opt to re-frame the order of creditors' priorities can be attributable to pressure group lobbying.[105] There is also an element of 'path dependence' at issue here. As articulated by Sarah Paterson when referring to reforming legal systems of secured transactions, incumbent groups can mobilise to obstruct change to complicated but historically entrenched systems and '[g]iven these factors of cost and interest group politics it may not be possible to drive change through unless the system is completely unsatisfactory (rather than not the best scheme available)'.[106] When legislators refrain from making emphatic choices, group pressures give rise to reactive but incremental 'compromise solutions'. As Ziegel concludes, this should be expected because, even with variations from jurisdiction to jurisdiction, the parameters of preferential debts may resemble 'a mosaic, not clean black and white'.[107] Ambiguous compromise could well be the natural result when '[t]here is probably no more intractable or controversial question in modern insolvency law than the distribution of an insolvent's assets among its creditors' and when 'creditors complain bitterly about how shabbily the bankruptcy system treats them'.[108] Creditors are sure to complain with even more instinctive and resentful bitterness when they believe that other creditors are earning a preference at their expense.

Conclusion

The legislature's choice as to the preferential debts that are plucked from the vulnerable equality of unsecured classes can seem to be more important than it actually is. Specifying the interests that should be most deserving of protection in insolvency bears the hallmarks of a noble crusade in the cause of distributive justice. There are valid reasons both to support and remove Revenue preference. Prepayment consumers have a case for increased safeguards. SMEs as trade creditors eternally suffer considerable losses in the event of debtor insolvency. However, the reality of corporate insolvency and the minimal amounts available for distribution can make a tokenistic gesture of the granting of newly preferential status to a group of creditors. As noted above, the available empirical data on the recoveries for creditors conveys this clearly. Changing the hierarchy of creditors' claims to nominally suit one class over another cannot have as significant a practical effect as creditors may imagine. Yet, priorities of creditors' claims remain instrumental in bringing some order to the allocation of very scarce funds.

In order for there to be a meaningful increase in the recoveries attained by creditors in such scenarios, efforts at obtaining an optimal distribution need to begin at a far earlier stage than the winding-up of a company. Rather than thinking about what happens when a company is, in fact, insolvent, the focus ought to be on promptly intervening to address and to alleviate a company's financial difficulties before this ever transpires. Preventive restructuring of a company's debts (as encouraged by the latest European Directive) and

104 See Lynch Fannon and Murphy (n 2), [8.84].
105 Symes (n 2), 249.
106 Sarah Paterson, 'Finding Our Way: Secured Transactions and Corporate Bankruptcy Law and Policy in America and England' (2018) 18 Journal of Corporate Law Studies 247, 268-9.
107 Ziegel (n 2), 805-6.
108 ibid, 793.

procedures of company rescue, such as examinership, help to negate problems of creditor losses before a company may have to enter into liquidation. It is within such procedures that the Irish judiciary should be relied upon to play a more pivotal part in ensuring that the interests of respective creditors are not being prejudiced.