Neutral Citation: [2014] IEHC 373

THE HIGH COURT

COMMERICAL

[2014 No. 2473P]

[2014 No. 36 COM]

BETWEEN

JAMES PATRICK FLANNERY AND LEXINGTON SERVICES LIMITED

PLAINTIFFS

AND

MORTIMER JOHN WALTERS, BRIAN CONNELL, ACTIVITY MONITORING SOLUTIONS LIMITED, CATHARSIS TECHNOLOGIES LIMITED, ASHLEY TRUST LIMITED AND ASHLEY NOMINEES LIMITED

DEFENDANTS

AND

CATHARSIS TECHNOLOGIES LIMITED

COUNTERCLAIM PLAINTIFF

AND

JAMES PATRICK FLANNERY, BRUCE BASHEER AND SEAF-2 LIMITED

COUNTERCLAIM DEFENDANTS

JUDGMENT of Mr. Justice Brian J. McGovern delivered on the 22nd day of July 2014

1. Applications have been made by various parties to these proceedings for security for costs. The defendants seek security for costs against the plaintiffs. The defendants in the counterclaim seek security for costs against the plaintiff in the counterclaim.

2. Dealing with the defendants' application, the court has to determine whether James Patrick Flannery (hereinafter "JPF") and Lexington Services Ltd. (hereinafter "Lexington") are sufficiently solvent to meet a costs order if they are unsuccessful in these proceedings. The first named plaintiff, JPF, resides in the principality of Andorra, while the second named plaintiff, Lexington, is a company incorporated under the laws of Malta, a Member State of the European Union.

3. The application is made pursuant to O. 29 of the Rules of the Superior Courts so far as the first named plaintiff is concerned. In the case of the second named plaintiff, the application for security is brought pursuant to O. 29 of the Rules of the Superior Courts and/or s. 390 of the Companies Acts 1963 to 2013. Order 29, r. 3 requires a defendant seeking security to file a satisfactory affidavit showing a defence upon the merits, and O. 29, r. 4 provides that the onus is on the applicant to establish reasonable grounds for his entitlement to the order.

4. The plaintiffs concede that the defendant have a *prima facie* defence, and also concedes that, *prima facie*, the defendant are entitled to an order for security for costs against the first named defendant, but argue that the court must consider the position of the second named plaintiff, Lexington. Counsel for the applicants accepts that if Lexington is solvent, the position of JPF is irrelevant.

5. Even though the first named plaintiff resides outside the jurisdiction and it is conceded that the defendants have a *prima facie* defence, the court retains a discretion in deciding whether or not to order security for costs. In the exercise of its discretion, the court must consider all the circumstances of the case. See *Malone v. Brown Thomas & Co. Ltd*. [1995] 1 ILRM 369. From the concessions made by the parties at the hearing of this motion, the matter can be most efficiently dealt with by considering the question as to whether or not Lexington will be unable to pay the costs of the defendant if successful in its defence. Lexington is a company which was previously domiciled and registered in the British Virgin Islands and is now registered in Malta. Since it is not a company incorporated within the State, strictly speaking, the provisions of s. 390 of the Companies Acts do not apply to it. In *Harlequin Property (SVG) Ltd. & Anor. v. O'Halloran & Anor*. [2012] IEHC 13, and in *Lough Neagh Exploration Ltd. v. Morrice et al* (Unreported, High Court, Laffoy J. 27th August 1997), the parties accepted that the principles to be applied in such an application were the same as those found in section 390. In this case, the parties also accept that is so, and that the appropriate test is whether there exists *". . . credible testimony that there is reason to believe that the company will be unable to pay the costs of the defendant if successful in his defence . . ."*

6. The plaintiffs argue that, in cases where security for costs is sought against a corporate plaintiff, the question before the court is not one of the company's solvency, but rather a question of whether the company will be able to meet the costs of the action if ordered against it. This does not involve a detailed analysis of the assets and liabilities of Lexington. See *Bula Ltd. v Tara Mines Ltd.* [1987] 1 I.R. 494, at 498. Affidavits sworn by JPF on 30th May and 20th June 2014, exhibit evidence of Lexington's solvency in the form of financial statements and a letter from the company's auditors which attest that the company will be able to meet the debts that fall due in the year to follow, with the company holding roughly €5m of equity on its balance sheet. The defendants argue that when one takes into consideration losses suffered by the company last year of approximately €10m, the chances of a costs order being met are small. They also argue that the letter from the company's auditor does not appear to make provision for the potential costs involved in defending these proceedings and there was no substantial information provided by the plaintiffs as to the nature of the assets which the company holds, or whether those assets would or could be realised. This submission is made in response to accounts of the company published for the year ending 31st December 2013, in which the auditors state;

> *"The company has reported losses from operating activities and has a positive net asset position. The losses sustained affect the exceptional costs after taking account of impairment provisions on a receiveable with a related party. On this basis, the directors are confident that the company will be successful in improving profitability, and accordingly considers it appropriate to prepare the financial statements under the going concern basis.*
>
> *The company is said to be a going concern if the company is successful in generating profits. However, there is no certainty that the company will be able to generate profits to continue as a going concern. The company may, therefore, be unable to continue realising its assets and discharging its liabilities in the normal course of business, but the financial statements do not include any adjustments that would result if the company were to be unable to continue as a going concern."*

7. The plaintiffs rely on the evidence from the financial statements for the year ending 31st December 2013, as supplemented by a report and financial statement showing the position from 1st January 2014, to 30th June 2014. The plaintiffs say that these reports and correspondence from the auditors confirm the company is solvent and that this is an absolute bar to the making of an order for security for costs against it.

8. It seems to me that these financial statements show a positive net asset position which is the most relevant consideration in considering the ability to meet a costs order. The company holds approximately €4.5m in assets and the costs of defending the action are estimated at €325,918.40. That evidence has not been challenged to any significant degree.

9. The onus of proof is on the applicants to establish reasonable grounds for the entitlement to the order and to meet the test set out in s. 390 of the Companies Acts. In my view, the evidence adduced does not meet that test, and accordingly, I refuse the defendants' application for security for costs against the second named plaintiff. Counsel for the defendants accepts that if no order is made against the second named plaintiff, that the position of the first named plaintiff is irrelevant so far as this application is concerned, so I will refuse the application for security against both plaintiffs.

10. The plaintiffs also raised a further objection to the defendants' application for security for costs on the grounds of delay. It is not necessary for me to consider that objection. But in case this matter should go further, I wish to state that there was no significant delay in the bringing of this application by the defendants. In *Dublin International Arena Ltd. v. Waterworld Ltd.* [2007] IESC 48, Denham J. noted that the delay must be of an undue and substantial kind. The period between the commencement of the proceedings and the application for security for costs in this case is three months. That does not amount to undue or substantial delay. Furthermore, the plaintiffs recently sought to deliver an amended statement of claim and the application for security for costs was made around the same time as the application to amend. Therefore, insofar as this issue was relevant, I am satisfied there was no delay in bringing the application by the defendants.

Counterclaim Defendants' Application for Security for Costs against the Counterclaim Plaintiff

11. The counterclaim defendants seek security for costs against the counterclaim plaintiff, CTL, on the basis that it is insolvent and would be unable to discharge the costs of the counterclaim defendants if required. CTL is a company registered in Malta, an EU Member State.

12. The same legal principles apply to this application. It is governed by O. 29 of the Rules of the Superior Courts. The parties are also agreed that although the Companies Acts do not apply to CTL, that the principle set out in s. 390 of the Companies Acts is the correct test to be applied.

13. The plaintiff to the counterclaim accepts that the defendants to the counterclaim have raised a *prima facie* defence. The counterclaim defendants allege that CTL is a company which is hopelessly insolvent and would be unable to meet a costs order if one were to be made against it. It is alleged that the liabilities of the company outweigh the assets to a significant degree and have been outstanding for over a year. This is denied by the counterclaim plaintiff which maintains its solvency as a company.

14. In response to the counterclaim application for security for costs, an issue arose as to whether an application for costs can arise as part of a counterclaim. The counterclaim plaintiff argued that it would be inappropriate for the court to make an order for security as the claims made are inextricably connected with the principal proceedings before the court.

15. The general principle that applies to security for costs applications brought by defendants to a counterclaim is that security for costs will not be given if the counterclaim arises as a defensive action and where a sufficient nexus exists between the claim and counterclaim. See *Crabtree (Insulation) Ltd. v. GTT Communications Systems* [1990] 59 BLR 43 (Bingham L.J.) and *Boyle & Anor. v. McGilloway & Ors*. [2006] IEHC 37 (Clarke J.) and *Oltech (Systems) Ltd. v. Olivetti UK Ltd.* [2012] IEHC 512 (Charleton J.).

16. The counterclaim defendants argue that the counterclaim is sufficiently distinct from the original claim as to allow them to seek security. It is argued that the counterclaim contains a new cause of action involving a claim for damages against new parties engaging new legal and factual issues which goes beyond a defence to the plaintiffs' claim. In *The Silver Fir* [1980] 1 Lloyd's Rep. 371, Lawton L.J. stated at p. 374:

> *"What Lord Esher M.R. was saying [in Neck v.Taylor] was that there is a discretion to award security for costs, even in cases which arise out of the same subject matter. But if the counterclaim is a defence and nothing more, then normally the discretion should not be exercised in favour of ordering security."*

17. The counterclaim raises a new claim in conspiracy and for damages which was not in the defence, and two of the defendants to the counterclaim were not joined in the main action. In *Sykes v. Sacerdoti* (1885) 15 QBD 423, Lord Esher M.R. stated that when a claim and counterclaim arise out of different matters and the counterclaim is really a cross-action, the court is entitled to require a defendant resident out of the jurisdiction to provide security.

18. But before reaching a decision on whether or not these facts give rise to special circumstances as to why I should exercise my discretion to refuse security for costs, I have to consider whether there is credible testimony that there is reason to believe that the plaintiff in the counterclaim would be unable to pay the costs of the defendants in the counterclaim if successful in their defence.

19. The defendants in the counterclaim argue that there is clear evidence that CTL would be unable to meet the counterclaim defendants' costs if required to do so. They rely on a statement of financial affairs which shows a total negative equity of €478,518. But the same statement of financial affairs shows the total equity and liabilities to be a positive sum of €533,179. That figure includes a sum of €402,602 for unpaid contributions which are claimed by the counterclaimant against the first named counterclaim defendant.

20. Counsel for the counterclaim defendants accepts that if you add in the sum of €402,602 alleged to be due from the first named defendant in the counterclaim that this would give the plaintiff in the counterclaim the ability to pay. But this would include funding as to 80% of the costs which was confirmed by counsel for the plaintiff in the counterclaim. It was argued by counsel for the defendants in the counterclaim that it was an unstatable proposition to suggest that the obligations of the first named defendant of the counterclaim extended to meeting 80% of the costs which might be awarded in favour of the defendants to the counterclaim. On the face of it, this seems a reasonable argument.

21. I am satisfied that the counterclaim not only joins additional parties to the proceedings, but also raises new claims raising new legal and factual issues going beyond the defence to the plaintiffs' claim. I am also satisfied that the defendants to the counterclaim have adduced credible evidence that there is reason to believe that the counterclaim plaintiff, CTL, will be unable to pay the costs of the defendants to the counterclaim if successful in their defence. Accordingly, I direct that the defendant and counterclaimant to furnish security for costs in respect of the issues arising on the counterclaim. I will hear counsel on the amount of security to be furnished.