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THE HIGH COURT

[2007 No. 348 COS]

IN THE MATTER OF TRAFFIC GROUP LTD IN EXAMINATION (UNDER THE COMPANIES) (AMENDMENT) ACT, 1990

AND IN THE MATTER OF THE COMPANIES ACTS, 1963 TO 2006

Judgment of Mr. Justice Clarke delivered on the 20th day of December, 2007

1. Introduction

1.1 The company named in the title to these proceedings ("Traffic") has been the subject of examination over the last number of months. On the 22nd of August, 2007, Martin Ferris ("The Examiner") was appointed interim examiner of Traffic and was, thereafter, appointed as examiner of the 14th of September, 2007.

1.2 On the 28th of November, 2007, the examiner presented his report under the provisions of s. 18 of the Companies (Amendment) Act, 1990 ("The Act"). The report put forward a scheme for the reorganisation of the companies affairs which had met with general support at the various meetings required to be conducted by the provisions of the Act, save that the Revenue Commissioners, in their capacity as a significant preferential shareholder, maintained opposition to the approval of the scheme.

1.3 In those circumstances a substantive hearing of an application to confirm the scheme took place before me at which counsel on behalf of the examiner and counsel on behalf of the petitioners commended the scheme to the court, while counsel on behalf of the Revenue Commissioners put forward argument as to why the court should not confirm the scheme. No other members or creditors played a role at that hearing. Having been informed by counsel on behalf of the petitioners and counsel on behalf of the examiner that, for practical reasons, a decision to approve the scheme would be unlikely to be effective unless immediately made, I indicated to the parties that I would inform them of my decision on the following day, but would reserve until a further occasion my detailed reasons for having come to the view which I would express.

1.4 On that basis, I ruled on the following day that the scheme should be confirmed subject to obtaining from the petitioners an undertaking as to non involvement to which I will refer in due course. That undertaking being forthcoming, I made the appropriate order confirming the scheme. This judgment is directed to setting out the reasons which led me to come to that conclusion. I should start by setting out the general circumstances in which the company went into examinership.

2. Background

2.1 Traffic commenced trading in October, 1985. Its principal promoter was a Dennis Booth. Traffic initially traded from a green field site at the IDA Centre in Prussia Street in Dublin. Its main business was the design, manufacture and wholesale of ladies fashion garments. The company was initially very successful and, by 1993, had established the brand "Traffic" and had reached a turnover of IR£4,000,000, employed two hundred people and had a customer base of the order of three hundred retail shops. Traffic continued to trade profitably until the early years of this decade, but those profits declined from a sum in excess of €200,000 in 2002, to under €70,000 in 2005. That downward trend continued, if not accelerated, giving rise to losses in excess of €500,000 in 2006, and even greater losses of almost €700,000 in the first seven and a half months of 2007 (that is up to the time of the presentation of the petition in respect of examinership). It may be that some of the losses attributable to 2007 were, in truth, more accurately attributable to 2006 by reason of an overvaluation of stock in 2006. The severe downturn in the financial success of Traffic was attributed to a range of factors which it is not necessary to detail here as they are not relevant to the issues which I have to address. However, by the time of the presentation of the petition in this case it was estimated (in that petition and in the supporting evidence) that the company had a deficiency of in excess of €850,000 on a going concern basis, and not far short of €1,500,000 on a winding up basis. For reasons which will become clear, the true position was a little worse than that. It will be necessary to return to some of the details of the financial position of Traffic as given to the court in the petition and in the verifying affidavits filed at that time, as those matters formed an important part of the basis for the opposition of the Revenue Commissioners to the confirmation of the scheme.

2.2 In any event against that background the company was admitted into examinership, and I now turn to the procedural history of that examinership.

3. Procedural History

3.1 This Court (Kelly J.) made an order for the appointment of an interim examiner on the 22nd of August, 2007. On the 14th of September, 2007, Edwards J., appointed the examiner. Orders extending the time for the delivery of the final report (with consequential orders extending the period of protection) were made by Kelly J., on the 31st of October, 2007, and Finlay Geoghegan J., on the 15th of November, 2007. It is important, in the context of the issues which I have to decide, to note that, in the course of seeking such extensions of time, the examiner brought to the attention of the court certain actions of the company in the immediate run up to the presentation of the petition which had been a cause of some concern to him. As those matters form the basis of the Revenue's opposition, I will deal with them in detail in due course. I am told that the Revenue suggested, at the relevant time, that, on the basis of those concerns, no extension of time should be granted. However, the relevant extension was, in fact, granted and it was indicated by the court that such matters could, if relevant, be raised by the Revenue before the Judge who would ultimately have to consider confirmation of the final report.

3.2 It is also important to note that the various statutory requirements in respect of the examiners final report have been met. Furthermore, all of the evidence suggested that the implementation of the scheme set out in that report gives the company a real chance of survival. Indeed that aspect of the case was not contested by the Revenue. I was, therefore, faced with a situation where it was clear that the statutory prerequisites for the exercise of the court's entitlement to approve and confirm the scheme were all in place, and further that it was a case where there was no doubt but that the company had a real chance of survival if the scheme was implemented. It is also clear that that most of the jobs (at least 16 out of 24) are to be retained. Against that background it is appropriate to turn next to the reasons put forward on behalf of the Revenue Commissioners for opposing confirmation of the scheme.

4. The Revenue Objections

4.1 The Revenue Commissioners relied on two somewhat connected matters as the basis for their opposition to confirmation. It was said that there were significant failures of disclosure on the part of the petitioners when initially invoking the courts jurisdiction by the presentation of the petition and the making of an application for the appointment of an interim examiner.

4.2 The same factual material is also said to give rise to an inference that those in charge of the company engaged in inappropriate actions in the immediate run up to the presentation of the petition, which actions were, it is said, compounded by the failure to disclose which I have already noted.

4.3 Two principal transactions were relied upon under both headings. It is the case that within a short period of time prior to the presentation of the petition, Traffic had given to Bank of Scotland Ireland ("BOSI") a charge over the company's assets. Up to that point BOSI was, so far as the company was concerned, an unsecured creditor. BOSI did, however, have the benefit of a guarantee from members of the Booth family which guarantee was supported by the lodgement of a significant sum of money in a bank account held with BOSI. As a matter of practicality the net effect of the giving of the charge over the company's assets was to, potentially, aid the position of the guarantors by virtue of allowing BOSI to obtain payment out of the company's assets and thus, as a matter of likelihood, not to have to invoke the guarantees to the consequent benefit of the members of the Booth family who had given those guarantees.

4.4 In a connected vein it is pointed out that, again in the period immediately prior to the presentation of the petition, the liabilities of Traffic with BOSI were reduced by a sum of approximately €340,000. This again had the effect of reducing the exposure of the guarantors. The relevant liability of Traffic to BOSI was on a so called "payline account" which gave a form of ninety day rolling credit to the company in respect of invoices issued by Traffic. As a result of the industry of the examiner, a reasonably clear picture of what happened in respect of that account has now emerged. There is no doubt that the payments to BOSI were due as of the dates when the payments were made. The relevant ninety day credit period in each case had expired. It is also factually the case that on all but one occasion during which the payline account has been in operation, Traffic had made the relevant payments by the due date (or in a small number of cases one or two days thereafter). There can, thus, be no doubt but that the payment pattern was in accordance with the company's normal practise.

4.5 While it is true to say that the payline account had been at its credit limit (€600,000) for quite some time prior to the reduction in the immediate run up to the presentation of the petition, it would seem that the relevant reduction occurred by reason of the fact that, due to the company's trading difficulties, no invoices were issued to enable further funds to be drawn down. It is clear, therefore, that the payments accorded with the orderly operation of the payline account. That is not, of course, the end of the matter. The fact remains that the payments had the potential to significantly benefit the guarantors by reducing the liabilities which they had guaranteed. The possibility that, had the company gone into liquidation, those payments might have been regarded as a fraudulent preference remains.

4.6 I should, in passing, mention that the Revenue also places some reliance on the fact that it is accepted that the net financial position of the company, as set out in the petition and the verifying affidavits, was overstated (that is the deficit was understated) by a small but nonetheless material amount. In fairness counsel for the Revenue quite properly agreed that that matter of itself could not be a proper basis for opposing the confirmation of a scheme which was otherwise appropriate. It was accepted that in the urgent and frequently fraught circumstances in which an application for examinership may be made, it may not be possible to prepare accounts with the level of accuracy that might be hoped for. Where the accounts as presented are relatively accurate, any falling off from absolute correctness could not, in my view, form a proper basis for refusing to confirm the scheme. That is not to say that there, nonetheless, remains a significant obligation on those who might wish to petition the court in an examinership to ensure that the financial state of the company is presented to the court in as accurate a way as is practically possible in all the circumstances.

4.7 Counsel for the Revenue did, however, suggest that even though that matter could not be a basis, by itself, for legitimately opposing confirmation of a scheme, it was nonetheless a matter to taken into account along with the other factors.

4.8 Against that background it is appropriate to look at the legal principals applicable to a decision such as that with which I was faced.

5. The Law

5.1 That the actions of the principals of the company (who will almost invariably be the petitioners) in the run up to, and during, an examinership can be a factor to be legitimately taken into account in deciding whether to confirm or refuse to confirm a scheme is clear from, for example, the decision of Costello J., in *Re Wogans (Drogheda) Ltd* (Unreported, High Court, Costello J., 7th May 1992). As pointed out by Costello J., on page 7 of the judgment, creditors whose interests are impaired by a scheme may object to the scheme on the grounds set out in s. 25 of the Act. However, Costello J., went on to note that:-

> "…the courts discretion under s. 24(3) to confirm, or to confirm subject to modifications, or to refuse to confirm the scheme proposed is not limited by the grounds set out in s. 25. If an abuse of the court's processes has been established, I do not think that the court should ignore it and consider on its merits a scheme which had subsequently been prepared. To do so would be to condone the abusive behaviour and encourage similar conduct in the future".

On the facts of the case before him, Costello J., considered that there had been an abuse of process and, for that as well as other grounds, refused to confirm the scheme under consideration.

5.2 However, the same Judge, in *Re Selukwe Ltd* (Unreported, High Court, Costello J., 20th December 1991), determined that it was appropriate to approve the scheme under consideration in that case, notwithstanding a finding that the relevant petitioners had failed to act with the utmost good faith at the time of the presentation of the petition and had, to their knowledge, significantly understated the relevant company's Revenue debt. However, Costello J. came to the view that:-

> "…the position in this case is such that these considerations to which I have referred are outweighed by what I consider to be the main consideration in this case, namely, the fact that there are thirty jobs at stake. I do not think the court should turn down the proposals if there is any prospect of saving those jobs. So notwithstanding the doubts which I have expressed I have decided to confirm the proposal subject to the modifications to which I have referred".

5.3 That the actions of those responsible for running the company in the immediate lead up to the presentation of a petition in respect of an examinership and any failure to properly disclose all relevant facts in such an application , are factors which the court can properly take into account is, therefore, clear. However, there must also be weighed in the balance, as Costello J., pointed out in *Selukwe*, the underlying object of the legislation.

5.4 It is important to note that the Act is not designed to immunise the principals or shareholders of a company from the consequences of the company concerned getting into financial difficulties. The value which shareholders may have in a company (whether they are involved in its management or not) may, in practise, be extinguished or greatly diminished by bad judgment in investing in the company in the first place, by bad management (either on the part of the investors themselves or those whom they trusted to run the company) or, indeed, plain bad luck. Whatever may be the cause, it does not seem to me that it is any part of purpose of the Act to solve the difficulties of such shareholders howsoever those difficulties may have arisen. If the Act were so designed it might well give some truth to the verse penned at the time of the introduction of limited liability companies into our legal scheme, which suggested that such companies amounted to a conspiracy by gentlemen (and at the relevant time it almost always

would have been gentlemen or those who claimed to be such) whereby they met together to decide by how much they would not pay their debts.

5.5 It is clear that the principal focus of the legislation is to enable, in an appropriate case, an enterprise to continue in existence for the benefit of the economy as a whole and, of equal, or indeed greater, importance to enable as many as possible of the jobs which may be at stake in such enterprise to be maintained for the benefit of the community in which the relevant employment is located. It is important both for the court and, indeed, for examiners, to keep in mind that such is the focus of the legislation. It is not designed to help shareholders whose investment has proved to be unsuccessful. It is to seek to save the enterprise and jobs.

5.6 It is as against that background that Costello J. felt that the high prospects of saving a significant number of jobs outweighed the lack of candor displayed by the petitioners in *Selukwe*. It is also important to note that, in addition to the lack of candor displayed in Wogans, it is clear from the remainder of the judgment of Costello J., in that case that he was also motivated by what he perceived were significant deficiencies in the scheme then under consideration. In addition Costello J. characterised the scheme as one which was in reality a proposal for a new commercial enterprise whereby, in truth, the existing enterprise and existing jobs would have been written off.

5.7 It seems to me, therefore, that a court should lean in favour of approving a scheme where the enterprise, or a significant portion of it, and the jobs or a significant portion of them, are likely to be saved. That is not to say that the court should disregard any lack of candor or other wrongful actions. It does, however, seem to me that the courts approach to such matters should take into account the following.

5.8 Firstly it needs to be recognised that there may be cases where the wrongful actions of those involved in promoting the examinership are so serious that the court is left with no option but, on that ground alone, to decline to confirm a scheme which would otherwise be in order. It is necessary, as Costello J. pointed out in *Wogans*, to discourage highly wrongful behaviour.

5.9 However in addition it seems to me that the court should consider the extent to which it may be possible (either by virtue of the provisions of the scheme as presented or modifications suggested by the court) to, as it was put by counsel for the petitioners, "neutralise" the effects of any such wrongful actions. The extent to which measures can be put in place to ensure that those who may have been guilty of a lack of candor or other wrongful action do not, themselves, benefit by it, is a factor to which significant weight should be attached. It is important, in my view, that in an appropriate case, examiners should have regard to such factors in formulating schemes for presentation to the court.

5.10 Where there is a high level of likelihood that the company can survive with a consequent saving of a significant enterprise and at least a significant proportion of the jobs at stake, the court should lean in favour of confirmation, especially if appropriate remedial measures can be put in place to mark and deal with the consequences of any lack of candour or other inappropriate action on the part of those charged with the management of the company.

6. Application to the Facts of this Case

6.1 I was satisfied that there was a lack of candor on the part of the petitioners in this case. Whatever may be said about the failure to give an accurate picture of the company's overall position in the petition, I was more than satisfied that a careful reading of both the petition and the grounding affidavit establishes that the court was not, by any manner of means, fully informed of the circumstances relating to both the charge in favour of BOSI and the significant payments made in reduction of the BOSI payline account together with the possible consequences of those payments. I was also satisfied that these are matters about which the court should have been told. For the reasons which I have sought to analyse, I was more than satisfied that an appropriate consideration by the court, even at the stage of the appointment of an interim examiner, but equally at the stage of the appointment of an examiner on foot of the petition, can and should be to have regard to the extent to which the primary focus of the petition is the protection of the enterprise and jobs (which is the statutory purpose) rather than an inappropriate attempt to protect the shareholders (which is most certainly not). In order for the court to assess such matters it is, of course, important that the court has all relevant facts which might impact on such a decision. Facts relevant to how the burden of the likely alternative of a winding up would fall upon the petitioners are clearly material in that context. I was, in those circumstances, satisfied that the court should have been given significantly greater detail at the time of the presentation of the petition concerning both the charge and the payments in favour of BOSI.

6.2 Secondly, I was satisfied that the circumstances surrounding the charge in favour of BOSI betrays an action on the part of the principals of the company which is open to legitimate significant criticism. The company was clearly insolvent or close to it at the time. This must have been known to the principals. The granting of a charge which would have had the effect of benefiting guarantors who, in turn, are all members of the same family as the promoters or are the promoters themselves, only needs to be described to be found inappropriate.

6.3 The making of the payments to BOSI are more problematic. As was correctly pointed out by counsel for the petitioners, cases in which an allegation of the making of a fraudulent preference is made, are often difficult of assessment. On the one hand there is no doubt that the payments made were due to BOSI and were made in accordance with the long existing practise of Traffic. There is also merit in the consideration that the continued support of BOSI would have been necessary to the companies survival in any event. On the other hand there is no doubt but that the payments had, and would obviously be likely to have, a beneficial effect on the guarantors whom, I have pointed out, are family members.

6.4 Except in a very clear case it will never be possible for a court, in the context of the limited timescale within which a final decision in respect of an examinership is required, under the Act, to be taken, to reach a conclusion as to whether certain actions might have amounted to a fraudulent preference in the event that the alternative of a winding up of the company had been adopted. While I was satisfied that those matters should have been disclosed by the petitioners, it did not seem to me that I could reasonably reach a conclusion that the actions themselves were wrongful.

6.5 Against that background I was satisfied that there was a significant lack of candor and also, so far as the charge was concerned, an inappropriate action on the part of the petitioners. However those factors did not seem to me to be so gross as would justify refusing to approve a scheme which seemed to have a high chance of successfully persevering the enterprise and most of the jobs concerned, most particularly if appropriate measures could be put in place to ensure that those who are responsible for the impugned actions do not benefit by them.

6.6 In that context it is important to note that, so far as Traffic is concerned, BOSI is being treated, for the purposes of the scheme, as an unsecured creditor. In effect the charge is now to be disregarded. This will mean that, along with all of the other unsecured creditors, BOSI will receive 10% of its liabilities but will, of course, be able to recover the balance on foot of the guarantees. It is true

to state that there will not, therefore, as a result of the scheme put forward by the examiner, be any benefit to any party as a result of the charge being put in place.

6.7 In addition, and for reasons such as those which I have sought to analyse, I formed the view that it would be inappropriate for the petitioners to continue, for at least a period of eighteen months, in any role of control in respect of the company. In those circumstances I invited counsel to obtain instructions to give an undertaking on behalf of the petitioners that they would not act as directors of Traffic for such a period. Such an undertaking was forthcoming.

6.8 It seemed to me that those measures went some not insignificant way towards ameliorating the consequences of the wrongful actions of the petitioners and their lack of candor, such that it would not have been appropriate to refuse to approve the scheme on those grounds.

6.9 The final matter which I felt it necessary to take into account arose out of the significant payments made to BOSI. It is, of course, the case that had the company gone into liquidation and had it transpired that the court was satisfied that those payments amounted to a fraudulent preference, those sums would have come back into the equation. It is at least possible that in those circumstances (and dependant in large part on the costs of the liquidation itself) that the Revenue Commissioners, as preferential creditor, might have benefited significantly by such a repayment. On that basis it was possible that one could have concluded that the scheme as proposed was unduly prejudicial to the Revenue Commissioners.

6.10 I do not rule out the possibility that such a consideration might, in a case where it was clear that there had been a fraudulent preference, be a matter which the court should take into account in assessing the fairness of the scheme as a whole. However for the reasons which I have set out earlier it did not seem to me that it would possible, with any safety, to reach even a tentative conclusion as to whether a finding of fraudulent preference could be made in this case. There remains, therefore, only a possibility that, on a winding up, there might have been more funds available to meet the entitlements of the Revenue as preferential creditor. It is clear from cases such *as Re Antigen Holdings Ltd* [2001] 4 I.R. 600, that a court can approve of a scheme, in all the circumstances, even where a creditor may be likely to do worse under the scheme than the same creditor might on a winding up. However it would, of course, be the case that if there were an extreme and disproportionate disparity between the position of a creditor on a winding up and under the scheme proposed compared with the position of other creditors under both alternatives, same might be a factor to be properly taken into account in ruling against confirmation of the scheme.

6.11 However in the light of the uncertainty concerning what would, in fact, have happened in a liquidation in this case, it does not seem to me that I could, on the ground that the monies paid to BOSI are not coming back into the company as part of the scheme, rule that the scheme is unfairly prejudicial to the legitimate interests of the Revenue Commissioners.

6.12 For those reasons I was not satisfied that there was any proper basis of sufficient weight to outdo the undoubted prospects for the survival of the enterprise and the maintenance of most of the jobs involved which form the other part of the balance. For those reasons I was not satisfied that it would have been appropriate to decline to approve the scheme and was prepared to approve same subject to receiving the undertaking to which I have referred.