Neutral Citation: [2016] IEHC 589

THE HIGH COURT

[2015 No. 297 Cos]

IN THE MATTER OF FÁILTE LOGISTICS AND DISTRIBUTION LIMITED (IN VOLUNTARY LIQUIDATION)

AND IN THE MATTER OF SECTION 819 OF THE COMPANIES ACT 2014

BETWEEN

EAMONN LEAHY

APPLICANT

and

GERARD O'KEEFE and MICHAEL O'KEEFE

RESPONDENTS

JUDGMENT of Mr. Justice David Keane delivered on the 21st of October 2016

Introduction

1. This is an application for a declaration of restriction against each of the respondents under s. 819(1) of the Companies Act 2014 ('the 2014 Act'), formerly s. 150 of the Companies Act 1990 ('the 1990 Act').

Background

2. Fáilte Logistics & Distribution Limited ('the company') was incorporated on the 30th May 2011. The company carried on business as a courier service.

3. On the 11th August 2014, the second named respondent certified to the Companies Registration Office that, at an extraordinary general meeting on the preceding 6th August, the members of the company had resolved to wind it up and to appoint the applicant as liquidator for that purpose.

4. At the commencement of the winding up, the respondents were the two directors of the company, and the first respondent was its secretary. The respondents were then joint managing directors of the company and each held a 10% shareholding in it.

5. The applicant has certified that, at the commencement of the winding up, the company was insolvent in that it was unable to pay its debts within the meaning of s. 570 of the Companies Act 2014.

6. On the 6th February 2015, the applicant submitted a report to the Director of Corporate Enforcement who received it on the 9th February. On the 11th May, the Office of the Director wrote to inform the applicant that he was not relieved of his obligation under s. 56(2) of the Company Law Enforcement Act 2001 ('the 2001 Act') to apply to this court for a declaration of restriction in respect of each of the respondent directors under s. 150 of the 1990 Act (now s. 819 of the 2014 Act).

7. The present application is brought by motion issued on the 21st July, originally made returnable for the 12th October. The application was heard on the 30th November last and judgment was reserved.

The legal issue

8. The respondents do not dispute that the company was unable to pay its debts at the commencement of its winding up. Nor does either respondent deny that he was a director of the company at the material time, or that the Director of Corporate Enforcement has not relieved the applicant of the obligation to bring the present application.

9. It follows that the Court is obliged to make a declaration of restriction under s. 819 of the 2014 Act in respect of each of the respondents, unless satisfied that the conduct of either or both comes within the circumstances set out in sub-s. (2) of that section.

10. The specific issue that arises under s. 819(2) of the 2014 Act is whether each of the respondents acted honestly and, more particularly, responsibly in relation to the conduct of the company's affairs.

The evidence

11. The company commenced trading on the 15th June 2011 and ceased trading in or about July 2013, a period of just over two years.

12. A separate company named Fáilte Couriers Limited ('Couriers') had gone into liquidation on the 13th July 2011, having traded in the same business sector since 1991, for a period of approximately 20 years. At the commencement of its winding up, Couriers owed a substantial debt to the Revenue Commissioners. The business of Couriers was operated by the respondents' father, and each of the respondents was a director of that company at the commencement of its winding up.

13. When the company commenced trading in June 2011, each of the respondents was employed by it. Staff members from Couriers were taken on by it. It sought to acquire or take over Couriers' customer base.

14. Each of the respondents became a director of the company in November 2012, replacing the company's previous directors. During the less than eighteen-month period of trading up to that point, the company has incurred a total liability to the Revenue Commissioners of €340,000, of which €182,000 had been discharged, leaving an outstanding liability to the Revenue Commissioners at that time of €158,000.

15. During the approximately eight-month phase of trading that followed, until the company ceased trading in July 2013, a further liability to the Revenue Commissioners of €187,000 was incurred, while payments to the Revenue Commissioners totalling some €190,000 were made.

16. The applicant avers that, from the information available to him, the company incurred a loss after tax of €271,409 for the year ending on the 30th June 2012 and a further such loss of €95,983 for the six-month period ending on the 31st December 2012.

17. At the commencement of its winding up, the company had a debt to the Revenue Commissioners of €171,735 for outstanding VAT and PAYE/PRSI payments. The Company had net realisable assets of just €250 against debts owed to preferential creditors of €288,198 and to non-preferential creditors of €235,019, giving rise to an estimated total deficiency of €533,067 before the costs of the liquidation are taken into account.

18. The applicant avers to his belief that the fundamental cause of the company's failure was that it did not have the capital resources to absorb its consistent trading losses. The applicant identifies the precipitating cause of that failure as the loss of key customers and, ultimately, the withdrawal of the company's invoice discounting facility during the second phase of trading already described.

19. The applicant acknowledges that the company did comply with its obligation to file annual returns in the Companies Registration Office with the exception of its returns for the year 2014 (incorporating its accounts for the year ending on the 31st December 2013).

20. The applicant further acknowledges that each of the respondents has co-operated with him throughout the liquidation.

21. However, the applicant avers to his belief that the facts disclosed demonstrate an instance of the 'phoenix syndrome', whereby a company which is wound up is reincarnated by virtue of the involvement in a later company of persons who were directors of the first company.

22. As indirect support for that proposition, the applicant avers that the respondents each became director of a company named Greenogue Warehousing Limited ('Greenogue') on the 3rd March 2011 and that Greenogue carries on a similar business to that of both Couriers and the company. In response, in an affidavit that he swore on the 23rd November 2015, the second named respondent avers that the respondents were not directors of Greenogue as of that date, before going on to accept that the respondents' respective spouses were then its directors and that it was then operating a small business through which the respondents were trading with two vehicles and no employees. It is perhaps fortunate for the respondents that, for the purposes of the present application, the Court is not required to consider the extent to which they may each be a shadow director or *de facto* director of Greenogue.

23. In a supplemental affidavit sworn on the 20th November 2015, the applicant avers that he has attempted to establish the extent to which the company's estimated deficiency of €533,067 was contributed to in the phase of trading after the respondents became directors in November 2012. The applicant has compared the profit and loss position of the company for the period from the 1st July 2012 until the company ceased trading in July 2013 with the last set of management accounts approved by the respondents for the six-month period up to the 31st December 2012. That analysis indicates that the company incurred a loss of some €620,015 during the period from the 1st January 2013 until it ceased trading in July of that year, although the applicant accepts that the sum in question may be an overstatement as the figure for sales recorded in the company's books and records for the period concerned seems disproportionately low. Nonetheless, the applicant is clear that, on any view, the company incurred significant additional losses through the respondent's decision to continue to trade after November 2012.

The factual issue

24. The specific factual issue raised by the applicant is whether either of the respondents can satisfy the Court that he acted honestly and responsibly in accepting appointment as a director of the company in November 2012 without taking any, or any sufficient, steps to satisfy himself:

(a) that the company was solvent; and

(b) concerning the nature and extent of the company's liabilities to the Revenue Commissioners, at that time.

The respondents' position

25. Michael O'Keefe, the second named respondent, swore an affidavit on the 23rd November 2015 in opposition to the present application on behalf of both respondents.

26. In that affidavit, he avers that, after Couriers went into liquidation, the respondents were approached to work for the company by the operators of a company that had been competing with Couriers who saw an opportunity to acquire some of Couriers' customer base. No explanation is provided concerning why the operators of that competitor company decided to incorporate a separate company with a similar name to Couriers for that purpose, instead of approaching those customers on their own company's behalf, nor is any explanation forthcoming of how they came to incorporate the company in May 2011, more than one month prior to the commencement of the winding up of Couriers.

27. The second named respondent goes on to aver that the investor behind the original directors of the company became unhappy with their stewardship of it in or around September 2012 and invited the respondents to replace them and to assume the role of joint managing directors of the company in exchange for the receipt by each of a 10% shareholding in it. The second named respondent acknowledges that, before accepting that offer, the respondents were made aware that the company had a revenue debt, but avers that they were told that an instalment repayment agreement was in place with the Revenue Commissioners and that the company was then meeting its repayment obligation of €4,000 per month.

28. The second named respondent avers to the respondents' belief that, despite its continuing losses, the company could trade out of insolvency but that their personal involvement in its management was essential to its survival. The second named respondent further avers to the initiation of a plan whereby: one member of staff would be let go; the hours of two other staff members would be reduced by half; an average staff wage cut of 10% would be implemented; fuel would be purchased in bulk to secure a discount; and an invoice discounting arrangement would be entered into with a particular company that the respondents appear to have believed would not withdraw from that arrangement in any circumstances by reference to an assurance to that effect that they had received from the main investor behind the company.

29. None of the foregoing averments is corroborated in any way.

30. The second named respondent acknowledges on behalf of the respondents that Couriers went into liquidation owing a substantial debt to the Revenue but avers that the respondents are making repayments by instalment in accordance with their means towards a limited portion of that debt (€35,000), representing monies owed by Couriers in respect of PRSI and PAYE.

31. The respondents seek to rely upon the applicant's acknowledgment that, during the phase of the company's trading when the respondents were directors, payments totalling €190,000 were made to the Revenue Commissioners, although a further Revenue liability of €187,000 was incurred. However, this suggests no more than that the continued repayment of the company's historical Revenue liabilities was effected through the diversion of the funds necessary to discharge its continuing Revenue liabilities while the company continued to trade; in other words, that this was simply a process of robbing Peter to pay Paul.

32. No detail is provided in support of the respondents' professed belief (or optimistic hope) that the implementation of their plan would permit the company to trade out of insolvency.

The law

33. In *La Moselle Clothing Ltd and Rosegem Ltd v Soualhi* [1998] 2 ILRM 345 at 352, Shanley J. identified a number of overlapping criteria that should be considered to determine whether a director has acted 'responsibly.' Those criteria were subsequently endorsed by the Supreme Court in *Re Squash (Ireland) Ltd* [2001] 3 IR 35, although, as Fennelly J. made clear in *Re Mitek Ltd; Grace v Kachkar* [2010] IESC 31, they should not be considered exhaustive or to substitute standardised judicial criteria for the general words of the statute. Of those criteria, the most relevant for the purpose of the present application are the following:

> (i) The extent to which the director's conduct could be regarded as so incompetent as to amount to irresponsibility.
>
> (ii) The extent of the director's responsibility for the insolvency of the company or the net deficiency in the assets of the company disclosed at the date of the winding up or thereafter.
>
> (iii) The extent to which the director, in his conduct of the affairs of the company, has displayed a lack of commercial probity or want of proper standards.

34. In *Re Swanpool Ltd; McLaughlin v Lannen & Anor*. [2006] 2 ILRM 217 at 223, Clarke J. noted that the approach of the Court in any restriction application will necessarily differ depending on the type of acts or omissions which are under scrutiny. Clarke J. went on to identify the three broad issues that normally arise in such applications, the second of which is 'the commercial management of the company most particularly at the period when the company was insolvent or heading in that direction.'

35. What Browne-Wilkinson V.C. described (in *In re Lo-Line Motors Ltd* [1988] Ch. 477 at 485) as 'ordinary commercial misjudgment' is plainly not sufficient to establish irresponsible conduct on the part of a director. As Murphy J. pointed out in *Business Communications v Baxter and Parsons* (High Court, 21 July 1995, unreported), one must be careful not to be wise after the event and to refrain from engaging in a 'witch hunt' simply because a business failed as businesses will.

36. Nonetheless, in considering whether the conduct of a director has been so incompetent as to amount to irresponsibility, it is appropriate to have regard to whether that director took legal or professional advice and, if so, whether the director followed it. In this case, when they agreed to become directors – indeed, joint managing directors – of a company with a consistent history of trading losses and a significant historical Revenue debt, there is no suggestion that either of the respondents directly sought or obtained professional advice of any kind in reaching the decision that the company could trade out of insolvency or in formulating their unsuccessful plan to that end.

37. Furthermore, the respondents in this case do not have the benefit of being able to point to a lengthy tenure as directors of the company prior to the period in the run up to its liquidation. Indeed, I do not believe it is unreasonable to observe that the tenure as directors of the respondents in this case largely, if not entirely, coincides with the period of the run up to the company's liquidation.

38. As regards responsibility for the company's insolvency or the deficiency in its assets, in *Re Verit Hotel and Leisure (Ireland) Ltd; Duignan v Carway et al* (High Court, 23 January 2002, unreported), McCracken J held that the use as working capital of monies deducted from employees' wages as their PAYE and PRSI contributions can, in itself, amount to irresponsible conduct on the part of a company's directors. Without ignoring the essential gravity of either form of conduct, it seems to me that the non-payment of fiduciary taxes – that is to say, taxes that have been deducted from employees' wages- is more reprehensible (hence, more irresponsible) than the non-payment of taxes directly owed by the company.

39. While it is important to acknowledge, as Finlay Geoghegan J. did in *Re Digital Channel Partners Ltd* [2004] 2 ILRM 35 at 40, that the mere fact that a company has failed to make its tax returns or tax payments for a relatively limited period prior to the commencement of its winding up does not of itself indicate dishonest or irresponsible conduct, it is important to have regard to the precise scope and circumstances of the company's delinquency in each case.

40. As Finlay Geoghegan J. observed in *Re James Murphy & Sons Sales (Dundalk) Ltd; Stafford v Murphy and Murphy* [2010] IEHC 115, a failure to recognise that a company is hopelessly insolvent and unlikely to be able to trade out of its difficulties can show a lack of commercial probity.

41. In opposition to the present application, Counsel for the respondents sought to rely on a single decision; that of Barrett J. in *Tadhg O'Conaill Heating & Plumbing Ltd; Fitzpatrick v O'Conaill* [2015] IEHC 4. In essence, the Court was urged to conclude that the respondents' decision to continue trading in November 2012, despite their own previous track record as directors; the company's established pattern of consistent trading losses; and its historical Revenue debt, should be seen as what Clarke J. characterised in *Re Swanpool Ltd* as 'a single (though perhaps significant) commercial misjudgement', insufficient, of itself, to amount to irresponsible conduct.

42. By reference to the clear analogy that Barrett J. found to exist between a company's failure to remit pension scheme deductions made from its employees' wages and a failure to remit PAYE and PRSI deductions, the respondents invite the Court to conclude that their decision to continue trading in November 2012 was a singular, if egregious, occurrence that does not amount to irresponsible conduct such as to exclude them from the scope of the s. 819(2) defence.

43. I cannot accept that submission. It requires the Court to focus on a single point of comparison between the relevant facts in each of the two cases concerned, to the exclusion of a number of significant points of difference between them. That, in turn, is redolent of an invitation to substitute standardised judicial criteria for the general words of the statute or, in the words of Barrett J., to wrongly adopt a 'formulaic, standardised "tick the box" approach' to determining restriction applications. The case must be considered through the prism of its overall context, and that entails a consideration of all of the relevant facts.

44. In *O'Conaill*, the company concerned traded successfully for many years under the stewardship of the respondent director prior to the economic crash or downturn in 2008. In this case, the company was never profitable; the respondents commenced employment

with it shortly after a company of which they were directors with a similar name in the same business went into liquidation owing a significant debt to the Revenue Commissioners; the respondents later took control of the company at a time when it was already in default of its Revenue obligations; and there is scant evidence of any, or any sufficient, attempt by the respondents to properly apprise themselves of the extent of the company's continuing trading and revenue difficulties at that time, or to take professional advice in that regard, before they made the decision that is should continue to trade.

45. In making the foregoing observations, I am not for one moment to be taken as suggesting that to attempt to trade out of difficulty is irresponsible per se. However, I do share the view expressed by Peart J. in *Re USIT World plc* [2015] IEHC 285 that directors in that situation must be careful only to take effective and realistic steps with proper advice and planning towards an achievable end, rather than embarking on a careless or reckless gamble.

46. As MacMenamin J. stated in *Re MDN Rochford Construction Limited; Fennell v Rochford & Anor* [2009] IEHC 397 (at para. 50):

> "While each case must be judged on its facts, there comes a point where optimism becomes hubris, and where belief that a company can trade out of its difficulties is simply wilful self-delusion. Commercial acumen is necessary. Hope must be matched by verification and objectivity. The absence of all of these necessary characteristics constitutes irresponsibility.'

47. Applying the foregoing principles to the evidence presented, I conclude that the respondents have failed to satisfy me that either of them acted responsibly as a director in the conduct of the company's affairs.

Conclusion

48. For the reasons I have given, in circumstances where each of the respondents has failed to establish a defence under s. 819(2) of the 2014 Act and where the necessary proofs are otherwise in order, the Court is obliged to make the appropriate declaration of restriction under s. 819(1) of that Act concerning each of the respondents, and I will do so.