The High Court

2003 No 459 COS

IN THE MATTER OF DOHERTY ADVERTISING LIMITED (IN OFFICIAL LIQUIDATION)

AND IN THE MATTER OF SECTION 150 OF THE COMPANIES ACT 1990 AND

SECTION 56 OF THE COMPANIES LAW ENFORCEMENT ACT 2001

BETWEEN

JAMES STAFFORD

Applicant

and

MARK BEGGS, ANTONY MARTIN, PASCAL TAGGaRT, SHAY MORAN, LIAM GASKIN

Respondents

Judgment of Mr. Justice Sean O'Leary delivered on the 13th day of March 2006

1. This is an application under s. 150 of the Companies Act, 1990 brought by the applicant who is the official liquidator of Doherty Advertising Limited ("the Company") having been so appointed by order of the High Court on 24th Sept. 2003.

2. A receiver had previously been appointed and in separate proceedings had sought and was granted an order that the first and second named respondents herein had been guilty of reckless trading to the extent that judgment in the sum of €2,200,00 or thereabouts was entered against these two executive directors of the Company. Kelly J. further made orders under s. 150 in respect of the first two respondents herein rendering these present proceedings against the first two respondents moot. The judgment therefore relates exclusively to the other respondents. These are the third, fourth and fifth named respondents who were non-executive directors of the company.

3. The liquidator had made his report to the Director of Corporate Enforcement and has not been relieved of this obligation to bring this application.

Company Background

4. The Company is a limited liability company now in liquidation. Prior to a management buy out (MBO) on 14th March 2001 it was a leading and prosperous advertising company. After the completion of the MBO it was an over-borrowed, under pressure, company living on borrowed time. Its only prospect of success after the MBO was further expansion of both the Irish economy and of the company's customer base. As restructured the company had no capacity to withstand even a temporary setback in either the economic progress of the country or in its customer base.

5. The MBO was largely financed by the lending by the company of €3.5 million (later rising to €4.6 million) to a company called Craigbury to pay the former owners for the sale by them of their shareholding in the company. Craigbury was then listed as a debtor under the current assets in the balance sheet of the company. This gave a distorted view of the liquidity if the company to those who accessed the Management Accounts Balance Sheet. The draft financial statement produced for the intervening year end also includes this sum as a current asset. As the Craigbury had no other asset or no method of repaying its debt sum due (theoretically on demand) was of no practical day-today use to the company.

6. The use of a company's funds in this way was not permitted until the 1980's when s. 60 Companies Act 1963 was amended to allow for assistance to be given in certain procedures were adopted. The court has no reason to believe that the proper resolutions were not passed and the legal niceties followed. Nevertheless the court places on record that the scale of the assistance rendered and the financial position of the Company after the MBO was unwise amounting almost to recklessness. Those who were directors at the time and any person who advised positively on the financial viability of the scheme bear a heavy responsibility for the demise of a viable business. The court, of course, has no information as to who may or may not have advised on the viability of the scheme and the identification of these persons (if any) is outside its remit.

7. The inevitable happened and advertising business in general temporarily reduced in volume. As a result the Company failed to maintain its anticipated turnover with disastrous consequences. As the cash has been raised by the factoring of debtors reduced turnover quickly translated into cash flow difficulties. The problem was masked from the non-executive directors to some extent by the creation of artificial sales figures based on advance billing of invoices. Whatever the ethical basis of the raising of invoices for future work of course the factoring of these debts was improper. The Court is satisfied that this impropriety cannot be visited on the third, and/or fifth named respondents

8. Sales target were not achieved leading to inevitable cash shortages.

Conclusion on reason for liquidation

9. The single biggest factor in the demise of the Company was the unwise financing of the MBO.

10. The applicant seems to agree with that analysis but does not limit his complaint on the actions of the directors to this matter.

Complaints of applicant

11. As already set out the applicant makes a valid complaint in relation to the method of financing the MBO. Against who is the MBO based complaint valid?

12. None of the three persons (i.e. the third, fourth or fifth named respondents) were directors of the company at the time of the MBO. At that time none of them (not even Mr. Gaskin who was involved through Watermarque in the arranging of the finance for the deal) owed any duty to the company. Those on the board in March 2001 apparently had been advised that the MBO was lawful. The newly appointed directors (20th September 2001, 3rd December 2001 and 20th September 2001 respectively) could not be expected to revisit the March 2001 deal. The general complaint under this heading fails against all three.

13. The complaints of the applicant relating to the MBO extend to a further transaction where money was lent to Craigbury in the sum

of €0.5 million approx in October 2001 for the purchase of 20% of the shares in Watermarque. This represented the reversing of assistance given in the original MBO. The applicant submits that this was connected with the original deal and constituted assistance by the Company in the purchase of its own shares. As such it should have been included in the original company resolution authorising the assistance. If it was assistance connected with the MBO then the later arrivals (the third, fourth and fifth named respondents) were surely entitled to presume that the necessary paperwork had been done prior to their arrival. If on the other hand it was a later agreement separate from the original MBO then it was not illegal (though maybe unwise.

14. Improper payments totalling €253,000 were apparently made in the repayment of a loan raised by the first named respondent Mr. Beggs. This was executed by advancing €258,121 to Craigbury in nine payments from 9th April 2001 to 16th October 2001. As the third and fifth named respondents were not appointed directors until 20th September 2001 the final payment alone made after their appointment would hardly have raised a reasonable suspicion in the mind of a prudent director in a company with a turnover of €17 million. The fourth named respondent could not have been involved as he was not appointed a director until December 2001.

15. The company made what the applicant calls improper payments to a Mr. Brian Donohue in settlement of a claim arising from his employment with the company. These payments were made on foot of an agreement of July 2001 and the third, fourth and fifth named respondents had no involvement in its negotiation. The payments, though made later, arose on foot the previously concluded agreement. The revisiting of the legal basis of a previously negotiated agreement by the incoming directors should not be necessary.

16. The applicant's suggestion that the bad debt from the Dublin Daily was evidence of improper conduct on the part of the third named respondent is unsupported by any evidence.

17. The applicant lays considerable emphasis on the absence of reliable management information in particular after November 2002. Up to that date the company was apparently breaking even but under pressure because of a fall off in turnover. In fact the real state may have been hidden by the advance invoice procedure but if so this group of respondents were unaware of this complication. Up to the 31st December 2002 the Company was in a marginal profit situation (on paper at least) as far as these respondents were concerned. The board meeting held on 14th January 2003 seems to have confirmed a trend of reducing turnover and heralded a difficult time for the Company. A cost reduction plan was put in place and this was monitored at informal meetings of board members. The absence of more formal board meeting is in the view of the court of little significance in the overall scheme of things. The failure of the non-executive directors to insist on cash flow projections from November 2002 to the middle of 2003 represents a failure of which the directors should not be proud. The court considers later herein whether this failure is of such significance as to make s. 150 orders appropriate

18. The improper opening and use of a bank account at AIB and the defective invoicing procedures complained of are not, in the view of this court, the responsibility of the non-executive directors.

19. The Board of directors did not function in a structured way. There was a degree of informality in this operation which could be criticised. This matter is also further considered.

20. The court rejects as unfounded any suggestion that Mr. Taggart's connection with the Dublin Daily was in the context of this application improper. Indeed the suggestion is so farfetched as to call into question whether this application is being supported by a trawl through all possible issues rather than an objective focusing on the real net issues. The difficulty reported by the respondents in extracting precise complaints in respect of each director is shared by the court.

21. The criticism of Mr. Gaskin's dual role as director of Watermarque and the Company is similarly rejected.

Conclusion on factual matters

22. There is no evidence of any dishonesty in respect of any one of these non- executive directors.

23. Two matters only are assessed as reflecting on the efficiency of the relevant non-executive directors

> 1. The absence of formal Board Meetings which made the evasion of the executive directors easier to sustain
>
> 2. The lack of cash of flows particularly from October/November 2002 to August 2003 when the receiver was appointed.

24. Neither of these matters is relevant to the fifth named respondent (as he resigned in November 2002). He is entitled to succeed.

25. While both of the remaining non-executive directors bear some responsibility the third named respondent is more responsible for the absence of board meetings as he was chairman of the Company

Law

26. The Law in this matter is not complicated, restriction is automatic unless at least one of the matters set out in s. 150 (2)(a), (b) or (c) applies. Only s. 150 2(a) is relevant herein. It provides

> (a) That the person concerned has acted honestly and responsibly in relation to the conduct of the affairs of the company and that there is no other reason why it should be just and equitable that he should be subject to the restrictions imposed by this section,

27. No lack of honesty has been found so the only issue is what does responsible action mean?

28. In *Re Squash (Ireland) Ltd* McGuinness J set out the following as matters to which the court should have regard;

> (a) The extent to which the director has or has not complied with any obligation imposed on him by the Companies acts 1963 – 1990.
>
> (b) The extent to which his conduct could be regarded as incompetent as to amount to irresponsibly
>
> (c) The extent of the directors responsibility for the insolvency of the company
>
> (d) The extent of the directors responsibility for the net deficiency in the assets of the company disclosed at the date of the winding up or thereafter

(e) 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.

29. The court is satisfied that paragraph (a) has no application to this case. Similarly there is no evidence that either of these two reaming directors contributed to the insolvency of the company or the net deficiency of the company as envisaged in paragraphs (c) or (d) above.

30. The court is further satisfied that while criticism could be made of certain aspects of the non-executive director's stewardship to include that they amounted to incompetence would be applying a very high standard. Further, even if one were to regard their actions as incompetent the assessment of their actions would not reach the higher standard of irresponsibility. Therefore the matters set out in paragraph (b) above are not present. Finally the most important test of all is that set out in paragraph (e) above i.e. lack of commercial probity or want of proper standards. It would be a harsh judgment to characterise that faults found in these ways.

31. Finally conscious that the purpose of restrictions under s. 150 is to protect the public from unsuitable directors rather than to punish the director the court considered in general terms whether the public are in need of protection from either of the third or fourth named respondent. Taking into account all the evidence the court has no hesitation in concluding that on this basis the making of the order requested is unnecessary.

32. The application in respect of the third to fifth named respondents is therefore refused. No order is made in respect of the first or second named respondents.

33. If the parties require an order on costs, that aspect of the case can be re-listed.