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THE HIGH COURT

2010 2 COS

IN THE MATTER OF MISSFORD LIMITED TRADING AS RESIDENCE MEMBERS CLUB AND

IN THE MATTER OF THE COMPANIES (AMENDMENT) ACT 1990, AS AMENDED

JUDGMENT of Mr. Justice Kelly delivered on the 20th day of January, 2010

Introduction
Missford Limited (the Company) petitions to have an examiner appointed to it pursuant to the provisions of s. 2 of the Companies (Amendment) Act 1990, as amended. If an examiner is appointed it hopes to have a scheme of arrangement approved by the court so that it *"can continue to trade profitably"*. (Vide p. 26 of the Petition)

In fact the Company has never traded profitably and such trading as it has done has been with the benefit of funds due to the Revenue Commissioners.

Background
The company was incorporated on 29th November, 2006, but commenced trading as recently as May 2008. It has a nominal capital of €1m of which only €100 is paid up. The principal shareholders are Simon, Christian and Geoffrey Stokes, each of whom holds 33 shares and David McDonnell who holds a single share. There are two directors of the company namely Simon and Christian Stokes.

It is a remarkable feature of the company that it has never made a net profit since it commenced trading. During that period it made incorrect returns to the Revenue Commissioners in respect of both Value Added Tax, PAYE tax and PRSI contributions. This has given rise to a debt in favour of the Revenue Commissioners in the sum of €1.2m. The Company is insolvent and it appears to me has been so for a considerable period of time.

The Company has a leasehold interest in premises at 41 St. Stephen's Green where it operates what is called a private member's club. The club is called *"The Residence"*. It is not typical of the normal private member's club in that its facilities at St. Stephen's Green include a bar and nightclub which are open to members of the public.

The Company's sources of income are membership subscriptions and food and beverage sales. It has 1,450 members each of whom pays an annual subscription.

Despite substantial increases in the amounts realised by way of membership subscriptions and the proceeds of food and beverage sales between 2008 and 2009, the losses sustained by the Company increased from €674,957 in 2008 to €678,342 up to the end of November 2009.

The petition attributes these losses as being *"primarily due to administrative expenses, depreciation, interest payable and VAT, PAYE/PRSI under returned"*. I will have more to say about this later in this judgment.

The reasons for the company's difficulties

Paragraphs 13 and 14 of the petition purport to deal with this topic. Three reasons are identified.

> **(1)** The first involves a loan of €616,709 which the Company made to related companies called Mayfair Properties Limited trading as Bang Café and Auldcarn Limited.
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> With little regard for the obligations of company law, the Company did not operate a bank account from its incorporation until February 2008 which was some six months after it commenced its renovation works on the property.
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> The bank account of Mayfair Properties trading as Bang Café was used as the Company's bank account. Membership subscriptions and bank finance were lodged into that account. The Company's monies in Mayfair's account were then used to discharge liabilities of the Company. The independent accountant in a supplemental affidavit sworn by him on 12th January, 2010, expressed concern at the accuracy of the recording of inter-company transactions because there were significant differences and potential errors in the inter-company balances of each company. He attempted a reconciliation and was partially successful in so doing. He concluded that whilst there was undoubtedly an inter-company balance owing to the Company by Mayfair, he was unable to quantify it. He also established that there was an inter-company balance with Auldcarn Limited in the sum of €113,105.
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> In oral testimony he expressed the view that these matters require further investigation and inquiry by an examiner if appointed. In the course of his evidence he qualified the expression of opinion contained in his independent accountant's report at Section 10. In that section, he indicated that he had not identified any matters which would warrant further inquiries with a view to proceedings under s. 297 or 297A of the Companies Act.
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> **(2)** The second reason which is given for the Company's difficulties is described as follows:-
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> > "The Company under declared VAT of approximately €207,118 and PAYE/PRSI of approximately €173,770 for the period January to June 2009. This was only identified in July 2009 after the Company hired a new financial controller. This additional liability, coupled with the Revenue Commissioners issuing an attachment order on the Company's bank account in or around 17th December, 2009, has put a further strain on the Company's finances. The Company's liability to the Revenue Commissioners is approximately €1.2m, €956,092 of which would rank as a preferential claim in a liquidation of the Company."
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> The attachment issued by the Revenue Commissioners arose after they had prudently decided to conduct an audit of the Company's affairs in September 2009. That audit arose because of a claim for a VAT refund made on behalf of the

Company. Supporting documentation was not furnished when the claim was made. The Revenue Commissioners requested such documents and the Company's new financial controller identified that the Company was not in a VAT refund position at all but was in fact indebted to the Revenue Commissioners. The audit was carried out resulting in an assessment of €472,000 plus penalties being raised. That liability was not discharged and so the Company's bank account was attached on 17th December, 2009. The account was in credit for €87,000.

It is clear from the evidence given to me *viva voce* by the independent accountant that it was the attachment issued by the Revenue Commissioners which triggered the decision to apply to this Court for protection under the examinership legislation.

Blame is attached to the former financial controller of the Company in respect of this state of affairs. In fairness, the directors, through counsel, accept that they carry responsibility for this matter. That said, it is difficult to understand, given the size and the single site location of the Company's business, that they could have been totally unaware of miscreancy of this order.

(3) The third reason given for the Company's difficulties is the incurring of capital expenditure on the premises prior to the commencement of trade. That was funded by borrowings of approximately €2.3m and lease finance of approximately €300,000. A further €800,000 was expended and funded out of what is described as *"working capital"*. I will return to that description later in this ruling.

Creditors
The single biggest creditor is Zurich Bank. It supports the Company's application. It is owed €2.3m but is well secured in that regard. It holds a first legal charge over the leasehold interest in the premises, 41 St. Stephen's Green, Dublin 2. In addition, it has a floating charge over all of the assets of the Company. It also holds an assignment over the licence attaching to the bar/club. It has obtained personal guarantees from each of the directors together with charges over life assurance policies in the names of Christian Stokes and Simon Stokes.

Given the level of security that it holds, it is not surprising that the bank supports the Company in this application. It continues to do so in circumstances where the interim examiner has reported to the court that the bank was disappointed to hear about the Company's cash flow difficulties because it had received no prior warning of such difficulties. It was also unhappy with the payments made by the Company to Mayfair and Auldcarn particularly since those payments appear to be prohibited under the terms of the bank's lending to the Company.

The Revenue Commissioners are owed €1.2m. They, through their counsel, described their position on the hearing of the application as one of *"very guarded neutrality"*. Counsel expressed concern that they did not wish to jeopardise the jobs of the employees but also indicated considerable dissatisfaction with the way the Company had behaved itself to date. The Revenue Commissioners are not convinced that the Company will have the ability to pay its taxes as they fall due in the future, never having done so in the past. At the conclusion of the hearing on Wednesday last, their counsel expressed the view that the Revenue Commissioners were no less sceptical in this regard than they were at its outset. They were also unhappy that the present management should remain in charge.

A number of other creditors were given specific notice of the hearing of the petition but did not appear. Trade creditors are owed €743,553. Lease financing outstanding is €205,174.

Employees
The independent accountant's report indicates that as of 30th November, 2009, the Company employed 61 people including its directors. By the end of December 2009 that had been reduced to 52 employees. Since the Company obtained the protection of the court, 11 employees have been made redundant. Further redundancies appear likely if an examiner is appointed to the Company.

The independent accountant's report
The independent accountant chosen by the Company to prepare the statutory report was Mr. Paul Wyse of Smith and Williamson Freaney, Dublin.

As there were a number of aspects of that report which caused me concern, I also heard oral evidence from Mr. Wyse.

The first matter that caused me concern was the independent accountant's statement that *"the Company has enjoyed great success as a venue and has secured 1,450 memberships to date"*. I found it difficult to understand the notion of the Company enjoying great success in the circumstances which I have already outlined. However, in his oral testimony, he indicated to me that that was really a reference to the location of the venue at which the Company conducts its business.

Of even greater concern to me was the following statement in the report:-

> *"The Company has incurred significant capital expenditure on its leasehold interest which has in the main been funded by bank borrowings of €2.3m from Bank of Zurich and by lease finance of circa €300,000. The Company has incurred approximately €800,000 in excess of these amounts which has been funded out of working capital. In addition the Company has lent funds of €616,709 to entities associated with the directors. These entities are not currently in a position to repay these monies borrowed. This has caused severe liquidity problems and the Company now owes circa €1.2m to the Revenue Commissioners and €743,533 to its trade creditors." (My emphasis)*

I was concerned that monies wrongfully retained by the Company after it had deducted them from employees' wages for PAYE/PRSI together with VAT payments made to it for onward transmission to the Revenue Commissioners were treated as working capital of the Company. The independent accountant confirmed to me that that indeed was so. Furthermore he told me that in so treating those monies he was acting in accordance with normal accountancy conventions. He agreed with me that that was an extraordinary state of affairs and that it in effect gave a respectability to the misuse of Revenue Commissioner's monies by regarding them as working capital of the Company. If the accountancy convention is as is he states it to be, then it is high time that it was changed so as to ensure that misuse of other peoples' monies by a company is not regarded by accountants as part of its working capital.

The independent accountant expressed the view that the Company has a reasonable prospect of survival and that the appointment of an examiner to produce a scheme of arrangement would give a more advantageous result to the Company's creditors than would a liquidation.

In forming this view, the independent accountant assessed the Company's prospects of survival as a going concern having regard

to:-

(a) The historical trading performance;

(b) Proposed restructuring initiatives; and

(c) A business plan for the two years ending 31st December, 2011.

Insofar as this latter business plan is concerned, it is one which was prepared by the current management of the Company without any outside input save for whatever views were expressed by the independent accountant.

The business plan rather remarkably projects that the Company with actual losses of €678,342 for the first eleven months of 2009 will return a profit of €58,458 in 2010 and €359,547in 2011.

Projections for the two years ended 31st December, 2011 which the independent accountant tells me were prepared on a conservative basis seek to demonstrate that the Company with an actual income of €3,121,516 for the first eleven months of 2009 will show an increase in 2010 to €3,871,211 and a further increase in 2011 to €4,325,347. Membership revenue is expected to continue to rise during this time and to jump from an actual revenue of €726,275 for the first eleven months of 2009 to a sum of €991,736 in 2011.

Whilst it is true that no club members have resigned despite the examinership and that a few new ones have joined and that others have written letters of support, this projection does involve a very substantial increase in membership revenue over the period projected.

At a time of national recession of unprecedented dimensions, I find it extremely difficult to believe that this Company's fortunes are going to improve in the manner opined by the independent accountant.

The court is entitled to look critically at the independent accountant's opinion and analysis. It is the unfortunate experience of the court that in an ever increasing number of cases, optimistic expressions of opinion by independent accountants at this stage of an examinership are, about 60 – 70 days into such examinership, shown to have been far too optimistic and the examinership collapses.

In the present case, I am highly sceptical of this expression of opinion. It runs entirely counter to what is actually happening in the hospitality sector of the economy. As the judge in charge of the Commercial List, I deal on a daily basis with the results of the present economic depression. The three areas of the national economy (apart from banking) which most manifest themselves in that list as being under strain are the building trade, the motor trade and the hospitality business. The projections which are made in the instant case and which suggest that this Company which has never made a net profit will move into profitability in the course of the present year bear no resemblance to the trend in the hospitality sector.

The independent accountant says that survival as a going concern is subject to five conditions. They are:-

(a) The ability of directors to maintain efficiencies already implemented on an ongoing basis;

(b) An investor agreeing to invest in the Company;

(c) Membership subscriptions paid in advanced being recognised in full and not written down in order to preserve the Company's good will;

(d) The acceptance of an appropriate scheme of arrangement by the creditors; and

(e) The bank's ongoing support.

Crucial to any scheme therefore is the presence of an investor. In evidence before me, the independent accountant indicated that an investment of €1m would be required in order to produce an acceptable scheme of arrangement.

Four letters were given to the court on a confidential basis from prospective investors. All of them make it clear that their expressions of interest are subject to due diligence examinations of the Company's affairs. Two of them mention a figure which is nowhere near the €1m which is required. One of them does not mention any figure at all. The fourth does mention a figure of between €750,000 and €1m.

As a result of an advertisement placed by the interim examiner, I am told that five further expressions of interest were received by him. I have no knowledge as to their details.

The interim examiner who was appointed on 5th January, 2010, made a report dated 13th January, 2010 indicating that it was his view also that the Company has a reasonable prospect of survival as a going concern. He indicated that if appointed, the most pressing issues for him would be:-

(a) The ongoing monitoring of the Company's cash flows;

(b) The search for an investor;

(c) The rationalisation of the Company's business; and

(d) An investigation into the transactions associated with Mayfair Properties Limited and Auldcarn Limited.

Despite my scepticism concerning these expressions of opinion, I have little option but to accept them since there is no evidence to the contrary and no creditor has opposed the appointment of an examiner. That is not, however, the end of the matter.

The legal position

The court is precluded from making an order for the appointment of an examiner unless it is satisfied that there is a reasonable prospect of the survival of the Company and the whole or any part of its undertaking as a going concern. (See s. 2(2) of the Companies Amendment Act 1990, as amended.)

In the present case, I have with reluctance accepted the only evidence proffered to me and so this threshold of proof has been met by the Company.

As was made clear by Fennelly J. in *In Re Gallium Limited* [2009] IESC 8 at para. 46:-

> *"A petitioner does not, by getting over that threshold, acquire a right to have an order made. I still think it is fair to say that the section confers a 'wide discretion' on the court, or alternatively, that the court should take account of all the circumstances. The establishment of a reasonable prospect of the survival merely triggers the power, which remains discretionary."*

In exercising its discretion, the court is entitled to take all of the circumstances into account. In doing so, it should bear in mind the principal purpose of an examinership. That was expressed in the following terms by Fennelly J. in the *Gallium* case and by Clarke J. in *In Re Traffic Group Limited* [2008] 2 ILRM 1.

Fennelly J. said *"the entire purpose of examinership is to make it possible to rescue companies in difficulty."*

Clarke J. said:-

> *"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."*

I would add that neither is it the purpose of the legislation to provide directors with a ready form of absolution in respect of corporate wrongdoings.

Discretion
I have already recited in short form that the business of this Company from its inception has been carried on with scant regard for its obligations under company law, to the Revenue Commissioners or indeed to its employees who had taxes and PRSI deductions made from their wages but never forwarded to the relevant authorities.

At s. 10 of the independent accountant's report where he was asked to express his opinion as to whether the facts disclosed to him would warrant further inquiries with a view to proceedings under ss. 297 or 297A of the Principal Act, he said as follows:-

> *"Based on the work carried out in preparing this report I have not identified any matters which would warrant further inquiries with a view to proceeding under s. 297 or 297A of the Principal Act. I recognise, however, that this report has been prepared within a short timeframe and it may be that the examiner may become aware of other factors, which may require to be brought to the attention of the court."*

That statement in his report was heavily qualified by him in giving oral evidence to me. He accepted that it was not possible to stand over that statement until further examination takes place concerning the way in which this Company was run and in particular its dealings with the related companies Mayfair and Auldcarn. The interim examiner is of like view.

The conduct of an inquiry in respect of s. 297A is an additional burden which will have to be undertaken by an examiner if appointed. It will not be the only additional burden. From the submissions made in court it is likely that an examiner, if appointed, will have to make an application to the court under s. 9 of the Act seeking to have the functions and powers of the directors performable or exercisable only by him. Even if he did not make such an application, it was made clear through his counsel that he would not be prepared to sanction any further payments out of the Company save with his express authority and approval. Given the way in which the Company has been run this is reasonable but will give rise to additional duties over and above the norm.

But the real problem is that an investigation of matters dealt with under s. 297A of the Act and any proceedings which might ensue simply could not be completed during the short period of examinership. It is well recognised by anybody who is involved in the operation of this legislation that although s. 297A is applicable in the course of an examinership, it is simply impossible within the limited time that an examiner is given to conduct a full inquiry and if appropriate to bring such proceedings to fruition. Counsel for the Company, whilst accepting that to be so, suggested that the matter could be met by an appropriate provision in any scheme of arrangement which might be presented. I do not accept that that suggestion has any practicality about it.

The effect of all of this will be that if an examiner is appointed a proper investigation and the bringing of proceedings if required under s. 297A will not be possible. Instead, if a scheme of arrangement is approved by the court, the directors over which there is at least a question mark concerning the propriety of their behaviour will succeed in having the liabilities of the Company written down, the Company continuing to trade and they avoiding a proper or full investigation, still less any consequences should it demonstrate a basis for a liability under Section 297A. That is not the purpose or object of this legislation. This is a case which on the facts disclosed to me warrants a proper investigation of the directors' conduct. That is not possible in the context of an examinership.

A further factor which I bear in mind in exercising my discretion is that to grant the relief sought here would not be to allow the continuation of the Company to trade profitably as is stated at para. 26 of the petition. Rather it would be to allow the Company to commence trading profitably. During the course of the hearing, I expressed myself as being unaware of any case where an examiner had been appointed in such circumstances. Counsel referred anecdotally to a small number of cases involving start up companies which had not made a profit but where the protection of the court was nonetheless given. They are few and far between and very much the exception. But they were not, as far as I am aware, companies which although they had not returned a profit, were trading by treating other people's money as part of their working capital.

There must come a time when companies that have flouted the obligations of company law, revenue law, and their obligations to employees should not be allowed to call in aid the very legislation that they have ignored so as to save the enterprise. Still less should it be allowed when it has or is likely to have the beneficial effect for delinquent directors that I have referred to earlier in this part of the judgment. This is such a case.

I am, of course, extremely mindful of the position of the employees. From what I was told they are employed for the most part, if not entirely so, under contracts of employment that are terminable on a short period of notice. Nonetheless they do have jobs and I am

anxious to ensure, as far as I can, that they will not be jeopardised. I believe that my refusal to appoint an examiner will not in the circumstances give rise to any greater jeopardy to their jobs than would be the case if an examiner were to be appointed.

First, it is clear that even with an examiner in situ, it is likely that there will be a further reduction in the number of staff employed. Secondly, on refusing the appointment of an examiner either the bank will appoint a receiver or alternatively, the court will appoint a liquidator or perhaps both will take place. If the bank really believes that this enterprise can be saved then it will make perfect sense for it to appoint a receiver and allow him to run the business for a period of time so as to enable the various expressions of interest which have been made to crystallise. If a liquidator is appointed, it is my intention to enable the liquidator to continue to run the business for the benefit of the winding up so as to produce a like effect.

It is clear from the independent accountant's report that the real attraction of this business is its venue. That will continue to be the case with or without an examiner. The enterprise can continue in being for a short period of time just as well as heretofore under a receiver of liquidator. If the expressions of interest have any reality about them then a purchase from the liquidator or receiver can be effected.

The fact that the business, if sold in the course of a liquidation or receivership, would be devoid of the involvement of the current directors will matter little because it was accepted that even if an examiner were to be appointed, it was essential that the current management be replaced.

Finally, of course, there is the position of creditors. The secured creditors are well secured as I have already described. The unsecured creditors are unlikely to do much better if at all in the case of an examinership. The Revenue Commissioners have preferential entitlement for part of their debt but it is difficult to ascertain whether they will do worse in a winding up, particularly if an investigation under s. 297A leads to proceedings and ultimate success.

It is in these circumstances that in the exercise of my discretion I refuse to appoint an examiner.

Conclusion
The petition is dismissed. The protection of the court is withdrawn. I direct that a copy of this judgment and the relevant court papers be sent by the registrar to the Director of Corporate Enforcement for consideration by him.