Neutral Citation: [2014] IEHC 463

THE HIGH COURT

[2013 No. 556 COS]

IN THE MATTER OF T. O'REILLY (ELECTRICAL SUPPLIES) LIMITED (IN VOLUNTARY LIQUIDATION) AND IN THE MATTER OF SECTION 150 OF THE COMPANIES ACT 1990 AND SECTION 56 OF THE COMPANY LAW ENFORCEMENT ACT 2001

BETWEEN

TONY McBRIDE

APPLICANT

AND

DECLAN O'REILLY AND DAMIEN GORE AND TERENCE TIERNEY AND DAVID McCANN

RESPONDENTS

JUDGMENT of Ms. Justice Finlay Geoghegan delivered on the 17th day of October 2014

1. T. O'Reilly (Electrical Supplies) Ltd. ("the Company") was incorporated in 1968 and carried on business in the supply of electrical products in Ireland. The Company was set up by the father of the first named respondent, Declan O'Reilly ("Mr. O'Reilly"). Mr. O'Reilly became a director of the Company on the 21st November, 1975, and subsequently its managing director and was the principal shareholder.

2. On the 12th July, 2011, it was resolved pursuant to s. 251 of the Companies Act 1963, that the Company be wound up by reason of its liabilities, and the applicant, Mr. Tony McBride, was appointed liquidator ("the Liquidator").

3. The second, third and fourth named respondents, each of whom were long-standing employees of the Company, were appointed as directors on the 12th November, 2004, and resigned on the 22nd June, 2011. On the 13th January, 2014, the third and fourth named respondents appeared before the Court in answer to this application and indicated also that they represented the second named respondent on that occasion. They indicated that none proposed putting any evidence before the Court. On the facts set out in the grounding affidavit of the Liquidator, the Court could not be satisfied that each of the second, third and fourth named respondents had acted responsibly in relation to the conduct of the affairs of the Company, whilst directors, and declarations of restriction of each were made pursuant to s. 150 of the Companies Act 1990.

4. This judgment relates to the application pursuant to s. 150 of the Act of 1990 against Mr. O'Reilly alone. The Liquidator and Mr. O'Reilly have sworn two affidavits each. The Court has also had the benefit of oral submissions by counsel for each.

5. It is not in dispute that Mr. O'Reilly was a director within 12 months of the date of commencement of the winding up, and that the Company, at the date of its winding up, was unable to pay its debts as they fell due within the meaning of s. 214 of the Companies Act 1963. Accordingly, Mr. O'Reilly is a person to whom s. 150 of the Act of 1990 applies. That being so, the Court is bound to make the declaration of restriction unless Mr. O'Reilly satisfies the Court that he acted both honestly and responsibly in relation to the conduct of the affairs of the Company, and that there is no other reason why it would be just and equitable that he should be subject to a declaration of restriction. On the facts in the affidavits, no such other reason arises. The only issue is whether, on the facts set out in the affidavits, the Court can be satisfied that Mr. O'Reilly acted both honestly and responsibly in relation to the conduct of the affairs of the Company as a director thereof.

The Law

6. Counsel for Mr. O'Reilly referred me to the decision of the Supreme Court per McGuinness J. *In Re Squash Ireland Ltd.* [2001] 3 I.R. 35, in which she cited with approval the judgment of Shanley J. in *La Moselle Clothing Ltd. v. Soualhi* [1998] 2 I.L.R.M. 345, at p. 352, where he, in turn, referred to what had been said by Browne-Wilkinson V.C. *in Re Lo- Line Motors Ltd*. [1988] BCLC 698 at p. 703, and then said: "…a director broadly complying with his obligations under the provisions of the Companies Acts and acting with a degree of commercial probity during his tenure as a director of the company, will not be restricted on the grounds that he acted irresponsibly". Counsel also referred to the approach of McGuinness J. in the same judgment that "the court should look at the entire tenure of the director and not simply at the few months in the run up to the liquidation".

7. Since the judgment in *Squash Ireland*, the proper approach of the Court to determining whether a director acted responsibly in the conduct of the affairs of a company in an application pursuant to s. 150 of the Act of 1990, has been considered in some detail by the Supreme Court *per* Fennelly J. *In Re Mitek Holdings Ltd.; Grace v. Kachlar* [2010] IESC 31, [2010] 3 I.R. 374. That decision is binding on me, and in a judgment in the matter of *Derbar Developments Ltd. (In Liquidation)* [2012] IEHC 144, at paras. 13-15, and repeated in *Re Abington Garage Doors Ltd. (In Liquidation); Clancy v. O'Callaghan & Anor.* [2014] IEHC 227, I summarised the current law following *Mitek* in the following terms:

> "13. The caselaw relating to s. 150 was reviewed in some detail by Fennelly J. in delivering the judgment in *Mitek Holdings Ltd. and the Companies Act* [2010] IESC 31, with which Hardiman J. and Finnegan J. concurred. In doing so, he cites with approval passages from the well-known judgments of Murphy J., in the High Court in *Business Communications v. Baxter and Parsons* (Unreported, High Court, 21st July, 1995) and Shanley J. in *La Moselle Clothing Ltd. v. Soualhi* [1998] 2 ILRM, 345. In the latter, Shanley J. interpreted s. 150 in the following way:
>
> > 'Thus it seems to me that in determining the 'responsibility ' of a director for the purposes of s. 150 (2)(a) the court should have regard to:
> >
> > (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 so incompetent as to amount to irresponsibility.

(c) The extent of the director's responsibility for the insolvency of the company.

(d) The extent of the director's 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'.

Fennelly J., at para. 74, summarises the proper approach of the Court to an application under s. 150 in the following terms:

'It is always appropriate to keep in the forefront of one's mind the terms of the applicable statutory provision. The question to be considered, in a case such as the present, where no question of honesty arises, is whether the director against whom an application for a restriction order is made 'has acted responsibly in relation to the conduct of the affairs of the company'. The context is, of necessity, a company which is unable to pay its debts. The court should, in the words of Shanley J. [in *La Moselle*] 'look at the entire tenure of the director and not simply at the few months in the run up to the liquidation'.

14. The above conclusion must be considered in the context of two earlier passages cited by Fennelly J. with approval. The first is from the judgment of McGuinness in *Re Squash Ireland Ltd.* [2001] 3 I.R. 31 at p. 40, where she stated:

'The question before the court is whether they acted responsibly and this, as was correctly stated by counsel on behalf of the respondent must be judged by an objective standard. In the cases of all companies which have become insolvent it is likely that some criticisms of the directors may be made; but to categorise conduct as irresponsible I feel that one must go further'.

And, secondly, the caution expressed by Murphy J. in *Baxter* that:

'Of course, one must be careful not to be wise after the event. There must be no single 'witch hunt' because the business failed as businesses will'.

15. Fennelly J. also cited with approval from Clarke J. in the High Court in the matter of *Swanpool Ltd. McLaughlin v. Lannen* [2006] 2 ILRM 217, and in particular, his emphasis on the need for the Court, in each application under s. 150, to take account of the context in which the relevant acts or omissions of the directors need to be considered. In *Swanpool Ltd.*, at issue was a repayment of funds to BES Investors at a time when the directors knew the company was insolvent or facing insolvency. In that decision, Clarke J., at p. 8, having considered certain of the earlier decisions already referred to, stated:

'It does, however, seem to me that the differences in approach identified in those authorities are more apparent than real. The approach of the court in any case under s.150 will necessarily differ depending on the type of acts or omissions which are under scrutiny. In broad terms there would seem to me to be three types of situation which the court is typically required to consider in such applications. They are:

1. Issues involving compliance by the company with its formal obligations under the Companies Acts including keeping books and records, making returns, holding meetings and the like;

2. The commercial management of the company most particularly at the period when the company was insolvent or heading in that direction; and

3. Compliance by the directors with the obligations identified in Frederick Inns to ensure that once the company was facing insolvency its assets were dealt with in a manner designed to ensure the proper distribution of those assets in accordance with insolvency law'.

Fennelly J expressed the view that the above is 'a particularly useful classification of the principal settings for consideration of the responsibility of directors in a modern business'. I respectfully agree."

8. The above is the approach I propose taking to the facts of this application.

The Facts

9. The Company traded very successfully for a number of years and expanded. It operated from a significant number of retail outlets, several of which appear to have been owned by related entities (and one by Mr. O'Reilly) and for which the Company was paying rent.

10. The Liquidator, in his affidavit, is of the opinion that the failure of the Company was primarily due to the following factors:

(i) Substantial decrease of approximately 60% in turnover in the years 2008 to 2011, primarily due to the collapse of the construction industry and decreased demand for products sold by the Company.

(ii) The Company incurred bad debts amounting to approximately €400,000 in 2011. Mr. O'Reilly also referred to an additional €200,000 bad debt in that period.

(iii) In 2011, rental payments amounted to 8.5% of total turnover, which was not sustainable.

(iv) The Company made loans to related companies to a value of €947,272 and an investment in a related company of €257,938, which have effectively proven to be irrecoverable.

11. The first causes of the insolvency of the Company identified by the Liquidator were external to the management of the Company.

Mr. O'Reilly has averred as to certain cost reduction steps taken in the face of these reductions, and I accept, on his evidence, that strenuous efforts were made by him and his colleagues, both to reduce costs and to keep the Company as a going concern. The issue appears to be whether certain steps taken were responsible.

12. In relation to the first matter identified by Clarke J. in *Re SwanPool Ltd.* in the summary of the law above, namely, compliance by the Company with its formal obligations under the Companies Acts, including keeping books and records, making returns, holding meetings, *etc*., the Liquidator makes no general complaint. The Liquidator is clearly satisfied that the Company maintained proper books and records and made returns. He does criticise certain individual items included therein to which I refer below. There appears to be some dispute as to the extent to which the remaining directors were involved in important decisions concerning the Company, but overall, considering the question of the discharge by Mr. O'Reilly of the Company's obligations under the Companies Acts, I am satisfied that, other than in relation to the issue of the abridged financial statements, he appears to have ensured compliance with same.

13. The next issue identified by Clarke J. in *Re SwanPool Ltd*. is the commercial management of the Company, particularly when the Company was either insolvent or heading in that direction, and, in particular, the commercial probity of decisions taken by Mr. O'Reilly as a director at that time. The relevant period appears to be that commencing with the accounts for the year ending the 30th April, 2009.

14. The Liquidator summarised the matters about which he has concern and which he considered should be put before the Court for the purposes of determining whether Mr. O'Reilly acted both honestly and responsibly as a director, as follows:

> (a) Non-disclosure of significant related party transactions in the abridged financial accounts for the year ending the 30th April, 2010;
>
> (b) reclassification of a management charge in the audited financial accounts for the year ending the 30th April, 2009, as a loan to a related company;
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> (c) reversal of certain rental charges from related companies in the audited financial accounts for the year ending the 30th April, 2009;
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> (d) treatment in the audited financial accounts for the year ending the 30th April, 2009 of a loan due from Pebblelane Ltd., a related company;
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> (e) advance of loans to connected/related companies in apparent breach of s. 31 of the Companies Act 1990;
>
> (f) significant credit card expenditure of a personal nature listed as motor travel expenses in the financial accounts.

15. The Liquidator also, in his affidavit, raised the extent to which all respondents cooperated with the Liquidator in the course of the liquidation, but also expressed the view, at para. 29, that each respondent afforded him full cooperation and assistance during his investigations into the affairs of the Company, and I am satisfied that any lack of cooperation is not a matter to which I should have regard.

16. The remaining matters above have been the subject of two affidavits sworn by Mr. O'Reilly and one intervening further affidavit of the Liquidator. I propose considering each of the matters at (a) to (f) inclusive.

(a) Non-Disclosure in Abridged Financial Accounts

17. The Company had its full financial statements audited each year. It also then prepared abridged financial statements for filing in the Companies Office as it is permitted and required to do. For the year ending the 30th April, 2010, at Note 7 in the notes to the full financial statements under a heading 'Transactions with Directors' it is stated:

> "***7. Transactions with Directors***
>
> T. O'Reilly Electrical Supplies Limited rents premises from companies whose ultimate controlling party is Mr. Declan O'Reilly. These related party transactions in the period were as follows:
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> ***Company Property Rent***

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> Balerotta Properties Limited Bray 62,962
>
> Piet Properties Limited Santry 57,851
>
> Crenard Technology Limited Blanchardstown 50,400
>
> Mr. Declan O'Reilly DunLaoghaire 57,000
>
> Damsen Properties Limited Golden Bridge 45,000
>
> In addition to the above, management fees in the sum of €88,374 was paid to Crenard Technology Limited for Declan O'Reilly remuneration."

18. However, under the same heading of 'Transactions with Directors' at Note 5 in the notes to the abridged financial statements filed in the Companies Office for the year ending the 30th April, 2010, the statement simply read:

> "There were no related party transactions with the directors during the period".

19. Mr. O'Reilly, in his first replying affidavit, accepts that there were incorrect statements in the 2010 abridged financial accounts. He points out that he had accepted and admitted the error in earlier correspondence with the Liquidator. He avers that the incorrect statement was included due to an oversight by the Board at a time of great stress and not a conscious effort to deceive or confuse creditors of the Company. He also seeks to maintain that the correct recording and provision of this information would not have made

any material difference to the position of the Company or the attitude adopted by the creditors by reason of long-standing commercial relationships built up. The Court is not in a position to form any view as to whether this latter averment is or is not correct.

20. The Liquidator, in his subsequent affidavit, points out that there was no disclosure of related party transactions in the abridged accounts for the year ending the 30th April, 2009, and that there is a statutory disclosure obligation which the directors had failed to comply with. The Liquidator contends that the failure to disclose the related party transaction therefore appears to be part of a pattern of non-disclosure. The Liquidator has exhibited the audited accounts for 2009 and the abridged financial statements. The full statements contain, at Note 7, the detail of transactions with Mr. O'Reilly and the related companies. In the abridged financial statements in 2009, the position is slightly different, in that there is simply no heading of 'Transactions with Directors' and no disclosure as the Liquidator avers there ought to have been. There is not the direct incorrect statement as in 2010.

21. Mr. O'Reilly has not been cross-examined on his affidavit. Whilst I accept that the Company and the Board may have been under financial pressure and stress in the autumn of 2010, when the abridged financial statements were prepared, I cannot accept that the inclusion of the incorrect statement was simply due to an oversight. It defies commonsense that a person, even under pressure or stress, preparing the set of abridged statements from the full financial statements, under the same heading of 'Transactions with Directors', instead of including the information in Note 7 in the full financial statements, would, by way of oversight only, have written "There were no related party transactions with the directors during the period". This is particularly so as the preceding note in the full financial statements and abridged financial statements under the heading 'Directors and their Interests', and the succeeding note in each under the heading 'Pension Costs' are identical in each document and the intervening note is radically different, and inconsistent with the note in the full financial statements. Further the copy of the abridged financial statement exhibited by the Liquidator discloses that they were approved by the Board on the 13th October, 2010, and signed on its behalf by Mr. O'Reilly and the third named respondent. That was the same day as the full statements were approved and signed by the same persons. The radical difference is obvious even on a cursory reading of each.

22. Accordingly, I have concluded that the incorrect statement in the abridged financial statement could not have been simply an oversight was probably deliberately included. This was serious, as it failed to disclose significant transactions with the directors, including remuneration for Mr. O'Reilly at a difficult financial time for the Company.

(b) Reclassification of Management Charge to Crenard Information Technology Ltd.
23. Whilst, in the summary in his affidavit at para. 19(b), the Liquidator refers to the reclassification being done in the 2009 accounts, at para. 23, when dealing with the detail of it, he refers to it having been done in the 2010 accounts. Mr. O'Reilly, at para. 16 of his replying affidavit, also refers to 2010. The complaint made is that the reclassification of monies paid to Crenard Information Technology Ltd ("Crenard") in respect of the remuneration of Mr. O'Reilly, as a loan to that related company, had the effect of reducing the reported loss for the Company by €88,374. Mr. O'Reilly does not dispute that this was the effect, but states: "In an effort to improve the company's financial position, a decision was taken by Crenard Information Technology Ltd. to waive such charge. I say that as the charge had already been paid by the company, that the reverse charge was then reclassified as a loan to Crenard Information Technology Ltd.". In the Liquidator's second affidavit, he again refers to the reclassification in the 2009 accounts, and therefore it is unclear to me whether this reclassification took place in 2009 or 2010, or possibly in both years. However, that is not central to what I have to decide in this application. What is important to my assessment of Mr. O'Reilly's responsibility as a director is the factual statement by the Liquidator, which is not disputed by Mr. O'Reilly in his final affidavit, that notwithstanding that Mr. O'Reilly says Crenard decided to waive the charge, such monthly management charges of €7,364.48 continued to be paid to Crenard in respect of Mr. O'Reilly's remuneration up to the date of the winding up of the Company in July, 2011. A genuine decision by Crenard to waive the management charge in either 2009 or 2010, by reason of the then financial position of the Company, appears to me inconsistent with the continued monthly payments of the management charge in the succeeding period (notwithstanding the then financial position of the Company) until July, 2011. The Liquidator's contention that the reclassification was a decision made to reduce the reportable loss of the Company in either or both of 2009 and 2010 appears well-founded.

(c) Reversal of Rental Charges from Related Companies
24. A similar complaint is made by the Liquidator in relation to a retrospective reduction of rents already paid to two related companies, Piet Properties Ltd. and Crenard. for the year ending 2009 of €50,000 and its reclassification as an inter-company loan with a resulting improvement in the results of the Company. Mr. O'Reilly explains that as the rents had been paid in the larger amounts, the reductions given were reclassified as loans. However, the Liquidator points out that there were not actual repayments to the Company of the rents paid and remains of the view that its purpose was to improve the results of the Company. Again, the Liquidator's view is supported by the evidence.

(d) Loan due from Pebbleland Limited
25. There was initially on the affidavit a dispute in relation to a sum of €100,000 due from a related company. However, Mr. O'Reilly has averred that this amount was repaid in August 2010, and the Liquidator has identified a lodgement to the Company's account with Allied Irish Banks Plc on the 6th August, 2010, of €100,000 with the narrative 'Pebblelane Ltd'. I am satisfied that this amount was repaid and am not taking into account any complaint made by the Liquidator in relation to this matter.

(e) Loans to Connected/Related Companies - Section 31 of the Companies Act 1990
26. Section 31 of the Companies Act 1990 prohibits a company, *inter alia*, from making loans to a connected person (other than a holding company or subsidiary) subject to certain exceptions, one of which only appears relevant on the facts herein. It is that the aggregate amount of such loans or financial transactions do not exceed 10% of the company's relevant net assets.

27. The Liquidator, at para. 26 of his grounding affidavit, states that the loans to connected companies totalled €947,272 for the period ending the 30th April, 2010, when the net assets of the Company were €1,941,061. Excluding the loans to a subsidiary, he avers that the remaining loans to Crenard and Pebblelane represented 17.65% of the net assets, and accordingly, appear to be in breach of s. 31 of the Act of 1990. In response, Mr. O'Reilly, at para. 19 of his affidavit does not dispute the position as of the 30th April, 2010, but states that the loan to Pebblelane was fully repaid by August, 2010. The amount of the loan is stated to be €178,000. The Liquidator accepts the repayment of €100,000 in his second affidavit, but even allowing for that amount, states that the amount of the loans outstanding, reduced by the said €100,000, still amounts to 12.5% of net assets. Further, at para. 14 of the second affidavit, he states that from the 2009 accounts, it appears that loans then outstanding from related companies (excluding subsidiaries) amounted to €507,741 which represented 23.7% of net assets in breach of section 31. Mr. O'Reilly, in his second affidavit, does not dispute these facts.

28. I wish to make clear that I am not determining on the affidavits that there was a breach of s. 31 of the Act of 1990. However, the undisputed facts do indicate that there were, in 2009 and 2010, very significant loans made by the Company to related

companies (which may have been in breach of s.31) at a time when its own turnover was decreasing significantly and it was under financial pressure. Those loans (other than €100,000 from Pebblelane) remain outstanding and have proved irrecoverable in the winding up. This is relevant to the responsibility of Mr. O'Reilly in relation to the proper financial management of the Company in the final years of its trading.

(f) Credit Card Expenditure

29. Mr. O'Reilly held the only Company credit card. The Liquidator carried out a detailed analysis of the Company credit card expenditure from the 3rd June, 2009, and the 3rd July, 2011, when €125,849 of expenditure was incurred and classified in the accounting records of the Company as 'Motor & Travel Expenses'. He provided copies of all the credit card statements for the period, detailing payments and dates to Mr. O'Reilly and sought explanations. Mr. O'Reilly has stated to the Liquidator and averred that the expenditure was primarily for business purposes but could not provide specific detail, principally as he said he required his diaries, which he believed the Liquidator had taken. The Liquidator has averred that he did not receive or have Mr. O'Reilly's diaries. Mr. O'Reilly also maintains that expenditure of €60,500 approximately per annum for a company with a turnover in the order of €6m per annum was not excessive. That does not appear a sufficient answer. Mr. O'Reilly, in his affidavit, has averred of the financial difficulties of the Company in 2009 to 2011, and steps taken by him to cut costs. He has averred that he was not paid a salary as managing director during the period. However, in so averring, he did not refer to the management charges paid to Crenard in the sum of €7,364.48 per month in respect of his remuneration. It is also relevant to the issue of the probity of the commercial management and his responsibility in the latter period of the Company if he was using a Company credit card to discharge personal expenditure. The Liquidator has exhibited to his affidavit the credit card analysis provided to Mr. O'Reilly. It gives a description of each item, and whilst there are several items, which if explanations were given by Mr. O'Reilly, may well have related to the business of the Company, there are others which, in the absence of Mr. O'Reilly providing any explanation, the only inference the Court can draw is that they were personal expenditure. By way of example, I would refer to monthly payments to Setanta Sports and Sky Digital, payments to doctor, dentists, for professional golf teaching, for bedroom furniture, home improvement, and to Brown Thomas and other retailers for clothes. There are, in addition, significant airline payments, restaurant and hotels in Ireland and abroad.

Conclusion

30. By reason of the findings which I have made in this judgment in relation to the facts before me concerning the incorrect disclosure in the abridged financial accounts in 2010 of the transactions with directors and the failure to disclose same in 2009; the reclassification of the management charge to Crenard in 2009 or 2010, notwithstanding the continued payment of same; the reclassification of rents without repayment; the significant amount of the loans to related companies in 2009 and 2010, and what appears to be personal expenditure by use of a Company credit card in the same years, I cannot be satisfied that Mr. O'Reilly has demonstrated to the Court that he acted responsibly as a director of the Company, particularly in the final years of trading of the Company. In reaching this conclusion, I have taken into account the positive matters, either expressly referred to or referred to by implication by reason of any lack of criticism relating to the proper keeping of books and records, and other than in relation to the abridged financial statement, and possibly s. 31 of the Act of 1990 compliance with Company Law requirements. Nevertheless, it appears to me that in the final years of trading, by reason of not just one decision taken which may have been an error of judgment *i.e.* the incorrect note to the abridged accounts, but rather, in a number of transactions, set out above, he failed to act as a director in relation to the conduct of the affairs of the Company in a manner which the Court could consider to have been responsible.

31. It follows that pursuant to s. 150 of the Act of 1990, the Court is bound to make the declaration of restriction.