Neutral Citation Number: [2007] IEHC 456

THE HIGH COURT

RECORD NO. 2007/214COS

IN THE MATTER OF HYDRO KLENZE LIMITED (LIQUIDATION)
IN THE MATTER OF THE COMPANIES ACT 1963-2002 (AS AMENDED)
IN THE MATTER OF SECTION 280 OF THE COMPANIES ACT 1963
(AS AMENDED) ON THE APPLICATION OF THE LIQUIDATOR,
RICHARD TREHY

BETWEEN

RICHARD TREHY

APPLICANT

AND
WILLIAM RUTHERFORD, LIAM DUFFY,

RESPONDENTS

BRIAN CAVANAGH AND RAYMOND SCOTT

The hearing resumed as follows on Thursday, 20th December. Judgment was delivered as follows Mr. Justice Smyth.

1. This judgment is concerned with the relationship between the Applicant and Brian Cavanagh, in particular in the context of section 150 of the Companies Act, 1990.

2. Hydro Klenze Ltd. ("The Company") is a limited liability company incorporated in the State on 30th April 2002 to engage in the business of wastewater pollution control and to provide services in relation to potable water.

3. The directors of the Company are Liam Duffy, Brian Cavanagh and Raymond Scott who were directors from the outset of the Company and Kenneth Ryan who was appointed on 16th December 2002. Raymond Scott's resignation was filed with the Companies Registration Office on 24th July 2004.

4. The issued share capital of the Company is €100.00 comprised of 100 ordinary shares of €1.00 each. The shareholders distribution is Liam Duffy: 25 Ordinary Shares; Brian Cavanagh: 12 Ordinary Shares; Kenneth Ryan: 25 Ordinary Shares; Raymond Scott: 25 Ordinary Shares; Liam Duffy and others: 13 Ordinary Shares. Those held by Mr. Cavanagh were described in his affidavit as "sweat equity" - this is to describe him not being in a position to invest capital in the Company, but his stake in the business granted due to the time and effort he gave to the Company.

5. The Company operated from premises at Ballintra, County Donegal. Its primary business activity was the production of a unique, dry cast, lightweight, dual purpose concrete tank. The tank was of special design enabling the simple installation of a biological treatment unit directed at cleansing domestic wastewater. As noted, the tank was dual purpose, enabling its installation as a conventional sceptic tank or that of treatment tank which provided a higher level of cleansing of the domestic wastewater. While demand for the product was good, difficulties associated with an Irish Agrément Certificate created considerable difficulties for the business. While Mr. Cavanagh was appointed a director of the Company on 10th April 2002, he was appointed, along with Mr. Liam Duffy, as joint secretary of the Company until 16th December 2002, at which point Kenneth Ryan was appointed.

6. The Company endeavoured to acquire a business, Water Treatment Ireland, in or about June 2002 (i.e. when Mr. Cavanagh was joint secretary of the company). This transaction involved a cash payment by Liam Duffy and a personal cheque payment from Raymond Scott to William Rutherford in the sum of €31,745 each. During the course of the dealings William Rutherford signed a bank mandate form, which, without further explanation, such as was necessary in his separate contest between the Applicant and Mr. Rutherford, a person could be pardoned for understanding Mr. Rutherford to be a director of the Company. In the events, having heard the dispute I made a decision and found that Mr. Rutherford was not a director of the Company. However, the carelessness of those responsible for maintaining the books and records of the Company, and in particular the secretary or secretaries of the Company, permitted this confusion to arise, must bear some responsibility for the events that unfolded thereafter. In addition, certain expenditure relating to stationery, vans and signwriting, and salt was involved. The deal collapsed and the monies were effectively lost. The transaction was not recorded in the Company's records.

7. The directors issued a Business Plan in November 2002 in relation to its business. This was allegedly reviewed by an expert who was appointed a director on 16th December 2002. The expert, Kenneth Ryan, an experienced Chartered Accountant agreed to an investment of €200,000 for a 25% interest, which included a €50,000 premium over and above the €150,000 investment agreed by Liam Duffy and Raymond Scott for their 25% investment. The Liquidator came to the view that the Business Plan had serious deficiencies. Prior to the issue of the Business Plan, Liam Duffy, a builder by trade, entered the lands which were allegedly owned by another director, Raymond Scott. He carried out various works on foot of an agreement granted to him by his fellow directors to construct a manufacturing facility. No planning permission was in place. Planning permission was not in place until March 2003 and the construction was completed in July 2003.

8. Notwithstanding the fact that planning permission was not in place, the Company ordered plant and machinery with a value of €81,065 with a delivery schedule of 8 weeks on 22nd November 2002. They acquired two cranes in January 2003.

9. The Financial Statements for the period ended 31st December 2002 were approved by the directors on 14th March 2003. In the view of the Liquidator, these did not show a true and fair view for a number of reasons as set out in detail in proceedings issued against the directors. The Liquidator, in his initial report to the Court, stated that "proper books and records were not maintained for reasons set out in the proceedings." Whilst the Liquidator's report to the Court notes that "production commenced in July 2003 and the first tanks were delivered in October 2003." On 14th October 2003 Kenneth Ryan and Raymond Scott discussed the "shareout of cash tanks" and a third director, Brian Cavanagh, has admitted he received €500 tax free payments which was noted by Kenneth Ryan as "Brian - €500 ex cash a/c no Tax."

10. Raymond Scott was the production manager and his two sons were employed as operatives. The sons were sacked and Raymond Scott effectively left his employment post in December 2003. In early January 2004 he had an altercation with Mr. Brian Cavanagh in front of two employees and then served a Notice to Quit on the Company.

11. The production facility was inappropriate to the Company's needs in the view of the Liquidator, as were the production procedures. The fact that employees could now clean up collapsed tanks in under 15 minutes warranted a mention in one of Brian Cavanagh's reports after he had taken over from Raymond Scott as production manager in January 2004.

12. The Liquidator, concerning bank accounts, stated as follows in his report:-

> "The Company obtained a facility letter of offer from AIB in January 2003 containing terms that the Company never provided. They switched banks to Bank of Ireland in March 2004 but allegedly continued to negotiate with AIB on a bona fides basis until AIB eventually issued a demand letter in October 2004. The bank had issued and threatened closure previously but by a series of delaying tactics and misrepresentations the Company managed to hold off the Bank until October 2004.
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> The directors incorrectly availed of the audit exemption provision, produced financial statements that did not show a true and fair view of the State of Affairs of the Company and persistently breached the Companies Acts."

13. To the extent that it is appropriate, Mr. Cavanagh is referred to in the course of the Liquidator's report to the Court and in particular under the heading of "Disposal of Assets". There the Liquidator notes that the Statement of Affairs disclosed assets with a net book value of €579,198, but in fact it only had realisable value of €199,500. He notes, in particular:-

> "The morning after the Liquidation I met with Brian Cavanagh at his request and he said he wished to make an offer of €100,000 for the total assets, including the buildings and he was making the offer on behalf of a Frank Harrington. The offer was rejected out of hand.
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> An auctioneer was appointed and all the assets, with the exception of the building, were sold to Frank Harrington Ltd. for a net €150,000. Dismantling and removal costs were borne by Frank Harrington Ltd."

14. On the sale of disposable of assets had a significant impact on the deficit and in the view of the Liquidator it was attributable to the negligence of the directors. In specific reference to Mr. Cavanagh the Liquidator states as follows in his report:-

> "He is included in the Statement of Affairs for Cash Loans of €5,071 which entry was made into his account by Journal Entry and not by lodgement to the bank account of the Company."

15. In the report of the Liquidator to the High Court dated 13th April 2007, there is an "Overview" expressed by the Liquidator and is (inter alia) in the following terms:-

> "This Company was incorporated on 13th April 2002 and went into Liquidation on the 14th December 2004, a very brief period by any standard. One does not have to look at any of the usual yardsticks to form a view as to why this Company failed. This Company failed from the sheer incompetence of the promoter/directors, which incompetence is evident throughout the proceedings issued by the Liquidator against the directors. The incompetence was compounded by an element of dishonesty as between themselves and towards third parties which is quite astounding given that three of the directors have their own business ventures."

16. Mr. Cavanagh did not have a business of his own. He was the sales director and in that capacity the Liquidator has criticism in his "Overview" in his report in the terms as follows:-

> "The Sales Director prepared a Business Plan which is one of the poorest the Liquidator has ever reviewed and according to several of the Directors they had this expertly reviewed by an experienced Chartered Accountant who, while acknowledging he made a few small changes, does not admit that he expertly reviewed it but does state that he invested on foot of it. The Business Plan omitted a critical transaction involving the loss of €63,487 in cash and losses from related activity in acquiring an existing business and incorporating that proposed acquisition into the new venture. This information was withheld from the fourth Director who, quite incredibly, when he was informed of it proceeded to go along ignoring, for whatever reasons, what most other people would perceive as "flashing red lights". The plan was also fatally deficient in regards to the Capital Costs of the project."

17. The Business Plan was much criticised by the Liquidator in his reports and affidavits and in particular he formed the view that:-

> "The failure of the promoters to draw up such an agreement and the failure to distinguish between their rights and obligations as shareholders, investors, employees and directors is another significant feature in the very short life span of the Company."

18. I am satisfied, and find as a fact, that both in respect of the intended acquisition of Water Treatment Ireland and in regard to the property transaction dealing with Scott's yard, the approach of any and all of the directors, to the extent that I am concerned with directors other than Mr. Cavanagh, could only be described as shambolic. The arrangements amounted to an absolute mess and showed no regard to the actual business problems, which even a cohesive management team could not have overcome. Insofar as the Water Treatment Ireland acquisition is concerned, Mr. Cavanagh states that he did his utmost to dissuade his co-directors from the acquisition in which it was paid for initially by two directors, who then placed themselves in the position of creditors, or debtors of the Company. Insofar as the transaction with Scott's yard is concerned, Mr. Cavanagh's defence is that Scott was a fellow director and he trusted him, and accordingly, all the parties proceeded on a basis of trust.

19. The simplest of untutored persons dealing with a property transaction would know that it should be in writing and that the terms should be clear. This was not so and Mr. Cavanagh knew about this and if he thought sufficiently strongly about dissenting from it, he could have resigned from the Company, but he did not.

20. The case made against Mr. Cavanagh was made generally under the following headings:

> 1) The Rutherford transaction.
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> This involved an ultimate loss to the company of over €62,000. The wholly informal nature of the transaction might be less blameworthy if the company got value for money - to have squandered the sum for almost nothing and then to fail to record the transaction in dealing with directors in the Financial Statement during a period when Mr. Cavanagh was joint secretary of the company, if not dishonest, was wholly irresponsible. Mr. Cavanagh avers he was adverse to the acquisition, its timing and structure. In my judgment, Mr. Cavanagh's explanation and exculpation of his involvement (paragraph 14 - 22 of his affidavit sworn 13th January 2006 and elsewhere) betoken a want of firmness in permitting the company to be "sucked into" a position of loss. He may not be the primary offender, but by failing to ensure or insist on notification in the Financial Statement to 31st December 2002 he

permitted a false picture to be presented to those outside the company.

As a director and secretary of the company, more particularly in his capacity as secretary, he was under a duty to maintain true and accurate records - to have in any way been party to the bank mandate being signed for which an outsider could pardonably consider Mr. Rutherford to have been a director showed a lack of attention to detail - it was not a dishonest act, it may even have been oversight or inadvertence - but it was irresponsible for Mr. Cavanagh to have so acted.

2) The failure to keep Minutes.

The Liquidator was concerned to note that apart from the meeting of 30th April 2002 to deal with the transfer of shares on incorporation and a meeting of 22nd October 2002 to finalise a verbal agreement between Liam Duffy, Raymond Scott and Brian Cavanagh as to their respective shareholdings, no other minutes of meetings were held by the directors until 16th December 2002.

While accepting that small private companies do not have the resources of a plc and that much of the business of such companies is done on an informal basis - yet this does not absolve the directors, especially one who is a secretary of the company, from keeping things on a proper footing by the holding of meetings, however brief and keeping a proper record thereof. The Liquidator identified the following as not contemporaneously being minuted - when clearly decisions had been made -

> (a) The construction of a facility on land claimed to be owned by Mr. Scott. Mr. Cavanagh went along with the notion of his fellow directors trusting Mr. Scott. However, Mr. Cavanagh as director/secretary should, in my judgment, have acted with independence and not only insisted on the matter being put on a proper legal footing but to record "the agreement" that subsequently unravelled.
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> (b) The acquisition of Water Treatment Ireland - this, despite any ineffective reservations of Mr. Cavanagh, should have been the subject of recorded minutes of whatever type of meetings were held to decide the matter and its implementation. The failure to appreciate the importance of proper record keeping by Mr. Cavanagh betokens a want of appreciation of corporate governance and the necessity to have regard to the rights of the public to be able to rely on the records of the company.
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> (c) The awarding to Liam Duffy of contracts while not per se in any way unlawful; it was not only prudent but proper that such a decision when made at whatever meeting (even in a yard or workshop) should have been minuted even if for no other reason than ensuring harmony amongst the directors who could point to the minute in the event of a dispute.
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> (d) the preparation of a Business Plan and that it be expertly reviewed. This fact was not minuted even though on Mr. Cavanagh's own evidence it was a necessary thing to do to plan ahead. Without wishing to belittle Mr. Cavanagh, an outsider seeking to understand what the company was about in a six-month period could be pardoned for considering the company moribund.

The this point of record keeping of a Business Plan is distinct from the several criticisms of the plan by the Liquidator. While undoubtedly the Business Plan (exhibit "BC 1") is open to the several criticisms levelled against it by the Liquidator, if it merely lacked a desired degree of detail and professionalism that would be, I believe, to use "a hindsight test", which all of the several cases opened to me by the parties say is impermissible. The Business Plan may have been of an amateurish character, but such would not amount to dishonesty. It points to a certain want of competence and in that regard is all of a piece with the "sloppy" record keeping.

However, the issue goes much deeper than that. A Business Plan will generally be based on a number of assumptions. A reader is, in my judgment, entitled to assume that if a particular material circumstance exists, it will be disclosed and if there is a material change in circumstances, such will be notified (by a rider, addendum or amended document) to the user of the document. The Liquidator particularised (under seven headings) the serious deficiencies in the report. While it was submitted on behalf of Mr. Cavanagh that many of the alleged deficiencies were either de minimis or could be explained away, I am unable to accept that, they are serious and they are cumulatively significant and misleading. To advance as reliable information as opposed to subjective opinion that an Irish Agrement Certificate was not really required but that the Irish Agrement Board was a promoter of an artificial barrier could be read as fact, not as opinion. To omit to mention the effective loss in acquiring Water Treatment Ireland and that 'Scott's yard' was not owned by the company amount to misleading information. These associated with the preparation and promulgation of this report, I find as a fact Mr. Cavanagh acted irresponsibly and dishonestly (if not consciously so).

3) The construction of a manufacturing facility without -

> (a) Having a proper proposal duly costed placed before the Board for its consideration; and
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> (b) Not seeking alternative offers for the works envisaged.

This issue was properly raised by the Liquidator. Mr. Cavanagh's response I could understand and accept as a narrative of facts as they occurred if all those involved were private persons acting in their own personal capacity. What marks the conduct at lowest irresponsible in a corporate context is that the conduct of directors in "running" a company affects its debtors and creditors not simply the directors inter se.

In my judgment, the most reliable yardstick by which this issue can be assessed is in exhibit "RTQ", being the comment of Loughside Engineering and their experience -

> "Firstly, the job kept being put back and this was a concern for us as it was holding up money that we had invested in plant for them. When the job eventually started, it was a complete nightmare, as there always seemed to be a difference of opinion between the directors of the company, particularly

Raymond Scott, Liam Duffy and Brian Cavanagh".

Disharmony amongst directors can arise from honest opinions strenuously held - however, to adopt Lord Styen's maxim "In law context is all", such conduct can be, and in the context of the facts - which I find accord with the Loughside Engineering memo - it was irresponsible.

The events surrounding the "refer to drawer" cheque of January 2004 can be viewed as either a genuine trade dispute (which should not have in any event arisen - there should have been no confusion over the lodgement) or gross irresponsibility in the carrying on of the business for which all directors must stand condemned. However innocent one might wish to consider Mr. Cavanagh, he participated in and continued to be part of the management and, in other perhaps than degree, he was irresponsible. He could have relinquished his directorship and if he continued with the company as employee, or indeed elsewhere, could be exempt from censure. No business can hope to succeed that loses the trust of 'the bank'; a "refer to drawer" cheque is an experience to be avoided at all costs. It matters nothing in "responsibility" terms that there may have been an arrangement in place between Mr. Ryan and the bank if Mr. Cavanagh was as he avers in paragraph 73 of his affidavit sworn on 13th January 2006 - "I was administering a matter which was not my direct role"..."

I think that as a director in January 2004 when he knew or ought to have known that the company was overdrawn at the bank - he should have been extra vigilant to ensure that no action was taken by the company or any other director that added further risk to the company. There is no evidence that he did so. While Loughside Engineering may not have represented the cheque - that does not excuse its issuance and referral in the first place.

4) Document titled "investment Summary & Background".

This was produced by "the directors of the company including this deponent" (affidavit of Brian Cavanagh sworn on 28th November 2006). Its purpose was to entice further investment. While it was referred to by (inter alia) Mr. Cavanagh in the context of alleged negotiations with a number of potential investors, it was a document produced at a time when the company was unable to meet its debts, was in dispute with AIB, could not obtain an Irish Agrement Certificate and was in serious dispute over its lands. None of these matters are expressly and unequivocally referred to in the document. The document was not an honest statement of facts - it was a highly irresponsible document to issue by the company or by its directors or to be used as a true basis for negotiation.

I have considered at length the several cases on the history of S. 150 of the Companies Act 1990 and I found the succinct review by Clarke J. in Re the matter of Swanpool Limited (In Voluntary Liquidation) (unreported, 4th November 2005) particularly helpful. Bearing in mind that the primary aim of S. 150 is to deal with directors who have behaved irresponsibly or dishonestly, I am satisfied and find as a fact that Mr. Cavanagh acted irresponsibly as a director of the company. Accordingly, I propose to make an order under S. 150 on that ground.