Neutral Citation: [2016] IEHC 592

THE HIGH COURT

[2016 No. 37 Cos]

IN THE MATTER OF SPUR (LIFFEY VALLEY) RESTAURANTS LIMITED

(IN VOLUNTARY LIQUIDATION)

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

BETWEEN

EAMONN LEAHY

APPLICANT

and

HELEN JAYNE BAILEY, STEPHEN JAMES LOGUE AND DENIS CREMIN

RESPONDENTS

JUDGMENT of Mr. Justice David Keane delivered on the 28th of October 2016

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

Background
2. Spur (Liffey Valley) Restaurants Limited ('the company') was incorporated on the 27th November 2001. As its name suggests, the company operated a restaurant in the 'Liffey Valley Shopping Centre' at Fonthill Road, Clondalkin, Dublin 22.

3. By ordinary resolution on the 25th January 2013, the members of the company resolved to wind it up and to appoint the applicant as liquidator for that purpose.

4. At the commencement of the winding up, the respondents were the directors of the company, and the first named respondent was its secretary.

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

6. On the 30th October 2013, the Office of the Director of Corporate Enforcement wrote to inform the applicant that he was not relieved of his obligation under s. 56(2) of the Company Law Enforcement Act 2001 ('the 2001 Act') to apply to this court for a declaration of restriction in respect of each of the respondent directors under s. 150 of the 1990 Act (now s. 819 of the 2014 Act).

7. The present application is brought by motion issued on the 1st February 2016, originally made returnable for the 7th March 2016. While there was some correspondence between the applicant and a representative of the first and second named respondents prior to the application, there was no appearance on behalf of any of the respondents in opposition to it.

The legal issue
8. From the evidence before me, I am satisfied that each of the respondents was a director of the company at the material time; that the company is, and was at the date of the commencement of its winding up, insolvent; and that the Director of Corporate Enforcement has not relieved the applicant of the obligation to bring the present application.

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

10. I am therefore required to consider whether I can be satisfied that each of the respondents acted honestly and responsibly in relation to the conduct of the company's affairs and that it is not otherwise just and equitable to subject any of them to restriction.

The evidence
11. The company traded for a period of approximately eleven and a half years between July 2001 and December 2012.

12. Each of the respondents was a director of the company throughout that period and until the commencement of the company's winding up. The first named respondent was operations director, the second named respondent was managing director, and the third named respondent was a non-executive director.

13. The applicant acknowledges that, with one notable exception to which reference will be made shortly, the company maintained proper books and records and that it filed the appropriate returns with the Companies Registration Office. According to the statement of affairs prepared by its directors, the company had unpaid Revenue liabilities amounting to €169,482 at the commencement of its winding up, comprising €155,450 in unpaid VAT and €14,649 in unpaid PAYE/PRSI. The company made the required VAT returns and payments for each two month period up to and including that of July and August 2012 and the necessary PRSI and PAYE payments for all periods up to and including September 2012.

14. The applicant avers that, while the company initially traded profitably, in later years it experienced a significant decline in its turnover from approximately €3.3 million in 2007/8 to €2.3 million in 2010/11. The directors sought to address this difficulty by implementing reductions in the company's overheads and staff costs but were unable to secure a reduction in the rent of its restaurant premises sufficient to permit it to continue to trade.

The factual issue
15. The specific factual issue raised by the applicant concerns the manner in which the company dealt with a debt that was owed to it by another company named Trinity Leisure Limited ('Trinity'). Trinity is an English registered company that holds 95% of the company's issued shares. According to both the directors' report in Trinity's most recent available returns (for the year ended the

30th June 2009) and its most recent available annual return made on the 19th January 2011, the directors of Trinity are the first and second named respondents.

16. The company's financial statements for the year ended the 30th June 2010 record that its assets include amounts owed to it by 'group undertakings' in the amount of €1,963,989, and that its liabilities include shareholders' loans in the sum of €1,117,645. No intangible assets are included amongst the company's fixed assets in its balance sheet as at the 30th June 2010.

17. In contrast, the company's financial statements for the year ended the 30th June 2011 record that the amount owed to it by a 'group undertaking' had fallen to €31,200; that it had no outstanding loans from shareholders; and that it now had intangible assets valued at €825,000. Moreover, the 2011 financial statements purport to restate certain figures from the 2010 financial statements and, in doing so, include €21,344 as the amount owed to the company by 'group undertakings' in 2010, instead of the figure of €1,963,989 actually recorded in the 2010 financial statements.

18. In correspondence with the first and second named respondents, the applicant was informed that Trinity was both the group debtor and the shareholder loan provider identified in the 2010 financial statements and that, for the purposes of the 2011 financial statements, the indebtedness of Trinity to the company was reduced by netting off those two sums. However, as the applicant points out, such netting off would have left Trinity as a net debtor of the company in the amount of €846,344.

19. The explanation that the first and second named respondents have provided for the further ostensible reduction of Trinity's debt to the company by an additional sum of €825,000, is that the company acquired franchise rights and the transfer of the lease of its restaurant premises from Trinity for an agreed consideration in that amount, leaving Trinity with a remaining indebtedness to the company of just €21,344.

The applicant's position

20. Concerning the acquisition of franchise rights by the company from Trinity, the applicant avers that he has not been provided with any, or any sufficient, details of the transaction whereby those rights were acquired or of the manner in which those rights were valued for the purpose of that transaction. In particular, the applicant's evidence is that the respondents have failed to provide him with a copy of the franchise agreement or with a copy of the software used to maintain the company's accounts that might enable any valuation of those rights to be meaningfully examined.

21. Similarly, in respect of the assignment by Trinity of the lease of the company's restaurant premises to the company, the applicant avers that the respondents have failed to provide him with a copy of that lease or with any independent valuation of it, in circumstances where the applicant expresses the belief, based on his professional experience, that, given the economic circumstances then prevailing; the high rent that was being charged on the company's premises; and the anticipated cost of replacing the specialist fit out of those premises, it is difficult to see how any significant value could have been ascribed to the tenant's interest in that lease at that time.

22. The liquidator points out that, when the company's 2011 financial statements (recasting, in relevant part, the company's balance sheet for 2010) were approved by the company's directors in March 2012, the respondents must have been aware that the company was by then in significant financial difficulty. Accordingly, the applicant acknowledges, and the Court accepts, that, in the absence of the necessary evidence to support the explanations proffered, it is not possible to be satisfied that the relevant transactions were not contrived and deliberately backdated to avoid, amongst other difficulties, the potential application of s. 286 of the Companies Act 1963. After all, were it not for those purported transactions, the company, which went into liquidation with an estimated net deficiency of €309,116, would have had a specific debt of €825,000 to pursue, whereas, in consequence of them, it has instead intangible assets to which an equivalent value has been ascribed in the company's accounts but which appear to have no realisable value in the liquidation.

23. Further, the respondents' failure to provide the necessary information and material in response to the applicant's request for it, amounts to a specific failure to co-operate with the applicant, as liquidator, capable of amounting by itself to a separate reason why it would be just and equitable to make a declaration of restriction against each of the respondents.

24. The position of the third named respondent is different from that of the other two, in that he was at all material times a non-executive director of the company. Indeed, in correspondence with the applicant on behalf of the first and second named respondents, some doubt was expressed as to whether he was, in fact, a director at all. The evidence adduced by the applicant is sufficient to satisfy me that he was, although he does not appear to have played any part in the conduct of the company's affairs during his tenure – a fact which, from that respondent's perspective, creates its own separate difficulty.

The law

25. As Murphy J. made clear in *Business Communications Ltd v Baxter and Parsons* (High Court, 21 July 1995, unreported), where the necessary proofs are otherwise in order under s. 150(1) of the 1990 Act (equivalent to s. 819(1) of the 2014 Act), the onus is on a respondent director to establish that he acted honestly and responsibly and that there is no other reason why it is just or equitable to restrict him, insofar as he seeks to rely on the provisions of s. 150(2) of the 1990 Act (equivalent to s. 819(2) of the 2014 Act) to resist the making of such an order .

26. Here, the respondents have elected not to appear in opposition to the application and, in many cases, that would be enough to determine its outcome. In this instance, in view of the relatively long and previously unblemished tenure of each of the respondent directors; in light of the company's previous record of general compliance with its obligations under the Companies Acts and the applicable taxation statutes; and because the concerns that have been very properly raised by the applicant refer to what are, in effect, just two transactions (albeit significant ones in light of the aggregate sum involved and the overall deficiency in the company's assets), I requested the applicant to address me on the relevant legal principles as they apply to the facts at hand.

27. The applicant suggests that each of the five matters identified by Shanley J. in *La Moselle Clothing Ltd and Rosegem Ltd v Soualhi* [1998] 2 ILRM 345 at 352 as those to which it is appropriate to have regard in determining whether a director has acted responsibly are relevant here. The Supreme Court approved the *La Moselle* test in *Re Squash (Ireland) Ltd* [2001] 3 IR 35, although as Fennelly J. made clear in *Re Mitek Ltd; Grace v Kachkar* [2010] IESC 31, the matters it identifies should not be considered exhaustive or as somehow substituting standardised judicial criteria for the general words of the statute.

28. Indeed, in *Re Tralee Beef and Lamb Ltd; Kavanagh v Delaney* (High Court, 20th July 2004, unreported), Finlay Geoghegan J. provided some amplification of the *La Moselle* test, pointing out that any significant breach of the general duty of skill and care that each director owes to a company, and, in that context, the specific duty of each director to inform himself about its affairs and to join with his co-directors in supervising and controlling them, is likely to amount to irresponsible conduct.

29. Quite separately, in view of the requirement imposed on directors to satisfy the Court that there is no other reason why it is just and equitable to make a declaration of restriction, the applicant acknowledges that the Court must also have regard to the conduct of each of the respondents after the commencement of the winding up, most notably, the failure of each to co-operate with the applicant, as liquidator, in not responding adequately to the specific requests that he made for copies of the franchise and lease agreements between the company and Trinity.

30. Having carefully considered the applicant's very helpful submissions, it seems to me that the matters most relevant to the issue of whether the Court can be satisfied that the respondent directors acted responsibly or, indeed, honestly in relation to the conduct of the company's affairs are:

> (a) the extent to which each has or has not complied with any obligation imposed on him (or her) by the Companies Acts;
>
> (b) the extent to which each and, in particular, the third named respondent has complied with the duty imposed on him by common law to inform himself about the company's affairs and to join with his co-directors in supervising them, and
>
> (c) the extent of the directors responsibility for the net deficiency in the company's assets disclosed at the commencement of its winding up.

31. The applicant notes that, because of the failure of the respondents to provide the documentation and information necessary to allow a proper examination of the purported franchise and lease agreements, it is not possible to be satisfied that there has been compliance with the requirements of s. 29 of the 1990 Act (equivalent to s. 238 of the 2014 Act) in respect of substantial property transactions between the company and persons, such as Trinity, connected with its directors.

32. The applicant further observes that the respondents' failure to provide him with copies of the relevant agreements is capable of amounting to a breach of the requirements of s. 202(1) of the 1990 Act, as amended (equivalent to s. 282 of the 2014 Act), which include the obligation to keep proper books of account that, amongst other things, correctly record and explain the transactions of the company and enable the annual accounts of the company to be readily and properly audited. As Murphy J. put the matter in *Business Communications*, already cited:

> 'Ordinarily, responsibility will entail compliance with the principal features of the Companies Acts and the maintenance of the records required by those Acts. The records may be basic in form and modest in appearance. But they must exist in such a form as to enable the directors to make reasonable commercial decisions and auditors (or liquidators) to understand and follow the transactions in which the company was engaged.'

33. The specific circumstances of this case create very obvious concerns. Although the company's financial statements for the year ending on the 30th June 2011 suggest otherwise, the purported lease and franchise agreements between the company and Trinity were not reflected on the balance sheet in the company's financial statements for the year ending on the 30th June 2010. Even in the earlier of those two periods, the company was already sustaining trading losses, according to those financial statements. Copies of the purported agreements have never been produced. The transactions concerned benefitted another company of which the first and second named respondents were directors and shareholders, giving rise to an obvious potential conflict of interest on their part in relation to the fiduciary duties that they owed to the company. The practical benefit that the company derived from those purported transactions is, to say the least, questionable, involving, as they did, the acquisition by the company at considerable cost of assets with little or no realisable value on insolvency when the company was already in financial difficulty. The amount expended by the company in those two transactions - €825,000 – is more than twice the company's net deficiency on insolvency of €309,116, according to the statement of affairs prepared by the respondents. The amount expended, whenever it occurred, was significant for a company that had net assets of €788,472 at the end of June 2010 and net assets of €619,506 twelve months later, according to its own financial statements.

34. Turning to the position of the third named respondent, there is nothing to suggest that his role was ever anything other than an entirely passive one. There was some suggestion in the course of the application that his involvement as a director of the company may have been prompted by the perceived requirement, at the time when the company was incorporated, for at least one of its directors to be a person resident in the State, in circumstances where the first and second named respondent were, and apparently are, resident in the United Kingdom. It is unnecessary, perhaps even inappropriate, to speculate in that regard. The inescapable fact is that the third named respondent agreed to become a director, for whatever reason, and did so. And, as the Court of Appeal has recently reiterated in *Director of Corporate Enforcement v Walsh* [2016] IECA 2, it would be contrary to the whole notion of proper corporate regulation to exonerate token directors from liability or relieve them from restriction on the basis of their voluntary adoption of an entirely passive role.

Conclusion

35. Taking these matters into account, in circumstances where each of the respondents has failed to establish a defence under s. 819(2) of the 2014 Act and where the necessary proofs are otherwise in order, the Court is obliged to make the appropriate declaration of restriction under s. 819(1) of that Act concerning each of the respondents and I will do so.