Neutral Citation [2013] IEHC 48

THE HIGH COURT

COMMERCIAL

[2010 No. 11862 P]

[2010 No. 36 COM]

BETWEEN

IIB INTERNET SERVICES LIMITED, IRISH BROADBAND AND INTERNET SERVICES LIMITED (TRADING AS IMAGINE NETWORKS)

AND

IMAGINE COMMUNICATIONS GROUP LIMITED

PLAINTIFFS

AND

MOTOROLA LIMITED

DEFENDANT

JUDGMENT of Mr. Justice Brian J. McGovern delivered on the 7th day of February, 2013

The Application
1. The defendant brings this application for security for costs pursuant to s. 390 of the Companies Act 1963.

2. The proceedings concern a claim for damages in excess of €138m arising out of losses allegedly incurred in the purchase and delivery of WiMax wireless internet technology from the defendant by the plaintiff companies.

3. Although this matter has been admitted to the commercial court, it has had a rather lengthy procedural history. Proceedings issued on 23rd December, 2010, and a number of interlocutory motions have been brought before the court, requiring redrafting of pleadings.

4. The matter last came before the court on 20th June, 2012, on the defendant's motion to strike out the fourth statement of claim delivered by the plaintiffs, for non-compliance with an order of Clarke J. made on 9th November, 2011, or in the alternative, dismissing the plaintiffs claim as bound to fail. Judgment was delivered on 2nd October, 2012, which resulted in the defendant's application being unsuccessful on both grounds. On 16th October, 2012, the current motion was issued.

Jurisdiction to order Security for Costs under s. 390 of the Companies Act 1963
5. Section 390 provides:-

> *"Where a limited company is plaintiff in any action or other legal proceeding, any judge having jurisdiction in the matter, may, if it appears by credible testimony that there is reason to believe that the company will be unable to pay the costs of the defendant if successful in his defence, require sufficient security to be given for those costs and may stay all proceedings until the security is given."*

6. The jurisdiction to grant security for costs is well established, with the test having been summarised in *Inter Finance Group Limited v. KPMG Peat Marwick* (Unreported, High Court, Morris P, 29th June, 1998), which may be paraphrased as follows:-

> To succeed there is an onus on the moving party the defendant to establish:-
>
> (a) that he has a *prima facie* defence to the plaintiff's claim; and
>
> (b) that the plaintiff will not be able to pay the defendant's costs if successful in his defence.

On the defendant's establishing these two facts, then the order sought should be made unless it can be shown that there are specific circumstances in the case which would cause the court to exercise its discretion not to make the order sought.

7. Thus, the jurisdiction under s. 390 is a discretionary one, as set out by Kingsmill Moore J. in *Peppard v. Bogoff* [1962] I.R. 180 at page 188:-

> *"I am of opinion that the section does not make it mandatory to order security for costs in every case where the plaintiff company appears to be unable to pay the costs of a successful defendant but that there still remains a discretion in the Court which may be exercised in special circumstances. In this case I find two special circumstances. The financial position of the plaintiff may, if he substantiates his case, be due to the very actions of the defendants for which they are sued; and there is a co-plaintiff within the jurisdiction to whom the defendants may look for payment of their costs."*

8. It is accepted by the plaintiffs that the defendant has set out a prima facie defence at law. But there remains a dispute as to the plaintiffs' ability to discharge an order for costs.

"Credible Testimony"
9. Counsel for the defendant contends that, in discharge of the onus upon it to show that the plaintiffs will be unable to meet a

potential costs order, it is sufficient for evidence that is *prima facie* credible to be put before the Court, to show that there is reason to believe that the company will be unable to pay costs. Further, counsel for the defendant submits that, in the absence of cross examination, the Court cannot adequately address the credibility or otherwise of the evidence proffered, but should rather, in the absence of any obvious flaws or defects, accept it as credible on its face.

10. In support of this proposition, counsel for the defendant cites the approach taken by in *Re McInerney Homes Limited* (No. 2) (Unreported, High Court, Clarke J., 10th January, 2011), in the context of an Examinership. Here, the court had regard to the decision of the Supreme Court in *Boliden Tara Mines Limited v. Cosgrove* [2010] IESC 62, in holding, essentially, that it would be inappropriate to dispose of the application on affidavit without cross examination:-

> *"The evidence of the Banking Syndicate on those issues did not seem to me to disclose obvious flaws or gaps of that type such as would allow the court to treat the conclusions reached from same as unsafe in the absence of cross examination. In those circumstances the only possible conclusion is that there is a credible basis for the Banking Syndicate's position."*

11. Counsel for the defendant further cites *Bula Limited v. Tara Mines* (No. 3) [1987] I.R. 494, with regard to the standard of scrutiny that may be expected of the Court, per Murphy J. at page 498:-

> *"There is, therefore, impressive evidence of insolvency. In fact the plaintiffs rightly and necessarily accept that they are insolvent insofar as that expression connotes an inability to meet debts as they fall due…*
>
> *However, I do not think it is necessary for me to enter into a detailed analysis of the assets and liabilities of Bula Limited. All that the section requires is that it should appear by credible testimony 'that there is reason to believe that the company would be unable to pay the costs of the defendant if successful in his defence.' The defendants believe that to be the position and the fact that the company's bankers have been pressing unsuccessfully for some five years to procure payment of the monies due to them must surely justify the pessimistic views of the defendants."*

12. Counsel for the plaintiffs places significant reliance on *Irish Press v. Warburg Pincus Capital Co. L.P. & Ors* [1997] 2 ILRM 263. In that case, an application under s. 390 was successfully resisted on the basis of the purported ability of the plaintiff to pay costs. Irish Press Plc was clearly insolvent, but put evidence before the court of assets being held in subsidiary companies. In the High Court, McGuinness J., taking into consideration the approach adopted by Murphy J. in *Tara v. Bula*, but, having particular regard to the evidence proffered from the plaintiff's auditors, held:-

> *"While Irish Press Plc is not in a particularly happy position and while its assets appear to be diminishing, it is not insolvent and continues to hold reasonably substantial assets through its subsidiary company. I must also take account of the fact that Mr. McHugh, a partner in the firm of Messrs Deloitte & Touche, who is not a director or member of the plaintiff company but the audit partner with overall responsibility for the plaintiff's audit, is prepared as a professional accountant with full knowledge of the plaintiff's financial affairs to aver that in his opinion the assets of the plaintiff will be sufficient to discharge the costs of the defendants.*
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> *On the balance of the evidence available, I feel that the plaintiff has sufficient resources to meet the defendant's costs in the proceedings in this Court, should such costs be awarded against the plaintiff. It does not seem to me that the liabilities of the plaintiff company itself are such as to materially alter this position and I would anticipate that the outgoings of the plaintiff in the fairly immediate future should not be extraordinarily heavy."*

On appeal, the Supreme Court upheld the approach adopted by McGuinness J.

13. In closing submissions, counsel for the defendant addressed the court on the test required by s. 390, namely whether there was credible testimony before the court which gives it reason to believe that the plaintiffs will be unable to pay the costs of the defendant if successful in its defence. The court was told that this did not require it to prefer the evidence of Mr. Brown (an accountant retained by the defendant) to that of Mr. Murphy (who was auditor of the plaintiff group of companies) or vice versa, and that, in any event, the court could not do this in the absence of cross examination. Counsel went on to say that the test is: *"is Mr. Brown's testimony credible?"* He urged the Court that the testimony could not be rejected as incredible in the absence of cross examination, having regard to the judgment of Clarke J. in *McInerney*. Therefore, he urged the Court to accept that the defendant has satisfied the first limb of the test set out in section 390.

14. Counsel for the plaintiff, referring to Irish Press v. Warburg, submitted that the correct approach is to look at the evidence available to the court, whether or not there is cross examination, and consider, in the light of that evidence, whether or not the burden of proof has been discharged.

15. In *Irish Press v. Warburg,* McGuinness J. in the High Court and Lynch J. in the Supreme Court embarked upon just such a balancing exercise, with the learned High Court Judge specifically commenting that she had reached her conclusion:-

> *"On the balance of the evidence available."*

16. It is also apparent from the decision of O'Neill J. in *Ochre Ridge Limited v. Cork Bonded Warehouse Limited & Anor* (Unreported, High Court, 20th December, 2000) that a similar balancing exercise was undertaken in the context of an application under s.390, involving relatively extensive examination of the evidence, on the balance of probabilities.

17. Finally, on this point, Fennelly J, speaking for the Supreme Court in *Hidden Ireland Heritage Holidays Limited v. Indigo Services Limited* [2005] 2 IR 115 said at page 121:-

> *The Court may have regard to any relevant circumstance which, as a matter of justice, would cause it to conclude that the order should not be made.*

It must be noted that, in making this statement, the learned judge was addressing the "*special circumstances*" limb of the test. However, it is indicative of the broad assessment of the particular position before the court that is necessarily undertaken in adjudicating upon an application under section 390.

18. I do not accept that the court should find itself precluded from making a detailed analysis of the evidence and that it should do no more than simply ascertain whether the defendant's evidence amounts to "*credible testimony*" on a *prima facie* basis. A plain

reading of s. 390 would seem to indicate that "*credible testimony*" should be read as involving consideration of evidence proffered on both sides, rather than simply addressing the evidence produced by the party moving the motion.

The Test for Ability to meet a Costs Order

19. In Ochre Ridge, O'Neill J. stated that the test is as follows:-

> *"[T]he onus of proving on the balance of probabilities, that, at the appropriate time, namely when the … Defendant would be successful in his defence that the Plaintiffs would be unable to pay the costs of the . . . Defendant."*

20. In *Parolen Limited v. Doherty & Anor* [2010] IEHC 71, Clarke J. observed that there may be a tendency towards the misapprehension that proof of insolvency is fundamental to the test required under section 390:-

> *"In applications for security for costs there is often, in my view, a tendency to confuse that test with the question of the solvency or otherwise of the relevant plaintiff company. There is, of course, a close connection between the two concepts. Both involve an identification of a company which has financial problems. In some cases there may not, in practice, be any difference. However, it is important to emphasise that the test is not as to whether the relevant plaintiff company is insolvent in the sense in which that term is used in relation to winding up or other similar areas of law. It has to be said that where parties in security for costs applications place before the court the expert views of accountants there has been an unfortunate tendency for those accountants not to identify the difference between insolvency in the proper sense of that term and the test on an application for security for costs and, thus, to give an opinion as to a matter which is not, strictly speaking, relevant*
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> *. . .*
>
> *It is important to emphasise that what a defendant is required to establish is that the plaintiff would not be in a position to pay costs should the litigation be successful. Where the costs would be significant, it is insufficient for the plaintiff concerned to say that it is not insolvent, if it is clear that it would not have available resources to meet those costs should it lose. A plaintiff, for example, which only had available to it a sum of €50,000 would manifestly not be able to pay €250,000 costs in the event that significant litigation mounted by it, where the relevant defendant was likely to incur costs of that order, was under consideration. Such a plaintiff company would undoubtedly be solvent. However, its solvency would not prevent it being properly described as being in a position where it would be unable to pay the likely costs of a successful defence to its litigation."*

The Evidence

21. In support of this application, the defendant cites a financial loss for Imagine Communications Group Ltd ("the Group") for the year ended 31st December, 2011, of €18,494,110.00 and accumulated losses up to that date of €73,573,601.00. Mr. Murphy, the independent auditor, in his report to the shareholders of the Group stated:-

> *"The net assets of the company as stated in the Group Balance Sheet and Company Balance Sheet . . . are more than half of the amount of its called up share capital and, in our opinion, on that basis there did not exist at 31st December, 2011, a financial situation which, under s. 40(1) of the Companies (Amendment) Act 1983, would require the convening of an extraordinary general meeting of the company."*

The auditor's report also contained an "*emphasis of matter*" paragraph, which was designed to indicate a significant uncertainty concerning the Group's ability to continue as a going concern. Such a paragraph does not qualify the auditor's opinion, but it cannot be ignored. The relevant paragraph states:-

> *"In forming our opinion, which is not qualified, we have considered the adequacy of the disclosures made in the financial statements concerning the Company's and the Group's ability to continue as a going concern. The Group incurred a loss for the period of €18,494,110 and has accumulated losses at 31st December, 2011, of €73,573,601. Primarily due to the uncertainty surrounding the court case, along with the other matters explained in . . . the financial statements, indicate (sic) the existence of a material uncertainty which may cast significant doubt about the Company's and the Group's ability to continue as a going concern. The financial statements do not include the adjustments that would result if the Company and the Group was unable to continue as a going concern."*

22. The defendant claims that the WiMax business, alone among the plaintiffs' undertakings, returns a profit. The plaintiffs submit that none of its companies are defending debt collection proceedings, and attributes the losses recorded in 2011 in large part to "*to non-cash right-offs of goodwill, amortisation and depreciation arising from the acquisition of businesses with infrastructure, spectrum licenses and customers*", with the write down intended to be offset against profits from the roll out of the WiMax network.

23. The plaintiffs submit that, while their poor trading performance has necessitated a re-negotiation of interest payments with their financiers, this is not the same as being in an insolvent position. The plaintiffs further claim that spectrum assets held by the Group of companies, being exclusive licenses held in certain broadcast frequency bands, for use in the provision of mobile broadband, are not recorded in the Group accounts for technical reasons. The plaintiffs claim to possess very substantial assets and submit that they will be capable, as a matter of fact, of discharging even the level of party and party costs estimated by the defendant, which is a figure that is, at some €4.5m, significantly larger than the plaintiffs' estimate of costs.

24. The Group companies' 2011 audited accounts show that there was a surplus of assets over liabilities amounting to €19.2m. The Group had net assets excluding the spectrum of €41.952m. In response to this application, the plaintiffs requested a valuation report be obtained in respect of the group's spectrum assets. A report was prepared by Dr. Mike Jeremy, which values the Group's spectrum assets between €50m and €120m. This evidence has not been challenged by the defendant.

25. Mr. Andrew Brown, an accountant with Deloitte, was commissioned by the defendant to provide an opinion on the plaintiffs' ability to pay the costs of the defendant on the basis of the 2010 and 2011 group accounts, and expressed the opinion that the plaintiffs would not be in a position to pay any award of costs in the event that they are unsuccessful at the trial of the proceedings. However, he had to concede that he made a number of mistakes in his report which was presented to the court. He overstated the losses of the Group as of 1st January, 2009, by a figure of some €9.2m and he also stated that the issue of spectrum held by the

Group was charged in favour of another company called Kreos. This is stated to be incorrect by Mr. Bolger, who swore an affidavit on behalf of the plaintiffs, and this statement has not been challenged by way of replying affidavit.

26. There is a significant difference between the level of costs postulated by each side's legal costs accountant for the trial on a party and party basis. The defendant comes up with a figure of €4,581,500 and the defendant suggests a figure of €757,680. At the hearing of this motion, counsel for the defendant submitted that, for the purpose of the application, the defendant is content to stand on the proposition that the plaintiffs will not be able to pay even the lowest figure put forward, namely €757,680.

27. Mr. Brown expressed the view that it would not have been possible, based on a consideration of the 2010 group accounts, to state that, if the defendant is awarded its costs, amounting to €4.5m, the Group will be able to meet that costs award. In looking at the 2011 group accounts, he concluded that the Group was heavily loss making.

28. The group made a loss on ordinary activities of €18.5m in the year ended 31st December, 2011, following a loss of €14.2m in 2010. The group had net current liabilities of €3.17m and had €626,069 in cash as at 31st December, 2011. Mr. Brown stated that the group had net assets of €19m but that €27m of its assets were in the form of intangible assets, namely goodwill, which is an illiquid asset which is not readily realisable or convertible to cash. He also pointed out that the group accounts and audit report highlighted growing concerns in the aforementioned "*emphasis of matter*" statement.

29. The plaintiffs complain that Mr. Brown has taken no account of key performance indicators, which show that the underlying trading position of the group significantly improved in 2011 compared with 2010. This included a 4.3% increase in gross margin, a very significant turnaround in the cash flow position from 2010, in the amount of €8,378,790, and an improvement of group EBITDA from 2010, in the amount of €4,003,926. Furthermore, they say that Mr. Brown does not address a number of exceptional one-off adjustments made in 2011, in respect of the impairment of fixed assets and inventory, which came to €8,601,736, and which adjustments are directly attributable to the alleged conduct of the defendant, which is the subject matter of these proceedings.

30. Mr. Seán Bolger, the Chief Executive Officer of Imagine Communications Group Limited and a director of each of the plaintiff companies, stated on affidavit that, apart from the €626,000, representing the Group's cash in bank at 31st December, 2011, the cash at bank balance of the un-audited management accounts at 30th December, 2012, was €847,000. In addition to the cash at bank of 31st December, 2011, the Group had €2m in funding available to it. In his affidavit in relation to this matter, sworn on 30th October, 2012, Mr. Bolger says that, at the date of swearing, €750,000 of the €2m had not been drawn down, and there thus remained available to the Group a cash balance of €1.6m, in addition to forecasted cash balances for the fifteen months to the end of 2013 ranging from between €1.045m to €1.436m. These estimated cash balances assume that the Group has already discharged legal costs of €825,000 in that period. Moreover, he states that, as is apparent from the report of Mr. Murphy, the Group company's auditor, there was a significant improvement in cash flows generated from operations in 2011, in the amount of €8.4m, and that Mr. Murphy expected this position to continue for 2012.

31. Mr. Murphy, as auditor to the plaintiff Group, is of the view that an award of costs of €1.5m could be met from the cash reserves of the group and that in the event of an award of costs of €4.5m against the company's costs could be met from a combination of cash reserves and the sale of assets.

Conclusions

32. Weighing up the evidence presented on behalf of both parties on this issue, I am not satisfied that the defendants have met the first test required by s. 390, namely that they have demonstrated by credible testimony that there is reason to believe the plaintiff companies will be unable to pay the costs of the defendant if successful in its defence. It is not necessary, therefore, for me to proceed to the consideration of whether there are special circumstances leaning towards the exercise of my discretion to refuse security for costs.

33. But, in case this matter proceeds further, I wish to state that there is cogent evidence to show that the requirement for the plaintiffs to write down the value of the Group assets is a direct consequence of the alleged breaches by the defendant that are the subject matter of the within proceedings, and insofar as that would affect the ability of the plaintiffs to meet the larger figure for costs which has been postulated by the defendants, it would seem to come within the ambit of *Peppard v. Bogoff*, and would be a sufficient ground for exercising the court's discretion not to grant security.

34. Finally, on the issue of delay in bringing this application, I am satisfied that the defendant moved with reasonable speed, having regard to all the circumstances. In any event, I am satisfied that the delay complained of would not, in itself, have been sufficient to cause me to exercise my discretion in denying the relief sought.

35. I refuse the application for security for costs.