Neutral Citation: [2014] IEHC 356

The High Court

Record no 2009/311Cos

In the Matter of Leo Getz Trading Limited (in Liquidation) and in the Matter of the Companies Acts 1963 to 2009

Between

George Kennington (Official Liquidator)

Applicant

and

John McGinley

Respondent

Judgment of Mr Justice Peter Charleton delivered on the 11th day of July 2014

The company in question, Leo Getz Trading Limited, was incorporated on 19 December 2006 and commenced trading in January 2007. The initial directors were Kevin McGinley and the respondent John McGinley, who also acted as company secretary up to his resignation as director in June 2007. The company traded in classic cars. Here we are talking about vehicles which change hands where values up to €100,000 seem moderate and can be many multiples of that. Unfortunately, the time line shows that this venture started at the commencement of possibly the worst time for the disposal of luxury vehicles in Ireland. The company was wound up on 6 July 2009 on the petition of the Revenue Commissioners on a proven unpaid debt of about €688,000 with other liabilities establishing insolvency in excess of €1.1 million. The company filed but one set of annual returns with audited accounts up to 31 December 2007, showing a modest profit. On the applicant George Kennington being appointed official liquidator, he reconstructed the assets and liabilities of the company. This was not easy, as books and records were partial and were finally delivered to him only in October 2009. He worked out that up to 31 December 2008, the company made a loss of about €426,000 and a loss up to 31 December 2009 of €785,000. His view was that the company was insolvent as of January 2008.

John McGinley lent and received back substantial sums during the currency of the trading life of the company. Some of the loans were apparently paid back in kind, in the form of the transfer of ownership of cars. The liquidator seeks the return of those loans under sections 286 and 139 of the Companies Act 1963 as amended, claiming in this plenary proceeding that the repayments from the company to John McGinley were a fraudulent preference, or had that effect.

Fraudulent preference

The fallout of company insolvency is provided for in many sections of the Act of 1963, the most serious of which is section 297 on fraudulent trading. Here, the case made by the liquidator is of fraudulent preference of the debts of the company to John McGinley over the debts of other creditors, with particular emphasis on unpaid tax. Two sections are relevant, sections 286 and 139. The one carrying the most onerous burden of proof is section 286, which is a provision substituted by section 135 of the Companies Act 1990:

> (1) Subject to the provisions of this section, any conveyance, mortgage, delivery of goods, payment, execution or other act relating to property made or done by or against a company which is unable to pay its debts as they become due in favour of any creditor, or of any person on trust for any creditor, with a view to giving such creditor, or any surety or guarantor for the debt due to such creditor, a preference over the other creditors, shall, if a winding-up of the company commences within 6 months of the making or doing the same and the company is at the time of the commencement of the winding-up unable to pay its debts (taking into account the contingent and prospective liabilities), be deemed a fraudulent preference of its creditors and be invalid accordingly.
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> (2) Any conveyance or assignment by a company of all its property to trustees for the benefit of all its creditors shall be void to all intents.
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> (3) A transaction to which subsection (1) applies in favour of a connected person which was made within two years before the commencement of the winding up of the company shall, unless the contrary is shown, be deemed in the event of the company being wound up—
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> (a) to have been made with a view to giving such person a preference over the other creditors, and
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> (b) to be a fraudulent preference, and be invalid accordingly.
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> (4) Subsections (1) and (3) shall not affect the rights of any person making title in good faith and for valuable consideration through or under a creditor of the company.
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> (5) In this section, 'a connected person' means a person who, at the time the transaction was made, was—
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> (a) a director of the company;
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> (b) a shadow director of the company;
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> (c) a person connected, within the meaning of section 26 (1) (a) of the Companies Act, 1990, with a director;
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> (d) a related company, within the meaning of section 140 of the said Act, or
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> (e) any trustee of, or surety or guarantor for the debt due to, any person described in paragraph (a), (b), (c) or (d).

John McGinley is the brother of the only director of Leo Getz Trading Limited and is thus a connected person, meaning that any disposition to him within two years back from 6 July 2009 can be a fraudulent preference provided that at the time of such payment the company was unable to pay its debts and provided such was made with a view to giving him a preference over other creditors. An intention to perpetrate a fraudulent preference to the recipient of the funds is required. In order to achieve an order under the section, a liquidator must establish that the dominant intention behind the disposition was to prefer the beneficiary; *Corran Construction Company Limited v Bank of Ireland Finance Limited* [1976, 1977] ILRM 175. At a remove of several years from the time of a transaction, and in the absence of direct evidence, intention may be impossible of direct proof. Instead, circumstantial evidence allows an inference of intention to be drawn in the appropriate circumstances; *Station Motors Limited v Allied Irish Banks Limited* [1985] IR 175. The latter authority, drawing on *Re M Kushler Limited* [1943] 2 All ER establishes four propositions as to the appropriate approach. These are that: firstly, dominant intention is required; secondly, hindsight may suggest such an intention but that is not enough since the circumstances seen in the light of what subsequently happened may mislead and instead an intention to prefer must be proven as of the time of the relevant disposition; thirdly, circumstantial evidence is to be assessed as to its probability, the fact that there might be another explanation for a payment is to be assessed as to the competing proofs and is not necessarily an answer; fourthly, since what is involved here is a fraudulent preference, solid grounds are needed since what is required is an inference of something which has the taint of dishonesty about it at the very least and which in extreme cases may be very much more than that. While in *Re Patrick and Lyon Limited*, Maugham J had doubted that moral blame was a necessary proof to make out a fraudulent preference, the later *Kushler* case establishes that the onus on a liquidator is not discharged where the state of facts established is consistent with both an unfavourable and a favourable inference; doubts as to the probable inference to be resolved against the party bearing the burden of proof. In both *Re M Kushler Limited and Station Motors Limited v Allied Irish Banks Limited,* the High Court was compelled to infer an intention to prefer because the purpose of the payments had been proven to be to reduce the amount of an overdraft on the bank accounts of both companies, which had been personally guaranteed in each instance by the directors. Thus the approach is to seek out the state of mind of the officer or officers of the company making the disposition judged from the circumstances as a whole and drawing such inferences as are appropriate; *Re Clasper Group Services Limited* [1989] BCLC 143.

Section 139 of the Companies Act 1990 provides as follows:

> (1) Where, on the application of a liquidator, creditor or contributory of a company which is being wound up, it can be shown to the satisfaction of the court that—
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> > (a) any property of the company of any kind whatsoever was disposed of either by way of conveyance, transfer, mortgage, security, loan, or in any way whatsoever whether by act or omission, direct or indirect, and
> >
> > (b) the effect of such disposal was to perpetrate a fraud on the company, its creditors or members, the court may, if it deems it just and equitable to do so, order any person who appears to have the use, control or possession of such property or the proceeds of the sale or development thereof to deliver it or pay a sum in respect of it to the liquidator on such terms or conditions as the court sees fit.
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> (2) Subsection (1) shall not apply to any conveyance, mortgage, delivery of goods, payment, execution or other act relating to property made or done by or against a company to which section 286 (1) of the Principal Act applies.
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> (3) In deciding whether it is just and equitable to make an order under this section, the court shall have regard to the rights of persons who have bona fide and for value acquired an interest in the property the subject of the application.

Proof of intention, in contrast to section 286, is not required. What is required is that a liquidator show that any property of a company was disposed of and that the effect of that was to perpetrate a fraud on the company. In this section, unlike in section 286, a broad authority is vested in the court since an order for repayment should only be made against any person to repay money or restore property where it is just and equitable to do so. In making any such decision, a court is obliged to have regard to the rights of those who have acted in good faith and have for fair value accepted such a disposal of company property. Here, a court is concerned with effect and not with intent; *Le Chatelaine Thudicum Limited (In Liquidation) v Conway* [2010] IR 529.

Fundamental to both sections, however, is the nature of the duties that are cast on company directors once a company becomes insolvent. In such circumstances, once a company has to be wound up and its assets applied in discharge of its liabilities, the directors have a duty to the creditors to preserve the assets to enable this to be done or as least not to dissipate same; *Re Frederick Inns Limited* [1994] 1 ILRM 187. That duty applies once it becomes clear that a company is insolvent; *McLaughlin v Lannen (Re Swanpool Limited)* [2005] IEHC 341 at 3.1.

Facts here

In the early days of this company, John McGinley the respondent loaned €270,000 to the firm in January 2007. This was completely repaid in April, March and June of that year in cash disbursements and by the transfer of a classic car on 18 June 2007. The running balance was therefore reduced to zero as between loans and repayments. Then, recorded in the company's books as loans from this source by three payments in 2007: €25,000 on 27 July; €50,000 on 2 August; and €175,000 on 3 August. There were then further loans to the company by John McGinley in the same year that made up a loan repayment in September, these loans being on 4 and 28 September. Focused on are five repayments and the disposition of two cars: 1 October 2007, €7000; 23 January 2008, €5000; 23 February 2008, €16,500; 18 April 2008, €45,000; and 28 May 2008, €29,500. The cheque stubs relevant to these payments are recorded as being referable to the return of a loan. In this respect, there can be little doubt. Was the company then insolvent? The evidence from the liquidator George Kennington was that he did a washout of profits and losses; and his evidence is most reliable. After September 2007, notwithstanding that liabilities were building up to the Revenue Commissioners only three payments were made to disburse taxes and these amounted to only €10,670. A competent and decent bookkeeper, Evan Brady, was employed by the company. He gave reliable evidence. The chaos that required so much work from the liquidator is not down to his lack of diligence. Rather, the principle of the company Kevin McGinley was less than forthcoming with explanations to his bookkeeper as to the source of funds and the need for disbursement. Rather, he seems to have focused his mind on cars and on the profits that might be made from same. Regrettably, it seems that every car was sold at a loss. It is difficult to know why the company kept going through 2008 and into 2009 before being wound up on the application of the Revenue Commissioners on 6 July of that year. Historically, there was false optimism in the Irish economy through 2007 and even after the bank guarantee by the Government in September 2008, most people refuse to believe that things could be as bad as they have turned out, in fact, to have been. Applying the standard derived from the authorities as to when it was clear that the company was insolvent, a reasonable appraisal of that date puts the matter after the time when the respondent John McGinley left the company. Certainly, unless matters improved dramatically, the €426,000 loss as of 31 December 2007 was on the relevant turnover sufficient to render this company insolvent. This translated into a loss of €785,000 to 31 December 2008. On any reasonable appraisal, the duty of the remaining director was to foster and maintain the assets of the company for the proper disposal to creditors. These repayments of loans may not, however, have been done with the probable intention as a dominant purpose of giving the respondent John McGinley preference over other creditors. The pattern of loans and repayments, so carefully worked out by George Kennington, establishes the receipt and repayment on two occasions of working capital from John McGinley. Were these repayments not to have been made, in those circumstances no further funds by way of loans could be forthcoming from that source. That, it seems probable is the dominant purpose to these transactions. Therefore, the burden of proof under section 286 is not established. On section 139, however, the effect of these dispositions was to establish a preference to repayment of fiduciary taxes to the central fund which cannot be allowed. The repayment of €102,100 must therefore be ordered. In similar circumstances were a bank to be preferred to the Revenue Commissioners so that funds might continue to be available from that source, a similar order would have to be made, provided that it would be just and equitable; but there the timescale would be six months and not two years as here because of the connection of John McGinley to the company.

On 2 March 2009, two cars were transferred from the company to the respondent John McGinley. These were a Ferrari Testa Rossa purchased on 27 July 2008 for €50,000 inclusive of VAT and which then had attributed value of €40,000 inclusive of VAT and an Aston Martin Vanquish S purchased a 19 February 2009 for €125,000 including VAT and which was given and attributed value of €110,000 inclusive of VAT. If this was a loan repayment, through payment in kind, the same considerations as involve the cash just dealt with would apply. In this instance, however, John McGinley has given evidence that he had had a collection of classic cars which he had disbursed and which he wished to build up again. He therefore made monies available to the company so that cars could be sourced which would suit his interests at some future point in time. The liquidator has shown that of the examples listed of payment in advance, perhaps one only could be regarded as probably fitting this pattern. The evidence from the bookkeeper to the company, however, was that prepayments for cars certainly came in from some customers. With the chaotic lack of explanation from Kevin McGinley as to the source of funds and the purpose for same, it is hardly surprising that mistaken entries would be made in the books and records of the company. The case made that all of the funds were for the purpose of future purchases of cars has not been made out. It is reasonable, however, to conclude that some of the funds advanced were for the purpose of car purchases. This accords with the live evidence of two witnesses, namely Evan Brady and John McGinley. The cars in question were held by John McGinley for three years. With the downturn in economic circumstances they were sold at a considerable loss by him for €107,000 in 2012; namely €40,000 for the Ferrari and €77,000 for the Aston Martin. In that context, the drop in values in terms of sale to John McGinley from the company is no different in reality to losses otherwise sustained on the books. It would not be just and equitable to require the repayment of these particular funds. In terms of the probability of the evidence, the case made out in that regard is probable.

Result

The respondent John McGinley will be ordered to repay the sum of €102,100 to the liquidator for the benefit of the liquidation.