Neutral Citation Number: [2008] IEHC 349

THE HIGH COURT

2007 No. 89 COS

IN THE MATTER OF SECTION 286 OF THE COMPANIES ACT 1963 AS AMENDED AND IN THE MATTER OF SECTION 139 OF THE COMPANIES ACT 1990

BETWEEN

LE CHATELAINE THUDICHUM LIMITED (IN VOLUNTARY LIQUIDATION)

APPLICANT

AND
NOEL CONWAY

RESPONDENT

Judgment of Mr. Justice Roderick Murphy delivered on the 11th day of November, 2008.

1. Facts underlying application

1. This is an application by the liquidator of the applicant company for a declaration that a transfer of goods and cash to the respondent by the company constituted a fraudulent preference or, in the alternative, a fraudulent disposition. The background to that transaction is as follows. In 2001 the respondent engaged Mr. Thudichum, a South African national with extensive experience in the retail trade, to manage the franchised Spar outlet in the respondent's premises at Ratoath, Co. Meath. After more than a year in this capacity, Mr. Thudichum approached the respondent with a view to leasing the premises. The respondent agreed.

2. The applicant company was incorporated on the 11th June, 2003, with Mr. Thudichum as its managing director, and went into occupation of the premises in October of that year. The respondent, in his own name and on behalf and with the agreement of the applicant company, continued to order some stock from the main supplier, BWG, which was associated with Spar. Invoices issued at the end of each week and were duly paid by the company. The respondent's accountant, Mr. Sweetman, became accountant to the company and oversaw these transactions.

3. Between October, 2003 when the company went into occupation, and April, 2004 shortly after a competing new retailer opened in the area, the parties' solicitors were engaged in correspondence concerning a written lease agreement. The draft lease provided that rent was payable weekly and calculated as 8% of net turnover, excluding VAT and disregarding what were termed 'agency sales', which term covered bus tickets and phone cards among other items. The respondent suggested that once these exclusions were taken into account, only about 5.5% of total weekly net turnover was paid, but this was disputed. The evidence did not establish a precise figure, but it was in the region of €30,000 per month approximately.

4. There was a dispute as to the effect of the correspondence to which I will return later in this judgment. Whether or not the written agreement came into effect however, the parties' commercial relationship carried on as planned, though the venture later ran into difficulties.

5. Despite a reduction in rent in August, 2005 to accommodate the applicant, the business experienced trading losses, largely because of an increase in competition with the opening of new retail outlets in the area. In March, 2006 Mr. Thudichum reached the conclusion that he could no longer continue to operate the business, and informed the respondent accordingly. On the 10th April, 2006, after two and a half years in occupation, the applicant "returned control of the premises" to the respondent.

6. The company was by then heavily indebted, both to the respondent and to other creditors, and was unable to pay its debts. The indebtedness to the respondent was in respect of rent owing and of four weeks unpaid invoices. On that date a stock take was performed in the presence of the respondent and Mr. Thudichum, after which the respondent took possession of cash sums on the premises totalling €9,500, together with stock valued at €112,080. The company was wound up on the 9th of September, 2006, and Mr. Randal Gray was appointed its liquidator.

7. The liquidator has applied to this court for a declaration that the aforementioned transaction is a fraudulent preference of, or alternatively a fraudulent disposition of its assets to, the respondent.

2. Fraudulent preference

8. So far as material, s. 286(1) of the Companies Act 1963, as amended by s. 135 of the Companies Act 1990, provides:

> "Subject to the provisions of this section, any…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… with a view to giving 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."

9. It is settled law that, to succeed in an application under this provision, the liquidator must prove that the transfer of property or funds was carried out with the dominant intention of preferring the recipient over the other creditors (*Corran Construction Co. Ltd. v. Bank of Ireland Finance Ltd.* [1976-77] ILRM 175 at 178; *Station Motors Ltd v. AIB Ltd.* [1985] I.R. 756 at 760). Where the court is faced with a member or director who has effective control over the affairs of the company, it may attribute his state of mind in this regard to the company (*Corran Construction* [1976-77] ILRM 175 at 178; *Station Motors* [1985] I.R. 756 at 761).

10. In *Station Motors*, Carroll J. accepted the principle laid down in *Re M Kushler Ltd* [1943] 1 Ch 248 that an intention to prefer cannot be inferred in hindsight merely from the fact that an actual preferment occurred. However, in the absence of direct evidence of intention it remains possible for the court to infer intention, even where an alternative explanation is open (*Station Motors* [1985] I.R. 756 at 761). Nevertheless, Carroll J. sounded a cautionary note, quoting the following passage from the judgment of Lord Greene MR in *Kushler*:

> "It must, however, be remembered that the inference to be drawn is of something which has about it, at the least, a taint of dishonesty, and, in extreme cases, much more than a mere taint of dishonesty. The court is not in the habit of drawing inferences which involve dishonesty or something approaching dishonesty unless there are solid grounds for drawing them." ([1943] 1 Ch 248 at 252).

11. In this case it is clear that an actual preferment occurred. Substantial amounts of stock and cash were transferred to the

respondent less than six months prior to the commencement of its winding up in September, 2006. Both at the commencement of its winding up and at the time of the impugned transaction the company was unable to pay its debts.

12. The presence or absence of an intention to prefer is more difficult to ascertain. In this case it is not disputed that Mr. Thudichum, as managing director, controlled the affairs of the company. He gave evidence of his mindset at the time of the transaction, saying it was his intention to hand over the stock and cash to the respondent. However, he said in evidence that he understood at the time that he, the respondent and Mr. Sweetman would arrive at a compromise arrangement with the other creditors such that no individual would be left unduly exposed to an unfair share of uncompensated loss in the form of bad debts owed by the company. The respondent emphatically denied having been told of any such proposal either before or at the time of the stock take. Mr. Sweetman indicated that it had not been suggested to him before the stock take, but that some time afterwards he and Mr. Thudichum had agreed to try to ensure each creditor received a portion of the debt owed to him.

13. I accept the evidence of Mr. Thudichum that he had formed the intention to reach such an arrangement at the time of the impugned transaction. On the balance of probabilities, however, I find that he did not communicate that intention to either the respondent or to Mr. Sweetman at or before that time. It was not a condition of the decision to return control of the premises to the respondent. Notwithstanding, I also find that his dominant intention in carrying out that transaction was to ensure, in co-operation with Mr. Sweetman and the respondent, that the arrangement he envisaged would become a reality. As Mr. Thudichum was at that time the company's managing director and was in control of its affairs, this intention can be attributed to the company for the purposes of the fraudulent preference question.

14. However, the applicant submitted Mr. Thudichum had, by means of the impugned transaction, left the question of who was to be compensated to the respondent. The court was invited to infer from this an intention to prefer the respondent. Such an inference appears not to be justified. The respondent may have been given the stock and cash, but, according to Mr. Thudichum's evidence, only as a prelude to their equitable division among the company's creditors. In addition, the submission on this point does not tally with the evidence. Both Mr. Thudichum and Mr. Sweetman confirmed that the arrangement was to be brought about through co-operation between the respondent and themselves: the decision was not to be left to the discretion of the respondent.

15. In reliance on the passage quoted above from the judgment of Lord Greene M.R. in *Kushler*, it was further suggested that this transaction was a fraudulent preference owing to the presence of a "taint of dishonesty" about it. However, that passage merely conveys that a fraudulent preference entails a taint of dishonesty; it does not follow that the presence of a taint of dishonesty, without more, necessitates the conclusion that a fraudulent preference occurred. In any case, the applicant relies in this regard on the alleged dishonesty of the respondent's conduct. In determining whether a fraudulent preference occurred, it is apparent from the authorities referred to that the court is concerned with the intention of the company, expressed through its director, not with that of the transferee.

16. Accordingly, the liquidator has not established that the impugned transaction was driven by a dominant intention to prefer the respondent. The claim under s. 286 must fail.

3. Fraudulent disposition

17. Section 139(1) of the 1990 Act provides:

> "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—
>
> > (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.
>
> (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.
>
> (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."

18. It is apparent from the terms of this provision that, before it can make an order under s. 139, the court must be satisfied that all of the following criteria are met:

> (i) there was a disposition
>
> (ii) of company property
>
> (iii) the effect of the disposition was to perpetrate a fraud either on the company, its creditors or its members.

19. Insofar as the meaning of the term disposition is concerned, the section is drafted in very broad terms apt to encompass almost any kind of transaction. For our purposes it is clear that the company, acting through Mr. Thudichum, gave the respondent possession of the stock and cash involved in the transaction. On the date of that transaction the company was insolvent and the respondent, with the co-operation of the applicant, resumed control of the premises together with all stock and cash thereon, and resumed trading in the ordinary course. This appears sufficient to come within the ambit of the section. The court must then consider and decide what the extent of the company's stock was at the time of the transaction.

4. Who owned the stock?

20. The question of whether the company owned the property at the time of the transaction is more complex. It was agreed that most of the stock concerned had been purchased by the respondent from BWG/Spar, the main supplier of goods to be sold at the premises. The parties had an arrangement whereby the respondent would purchase goods from BWG/Spar on his account, before transferring them to the applicant to be sold in the ordinary course. The applicant would then reimburse him. Those goods were acquired subject to a clause providing for BWG/Spar to retain title until it had been paid in full. While the respondent had paid all

debts owing to BWG/Spar in respect of goods delivered to the premises, the applicant had not reimbursed him for the last four deliveries invoiced. The respondent argues that the reservation of title clause applied not only in his dealings with BWG/Spar, but also in the context of his arrangement with the applicant. Accordingly, the respondent submits, although he had acquired title having paid for the goods included in the final four deliveries, that title never vested in the applicant company owing to its failure to reimburse him.

21. The respondent advances two grounds for suggesting that the reservation of title clause operated between him and the applicant. The first is founded on Clause 17 of the draft lease agreement between the parties, which provides:

> "The Tenant is on notice that the Grocery Store/Off-Licence is leased subject to an agreement between BWG/Spar of the One Part and the Landlord of the Other Part. The Tenant shall comply in all regards with all the obligations of the Landlord pursuant to the terms of the said Agreement but shall not be entitled to any direct or indirect budget support scheme or capital grants for shop redevelopment or otherwise or any other financial incentive pursuant to or ancillary to the said Agreement."

22. As noted above, there is a dispute as to whether this lease bound the parties, at least beyond those terms which had been acted upon in practice. The solicitor acting for the respondent at the time gave evidence that he had sent a draft lease to the applicant's solicitor and had understood that, after the insertion of a series of amendments, it was agreed between the parties. Attention was drawn to a letter of the 15th April, 2004, in which the applicant's solicitor purported to defer consideration of the question in light of the opening of a new retailer in the area and the increased competition emanating from it. The respondent's solicitor regarded this letter as merely raising a commercial issue rather than as a denial that the provisions of the lease applied.

23. However, even if the court were to assume that the lease became operative it cannot accept the proposition contended for. The respondent contracted with BWG/Spar in his own name and, as was accepted in evidence, he would be liable to pay for the goods irrespective of whether he received payment from the company. He may have acted for the benefit of the company in paying for the goods, but he acted in his own capacity rather than as the company's intermediary, and he remained bound by his obligations toward BWG/Spar in this respect. Accordingly, one of the fundamental incidents of an agency relationship was lacking (see White, *Commercial Law*, 2002, at 79). Accordingly, the respondent was not the agent of the company in paying for the goods. Equally, the company was not the agent of the respondent in ordering the goods as it ordered them for its own use and benefit. While there was no evidence as to the accounting or tax provisions of these transactions, it seems to have been a purchase by the respondent and a sale of stock to the applicant company.

24. Clause 17 was designed to prevent the company from interfering with the performance by the respondent of his obligations under the franchise agreement with BWG/Spar. It is not worded in such a way as to affect the relations between the parties to these proceedings at all, save in that the applicant undertook a duty toward the respondent to have regard to the respondent's obligations toward BWG/Spar, which included sourcing stock from BWG/Spar. While the reservation of title until payment binds the respondent it is not a term in the stocking arrangement whereby the company was to pay the respondent. Accordingly, Clause 17 cannot have extended the reservation of title clause so as to apply to transactions between the applicant and the respondent involving BWG/Spar goods.

25. The respondent relied on an alternative argument independent of the disputed agreement: that he had undertaken a considerable risk in that he was liable to pay BWG/Spar whether or not he was reimbursed by the applicant. The applicant should not be in a better position *vis-à-vis* the respondent than the latter found himself in concerning his dealings with BWG/Spar. Accordingly, a term should be implied into the tenancy agreement extending the reservation of title clause so that title to the BWG/Spar goods would remain with the respondent until he was reimbursed by the applicant.

26. The test for implying terms into contracts to give effect to the true intentions of the affected parties was the subject of a decision of a unanimous Supreme Court in *Carna Foods Ltd v. Eagle Star Insurance Co. (Ireland) Ltd* [1997] 2 I.R. 193. There Lynch J., delivering the judgment of the Court, rejected the suggestion of an implied term requiring the giving of reasons for the cancellation of an insurance policy. He declined to imply such a term because, had an officious bystander inquired as to whether reasons would be given:

> "The defendant's answer would have been an emphatic "No" whereas to imply such a term into the policies the answer would have to be by both parties "Yes, of course" expressed rather testily to discourage the officious bystander from further interrupting." ([1997] 2 I.R. 193 at 200).

27. He quoted with approval from the judgment of Pearson LJ in *Trollope and Colls Ltd v. North West Metropolitan Regional Hospital Board* [1973] 1 WLR 601 at 609:

> "An unexpressed term can be implied if and only if the court finds that the parties must have intended that term to form part of their contract: it is not enough for the court to find that such a term would have been adopted by the parties as reasonable men if it had been suggested to them: it must have been a term that went without saying, a term necessary to give business efficacy to the contract, a term which, though tacit, formed part of the contract which the parties made for themselves."

28. Similarly, in *Sullivan v. Southern Health Board* [1997] 3 I.R. 123, Murphy J., delivering the judgment of a unanimous Supreme Court, considered whether the officious bystander test was satisfied:

> "Clearly that condition is not met where the question posed by the ubiquitous bystander is answered in the negative or even where it is the subject matter of further discussion between the parties." ([1997] 3 I.R. 123 at 131).

29. The test is a stringent one and must be applied with care so as to avoid substituting what the court believes the parties should have agreed for their true intentions at the time of contracting. Maguire CJ, delivering the judgment of the Supreme Court in *Ward v. Spivack Ltd* [1957] I.R. 40, put the matter as follows:

> "although it might have been a reasonable thing for Mr.. Spivack to have agreed to … I am quite unable to hold…that had the matter been raised Mr.. Spivack must have agreed. To read such a term into the contract would in my view not be to make clear the intention of the parties unexpressed at the time but would be to make a new contract." ([1957] I.R. 40 at 48).

30. In my view, had the matter been raised at the time of contracting it cannot be said that the parties must have agreed.

Reservation of title clauses may have become increasingly common in commercial life, but they are a departure from the traditional understanding of contractual dealings. They deprive the purchaser, at least for a time, of the title to the goods which he would otherwise acquire immediately, albeit that he would have to pay for them later. They may also qualify his right to deal with the goods, not least by imposing requirements as to their separate display and storage.

31. Cases such as this bring to light another of their potential affects, in that if the reservation of title clause were enforceable against the company, it would not be able to treat the goods as its assets for the purposes of a liquidation. It cannot be considered obvious that the company would have agreed to this as a condition of its dealings with the respondent. Far from being sufficiently obvious as to go without saying, I consider that, at a minimum, there would have been further discussion of the matter had it been raised at contracting stage.

32. In addition, I cannot see that business efficacy requires the implication of such a term. The parties had agreed that the respondent was to be reimbursed for BWG/Spar purchases, so that in effect the applicant was buying goods on credit from the respondent. Such arrangements are often entered into not only without reservation of title clauses but without any form of security. A reservation of title clause in this case would have facilitated one of the parties, but it could not be called 'necessary' to give business efficacy to the arrangement.

33. This disposes of the reservation of title question, and accordingly the question of whether the clause was drafted in such a way as to validly vest title in the supplier until payment was made does not arise for decision.

34. The final question I have to address in determining whether a fraudulent disposition occurred is whether the effect of that disposition was to perpetrate a fraud on the company, its creditors or members. While this question does not seem to have been judicially considered, assistance can be drawn from commentators on the area. It has been suggested that unlike s. 286, which focuses on intention, the fraud criterion in s. 139 merely requires that the company, its creditors or members be deprived of something to which it is, or to which they are, lawfully entitled (Courtney, The Law of Private Companies, 2nd Ed. 2002, at para. 27.093). I would adopt this proposition as a correct statement of the law. Accordingly, the company was at the time of the changeover on the 10th day of April, 2006, entitled to the ascertainable current assets which were assumed by the respondent, subject to a consideration of whether the respondent, as landlord, was entitled to distress in relation to rent owed.

5. Distress by landlord

35. It was submitted, in the alternative, that the respondent as landlord only took what he was lawfully entitled to in satisfaction of rent arrears by way of distress, and, for the remainder, in satisfaction of a vendor's lien on the goods supplied to the applicant.

36. The first point might be accepted if distress had in fact been levied, but here that is not the case. Where distress is carried out written particulars of the rent distrained for must be delivered to the person in possession of the premises or, if he is not found, must be affixed to the premises (ss. 10 and 14 of the Ejectment and Distress (Ireland) Act 1846). After that point the goods must be impounded, and can be sold by public auction only if the tenant has not redeemed them within eight days (s. 4 of the Distress for Rent Act 1741, and s. 5 of the Distress for Rent Act 1751).

37. Here no such procedure was carried out. There is no evidence of written particulars of rent owing having been served on the applicant, and no evidence of the stock or any portion thereof having been held back so that the applicant might redeem it. The transaction, far removed from the usual reality of distress, was entirely voluntary. The argument founded on distress appears to be an attempt to apply to the transaction in hindsight a view which was not in the mind of any of the parties at the time.

38. It was submitted that the respondent was entitled to a vendor's lien over the goods he had paid for in order to facilitate the applicant. Counsel argued that the respondent was entitled to rely on this lien because the respondent had come lawfully into possession of the stock and cash. On the evidence of both the respondent and Mr. Thudichum, the transfer of the 10th April, 2006, had accorded with Clause 19 of the draft lease. Clause 19, as amended by the solicitor for the company, provided for the return of all stock in trade to the applicant at the termination or expiry of the lease, with provision for the applicant to be reimbursed for the stock.

39. However, even if Clause 19 came into operation, it cannot be said that the respondent came lawfully into possession of the property. The fact remains that it was the property of the company and that, contrary to the terms of Clause 19, the company was not reimbursed for it. Accordingly, this clause cannot be relied on in support of the contention that the respondent acquired the property lawfully. Insofar as the respondent may have been entitled to a lien over stock, it cannot be such as to confer on him priority to the exclusion of other creditors.

6. Conclusion

40. I am satisfied that the disposition in favour of the respondent had the effect of perpetrating a fraud on the applicant in depriving it of its assets, and on the creditors in diminishing the pool of assets available for distribution upon liquidation. The creditors were thus denied the possibility of having a portion of the debts owed to them repaid, and were accordingly deprived of a benefit to which they were lawfully entitled.

41. Since the respondent acquired the cash and the proceeds of sale of stock he appears to have had the use, control or possession of such monies and is accordingly a person to whom the section applies. Since he acquired the stock and cash knowing that the company could not fully discharge its debts to its other creditors, he cannot be said to have acquired the property bona fide, and accordingly s. 139(3) has no application to the present proceedings. The court may therefore require the respondent to pay a sum to the company in respect of the property acquired. That property, being the current assets of the company in respect of which evidence was given, seems to be limited to stock and cash.

7. How is such sum to be calculated?

42. Section 139 refers to "the proceeds of such sale or development [of the property]". The section adds the more general phrase "or pay a sum in respect of [the disposition]" to describe what should be returned to the company, which appears to leave the court to determine what sum should be repaid, rather than simply requiring repayment of precisely the proceeds of sale in all cases. The court has discretion regarding terms and conditions of its order, which is to be made on just and equitable grounds.

43. For the purpose of determining what should be paid to the company the court is bound to take into account all the circumstances of the case.

44. It is common case that the respondent in effect wrote off €80,000 in rent due from the applicant by taking that amount from the rent he was paid and transferring it into the BWG/Spar account to help the applicant overcome financial difficulties. As this sum was

written off it is, accordingly, not due and owing by the company to the respondent.

45. I accept that the respondent, through inadvertence, allowed credit card payments to be credited to the company's bank account in the months following the stock take and before liquidation, with a net gain of €21,368 for the company. While no evidence was adduced as to when the company's bank account(s) were closed, nor of the nature of such payments, it is strange that the bank accounts remained opened after the handover of the premises.

46. The company would appear to have no entitlement to the sum of €21,368 in respect of credit card payments. The respondent was not bound to give such benefit. There was no consideration for such payment. It was due and owing to the respondent who is entitled to claim for that sum in the liquidation.

47. The purchase price of BWG/Spar goods bought by the respondent, for which he was not reimbursed by the applicant is a debt owed in common with those owed to other creditors, to be addressed in the ordinary course of the distribution of assets on liquidation according to the statutory order of priority among creditors. Though it is unclear whether rent due and owing was formally demanded, is a debt due to the respondent. No evidence was given in relation to any bank balances. The evidence was that the respondent acquired €9,500 in cash and stock valued at €112,080 from the transaction, totalling €121,580.

48. The respondent is entitled to claim in the liquidation for payments made to Spar for the four weeks and for the credit card payments totalling €21,368 net.

49. Accordingly, the court declares that it is satisfied that it is just and equitable that the respondent pay to the liquidator the sum of €121,580, being the value of the property of the company which was disposed of on the 10th April, 2006, less the net sum contributed to the company by way of the credit card payments referred to above.