Neutral Citation Number: [2010] IEHC 309

THE HIGH COURT

2010 191 COS

COMMERCIAL

IN THE MATTER OF COGNOTEC LIMITED (IN RECEIVERSHIP)

AND

IN THE MATTER OF SECTION 316 OF THE COMPANIES ACT 1963

JUDGMENT of Mr. Justice Brian J. McGovern delivered on the 30th day of July, 2010

1. This is an application for direction on foot of s. 316 of the Companies Act 1963 ("the Act"). The application is brought on behalf of Kieran Wallace, the receiver of Cognotec Ltd. ("the Company") for:

> (a) Directions as to the validity of a debenture dated 7th March, 2006, created by the Company, in favour of Barclays Bank Ireland plc. ("the Bank");
>
> (b) directions as to the validity of Kieran Wallace's appointment as receiver of the Company, pursuant to the debenture;
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> (c) a direction that the debenture, the appointment of Kieran Wallace as receiver of the Company, and the Bank's interest, as mortgagee and chargee of any property comprised in the debenture, are not invalidated by any breach of s. 60 of the Companies Act 1963;
>
> (d) a direction that the Company is estopped from voiding the debenture, pursuant to s. 60(10) of the Companies Act 1963, or otherwise;
>
> (e) a direction that Kieran Wallace, as receiver of the Company, is entitled to pay to the Bank, the proceeds of the sale of any property sold or otherwise realised by him on foot of and in accordance with the debenture.

The plaintiff seeks other consequential relief, including an order, if necessary, pursuant to s. 316(3) of the Companies Act 1963, that he be relieved wholly, or to such extent as the court thinks fit, from personal liability in respect of anything done or omitted by him in relation to any property purporting to be compromised in the debenture.

2. The Company is in receivership and has ceased trading. It designed and produced computer software used by banks and other financial institutions to assist them in trading in foreign exchange and other financial instruments. Mr. Kieran Wallace was appointed receiver and manager by the Bank on foot of a debenture executed by the Company on 7th March, 2006. The debenture secured a loan of US$12,500,000. The Bank loaned this money in two tranches to the Company. On 7th March, 2006, a sum of US$10 million was lent and on 18th July, 2006, a further sum of US$2,500,000 was drawn down. It was accepted by the parties that this latter sum was not to facilitate the purchase of the Company's shares, but was for the purpose of repaying a loan.

3. Of the monies lent by the Bank to the Company, US$10m was provided for the purpose of financial assistance in connection with the purchase or acquisition of its own shares. A reorganisation of the Company involved one of its shareholders (Softbank AM Corporation) selling its shares to the remaining shareholders. The shares were to be held by Cognotec Ireland Ltd. ("Ireland") which, in turn, would be controlled by Cognotec Holdings Ltd. ("Holdings"). The funds were borrowed by Holdings, as borrower, and both Ireland and the Company provided a guarantee to the Bank in respect of the borrowings. Holdings was to lend the funds to Ireland for the purchase of the shares and following the reorganisation of the Company, Holdings would become the holding company of Ireland, and Ireland would, in turn, become the immediate holding company of the Company.

4. The Company executed a debenture comprising a fixed and floating charge over its assets (including its Intellectual Property) as security for these borrowings.

5. Because the loan was for the purpose of providing financial assistance in connection with the purchase or acquisition of the Company's own shares, s. 60 of the Companies Act 1963, applies. The following are the relevant provisions of s. 60:

> *"60(1) Subject to sub-sections (2), (12) and (13), it shall not be lawful for a company to give, whether directly or indirectly, and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase or subscription made or to be made by any person of or for any shares in the company, or, where the company is a subsidiary company in its holdings company.*
>
> *(2) Sub-section (1) shall not apply to the giving of financial assistance by a company if-*
>
> *(a) such financial assistance is given under the authority of a special resolution of the company passed not more than twelve months previously; and*
>
> *(b) the company has forwarded with each notice of the meeting at which the special resolution is to be considered . . . a copy of a statutory declaration which complies with sub-sections (3) and (4)*
>
> *and also delivers, within 21 days, after the date on which the financial assistance was given, a copy of the declaration to the Registrar of Companies for Registration.*
>
> *(3) The statutory declaration shall be made at a meeting of the directors held not more than 24 days before the said meeting, and shall be made by the directors or, in the case of a company having more than two directors, by a majority of the directors.*
>
> *(4) The statutory declaration shall state-*

(a) the form which such assistance is to take;

(b) the persons to whom such assistance is to be given;

(c) the purpose for which the company intends those persons to use such assistance;

(d) that the declarants have made a full enquiry into the affairs of the company and that, having done so, they have formed the opinion that the company, having carried out the transaction whereby such assistance is to be given, will be able to pay its debts in full as they become due."

The section provides that, if a director makes a statutory declaration without having reasonable grounds for his opinion that the company will be able to pay its debts in full as they fall due, shall be guilty of an offence and liable to a fine and/or imprisonment or both.

6. Sub-section 14 states:

"Any transaction in breach of this section shall be voidable at the incidence of the company against the person (whether a party to the transaction or not) who had notice of the facts which constitute such breach."

7. As can be seen from the text of the Act, a copy of the statutory declaration which has to comply with sub-sections (3) and (4) has to be delivered to the Registrar of Companies for Registration within twenty-one days after the date on which the financial assistance was given. That was not done in this case. The Bank maintains that it was not aware of this at the time. It had instructed Messrs. Matheson Ormsby & Prentice, solicitors, to act for them in the transaction. McCann Fitzgerald, solicitors, were acting for the Company, Holdings and the other group company involved. McCann Fitzgerald undertook to deliver the statutory declaration to the Companies Registration Office. For reasons which are unexplained, they did not do so within the relevant period and the Bank only became aware of this default in October 2007.

8. Mr. Cregan S.C. for the Company accepted that all necessary steps in the statutory validation procedure were completed except for the delivery a copy of the statutory declaration of the directors to the Registrar of Companies for Registration within twenty-one days after the date on which the financial assistance was given. Therefore, what the court has to consider, in this case, is what was the effect of that failure.

The law

9. Section 60(14) provides:

"Any transaction in breach of this section shall be voidable at the instance of the company against any person (whether a party to the transaction or not) who had notice of the facts which constitute such breach."

There was no disagreement between the parties as to what kind of notice was required, namely, actual notice. The case of *Bank of Ireland Finance Ltd. v. Rockfield Ltd.* [1979] 21, involved the loan of money by the plaintiff to two individuals for the purchase of lands on the understanding that the property would be conveyed by them to a company called Rockfield Limited. Unknown to the plaintiff, the defendant company was the owner of the property and that fact was recorded on the Folio in the Register of Freeholders in County Wicklow. Prior to advancing the money, the plaintiff did not make any enquiries about the ownership of the property and had not seen either the Folio or the Certificate of Title. The two individuals concerned used the money to buy the issued shares in the defendant company and, thus, obtain control over it. It was, therefore, an act coming within the ambit of s. 60(1) of the Companies Act 1963. The bank had taken security for the loan, which, it transpired, was for the purchase of shares in the company. The Supreme Court held that "*notice*" within the meaning of s. 60(14) meant actual notice and not constructive notice. Kenny J. stated, at p. 36:

"This is the first case, as far as I know, in which the meaning of sub-s. 14 of s. 60 has been considered by any court in this country. The onus of proving that the money was advanced for the purchase of shares in the defendant company lies on the person who alleges this. The plaintiffs do not have to prove that they had no notice of facts which constituted a breach of section 60. What has to be established is that the plaintiffs had notice, when lending the money, that it was to be used for the purchase of shares in the defendant company. The fact which constituted such breach in this case was the application of £150,000 to the purchase of the shares in the defendant company. As the purchase followed the loan, the defendants must establish that the plaintiffs knew, at the time when they made the loan, that it was to be applied for this purpose. If they got notice of this, subsequently, that is irrelevant.

The notice referred to in sub-s. 14 of s. 60 is actual notice and not constructive notice. As there has been considerable confusion as to the meaning of the terms 'actual notice' and 'imputed notice' and 'constructive notice' - a confusion which has been pointed out by many judges and text-book writers - I wish to say that I use the term 'actual notice' as meaning, in this case, that the plaintiff bank, or any of its officials, had been informed, either verbally or in writing, that part of the advance was to be applied in the purchase of shares in the defendant company, or that they knew facts from which they ***must*** *have inferred that part of the advance was to be applied for this purpose."*

10. In *Lombard and Ulster Banking Ltd. v. Bank of Ireland and Brook House School* (Unreported, High Court, 2nd June, 1997), there was further judicial analysis of the meaning of s. 60(14) of the Act, by Costello J. In that case, the company sought to avail of the validation procedure under the section, but there were a number of procedural defects in the manner in which this was done. The company agreed to give the bank a guarantee and charge as security for a loan to buy shares in the company. The bank had incorrectly been told that the validation procedure had been complied with when this was not so. Costello J. stated, at p. 10 of the judgment:

"What [s. 60(14)] means is (a) that although a transaction in breach of the section is illegal, it is only 'voidable' not void, and (b) it is only voidable against a person who had notice of the facts which constituted the breach.

There are three issues arising on the 'notice' point in this case. Firstly, the liquidator has argued that the phrase 'transaction in breach of the section' means the carrying out of a transaction prohibited by s.(1) and that as Lombard and Ulster knew that the transaction was prohibited by sub-section (1), it had sufficient 'notice' for the purposes of sub-section (14) to enable the company to avoid the transaction. I do not think that that can be correct. The sub-section

does not permit the avoidance of a transaction which is 'in breach of sub-section (1) of this section', but 'any transaction in breach of this section'. And so, if a lender knows that an attempt to validate a prohibited transaction and avoid breaching the section by adopting the procedures set out in sub-sections (2), (3) and (4) is to be made, I do not think that he has notice of any breach within the meaning of the sub-section unless it can be shown (a) that there was, in fact, non-compliance with the sub-sections and (b) that he knew of the facts which resulted in non-compliance.

Secondly, as to the onus of proof, if, as has happened in this case, a defendant puts in issue the validity of a transaction prohibited by s. 60, the onus is on the plaintiff to establish his case. However, if he fails to establish the validity of a transaction, it does not follow that his claim on foot of a Deed which is part of the transaction and is otherwise valid, fails - the transaction is merely a voidable one. And it seems to me that the onus is then on the company which seeks to avoid it to show that the plaintiff had 'notice' as required by sub-section (14). This means that in this case, the liquidator must establish, as a matter of probability, that Lombard and Ulster had 'notice' that there was non-compliance with the provisions of sub-sections (2), (3) and (4). If he cannot do so, the deed of charge is enforceable.

Thirdly, as to the nature of the 'notice', it is not sufficient for the liquidator to show that if Lombard and Ulster had made proper enquiries, that they would have ascertained that the company had failed to comply with the sub-section. It must be shown that Lombard and Ulster had 'actual notice' of the facts which constituted the breach, that is, (a) that they or their officials actually knew that the required procedures were not adopted, or that they knew facts from which they must have inferred that the company had failed to adopt the required procedures, or (b) that an agent of theirs actually knew of the failure or knew facts from which he must have inferred that a failure had occurred (see; Bank of Ireland v. Rockfield Ltd. [1979] I.R. 21, 37). 'Constructive notice' of the failure is not sufficient for sub-section (14)."

11. The *Lombard and Ulster* case has a direct relevance to the issues before me because it is quite clear that all the parties to the agreement to provide financial assistance knew that it was for the purchase of shares in the Company and therefore, *prima facie*, unlawful, unless a permitted validation under the section could be effected.

12. A significant plank in the Company's submission in seeking to void the transaction is that the Bank knew that the provision of finance was an illegal transaction as it was to enable the Company to purchase its own shares. I do not accept that submission because the test is not whether the Bank knew the transaction was in breach of s. 60(1), but whether it was a transaction in breach of the entire section. A similar argument was made in the *Lombard and Ulster* case and was rejected by Costello J. who stated that sub-section 14 referred to " . . . *any transaction in breach of this section* . . ." and not the voidance of a transaction which is "*in breach of sub-section* (*1*)". There is no ambiguity in the words of the section and I entirely agree with the views expressed by Costello J. and would adopt them. In the case of *Bank of Ireland v. Rockfield Ltd.*, the issue was whether or not the bank knew that the transaction was one involving s. 60(1), but that is not the issue here.

13. From the decisions referred to above, three principles emerge:-

(i) The onus of establishing that a person is on notice of a breach of s. 60 lies on the person asserting it.

(ii) The notice required to be established is actual notice not constructive notice.

(iii) The party asserting that a person is affected by actual notice must establish that they had such notice (of the relevant breach) prior to or simultaneously with the transaction sought to be impugned - and not thereafter.

14. On 7th March, 2006, US$10m was drawn down and the debenture was created on the same date. On this date, the directors also swore the necessary statutory declaration. The balance of the facility which was US$2,500,000 was drawn down on 18th July, 2006. As I have already stated, this was not for the purchase of the Company's shares. A copy of the statutory declaration should have been furnished to the Registrar of Companies for Registration within twenty-one days from the date on which financial assistance was given (7th March, 2006). This was to comply with s. 60, sub-section (2)(b). Messrs. McCann Fitzgerald, solicitors for the Company, had undertaken to deliver the statutory declaration to the Companies Registration Office but for reasons which are unexplained, this was not done in time. The Bank only became aware of the late filing of the statutory declaration in October 2007 when conducting a review of its security.

15. On 19th March, 2010, the directors of the Company purported to hold a board meeting in Jerusalem, Israel, to void the security in accordance with the provisions of section 60(14). The circumstances surrounding the meeting were unusual. There were three directors of the Company, namely, Mr. Brian MacCaba, Mr. John Byrne and Ms. Hilary Guiney. Evidence was given on affidavit that Ms. Guiney and Mr. MacCaba attended the meeting at Mr. MacCaba's home in Jerusalem and that the third named director, Mr. Byrne, joined the meeting by telephone from London. The evidence concerning the meeting was, to say the least, unsatisfactory and incomplete.

16. The question of an alleged breach of the statutory validation procedures under s. 60 was first raised by Syndicated Investments ("Syndicated") which is a shareholder in the Company and was one of the purchasing shareholders of its Softbank shares. Subsequent to the appointment of the receiver, Syndicated made a number of claims in respect of the Company. It alleged that it had a first fixed charge over the Company's Intellectual Property in priority to that of the Bank. Secondly, it alleged that it was the owner of the Company's Intellectual Property. In order to deal with these assertions, the receiver instituted proceedings against Syndicated [2010 No. 1125 P] and also against the directors of the Company [2010 No. 73 COS]. A default judgment was entered in the proceedings against Syndicated. In the course of the hearing of this present application, counsel for the receiver sought to impugn the motives of the directors of the Company and Syndicated in seeking to void the transaction which is the subject matter of this dispute. They raised issues which would be of serious concern if they were established in evidence. Issues concerning the validity of the board meeting in Jerusalem were also raised. Mr. Sreenan S.C. for the receiver, relied on the case of *United Dominions Trust (Ireland) Ltd.* [1993] I.R. 412. In that case, Keane J. stated at p. 416:

"It is clear that when a receiver is appointed by a debenture holder under the powers in that behalf in the debenture, the powers vested by law in the directors of the company are not thereby terminated. They may not, however, be exercised in such a manner as to inhibit the receiver in dealing with and disposing of the assets charged by the debenture or in a manner which would adversely affect the position of the debenture holder by threatening or imperilling the assets which are subject to the charge. Subject to that important qualification, the powers vested in law in the directors remain exercisable by them and include the power to maintain and institute proceedings in the name of the company where, so to do, would be in the interests of the company or its creditors."

Counsel for the receiver argued that the directors did not have the power to convene a board meeting to void the security, having

regard to the fact that they had already taken the necessary steps to validate the procedure at an earlier date, and that there was no evidence that they could show that the interests of the Company or its creditors would be served by such action. In fact, he pointed out that they might be liable for criminal sanctions under the terms of the section, if they were to void the security, because they would then be acting in breach of the provisions of s. 60 as provided for in sub-section 15.

17. Before adjudicating on these matters, it is necessary to determine whether or not the Bank had actual notice of the fact which constituted a breach of s. 60 in this case, which was the late delivery of a copy of the statutory declaration to the Registrar of Companies for Registration. If the Company did not have notice of that breach, then the transaction was not voidable at the incidence of the Company and any purported decision made at the board meeting in Jerusalem on 19th March, 2010, would have no effect in that regard.

Conclusions

18. I accept the evidence offered on behalf of the Bank in this case that they did not have actual notice of the breach. Any failure to deliver the statutory declaration for registration within the time allowed only taints the validation procedure and becomes relevant if the Bank had actual notice. Although I was referred to the decision In *Re N.L. Electrical Ltd., Ghosh and Another v. 3i plc.* [1994] 1 B.C.L.C 22, which dealt with the consequences of failing to deliver the particulars to the Companies Registration Office, it is not necessary to consider its application in this jurisdiction in circumstances where the Bank did not have notice of the failure to deliver the declaration for registration. Nor do I have to construe sub-section 14 to determine whether it could have been the intention of the legislature that a failure to deliver the declaration for registration would have the effect contended for by the Company.

19. I give the following directions on the motion brought, pursuant to s. 316 of the Companies Act 1963:

(a) The debenture dated 7th March, 2006, created by the Company in favour of Barclays Bank Ireland plc. is a valid debenture;

(b) the appointment of Mr. Kieran Wallace, pursuant to the debenture, is valid;

(c) the debenture, the appointment of Kieran Wallace as receiver of the Company and the Bank's interest as mortgagee and chargee of any property comprised in the debenture are not invalidated by any breach of s. 60 of the Companies Act 1963;

(d) the decision of the board meeting in Jerusalem on 19th March, 2010, purporting to void the security is null and void and shall not affect the debenture of 7th March, 2006, held by the Bank and the Company is estopped from voiding the debenture, pursuant to s. 60(1) of the Companies Act 1963;

(e) Mr. Kieran Wallace, as receiver of the Company, is entitled to pay to the Bank the proceeds of the sale of any property sold or otherwise realised by him on foot of and in accordance with the terms of the debenture.