Neutral Citation: [2013 IEHC 498

THE HIGH COURT

[2012 No. 3488S]

BETWEEN

LISAVAIRD SALES LTD AND LISAVAIRD MARKETING LTD

PLAINTIFFS

AND

MUINGNAMINNANE WINDFARMS LTD

DEFENDANT

JUDGMENT of Kearns P. delivered on the 14th November, 2013.

The plaintiffs' claim in these proceedings is for the sum of €504,000 allegedly due to the plaintiffs by the defendant company. The defendant company was incorporated in 2001 to finance, construct and operate a wind farm at Muingnaminnane in Tralee, Co. Kerry. The defendant company is wholly owned by its three principals and promoters, namely, Mr. Mike Barry, Dr. Aidan Forde and Dr. John Bourke. The promoters own the lands near Tralee where the wind farm is sited.

The plaintiff companies operate a farmers' co-operative in Clonakilty, Co. Cork. They had funds available for investment in 2007. In that month, Aidan Forde of the defendant company approached the plaintiffs with a funding proposal whereby it was envisaged that the plaintiffs would provide mezzanine financing of €1.2 million to the defendant for five years at a fixed annual return of 9 %. This funding was to be used by the defendant to invest in the Muingnaminnane Windfarm. The total capital expenditure envisaged for the project was in excess of €20 million. €18,628,000 was being advanced to the promoters and the defendant company via a finance facility provided by Ulster Bank pursuant to the terms of a facilities agreement dated the 26th March, 2007. The further funds required by the promoters were provided by means of a BES investment of €1 million provided by other investors. The BES investment and the proposed investment by the plaintiffs provided the equity which Ulster Bank required as part of their agreement with the defendant and its promoters.

The plaintiffs decided to proceed with the investment which offered a generous rate of annual return. However, the plaintiffs wished to structure the investment so as to benefit from tax relief available for an investment in renewable energy under s. 486B of the Taxes Consolidation Act 1997. In order to benefit from the relief under s. 486B of the Act it was necessary for the plaintiffs to make an equity investment in the defendant's company, as opposed to the mezzanine financing that had originally been proposed. The proposed investment thus reconfigured as a share purchase investment under s. 486B, was intended to provide a dividend return to the plaintiffs of approximately 9% per annum, together with some further benefits by way of tax relief.

The plaintiffs thus subscribed €1,200,000 in October, 2007 for a number of "B" Shares in the defendant. From the evidence of Gillian Keating, the plaintiffs' legal advisor in this matter, I am satisfied that the plaintiffs were anxious to protect their position in the event that the defendant company failed to make profits out of which the annual dividends could be paid. This led on the 30th August, 2007, to the insertion by the parties legal advisors of an amendment to Article 2(B)(ii) of the defendant's Articles of Association so that in amended form it read as follows:-

> "B Shares: The holders of B Shares shall be entitled to be paid on a cumulative dividend at the rate of 9% per annum on the amount paid on the B Shares held by them respectively including any premium thereon. The holders of B Shares may be entitled to a further dividend payment representing 0.01% of distributable profits provided the Company in General Meeting so resolves. **In the event that a dividend is not paid in any one year whether declared or not it shall become a debt due and payable by the company to the holders of the B Shares."** (Emphasis added)

The underlined sentence was clearly directed to a scenario which might arise if the defendant company failed to generate profits which would permit the declaration of a dividend or payment thereof.

The plaintiffs proceeded with the investment in October, 2007 but, subsequent to the investment having been made, the defendant company decided that it could not structure its company so as to allow the plaintiffs avail of the s. 486B relief. Apparently this would have been impermissible having regard to the finance being received by the defendant from the BES scheme.

Instead of unravelling the arrangements with the plaintiff companies (who are now shareholders in the defendant company) it was agreed that the annual dividend would be increased from 9% to 10.5% to compensate the plaintiff companies in circumstances where they could no longer avail of the s. 486B relief.

The project proceeded and a dividend was declared and distributed in the years 2008 and 2009 to the plaintiffs but none was declared or distributed in the years 2010, 2011, or 2012. In circumstances where the defendant company asserts there were no profits out of which a dividend could be declared for those years, the plaintiffs have sought to recover accumulated arrears of dividend for those three years – as a debt due and payable – in the sum of €378,000, together with a further €126,000 in respect of the year 2013, making a total of €504,000.

The defendant for its part asserts that the payments cannot lawfully be made as the defendant in the relevant periods had no distributable profits within the meaning of s. 45 (2) of the Companies (Amendment) Act 1983 and that:-

> a) In those circumstances, there has been no "dividend" as contemplated by Article 2(B)(ii) of the defendant's Articles of Association and, thus, nothing that can become a debt due and payable to the holders of B Shares; or
>
> b) In the alternative, Article 2(B)(ii) of the defendant's Articles of Association does not place the plaintiffs in the position of a creditor of the company, but rather they remain at all times a member of the defendant company as shareholders therein and all sums contemplated therein remain "distributions" that are subject to the restrictions laid down by s. 45(1)

of the Companies (Amendment) Act 1983; or

c) Alternatively, if Article 2(B)(ii) purports to place the plaintiffs in the position of a creditor of the company with respect to any unpaid dividend, then that agreement is illegal and/or void as a matter of law and public policy and is consequently unenforceable as against the defendant. The defendant company by way of counterclaim reclaims the payments made by them to the plaintiff companies for the years 2008 and 2009 on this basis.

A further issue exists with regard to the rent paid by the defendant company to the promoters. The plaintiffs contend that the annual sum for rent should not be factored into the figures for profits and indeed as a result of an agreement entered into by the parties, should not have been paid unless there were sufficient profits which would permit the payment to the plaintiffs of their annual sum after payment of such rent. They rely on a particular email of the 31st August, 2007, emanating from Dr. Forde to the plaintiffs' accountant for this purpose. Had such rent not been withdrawn from the defendant companies' accounts, it is alleged there would have been adequate reserves out of which to pay the plaintiff companies. On this collateral point, counsel on behalf of the defendant argued that any such agreement was superseded by the subscription agreement which expressly purported, at clause 5.9 thereof, to be the "entire contract" between the parties, thus negativing the earlier email and any agreement to which it may have related.

By way of reply, counsel on behalf of the plaintiff argued that the parties in this case had entered a "special contract" whereby the defendants undertook to discharge the annual sum as a debt in a situation where no profits existed whereby a distribution could be made to the plaintiffs qua members. He submitted that the Court was obliged to look at the substance of the agreement between the parties. In truth, this was never a true share purchase equity investment, but rather a loan in respect of which a special provision so acknowledging had been inserted at clause 2(B)(ii) of the Articles of Association. That was sufficient to establish a "special contract" tailored to the particular needs and requirements of the plaintiffs in this case.

THE EVIDENCE

Mr. Patrick Moriarty is general manager of both plaintiff companies who engage as a farmers' Co-Op in Clonakilty, Co. Cork. The plaintiffs have a number of non-farm investments, including two wind farms. They received a proposal from the defendants in May, 2007. The basic structure of the deal was one whereby the plaintiffs would provide €1.2 million by way of equity investment, the same to be repaid after five years, with provision for a defined 9% annual return by way of interest on the investment during that time. He was aware that Ulster Bank were putting €18 million into the project and that the plaintiffs further contribution was to provide the equity input which the bank required and the promoters needed. The investment initially was to be by way of mezzanine loan, but the plaintiffs then tried to advance the funds as a share subscription agreement so as to obtain s.486 relief and in this formulation the plaintiffs purchased ordinary B Shares. These shares carried no rights except the entitlement to receive dividends, but, on legal advice, a term was inserted into Article 2(B)(ii) of the defendant's Articles of Association so as to ensure that the returns under the agreement would operate in effect like a loan. The final sentence of Article 2(B)(ii) was designed to ensure that the plaintiffs would receive a fixed return on their loan regardless of whether or not the defendant had profit available for distribution.

Mr. Moriarty said that the investment monies were paid in October, 2007. Shortly afterwards the defendants made clear that the plaintiffs could not avail of s. 486 because of the BES and to compensate the plaintiffs the 9% annual return was changed to 10.5% in November, 2007. As far as Mr. Moriarty was concerned, it was now a loan by way of share purchase. They also had the reassurance of an understanding in relation to the payment of rent on the site which was owned by the proprietors, that the rent would not be taken into account by the defendant when assessing profits.

The plaintiffs duly received their dividend in the years 2008 and 2009, but in 2010 they received an email to say the dividend for 2009 should not in fact have been paid. The plaintiffs received nothing in 2011 or 2012 either. With hindsight Mr. Moriarty felt the plaintiffs would have been better off had they gone back to a straight loan arrangement with the defendants.

Mr. Derry Crowley is an accountant, who advised in relation to the funding proposal in May, 2007. He examined the cash flow charts of the defendant in August, 2007. He noted that, apart from a sum of €100,000, the promoters were themselves not injecting any other money of their own into the project. While the project had commenced as a mezzanine loan, the s. 486 opportunity required a share purchase.

Having looked at the cash flow chart, he was concerned that there might not be sufficient cash available to the defendants to make the annual payments and thus agreed with Aidan Forde of the defendants that the payment of the dividend would be given priority over any obligation on the part of the defendants to pay rent. He produced an email from Mr. Forde which is dated the 31st August, 2007, and which states:-

"As discussed yesterday, I would like to confirm that the owners of the lands leased to Muingnaminnane Windfarms Ltd. do not intend, in the event of poor revenues to the Muingnaminnane Project, to demand the payment of land rent but only to the extent that the payment of the land rent would prevent the payment of monies due to Lisavaird Co-Op.

We note that this commitment is over and above what would be expected in a normal mezzanine finance arrangement in that rental payments for the wind farm site are normal operational costs and in general are paid before any loans and/or dividends are dealt with."

However, what had occurred was that the defendants in this instance had taken payment of rent into account to assert there were no profits. This was in clear breach of this collateral arrangement and there would have been adequate funds to pay the dividends had the defendants not depleted their cash reserves in this way.

He confirmed Mr. Moriarty's evidence to the effect that Mr. Forde, following the closing of the deal, indicated that s. 486 relief was a problem for the defendants, in that they needed to drop it because of the BES investment. He confirmed that the defendants offered to increase the dividend rate on the plaintiff's investment to 10.5% and the figure was accordingly amended in the Articles of Association to reflect this agreement.

He was cross-examined about the plaintiff's further claim for a payment for the year 2013 in which context it was pointed out to him that the calendar year had not yet expired. Mr. Crowley agreed, but felt that the relevant accounting period for the payments to the plaintiffs was the anniversary of the agreement made in October, 2007 so that the payment was therefore due. He had examined the annual accounts of the defendant company and in his view the payments due to the plaintiffs should have appeared in those accounts as a debt due to them.

Gillian Keating is a solicitor and partner in the firm of J.W. Donovan. She also confirmed that what had commenced as a mezzanine loan was converted for s. 486 purposes into a share purchase agreement, as this was necessary for the purpose of obtaining tax relief for the plaintiffs and the documents were prepared on this basis. While it was intended that the dividends would be payable out of profits earned by the defendant company, she was anxious to provide an additional measure of security for her clients in a situation where profits sufficient to declare a dividend might not arise. She was mindful of the requirements of s. 45 of the Companies Act and saw no legal difficulty in inserting an amendment to Article 2(B) whereby the dividend obligation falling on the defendant was in effect converted into a debt due by the defendant company in circumstances where there were no profits. While she had not used this device previously, she was aware it had been availed of in other cases, and felt it was perfectly legal and above board.

She had also given consideration to the fact that the landlord to whom rent was payable was a separate though connected party to the defendant company and had sought confirmation from her counterpart solicitor for the defendant that a letter would be furnished on behalf of the promoters confirming the subordination of the rent payments in the manner outlined by the previous witnesses. She also stated that Ulster Bank was quite happy to confirm their agreement to the mode of distribution and payment of dividends and had no concerns with clause 2(B)(ii).

She was cross-examined on the basis that it was not generally possible to be a shareholder and creditor at the same time. She agreed with this proposition and agreed that the shares had never been cancelled or given back.

At the end of the plaintiffs' case the defendant elected not to call evidence and sought a direction for the reasons now stated.

DEFENDANT'S SUBMISSIONS
Counsel on behalf of the defendant submitted that the payments in question could not be made having regard to the provisions of s. 45(1) of the Companies (Amendment) Act 1983. That is because the plaintiffs were, at the time they committed their cumulative equity investment of €1.2 million into the defendant, on notice and aware that the plaintiffs ability to receive the dividend was prescribed by law. The Articles of Association of the defendant and s. 45(1) of the Companies Act must be construed without regard to the subjective intention of the parties at the time the relevant Article was being drafted. Further, the defendant contended that the Facilities Agreement furnished in advance of the subscription by the plaintiffs provided that the borrower could not, without the lender's prior consent, make any distribution of assets to shareholders. Precisely because of a concern articulated on behalf of the plaintiffs by their solicitors as to the effect of this clause, the particular condition was modified by a letter from Ulster Bank to the defendant dated the 9th October, 2007, which waived that particular contractual provision provided however that "such dividend is lawful in all respects". Indeed, by letter dated the 5th October, 2007, the plaintiffs' solicitors had noted the waiver and invited confirmation that "no other finance document prohibits or in any way impedes the company from declaring dividends subject always to the provisions of the revised letter of consent and the Companies Acts".

A dividend may only be made out of distributable profits. The defendants audited accounts reveal no distributable funds for any of the years 2009, 2010, 2011 or 2012. In those circumstances the operation of s. 45 (1) can only mean that no dividend could lawfully have been declared or paid.

For the Court to enforce the contract in the manner contended for by the plaintiff would be contrary to public policy. If Article 2(B)(ii) were to have the construction contended for by the plaintiffs, it would represent an undertaking to the effect that certain shareholders of a company were entitled to receive (by virtue of their shareholding alone) a payment representing 10.5% of their initial investment annually, irrespective of whether any distributable profits exist or not. Any suggestion made by the plaintiffs that the 10.5% provision somehow "mutates" from a dividend to a debt that is due and owing by the defendant is untenable. The dividend cannot have some alternative freestanding status as an enforceable debt which the shareholder can sue for qua creditor.

The provision of the Companies Act 1983 at s. 45(1) existed for a very good reason, namely, the protection of creditors. The statutory provision recognised the requirement for the maintenance of capital reserves. Disguised distributions to members of a company were thus impermissible. Section 51 of the Act of 1983 defines "distribution" as meaning every description of distribution of a company's assets to members of the company, whether in cash or otherwise, excepting four categories of distribution, none of which apply in this case, namely, issue of bonus shares, redemption of preference shares, reduction of share capital or distribution on winding up. A payment from the defendant to the plaintiffs calculated as a dividend is prima facie a distribution as the plaintiffs are members of the defendant company. That a distribution envisages a payment of a dividend from profits (but not the discharge of commercial indebtedness) was made plain in *Igote Ltd. v. Badsey Ltd.* [2001] 4 I.R. 511. Further, in *Progress Property Co. Ltd. v. Moor and Others* [2011] 1 W.L.R. 1, the English Supreme Court held that a payment paid out of capital, which on analysis is a dividend, is unlawful.

It does not matter what the parties chose to call it. The Court looks at the substance rather than the outward appearance. The plaintiffs in this case were seeking to extract value from the defendant company by reference to a liquidated sum in the absence of distributable funds.

The point raised in relation to the exclusion of rent from the defendant's reserves was of no assistance to the plaintiffs, as the email of the 31st August, 2007, was superseded by the Share Subscription Agreement and by clause 5.9 thereof which provided that the agreement and the schedules thereto embodied the "entire agreement and understanding between the parties" and superseded all prior statements, representations, agreements and understandings relating to the transaction in question.

Even without this contractual protection, the defendant was still under an obligation to pay rent due to the landowners under the terms of a lease and were thus obliged to provide for it in the accounts. Further, even if no rent had been paid in any of the years in respect of which this claim arises, the defendant would still have no reserves available for distribution because the deficit in each year on the profit and loss account was greater than the rent payable.

THE PLAINTIFFS' SUBMISSIONS
It was submitted on behalf of the plaintiffs that the Court should look to the substance of what was intended by the parties in this case.

While a company's memorandum and articles of association together form a statutory contract by virtue of s. 25 of the Companies Act 1963, the parties may nevertheless enter a separate collateral non-statutory contract which is capable of being enforced as between the member and the company. In this case, the plaintiffs were not asserting that the agreement between the parties was a section 25 statutory contract but rather a "special contract" and that the plaintiffs' rights were enforceable by virtue of this special contract. In this regard reliance was placed on the decision of the High Court of Australia in *Bailey v. New South Wales Medical Defence Union* Ltd [1995] H.C.A. 28.

If the Court found that such a contract did exist, and every consideration of fairness and equity required that it should, then the funds were due to the plaintiffs not by virtue of the fact that they were shareholders in the defendant, but rather as a lender for a fixed annual return. It was clear from the evidence that it was always the plaintiffs' intention and requirement that they be paid a fixed payment every year and without such an assurance the investment would not have been made.

In these circumstances s. 45 of the Companies (Amendment) Act 1983 had no application by reason of the express wording of Article 2(B)(ii) of the Articles of Association. Indeed, by agreement of both parties and with the benefit of legal advice, the relevant article was amended so as to ensure the plaintiffs would receive a fixed return on the finance provided to the defendant irrespective of whether or not the defendants declared a dividend or had profits available to make that distribution. It was obvious in this case that had the defendant not agreed to amend the Articles of Association the monies would not have been advanced to the defendant.

The distribution provided for in the Articles was not one being made to the plaintiffs *qua* member, but rather was being made to them as creditors of the company.

The plaintiffs in this case are not typical shareholders. They do not have any right to participate in the management of the defendant company and do not have voting rights.

As regards the deduction of rent from the capital reserves of the defendant company, it was submitted that these deductions were made by the defendant in circumstances where it was not legally obliged to do so. The email of the 31st August, 2007, made it clear that the rent would not be paid to the owners of the lands leased to the defendant in the event of poor revenues, to the extent that the payment of the rent would prevent payment of monies to the plaintiff.

The Share Subscription Agreement with its "entire contract" clause referred only to the plaintiffs' subscription to shares in the defendant company and did not refer to the collateral agreement with regard to rent. The fact that the confirmation was expressly sought and given by the defendant on the 31st August, 2007, induced the plaintiffs into entering the Share Subscription Agreement and could only in the circumstances be construed as a collateral contract.

It followed that if the defendant had not made the rental payments, the defendant would have had sufficient reserves to make the distribution. As of the 31st December, 2012, the accumulated negative reserves of the company were €378,643. If the rental payments were added back, there would in fact be positive reserves of €205,631.

The submissions advanced on behalf of the defendant, if accepted, would obviously be a complete bar to the defendant's counterclaim. More importantly, however, such a finding would deprive the plaintiffs of the annual sums to which they were clearly entitled and, given the poor performance of the defendant company, might jeopardise the entire capital sum invested by the plaintiff companies with the defendant.

DECISION

Section 45 subsections (1) and (2) of the Companies (Amendment) Act 1983 provide as follows:-

> "(1) A company shall not make a distribution (as defined by section 51) except out of profits available for the purpose.
>
> (2) For the purposes of this Part, but subject to section 47 (1), a company's profits available for distribution are its accumulated, realised profits, so far as not previously utilised by distribution or capitalisation, less its accumulated, realised losses, so far as not previously written off in a reduction or reorganisation of capital duly made."

That said, and as noted in Courtney *The Law of Companies* (3rd ed., Bloomsbury Professional at para. 10.098:-

> "In order for s. 45 (1) of the Companies (Amendment) Act 1983 to regulate a payment by a company, the payment must be made to a member or a nominee of a member in the person's capacity as a member. A payment by a company to a person who is not a member of the company (or in any way connected with a member) will not require to be made from distributable profits. The payment by a company of a lawful debt, for example, will not be invalidated by reason of s. 45 even where the company is insolvent after the payment has been made or the financial effect is to wipe out its capital. A payment to a member's nominee, such as to a company owned and controlled by that member, may fall to be treated as being a distribution to that member."

Section 51 of the Act of 1983 defines "distribution" as meaning:-

> "… every description of distribution of a company's assets to members of the company, whether in cash or otherwise", excepting four categories of distribution none of which apply in this instance.

I am satisfied that a payment from the defendant to the plaintiffs, calculated as a dividend, is prima facie a distribution since the plaintiffs are members of the defendant.

In *Igote Ltd. v. Badsey Ltd.* [2001] 4 I.R. 511, the plaintiff had sought judgment on foot of a share subscription agreement entered into with the defendant. The plaintiff contended that the agreement amounted to a contractual obligation on behalf of the defendant to pay £40,000 *per annum*. The defendant argued that the agreement amounted to an obligation only to pay the sum by way of dividend, if available from distributable funds.

Much of the consideration by the Supreme Court in that case was directed to the "intention" of the parties and emphasised the dangers of seeking to extract from the transaction the subjective intention or motivation of one or other, or even both, of the parties. In the course of his judgment, Murphy J. at p.518 stated:-

> "In my view the Judge erred in ascertaining the intentions of the parties from the evidence heard by him as well as the alterations aforesaid and documents prepared in the course of the negotiations. The intention of the parties may be gleaned only from the document ultimately concluded by them, albeit construing it in the light of surrounding circumstances but not ascertaining their intentions from such circumstances. Such a process would be justified only where one or other of the parties claimed rectification of the document executed by him: that is not the present case.

On p.520, Murphy J. further stated:-

> "Unhappily, it would seem to me that the effort to place the agreement in the context in which it was made evolved into an impermissible investigation of the subjective intentions of the parties in entering into the agreement. I have no doubt

> that the agreement and in particular clause 4.3 thereof properly construed requires the defendant and the other parties thereto to procure the payment of the sums of £40,000 by way of dividend subject to the necessary qualification that such sums may only be paid when profits are available for that purpose."

In that case the plaintiffs' contention that the annual payment of £40,000 was a contractual commitment to pay that sum amounting to an "indebtedness by the defendants" was rejected and the defendant's argument that the particular obligation was to pay the sum by way of dividend and accordingly to make the payment only if profits were available for that purpose, was successful.

In *Progress Property Company Ltd. v. Moor & Others* [2011] 1 W.L.R. 1, the British Supreme Court held that a payment paid out of capital (and not out of distributable funds) which, on analysis, is found to be a dividend, is unlawful. It further held that "whether or not the transaction is a distribution to shareholders does not depend exclusively on what the parties choose to call it. The court looks at the substance rather than the outward appearance".

It seems to me that these rules must be strictly construed and applied, given that they exist for the protection of creditors of a company. This is not a case where the plaintiffs' companies were service providers to the defendants or anything of the sort. They are in the unfortunate position that having commenced this transaction, first by way of mezzanine loan, and then by way of s. 486 investment, they entangled themselves in a share subscription agreement which, when the BES scheme ruled out that particular option, left them nonetheless as members of the defendant company. As Mr. Moriarty himself pointed out, they might have been better off going back to square one and starting all over again. Instead, the share subscription agreement was maintained and altered only by the insertion of a new rate of return by way of the specified annual dividend.

I cannot accept the contention advanced on behalf of the plaintiff that this transaction constituted a "special contract" such as would circumvent the application of s.45 of the Companies (Amendment) Act 1983. Nor do I think that the decision of the High Court of Australia in *Bailey v. New South Wales Medical Defence Union Ltd.* [1995] H.C.A. 28 is of any particular assistance to the plaintiff.

In that case the High Court found that a special contract could legitimately be brought into existence between a company and a member (which might or might not be defined by reference to its articles). It was in circumstances where the nature of the special contract did not conflict with any statutory provision, such as arises in the instant case by application of s.45 of the Act of 1983.

In *Bailey's* case, the plaintiff, Mrs. Bailey, was the widow of Dr. Bailey who had been sued for medical negligence. Dr. Bailey was initially indemnified by the defendant union, but the union later withdrew cover and the patient obtained judgment against both Dr. Bailey's estate and the union. Judgment was also given in favour of Dr. Bailey's estate and the union appealed. The issue on appeal was whether or not the union was liable to indemnify Dr. Bailey's estate and the matter turned on the construction of the union's articles of association. These articles provided an indemnity for members and their personal representatives against liability for damages arising out of any claim against a member for professional acts or omissions. The articles of association were amended after Dr. Bailey joined the union to provide the union with absolute discretion in deciding whether or not to indemnify a member. Notwithstanding the refusal of indemnity by the union, the court held:-

> "There can be no doubt that during each of the years in which Mr. Crawford suffered injury there was a contract of insurance between the Union and Dr. Bailey. Nor, in our view, can there be any real doubt that, notwithstanding that its terms were largely to be found in the company's articles, the contract was made individually with Dr. Bailey as an insured and was therefore a special or actual contract which was distinct from the covenants which were deemed to arise from the articles under the relevant companies legislation."

The court very reasonably took the view that it could not have been the intention of the parties that insurance cover already purchased upon terms contained in the articles should be diminished by a subsequent alteration to those articles.

However, the issue in the instant case is not whether a special contract can be created between a company and one of its members, but rather whether a special contract made between a company and its members can operate in such a way as to displace or circumvent s.45 of the Act.

While Gillian Keating, the plaintiffs' solicitor, stated her belief that this device had been successfully utilised in other cases, no practical instances were in fact demonstrated, nor was any legal precedent cited to suggest that such a device had passed legal scrutiny by courts in this jurisdiction.

On this aspect of the case, therefore, I am satisfied that the plaintiffs cannot succeed.

That, however, does not dispose of the matter, because I am quite satisfied that a collateral contract was made between the parties whereby the promoters represented to the plaintiffs that rent payments would be subordinated to dividends payable to the plaintiffs under the share subscription agreement.

The terms of the email dated 30th August, 2007, are clear and unambiguous. Monies were not to be extracted from the company's accounts to meet an arrangement between the company and its promoters which was effectively operated by the promoters in such a way as to deplete their cash reserves and deny the plaintiff companies the dividends to which, in my view, they were entitled. Indeed, as pointed out by counsel on behalf of the plaintiffs, they would never have entered this agreement but for this representation and undertaking and I am satisfied that the plaintiffs' claims in this regard are well founded.

In *A.I.B. v. Galvin Developments (Killarney) Ltd. & Others,* [2011] I.E.H.C. 314, (Unreported, High Court, Finlay Geoghegan J., 22nd July, 2011), Finlay Geoghegan J. held that a collateral agreement existed in written "heads of agreement" drawn up by the bank in advance, according to which the bank agreed to limit its rights of recourse to 50% of the drawn debt. The representations were intended to induce the potential borrowers to continue in negotiations with the bank to obtain the facilities. However, the personal guarantee subsequently given by the defendants was not limited to 50%. In stating the law on collateral agreements, Finlay Geoghegan J. cited with approval the decision of Cooke J. in the Supreme Court of New Zealand in *Industrial Steel Plant Ltd. v. Smith* [1980] 1 N.Z.L.R. 545, who in turn had quoted with approval from Cheshire and Fifoot on *Contracts* (5th N.Z. Ed. 1979, 53-54):-

> "The name is not, perhaps, altogether fortunate. The word 'collateral' suggests something that stands side by side with the main contract, springing out of it and fortifying it. But, as will be seen from the examples that follow, the purpose of the device usually is to enforce a promise given prior to the main contract and but for which this main contract would not have been made. It is rather a preliminary than a collateral contract. But it would be pedantic to quarrel with the name if the intervention itself is salutary and successful."

This approach was adopted and followed by Hogan J. in *Tennants Building Products v. O'Connell* [2013] I.E.H.C. 197, (Unreported, High Court, Hogan J., 17th April, 2013) in which he stated:-

> "The effect of this case-law may be said to be that while the courts will permit a party to set up a collateral contract to vary the terms of a written contract, this can only be done by means of cogent evidence, often itself involving (as in *Mudd* and in *Galvin*) written pre-contractual documents which, it can be shown, were intended to induce the other party into entering the contract. By contrast, generalised assertions regarding verbal assurances given in the course of the contractual negotiations will often fall foul of the parol evidence rule for all the reasons offered by McGovern J. in Deane."

Quite clearly the defendant would have had sufficient reserves to make the distribution had they not deducted the rental payments. By drawing them down, the accumulated negative reserves of the company as of the 31st December, 2012, were €378,643. If the rental payments are added back, there would in fact be positive reserves of €205,631.

The defendant endeavours to counter this aspect of the claim by saying that the share subscription agreement supersedes the representation set out in the email to which I have referred. In this regard, clause 5.9 of the share subscription agreement provides as follows:-

> "This Agreement and the Schedule annexed hereto embody the entire agreement and understanding between the Parties hereto and supersede all prior statements representations agreements and understandings relating to the subject matter hereof. This Agreement shall not be varied or cancelled unless the variation or cancellation is expressly agreed in writing by all of the Parties."

I accept the submission made by counsel on behalf of the plaintiffs that this clause relates to everything contained in the share subscription agreement, but not to matters altogether outside of it, as this representation clearly was.

I am therefore satisfied the plaintiffs are entitled to judgment, but I propose to hear further submissions from both sides in relation to the amount of profits before entering judgment for any particular sum.