[Neutral Citation Number: 2005 IEHC 421]

THE HIGH COURT

[2004 No. 74 COS]

IN THE MATTER OF KELLY TECHNICAL SERVICES (IRELAND) LIMITED (IN VOLUNTARY LIQUIDATION) AND IN THE MATTER OF SECTION 150 OF THE COMPANIES ACT, 1990 AND SECTION 56 OF THE COMPANY LAW ENFORCEMENT ACT, 2001.

BETWEEN

TOM KAVANAGH

APPLICANT

AND

RAYMOND KELLY, DECLAN KELLY, TIM KELLY, BRIAN HARNETT, AND PATRICK O'FLAHERTY

RESPONDENTS

Judgment of Mr. Justice MacMenamin dated the 28th day of July, 2005.

1. In these proceedings the applicant seeks a declaration that the respondents being persons to whom Chapter I, Part 7 of the Companies Act, 1990 applies, shall not for a period of five years be appointed or act in any way, whether directly or indirectly, as a director or secretary or be concerned or take part in the promotion or formation of any company unless that company meets the requirements set out in subs. 3 of s. 150 of the Companies Act, 1990 (as amended). The applicant is the liquidator of the above entitled company, having been so appointed on 24th July, 2000. On the same day a resolution to wind up the company was passed while administrative receivers were appointed to the U.K. company on 12th July, 2000.

2. The first, second and fourth named respondents were directors of the company at the time of the commencement of the winding up of the company. The third named respondent, Tim Kelly, was a director for the period from October 1998 to 13th June, 2000, a period within twelve months of the liquidation date.

3. The fifth named respondent, Patrick Flaherty was not formally appointed a director of the company. However for reasons set out hereinafter in this judgment the applicant makes the case that he was a de facto director pursuant to s. 27 of the Companies Act, 1990.

4. At the date of commencement of the winding up the company was unable to pay its debts within the meaning of ss. 2 and 4 of the Companies Act, 1963. The company was incorporated on 12th October, 1998, had an authorised share capital of 12,697,738 shares, of which four were issued and the company had its registered office at Lyndican, Claregalway, County Galway.

Background

5. The company was involved in the supply of contract labour in relation to cabling and laying of telecommunication services. The company had a common shareholding with Kelly Technical Services Limited ("the U.K. company") in that each of the first, second and third named respondents were common, equal shareholders in each entity. Both businesses were engaged in the same business. It is contended from affidavits filed on behalf of the respondents that the U.K. company was funding the company in suit. By way of further background, the company appears to have been formed in order to transact installation work with Eircom.

6. This was the company's principal contract. The purpose of the contract was to provide specialist copper jointing services in the cable laying industry and this was awarded to the company in or about April, 1999.

7. The company was established in or about October, 1998, with the same shareholding as Kelly Technical Services Limited ("KTS U.K."), a company which was established in February, 1993, in which Raymond Kelly, Declan Kelly and Tim Kelly were each 33% shareholders. Both companies were involved in the same line of business and both collapsed in or about the same time.

8. Following the commencement of work on the contract with Eircom in May, 1999 it became apparent to the directors that there was a local shortage of appropriately qualified staff. As a result, apparently on the suggestion of Eircom the company began to recruit employees in South Africa in 1999 specifically to recruit engineers skilled in copper jointing. On 27th September, 1999, the company entered into employment contracts with approximately 80 engineers at a basic wage of IR£700 per week. The company arranged transport and work permits, paid accommodation and purchased tools and transport necessary for the workers to carry out their work in accordance with the standard set by Eircom.

9. Work continued on the Eircom contract until approximately 21st December, 1999. On that date Eircom informed the company by telephone that it was experiencing budgetary problems and that it would be "suspending" the contract until further notice. On 7th January, 2000, written confirmation was received that the contract had been "suspended/postponed". This action along with the company's consequential legal difficulties with its South African employees were both factors which led to the collapse of the company.

10. On 5th January, 2000, the company made its South African workers redundant. These workers commenced legal proceedings for breach of contract against the company, KTS U.K., and Raymond Kelly and Declan Kelly personally. KTS U.K. was joined in the action on the basis that the two companies allegedly operated as one and hence were jointly and severally liable. An interim order was obtained which required the company to re-employ the workers and to supply them with vehicles and accommodation.

11. Subsequent to a hearing in the High Court this court found in favour of the workers in respect of liability. Prior to the issue of quantum being considered by the court, on 31st May, 2000, the company and KTS U.K. reached what was stated to be an out of court settlement with the South African workers whereby, *inter alia*, the company agreed to reinstate the workers, pay them general damages which totalled IR£480,000 plus costs estimated at IR£ 250,000. It was also agreed that the workers' wages would be increased to IR£800 per week for those working in the United Kingdom.

12. The respondents' case is that following the entry into this settlement, which also bound KTS U.K., a firm called Griffin Factors, which was providing factoring facilities to KTS U.K. became nervous as to KTS U.K.'s financial position. On 20th June, 2000, KTS U.K.'s directors which included Raymond Kelly appointed advisers to consider its financial position. On 7th July, 2000, the directors were advised to appoint an administrative receiver to KTS U.K., which receiver was then appointed on 12th July, 2000. Simultaneously, steps were taken to wind up the company in suit which led to the liquidator's appointment on 24th July, 2000.

13. It is contended on behalf of the applicant that the company in suit and KTS U.K. were effectively run as one entity. During the early part of its trading the company had no bank account and transactions were done through the bank account of KTS U.K. A

substantial inter-company balance arose between the two companies. The liquidator has sought to establish the true level of this balance. For the purpose of the statement of affairs the balance is the sum of €2,011,256, the balance per the books and records of the company is €683,346 and the balance for the receivers of KTS U.K. is €1,607,831. The liquidator states that he has been unable to obtain a satisfactory explanation for major movements on this account and for these balances.

14. The liquidator states that on cessation of trading by the company, many of the South African employees had left secure and pensionable employment in South Africa to take up contracts with the company. He states that they were treated in an appalling manner. Many employees were left in a situation where their accommodation had been previously paid for by the company, as per the terms of their contract. When the company ceased trading these employees and their families were apparently left with no accommodation, wages or entitlements and no flights home. The liquidator adds that when he visited the factory premises he was appalled to see several families with young children, having already been thrown out of their accommodation with nowhere left to go, sleeping, cooking and washing in the factory, in what can only be termed minimal facilities.

15. The creditors meeting took place on 24th July, 2000. Messrs. Actons Solicitors were present acting for the 70 employees. The only substantial vote in favour of the members' nominee was in respect of the inter-company debt owing to KTS U.K. The main opposition to the members' nominee were several trade creditors and employees.

16. Actons wrote to the members' nominee as liquidator on 20th July, 2000, that is four days before the creditors meeting. In that letter the firm outlined the monies owing on foot of the settlement agreement, which included the settlement amount, legal fees, arrears of wages, statutory notice and holiday pay balances owing on foot of the employment contracts.

17. The liquidator contends that the figures showing in the statement of affairs for the purposes of the creditors meeting grossly understate the legal settlement figures and costs.

18. The liquidator states his belief that the directors may have overstated the inter-company balance appearing in the statement of affairs and understated the legal settlement costs in an effort to frustrate the appointment of the creditors' nominee as liquidator. On the first count of proxies the value clearly favoured the members' nominee when using the creditors' balances on the statement of affairs. Following an indication by the employees' solicitors, Messrs. Actons, that the matter be referred to the High Court, the directors consented to the creditors' nominee being appointed as liquidator. That creditors' nominee is the applicant herein. Messrs. Actons Solicitors are instructed by him also.

19. In the statement of affairs as appearing in the papers a figure of €26,664 was stated as realisable in respect of plant and equipment, tools, furniture and fittings, despite having a net book value of €411,000. A substantial amount of tools and equipment apparently went missing prior to the liquidator's appointment. There remains a large deficiency in assets.

20. The statement of affairs shows Eircom as a debtor in the sum of €124,434.00. Eircom have refused to pay this debt. When the directors were queried on this issue they stated that there was no money owing from Eircom as they had agreed, prior to the liquidation, to write-off this debt as the company had agreed to provide "free man hours" worth €146,020 and that this should be allowed as a set-off against the debt.

21. In October, 2001, Eircom issued proceedings entitled *Eircom Plc v. Kelly Group Limited* Record No. 2001/84, claiming €156,952 relating to their counterclaim on the debt owing by Eircom to the company. The decision by the Master of the High Court that the claim should be struck out as against the Kelly Group was successfully appealed to the High Court. The order of the High Court (Quirke J., 4th June, 2003) states that there is evidence suggesting that there is a contractual relationship between Eircom Plc and the Kelly Group. These proceedings are still pending.

22. In order to place matters in context it would be useful here to set out some further background material. The third named respondent, Tim Kelly, is the eldest of the three brothers who are respondents herein. He was born on 9th March, 1954. He is the chairman and 90% shareholder of Kelly Communications Group Limited, an English company which has an annual turnover of approximately Stg.£60 million. In 1993 the third named respondent invested the sum of Stg.£210,000 in Kelly Technical Services Limited (KTS U.K.) in which the first and second named respondents were involved. This company is not a subsidiary of Kelly Communications Group Limited. The purpose of this investment by the third named respondent was to assist his brothers and to set them up in business. The third named respondent hoped that dividends from KTS U.K. would pay off his initial investment.

23. It is accepted that the third named respondent was a non-executive director of KTS U.K. from the outset and remained so until his resignation on 7th June, 2000. The third named respondent states that he had little involvement with KTS U.K. during his tenure as director. He was furnished with no information relating to the affairs of the company. During 1999 he consulted with his financial advisers, MacIntyre Hudson Chartered Accountants, and expressed his concern at his inability to obtain information as to KTS U.K.'s trading and sought advice in relation to his entitlement as a director of KTS U.K. to information regarding that company. MacIntyre Hudson subsequently furnished written advice on 20th and 21st September, 1999 and again on 9th February, 2000, following a further enquiry from their client, the third named respondent. The third named respondent points out that there is no mention in any of the correspondence of the Irish company or of any responsibilities under Irish law. The only references are to English law and to the English company.

24. The third named respondent's signature does, however, appear on form B10 for that company, indicating consent to act as a director thereof. Whilst he accepts that his signature does appear on the form and is genuine, he states that he has no recollection of signing the form and presumes that he signed it amongst a batch of papers, not appreciating the significance of the document. At no stage up to the liquidation of the company in suit was the third named respondent, he avers, alerted to the fact that he had been listed as a director of that company.

25. The third named respondent states that he did not become aware that he was listed as a director of the company in suit until a conversation with the liquidator, who is the applicant herein, on 26th October, 2000. The third named respondent contends that he had absolutely no involvement in the affairs of the company in suit (KTSI). KTSI was established with the same shareholding as KTS U.K. The first, second and third named respondents held 33% of the shares in each company. The third named respondent, however, did not invest any money, it is contended, in the company in suit and it is contended that the shareholding in KTSI was simply consequent upon the third named respondent's interest in KTS U.K.

26. In late December, 1999, the directors claimed that Eircom suspended its major contract with the company indefinitely. From the liquidator's investigations Eircom, while reducing the volume of work at that time, did not actually terminate the contract and a slow down in work was provided for in the contract. The applicant asserts that from this point onwards up to the date of liquidation the conduct of the directors was reckless. In January, 2000, the company rendered the 70 contracted South African employees

redundant.

27. The directors, it is contended, failed to secure sufficient projects for the company to survive after Eircom reduced the volume of work. The liquidator further questions the commitment of the directors to the company in the light of the fact that there was procured a new substantial Eircom contract in June, 2000, which was put in the name of a connected company but not that of the company in suit.

28. The liquidator further contends that the company continued to run up costs in relation to employment contracts, sub-contractors' costs, managerial wages, vehicle maintenance and other overheads after early 2000 when the turnover of the company had fallen dramatically from a figure of IR£2.698 for the eight months to 31st December, 1999, to a figure of only IR£600,707 for the four months ended 30th April, 2000. In the four months ended April, 2000, however, sub-contractors' costs averaged IR£239,000 per month, which is similar to the costs per month prior to the collapse in the company's turnover. The collapse in turnover, therefore, does not appear to have been matched by a reduction in the sub-contractors' costs. For the four months ended 30th April, 2000, managerial wages averaged IR£26,000 per month, which was actually substantially higher than the figure of IR£18,000 monthly average during the eight months ended 31st December, 1999, despite the dramatic fall in turnover. The vehicle maintenance costs for the four months ended April, 2000, amounted to IR£44,000 per month, compared to IR£ 19,000 per month for the eight months ended 31st December, 1999, even turnover had collapsed dramatically.

29. Furthermore, the liquidator points out that the company had run up significant liabilities in relation to a legal settlement with the South African employee, hereinafter called the *Zutphen* proceedings, in relation to their contracts and the associated legal costs at a time when they were aware that the company was not solvent. They then arranged the winding up of the company shortly after negotiating the release of two of the directors from any personal liabilities arising from the settlement.

30. One factor in inducing the settlement may have been a letter from Messrs. Matheson Ormsby Prentice, solicitors, then acting for the company in suit. This letter was dated 18th May, 2000 and was addressed to Messrs. Actons, then the solicitors acting on behalf of the South African employees. The letter was headed:

> "High Court 2000/367P – *Zutphen & Others v. Kelly Technical Services (Ireland) Limited & Others*
>
> We write to inform you that Eircom has now finalised its tender 2000 project. Under this project Eircom have reduced the number of contractors from 17 to 5 with a consequent increase in work for the successful contractors. Subject to formal legal agreements being entered into, our clients have been awarded three Eircom regions, Galway, Sligo and South Dublin, for a period of twelve months subject to whatever terms are specified in the contract. The formal contract is due to be signed by Eircom and our clients on Friday, 26th May.
>
> It is anticipated that there will be a requirement for a large number of jointers and it is proposed that the plaintiffs in South Africa will be contacted shortly to explain the position. Arrangements will be made for some of the plaintiffs to return to Ireland in the next few weeks. As you are aware, Irish work permits are already in place to allow those plaintiffs in South Africa to work for Kelly Technical Services (Ireland) Limited.
>
> We are also instructed that our clients are in the process of finalising U.K. work permits for these plaintiffs in South Africa. We have been instructed that work permits have been processed for (here the names of the workers are set out) and our clients will be writing to these individuals immediately to offer them available work in the U.K.
>
> We are instructed that the remaining permits for the other plaintiffs in South Africa are currently being finalised by the immigration authorities in the U.K. and will keep you informed as and when each permit has been finalised.
>
> Yours faithfully"

31. A further issue which arises in these proceedings is the extent to which the company in suit and KTS U.K. were effectively run as one entity. The applicant points to a number of different factors which he says are evidence to this proposition. These include:

> 1) The letter of appointment to South African employees was on the letterhead of *"Kelly Technical Services"* not in the name of the company.
>
> 2) Similarly the Eircom contract of 4th May, 1999 also referred to *"Kelly Technical Services"* and did not specifically reference the company herein. Correspondence emanating from Eircom demonstrates a similar lack of clarity regarding the contracting entity.
>
> 3) It appears from certain correspondence with Eircom and affidavits filed in the proceedings entitled *Eircom PLC v. Kelly Group Limited* (Record No. 2001/840 S) that Eircom believed itself to be dealing with the Kelly group. In that regard the submission made to Eircom in March, 1999 was on "Kelly Group Limited" letterhead and enclosed a proposal entitled "The Kelly Group PODE proposed outsourcing of Telecom Éireann".
>
> 4) The company and KTS U.K. had the same bank account from October, 1998 until November, 1999.
>
> 5) A number of entities negotiated a "memorandum of understanding" with Eircom in early 2000. This memorandum of understanding was signed in early April of that year.
>
> 6) On June 2nd, 2000, a further contract was entered upon with Eircom. A confidentiality agreement annexed thereto was signed by Mr. Raymond Kelly, the first named respondent, on behalf of *"Kelly Technical Services Limited"* In addition a document entitled "Certificate of safety statement" annexed to the agreement is also signed by him on behalf of *"Kelly Technical Services"* which did not specifically reference the company herein.

32. An area of specific reference from the applicant is the conduct of the respondents in the context of the Zutphen proceedings.

33. The first of these issues relates to an affidavit which was sworn by Mr. Declan Kelly in the Zutphen proceedings on 17th January. In the course of those proceedings a motion was brought to restrain any dissipation of assets of the company in suit within this jurisdiction.

34. In the course of that part of the proceedings Mr. Declan Kelly swore in an affidavit of the 17th January, 2000:

(i) "I say that the defendants herein have absolutely no intention whatsoever of dissipating assets. I say that the first and second named defendants herein that is KTS Ireland (that is KTS Ireland and KTS U.K.) are successful companies trading in the Republic of Ireland and United Kingdom respectively. I say that both companies are solvent and that any movement of assets which might take place would be purely in the normal course of business. I say that the first named defendant will have an anticipated annual turnover of approximately €6 million for the period ending on 31st March, 2000 and will have an anticipated approximate turnover of €15 million for the period ending on 31st March, 2001 and the second named defendant will have an anticipated turnover of approximately STG £12 to £14 for the financial period ending on 31st March, 2000 and will have an anticipated approximate turnover of STG £25 for the financial period ending on 31st March, 2001".

35. Furthermore Mr. Declan Kelly averred in the same affidavit

"I say that the first and second named defendant are substantial companies and should it transpire that any liability is owed by either of these defendants to any of the plaintiffs then both companies are in a position to meet an award of damages that may be given. I say that in the circumstances of the present dispute damages is an adequate remedy should the plaintiffs be successful in their claim".

36. In or about 13th April, 2000, a preliminary issue in the *Zutphen* proceedings was heard and in the course of these Patrick O'Flaherty the fifth named respondent described himself as finance director of the company and gave evidence stating the company expected to turn over IR£6 million in that year and that their major source of work was the contract with Eircom.

37. In the course of an affidavit sworn herein Mr. Raymond Kelly the first named respondent refers to a number of projects for which the company tendered between February and May 2000 these were he said the subject matter of serious conversations. Mr. Raymond Kelly instances seven particular projects, worth in excess of some IR£15 million. It may be significant that the company in suit did not in fact successfully tender for any of those projects.

38. This raises the question as to how realistic, if at all the assurances were of Mr. Declan Kelly regarding the solvency of the company in January, 2000 and in a more profound way raises issues as to whether the main defendants in the *Zutphen* proceedings, that is Raymond Kelly and Declan Kelly, were either profoundly naïve and optimistic or alternatively equally disingenuous.

39. A preliminary hearing of the *Zutphen* proceedings was conducted in April 2000 on the question of frustration of the contract. The company lost these proceedings and the main action was set down for an early trial. On 29th May, 2000 the proceedings were compromised and the company agreed to pay €610,109 to the plaintiff's over a number of instalments. The High Court approved this settlement on 30th May, 2000, and costs were awarded against the company in the region of €700,000.

40. As of the 30th April, 2000, the company's internal management accounts clearly showed the company to be a solvent with net liabilities of €1,109,980. The directors statement of affairs dated 12th July, 2000, showed an ultimate deficit of €4,297,979. The applicant states that it is clear that when the directors entered the settlement agreement they were aware or ought to have been that the company was insolvent. The company ultimately paid three amounts totalling €244,042 as part of the agreement but the remaining payments totalling €365,867 were left unpaid.

41. On 13th June, 2000, Mr. Tim Kelly the third named respondent resigned as a director of the company in suit. On 12th July, 2000 joint administrative receivers were appointed to KTS U.K. In and around the same time that company sent out notices calling a creditors meeting of the company which was held on 24th July, 2000.

42. Immediately after the receivers were appointed to KTS (U.K.) its assets were purchased from the receivers by Kelly Technical Solutions Limited a U.K. registered company for the sum of €1,123,188. This company was incorporated on 11th May, 2000 and the directors thereof are Declan Kelly, Raymond Kelly and Brian Harnett. These were the first second and fourth named respondents herein. The solicitors for the defendants in the *Zutphen* proceedings wrote to the plaintiffs solicitors Messrs Acton on 19th May, 2000 stating that their clients had been awarded a major contract which was due to be signed on 26th May, 2000. This has been referred to earlier.

43. While the new contract was indeed signed on 2nd June, 2000 it was in the name of KTS U.K. and was supported by the submission of the audited financial statements of KTS U.K. Therefore the company in suit that is the Irish company was excluded from the contract.

44. Furthermore as part of the settlement with the litigation with the employees the parties agreed that the settlement and costs were to be paid by the two defendant companies and the actions against Declan Kelly and Raymond Kelly who had been sued in their personal capacities was struck out. It is contended that this is relevant as these directors were aware or ought to have been so of the insolvency of the company. The applicant contends that this particularly relevant in view of the fact that Declan Kelly and Raymond Kelly insisted on being personally released from the judgment in the *Zutphen* proceedings and thereafter were directors at the time of the collapse of both companies which thereby rendered uncollectible a large portion of the settlement and the costs. The liquidator states that at the time of entry into the settlement agreement the directors and each of them were aware or ought to have been that the terms of the settlement would not be implemented.

45. It will be noted that at the time the new contract was entered into no notification of this important fact was given to the defendants' solicitors. It is stated that the execution of the settlement was delayed pending confirmation of this by the defendants solicitors, and the phased payments under the settlement were premised on the basis of the companies continuing to trade as was represented that they would. Clearly it was highly unlikely that if the plaintiffs' solicitors had been aware that either one of the two defendant companies was in financial difficulty, or that the June, 2000 contract was put in the name of KTS U.K. they would not have released the two directors personally from the proceedings.

46. There are two other factors which are relevant.

47. The first of these is that there is evidence of a substantial accumulation of revenue debt. A PAYE/PRSI in an amount of €145,316.78 is due and owing to the Revenue Commissioners. It appears that this represents outstanding returns for a two year period.

48. A further point relates to the financial position of the United Kingdom company. In the course of a report obtained from an English firm of consultants, Franklin Williams Foy the following is stated with regard to the U.K. company.

> "By May 2000, however, the seriousness of the situation became all too apparent and in a confidential memorandum to the Board dated 31st May, 2000 the financial controller (Mr. P. O'Flaherty) attempted to quantify the likely future effects. His analysis demonstrated that outside assistance in the form of additional funding was urgently required together with the implementation of cutbacks and the elimination of any unprofitable but strategic tendering".

49. Mr. O'Flaherty further noted in the confidential memorandum that "the position is that KTS will not survive without outside assistance".

50. It is also clear from the Franklin Williams Foy report that the United Kingdom company is likewise in substantial difficulty. It had entered into an agreement with the British Customs and Excise Authorities in relation to outstanding value added tax on 9th May, 2000. It is pointed out on behalf of the liquidator that in circumstances where the case is made that the U.K. company was funding the company in suit and where there were common directors, the directors of the Irish company cannot but have been aware of the parlous financial state of the company prior to the 29th May, 2000. The Franklin Williams Foy report dated 7th July, 2000 indicated that the continued trading of the UK company "will become impossible in the near future without additional funding". It also states that a draft statement of affairs was complied but that "there seems little likelihood that realisations would be sufficient to pay the unsecured creditors of either company".

51. It is further pointed out that the directors statement of affairs dated 12th July, 2000 show a net deficit of €4,297,979. In affidavits filed by the respondents it is averred that at the time of the settlement agreement it was believed that a contract with Eircom was imminent. This, it is contended, was contradicted by a document entitled Confidential Memorandum dated 31st May, 2000, and prepared by Mr. O'Flaherty which states as follows

> "We are in discussion with Eircom and a joint venture. This would involve setting up a new company KTS contributing existing business, Eircom contributing cash for equity … at present the proposed terms are no (sic) favourable.

52. On 2nd June, 2000, the contract was indeed entered into with Eircom pursuant to which an entity to be known as "Kelly Technical Service Limited" agreed to provide services to Eircom the respondents contend that this company was on behalf of the company. However it will be noted that it is in the name of a connected company.

53. One final factor is adverted to by the liquidator. This is that at the time of the initiation of the contract, and the employment of the South African employees the names of the Irish and UK companies were used interchangeably inversely at the time when the directors knew or ought to have known as to the insolvency of the company clear efforts were made to attribute liabilities to the company in suit and to ensure that any new projects were entered into by a different and separate company. In this connection there is one striking feature which is the failure on the part of the respondents to provide any adequate explanation as to the circumstances of the termination of the contract with Eircom, and that company's apparent willingness to enter into a new contract with a different company.

54. In the light of the foregoing the liquidator contends that there has been;

> (a) Evidence of failure to comply with the directors' common law duties,
>
> (b) Failure on the part of the directors who appraise themselves with the company's financial circumstances
>
> (c) Release of the first and second named respondent from the *Zutphen* proceedings resulted in their escape from personal liability at a time when they owed a duty to the company,
>
> (d) Failure to preserve the company's assets,
>
> (e) A completed absence of evidence of compliance with statutory duties on the part of the directors regarding the Companies Acts,
>
> (f) Trading while insolvent,
>
> (g) Inadequate financial controls,
>
> (h) Revenue debt
>
> (i) The formation of Kelly Technical Solutions Limited on 11th May, 2000, wherein the first, second and fourth named respondents are listed as directors this company purchased the assets of the U.K. company from the administrative receiver,
>
> (j) Utilisation of inter company accounts,
>
> (k) A gross under-valuation in the statement of affairs,
>
> (l) Overall a grossly cavalier approach on the part of the respondents to the company and business matters, and,
>
> (m) Failure of cooperation from the respondents in the course of the liquidation.

55. The case on behalf of the first, second and fourth respondents was most ably presented by Mr. Brian Kennedy BL. In the course of his written and oral arguments he drew attention to the following factors.

56. First that those respondents did not ignore the company's financial position but legitimately felt that it was appropriate for the company to continue to trade and have confidence as they did that the various discussions in which the company was engaged would result in further projects.

57. Second that the relevant period in issue was under seven months at all times prior to the decision to wind up the company its directors believe that its prospects were substantial and serious. The company had a clear perception from its dealings with Eircom that Eircom wished to make amends in a difficult position in which it had placed the company following the suspension of the contract in which its South African employees were working.

58. Third that the criticism of failing to secure further projects is misplaced. The company was engaged in specialist contracting services and replacement business was not easily obtained. Furthermore it is clear that the company engaged in serious discussions with the number of companies in relation to new projects between February and May, 2000.

59. Fifth Mr. Kennedy lay particular emphasis on the fact that until KTS U.K. went into receivership it was continuing to fund the company. At the time of liquidation the company owed KTS U.K. IR£1.26 million a sum substantially greater than the IR£874,000 net liabilities of the company set out in its April 2000 management accounts relied on by the liquidator in support of his assertion that the company was insolvent as of 31st May of that year on the basis that KTS U.K. was continuing to support the company, the Irish company was solvent, it was submitted, in that it was able to meet its debts as they fell due. Moreover it was contended all avenues were being pursued by the company in order to obtain a cash injection to secure its future including the engagement of Franklin Williams Foy to conduct an overall review of the position.

60. Sixth Mr. Kennedy submits that while the liquidator raises concerns as to the costs of the company during the year 2000 which he considers to have been unduly high in the light of the suspension of the Eircom contract, the company did not increase its overheads at this time: the increased costs recorded in its books reflected commitments entered into it by the company prior to the suspension of the Eircom contract e.g. vehicle hire, wages and other expenses paid to the South African employees. Additionally it is contended that further work provided to the company by Eircom after January, 2000, resulted in an increase in various overhead categories as a different set of management and labour skills were required.

61. With regard to the settlement agreement in the *Zutphen* proceedings Mr. Kennedy states that the respondents aver in their affidavit that they honestly believed at the time of said compromise that the company would be able to pay this liability along with its other debts having regard in particular to the sums owed to KTS U.K. which was supporting the company and whose liabilities were effectively deferred. He also points out that at the time of entry into the agreement the respondents also placed much hope on a promise they received from Eircom that a substantial amount of work would flow to the company from the contract which was being negotiated at that time. Eircom had indicated that work from the second contract would begin in June 2000. Unfortunately he states, in early June, Eircom indicated that such work would be postponed until September. At that point Franklin William Foy were employed to review the position of KTS U.K. and the company in suit leading quickly to the appointment of the administrative receiver to KTS U.K. and the winding up of the company.

62. Finally from an evidential perspective Mr. Kennedy states that it is salient to note that the liquidator has not chosen to cross examine the respondents as to their state of mind in relation to the continued trading of the company. In this regard he relies on the comments of Finlay Geoghegan J. in the case of *Re The Computer Learning Centre (Ireland) Limited (In Voluntary Liquidation)* (High Court, Unreported, 7th February, 2005). In the course of that judgment Finlay Geoghegan J. stated …

> "I accept that a court should have significant regard to statements made on oath by a deponent as to his own knowledge and his state of mind at any particular time and that in general, in the absence of cross examination, such evidence should be accepted by the court. However, I would not exclude that there may be circumstances in which, without the necessity of cross examination, a party would be entitled to submit to a court that such evidence should not prevail".

63. Mr. Kennedy submits that such circumstances do not exist in this case.

64. With regard to the relationship with the U.K. company Mr. Kennedy submits that

> (a) that it must be noted that the company in suit was a significant beneficiary of its relationship with KTS U.K. which continued to fund it: there is no suggestion of the respondents of having favoured one corporate entity over the other.
>
> (b) while it is accepted with hindsight that the distinction between the company on the one hand and KTS UK on the other was not as clear as it might have been. There were understandable reasons for each of the matters referred to by the liquidator.

65. These include:-

> The first Eircom contract of 4th May, 1999, was in the name of Kelly Technical Services. This apparent ambiguity Mr. Kennedy submits arose because Eircom drafted the contract without the company's involvement.

66. The fact that the company in suit did not open a bank account until November, 1999, rendered it a matter of expediency that its banking transactions during the first months of trading should be through an account in the name of the U.K. company. He submits all transactions were specific to the company and meticulous records were kept at all time allowing for differentiation of the funds with two companies.

67. The second Eircom contract was drafted by Eircom again without any input from the company or KTS U.K. Eircom simply added the word Limited to Kelly Technical Services on what is stated to be an erroneous understanding that this was the company's correct title – regarding the treatment of the inter-company accounts it is submitted that while there was a difference between the sum owed as per the statement of affairs on the accounts of the receiver of KTS U.K. is ensued to a simple error i.e. "double" reconversion of the relevant figures from sterling to punt. In any event, it is contended this is of little practical significance given that it appeared that no dividend will be paid by the company to KTS U.K..

68. Regarding the treatment of the South African employees Mr. Kennedy submits that;

> 1. They were employed for a legitimate business reason at the suggestion of Eircom in the absence of suitably qualified local engineers they were well paid and remunerated.
>
> 2. Following the suspension of the Eircom contract the company was left in a difficult position: the directors considered that it was in the best interests of its company to dismiss the employees doing so on the understanding that they were legally entitled to do so. Ultimately it was considered again in the best interests of the company appropriate to compromise the proceedings.
>
> 3. The precipitating factor in the collapse of the Irish company was the fact that KTS U.K.'s bankers Griffin Factors lost confidence with KTS U.K. leading ultimately to its placing into administrative receivership. This was not envisaged at the time of the entry into compromise.

4. The attempt to remove the first and second named respondents as defendants to the South African proceedings was warranted in circumstances where there was no proper cause of action against them given they were not parties to the contracts with the South African employees.

5. While it is accepted that at the time of the winding up the company had substantial revenue liabilities the company did pay corporation tax and VAT returns and submitted P30 forms in relation to PAYE and PRSI on a regular basis. Furthermore the company liaised with revenue in relation to its arrears and entered into an arrangement for the payment of same with which it was ultimately it was not able to comply. The only outstanding taxes in respect of which there was documentation before the court (PAYE/PRSI) arose in the company's final year of trading. In addition there was no evidence that the company of having preferred other creditors over the Revenue Commissioners (see *Re Digital Channel Partners Limited* [2004] 2 ILRM 35). Finally it was submitted that the directors had at their own expense provided the service of one Kieran Gaughan to the liquidator for four weeks to assist him with the collection of the company's assets and also there had been detailed correspondence entered into on their behalfs by one Mr. Vass Lottari, Financial Advisor.

69. Finally Mr. Kennedy submits that;

1. there was no suggestion that any of the first, second and fourth named respondents had benefited personally,

2. there was no suggestion that the company had kept inadequate books or records or that the respondents did not obtain adequate professional advice, factors referred to by McGuinness J. in the Supreme Court decision in Re Squash Ireland Limited [2001] 3 I.R. 35,

3. they made significant efforts to keep the company afloat after it got into difficulties,

4. there was no suggestion that the company had traded over a substantial period of time while in financial difficulties: the company's difficulties and its demise all occurred within a six month period,

5. there was no evidence that the first, second and fourth respondents were individuals who were a danger to creditors or from whom the public needed to be protected in the terms used by Browne Wilkinson V.-C. in the case of Re Lo-Line Motors Limited [1988] BCLC 698.

Legal Principles

70. It is now necessary to turn to the legal principles applicable in an application of this type.

71. Section 150(2)(a) of the Companies Act, 1990, identifies the issues as to which the first named respondent must satisfy the court so as to avoid a restriction order being imposed:

> "(a) that the person concerned has acted honestly and responsibly in relation to the conduct of the affairs of the company and that there is no other reason why it would be just and equitable that he should be subject to the restrictions imposed by this section."

72. No allegation has been made on the evidence that the respondent has not acted honestly. Thus the issue for decision is whether or not the respondent has acted "responsibly".

73. The appropriate standard to be used in determining whether directors have acted responsibly was considered by the Supreme Court in the case of *Re Squash (Ireland)* [2001] 3 I.R. 35 in which McGuinness J. emphasised:

> "In the case of all companies which become insolvent it is likely that some criticisms of the directors may be made. Commercial errors may have occurred; misjudgements may well have been made; but to categorise conduct as irresponsible I feel that one must go further than this."

74. In deciding whether a director is unfit McGuinness J. quoted a passage from the English case of In Re Lo-Line Motors Limited [1998] B.C.L.C. 698, 703, a decision of Browne-Wilkinson Q.C., which was also quoted by Shanley J. in the case *of La Moselle Clothing Limited v. Soualhi* [1998] 2 I.L.R.M. 345;

> "The approach adopted in all the cases to which I have referred is broadly the same. The primary purpose of the section is not to punish the individual but to protect the public against the future conduct of companies by persons whose past record as directors of insolvent companies has shown them to be a danger to creditors and others … Ordinary commercial misjudgement is in itself not sufficient to justify disqualification. In the normal case, the conduct complained of must display a lack of commercial probity, although I have no doubt that in an extreme case of gross negligence or total incompetence disqualification could be appropriate."

75. Thus a director complying with his obligations under the provisions of the Companies Acts and acting with a degree of commercial probity during his tenure will not be restricted on the grounds that he has acted irresponsibly. In the case of *Re Colm O'Neill Engineering Services Limited* (ex tempore judgment, 13th February, 2004) Finlay Geoghegan J. stated:

> "What is also clear from the decisions to date is, firstly, that simply bad commercial judgment does not and will not be considered by the court to amount to a lack of responsibility by directors. Further, that the courts must be careful in considering applications under this section not to, as was described in one judgment, permit the conducting of witch-hunts against directors and, perhaps more importantly from the court's perspective, not to view the matter with the inevitable benefit of hindsight which arises in the course of the liquidation. This latter observation is sometimes difficult to observe and (a misprint for "in") practice as the actions or inactions of the directors which it is being suggested may indicate a lack of responsibility are inevitably considered by a liquidator with the benefit of hindsight and it is, perhaps, difficult for the court to avoid looking at it on occasion from that perspective."

76. The primary source for the applicable principles to be considered in determining whether a director acted "honestly and responsibly" are to be found in the decision of the late Shanley J. in the case of *La Moselle Clothing Limited v. Soualhi* in which he set out the five well known criteria to which the court should have regard:

a) the extent to which a director has complied with the obligations imposed by the Companies Acts;

b) the extent to which the director's conduct could be regarded as so incompetent as to amount to irresponsibility;

c) the extent of the director's responsibility for the insolvency of the company;

d) the extent of the director's responsibility for the net deficiency in the assets of the company disclosed at the date of the winding up or thereafter; and

e) the extent to which the director displayed a lack of commercial probity or want of proper standards.

77. To these tests have been added one additional test identified by Finlay Geoghegan J. in *Kavanagh v. Delaney* (*re Tralee Beef and Lamb Ltd*) (High Court, 20th July, 2004) where she supplements Shanley J.'s first test set out at (a) by an additional test, that is the extent to which a director has or has not complied with any obligation imposed on him/her not only by the Companies Acts but also with duties imposed by common law.

78. In the course of *re Costello Doors Limited* (Unreported, High Court, 21st July, 1995) Murphy J. stated that the maintenance of proper books and records in such a form as to enable directors to make reasonable commercial decisions, and the employment of appropriate experts went a long way towards proving that a director had acted reasonably. Similarly, in the case of *Business Communications v. Baxter* (21st July, 1995) Murphy J. opined:

> "Ordinarily 'responsibly' will entail compliance with the principal features of the Companies Acts and the maintenance of the records required by those Acts. The records may be basic in form and modest in appearance. But they must exist in such a form as to enable the directors to make a reasonable commercial decision and auditor (or liquidators) to understand and follow the transactions in which the company was engaged."

Applications of Principles of Law to the First, Second and Fourth Named Respondents

79. There were a number of factors regarding these respondents which are all too clear. These are;

1. They are all executive directors of the company,

2. The first and second named respondents were each 33% shareholders,

3. There is ample evidence outlined hereinbefore that the company continued to trade and to incur liabilities in the first half of 2000 after its contract with Eircom had been suspended.

80. It is simply not sufficient for these respondents to refer to the pursuit of other projects. The truth of the matter was that the company was formed to pursue Eircom work. It was entirely reliant on KTS U.K. for its continued funding. It was or should have been clear that KTS U.K. was itself under serious pressure vide its arrangement with the British Customs and Excise Authorities. At the very minimum, to use Shanley's J.'s pithy phrase there was a failure to "see the writing on the wall". Unfortunately however I do not consider that the matter was confined to this. I say this because I infer that the conduct of the first, second and fourth named respondents between January and May, 2000, was consistent only with the following:

(1) a policy of allowing the liabilities to rest with the company in suit,

(2) grossly inflated view of the company's potential future based on entirely over optimistic projections,

(3) clear evidence of a growing awareness of the difficult position of KTS UK,

(4) a gradual process of distancing new projects from KTS U.K. Limited and the company in suit. This is evidenced not only by the absence of any minutes concerning the settlement of 30th May, 2000 but also the "confidential memorandum" as to how new work or new Eircom projects were to be dealt with by a different company,

(5) I do not believe that there was any sufficient evidence before the directors to justify a contention that they honestly believed the company could trade out of its difficulties. While the company's future projects were expressed in terms of high aspiration for the purposes of the affidavits sworn on 17th January in the Zutphen proceedings it is remarkable that they were ultimately not realised at all in reality.

81. Having regard to the onus of proof which arises in this case there is very little evidence of what steps the first, second and fourth named respondents were taking to rescue the company at a time when they well knew the precise position facing the UK company. It is simply not open to these respondents to contend that in the words of Mr. Micawber "something will turn up" when they knew precisely the pressure upon the United Kingdom company.

(6) These respondents contend that they honestly believed at the time of the Zutphen settlement that the company would be able to pay this liability. While I must have regard to the remarks of Finlay Geoghegan J. in the Computer Learning Centre case if these respondents genuinely believed that the company would be able to pay this liability along with its other debts then taking this belief literally and in the context of the overall situation they are, and would be indeed a danger to creditors from whom the public needs to be protected.

(7) There is clear evidence of a lack of distinction between the identity of the Irish and United Kingdom companies while certain of the documentation may be explicable upon the grounds set out, it is indeed noticeable that such lack of distinction rapidly disappeared at a time when the question of the personal financial liability of the first and second named respondents emerged.

(8) I think the liability to the Revenue Commissioners speaks entirely for itself and is a factor to which the court must particularly have regard.

(9) Having regard to the foregoing the court has no alternative but to grant the relief sought on the Notice of Motion regarding the first, second and fourth named respondents that is to grant a declaration that Raymond Kelly, Declan Kelly and Brian Harnett being persons to whom Chapter 1 of Part 7 of the Companies Act 1990 applies shall not for a period of

five years be appointed or act in any way, whether directly or indirectly as a director or secretary or be concerned or take part in the promotion or formation of any company unless that company meets the requirements set out in subs. 3 of s. 150 of the Companies Act 1990 (as amended).

The Position of the Third and Fifth Named Respondents

82. There are a number of factors which it is urged distinguish the position of the third named respondent from those above identified these include:

(1) that he did not give an unformed consent to becoming a director of the Irish company,

(2) that at no stage prior to the liquidation of the Irish company was he aware that he was a director thereof, and,

(3) that in such circumstances he could not have been dishonest or irresponsible in the manner necessary to base a declaration under s. 150.

83. In this context it is relevant to recollect that the third named respondent is the elder brother of the first and second named respondents. While he invested in the UK company such company has not been a subsidiary of Kelly Communications Group Limited the group of companies run by the third named respondent.

84. It is clear that the third named respondent was a non-executive director of KTS U.K. and remained so until his resignation on 7th June, 2000. The court must also have regard to the fact that there was documentation adduced, which was not challenged regarding efforts made by the applicant to obtain information as to KTS U.K.'s trading position and also his entitlements as director of KTS U.K. While the third named respondent's signature appears on the B10 form which indicates consent to act as director of the company, the court must also have regard to the fact that no further evidence has been adduced whether by affidavit or by cross-examination to supplant what is submitted on behalf of that respondent that is that the documentation in question was signed by him inadvertently and that he became aware of his position as a director of KTS I only on 26th October, 2000.

85. While I accept that a person's signature on the appropriate statutory form to act as a director is strong prima facie evidence that he is consented to become a director, this is not conclusive (re: see the case of Re CEM Connections Ltd BCC 917 wherein Mr. Registrar Rawson stated:

"In my judgment for the appointment of a director of a company to be valid it is necessary that the person appointed should give *informed* consent of that appointment … the fact that a person signs a form of consent is, of course, strong prima facie evidence that consent was given, but it is not in my view conclusive and may be rebutted by evidence which indicates that the signature was obtained without the person signing the document appreciating what he or she was doing."

86. In this regard the court considers that the burden of establishing that the respondent is "a person to whom s. 150 applies" lies with the applicant accordingly that burden, as distinct from the burden which arises once the application of the Act is established remains upon the liquidator. In the absence of cross-examination I am not satisfied that that burden has been discharged by the liquidator.

87. In this connection the court may place some weight on the fact that the correspondence regarding KTS UK in 1999 makes no reference to the Irish company. There is no evidence that up to October, 2000, there was any indication that Mr. Tim Kelly the third named respondent had directed his mind to the fact that he is a director of the Irish company nor was there any document which was sent to him which had his name mentioned as a director of that company. I do not think that there has been any admissible or satisfactory evidence to demonstrate that the third named respondent was a person to whom s. 150 refers.

88. One turns finally to the position of the fifth named respondent Mr. O'Flaherty the following factors are relevant here. The first is that he had no financial interest share holding, share options, fees or benefits not only from the Irish company but also from the U.K. company other than his salary from KTS U.K. The liquidator is therefore asking the Court to hold that Mr. O'Flaherty assumes the status and function of a director in circumstances where he was not being paid for doing so and had no financial incentive so to do. The court may also have regard to the fact that the other respondent directors other than the third named respondent are adamant that Mr. O'Flaherty was not a director of the Irish company.

89. It is uncontested that Mr. O'Flaherty had no involvement with setting up the Irish company or securing the Eircom business. It is clear that he did sign some of the letters of appointment regarding the recruitment of the South African technicians but he avers, and this is not contradicted, that these may have been signed in the absence of the first, second or fourth respondents. It is also relevant that he was involved with the preparation of the defence of the *Zutphen* proceedings. However KTS U.K. was also a defendant thereto and both companies were represented by the same firm of solicitors. Mr. O'Flaherty was therefore appropriately involved in the defence of the proceedings given that he is a financial director of KTS U.K. although he avers that all decisions made in relation to the defence of the proceedings were made by Mr. Raymond Kelly and Mr. Declan Kelly.

90. There is no evidence that Mr. O'Flaherty had any involvement at all with the Irish Company until the *Zutphen* issue emerged other than to ensure the separation of the banking affairs of the companies. Moreover the Irish company had its own financial controller one Peter Richardson who kept the books and records of the company in the company's premises in Galway.

91. Two other factors are also relevant. These are first that notwithstanding his allegation that Mr. O'Flaherty is a de facto director the applicant does not appear to have made any serious effort to contact him or seek his assistance in relation to the company. Second Mr. O'Flaherty did not attend the creditor's meeting. This is to a degree supportive of his contention that he did not consider himself to be a director of the company in suit.

92. It is indeed true that Mr. O'Flaherty was involved in the preparation of the confidential memorandum to which reference has been made earlier. Its contents reflect no credit upon him. Indeed his contents may well reflect upon his status as a director of the UK company.

93. The contention that Mr. Raymond Kelly informed the creditors meeting that Mr. O'Flaherty was a director of the company must be balanced with that respondent's unequivocal averment that he was not a director of the company. I do not consider that the fact that Mr. O'Flaherty provided information regarding the Irish company renders it any the more probable that he should be seen as a director.

94. While he was an authorised signatory on behalf of the company it will be noted that at his insistence the bank accounts of the Irish and UK company were kept separate. The fact that he was an authorised signatory does not in itself render it more likely that he was a director.

95. Finally I do not think that sufficient evidence has been adduced to indicate that Mr. O'Flaherty was part of the corporate governing structure of the company in suit.

96. While the Court will have regard to the transcript of evidence wherein he is referred to as a director of the company in suit I do not think that the transcript in itself is sufficient to demonstrate that Mr. O'Flaherty truly believed had acted or conducted himself as a director or as a shadow director in accordance with the principles outlined by O'Neill J. in the case of Lynrowan Enterprises (Unreported, High Court, O'Neill J. 31st July, 2002). In particular I do not consider there is evidence that Mr. O'Flaherty directed the affairs of the company on an equal or more influential footing than the first, second and fourth respondents, or in any way conduct and himself so as to constitute a shadow or de facto director.,

97. In this context I am having regard to the fact that the onus lies upon the applicant to demonstrate that this respondent was a shadow director on the balance of probabilities.

98. Having regard to the foregoing I conclude that it has not been proved that the fifth named respondent was a director or a shadow director and I therefore conclude that the relief sought should not be granted in regard to that respondent.