THE RESPONSIBLE DIRECTOR IN AN ECONOMIC DOWNTURN: LESSONS FROM THE RESTRICTION REGIME

DEIRDRE AHERN*

I. Introduction

In a national and global economic downturn which is relatively entrenched, many companies struggle to survive. Typically a company will have fewer orders and customers will take longer to pay. In turn, the company may also delay making payments to suppliers. The directors of such a company may fervently hope that the company can trade out of its difficulties. Ultimately, however, severe cash flow difficulties may leave the company in a position where it is not able to pay its debts as they fall due and, if examinership is not a realistic means of corporate rescue, the company may go into insolvent liquidation. Against this backdrop, the restriction regime under section 150 of the Companies Act 1990 is highly significant.[1]

A major aim of the restriction regime was to put a stop to the "Phoenix syndrome"[2] whereby directors of an insolvent company simply went on to establish a new company rising from the ashes of its predecessor to carry on the same business.[3] In doing so, the company's directors were able to leave behind non-compliance with the company's legal obligations and liabilities incurred to creditors and to simply start again with a clean slate. Therefore the primary purpose of the restriction jurisdiction is to protect the public against the future conduct of companies by persons whose past records as directors of insolvent companies have shown them to be a danger to others, particularly creditors because they have not acted honestly or responsibly or because there is another reason why it would be just and equitable to restrict them. This function of restriction is particularly valuable given that cases under the fraudulent trading[4] and reckless trading[5] provisions are few and far between.

* Lecturer in law, Trinity College, Dublin.

1. See generally Deirdre Ahern, *Directors' Duties: Law and Practice* (Thomson Round Hall, forthcoming 2009), at chapter 15.
2. The Roman poet Ovid recounted the story of the Phoenix as a mythical bird which burns itself in the flames of a fire in order to be reborn from the ashes. The Phoenix is resurrected to embark on the next phase of its life journey.
3. See *Report of the Working Group on Company Law Compliance* (1999) (the "McDowell Report").
4. Companies Act 1963, section 297 (as substituted by Companies Act 1990, section 137).
5. Companies Act 1963, section 297A (inserted by Companies Act 1990, section 180(3)).

Pursuant to section 56 of the Company Law Enforcement Act 2001, liquidators of insolvent companies are obliged to make a restriction application to the High Court in respect of the directors unless relieved of the obligation by the Director of Corporate Enforcement. The effect of section 150(1) of the Companies Act 1990 is that where a declaration of restriction is made, the relevant person who is restricted cannot be appointed as a director or secretary of a company or "be concerned or take part in the promotion or formation of any company" for a five year period unless the company meets certain minimum capitalisation requirements. There are also certain consequences for a company with which a restricted person becomes involved. While it is still possible for a restricted person to carry on business using an unincorporated form of business organisation or, where adequate finance is available, an appropriately capitalised company, in business life there is undoubtedly a stigma attached to being restricted.[6]

Three key factors for judicial consideration in deciding whether a declaration of restriction is mandated are enumerated in section 150(2)(a) of the Companies Act 1990 – whether the director acted honestly, whether the director acted responsibly and whether there is any other reason why it would be just and equitable to restrict the director. These factors receive no further legislative elucidation. As a result, the courts are free to mould their own principles while recognising that each case turns on its own facts. The courts have regarded irresponsible conduct as justifying restriction in its own right as a stand alone ground separate from dishonesty.[7] It is judicial treatment of the question of whether a director acted responsibly which is the focus of this article.

The focus in section 150 on the issue of whether a director can be said to have acted responsibly has led to a judicial consideration of whether the acts and omissions of directors are considered to be sufficiently serious as to require a declaration of restriction to be imposed on them in the interests of protecting investors and creditors. While an economy is buoyant, it is relatively easy to pinpoint trading practices which are risky. However, the goalposts of what is acceptable conduct may shift in an economic downturn where many companies are fighting for survival and new tactics are being employed by businesses in a difficult trading environment. It is important that the right balance be found by the courts between curtailing reckless directorial behaviour which shows a wanton disregard for the interests of creditors, on the one hand, and conduct which, though ill-judged and commercially unsuccessful, lacks the same element of blameworthiness, on the other. It is contended that a relatively pragmatic approach has been adopted by the courts to reviewing directorial acts and omissions, an approach which is attuned to commercial realities rather than

6. For judicial commentary on the stigma associated with a declaration of restriction see *Business Communications Ltd v Baxter* 21 July 1995, at 14 (HC); *Re Tralee Beef and Lamb Ltd (in liq); Kavanagh v Delaney* [2008] IESC 1; [2008] 2 ILRM 420, at 427.
7. See *eg*, *Re Cavan Crystal Group Ltd* 26 April 1996 (HC); *Re Squash (Ireland) Ltd* [2001] 3 IR 35 (SC); *Re Club Tivoli Ltd (in vol liq); Foster v Davis* [2005] IEHC 468.

being unduly focused on high-minded principles. This involves an understanding that calculated risk-taking should be permissible and that the dividing line between solvency and insolvency is likely to be blurred rather than bright line in nature.[8]

Against this background, this article assesses the type of conduct which is likely to be considered to be irresponsible in a difficult trading environment and which may lead to a declaration of restriction being made.[9] Part II begins by considering the purpose of the restriction regime as this colours the exercise of judicial judgment in deciding what level of irresponsibility merits restriction. Part III considers the temporal period over which the court will review a director's conduct to determine whether the director acted responsibly. Part IV considers the judicial approach to formulating base principles applicable to determine the responsibility question. Part V focuses on selected themes in the corpus of restriction decisions which are relevant to directors' conduct in a downturn – keeping abreast of the company's financial position, taking steps to avoid trading recklessly, avoiding compromising creditors' interests, and adopting a sensible approach to risk-taking. In Part VI it is concluded that a relatively astute approach is taken by the courts to failed businesses and that the restriction case law contains much in the way of advice in relation to the best practices to be followed by directors should their company experience trading difficulties.

II. The Purpose of Restriction

In any situation where a company has gone into insolvent liquidation, the conduct of the directors is likely to be open to question in some respects since entry into insolvent liquidation by definition signals that the business of the company has ended in failure. However, the purpose of the restriction regime is not to punish errant directors for their failings. Rather, taking a cue from the similar but distinct disqualification regime applicable to directors in the UK under the Company Directors Disqualification Act 1986, judicial pronouncements indicate that the protection of the public, particularly investor and traders, is the paramount objective. In *Re Lo-Line Electric Motors Ltd* Browne-Wilkinson VC made the following influential pronouncements:

> What is the proper approach to deciding whether someone is unfit to be a director? The approach adopted in all the cases to which I have been

8. Indeed, it is common to speak of the "twilight zone" between solvency and insolvency. See *eg* Andrew Keay, "The Director's Duty to Take into Account the Interests of Company Creditors: When is it Triggered?" (2001) 25 *Mon LR* 315; Tony Ciro, "The Twilight Zone Revisited: Assessing the Enforceability of Pre-liquidation Transactions in a Corporate Group Insolvency" (2005) 20 *JIBLR* 590.
9. Issues relating to the burden of proof in restriction applications are outside the scope of this article.

> 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 have shown them to be a danger to creditors and others. Therefore the power is not fundamentally penal. …[10]

The oft-quoted *Lo-Line* public protection rationale has been adopted by the Irish courts as equally applicable in this jurisdiction and received the imprimatur of the Supreme Court in *Re Squash (Ireland) Ltd.*[11] Consequently, section 150 has been described as giving "effect to a public interest in seeing that persons should no longer enjoy the unqualified right to become involved in the formation of companies where they have been directors of companies which have failed due to insolvency."[12] Thus the restriction regime provides for the scrutiny of directors' conduct in order to determine whether it is in the public interest that they should be restricted. Where persons have not acted responsibly, the court may take the view that the "public, being future creditors, should be protected in the future by a period of restriction."[13]

Business failure is not in itself sufficient to justify restriction. One consequence of the judicial understanding of section 150 as being about protection rather than punishment is that the notion of restriction proceedings as involving a "witch hunt" has been dismissed as inappropriate.[14] Genuine commercial failure is not the target of section 150. As was said in the McDowell Report, "[t]he purpose of company law is neither to prevent nor to insure against – still less punish – commercial failure."[15] The courts have been careful not to make pronouncements which would stifle the commercial risk-taking which is inevitable in entrepreneurship. In the leading Supreme Court decision on restriction, *Re Squash (Ireland) Ltd*, McGuinness J acknowledged that, in the case of insolvent companies even where criticism could be made of the directors, some leeway ought to be given to them.[16] She stated, "[c]ommercial 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."[17]

Having illuminated the rationale of the restriction regime as being focused on public protection of investors and traders, the discussion which follows

10. [1988] 2 All ER 692, at 696 (Ch D).
11. [2001] 3 IR 35 (SC).
12. *Re Verit Hotel and Leisure (Ireland) Ltd (in rec and in liq); Duignan v Carway* [2001] 4 IR 550, at 561, *per* Fennelly J (Murray and Hardiman JJ concurring) (SC).
13. *Re USIT World Plc* [2005] IEHC 285, at 80.
14. *Business Communications Ltd v Baxter* 21 July 1995, at 17 (HC); *Re Squash (Ireland) Ltd* [2001] 3 IR 35, at 37, *per* McGuinness J (Geoghegan and Fennelly JJ concurring) (SC).
15. *Report of the Working Group on Company Law Compliance and Enforcement* (1998), at [1.13].
16. [2001] 3 IR 35 (SC).
17. *Ibid*, at 39.

considers how directorial behaviour is measured and judged, beginning with a consideration of the relevant temporal period for the conduct to be reviewed.

III. Temporal Period for Review of Conduct

Both the legislature and the courts have circumscribed the temporal limits for the review of directors' conduct for the purposes of section 150. By virtue of section 149(2) of the *Companies Act 1990*, section 150 is applicable to any person who was a director or a shadow director of a company within the 12 month period prior to the commencement of an insolvent winding-up.[18] It is therefore not surprising that this 12 month period is relevant in assessing whether a respondent acted honestly and responsibly in relation to the conduct of the company's affairs. In *Re Gasco Ltd (in liq)* McCracken J referred to section 149(2) and said that the court looks particularly at the behaviour of directors and the conduct of the company in the 12 months prior to the commencement of the company's winding up:

> I think it is quite significant that no restrictions can attach to somebody who has ceased to be a director of the company more than twelve months before the winding up. This seems to me to indicate that the primary aim of section 150 is to deal with directors who have behaved irresponsibly or dishonestly during the last twelve months of the life of the Company, and that the actions of a director who is subject to section 150 are to be looked at primarily in the light of his actions during that period. This indeed has a considerable practical logic, as it is presumably intended to focus attention on the behaviour of the directors in the period leading up to the winding up, and to try to ensure that they deal responsibly with creditors when a company is in difficulties. In my view, therefore, there should be particular scrutiny of the actions of directors during the final months before winding up.[19]

However, the courts have generally taken a broader view of the time period in which a director's role in the company's affairs may be scrutinised for purposes of the section than that exhibited in *Re Gasco.* In the earlier seminal case of *La Moselle Clothing Co Ltd v Soualhi*[20] it was indicated that the courts will review a director's conduct in terms of the entire tenure of the director rather than restricting their scrutiny to the last months of the company's life leading up to the liquidation. That understanding was adopted by the Supreme Court in *Re Squash (Ireland) Ltd* where McGuinness J stated that the court should look at

18. Companies Act 1990, section 149. Pursuant to section 251 of the Companies Act 1990, directors of insolvent companies which are not being wound up will also fall within the net.
19. 5 February 2001, at 7 (HC).
20. [1998] 2 ILRM 345 (HC).

"the entire tenure of the director and not simply at the few months in the run up to the liquidation."[21] That has been the accepted understanding of the appropriate time period for review ever since.[22] Thus, for example, in *Re Club Tivioli Ltd (in vol liq); Davis v May*[23] the High Court had regard to the fact that the first respondent's failure to pay VAT dated from the very beginning of his directorship.

The application of the *Squash (Ireland)* tenure approach has led to expansive treatment of directorial conduct in liquidators' affidavits and consequently in restriction decisions. Setting the temporal period for review of directors' conduct as their entire tenure is good news for directors who have on the whole acted responsibly throughout the company's life and whose conduct is only open to question in relation to the circumstances leading to the company going into insolvent liquidation. This is of assistance where the company has generally been well-run and traded successfully but the directors have allowed the company to trade for a limited period while insolvent in the hope that business would pick up.

IV. Judging Responsibility: Some Base Principles

The question of whether a director acted responsibly is judged in relation to the conduct of the affairs of the company in question.[24] No further legislative guidance is provided to the courts on how to judge whether a director acted responsibly. Hence the courts have developed their own base principles while emphasising the importance of examining each case on its own merits. These broad principles are examined here before highlighting more specific themes in restriction case law in Part V.

Initially the concept of acting responsibly was judicially linked to a reasonable level of compliance with the requirements of the Companies Acts. In one of the earliest restriction cases, *Business Communications Ltd v Baxter*,[25] acting responsibly was conceived of by Murphy J as generally involving compliance with the principal features of the Companies Acts as well as maintaining books and records required by the Companies Acts. However, the basic *Business Communications* understanding of responsibility as limited to general compliance with the Companies Acts and keeping of proper books and records later gave way to a more sophisticated set of criteria based on relevant factors enunciated by Shanley J in *La Moselle Clothing Ltd (in liq) v Soualhi*.[26] The *La Moselle* criteria were set out by Shanley J in that case as follows:

21. [2001] 3 IR 35, at 41 (SC).
22. For an attempt to reconcile the *Re Gasco* approach and the *Squash (Ireland)* approach see *Re USIT World Plc* [2005] IEHC 285, at 65–66.
23. [2005] IEHC 468.
24. Companies Act 1990, section 150(2)(a).
25. 21 July 1995 (HC).
26. [1998] 2 ILRM 345 (HC).

> [I]n determining the 'responsibility' of a director for the purposes of s.150(2)(a) the court should have regard to:
> (a) The extent to which the director has or has not complied with any obligation imposed on him by the Companies Acts 1963–1990.
> (b) The extent to which his 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.
> (e) The extent to which the director, in his conduct of the affairs of the company, has displayed a lack of commercial probity or want of proper standards.[27]

The *La Moselle* criteria subsequently received the imprimatur of the Supreme Court in *Re (Ireland) Ltd* and McGuinness J noted that the relevant standard by which directors were to be judged was an objective standard.[28] Since then the *La Moselle* criteria have been quoted as a matter of course in statements of the applicable law in restriction decisions. However, there have been other attempts at subsequent judicial refinement and fine-tuning of the applicable principles.

While undoubtedly highly significant in terms of doctrinal development, the *La Moselle* factors have nevertheless been treated as being merely indicative in nature so that the presence of one or more of the factors is not treated as decisive of restriction being merited. In *Re USIT World Plc*[29] Peart J provided the following exposition of the judicial weighing process concerning the *La Moselle* criteria:

> The list I am sure cannot be regarded as exhaustive, and neither in my view does the presence of one or more factors in a particular case mean that in that case the director must be regarded as having acted either dishonestly and/or irresponsibly to such an extent as to warrant restriction. Each case will have to be looked at on its own particular facts. In one case a director may have been culpable in respect of a number of the factors on the list, but in the heel of the hunt none of those factors had any direct or meaningful bearing on the failure of the company. In another case, a director may fall foul of only one of the factors, yet that lapse may be of such a degree and have such a direct bearing on the insolvency of the company that it outweighs all the other ways in which the director conducted himself/herself honestly and responsibly as a director, and be such that the public should be protected for the period of the restriction from any risk that it might happen again.[30]

27. [1998] 2 ILRM 345, at 352.
28. [2001] 3 IR 35 (SC).
29. [2005] IEHC 285.
30. [2005] IEHC 285, at 67.

A further attempt at judicial enumeration of the types of conduct falling for consideration under the rubric of irresponsible conduct came about in *Re Swanpool Ltd (in vol liq); McLaughlin v Lannen.*[31] Clarke J, having reviewed a number of authorities, noted that in broad terms there were three types of situation with which the court is typically faced in applications under section 150 which do not involve dishonesty:

> 1. Issues involving compliance by the company with its formal obligations under the Companies Acts including keeping books and records, making returns, holding meetings and the like;
> 2. The commercial management of the company, most particularly at the period when the company was insolvent or heading in that direction; and
> 3. Compliance by the Directors with the obligations identified in *Frederick Inns* to ensure that, once the company was facing insolvency, its assets were dealt with in a manner designed to ensure the proper distribution of those assets in accordance with insolvency law.[32]

The Court was of the view that the directors were entitled to rely on having a clean bill of health under one or more categories as a mitigating factor to be taken into account in relation to failings under another category. However, the *Swanpool* cost-benefit approach has not been particularly influential in subsequent case law.[33] Clarke J also noted that in some cases a failure which involves a single instance may justify the making of an order under section 150 while in others failures which are relatively minor but are numerous and protracted could give rise to an overall finding of a level of irresponsibility sufficient to warrant the making of a declaration of restriction. Here a single breach of duty involving the making of payments to investors at a time when the company's solvency was in doubt was found to be sufficient to warrant the making of declarations of restriction.

A further innovation has been the introduction of a causation test to be satisfied in connection with the *La Moselle* criteria. In *Re USIT World Plc (in liq)*, Peart J stated that, in seeking to satisfy the court that a declaration of restriction should not be made, a director must establish that "where there are matters about which they can be rightly the subject of criticism, there is in reality no causal link between those culpable matters and the insolvency" in order to avoid a finding of irresponsibility.[34] Thus a court should not make a finding of irresponsibility where the matters complained of were not causative of the company's demise. The need for this causal link, which is not provided

31. [2006] 2 ILRM 217.
32. *Ibid*, at 223.
33. *Swanpool* was referred to in *Re DCS Ltd (in vol liq); Fitzpatrick v Henley* [2006] IEHC 179; *Re Pineroad Distribution Ltd (in vol liq); Stafford v Fleming* [2007] IEHC 55; *Re Hydroklenze Ltd (in liq); Trehy v Rutherford* [2007] IEHC 456.
34. [2005] IEHC 285, at 60.

for in the 1990 Act, has not, however, been universally adopted as a matter of course in later restriction decisions.

In *Re Tralee Beef and Lamb Ltd (in liq); Kavanagh v Delaney*[35] Finlay Geoghegan J, saw fit to add a new factor to those listed by Shanley J in *La Moselle*. She observed that Shanley J's judgment in *La Moselle* did not suggest that courts should ignore the common law and equitable duties of directors. Accordingly she reformulated paragraph (a) of the *La Moselle* criteria to state:

> a court should have regard not only to the extent to which a director has or has not complied with any obligation imposed on him/her by the Companies Acts but also with duties imposed by common law.[36]

However, on an appeal to the Supreme Court[37] by one of the respondents, Hardiman J's judgment allowing the appeal[38] referred with approval to the *La Moselle* criteria for deciding whether a director had acted responsibly and doubted the wisdom of embellishing them to include an additional criterion in relation to a director's compliance with his or her common law and equitable duties.

The first limb of the Supreme Court's reasoning centred on the fluid nature of directors' duties. It was reasoned that statutory obligations under the Companies Acts were of their nature easy to ascertain. By contrast, the common law and equitable duties applicable to directors were categorised as being "more amorphous and … expressed in words of very general purport."[39] This is certainly the case; nevertheless the broadly formulated nature of these currently non-statutory duties does not detract from their legally binding nature.[40] Moreover, it is well settled that they arise by operation of law.[41] The Supreme Court also expressed concern that since the appellant had taken advice on his personal liability before the winding up, he would have been advised based on the *La Moselle* criteria and he was therefore dealt an injustice when Finlay Geoghegan J took a more expansive approach than had previously been the practice. Hardiman J referred to the need to respect the appellant's constitutional rights "not only to fair procedures but to his good name and the associated right to earn a living by the practice of his profession."[42] He concluded that, in the absence of detailed argument on the issue, it was not appropriate for Finlay Geoghegan J to have amplified the relevant criteria after the hearing given the stigma attached to a declaration of restriction.

35. [2005] 1 ILRM 34.
36. *Ibid*, at 41.
37. [2008] IESC 1; [2008] 2 ILRM 420.
38. Macken and Finnegan JJ concurring.
39. [2008] 2 ILRM 420, at 430.
40. On this see *Jones v Gunn* [1997] 3 IR 1, [1997] 2 ILRM 245 (HC) where McGuinness J held that a duty on directors to consider the interests of creditors ran in parallel to the statutory provision for civil liability for reckless trading in section 297A of the Companies Act 1963.
41. *Base Metal Trading Ltd v Shannon* [2004] EWCA Civ 1316, at [76], *per* Arden LJ.
42. [2008] 2 ILRM 420, at 430.

This discussion hints that it is unfair for the courts to refine applicable legal principles since a respondent would not be aware that there would be a change to the legal principles applied.[43] However, the ability of the courts to hone and develop the law on a case by case basis is central to our common law system. In fact the law on restriction has developed on a case by case basis within the overall statutory framework. In effect, judicial grafting was precisely what the late Shanley J had done in *La Moselle* when he had expanded the approach previously taken by Murphy J in *Business Communications v Baxter*.[44] Indeed, in the context of a disqualification application under section 160 of the Companies Act 1990, in *Re National Irish Bank Ltd; Director of Corporate Enforcement v Seymour*[45] Murphy J extended the court's review beyond the issue of compliance with the Companies Acts so as to include compliance with the Finance Acts and legislation generally. It is, however, conceivable that the consideration of directors' duties in restriction applications may receive a more sympathetic hearing in the future given that it is proposed to place them in statute[46] in pursuance of the Company Law Review Group's recommendation to this effect.[47]

V. Selected Themes in Judicial Examination of Directorial Conduct

Having examined the key precepts to which the courts have regard in restriction decisions, this Part highlights selected themes in restriction case law which have particular relevance in the current economic climate where stagnation has led to challenging trading conditions and cash flow difficulties for companies. Closer examination of judicial pronouncements yields important advice to directors who find themselves between a rock and a hard place in seeking to keep their company going but wishing to avoid the sanction of restriction.

Importance of keeping abreast of the company's financial position

Restriction decisions frequently disclose a failure to ensure that proper books and records are maintained as required by section 202 of the Companies Act 1990. Responsibility for keeping proper books is "a joint and separate liability

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43. The Supreme Court appeared to believe that the effect of a restriction order on a professional person's reputation made it *sui generis* in terms of the procedures and safeguards which must be applied. However, this point was not fully developed.
44. A similar judicial approach was also evident in the seminal *Re Barings Plc (No. 5); Secretary of State for Trade and Industry v Baker* [1991] 1 BCLC 433 (Ch D), the principles of which were given High Court approval in *Re Vehicle Imports Ltd (in liq)* 23 November 2000 (HC).
45. [2007] IEHC 102.
46. *General Scheme of Companies Consolidation and Reform Bill* (2007), Part A5, Head 9.
47. Company Law Review Group, *First Report (2000–2001)* (Company Law Review Group, 2002), at [11.3.7].

on each of the directors."[48] Directors need to ensure that proper books and accounts are kept so that they are in a position to determine the company's financial position. This is particularly crucial where there is a doubt as to the continuing viability of the company. Keeping proper books and records will enable the directors to be in a position to exercise their judgment as to whether it is appropriate to continue trading. Compliance is also important so that if a liquidator is appointed he or she will be in a position to determine accurately the company's financial position including the identification of the company's debtors and creditors.[49] The duty to keep proper books and records has been regarded as extending to the keeping of minutes of meetings.[50]

The primary responsibility for ensuring that proper systems of accounting are put in place lies with the executive directors.[51] The restriction case law establishes that directors cannot completely wash their hands of this responsibility by giving someone else, be they a co-director or employee, responsibility for the maintenance of books and records. In *Capital Auto Group Ltd (in vol liq); Foster v Swords* Peart J stated that it was not open to a director to simply say that the maintenance of books and records were the responsibility of his co-director and that he presumed that all was being attended to.[52] He had this to say in relation to the ultimate responsibility of each director:

> Each director as part of acting responsibly has a duty to inform himself without any doubt, as to whether books and records are being kept. Sometimes this is achieved by the employment of suitable staff. Other times it is achieved by each director himself or herself making sure that all matters of that kind are looked after and being attended to as required.[53]

While a failure in the sphere of keeping books and records can suffice to establish irresponsibility justifying the imposition of a restriction order, in general, the judicial approach has been to look at the surrounding circumstances before making an assessment as to whether there is a sufficient level of irresponsibility to justify making a declaration of restriction. In *Re Costello Doors Ltd* the directors contended that the company's accounting records were arranged in an orderly manner, that proper books of account were maintained and that the company had engaged the services of both book-keepers and accountants.[54] However, the High Court accepted the liquidator's contention that for a crucial period in the company's life there was inadequate preservation

48. *Re Vehicle Imports Ltd (in vol liq)* 23 November 2000 (HC), at 14.
49. Otherwise time and money are spent by the liquidator on seeking to ascertain the company's financial position, ultimately at the expense of the company's creditors.
50. *Re Hydro Klenze Ltd (in liq); Trehy v Rutherford* [2007] IEHC 456.
51. *Re Cooke's Events Co Ltd (in liq); Kavanagh v Cooke* [2005] IEHC 215; [2006] 1 ILRM 191.
52. [2005] IEHC 434.
53. *Ibid*, at 7. See also *Re Careca Investments Ltd (in liq); Ferris v Farrell* [2005] IEHC 62.
54. 21 July 1995 (HC).

of basic records or compliance with the Companies Acts. Nevertheless, Murphy J decided that the directors ought not to have orders made against them. It was held that, in the circumstances of the case, it was not irresponsible to fail to write up the appropriate books for a particular period, particularly since the book-keeper's employment had been terminated. Significantly, 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 would help to show that the directors had acted responsibly.

In *La Moselle Clothing Ltd v Soualhi* Shanley J noted that a failure to keep proper books of account, which may be caused by the incompetence of a director, may directly contribute to a company becoming insolvent.[55] Furthermore, where proper up to date books and records have not been maintained, a liquidator may not be in a position to ascertain the company's assets and liabilities with precision nor the reason for the company's insolvency.[56] In *Re Gasco Ltd* McCracken J found that the failure to keep records was seriously irresponsible and had meant that the liquidator was unable to find evidence of substantial payments owed to the company.[57] A restriction order was made against the de facto managing director.

What is required in relation to the maintenance of books and records is not a perfect approach, but rather an adequate one. In *Business Communications Ltd v Baxter*[58] Murphy J pointed out:

> To obtain exemption from the restraint which must otherwise be imposed by virtue of section 150 of the Act of 1990, all that is required is the exercise of a suitable degree of responsibility. Ordinarily responsibility 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 reasonable commercial decisions and auditors (or liquidators) to understand and follow the transactions in which the company was engaged.[59]

Based on their obligations under section 202, it is expected that directors should be able to determine the financial position of the company from the company's accounts and to act accordingly. In *Re Finchley Construction Ltd (in vol liq), Roache v Culloo*[60] the company continued to trade while insolvent leading to a deficit on liquidation in excess of €3 million. The directors' failure to see the writing on the wall in the company's management accounts which indicated that the company was in considerable financial difficulty was regarded as

55. [1998] 2 ILRM 345 (HC).
56. See *eg*, *Re Capital Auto Group Ltd (in vol liq)*; *Foster v Swords* [2005] IEHC 434.
57. 5 February 2001 (HC).
58. 21 July 1995 (HC).
59. *Ibid*, at 17–18.
60. [2005] IEHC 448.

evidence of incompetence and restriction orders were made against two executive directors. The courts have also recognised that it may be prudent for the directors to put in place accounting systems which go beyond the minimum requirements of section 202. In *Re Cooke's Events Co Ltd (in liq); Kavanagh v Cooke*[61] Mac Menamin J commented on the fact that during its entire trading period the company had no management or audited accounts prepared. Although there was no statutory requirement for the company to prepare such accounts, the failure to do so showed poor management since the directors could not be clear as to the company's financial position.

Avoiding trading recklessly

One of the key issues in any restriction application is the conduct of the directors in relation to the company's insolvency. It has been recognised that the directors of a company are not required to cease trading and appoint a liquidator at the first moment when it becomes apparent that the company may not be capable of paying its debts as they fall due. A certain amount of leeway is given to directors who trade for a short period while the company is insolvent in the hope that the company can trade out of its difficulties. However, where a company continues to trade while insolvent over a protracted period, this will be viewed in a different light and is likely to categorised as irresponsible. This is so *a fortiori* in cases where the directors have flagrantly continued to trade while in no doubt about the company's untenable position.

What is required to establish a company's insolvency for the purposes of the restriction regime is laid down in section 214 of the Companies Act 1963, the most frequently cited aspect being section 214(c) which provides that insolvency involves a company being unable to pay its debts, taking into account any contingent and prospective liabilities of the company.[62] In the broader commercial context, the term "insolvent" may be deployed in different senses – it may relate to cash flow insolvency or insolvency on a balance sheet basis. In *Re Club Tivioli Ltd (in vol liq); Foster v Davis* Mac Menamin J discussed the ways in which the term "insolvency" may be used:

> The word 'insolvency' may be used in two different contexts. The first is where a company is, in a commercial sense, 'not financially viable.' This is referred to as 'commercial insolvency'. This may be the case either where such company is unable to pay its debts as they fall due (the cash flow test) or where its liabilities (including the value, in practical terms of its contingent and perspective liabilities) exceed the realisable value of its assets (the 'balance sheet' test). The two tests are interrelated. The company which is commercially insolvent in the cash flow sense only is generally heading towards insolvency in the balance sheet sense also. This

61. [2005] IEHC 215; [2006] 1 ILRM 191.
62. Companies Act 1990, section 149(1).

> is because the adverse cash flow is eating into its capital base. Conversely a company which is commercially insolvent in the balance sheet sense only is generally heading towards insolvency in the cash flow sense also because the cash flow will need to be used sooner or later to meet the balance sheet deficiency. The second context in which the term 'insolvency' is used is where a commercially insolvent company is actually the subject of a pending statutory insolvency scheme.[63]

In *Re USIT World Plc* the liquidator expressed concern that the company had traded while it was insolvent on a balance sheet basis.[64] Peart J recognised that a reasonable and limited effort at trading out of the company's difficulties is not irresponsible. He made the following pertinent comments on the issue:

> Many companies will experience for many reasons unrelated to the general health of the company, a downturn in profitability over a quarter, two quarters or even three quarters. That in my view does not mean that even where a risk of insolvency downstream is warranted or anticipated, some reasonable effort at rescuing the situation may not be permitted to be undertaken. To attempt to trade out of a difficulty is not an irresponsible act. Care of course must be taken to ensure that effective and realistic steps are taken and that creditors' interests are kept to the fore, rather than that a careless or reckless gamble is taken without proper advice and planning to an achievable end. Some sort of short term emergency fire-fighting must be permitted to take place…. Many companies have survived and prospered after temporary setbacks.[65]

In this case it was acknowledged that the fallout of 11 September 2001 had a very large part to play in the company's difficulties since it led to financing being pulled. Furthermore, the directors had taken legal and accountancy advice in relation to its continued trading after September 11. In relation to the facts before him, Peart J stated that "[t]his is not a case where heads were placed in the sand so that problems on the horizon were ignored."[66] For an attempt to trade out of difficulties to be judged irresponsible, there would have to be "some element of recklessness or culpable want of care on the part of a director."[67] He emphasised that it was not sufficient that the directors took decisions that later turned out to be the wrong decisions with the benefit of hindsight.

As noted above, the outcome of each case will depend on a wide number of factors. As a general proposition, however, although trading for a number of weeks or even months while insolvent may be acceptable, continuing to do so

63. [2005] IEHC 468, at 16–17.
64. [2005] IEHC 285.
65. *Ibid*, at 70–71.
66. *Ibid*, at 71.
67. *Idem*.

over a number of years is likely to be branded as irresponsible. In *Re Pineroad Distribution Ltd (in vol liq); Stafford v Fleming*[68] Hanna J regarded the company having traded while insolvent for a period of two years as evidence of irresponsibility and he castigated the directors for having traded for far too long, having regard to the scale of the company's liabilities to the Revenue Commissioners. He said that while the respondents had not acted in a consciously dishonest way, they had acted in a grossly irresponsible way by shutting their eyes to the long standing and increasing debt owed to the Revenue Commissioners in respect of PAYE/PRSI and VAT and continuing to trade far beyond what was reasonable. In doing so, they were said to have acted with gross recklessness and contrary to the interests of creditors. Protracted trading while insolvent was also at the centre of *Re Newcastle Timber Ltd (in liq); Maloney v Smullen*.[69] The liquidator of the companies applied for orders under section 160 of the Companies Act 1990 or alternatively under section 150 to have the company's directors disqualified or restricted. The High Court determined that by acting incompetently and by trading while insolvent for four years and preferring certain creditors, the directors had acted irresponsibly. However the court considered that the protection of the public did not warrant the making of a disqualification order but it did make restriction orders against both directors. McCracken J stated:

> [t]o trade while insolvent for one year, or perhaps two years, in the hope that the company may trade out of its problems is understandable, but to have kept Newcastle trading insolvently for some four years, and allowing Revenue debts to build up, appears to me to be totally irresponsible.[70]

In some cases in which the company has continued to trade while insolvent, aggravating factors will colour the court's view of matters. One of the most egregious examples of a company continuing to trade over an extended period while insolvent is documented in *La Moselle Clothing Ltd (in liq) v Soualhi*.[71] The respondent director of two companies in liquidation had not made any effort to stop trading although it was clear the two companies were insolvent. Trade creditors were paid off at the expense of the Revenue Commissioners and other creditors such as Dublin Corporation and the companies' landlords. Large expenses were incurred on extensive world travel which may not have been business-related. Furthermore, a large salary and drawings were withdrawn at a time when the company was insolvent. In those circumstances Shanley J had no difficulty in classifying this conduct as irresponsible and making a declaration of restriction. In *Business Communications Ltd v Baxter* the company's insolvency was established in June 1993 but the company continued

68. [2007] IEHC 55.
69. [2001] 4 IR 586 (HC).
70. *Ibid*, at 592–593.
71. [1998] 2 ILRM 345 (HC).

to trade until December 1993 despite advice to the contrary.[72] Furthermore, prior to its liquidation, the company's overdrawn bank account was brought into credit by the company thereby relieving the exposure of the directors on foot of personal guarantees. In addition the statement of affairs circulated at the creditors' meeting seriously over-estimated the likely realisation of assets. Murphy J held that certain of this conduct was of "questionable commercial morality" and made declarations of restriction.[73]

Avoiding compromising creditors' interests

When the company's financial outlook is not good such that the company is insolvent, there is a real risk of insolvency or the company is of doubtful solvency, the directors are under a duty to consider the interests of creditors.[74] When a company's insolvency is inevitable the assets of the company should be preserved for proper distribution to the creditors in accordance with the statutory order of priority. Apart from the company continuing to trade while insolvent, thereby accruing further debts, creditors' interests may be adversely affected by payments which prefer certain creditors and other actions which lead to a reduction in the assets of the company available for distribution.

Where a company is experiencing cash flow difficulties, the directors can act sensibly to minimise risks to creditors. In *Re Streamline Ltd* Shanley J did not find any conduct on the part of the directors which would have amounted to a want of commercial probity or which in any way contributed to the insolvency of the company or to the net deficiency in the company's assets.[75] In so holding, he had regard to an offer from the directors of the company to discharge by instalments the debt due to the applicant creditor; that the company had, for a number of months prior to its winding up, traded on a cash delivery basis; and to the detailed restructuring proposals drawn up by the directors which, he held, did not represent the actions or plans of persons who believed their business was then insolvent.

It is likely to be considered irresponsible for the directors not to have in place adequate financial controls to provide an indication of how the company is trading. In *Re SPH Ltd (in vol liq); Fennell v Shanahan* the first respondent was described as being the prime mover in the company and in day to day control.[76] The second respondent was a non-executive director. The company operated under significant financial pressure in its last six months of trading and

72. 21 July 1995 (HC).
73. *Ibid*, at 19.
74. *John C Parkes & Sons Ltd v Hong King Shanghai Banking Corporation* [1990] 1 ILRM 341; *Re Frederick Inns Ltd* [1991] ILRM 582 (HC), [1994] 1 ILRM 387 (SC); *Re Swanpool Ltd (in vol liq); McLaughlin v Lannen* [2005] IEHC 341 [2006] 2 ILRM 217; *Hughes v Hitachi Koki Imaging Solutions Europe* [2006] IEHC 223; [2006] 3 IR 457.
75. 24 June 1998 (HC).
76. [2005] IEHC 59.

the liquidator expressed the view that the company may have lacked the necessary measurement controls to trade successfully or profitably resulting in constant cash flow issues. Shortly before the company was wound up it received a demand from the Revenue Commissioners for €277,569.54. The directors estimated in their statement of affairs that the deficit facing the company was in the order of €1.7 million. The issue for the High Court was whether the respondents acted responsibly in relation to the control and supervision of the financial affairs of the company, having regard in particular to the amount of liability to the Revenue Commissioners, and the manner and period in which this had been allowed to accumulate. Finlay Geoghegan J stated that the respondents either knowingly permitted significant sums due to the Revenue Commissioners to accrue without providing for the payment thereof, or alternatively, if they were unaware of the liabilities accruing that they failed to put in place appropriate systems to inform themselves of the financial position of the company to allow them properly control and manage the affairs of the company. The Court concluded that the respondents had not acted responsibly in relation to the conduct of the affairs of the company whilst directors. Declarations of restriction were therefore made against both respondents.

When a company is in financial difficulties, the courts have considered it irresponsible for the directors to procure payments to themselves at the expense of creditors. In *Re Outdoor Advertising Services Ltd* the directors were found by Costello P to be fully aware of the huge debt of the company.[77] By making payments to personally benefit one of the directors and two other companies owned by the directors who were not creditors of the company, the directors were found to have acted irresponsibly. In addition, Costello P held that they did not act honestly as they consciously and deliberately acted at the expense of the company's creditors, for the benefit of one of the directors and companies owned by the directors. Directors may also act irresponsibly in seeking to reduce their own exposure on foot of personal guarantees given to a bank. For example, in *Business Communications Ltd v Baxter* the company's overdrawn bank account was brought into credit by the company, thereby relieving the exposure of the directors on foot of personal guarantees.[78] In *Re Finchley Construction Ltd (in vol liq), Roache v Culloo* two of the respondents who were restricted had transferred a loss from their partnership to the company thereby increasing the net deficiency of the company by a very substantial sum.[79]

The company's level of expenditure, particularly in relation to drawings is likely to be scrutinised in a restriction application. The issue of irresponsible expenditure for personal benefit arose in *La Moselle Clothing Ltd v Soualhi*.[80] The respondent director permitted the company to trade at a time when he knew that the company was insolvent. The company used monies due to the Collector

77. 28 January 1997 (HC).
78. 21 July 1995 (HC).
79. [2005] IEHC 448.
80. [1998] 2 ILRM 345 (HC).

General and to a creditor, Cambridge Confirming Ltd, to finance trading activities and the respondent's own very extensive personal travel. Shanley J found that the respondent was aware that the company could not trade and at the same time discharge its liabilities to the Collector General and to Cambridge Confirming Ltd. This was considered to be improper and if not actually dishonest, certainly irresponsible, and a declaration of restriction was made. There was scant evidence that the numerous foreign travel expenses related to legitimate business journeys but the Court considered that even if they were legitimate business trips, the level of costs so incurred and discharged by the company was such as to demonstrate a want of commercial probity having regard to the overall parlous financial position of the company. Shanley J accepted the liquidator's view that the company continued to trade when the director knew well that it was insolvent; that the director, notwithstanding the insolvency of the company, maintained a very expensive lifestyle funded by the company; and that the drawings taken by the director were not the actions of a responsible director.

In other instances, the directors have preferred certain creditors in the general body of unsecured creditors to the prejudice of others. In *La Moselle* trade creditors were preferred at the expense of the company's landlords and the Revenue Commissioners. Preference of trade creditors also arose in *Re DCS Ltd (in vol liq); Fitzpatrick v Henley* where preference was given to a number of creditors in the period between cessation of trading and the decision to wind up the company.[81] The creditors whose debts were discharged were those on whom the first respondent thought he would be reliant in the future trading of a new company. Furthermore, certain creditors were not informed of the creditors' meeting. In addition, there was an under-valuation of the leasehold interest such as would affect the interest of the creditors as a whole. The effect of the actions of the first respondent was regarded as reducing the assets of the company, thereby preventing them being applied *pro tanto* in discharge of the company's liabilities. The High Court made an order under section 150 against the first respondent but did not make an order against the second respondent who was the first respondent's mother.

Re Swanpool Ltd (in vol liq); McLaughlin v Lannen involved another instance of a creditor being preferred.[82] The liquidator of Swanpool and Travelodge sought a declaration of restriction against two directors of the companies in liquidation. The companies owned development land which, with planning permission for development, was worth approximately €2 million. After planning permission was granted for development, the directors of the company secured an investment through a Business Expansion Scheme (BES). After this investment took place, the planning permission was successfully appealed to An Bord Pleanála by a third party. This reversal of planning permission greatly reduced the value of the land, to the extent that the company

81. [2006] IEHC 179.
82. [2005] IEHC 341; [2006] 2 ILRM 217.

was not in a position repay its debts. However, even after the directors were aware that the company could not repay its debts, they proceeded to repay the BES investors in full, thereby reducing the amount of assets left for other creditors in a liquidation situation. Clarke J held that one of the most important obligations of any director is to ensure that when a company is facing insolvency, its assets are dealt with in accordance with law. The Court took account of compliance by the directors with the obligations identified in *Re Frederick Inns Ltd* to ensure that once the company was facing insolvency its assets were dealt with in a manner designed to ensure the proper distribution of those assets in accordance with insolvency law.[83] It was said that any significant failure in that regard would demonstrate a level of irresponsibility sufficient to warrant making a restriction order. Clarke J concluded that while the conduct of the respondents was at the lower end of the spectrum of seriousness, it was still sufficient to meet the threshold for the making of a declaration of restriction.

Payments to professional advisers may, however, be looked at in a different light to other payments. A payment of €250,000 to the group's solicitors for past and future advices made the day before the appointment of a provisional liquidator was raised as a matter of concern by the liquidator in *Re USIT World Plc*.[84] Peart J noted that the payment was small in relative terms when placed in the context of the size of the company's enterprise and the overall multi-million losses to creditors. Moreover, it was not a disguised attempt to funnel funds through to the directors. Therefore it was not judged to be irresponsible or dishonest.

Where monies owing to the Revenue Commissioners are used to finance continued trading, this may be regarded as irresponsible. This matter was considered in *Re Digital Channel Partners Ltd (in vol liq); Kavanagh v Cummins* where the High Court decided that, while failure to make tax returns and to pay relevant taxes were clear breaches of the Taxes Acts, on the facts presented, they related to a relatively limited period and did not of themselves indicate that the directors of the company had acted dishonestly or irresponsibly.[85] Finlay Geoghegan J commented that there must be something more than a limited failure over a short period to establish that the directors had acted irresponsibly. She considered that irresponsibility could be established where there was evidence of a selective distribution or selective payment of liabilities of a company, a total disregard of obligations to the Revenue Commissioners or a decision to use taxation liabilities for the purpose of financing the company. Financing the company from taxation liabilities came under scrutiny in *Re Verit Hotel and Leisure (Ireland) Ltd (in rec and in liq); Duignan v Carway* where for a significant period of time prior to liquidation, the company was being kept alive by trading using monies due to the Revenue Commissioners and allowing arrears to build up.[86] Significantly, McCracken J rejected the contention that if

83. [1994] 1 ILRM 382 (SC).
84. [2005] IEHC 285.
85. [2004] 2 ILRM 25 (HC).
86. [2002] IEHC 1.

a company is temporarily short of funds it may be justified in not paying the Revenue Commissioners PAYE and PRSI monies on behalf of its employees. It was held that continued trading using what was, in effect, employees' money without their knowledge or consent was totally irresponsible. This had been a deliberate policy on the part of the board of directors and on this ground alone, the directors were restricted. In so deciding McCracken J stated, "[t]o try to justify trading by using what is in effect its employees' money without their knowledge or consent, is to me a quite bizarre and totally irresponsible attitude."[87]

It may also be considered irresponsible for the directors to have failed to initiate the winding up of a company when they knew or ought to have known that the company was insolvent. In *Re Careca Investments Ltd (in liq); Ferris v Farrell* the company which was the subject matter of the proceedings was a single purpose company.[88] The company had purchased land at a substantial profit and this was the only significant transaction of the company while it traded. The petition to wind up the company was presented by the Collector General on foot of a capital gains tax liability in circumstances where the company had not traded for approximately four years. The respondent director was restricted on the basis that he had let matters lie until the Revenue Commissioners became active. On the issue of why steps had not been taken to wind up the company, no explanation was given by the director as to why he did not take the advice which he was given by his solicitor to the effect that he should have sought to have the company wound up, other than a plea of absence of funds. The High Court held that the director failed to act responsibly by virtue of not taking adequate steps to ensure the winding up of the company within a reasonable period of it ceasing to trade and in circumstances where he knew or ought to have known that it was likely to be insolvent.

Adopting a sensible approach to risk-taking

The courts understand that the basic role of the directors involves an element of risk-taking. However, in restriction decisions what constitutes appropriate risk-taking is regarded as a matter of degree.

The manner in which a company has been managed by the directors will inevitably come under scrutiny in section 150 applications in a quest to understand why the company became insolvent. The decisions on restriction applications have shown the courts to be conscious of avoiding the trap of being too wise after the event. The courts are sympathetic to directors whose businesses have collapsed through no fault of their own. In *Business Communications Ltd v Baxter* Murphy J cautioned, "of course one must be careful not to be wise after the event. There must be no 'witch hunt' because a business failed as businesses will."[89] Indeed, the size of the company's

87. [2002] IEHC 1, at 7.
88. [2005] IEHC 62.
89. 21 July 1995, at 17 (HC).

deficit will not preclude a court from concluding that the directors had acted responsibly.[90]

In the case of *Re Colm O'Neill Engineering Services Ltd*[91] Finlay Geoghegan J observed that in spite of judicial exhortations to the contrary, it was difficult for a liquidator and a court to avoid on occasion examining the actions or inactions of directors with the benefit of hindsight. However, in scrutinising the commercial management of the company, the courts have acknowledged that risk-taking is central to entrepreneurship and to the role of the directors in guiding the company's fortunes. This was robustly endorsed by Peart J in *Re USIT World Plc*[92] where he acknowledged that "[i]t is the very essence of entrepreneurial endeavour that risks are taken."[93] He also stated:

> If an entrepreneur were to be obliged, on pain of being found to be irresponsible and of being restricted under the section, to avoid taking any decision which at some date in the future might be found to have risk attached to it, the business life and a large component of the economic driver of the economy of the State would stultify. I do not believe that this is what the legislature had in mind when enacting section 150.[94]

Consequently, in restriction decisions a line has been drawn in the sand between responsible, calculated risk-taking and irresponsible, reckless risk-taking. In *Re USIT World* Peart J drew a distinction between calculated risks and reckless risks. A calculated risk "lacks recklessness or carelessness, or wilful disregard of the interests of others, whether creditor or shareholder or employee, which would classify it as irresponsible."[95]

He said that where a risk is taken against a background of planning and a knowledge from which to assess the risk and where appropriate advice has been taken, such a risk may be reasonably characterised as a calculated risk. Peart J noted that the greater the amount of money involved in the risk, the greater the obligation on the directors to ensure that appropriate care is taken in all aspects of its planning, so that all reasonably foreseeable factors which may cause the venture to fail are anticipated and guarded against. In this case the directors were found to have acted sensibly throughout the company's trading life and declarations of restriction were not made.

The courts have been understanding of the impact of broader economic forces on a company's trading outlook and have been understanding of insolvency resulting as a consequence of economic conditions outside the control of the directors. This is important as many directors find their companies in cash flow difficulties and struggling to gain business in the midst

90. *Re Digital Channel Partners Ltd (in vol liq); Kavanagh v Cummins* [2004] 2 ILRM 35 (HC). See also *Re USIT World Plc* [2005] IEHC 285.
91. 13 July 2004 (HC).
92. [2005] IEHC 285.
93. *Ibid*, at 79.
94. *Ibid*, at 80.
95. *Ibid*, at 84.

of a global recession. The restriction case law indicates that directors will not be held accountable for events which are outside their control and which ultimately lead to the company's winding up. In both *Re USIT World Plc*[96] and *Re AMS IT Consulting Ltd; Keane v Kalsi*[97] the High Court acknowledged the impact of the event of 11 September 2001 in creating a downturn as an example of factors outside the control of the parties which had contributed to the company's insolvency. In *Re USIT World* the fall-out of 11 September 2001 seriously affected the student travel market and the fortunes of USIT as a group. Ulster Bank did not provide anticipated funding and the company became strapped for cash and ultimately collapsed. Peart J found that the directors had acted honestly and responsibly and that there was no other reason why it would be just and equitable to restrict them. In *Keane v Kalsi* the company was a start up company in the IT sector which "suffered an immediate and serious reverse" in the aftermath of September 11.[98] The Court was satisfied that the directors had acted promptly to have the company brought into voluntary liquidation and despite certain deficiencies in relation to failures to comply with the Companies Acts, declarations of restriction were not considered to be warranted.

Another instance of judicial understanding of external economic forces can be seen in *Re Money Markets International Stockbrokers Ltd (in liq)* where a section 150 application was brought against the respondent director-shareholders who were primarily responsible for the operation of the company's stockbroking business.[99] As a result of the sudden termination of an agreement which the company had with a UK broker, the company sustained a substantial loss. This loss was exacerbated by further problems in the market. Then, when a facility from a financial institution was withdrawn, the company was forced into liquidation. The Court was of the view that "[t]he series of misfortunes described would be difficult for even the most perspicacious of directors to anticipate."[100] The conduct of the directors was not regarded as the causative factor in the insolvency of the company nor were they responsible for any deficiency in assets which, in any case, ultimately occurred after the respondents had resigned, and the company had been taken over and administered by others. Mac Menamin J did not consider that the evidence presented to him constituted a sufficient basis for making declarations of restriction against the respondents.

It is particularly important for directors to seek appropriate professional and legal advice about the wisdom of continuing to trade when the company is experiencing financial difficulties. This is a responsible course of action and where the directors take and act on professional and legal advice this may prevent a restriction application or a finding of irresponsibility[101] being made

96. [2005] IEHC 285.
97. [2006] IEHC 12.
98. *Ibid*, at 6.
99. [2006] IEHC 350.
100. *Ibid*, at 17.
101. See *eg*, *Re Squash (Ireland) Ltd* [2001] 3 IR 35 (SC); *Re Camoate Construction Ltd (in liq); Coyle v Callanan* [2005] IEHC 346; [2006] 1 IR 447.

so long as reliance on such advice was not blind reliance.[102] Indeed, while seeking appropriate advice is important, directors are required to exercise their own independent judgment as stewards of the company's destiny.

VI. Conclusion

Directors are possessed of broad discretionary powers to be exercised for the benefit of the company. However, when dark clouds appear on the horizon, the company is no longer seen as an economic contributor but rather as a potential economic liability and the directors at its helm need to be encouraged to steer the company along a path which inflicts minimum pain on existing and future creditors. Although fundamentally protective in purpose, the imposition of a declaration of restriction remains a strong sanction given the practical restrictions it imposes on participation in corporate life and the undoubted stigma which the imposition of such a sanction attracts. The main lesson to be gleaned from the restriction case law for directors in these difficult times is that directors are expected to be remarkably adaptable and chameleon-like in moving from their own interests to those of the company. Furthermore, when things get rocky, directors are expected to curb the natural management urge to engage in more risky activity with a view to trading out of difficulties as the interests of creditors intrude.

More and more commonly, companies are victims of plain bad luck attributable to the fall-out of the global economic downturn. It is therefore important that the well-intentioned director is not subject to sanction in respect of events outside his or her control or on the basis of limited efforts to trade through a difficult time.[103] The courts have been relatively astute in their approach to failed businesses. There is an understanding that it is in the nature of entrepreneurship that some businesses may fail. Moreover, it is understood that some factors are outside the control of companies and their directors. Directors who keep abreast of the company's financial position through the maintenance of appropriate books and records are in a position to make informed decisions about the company continuing to trade in a difficult economic climate. Further evidence of responsibility is shown in seeking and considering legal and other professional advice. However, given that the current downturn looks set to continue for some time, the writing is very much on the wall in relation to the likelihood of trading difficulties being insurmountable. It can therefore be expected that increasingly less leeway may be given by the courts to directors who cause their company to continue to trade while insolvent.

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102. *Re Bradcrown Ltd, Official Receiver v Ireland* [2001] 1 BCLC 547 (Ch D).
103. In some cases where a corporate rescue plan may salvage the company, it may be appropriate to seek court protection through petitioning for the appointment of an examiner under Part II of the Companies (Amendment) (No 2) Act 1999.