Not So Separate Legal Personality and Bad Debts

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Introduction

In the harsh economic conditions which prevail, increases in bad debts and difficulties in securing payment are common experiences for many. Financial difficulties resulting in poor payment conditions can affect any of your clients. Many legislative measures have been enacted which seek to prevent the “phoenix syndrome” but restriction and disqualification orders do not ensure your client is paid. Another phenomenon is the “scorched earth” problem identified by the McDowell Report1, where the extent of insolvency is such that the appointment of a liquidator is highly unlikely for monetary reasons, but remedies are nonetheless required. So the provisions of, inter alia, section 251 of the Companies Act, 1990 (CA,1990) are worthy of recall.

The net effect of section 251 is that the powers ordinarily vested in a liquidator to examine company officers, recover company assets and swell the resources available to creditors of the company, can be exercised by, for example, a creditor or the Director of Corporate Enforcement (DCE).

Bad debts where a company is not being wound up

Section 251 of the CA, 1990 provides for relief where the debtor company is insolvent but not being wound up due to the insufficiency of its assets. That is the critical precondition to the courts jurisdiction to make orders under section 251. Any other approach would just circumvent the liquidation process in situations where a realisation and distribution of assets was feasible. Section 251 applies where execution or other process issued on a judgment or other court order in favour of a creditor is returned unsatisfied, or where the court is satisfied the company is unable to pay its’ debts and the court is of the opinion that the reason, or principal reason, for the absence of winding up is the insufficiency of the companys’ assets. In either scenario the court is empowered to make a series of orders which could otherwise not be made, absent a winding up.

Section 251(2) provides that certain sections of the Companies Acts shall apply notwithstanding that the company is not being wound up. They are sections 139, 140, 149, 203 and 204 of the CA, 1990 and sections 243, 245, 245A, 247, 295, 297, 297A and 298 of the Companies Act, 1963 (CA, 1963). Some of those provisions have the effect that certain company officers, or others, can be made personally liable for the debts of the company. That may provide some means of recovery for your client and it is those provisions in particular which are reviewed below.

1 Reopr of the Working Group on Company Law Compliance and Enforcement (1998)
Who can avail of the provision?

It seems that a company’s creditors and shareholders have locus standi but section 251 is silent on the question of the applicants identity. However, in *Alba Radio Ltd. v Haltone (Cork) Ltd.*, a creditor who had obtained judgment against the company was the successful applicant pursuant to section 251 and the judgment of Barron J. raised no issues concerning locus standi. It seems that the application can be made by any creditor and not necessarily only one who has obtained judgment against the company. The DCE has locus standi pursuant to section 251(2A), as inserted by section 54 of the Company Law Enforcement Act, 2001 (CLEA, 2001).

Interestingly, if it is the DCE who applies for any orders under section 251 and recovers any amounts, your client, or any other creditor, has a period of only one month from the date of judgment in which to apply for a share of those funds.\(^2\)

**Section 251 gives access to various provisions of the CA, 1990 in the absence of a winding up**

Orders can be sought on foot of sections 139, 140, 149, 203 and 204 of the CA, 1990. The consequences of those various sections are as follows;

**Fraudulent Dispositions of Property, section 139**

These differ from fraudulent preference transfers as these dispositions are not normally those made to creditors. Section 139 of the CA, 1963 provides that a liquidator, creditor or contributory of a company can apply for the return of transferred property and the court can order its return to the company. There is no requirement to show intent to defraud and the section merely requires that the applicant show that the effect of the transfer of property was to perpetrate a fraud on the company. A gift of company property to its controllers, for example, might have the effect of perpetrating a fraud on the company. The provisions of section 251(2) mean that this course is now open to a creditor or contributory where no winding up has commenced.

**Related companies may be required to contribute, section 140**

The applicability of section 140 to this scenario, where there is no winding up, has the effect that the court can, pursuant to sub-section 1, order that a contribution be made to the debts of the debtor company by a “related company”. Related company is defined by sub-section 5 to include, inter alia, subsidiary and holding companies, as well as any company which holds half in nominal value of its equity share capital, or whose shareholders do so. The court can only make such an order if it is satisfied that it is just and equitable to do so. Sub-section 2 provides that to be so satisfied the court shall consider, inter alia,

- whether your clients debtor company may have been under the management and control of another company, and
- its conduct towards the creditors of the debtor company.

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\(^2\) S.251(4)(b) as inserted by s.54 Company Law Enforcement Act, 2001
However the court must also be satisfied, according to sub-section 3, that the related companies actions or omissions caused the insolvency problems of the debtor company.

**Restriction on Directors of Insolvent Companies, section 149**
The amendment in 2001 to include section 149 within the list of orders which can be obtained on foot of section 251 has the effect that Chapter 1 of Part VII of the Companies Act, 1990 now applies. Section 54(a) of the CLEA, 2001 effected this change and made the provisions on restriction of directors available to the court where section 251 is invoked. That will not improve your clients prospects of payment but other provisions may have that effect.

**Liability of officers of company where proper books of account not kept, sections 203 and 204**
Section 202(1) of the CA, 1990 requires every company to keep proper books of account. If a company fails to do so and the court is satisfied that ;

- the failure has either contributed to the company’s inability to pay all of its’ debts, or
- resulted in substantial uncertainty as to what its’ assets and liabilities are, or
- substantially impeded the orderly winding up of the company,

the court may, on foot of section 204 of the CA, 1990, impose unlimited personal liability for the debts and other liabilities of the company on any officer or former officer of the company who was in default.

Section 202(1) stipulates that a company must keep proper books of account which, inter alia, correctly record and explain company transactions, enable the financial position of the company to be ascertained at any time and facilitate proper auditing. Section 202(3) provides some guidance on what is required as regards the keeping of books of account. It stipulates, inter alia, that all monies received and expended by the company must be recorded, as well as the matters in respect of which the receipt and expenditure take place. Additionally, assets and liabilities must be recorded. Section 202(4) provides that proper books of account shall be deemed kept if they comply with the sub-sections and give a true and fair view of the company’s affairs and transactions.

While section 203 provides for the attachment of criminal liability to an officer who is in default, section 204 (1) authorises the court to declare any officer, or former officer, of a company, who is in default of section 202(1) personally liable, without limitation, for the debts and other liabilities of the company. That is a provision which might have a positive practical consequence for a creditor.

The possible advantage to creditors of the provision can be seen in the case of *Re Ashclad Ltd.; Forrest v Harrington and Culleton* where one of the grounds for the decision to make the respondent personally liable for some company debts was that the breach of section 202(1) contributed to the company’s inability to pay all of its debts.

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1. (5 April 2000, unreported), High Court (Geoghan J.)
**Section 251 also gives access to various provisions of the CA, 1963 in the absence of a winding up**

The section also renders applicable certain sections of the Companies Act, 1963. These are sections 243, 245, 245A, 247, 295, 297, 297A and 298 of the Companies Act, 1963.

The orders the court can make are indicated by section 251(2) and include the power to assess damages against directors and the power to make an order directing the return of assets improperly transferred. The court can also hear applications for orders to summon people for examination or to declare fraudulent trading.

**Information gathering is made possible, sections 243, 245 and 245A**

The application of sections 243 and 245 can have very practical consequences, providing the court, as they do, with the power to order the facilitation of inspection of company books by a creditor, or the examination of officers on oath, respectively. Section 245A provides that where a person examined is found to be indebted to the company, or in possession of company records or property, the court can order the transfer of those, or of funds, to the liquidator. That too could improve a creditors position financially.

**Criminal matters, sections 247, 295 and 297**

Section 247 contains a power to arrest any absconding officer or contributory and section 295 provides for the criminal prosecution of officers of a company who have defrauded a company. Section 297 creates criminal liability for fraudulent trading but these are not the significant provisions for the companys creditors.

**Civil liability and unlimited personal liability for company debts where there has been fraudulent or reckless trading, 297A**

There is a certain uncertainty around this provision because section 251 lists in a table those sections which can be invoked absent the winding up and it is inconsistent. The table indicates that section 297A can be invoked but the text describing section 297A lists only civil liability for fraudulent trading and, as Courtney notes, reckless trading is not mentioned. It seems inconceivable however that a court would preclude an application for an order pertaining to reckless trading where a “scorched earth” scenario were presented to the court.

The decisions in *Re Hunting Lodges Ltd* and *Re Aluminium Fabricators Ltd* illustrate that significant payments can be ordered from officers, or others, and made available to creditors.

Assuming section 297A is available to a creditor in its entirety, payments may also be available to creditors on foot of findings of reckless trading, such as that in *Stafford v*

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5 [1985] I.L.R.M. 75
6 [1984] I.L.R.M. 399
Fleming\textsuperscript{7}, where coupled with an allocation of personal liability for the debts of the company.

\textbf{Liability for damages arising from misfeasance, section 298}

The court is empowered to compel any company officer to make a contribution to the assets of the company where any misapplication or other breach of duty has taken place. In \textit{Re Contract Packaging Ltd.}\textsuperscript{8} the court found that the directors were in breach of their fiduciary duties and declared that certain property was held by them in trust for the company and ordered that it be conveyed to the liquidator.

\textbf{Conclusion}

If a creditor has not succeeded in securing payment but has reason to believe that the insolvent company has been managed in an improper way, section 251 may provide a remedy and some prospect of payment.

\footnotesize{\textsuperscript{7} [2007] 8 I.C.L.M.D. 25
\textsuperscript{8} (16 January 1992, unreported), High Court (Flood J.)}