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CHAPTER 4

**THE DYNAMIC ENTREPRENEUR OR THE
TOTALLY INCOMPETENT FOOL?
THE ROLE OF NORMS IN IDENTIFYING LEGITIMATE
RISK-TAKING UNDER IRISH COMPANY LAW**

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1. INTRODUCTION

In the last six years or so, since the establishment of the Office of the Director of Corporate Enforcement under the Company Law Enforcement Act 2001 and the consequent animation of applications to the High Court under ss.150 and 160 of the Companies Act 1990, the Irish judiciary and the commercial bar have had the opportunity to consider the issue of risk-taking in the corporate context. Because of the tightly drawn legislative framework which underpins applications for restriction orders and disqualification orders under ss.150 and 160¹ respectively, it has been possible for the judiciary to closely scrutinize managerial and directorial behaviour against a standard of acceptable risk-taking in a manner which has not occurred before in the history of Irish company law. In the course of their decisions the judiciary has expressed various views on the nature of entrepreneurship and risk-taking and on the issue of what is and what is not a legitimate business risk. This article will examine some of the most interesting of these judgments with two goals in mind. The first is to cast some light on the possibility of developing a set of “bright line” rules or standards as to legitimate commercial risk taking in this area. The second is to ask some interesting questions of an academic nature on the role of judicial rhetoric in Irish company law using the section 150 and 160 cases as illustrative of a broader discourse on the role of non-legally enforceable norms or NLERs as they are sometimes described in the academic literature. Thus the paper will

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¹ See ss.150 and 160 of the Companies Act 1990, as amended by the Company Law Enforcement Act 2001.

firstly provide a context for the author's interest in the role of norms in company law. Secondly it will briefly describe the academic literature on this question. Thirdly it will focus on the Irish section 150 and 160 cases where the role of norms seems evident and finally will proffer some concluding remarks.

2. CORPORATE GOVERNANCE AND THE ROLE OF NORMS

Some time ago this author considered a transatlantic case which had arisen in relation to the loss of over €500 million by AIB in a rogue trading scandal.² Whilst some aspects of the unsuccessful investor litigation against directors and senior officers of AllFirst Bank (the subsidiary of AIB) and institutional defendants, AIB, AllFirst Bank and AllFirst Financial presented interesting issues concerning Irish and English company law on shareholder actions, in contrast to similar laws in the US,³ one of the clear lessons to be learnt from a consideration of the entire series of events was that the corporate litigation had little potential to add to the resolution of the corporate governance questions which the case history raised. In fact the litigation seemed almost irrelevant in light of other steps taken by management to resolve corporate governance concerns of the shareholders as a whole. These steps included commissioning an independent investigation on events,⁴ making significant changes at senior management level and restructuring the bank's US investments.⁵ Throughout the interesting but failed litigation and in the period afterwards, Allied Irish Banks continued to be a highly profitable company generating considerable income from its domestic banking operations.⁶ Because of its profitability, in governance

² I. Lynch Fannon, "A Transatlantic Case: The Derivative Action as a Corporate Governance Tool" (2005) 27 D.U.L.J. 1.

³ *Tomran Inc. v William M. Passano, Jr. et al.*, unreported, Baltimore City Circuit, Matricciani J., Case No. 24-C-02-002561. This case was a derivative action brought by the plaintiff, the holder of ADS representing shares in AIB quoted on the NYSE. In this case the primary relevant state law was either the law of New York or of Maryland, in both cases similar to the law of Delaware in relation to the issues at hand. For a discussion of the relevant law on this issue in these states see M. Dooley, *Fundamentals of Corporation Law* (New York: Foundation Press, 1995), 300ff [FOOTNOTE OR PAGE NUMBER?].

⁴ Promonotory Financial Group and Wachtell Lipton Rosen and Katz, "Report to Board of Directors of Allied Irish Banks P.L.C., AllFirst Financial Inc., and AllFirst Bank Concerning Currency Trading Losses" (March 2002) (hereinafter referred to as the "Ludwig Report"). See further www.aib.ie.

⁵ These actions included selling the US subsidiary operations and before this securing the resignation of a number of key staff there. In addition AIB embarked on a significant buyback of its shares, including those traded on the NYSE. These actions and the report mentioned in n.4 are discussed more fully in Lynch Fannon, above at fn.2.

⁶ In July 2004, the report of Allied Irish Banks on the half-year to June 2004 noted an increase in earnings per share of 10 per cent to €0.644 cents and an increase of 13 per cent in the profitability of, inter alia, its US operations. In 2005 after tax profits increased to US\$1,387m from US\$1,105m in the previous year. For the full text of the press release from Allied Irish Banks on July 27, 2004, see www.aibgroup.com (accessed on July 29, 2004).



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terms, the company continued to comply with the *primary imperative from its shareholders*.⁷ (This was the case despite the trading losses suffered at the hands of John Rusnak and also despite considerable trading losses incurred by its other foreign operations, primarily in Poland).⁸

The centrally compelling narrative in this case history was that the corporate governance issues, which might have centred on oversight and monitoring by management of the bank's activities⁹ were much more effectively managed and resolved outside the legal arena, through pro-active management of the matter by the Board of Directors and through the continued successful and profitable management of the banking operations as a whole.

“Throughout the history of this trading scandal it is clear that the Board of AIB has been very proactive in seeking to allay investor fears in relation to the losses caused, underscored by the appointment of the investigating team, which led to the publication of the Ludwig report. The goal presumably is to achieve some sort of resolution of the issues which this scandal raised, and for the most part this strategy seems to have been effective. Most shareholders seem to be content with the resolution if one is to judge by investor confidence as reflected in share price and by various business and media reports. The shareholders have laid down their metaphorical swords and why should they not?”¹⁰

The story raises questions about the role of legal standards in company law and the relationship of those rules, whether statute-based or judicially developed, to what are generally described as norms or non-legally enforceable norms. The

⁷ For an interesting development of academic thinking on current profit maximisation imperatives as experienced by management of public companies see L.E. Mitchell, *Corporate Irresponsibility: America's Newest Export* (New Haven and London: Yale University Press, 2001). Following publication of this text by the influential US corporate law scholar, Lawrence Mitchell, a collection of articles was published in the *George Washington Law Review* considering governance issues in the more somber post-Enron and Worldcom atmosphere which currently prevails. Consideration of concepts such as shareholder primacy and shareholder wealth maximisation in this new zeitgeist has clearly begun the quest for a new set of answers. See in particular D. Millon, “Why is Corporate Management Obsessed with Quarterly Earnings and What Should be Done About It?” (2002) 70 *George Washington Law Review* 890 and M. Gulati, “What are Larry's Criteria for Good Corporate Law?” (2002) *George Washington Law Review* 886.

⁸ See the interim report from the company posted on July 29, 2003 which gave profit and loss statements for the half year to June 30, 2003. This report showed that whilst Allied Irish Bank figures improved from 2002 to 2003 in its domestic banking operations from 294 million to 310 million in 2003 and in its operations in Great Britain and Northern Ireland, from 117 million to 125 million it suffered losses in Poland, from 24 million to 8 million and in the United States, from 117 million to 66 million. The report summary also states that, “the profit and loss for half year to June 30, 2003 includes AllFirst up to March 31, 2003 and the Group's 22.5% share of M & T's profit from April 1, 2003.” The trading occurred during 2002.

⁹ See a somewhat similar scenario but with very significantly different outcomes for the bank and for senior management in the discussion of Barings Bank plc below.

¹⁰ Lynch Fannon, above at fn.2, at p.26.

latter seem to have a particularly important role to play in the context of company law and its relationship to commercial activity. Naturally of course academics in the US¹¹ had already started considering this question some time ago and so a number of questions have already been raised which require consideration in the corporate law arena on this side of the Atlantic.

3. A BRIEF DISCUSSION OF THE ACADEMIC CONSIDERATION OF NORMS IN THE CORPORATE CONTEXT

(a) The first kind of norm or non-legally enforceable rule (NLER)

The identification of NLERs seems to have begun with a consideration of the role of social norms in the economics field, where theories have been developed in the last decade recognizing that not all economic transactions can be explained by reference to economic motivators and that social norms and values and other norms of behaviour play a role in transactional decisions.¹² This has been extended to the area of behavioural finance¹³ and more recently into legal scholarship¹⁴ and to the relationship between law and norms of behaviour, usually classified as non-legally enforceable norms. So at first glance these kinds of norms could amount to anything which motivates individuals to act in ways which may be ethical or moral but not necessarily mandated or required by law. This brings us to our first kind of norm which can include, for example, a social norm that it is expected that senior management act in accountable and responsible ways and that in some way this norm is internalized. Alternatively one could hypothesise that it is expected that senior management of large companies are seen to react in a dynamic way to corporate events such as the

¹¹ See further Lynch Fannon, above at fn.2, at p.26. for some references.

¹² See generally <http://cowles.econ.yale.edu>. See R.J. Shiller, *Behavioural Economics and Institutional Innovation* (2005 [PLEASE INSERT PUBLICATION DETAILS]) on the impact of behavioural economics on the law and economics school. "The discovery of behavioural economics in the past decade or two is really a return to reality from an untenable position that the rational optimizing model is the only framework for economics." See further N. Mazar, and D. Ariely, "Dishonesty in Everyday Life and its Policy Implications". *Journal of Public Policy and Marketing* [PLEASE INSERT PUBLICATION DETAILS].

¹³ R.J. Shiller, *Irrational Exuberance* (Princeton: Princeton University Press, 2000) which considers the dot.com bubble and the second edition of the same text (2005) which topically for Irish audiences considers the housing market bubble in the United States. 2001–2006/7.

¹⁴ See Symposium, "Norms and Corporate Law" (2001) 149 Univ. Pa. L. Rev.1607; Symposium, "The Legal Construction of Norms" (2000) 86 Va.L. Rev. 1577 (commenting on a number of social norms which regulate civic acts, and the economic internalization affecting these civic acts); M.A. Eisenberg, "Corporate Law and Social Norms" (1999) 99 Colum. L. Rev.1253, 1254–55; see generally R. Ellickson, "Law and Economics Discovers Social Norms" (1998) 27 J. Legal Studies 537, 538–39 (noting the impact of legal scholarship on social norms); and "Symposium: Law, Economics and Norms" [IS THIS ARTICLE NAME CORRECT?] (1996) 144 U.Pa.L.Rev..



Rusnak trading matter. We can thus suppose that some of these kinds of norms motivated the management of AIB to take the steps that they took. There is no doubt that possible shareholder litigation and threats of similar actions would contribute to a proactive stance, but what is important in the context of norm scholarship is that many of the steps taken to “fix” the problem were not legally motivated, i.e. the officers of the bank were not obliged to act. One of the interesting points made by NLER scholars is that adherence to norms of behaviour seems to work particularly well when the nature of the community is closed and where reputational interests are extremely valuable. This is clearly a useful analysis in this case in view of the membership of the board of AIB, the importance of reputation to its members and the close knit character of the Irish business and financial community.¹⁵

Although this area of enquiry is of great interest, particularly in a multi-disciplinary context, these kinds of social norms will not be considered in any further detail in this paper.

(b) A second kind of NLER: the kind with the “judicial backstop”¹⁶

Another kind of NLER which has been identified in the US literature is the one that judges describe either when they are interpreting statutory standards or filling out obligations described in the common law. Here academics in the US have noted that in the area of directors’ duties it is quite common for judges to describe what directors and others *should and should not do* but without necessarily identifying a legal standard to go with it, and also without visiting any particularly significantly legal consequences on the actors for not behaving in this way. A most recent example from the US which caused considerable interest arose in the case brought by minority shareholders regarding executive remuneration in the Walt Disney Corporation. In the Delaware Chancery Court Chancellor Chandler,¹⁷ deciding the matter, had to consider allegations by shareholders of breaches of directors’ duties and wasting of corporate funds in relation to the hiring and firing of Michael Ovitz. Here the court found that “many aspects of the defendant’s conduct ... fell significantly short of the best practices of ideal corporate governance” but went on to state that “Delaware law does not ... hold fiduciaries liable for a failure to comply with *aspirational ideals of best practise*”.¹⁸ Even more interesting is the following statement from

¹⁵ See further Symposium, “Norms and Corporate Law” (2001) 149 U.Pa.L.Rev. In this collection see in particular on this type of norm, J.C. Coffee, Jr., “Do Norms Matter? A Cross-Country Evaluation” (2001) 149 U.Pa.L.Rev. 2151. See further E.B. Rock and M.L. Wachter, “Norms and Corporate Law: Introduction” (2001) 149 U.Pa.L.Rev. 1607.

¹⁶ Rock and Wachter, “Norms and Corporate Law: Introduction” (2001) 149 U.Pa.L.Rev. 1607 at pp.1611–1613.

¹⁷ *In re the Walt Disney Company Derivative Litigation*, No. 15452 (Del. Ch. Aug. 9, 2005).

¹⁸ As Lymon Johnson has asked what do the judges think they are doing here? The judicial understanding of what exactly the purpose of their rhetoric is will be considered below. L.

the Delaware court which goes on to state in *Disney* that it recognizes the importance and “essence of business risk” and also states that where decision-makers act “as faithful servants ... the redress for failures ... *must come from the markets.*” In effect the court is indicating that the actions of the directors fell short of best practice but that they are not legally accountable. Nevertheless the court envisaged that if the directors were rendered accountable for their actions in the market through shareholder or other internal corporate actions, that this would be the appropriate vehicle for setting the higher standards aspired to in the judgment. In effect there is a judicial deferral to the market; something which we will see is quite common in our own jurisprudence.

In the Delaware court in the United States, most of the judicial rhetoric about best practice, or about managerial and directorial standards of behaviour concerns the central corporate governance question, i.e. it focuses almost exclusively on the director-corporation-shareholder relationship. In contrast, cases on this side of the Atlantic arising from that particular relationship are few and far between. Instead the occasion for scrutinizing judicially-generated norms arises in the context of the director-corporation-creditor (and sometimes general public) relationship. The third part of this article, the central part, will consider Irish judicial activity in the context of section 150 and 160 applications.

(c) A third kind of NLER: The norm that replaces law

Before moving on to consider the role of judge-made norms in Part 3 we must finally describe a different school of norm scholarship which moves from a descriptive analysis of what is occurring to a prescriptive analysis. In this scholarship a broader definition of non-legally enforceable norms is argued for. This kind of norm scholarship seeks to proactively identify voluntarism and self-regulation as an effective way of monitoring corporate and directorial action exclusively of any legislative or judicial activity. A good example here is the attempt by this kind of norm scholarship to embrace the CSR movement (i.e. the Corporate Social Responsibility movement). Broadly speaking CSR will consist of a body of non-legally enforceable norms of good behaviour, for example proactive environmental actions, community activism and other kinds of actions which will deliver beneficial results. Here a school of thought puts forward the idea that norms will yield behaviour which is desirable but which, it is argued, law cannot and perhaps ought not to deliver.¹⁹ This is a more difficult proposition. In this scholarship regulation and law is viewed as hostile to business interests, enforcing non-voluntary standards that corporations will not accept. In a nutshell, a clear preference is expressed for voluntary policies over hard-core regulation sometimes justified by the argument that self-regulation or

Johnson, “After Enron: Remembering Loyalty Discourse In Corporate Law” (2003) 28 Del. J. Corp. L. 27.

¹⁹ I. Lynch Fannon, “The Corporate Social Responsibility Movement and Law’s Empire: Is there a Conflict?” (2007) 58 N.I.L.Q. 1.

voluntarily accepted codes will yield standards which are more acceptable and ultimately therefore more effective. What is most worrying is that this view of the efficacy of self-regulation will be hijacked by those who want to keep the regulators away, reflecting what Chomsky has described as the “American passion for de-regulation”, a passion which reached its zenith of achievement in the late 1990s but perhaps is on the decline slightly since Sarbanes-Oxley was passed. For example, Coffee rather worryingly states that the idea that corporate behaviour “may be more shaped and determined by social norms than by legal rule seems to an idea whose time has come”.²⁰ This may well be true in a socially descriptive way but Coffee does not shy away from the prescriptive position and goes on to state that commentators “have placed the relative efficacy of social norms as compared with legal rules at the center of the debate over the judicial role in corporate law.” He also seems to express support for the argument that perhaps the courts should be less rigorous because social norms adequately govern behaviour.²¹ In some of the judgments considered below, even though this approach is not overtly articulated one can legitimately ascribe these sentiments to some of the judicial commentary on directorial behaviour. Unfortunately, a number of norm scholars make such robust arguments for the facilitative role of company law that one can only conclude that the agenda is to resist further regulation rather than explore the relationship between norms, corporate laws and good outcomes in any genuine way. Thus in his work, Coffee quite peculiarly identifies the Scandinavian countries as areas where norms seem to place an important role, but fails to acknowledge the equally if not more important fact that these jurisdictions are highly regulated. Norman Veasey similarly decries²² further attempts at Federal regulation as exemplified by Sarbanes Oxley and argues that norms have operated quite well against the backdrop of the common law, again seeming to advocate a hands-off approach for statutory regulators.

In conclusion of this part then, two cautionary notes must be sounded. The first is that non-legally enforceable norms will not yield uniform responses to issues which matter to us. Even though voluntarism can play a part in engaging in discourse with companies and their directors and managers on evolving standards of behaviour, legal standards must articulate what is desirable for all. It is argued here that law cannot be viewed as merely presenting a minimum standard, paving the way for voluntarily adopted standards of competence and socially responsible behaviour. The function of law is to yield high standards in its own right through high legislative standards, effective enforcement and penalties. The second cautionary note is about the danger that the movement towards self-regulation or voluntary codes will be hijacked by those who favour voluntarism in a cynical way. Those who are descendants of the law and

²⁰ Coffee, above fn.15 at p.2151.

²¹ Coffee, above fn.15 at p.2151.

²² N. Veasey, “The Judiciary’s Contribution to the Reform of Corporate Governance” [2004] *Journal of Corporate Law Studies* 225.

economics school of thought, who see again a theoretical argument for resisting what they consider to be “big government”. Both of these dangers are inter-related.

4. THE ROLE OF NORMS IN IRISH COMMERCIAL ACTIVITY

Following from this brief analysis in Part 2 the rest of this article will focus primarily on the second kind of norm: that created with a judicial backstop.

It is clear that judges on this side of the Atlantic also engage in describing in a non-legally enforceable way aspects of *best practice* without visiting legal consequences for breach of them. As is well-known at this point, the application for restriction under s.150 of the Companies Act 1990 is based on a statutory reversal of the burden of proof so that the onus is on the respondent to show that he or she has acted responsibly and honestly in relation to the conduct of the affairs of the company. Under s.160 it is envisaged that applications can be brought to disqualify directors on a number of grounds, amongst which the ground that the respondent is “unfit to be concerned in the management of a company” has given rise to much commentary. Both the standards of responsibility and unfitness to manage have allowed the judiciary to expand on their ideas of acceptable risk-taking and provide an opportunity to address the broader questions surrounding the creation of norms based on a legal framework.

At the very beginning of the litigation on ss.150 and 160 the Irish judges relied on some English decisions for guidance as to how to delimit what was acceptable or unacceptable in the modern context for directors. So in cases such as *Business Communications Ltd. v Baxter*,²³ *Re Newcastle Timber Ltd. and Atwood Ltd.*²⁴ and *Re La Moselle Clothing Ltd.*²⁵ the High Court relied on the statements in *Re Lo-Line Motors Ltd.*²⁶ referred to below. Thus in *Re Lo-Line Browne Wilkinson V-C* made the following statement²⁷:

“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 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 records as directors of insolvent companies has shown them to be a danger to creditors and others. Therefore, the power is not fundamentally penal. But, if the power to disqualify is exercised, disqualification does involve a substantial interference with the freedom of the individual. It follows that the rights of the individual must be fully protected. Ordinary commercial misjudgment is in itself not sufficient to justify disqua-

²³ Unreported, High Court, Murphy J., July 21, 1995.

²⁴ [2001] 4 I.R. 586.

²⁵ *La Moselle Clothing Ltd v Soualhi* [1998] 2 I.L.R.M. 345.

²⁶ (1988) B.C.L.C. 698.

²⁷ (1988) B.C.L.C. 698 at 703.

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lification. 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.”

This approach was affirmed and also followed by the Supreme Court in *Re Squash (Ireland) Ltd.*²⁸

With these standards in mind the Irish judiciary embarked on an attempt to distinguish between behaviour that was not ideal, that was in fact in some cases “incompetent” and “irresponsible”, sometimes “unwise”, but which nevertheless was not worthy of attracting legal consequences and, on the other hand, behaviour which was illegal because it went beyond mere commercial misjudgment and lacked “commercial probity”. In addition, in some cases the courts quickly agreed to that idea it was possible to identify behaviour which in between these two poles, behaviour which was “totally incompetent” or “grossly negligent” and therefore illegal. The spectrum of irresponsibility which could range from “totally” to “mildly”²⁹ irresponsible was similarly accepted as a spectrum of behaviour readily discernable through judicial scrutiny.

The courts have thus expressed a willingness to identify bad behaviour which is still legitimate and seem to have confidence in their ability to distinguish illegal bad behaviour from the more legitimate kind of bad behaviour. In addition the judges express some confidence in the notion that they will be able to identify extreme cases of incompetence and irresponsibility which will similarly attract legal consequences. Sometimes we will see that the judiciary describes this kind of bad behaviour as total incompetence or total irresponsibility.

Despite the rhetoric, however, and even though the rhetoric might be helpful, the facts of each case seem to be very difficult to classify a priori. Thus it is not easy to predict what behaviour will be regarded by the judge to be just incompetent (or perhaps colloquially we could describe this as being “not great but not illegal”) and totally incompetent (illegal), and what will be considered to amount to behaviour lacking in commercial judgment (not great) and lacking commercial probity (illegal). Four years on from the original group of decisions it is clear from the decision in *Re Barnroe Ltd; Director of Corporate Enforcement v Rogers*³⁰ that the courts continue to adhere to the essential dividing line as laid out in *Re Lo Line* as far as the rhetoric is concerned, but again the difficulty lies in how to classify a particular pattern of facts in accordance with the “guidelines”.

Here, the respondents had been directors of the company named in the above-entitled proceedings. The applicant sought disqualification orders under s.160 against them both on the following grounds:

²⁸ [2001] IESC 200.

²⁹ For a consideration of this distinction see *Re Xnet information Systems (in voluntary liquidation); Higgins v Stafford and the Director of Corporate Enforcement (notice party)*, unreported, High Court, O’Neill J., October 10, 2006, considered in more detail below.

³⁰ [2005] IEHC 443; unreported, High Court, O’Leary J., December 21, 2005.

- (a) The respondents had failed to keep proper books of account within the meaning of s.202 of the Companies Act 1990.
- (b) The respondents operated a bank account for the Company which was not recorded in the Company's books or records and failed to notify the Company's auditor of its existence.
- (c) The respondents misappropriated Company funds to personal bank accounts and used a Company bank account for the purposes of personal expenditure. Additionally the respondents caused the Company to expend monies in relation to property owned personally by them.
- (d) The respondents maintained or created twin sets of financial statements for the same accounting periods for the purpose of giving a false impression of the Company's position.
- (e) The Company failed to file revenue returns on a timely basis.
- (f) The respondents caused the Company to trade over an extended period of time when the Company was insolvent.

The applicant submitted that such matters rendered the respondents unfit to be concerned in the management of a company.

O'Leary J. held that the breaches as outlined amounted to breaches of the directors' duties to the company, and that (b), (c), (d) and (f) "amount[ed] to fraud on the part of the respondents in connection with the operation of the Company." He went on to state that the matters outlined at b) and c) were "of the utmost seriousness [and] qualitatively different to the serious but more frequently occurring complaints at a), e) and f) [**WHERE DOES THIS QUOTE END?**]."

O'Leary J. again referred to *Re Lo-line Electric Motors Ltd*³¹ and also described the purpose of disqualifying directors as outlined in that decision as not being punitive in nature but primarily designed to protect the public. "Ordinary commercial misjudgment" per se was insufficient to justify disqualification: "the conduct complained of must display a lack of commercial probity, although ... in an extreme case of gross negligence or total incompetence disqualification could be appropriate." As to the law on the appropriate period of disqualification, O'Leary J. cited the following passage from the judgment of Finlay Geoghegan J. in *Re Cautious Trading Ltd: Director of Corporate Enforcement v Forristal*,³² to the effect that "in the absence of any relevant evidence in relation to a respondent, other than the minimum proofs to satisfy s.160 (2) (h) ... a period of disqualification" was appropriate. O'Leary J., stating that, "a disqualification, no matter for how short a period, will be seen in the business community as a far greater sanction than a restriction", held that in the instant case disqualification for a period of five years was appropriate.

³¹ [1988] 2 All E.R. 692 at 696.

³² [2005] IEHC 85.

The corporate advisor might take heart in O'Leary J. distinguishing between bad behaviour of the utmost seriousness and bad behaviour that was serious but more common, such as not keeping proper books of account. He or she might be forgiven for thinking that perhaps if the respondents in *Barnroe* had only failed to keep books of account, things might not have gone so badly. However, the decision of the Supreme Court in *Cahill v Grimes*³³ illustrates the foolhardiness of such an approach. Referring to his own earlier statements in *Business Communications Ltd v Baxter & Anor*³⁴ which he describes as "fortuitous" Murphy J., delivering the judgment of the Supreme Court, emphasized the importance of the relatively ordinary and mundane activity of maintaining proper corporate documents, however, "*basic in form and modest in appearance*" such documents might be. The court expressed the view that the keeping of records is important to facilitate the orderly management of a company and most importantly, in this context, the orderly liquidation of the company. In the judgment of the court the respondent's lack of malice and the fact that such destruction of documents seemed to be a one-off act of mismanagement were not sufficient to exonerate him.³⁵ "[A].... significant feature of the judgment of Mr. Justice Smyth was his statement that he allowed time to Dr Grimes to reconsider the argument which he made to the court and notwithstanding the opportunity given to him he, Dr Grimes, '*continued in a vein as to betoken a total disregard in his conduct complained of*'. It was the fact that Dr Grimes could not then—and does not now—appreciate the gravity of his misconduct that justifies the conclusion that he is unfit to hold the office of liquidator and casts serious doubt upon his suitability to participate in the management of any company."³⁶ The disqualification of the respondent for seven years was therefore upheld.

From a guidance or norm scholarship point of view it is possible to extrapolate that in O'Leary J.'s judgment there are matters which are so serious that legally they are beyond redemption, there are other matters which are also serious but more common and therefore perhaps more likely to be exonerated, but the Supreme Court has indicated that exoneration will not be possible even in the more milder instance of misbehaviour, where there is no remorse or consciousness of one's wrongdoing displayed.

Another area of activity which the judiciary have endeavoured to provide guidance is in relation to decisions which may not have been wise but which

³³ *The Matter of CB Readymix; Cahill v Grimes* [2002] IESC 12; Supreme Court, March 1, 2002. See also the decision of Smyth J. in the same case in the High Court. *Re Readymix* [2002] 1 I.R. 372.

³⁴ *Business Communications Ltd v Baxter & Anor*, unreported, High Court, Murphy J., July 21, 1995.

³⁵ This is entirely appropriate in light of the fact that the statute makes no mention to the presence or absence of malice as a significant element and does not require any pattern of activity, nor does it exclude responsibility by reference to the frequency or infrequency of the behaviour in question.

³⁶ Above fn.29.

cannot be considered to be legally blameworthy in hindsight. The difficulties presented by exercising too much hindsight in the commercial world were mentioned by Murphy J. in *Business Communications Ltd. v Baxter and Or.*³⁷ and have recently been echoed by O’Leary J. in *Re Camoate Construction Ltd.*³⁸ This latter case concerned an application by liquidators of the named company for restriction orders against the three respondents. Liquidators claimed that a payment to the second respondent by the company in respect of his shares was contrary to s.60 of the 1963 Act [???PLEASE INSERT THE FULL NAME OF THE ACT???]. The respondents said they had received legal advice from a solicitor that the transaction was not contrary to s.60. O’Leary J. held that none of the respondents had acted irresponsibly or dishonestly. Although the actions of the first and third respondents in allowing the company continue to trade for three months after January 2003 were “not wise”, O’Leary J. said he was mindful of the remark of Murphy J. in *Business Communications Ltd. v Baxter* that the court “must be careful not to be wise after the event. There must be no ‘witch-hunt’ because the business failed, as businesses will.”³⁹

(a) The difference between delegation and abdication

The issue of managerial or directorial oversight is another area presenting judicial attempts to give guidance as to best practise. Again on this side of the Atlantic the occasion for considering the outer edges of what is in fact a duty of skill and care has taken place in the context of applications for disqualification of directors, rather than in the context of shareholder or investor litigation. A useful point of departure is the decision of Parker J. in *Re Barings Bank plc (No. 5)*.⁴⁰ The decision of the Chancery Court arose in relation to applications for the disqualifications of some of the directors of Barings Bank plc following its collapse through losses sustained in another rogue trading scandal. Unlike AIB, the losses were such that the bank could not sustain them and so on insolvency applications to disqualify various directors were made. The court had a number of observations to make about delegation and its consequences including the following:

“But just as the duty of an individual director ... does not mean that he may not delegate, neither does it mean that, having delegated a particular function, he is no longer under any duty in relation to the discharge of that function,

³⁷ *Business Communications v Baxter and Another*, unreported, High Court, July 21, 1995.

³⁸ [2005] IEHC 346; High Court, July 29, 2005.

³⁹ In relation to the share transaction, the court was of the view that it was contrary to s.60, in that the company assisted in the purchase of its own shares. O’Leary J. said he was “astonished” that a solicitor could have advised otherwise, but the respondents were entitled to rely on such (erroneous) legal advice.

⁴⁰ *Re Barings plc. (no.5)* [1999] 1 B.C.L.C. 433. The latter summary (regarding delegation and oversight by directors) had been approved by the Court of Appeal ([2000] 1 B.C.L.C. 523).

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notwithstanding that the person to whom the function has been delegated may appear both trustworthy and capable of discharging the function ...”

In his concluding remarks Parker J. stated:

“... directors are entitled ... to delegate particular functions to those below them in the management chain, and to trust their competence and integrity to a reasonable extent [but] the exercise of the power of delegation does not absolve a director from the duty to supervise the discharge of the delegated function”.⁴¹

These ideas certainly sound like good guidelines for appropriate governance not only in companies, but also in other organisations and in fact they have been approved in Ireland. In *Re SPH Ltd. (in vol. liq.)*; *Fennell v Shanahan*⁴² orders under s.150 of the Companies Act 1990 were sought by the liquidators against the first and second respondents, who were husband and wife directors of the company. The husband was the “prime mover” behind the company; the wife was a non-executive director. The statement of affairs given by the directors estimated the ultimate deficiency of assets at over €1.7 million. There was a Revenue debt of approximately €25million.

Finlay Geoghegan J. noted that the onus lies on the director to establish that he or she acted honestly and reasonably. She cited the tests set out by Shanley J. in *La Moselle Clothing Ltd.*⁴³ (approved by the Supreme Court in *Re Squash (Ireland)*⁴⁴) and in her own judgment in *re Tralee Beef and Lamb Ltd.*⁴⁵ (wherein she had previously adopted the passage from the judgment of Parker J. and had held the court should have regard to the degree of compliance with a director’s common law duties). Despite the facts that the company met its obligations regarding books and records, except for the year ended March 30, 2002, and that no issue regarding honesty was raised, it was held that there was a serious issue regarding the control and supervision exercised by the respondents over the company’s financial affairs, having regard in particular to the amount of the Revenue debt and the manner in which it had been allowed to accumulate. These facts prevented the court from finding that the respondents had at all times acted responsibly and the orders sought were granted.

Interestingly Parker J. felt obliged to point out that “No rule of universal application can be formulated as to the duty referred to ... above.” This seems to be borne out by the decision of Peart J. in *Kentford Securities* considered below.⁴⁶

⁴¹ *Re Barings plc. (no.5)* [1999] 1 B.C.L.C. 433. The latter summary (regarding delegation and oversight by directors) had been approved by the Court of Appeal ([2000] 1 B.C.L.C. 523).

⁴² [2005] IEHC 152; High Court, May 25, 2005.

⁴³ Above fn. [PLEASE COMPLETE REFERENCE]

⁴⁴ Above fn. [PLEASE COMPLETE REFERENCE]

⁴⁵ [2004] IEHC; July 20, 2004.

⁴⁶ Below fn. [PLEASE COMPLETE REFERENCE]

Indeed sometimes the burden of identifying what is bad but not illegal and what is bad and illegal becomes extremely onerous as we can see when we consider Peart J.'s observations of the vagaries of human nature in *Re USIT World plc*⁴⁷ where an application was brought to restrict Gordon Colleary. In eventually exonerating Mr Colleary, having spent some time considering standards of directorial behaviour, Peart J. noted that, "it is the very essence of entrepreneurial activity that risks are taken" and that "The intention of the legislature [in enacting restriction and disqualification provisions] is not to stultify risk taking or business life ...". (This is not quite true because it was precisely the intention of the legislature to stultify certain kinds of risk-taking).

For Peart J., the corporate director or officer can loosely be categorised as being one of two kinds of actor: firstly a well-intentioned but misguided individual who might have unfortunately caused losses because he or she was acting in ways which may have been "unintentional, ignorant, [resulting from]lack of education, naïve, over-enthusiastic, inexperienced, careless, unlucky ..." (these surely can be categorised as types of motivations falling short of best practise without attracting legal consequences) or the director or officer can be something much less attractive, a person who is "calculating, callous, opportunistic to the point of criminality, contrived yet convincing ... all these people can be restricted ...". These activities fall into the category of illegal activity infringing legal standards. So as with the Delaware Court in the United States, and as with many other judges in the company law context, Peart J. acknowledged in this passage, that certain kinds of actions do not meet *best practise* but are well shy of attracting legal liability. In a closely reasoned judgment, Murphy J., in answering the question what does it mean to be unfit to be a director of a company leading to disqualification, similarly differentiated between ordinary commercial misjudgment (*again not meeting aspirational standards of best practise*) which is in itself not sufficient to attract disqualification and conduct displaying a lack of commercial probity which does attract legal consequences. However, Murphy J. also widened the scope of legal consequences by stating that sanctioned behaviour can include cases of gross negligence or total incompetence.⁴⁸

5. THE POSSIBILITY OF DRAWING SOME BRIGHT LINE RULES

The danger must be clear to the reader even after considering these few examples of judicial rhetoric in this area. Even though the possibility of providing guidance as to best practise is present there is also the possibility that the sheer volume of adjectives which have been employed to describe legally acceptable behaviour (unwise, incompetent, mildly irresponsible, naïve, ignorant

⁴⁷ [2005] IEHC 285.

⁴⁸ *Re Readymix Ltd.* [2002] I.R. 372.



but always contrite) and the legally unacceptable (lacking in commercial probity, grossly negligent, totally incompetent, totally and wildly irresponsible and lacking in remorse) becomes overwhelming. For those advising directors and officers and others, the possibility of identifying accurately all of the ranges of behaviour which could be encompassed from case to case accordingly diminishes. Even the apparently straightforward issue of maintaining proper books of account falls into the realms of debatable standards of behaviour depending on the surrounding circumstances. One of the problems facing those wishing to analyse the extensive judicial statements in this area is whether there are any clear guidelines as to what will be considered behaviour which crosses over the line of not complying with aspirational guidelines of best practise to behaviour worthy of sanction. Moreover, even where the facts are made out which would justify a disqualification order, the legislative provisions provide expressly for judicial discretion in deciding not to disqualify and also provide for a discretionary decision as to the period of disqualification. This is clearly stated by the Supreme Court in *Cahill v Grimes*.⁴⁹ The identification of a bright line dividing such behaviour is further complicated in this area of law by the fact that in Irish company law we have the penalty of restriction operating at a lower or less serious level than disqualification. This allows the judiciary plenty of room for discretion in considering a broad spectrum of behaviour. In addition, the possibilities presented by applications for relief under the relevant provisions also provide further room for consideration and deliberation over types of behaviour as the following case illustrates.

In *Re Xnet information Systems (in voluntary liquidation); Higgins v Stafford and the Director of Corporate Enforcement (notice party)*⁵⁰ the applicant sought relief under s.152 of the Companies Act 1990 from the declaration of restriction made by the High Court (Finlay Geoghegan J.) on May 24, 2004. The main ground on which Finlay Geoghegan J. had held that the applicant's conduct had been *irresponsible* (emphasis added)⁵¹ and thus failed to meet the standard required by s.150 was that the applicant had (along with another director) taken three separate loans from the company for amounts totalling over €580,000 and purported to enter into a contract to sell to the company for over €150,000 business fixtures and fittings, all without bringing the matters to the attention of the other directors. This behaviour was held to be in breach of s.194 of the 1963 Act [FULL NAME OF THE ACT?].⁵²

⁴⁹ Above fn. [PLEASE COMPLETE REFERENCE]

⁵⁰ Unreported, High Court, O'Neill J., October 10, 2006.

⁵¹ Obviously attracting sanction under the restriction order provisions but not otherwise where disqualification is at play or where directors' common law duties are at issue. Note that in this section the author seeks to italicize all references to either standards of behaviour or standard which increase the level of judicial discretion exercisable to illustrate the practical impossibility of drawing bright line rules.

⁵² See judgment dated May 6, 2004. These actions also amount to a breach of fiduciary duties preventing conflict of interest. They are also potentially in breach of Pt III of the Companies Act 1990.

On behalf of the applicant seeking relief it was submitted that s.152, in contrast to the rigidity of s.150, gave the court a very broad discretion to intervene whenever it considers that it is *just and equitable* to do so.⁵³ It was submitted that the following factors should be taken into account by the court: the applicant's constitutional right to earn a livelihood; the absence of any finding of *dishonesty* against the applicant; *the applicant's conduct* since the winding up; s.150's role in protecting investors and the public and the effect, if any, on the deterrent value of the section 150 restriction. *Hardship suffered by the respondent* should also be considered, particularly in relation to the constitutional right to earn a livelihood. It was submitted that on an application under s.152, the court should consider whether the effect on the particular individual was arbitrary or excessive, having regard to the legitimate object of statutory restriction. In addition, it was argued that, whereas *all* conduct attracting restriction under s.150—"from the *worst dishonesty* to the *mildest irresponsibility*"—was treated in the same manner, the court was free upon a section 152 application to inquire into the gravity of the conduct, which, in the particular case, had led to the declaration of restriction. It was argued that the applicant had suffered in that he was *unable to engage in entrepreneurial activity* and had *to rely on his wife's income*, at a time when he bore significant personal financial losses resulting from the company's winding up. He had also repaid to the company €25,000. In relation to the deterrent effect of s.150 as a mechanism to protect investors and the public, it was submitted that this was much less engaged where, as here, there had been no finding of *dishonesty* or *bad motive*. In addition, the applicant had already had to *endure the stigma* attaching in the commercial world to a declaration of restriction, a factor referred to by Murphy J. in *Business Communications v Baxter*. In light of the two-year period for which the applicant had now been subject to the section 150 order, it was argued that to accede to the section 152 application would not undermine the deterrent effect of s.150.

The Director of Corporate Enforcement, in opposing the application for relief, argued that, though inexactly equivalent, the UK and Australian experience regarding relief of directors from orders of disqualification, was of considerable guidance and assistance. It was argued that the case law from those jurisdictions suggested the following propositions:

- It must be established that a particular company required a director in a prohibited capacity.
- The legislature must be taken to have been aware that every order of restriction or disqualification would result in a degree of hardship, but the legitimate object of protecting the public outweighed any punitive effect on a restricted individual.

⁵³ Reference was made to *In Re Ferngara Associates Ltd; F & R Robinson v Forrest* [1999] I.R. 426 and *Carolan and Cosgrave v Fennell* [2005] IEHC 340. (Arguably in light of *Cahill v Grimes* these actions could have grounded a disqualification application).



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- More regard must be had to the interests of third parties, such as the prospective creditors, employees and directors of any company of which the applicant under s.152 wishes to act as director in future. The court should be satisfied, both that the concerns giving rise to the section 150 declaration have been addressed and that the deterrent value of s.150 was not undermined, before acceding to an application under s.152.
- In light of such considerations, and the mandatory five-year period of restriction enacted by the legislature, the court should be slow to allow an application under s.152. The court's prime focus should be whether a total or partial relief would protect the public.
- Relief, where granted, should generally be limited and conditional, unless the circumstances clearly warranted otherwise.⁵⁴

The ODCE argued that the findings of Finlay Geoghegan J. were extremely serious (possibly echoing O'Leary J. in *Barnroe*) and had demonstrated an entirely inadequate understanding on the applicant's part of the role and duties of a director, particularly in the very sensitive area of dealings in which a director was personally interested. Alternatively, the ODCE also proposed a list of conditions which should be attached in the instant case, should the court be disposed to favour relief. These included that the share capital limit contained in s.150(3) should continue to apply, but be reduced to €40,000, and that a majority of the board of directors of any new company must be independent of the applicant, his wife and any other relative and that no board meeting should take place at which the applicant and his wife were a majority.

O'Neill J. held that the application must be viewed in light of the "fundamental purpose" of s 150, i.e. protection of the public. The wording of s.152(1)⁵⁵ meant that the five-year period was not to be considered as equivalent to a jail sentence, which a director *must serve out* or endure. O'Neill J. was further of the view that the relatively low capitalisation requirement contained in s.150(3) indicated that the legislature had been intent on the "relatively speedy rehabilitation" of directors in respect of restriction orders made. Furthermore, O'Neill J. said that the "low capitalisation threshold" in s.150(3) meant that as a practical matter the public would be "relatively unprotected from restricted directors who happen to have access to modest levels of wealth."⁵⁶ Accordingly, having regard to Art.40.1 of the Constitution, the statute must not be interpreted so as to "work an invidious discrimination against impecunious persons".

Applying these considerations to the instant case, O'Neill J. first looked to the reasons for the declaration of restriction. There was *a scale of wrongfulness*: At

⁵⁴ In the author's view the propositions of the ODCE are worth serious reflection, not least because they do attempt to provide a coherent set of guidelines which seem to be difficult to extract from the range of decisions available.

⁵⁵ ("not more than one year after a declaration has been made in respect of him").

⁵⁶ Not everyone would describe €60,000 plus as "a relatively modest amount" as it is currently about 30 per cent more than an average annual salary for most.

the one end were actions such that no court would be satisfied to lift a restriction order, and at the other were actions such as had been involved in *Re Ferngara Ltd; F & R Robinson v Forrest*. Next the court should have regard to the “need” or “interest” of a director in having the restriction lifted. It would not be sufficient for an applicant simply to seek to have the restriction removed for the sake of his reputation; he must have a “plan or intention to re-engage in trade through the medium of a limited company”. An applicant must also satisfy the court that, having regard to his impecuniosity, the capitalisation requirement is to him “an insurmountable obstacle”. The requirement should be lowered, where it is shown that the level of risk to the public would be low. Hardship while relevant must remain secondary to the crucial consideration: protection of the public. According to O’Neill J., the conduct for which the applicant in the instant case had been restricted was somewhere between the two ends of the “scale of turpitude” and were “serious matters” but that it should also be borne in mind, that Finlay Geoghegan J. had found that the applicant had behaved responsibly for the greater part of the life of the company. Since the winding up of the company, also, the applicant had, despite straitened financial circumstances, abided by an agreement to repay monies due to the company by him.

O’Neill J. said he was satisfied that the applicant had received a “very expensive lesson” from the collapse of the company and the findings of Finlay Geoghegan J. The court was satisfied that the applicant had “absorbed guidance and instruction from these”. He had been restricted since May 2004 and had to suffer the stigma attaching in the business community to such status, such stigma being a major part of the deterrent effect of s.150. The essence of the applicant’s case was that he was an entrepreneur with an expertise in the computer industry and that he had developed ideas of commercial potential, which he would be unable to exploit without forming and being the director of a limited liability company. It was also submitted that it was beyond the applicant’s capacity to raise the €63,000 required to benefit from the section 150(3) exemption and that, in any event, even if he were to attempt to exploit his ideas commercially, investors would be in a position to demand an unfair and disproportionate share of his enterprise, given his restricted status. The court accepted that it would be disproportionate and unfair to allow the applicant to remain in a position whereby he would be “compelled to concede to others a disproportionate and perhaps unfair share in the ownership in the exploitation of his ideas”.

Therefore the court concluded that it was appropriate to lift the restriction order on condition that the section 150(3) requirement on minimum capital would remain but be reduced to €7,500 and that the applicant must inform the notice party of any company in which he became director, secretary, or any position to which a declaration of restriction applies.

As a commentary on this case the following points are worth considering. Firstly, the actual actions of the directors may not have in this case been described as dishonest but it might certainly be reasonable to regard them as being so, in light of the clear breach of fiduciary duties, breaches of Pt III of the



Companies Act 1990 and breaches of s.194 of the 1963 Act. It is fair to observe that if this much ink had been spilled worrying over the state of mind or standard of behaviour of the average petty thief in the criminal courts in addition to considering their constitutional right to earn a livelihood, the hardship they would endure, the stigma attaching to them after a penalty is imposed, it is very possible that levels of incarceration would be substantially reduced in this state. Another interesting point which underscores the possibility for disagreement amongst the judiciary as to where on the spectrum one can pin a particular action is that even as far as the minimum capital requirement imposed under s.150(3) was concerned, none of the parties could agree whether the sum is expensively devastating, relatively modest or prohibitive leading to three different amounts of minimum capital being argued for as the order continued, i.e. €60,000 (as the full amount required), €40,000 and €7,500 with various views expressed as to what sort of an amount of money these are.

In a similar vein trading whilst insolvent has attracted a five-year period of disqualification *In the matter of James Pierce & Sons Limited; Director of Corporate Enforcement v James Pierce and Rosemary Pierce*⁵⁷ but in *Newcastle* the view of the court was that trading whilst insolvent for a period of four years was a different matter. Here the court distinguished between the first and second two-year periods. McCracken J. observed that:

“...To trade while insolvent for 1 year, or perhaps 2 years, in the hope that the company may trade out of its problems is understandable, but to have kept Newcastle trading insolvently for some 4 years, and allowing Revenue debts to build up, appears to me to be totally irresponsible. I do not have the same discretion under Section 150 as I have under Section 160, and the Directors have not satisfied me that they acted responsibly, and accordingly I think I am bound to make an Order under Section 150.”

Similarly failing to supervise the issuing of blank cheques was sufficient in the view of Peart J. in *Foster v Swords* to warrant disqualification⁵⁸ whereas on a similar oversight issue the same judge was more lenient to an albeit youthful, but nevertheless qualified accountant, whom we will encounter in our consideration of the *Kentford* case below.

⁵⁷ Unreported, High Court, Finlay Geoghegan J., December 18, 2006. A note of this judgment is available on www.odce.ie.

⁵⁸ [2005] IEHC 434; unreported, High Court, December 21, 2005. This case concerned applications for orders under s.150 of the Companies Act 1990 against two directors of the named company. The second respondent, Mr Chambers consented to such an order being made against him. The issue was whether an order should be made against the first respondent. Inadequate books and records were kept for the 17 months preceding appointment of the liquidator. S stated that the maintenance of books and records had been C's responsibility; C claimed that the opposite was the case. Peart J. held directors had a duty to inform themselves as to whether books and records were being kept: It was not enough for S to say that he presumed all was being attended to by C. His failure to adequately concern himself was

(i) The importance of judicially created norms. So what ARE the judges doing?

A benign theory is that judges are sketching out best practice; either for future legislators to consider or for guidance on good governance for current directors and in doing so are creating something akin to voluntary codes of good corporate behaviour which will compliment existing legal standards and inform the creation of future legal standards. On a positive note, Lymon Johnson's observations on judicial rhetoric in the United States in the related area of directors' duty of loyalty are instructive. He states that the duty of loyalty can offer "a doctrinal avenue for addressing a potentially broader area of director misconduct than is commonly thought." In reviewing a range of US cases on directors' obligations to the company he hypothesizes that "rhetoric matters too precisely because it affects behaviour."⁵⁹ The same analysis can be applied to Irish judicial statements in the context of section 150 and 160 applications. Best practice can become a legal standard. For example many years ago Carroll J. in *Re Hunting Lodges Ltd.*⁶⁰ reprimanded the spouse/nominal director of that company in very trenchant terms:

"The day has long since passed since married women were classified with infants and persons of unsound mind as suffering from a disability so far as responsibility for their acts was concerned ... Mrs. P cannot evade liability by claiming that she was only concerned with minding her house and looking after her children. If that was the limit of responsibilities she wanted she should not have become a director of the company ... A director who continues as director but abdicates all responsibility is not lightly to be excused."

Here Carroll J. rendered what might have then been considered a norm of behaviour into a legally reprehensible omission when she remonstrated with the stay at home wife/nominal director of that company for not keeping abreast of company affairs. The consequence was that the nominal director was held personally liable for the debts of the company and it is clear that this principle has now become part of our law.⁶¹ Similarly, to take an example from the English courts regarding the common law duty of skill and care, Hoffman J. in *Norman v Theodore Goddard*⁶² and in a second decision in *Re D'Jan of London*

irresponsible. Also, if it was indeed true, the fact that one director could sign 76 cheques without the other's knowledge was evidence that the company's affairs were not being conducted in a responsible manner. Peart J. was not satisfied that S had in all respects acted honestly and responsibly in relation to the affairs of the company, and so the order sought would be made.

⁵⁹ Johnson, L: at n.120 [PLEASE COMPLETE REFERENCE]

⁶⁰ [1985] I.L.R.M. 75.

⁶¹ At the time her decision was criticized by many not least Ussher in *Company Law in Ireland* (London: Sweet and Maxwell, 1986) [IS THIS REFERENCE CORRECT?] pp.522–525. The author of this seminal text on Irish company law expressed the view that the orders made in the case were not entirely within the terms of the legislation. However, this decision of Carroll J. has withstood the test of time.

⁶² [1991] B.C.L.C. 1028.

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*Ltd.*⁶³ set out a twofold objective/subjective standard for the directors' duty of care. The duty which a director owes will be considered to be that which a reasonably diligent person would owe given (a) the general knowledge skill and experience that may *reasonably* be expected of a person carrying out the same functions as are carried out by the director in relation to the company-objective and (b) the general knowledge skill and experience that that director has. Lord Hoffman himself acknowledged that in developing the element of reasonable expectation in (a) that he had overstated this duty in these cases, although the standard was not central to the cases in question. Under older authorities such as *Re City Equitable Fire Insurance Ltd.*⁶⁴ and *Re Brazilian Rubber Plantations Ltd.*⁶⁵ there was no objective standard at common law. (The standard of care that a director was required to meet under these authorities was the standard expected of another director with his skill and experience appointed to the same position as he or she had been appointed to by the company). Nevertheless, despite the fact that it was clearly accepted that Lord Hoffman had extended the scope of the duty in these decisions, the Law Commission report on Directors Duties adopted these standards as "a remarkable example of the modernization of law by the judges".

A less benign theory, which raises more complex questions, is that judges are implicitly acceding to the "hands-off" requests explicitly made by many in the corporate world. Although this theory might be construed as proposing a conspiracy between the judiciary and a business elite,⁶⁶ there is a positive interpretation of the "hands-off" or laissez-faire approach. This interpretation can be encapsulated by two ideas proffered by NLER scholars, both of which implicitly posit that the realm of activity with which we are concerned, business risk-taking, and the possible sanctions and their consequences, loss of reputation, means of generating wealth and loss of livelihood present an area of enquiry that is peculiarly distinguishable from other areas of behaviour which are scrutinized by the courts, for example in the context of criminal law.⁶⁷ The first is the idea that NLERs can be very or quite effective in monitoring managerial performance and guiding best practice in the corporate context. The second and more significant idea is that corporate law facilitates and perhaps should continue to facilitate the operation of NLERs in guiding good managerial behaviour towards shareholders.⁶⁸

In the opinion of this author it seems clear that members of the Irish judiciary may have adopted aspects of both these theories, the benign and less benign,

⁶³ [1994] B.C.L.C. 561.

⁶⁴ [1925] Ch. 407.

⁶⁵ [1911] 1 Ch. 425.

⁶⁶ A conspiracy which might be of interest to those who engage in a certain kind of "judicial realism" analysis regarding the relationship of the judiciary to particular sectors in society.

⁶⁷ The author acknowledges the possible contradiction between this observation and observations made earlier regarding the position of the petty thief.

⁶⁸ See N. Veasey, "The Judiciary's Contribution to the Reform of Corporate Governance" [2004] J.C.L.S. 225 for summary.

without necessarily articulating it on these terms. Examples of the former are led by the statements of Carroll J. in *Re Hunting Lodges Ltd.*, statements by Murphy J. referred to in this article regarding the keeping of corporate documents and to some extent statements of O'Leary and Finlay Geoghegan JJ. in relation to standards of decision-making. In relation to the second theory, rhetoric of Peart J. in *USIT*, of O'Neill J. in granting relief in *Xnet* and statements of Peart J. in *Kentford* considered in this section, would seem to indicate that some members of the judiciary might continue to prefer a more facilitative role for company law in this area of activity. Their statements could be interpreted as acknowledging a preference for a "norm" driven approach providing guidelines as to best practice rather than a legally driven, sanctions-based approach which depends on uniformity of standards in all cases.

In *Re Kentford Securities Limited (under investigation); Director of Corporate Enforcement v Patrick McCann*,⁶⁹ the court declined to make an order under s.160 in respect of the respondent.

A report by an authorised officer (appointed by the Minister for Trade and Enterprise) found that Kentford was used by the late Des Traynor (who died in May 1994) as "a vehicle for withdrawing monies from and paying monies into the Ansbacher deposits on behalf of Irish resident individuals and companies, thereby facilitating the evasion of taxes". The respondent, who had acted as a director and auditor of the company, swore in an affidavit that the first occasion on which he became aware that Kentford had any connection to the so-called Ansbacher accounts was when he heard it emerge at the Moriarty Tribunal, that he was never party to any scheme to defraud the Revenue Commissioners, and that he never intended to commit any wrongful act. Peart J. accepted this evidence. There was, said Peart J., "no suggestion made on the present application that the respondent made any improper financial gain from his involvement with Kentford".

The applicant submitted that a number of matters rendered the respondent unfit to be concerned in the management of a company including the fact that the respondent had acted as auditor of Kentford while still a director thereof, in contravention of s.163 of the Companies Act 1990. In addition company documents filed with the Registrar of Companies attempted to disguise this transgression by being deliberately backdated to March 14, 1989. The respondent, as auditor, issued reports on the company's financial statements for the years ending March 31, 1990, 1991, 1992 and 1993, at a time when he knew (or should have known) that the picture presented of a dormant company with £2 assets and share capital respectively was false and misleading, given that large transactions were going through the company's bank accounts, and that there were substantial balances in those accounts. The authorised officer was of the view that, by his conduct in this regard, the respondent had committed offences under s.22(3) of the Companies (Amendment) Act 1986 and s.242 of

⁶⁹ Unreported, High Court, Peart J., January 17, 2007. Written judgment available at www.odce.ie (pdf).



the Companies Act 1990 and thereby facilitated the defrauding of the Revenue Commissioners. Finally, the respondent knowingly submitted to the authorised officer a forged document, in support of an assertion that he (the respondent) had been assured by Mr Traynor that Kentford was a dormant company with no assets or liabilities.

Peart J. was satisfied that the resignation date of March 14, 1989 had been contrived in 1992 but was of the view that this was in keeping with a culture of signing blank documents and/or backdating documentation. As regards the auditor's reports for 1990–1993, Peart J. said he was satisfied that at the times he signed those reports, the respondent had not signed any form of resignation as a director but that “on the balance of probability this was not a deliberate or conscious breach of the law” noting that the respondent attached little importance to the requirement that he should not act as auditor without having formally resigned as a director. Peart J. said he had no doubt that the respondent “arranged for some backdating of documentation in order to correct the paper record.” For a period of time, as a result of “a culture in which he was immersed”, the respondent had signed without question any blank documents required of him. Peart J. held that the respondent had breached his duty as auditor by signing the unqualified reports for the years 1990–1993. It was no answer that he had accepted an assurance from Mr Traynor that Kentford was a dormant company with no assets or liabilities. It was not enough for an auditor simply to “go through the motions”; rather his duty was to “pro-actively satisfy himself that what he was told was in fact the situation”. Finally, in relation to the forged document handed over to the authorised officer, Peart J. stated that the respondent must have been aware that it was a fabrication and held that the respondent had not acted in a bona fide manner in passing it to the authorised officer. However, Peart J. said he accepted that the respondent had not been aware of the illegal nature of Kentford's activities.

In relation to all matters complained of by the applicant, the court found against the respondent but surprisingly the court declined to grant a disqualification order. Peart J. took into account that the events in question had occurred between 1988 and 1994, and had begun when the respondent was a very recently qualified accountant. It was also important to bear in mind that the respondent made no financial gain from the illegal activity of the company, “even his failure to observe proper standards as an auditor facilitated the scheme of tax evasion of which he was not aware.” Peart J. expressed himself unable to avoid the conclusion that “the respondent was at the time a very small and insignificant cog in the larger wheel being turned by Mr Des Traynor”. It was Traynor and his associates involved in the tax evasion scheme that had benefited from the respondent's naivety, lack of attention to his responsibilities and carelessness. Since that period, the respondent had been given a “clean bill of health” by his professional body. Peart J went on to state that “the consequences of a disqualification order being made against an accountant in private practice are devastating”—“*worse even*” (emphasis added) than restriction of a director

under s.150. A person subject to a disqualification order would be unable to trade *via* the medium of a limited liability company. The court must balance the effect on a respondent's right to earn a livelihood with the legislative intent to protect the public from auditors who have "fallen short of the standards expected of such an important profession in the commercial life of the country".

Again the by now familiar refrain was re-iterated that the purpose of disqualification was not punitive, but protective of the public. The "only function of the Court" was to:

"prevent a respondent from acting as an auditor or other officer of a company, where the evidence is sufficient to demonstrate that as a matter of probability ... the person in question would present a current risk to members of the public who may be adversely affected". (emphasis added)

Pear J. was satisfied that the respondent in the instant case presented no such current risk, emphasising "the use of the present tense" in relation to unfitness to be involved in the management of a company and noting that the statutory scheme was consistent with the court declining to make an order even where it has found that a respondent has breached his duty as auditor, and/or is unfit to be concerned in the management of a company. While the evidence of the respondent's past conduct disclosed many shortcomings, Peart J. declared himself satisfied that:

"whatever irregular and improper conduct he was mixed up in all those years ago at the behest of his employer and Mr Traynor is a thing of the past, and that the experience of being caught up in other people's deceptions and illegality has been a chastening one for him and one to which he will never risk returning."

Since the respondent did not *currently* represent "a danger from which the public ought to be protected", the court would decline to grant the order sought.

6. CONCLUSION

This article will conclude by making two brief points, hopefully arriving at some clarity assisted by brevity.

Firstly, it is timely and important that the Irish judiciary express awareness of and perhaps articulate their intellectual interest in the exercise regarding rhetoric and norms in which they are engaged. The use of judicial rhetoric can be most instructive where it is thoughtfully designed to give clear guidance as to what is best practice, what is considered to fall short of such standards and what is considered to be beyond a mere failure to meet standards of best practice and therefore illegal and worthy of sanctions. These sanctions are admittedly serious

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for those engaged in commercial activity and this provides the single most compelling reason for clarity in this area. Our consideration at the beginning of the article of other kinds of norms allows us to acknowledge that not only are the sanctions serious in terms of inhibiting the ability to earn a livelihood through the medium of a limited liability company, but that the sanctions are also significant in non-legal ways, in particular in terms of loss of reputation which is particularly important in a relatively small and close-knit community.

For the judiciary, the goal is to pursue what Johnson has described in the context of judicial rhetoric in the US on the duty of loyalty, as a doctrinal avenue of intellectual engagement which will promote “creative-but still disciplined and historically faithful-discourse about where and how to draw ... decidedly unsettled boundaries ... in modern corporate law.” It is easy to accept the role of norms or non-legally enforceable rules or standards, particularly in an emerging area of legal practice. There is no question that well constructed judicial statements can operate to provide clear guidance to those involved in the management of companies and to their legal advisors. It is indeed helpful when the judiciary provide us with opinions of what behaviour might be considered to be indicative of “sailing windward of the law”⁷⁰ and to indicate to advisors and practitioners what is required to comply with aspirational ideals of best practice. However, the level of rhetoric currently surrounding s.150 and s.160 is overwhelming and would seem to operate against the provision of such guidance.

This brings the article to the second brief concluding point and that is that even though the original legislative provisions are comparatively admirably clear and have worked well, it is arguable that the level of argument and consequent rhetoric has in fact clouded that clarity. Guidelines issued by the Office of Director of Corporate Enforcement, although useful in “non-pathological” situations involving the majority of commercial men and women are reduced to points of argumentation in the case law. As a consequence it is not clear whether they can be relied on for any significant period. Timely reclarification and restatement of the basic legislative framework incorporating the best judicial guidelines might be very worthwhile.

⁷⁰ An interesting phrase used quite a long time ago by O’Hanlon J. in a decision regarding the behaviour of an auditor, one Des Traynor in a fraudulent trading action in *Re Kelly’s Carpetdrome (No. 2)*, unreported, High Court, O’Hanlon J., July 13, 1984.

