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# RECKLESS TRADING: CRITICAL ANALYSIS AND PROPOSALS FOR REFORM

Thesis presented by
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for the degree of
**Doctor of Philosophy**

**University College Cork**
**School of Law**
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2021

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## DECLARATION

This is to certify that the work I am submitting is my own and has not been submitted for another degree, either at University College Cork or elsewhere. All external references and sources are clearly acknowledged and identified within the contents. I have read and understood the regulations of University College Cork concerning plagiarism.

## ABSTRACT

A company is an entirely separate person from its owners and controllers. Thus, if the company becomes insolvent, its directors are not responsible for its debts. The risks are instead externalised to the company's creditors. The purpose is to encourage entrepreneurship and commercial risk-taking. This can, however, lead to reckless trading behaviours by directors to the detriment of creditors.

Finding the correct balance between supporting valid commercial risk-taking and entrepreneurship, on the one hand, and encouraging financial responsibility towards creditors on the other is thus a crucial issue in company law. Too much emphasis on the former can result in financial and economic crises. Too much emphasis on the latter can stultify and have a chilling effect on business activity. This is where the concept of reckless trading becomes of vital importance. Measures have been introduced in many jurisdictions. A reckless trading provision exists in Ireland in the form of section 610 Companies Act, 2014. The purpose of these measures is to impose personal liability for creditors losses on directors who, when the company was financially distressed, ran the business in an irresponsible manner, causing otherwise avoidable losses to creditors. This type of legislation, both in Ireland and elsewhere, has been largely unsuccessful. The provisions are infrequently invoked and when they are, the success rate is low.

The first central research question of this thesis is to investigate why this is so. These difficulties may arise from an internal source. It will be asserted that section 610 is confusingly and inadequately drafted. Suggested amendments to increase its invocation rate and effectiveness will be put forward. The problems may also derive from external factors. Reckless trading type behaviour may be infrequent. Moreover,

high legal costs may deter liquidators and creditors from invoking the section especially as directors of failed companies may be financially constrained themselves. Once it has been determined why the provision is so infrequently invoked, the second central research question will be addressed. Considering the difficulties, perhaps a reckless trading provision is not required at all? The thesis will assert that the other rules and regimes examined due not act as suitable alternatives. Moreover, a reckless trading provision has theoretical support.

The final research question asks whether, in addition to legislative amendments, other solutions also exist which could be deployed in tandem with a revised section. The role of public enforcement will be examined. The thesis will assert that a criminalised reckless trading provision would be neither beneficial nor effective. However, the potency of the provision would be considerably improved via civil public enforcement. In particular, it will be argued that the Office of the Director of Corporate Enforcement should have an oversight and invocation role with regard to the provision. Importantly also, the ODCE should be granted the ability to impose a financial sanction in certain circumstances. The thesis thus produces workable solutions to improve the efficacy of the Irish reckless trading provision.

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**UNITED KINGDOM**

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**NEW ZEALAND**

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Companies Amendment Act, 1980

Companies Act, 1993

Companies Amendment Act, 2014

## TABLE OF ABREVIATIONS

| | |
|---|---|
| ASIC | Australian Securities and Investments Commission |
| CLRG | Company Law Review Group |
| LRC | Law Reform Commission |
| UK | The United Kingdom |

# CHAPTER ONE: INTRODUCTION

## (I) CENTRAL RESEARCH QUESTIONS AND NOVELTY

### (i) Introduction

Company law contains two key concepts namely separate corporate personality and limited liability. The purpose of these concepts is to promote commercial risk-taking by allowing the risk of loss to be externalised outwards from shareholders and directors. The concepts are an acknowledgment that credit is vital in the business world and is the life blood of industry.[2] That these concepts can be abused especially in insolvency situations has been an intractable problem since the initial creation of the corporate structure. One of the most important questions which have arisen in several jurisdictions with legal systems similar to Ireland is whether the corporate law system as structured is capable of preventing such misuse of these concepts and thus preventing otherwise avoidable losses to creditors and others dependent on the business.

A common approach in many jurisdictions has been the creation of an exception to separate legal personality whereby the courts, on the application of a liquidator or creditor, can disregard the separate legal personality of the company, look to the trading behaviours of the controllers and, if necessary, make them personally liable for the company's debts. In Ireland, this exists as reckless trading in the form of section 610 Companies Act, 2014. Similar legislation exists in other jurisdictions. The trend, especially in recent times, has been an increase in this type of provision. That said, the Irish reckless trading provision, in common with equivalent legislation elsewhere, has emerged as a rather weak deterrent. In Ireland, few reckless trading cases have been taken. Other jurisdictions, in particular the UK, have had similar experiences. Academic and practitioner consensus here and abroad[3] maintains that difficulties exist with the application and outcomes of reckless trading type provisions.[4]

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[2] Insolvency Law and Practice – Report of the Review Committee [1982] Cmnd 8558 para.10

[3] Williams, 'What We Can Expect to Gain From Reforming the Insolvent Trading Remedy' [2015] MLR 55, Taylor, 'Directors' Duties on Insolvency in New Zealand: An Empirical Study' [2018] 28(2) New Zealand Universities Law Review 172 and Steele and Ramsay, 'Insolvent Trading in Australia. A Study of Court Judgments from 2004 to 2017' [2019] 27 Insolvency Law Journal 156

[4] See in particular Lynch Fannon, Reckless Trading: Good and Bad Risk-Taking in Irish Companies [2017] Commercial Law Practitioner, 24(1) 7

Thus, the central considerations of this thesis are indicated; the ability of limited liability and separate corporate personality to allow company directors to exacerbate the creditors' position by not liquidating the company at the appropriate time and legislative attempts in the form of reckless trading type provisions to manage such situations. The thesis will examine the balance which must be struck. The business world is uncertain. No matter how well considered or well planned 'safe bets' can go wrong due to unforeseen circumstances or simple bad luck. If company legislation disproportionately favours creditors, then viable companies may be collapsed at the first sign of trouble. Directors would be too fearful of the consequences to attempt to trade out of difficulties.[5] This would have significant consequential effects throughout the economy as workers are made redundant and other linked businesses fail. Further, planned and reasonable risk-taking by company directors may be inhibited. Moreover, the decision to provide credit is a deliberate choice. The creditor understands that this entails risk but goes ahead anyway because the trade-off is business expansion.

On the other hand, where debtor companies are overly favoured, irresponsible trading is encouraged. Further, creditors may only accommodate financially strong companies. This will limit economic growth. Lawmakers, in formulating reckless trading type provisions, must be careful not to discourage entrepreneurial risk-taking. There is also the difficulty that an ultimately unsuccessful course of action can become obviously unacceptably risky with the benefit of hindsight.[6] This search for an equilibrium is perhaps best described by the Cork Committee as follows; *"A balance has to be drawn between the right of an honest and prudent businessman to work hard, to continue to trade out of difficulties if he can genuinely see light at the end of the tunnel, and the corresponding obligation to 'put up the shutters', when, by continuing to trade he would be doing so at the expense of his creditors and in disregard of those business considerations which a reasonable businessman is expected to observe."*[7]

[5] This danger is highlighted in Finch, Corporate Insolvency Law Perspectives and Principles, 2nd Edition (Cambridge: Cambridge University Press, 2009), p.176-177.
[6] For a discussion on this point see Ussher, Company Law in Ireland, (Dublin: Sweet & Maxwell, 1986), p.530-532.
[7] Insolvency Law and Practice – Report of the Review Committee [1982] Cmnd 8558 para.216

A further important issue also arises. Where a company is close to insolvency or insolvent, due to separate legal personality, the risk situation is reversed. An excessively risky course of action now carries no risk.[8] If the risky course of action fails, it cannot make the situation any (or that much) worse. If it succeeds, the company and all involved are safe. This has been described by Prentice as a *'perverse incentive.'*[9] Keay and Zhang put this idea more bluntly; the creditors will take the shareholders' place as the owners of the residual value of the company; thus the directors are effectively playing with the creditors' money.[10]

Considering all the above, having effective and correctly balanced reckless trading legislation which prevents the abuse of the corporate form in the vicinity of insolvency but does not inhibit entrepreneurial activity is of the utmost importance. This was recognised by the Report European Commission's High-Level Group of Company Law Experts as long ago as 2002 when it recommended a European wide reckless trading provision.[11] It elucidated the advantages of a properly balanced provision; creditors would be protected without overly restricting directors, and it would enhance creditors' confidence and willingness to do business. These advantages will be kept in mind throughout this thesis.

**(ii) The Central Research Questions**

The thesis will address three interconnected central research questions. Reckless trading type measures have been largely unsuccessful both in Ireland and in other jurisdictions. The provisions are infrequently invoked.[12] When invoked, application is often problematic. The first central research question investigates why this is so. These difficulties could arise from an internal source; the section itself has not been properly drafted[13] or from an external source, for example, the fact that it is pointless to pursue

[8] Davies, Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency' [2006] 7(1) EBOLR 301 para 2.2.

[9] Prentice, Corporate Personality, Limited Liability and the Protection of Creditors in Grantham & Rickett (eds.) Corporate Personality in the 20th Century (Oxford: Hart Publishing, 1998) p.108-109

[10] Keay, Zhang, "Incomplete Contracts, Contingent Fiduciaries and a Director's Duty to Creditors" [2008] 32(1) Melbourne University Law Review 141 at 144

[11] Report of the High Level Group of Company Law Experts on a Modern Company Law Regulatory Framework for Company Law in Europe (Brussels 4 November 2002), p.16

[12] Specifically, there have been four Irish cases between 1990 and 2019.

[13] Specific textual amendments will be suggested in Chapter 4. See also Lynch Fannon, Reckless Trading: Good and Bad Risk-Taking in Irish Companies [2017] Commercial Law Practitioner, 24(1) 7 on the issue of legislative change.

an impecunious director. Textual amendments will be suggested to improve the invocation and success rates. It would be impossible to suggest such amendments without understanding whether external problems exist also.

The second central research question is an adjunct to the first. Considering the current lack of invocation, perhaps a reckless trading provision is not necessary at all? Other existing legal rules might act as suitable alternatives. In this regard, the developing directors' duty to have regard to the interests of creditors will be examined as will the successful restriction and disqualification order regimes. Reckless trading will further be examined through the theoretical lens of contractarianism, stakeholder theory and judicial realism. The purpose of this analysis is to determine whether the provision has theoretical support.

The third central research question asks whether there are other solutions in addition to legislative amendments to the section. Such possible solutions must be ones which will increase both the invocation and success rate. Considering the well-known limitations of private enforcement towards directors in Ireland,[14] the role of public enforcement (both civil and criminal) will be examined. In particular, the thesis asks whether the mooted criminalisation of reckless trading behaviour would be beneficial.[15] Moreover, the format of a public enforcement regime is suggested.

**(iii) The Methodologies**

The thesis blends together both doctrinal and comparative methodological approaches. Both will work in tandem to answer the research questions. Doctrinal methodology is primarily used. Its purpose is to produce a critical overview of the legal framework for reckless trading. Doctrinal methodology takes an internal view of the law. It investigates the existence and formulation of legal structures through the analysis of procedures and texts.[16] The approach involves a close textual analysis of the statute

[14] See for example Ahern, 'Directors' Duties: Broadening the Focus Beyond Content to Examine the Accountability Spectrum' [2011] 33(1) DULJ 116

[15] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018)

[16] Chynoweth, 'Legal Research' in Knight and Ruddock, Advanced Research Methods in the Built Environment (Oxford: Wiley Blackwell, 2008), p.29

and the relevant cases.[17] This is largely no different to the analysis carried out by practitioners and judges[18] and is therefore one which I am comfortable with as a former practitioner. It is a methodology which reflects the inner relationship between legal scholarship and legal practice.[19] It is necessary to acknowledge, however, that the choice of this methodology is the product of careful consideration and not an unthinking adherence to a single approach.[20]

Due to the limited Irish case law in particular and the fact that only one section is involved, a central hallmark of doctrinal methodology will be displayed: close analysis of decisions of the higher judiciary together with legislation. This is fundamentally a dissection of the law as it is and requires the application of critical skills.[21] Essentially, the internal approach which dominates doctrinal scholarship is used.[22] This method requires an adherence to the skills and conventions of legal analysis[23] while keeping in mind that there is a limit which is inherent in language as to the level of guidance which the wording of a provision can provide.[24] The legal position is examined for consistency and coherence.[25] As the first and third central research questions concern proposed reforms, it is of fundamental importance to fully understand what the law is now.[26]

It is also crucial to be aware of the limitations of doctrinal analysis. It has inherent short comings, and thus cannot be the sine qua non. It is of vital importance to recognise that the identification of the legal rules, while valuable, is not an end in

[17] Dixon, 'A Doctrinal Approach to Property Law Scholarship. Who Cares and Why?' [2013] 3 Property Law Review 160 at 163
[18] Chynoweth, 'Legal Research' in Knight and Ruddock, Advanced Research Methods in the Built Environment (Oxford: Wiley Blackwell, 2008), p.32
[19] Smits, 'Refining Normative Legal Science: Towards an Argumentative Discipline' in Coomans, Grunfeld and Kamminga (eds) 'Methods of Human Rights Research' (Cambridge: Intersentia, 2009) p.46.
[20] Van Gestel and Micklitz, 'Why Methods Matter in European Legal Scholarship' [2014] 20(3) European Law Journal 292 at 302
[21] Dixon, 'A Doctrinal Approach to Property Law Scholarship. Who Cares and Why?' [2013] 3 Property Law Review 160 at 64
[22] McCrudden 'Legal Research and the Social Sciences' [2006] 122 LQR 632 at 634
[23] Chynoweth, 'Legal Research' in Knight and Ruddock, Advanced Research Methods in the Built Environment (Oxford: Wiley Blackwell, 2008), p. 35
[24] Hart, The Concept of Law, 3rd Edition (Oxford: Oxford University Press 2012), at 127
[25] Dixon, 'A Doctrinal Approach to Property Law Scholarship. Who Cares and Why?' [2013] 3 Property Law Review 160 at 162
[26] Dixon, 'A Doctrinal Approach to Property Law Scholarship. Who Cares and Why?' [2013] 3 Property Law Review 160 at 163

itself. The thesis must not begin and end with simply putting the various rules in order[27] for a number of reasons. Firstly, such a limitation would not engage the wider research community. It would also disregard the social and economic reality of which the rules form an integral part.[28] It would ignore an important purpose of the inquiry – to identify how the existing law is failing to achieve its aims.[29] Finally, it would ignore McCrudden's perspective that doctrinal methodology should encompass a wider perspective and should include considerations of justice and utility as well as the policy considerations of politicians.[30]

With the above points in mind, it is noted that it is a characteristic of doctrinal analysis that it makes reference to external factors as well.[31] This has the advantage of providing an analysis of how law operates in society and thus counterbalances the limitations of an excessively narrow approach.[32] Doctrinal scholarship thus moves beyond an exact and consistent application of legal rules and principles and recognises that law is not applied with perfect impartiality. Therefore, doctrinal legal scholars cannot confine themselves to a purely technical interpretation but must interact with the underlying policies and facts behind the legislation and courts cases.[33]

The second research method used is comparative legal research. This method concerns the study of the relationship of the rules of one legal system to those of another. It makes comparisons in order to identify the how these systems differ and their similarities[34] in the hope that a broader field of inquiry will present itself.[35] This methodology is described by Kamba as *'the study of, and research in, law by the systematic comparison of two or more legal systems; or of parts, branches or aspects*

[27] Westerman 'Open or Autonomous: The Debate on Legal Methodology as a Reflection of the Debate on Law (October 30, 2009) at p. 3.
[28] Dixon, 'A Doctrinal Approach to Property Law Scholarship. Who Cares and Why?' [2013] 3 Property Law Review 160 at 164.
[29] Dixon, 'A Doctrinal Approach to Property Law Scholarship. Who Cares and Why?' [2013] 3 Property Law Review 160 at 165
[30] McCrudden 'Legal Research and the Social Sciences' [2006] LQR 632 at 635
[31] Chynoweth, 'Legal Research' in Knight and Ruddock, Advanced Research Methods in the Built Environment (Oxford: Wiley Blackwell, 2008), p.30
[32] McCrudden 'Legal Research and the Social Sciences' [2006] LQR 632 at 640-641
[33] Van Gestel and Micklitz, 'Why Methods Matter in European Legal Scholarship' [2014] 20 European Law Journal 292 at 311
[34] Nelken, Comparative Law and Comparative Legal Studies' in Orucu and Nelken (Eds) Comparative Law: A Handbook (Oxford: Hart Publishing, 2007), at p.25
[35] Reitz, 'How to do Comparative Law' [1998] 46(4) American Journal of Comparative Law 617 at 626

*of two or more legal systems*'.[36] Further, as Nelken has pointed out comparative studies are important worldwide in guiding law reform efforts.[37] That said, it is more than a matter of simply drawing comparisons.[38] Casual references to other legal systems are insufficient.[39] The comparison here will be at the micro-level[40] as section 610 is one of many 'reckless trading' type provisions which exist in a number of jurisdictions. In this regard it is important to ensure that the laws being compared are functionally equivalent.[41] The methodology is applied concerning a specific problem.[42] Indeed, Kamba states that comparative lawyers rely increasingly on a problem-solving approach. In relation to a specific difficulty, researchers determine how that problem is solved within the various legal systems and, more importantly, why it was solved in that particular way.[43]

The use of the methodology has a number of features. Particularly, due to the emphasis on practical solutions to the problems identified, the functional method will be prominent. This methodology has been described as centrally relevant to contemporary comparative law because it is directed towards the practical.[44] Its three central premises (that it is a problem solving approach, that problems are similar across the different legal systems and that legal systems tend to resolve problems in similar ways)[45] augment its suitability especially as it is an attempt to avoid viewing other legal systems through the mind set of one's own jurisdiction.[46] Comparative legal research methodology will also be used to trace the development of the provisions,

[36] Kamba 'Comparative Law: A Theoretical Framework' [1974] 23(3) ICLQ 485
[37] Nelken, Comparative Law and Comparative Legal Studies' in Orucu and Nelken (Eds) Comparative Law: A Handbook (Oxford: Hart Publishing, 2007), at p.13.
[38] Glendon, Carrozzo and Picker 'Comparative Legal Traditions- Texts, Materials and Cases on Western Law' 4th Edition (St. Paul MN: West Publishing Co., 2014), at p.4
[39] Kamba 'Comparative Law: A Theoretical Framework' [1974] 23(3) ICLQ 485 at 489
[40] De Cruz, Comparative Law in a Changing World 3rd Edition (Oxfordshire: Routledge Cavendish 2007), at p.233
[41] Reitz, 'How to do Comparative Law' [1998] 46(4) American Journal of Comparative Law 617 at 620-621
[42] Zweigert and Kotz, Introduction to Comparative Law 2nd Edition (Oxford: Oxford University Press, 1992), at p.5
[43] Kamba 'Comparative Law: A Theoretical Framework' [1974] 23(3) ICLQ 485 at 517
[44] Glendon, Carrozzo and Picker 'Comparative Legal Traditions- Texts, Materials and Cases on Western Law' 4th Edition (St. Paul MN: West Publishing Co., 2014), p.18
[45] These central premises are described by Glendon, Carrozzo and Picker 'Comparative Legal Traditions- Texts, Materials and Cases on Western Law' 4th Edition (St. Paul MN: West Publishing Co., 2014), pgs. 18-19.
[46] Glendon, Carrozzo and Picker 'Comparative Legal Traditions- Texts, Materials and Cases on Western Law' 4th Edition (St. Paul MN: West Publishing Co., 2014), p.19

thus central to the thesis will be a comparative analysis from the other jurisdictions outlining how these provisions developed, how the provisions operate in practice, the strengths of the provisions and the difficulties which exist with their implementation. The method is useful as it allows the researcher to move beyond the minutiae of legal thinking. Instead, the contours and dominant characteristics of the law can be viewed.[47] Thus suggestions for Irish reform, remedies and outcomes can be drawn from other jurisdictions' experiences. This is one of the most important practical roles of comparative methodology.[48] The UK and New Zealand measures will be considered in detail. To a lesser extent, the Australian experience will also be explored.

It is important to keep in mind that researchers often get lost when embarking on comparative research.[49] In this regard, care must be taken in choosing the appropriate legal systems for comparison.[50] The three jurisdictions have been chosen in the belief that a limited range will allow a deeper comparison.[51] That said, while the third research question requires a practical solution to the legal problems identified, Van Hoecke warns against simply copying from the comparative jurisdictions. Some solutions may be accidentally similar and may, in fact, hide more important differences at the level of the concepts used.[52] It is important to consider the wider political, social, economic and cultural differences between countries.[53] While the same legal ideas and infrastructures keep emerging, every system is a product of its own cultural and political history.[54] Under similar social, economic and cultural forces in different jurisdictions, law can change by means of radically different legal techniques. This is despite the fact that the economic or social objectives may be the same. Thus, it is important to keep in mind the aim in using this methodology; contributing to the improvement of the Irish legal system.[55]

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[47] Kahn-Freud, Selected Writings, (London: Stevens & Sons, 1978), p.275
[48] Kamba 'Comparative Law: A Theoretical Framework' [1974] 23(3) ICLQ 485 at 495.
[49] Van Hoecke, "Methodology of Comparative Legal Research" [2015] 12 Law and Method 1 at 1
[50] De Cruz, Comparative Law in a Changing World 3rd Edition (Oxfordshire: Routledge Cavendish 2007), pgs.232-233
[51] Van Hoecke, "Methodology of Comparative Legal Research" [2015] 12 Law and Method 1 at 5
[52] Van Hoecke, "Methodology of Comparative Legal Research" [2015] 12 Law and Method 1 at 7. See also
[53] Kamba 'Comparative Law: A Theoretical Framework' [1974] 23(3) ICLQ 485 at 511
[54] De Cruz, Comparative Law in a Changing World 3rd Edition (Oxfordshire: Routledge Cavendish 2007), p.223.
[55] Van Hoecke, "Methodology of Comparative Legal Research" (2015) 12 Law and Method 1 at 2

One must not jump to the conclusion that a solution which has worked in one of the other jurisdictions will be automatically suitable in Ireland.[56] Legal transplantation is fraught with difficulties.[57] Indeed, comparison should not stop at the level of either legislation or case law. This is in no small part due to the fact that law in action may be quite different to law in the books.[58] The social reality may in fact be much different to that which the similarity of the rules suggests.[59] It is also important to be aware that my own analysis may be shaped by the intellectual and theoretical trends and societal developments to which I have been exposed.[60] This highlights a limit of the methodology; legal problems may not be the same everywhere.[61] A further pertinent warning is an absence of case law may have diverging explanations.[62] It is imperative not to look at the comparative legal systems using the doctrinal framework of the Irish system but to try to transcend it.[63]

It will also be necessary to examine the history of the provisions in Ireland and the two chosen comparative jurisdictions. Thus, the historical method is also important. As Van Hoecke states, *'... its use cannot be avoided in any comparative research. Fully understanding the law as it functions today in some society, is only possible when one knows where it comes from and why it is as it is today.*[64] In particular, historical comparisons will often explain why the law is as it is in a particular jurisdiction. Identical objectives are often achieved through very different techniques and these techniques are determined by different historical legal traditions.[65] The law of any specific jurisdiction is situated within a particular historic and geographical context and it derives it context from its political, economic and institutional character.[66] The reason for similarities and differences are often only understandable

[56] Zweigert and Kotz, Introduction to Comparative Law 2nd Edition (Oxford: Oxford University Press 1992) p.16.
[57] Kahn-Freud, 'On Uses and Misuses of Comparative Law', [1974] 37(1) MLR 1 at 6.
[58] Van Hoecke, "Methodology of Comparative Legal Research" (2015) 12 Law and Method 1 at 22
[59] Van Hoecke, "Methodology of Comparative Legal Research" (2015) 12 Law and Method 1 at 7
[60] Peters and Schwenke, 'Comparative Law Beyond Post-Modernism' [2000] 49(4) ICLQ 800 at 829.
[61] Van Hoecke, "Methodology of Comparative Legal Research" (2015) 12 Law and Method 1 at 10
[62] Van Hoecke, "Methodology of Comparative Legal Research" (2015) 12 Law and Method 1 at 7
[63] Van Hoecke, "Methodology of Comparative Legal Research" (2015) 12 Law and Method 1 at 27
[64] Van Hoecke, "Methodology of Comparative Legal Research" (2015) 12 Law and Method 1 at 18
[65] Kahn-Freud, Selected Writings, (London: Stevens & Sons, 1978), p.281
[66] Glendon, Carrozzo and Picker 'Comparative Legal Traditions- Texts, Materials and Cases on Western Law' 4th Edition (St. Paul MN: West Publishing Co., 2014), p.33

after a study of the history of the rules in the first place.[67] Indeed, section 610 is based on a now repealed New Zealand provision[68] and the New Zealand reckless trading provision as it exists today is quite different.[69] Likewise, though both the UK and Irish legislatures where heavily influenced by the findings of the seminal Cork Report,[70] their legislative solutions to the problem of reckless trading diverge considerably.

In conclusion, while the methodologies work in tandem, doctrinal methodology is the primary research method in this thesis. This is appropriate; an important aspect of the thesis is examination and interpretation of a particular piece of legislation and its attendant case law. However, the limitations of doctrinal research are not disregarded. The approach taken must not be narrowly internal. Outsider perspectives must be incorporated.[71] Further, the law involved must be anchored within its economic, social and political contexts. Comparative methodology is important also in order to cast light on the Irish provision and suggest improvements to its functionality. That said, the dangers implicit in a naïve use of this method are acknowledged as are the difficulties inherent in legal transplantation.

**(iv) Original Contribution**

This thesis uses theoretical lenses and methodological frameworks which have been used by other commentators. Specifically, in the Irish context, Lynch Fannon and Murphy have provided a doctrinal[72] and a comparative consideration of case law in both the UK and New Zealand[73] as has, to a lesser extent, Flynn,[74] and MacCann.[75] Lynch Fannon has also provided an innovative textual analysis of the section and has explored the possible reasons for the underutilisation of the provision. She has put forward rational suggestions for the redrafting of the provision. Importantly, she has

[67] Glendon, Carrozzo and Picker 'Comparative Legal Traditions- Texts, Materials and Cases on Western Law' 4th Edition (St. Paul MN: West Publishing Co., 2014), p.6
[68] S.32 Companies Amendment Act, 1980. See in particular 120(b) Seanad Deb. Cols.2439-2440
[69] S.135 Companies Act, 1993.
[70] Insolvency Law and Practice – Report of the Review Committee [1982] Cmnd 8558
[71] Hutchinson and Duncan, 'Defining and Describing What We Do: Doctrinal Legal Research' [2012] 17(1) Deakin Law Review 83 at 115
[72] Lynch Fannon and Murphy, Corporate Insolvency and Rescue 2nd Edition (Dublin: Bloomsbury, 2012) paras.10.01-10.87.
[73] Lynch Fannon and Murphy, Corporate Insolvency and Rescue 2nd Edition (Dublin: Bloomsbury, 2012)
paras.10.88-10.111
[74] Flynn, 'Reckless Trading' [1991] 9(8) ILT 186
[75] MacCann 'Reckless Trading: No Looking Back? Part 1 [1992] 10 ILT 3

distinguished between entrepreneurial risk-taking which company law supports and harmful operational risk-taking which it does not.[76] However, while unique perspectives have been provided in the literature, the Irish provision has not been the subject of an extensive examination to date. Likewise, while both Williams in the UK[77] and Taylor[78] in New Zealand have determined the number of reported cases in these jurisdictions and the possible reasons for their rarity, no similar detailed attempt to determine why the provision is so little used has been carried out in Ireland. The thesis does in this way provide a novel contribution to the literature.

Moreover, the thesis, while underpinned by the existing literature, examines section 610 from a novel angle and provides unique insights into the provision's genesis, interpretation, application and reform. It examines the effect of the restriction and disqualification order regime on reckless trading type behaviour and, uniquely, argues that such behaviour is currently effectively regulated by these public enforcement regimes. This discovery underpins the later argument that the inclusion of a public enforcement regime within the reckless trading provision would improve its accessability and success rate.

Similarly, building on the foundation created by Lynch Fannon and an extensive examination of the origin of the Irish provision, the argument is made that the 'deeming' provisions within section 610(3) have been misinterpreted in case law and are, in reality, merely examples of reckless trading behaviour. This is a unique insight. Its consequences are far reaching. Read in this light many of the difficulties with the application of the section fall away.[79] Again, building on Lynch Fannon's work,[80] the shortcomings of the defence in subsection (8) are extensively analysed and proposals put forward for its reform. Finally, while the issue has already been considered by

[76] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7
[77] Williams, What Can We Expect To Gain From Reforming the Insolvent Trading Remedy [2015] 78(1) MLR 55
[78] Taylor, 'Directors' Duties on Insolvency in New Zealand: An Empirical Study' [2018] 28(2) New Zealand Universities Law Review 172
[79] Breen, 'Fictions or Guidelines? The Deeming Provisions in Section 610 of the Companies Act 2014' [2019] 26(9) CPL 168.
[80] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7

Lynch Fannon[81] and the LRC[82] the thesis contains a singularly extensive analysis of the framework for a criminalised reckless trading provision. It also addresses a significant gap in the existing literature, which form of civic public enforcement would improve the section's effectiveness.

**(v) Structure of Thesis**

Building upon the central research questions and the methodologies used, the thesis is divided into ten chapters. Chapter Two traces and analyses the history and evolution of the reckless trading provision in Ireland and New Zealand and of wrongful trading in the UK. Though short, this chapter is important. It would be impossible to understand the provisions without also understanding their development. Doctrinal analysis of the Irish provision and comparative analysis with the other two jurisdictions would be otherwise unconvincing. Chapter Three contains a doctrinal analysis of the Irish provision and its limited case law. The purpose is to understand the strengths and weakness of the provision and the light cast on its operation by the case law. This chapter also answers a very important question – from an external perspective, why the provision is so little used. Chapter Four engages in comparative analysis focusing on the UK and New Zealand. By highlighting the successes and failures within these jurisdictions' regimes, the insights gleaned, along with the conclusions from Chapter Three allow the development of potential Irish legislative changes to improve the invocation rate and functionality of section 610.

The following three chapters of the thesis answer the second central research question. Chapter Five analyses reckless trading from the perspectives of three important legal theories; contractarianism, stakeholder theory and judicial realism. The chapter demonstrates that the concept has theoretical support. The next two chapters ask whether a reckless trading provision is necessary at all. Other legislative provisions may satisfactorily police the behaviour. Both the restriction and disqualification order regimes and the directors' duty to creditors are examined in this regard. Both chapters conclude that, for different reasons, neither is sufficient. Importantly, Chapter Six

[81] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7

[82] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018) Part 11

demonstrates that reckless trading behaviour is controlled in Ireland via the restriction and disqualification order regimes.

Chapter Eight poses a question of contemporary importance;[83] should the reckless trading provision be criminalised? To answer this question comprehensively, the chapter considers the essence of what makes behaviour criminal and the place of reckless trading in that continuum. It also considers the impact of criminal legislation in Australia and New Zealand before arguing that such a step would not be appropriate in Ireland. This still means, however, that the proposed legislative changes by themselves may not sufficiently increase the invocation rate and functionality of the section. An additional solution is therefore necessary. Chapter Nine argues that an increased role for the ODCE and an administrative sanction regime would achieve these two aims. A skeleton proposal for a workable scheme is developed and comparable regimes in the UK and Australia are critically examined.

The concluding chapter presents the main research findings of the proceeding segments. Moreover, the contribution of each in addressing the central research questions is analysed. A two-pronged problem-solving approach is suggested; legislative change to the section itself combined with civil public enforcement of the provision.

Finally, the thesis is based on the materials available to 31 August 2021.

[83]See, in particular, Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences, Ch.12 (Dublin 2018)

# CHAPTER TWO: THE ORIGINS OF RECKLESS TRADING

## (I) INTRODUCTION

This chapter traces the historical development of the reckless trading concept in the three jurisdictions under consideration. Such a review is important. It would be difficult, if not impossible, to fully understand the provisions as they are now without also understanding the historic developments and influences. This is especially the case as the New Zealand provision appears to have had a significant impact here. Likewise, the influence of the seminal Cork Committee Report[1] cannot be underestimated. The review is particularly important regarding the wording of the Irish provision. As we will see in Chapter Three, the drafting of the section is complex, and it appears to contain anomalies. The analysis of these issues would be far less convincing without investigating how they arose in the first place

## (II) THE UNITED KINGDOM

### (i)The Greene Committee Report

That the twin principles of limited liability and separate legal personality could be abused was recognised relatively early. An initial instance of this is the Greene Committee Report.[2] The particular fraud which concerned the Committee was known as 'filling up the debenture'. The director of the company who knew that the company was close to liquidation would hold a floating charge. That floating charge would then be 'filled up' by having the company obtain goods on credit. A receiver would then be appointed to the company. The goods so obtained would be subject to the director's floating charge. The Committee considered that this 'trick' could not be adequately dealt with by amending the current law.[3] Instead, it recommended that a new concept, described as fraudulent trading, be introduced instead. This new concept would contain a two-fold sanction. Firstly, the director would be made personally liable for the debts of the company and secondly a criminal penalty would ensue.[4] The direct result of these recommendations was an inclusion in UK law for the first time of a

[1] Insolvency Law and Practice – Report of the Review Committee [1982] Cmnd 8558
[2] Greene, Report of the Company Law Amendment Committee (1926) Cmnd 2657
[3] Greene, Report of the Company Law Amendment Committee (1926) Cmnd 2657 para.61
[4] Greene, Report of the Company Law Amendment Committee (1926) Cmnd 2657 para.62.

fraudulent trading provision in the form of section 75 of the Companies Act, 1928. Ultimately, fraudulent trading was difficult to prove as dishonesty was required. This was to cause problems in the future.

**(ii) The Jenkins Committee Report**

Greene was followed by the Jenkins Committee Report from 1962.[5] The latter Committee recognised that the Companies Act, 1948 did not deter directors from continuing the business of a company which they were fully aware was doomed to insolvency.[6] Jenkins recommended that an extension should be made to the fraudulent trading civil sanction whereby directors of an insolvent company who had acted in an irresponsible manner could be made personally liable for some or all of the debts of the company.[7] Thus the genesis of reckless trading lies in limitations of the fraudulent trading provisions.

**(iii) The Cork Committee Report**

The Companies Act, 1948 remained unchanged however and the next development was the Cork Report of 1982.[8] This Report contained an investigation of and recommendations on the modernisation of insolvency law. In discussing fraudulent trading, the Cork Committee concluded that it was appropriate to have a criminal offense of carrying on a business dishonestly. In the absence of actual absence of dishonesty, no criminal sanction should exist.[9] Nevertheless, the Committee did recognise that this created a problem. The dishonesty requirement set the bar too high as personal liability could not be imposed on directors absent such a finding.[10] In essence, the Committee concluded that while trading in a fraudulent manner carried sanctions, irresponsible behaviour no matter how reprehensible, did not. The Committee recommended that a provision be added whereby compensation would be

[5] Board of Trade, Report of the Company Law Committee, ('The Jenkins Report') (London June 1962) Cnmd 1749
[6] Board of Trade, Report of the Company Law Committee, ('The Jenkins Report') (London June 1962) Cnmd1749 para.499
[7] Board of Trade, Report of the Company Law Committee, ('The Jenkins Report') (London June 1962) Cnmd1749 para. 503
[8] Insolvency Law and Practice – Report of the Review Committee [1982] Cmnd 8558
[9] Insolvency Law and Practice – Report of the Review Committee [1982] Cmnd 8558 para.1777
[10] In Re. Patrick and Lyon Ltd. [1933] Ch 786 Maugham J. stated that the fraudulent trading provisions require *'actual dishonesty …involving real moral blame'*

available to those who suffer foreseeable loss due to the reckless and unreasonable behaviour by those in control of a company in an insolvency situation.[11]

The proposed new section would introduce a new concept 'wrongful trading'. A company would be trading wrongfully if a threefold test was passed (i) the company was either insolvent or could not pay its debts as they fell due and (ii) it incurred liabilities to other persons without a reasonable prospect of meeting them in full and (iii) a person who was party to the carrying on of the company's trading knew or ought to have known that the trading was wrongful. Where these three conditions were fulfilled, the director could be made personally liable for some or all of the company's debts.[12]

The Committee proposed other hallmarks of wrongful trading. The test was objective not subjective.[13] It could occur both where a company was unable to pay its debts as they fall due and where a company's assets exceeded its liabilities.[14] Wrongful trading could also occur where the company was simply undercapitalised.[15] The director must be a party to the wrongful trading. It was not sufficient that he or she was merely privy to it.[16] That said, willful blindness was not an escape route.[17] The remedy should only be available in liquidation or receivership situations.[18] The Committee considered that the court should have a wide range of discretion and flexibility when it came to awards for wrongful trading. Very importantly, a creditor would have locus to take a case and the court could make an award to that particular creditor.[19] Further, even where a director had actual or constructive knowledge of wrongful trading, relief from liability should be available where the person acted honestly.[20] Finally, the Committee recommended that a director of a company facing insolvency would have the ability to apply to court for leave to continue trading. If leave were granted no claim for

[11] Insolvency Law and Practice – Report of the Review Committee [1982] Cmnd 8558 para.1778
[12] Insolvency Law and Practice – Report of the Review Committee [1982] Cmnd 8558 para.1781
[13] Insolvency Law and Practice – Report of the Review Committee [1982] Cmnd 8558 para.1783
[14] Insolvency Law and Practice – Report of the Review Committee [1982] Cmnd 8558 para.1784
[15] Insolvency Law and Practice – Report of the Review Committee [1982] Cmnd 8558 para.1785
[16] Insolvency Law and Practice – Report of the Review Committee [1982] Cmnd 8558para.1787
[17] Insolvency Law and Practice – Report of the Review Committee [1982] Cmnd 8558 para.1788.
[18] Insolvency Law and Practice – Report of the Review Committee [1982] Cmnd 8558 para.1792
[19] Insolvency Law and Practice – Report of the Review Committee [1982] Cmnd 8558 para.1797
[20] Insolvency Law and Practice – Report of the Review Committee [1982] Cmnd 8558 paras.1793-1795.

wrongful trading could arise.[21] Overall, the Committee proposed an extremely comprehensive regime.

The Cork Committee concluded that a balance had to be struck. Business should not be discouraged, and it should be recognised that business does entail risk. On the other hand, an environment should be developed in which irresponsible or reckless behaviour is discouraged and carries with it the sanction that those who take excessive risk and thus abuse the privilege of limited liability are made personally liable for the consequences of their conduct.[22] The Committee concluded by saying that the new wrongful trading regime was of the '*utmost importance'* and that its implementation was one of '*urgent necessity'*. [23]

As a result of the Cork Committee Report, the Department of Trade and Industry set out its insolvency policy in a White Paper; A Revised Framework for Insolvency Law.[24] While one of the Paper's main policy objectives was the sanctioning of irresponsible behaviour by company directors, it departed from the framework designed by the Cork Committee.[25] Thus the ultimate wrongful trading provision does differ materially from that which the Cork Committee recommended. It appears that the Department considered that the Cork Committee proposals imposed too severe responsibilities on directors for their companies' liabilities.[26]

**(iv) Section 214 Insolvency Act, 1986**

Wrongful trading was introduced as section 214 Insolvency Act, 1986. (The section was originally enacted as section 15 Insolvency Act, 1985). The section can be

[21] Insolvency Law and Practice – Report of the Review Committee [1982] Cmnd 8558 para.1798
[22] Insolvency Law and Practice – Report of the Review Committee [1982] Cmnd 8558 para.1805.
[23] Insolvency Law and Practice – Report of the Review Committee [1982] Cmnd 8558 para.1805
[24] White Paper, A Revised Framework for Insolvency Law [1984] Cmnd 9175
[25] Campbell, Wrongful Trading and Company Rescue, [1994] 25(1), Cambrian Law Review 69 at 69-71.
[26] Keay and Murray, 'Making Company Directors Liable: A Comparative Analysis of Wrongful Trading in the United Kingdom and Insolvent Trading in Australia' [2005] 14 Int. Insolv. Rev. 27 at 30.

described as an attempt to prescribe a minimum standard of behaviour for directors.[27] In general, its introduction was greeted with optimism.[28]

Section 214 is still in place in substantially the same form today and is set out in Appendix One. Essentially a director who allows a company to trade past the point where he or she knew or ought to have concluded that there was no reasonable likelihood of avoiding an insolvent liquidation is penalised.[29] There is a possible escape route; taking every possible step in order to minimise loss to creditors.[30] If the director can prove that this was done no personal liability will attach. The court will take into account the skill and knowledge which the director actually had and the skill and knowledge which would be expected of a person in the director's position.[31] Interestingly, there is no overarching concept of 'wrongful trading'. The test instead is quite narrow; a point comes beyond which the company should not continue to trade – did the directors allow the company to trade past that point? Importantly also only the liquidator can make an application under section 214 and the loss must be suffered by the company. Thus, the Cork Committee's recommendations for flexibility as to the applicant and entitlement to awards where not followed.[32]

## (III) IRELAND

### (i)The Cox Report

The starting point in Ireland is the Cox Report of 1958.[33] Again, there was recognition that the doctrine of separate legal personality could, in certain circumstances, be a recipe for fraud,[34] in particular via what must have been by that point the very old trick of the filling up the debenture.[35] The recommendation for that and other types of fraudulent dealings was the imposition of unlimited personal liability and criminal

[27] Keay and Murray, 'Making Company Directors Liable: A Comparative Analysis of Wrongful Trading in the United Kingdom and Insolvent Trading in Australia' [2005] 14 Int. Insolv. Rev. 27 at 50.
[28] See, in particular, Prentice, 'Creditor Interests and Directors' Duties' [1990] 10 OLJS 265.
[29] S.214(2)
[30] S.214(3)
[31] S.214(4)
[32] Insolvency Law and Practice – Report of the Review Committee [1982] Cmnd 8558 para.1797
[33] Cox, Report of the Company Law Reform Committee (Dublin 1958)
[34] Cox, Report of the Company Law Reform Committee (Dublin 1958), para.21
[35] Cox, Report of the Company Law Reform Committee (Dublin 1958), para.201

sanction on fraudulent directors[36] This recommendation resulted in the inclusion in the Companies Act, 1963 of a section mirroring the UK fraudulent trading section.[37]

**(ii) Section 610 Companies Act, 2014**

Little then occurred in Ireland in this area for almost three decades. However, by the late 1980s it became increasingly obvious that the Irish company law landscape was too favourable to those who engaged in irresponsible behaviour and abused the privilege of limited liability. While influenced by the Cork Report, the Irish legislature did not adopt its recommendations in full or duplicate section 214 Insolvency Act, 1986. It did follow some proposals such as granting locus standi to creditors to take an application and flexibility as to awards. Overall, however, the Irish legislature introduced its own quite different concept 'reckless trading' in the form of section 138 Companies Act, 1990 which inserted a new section 297A into the Companies Act, 1963. This section now exists unchanged in all material respects as section 610 Companies Act, 2014 and is set out in Appendix Two. It is a more complex and multi-layered provision than its UK counterpart. The section applies to officers of insolvent companies and an application may be taken by a liquidator, creditor, receiver or examiner. The Irish section grants the court the power to impose personal liability on directors in the following circumstances:

1. Where the director is knowingly a party to the carrying on of any business of the company in a reckless manner.

2. The director can be "deemed" to have been knowingly a party to the carrying on of any business of the company in a reckless manner where having regard to the general knowledge, skill and experience that may reasonably be expected of a person the director's position, the director ought to have known that his or her actions would cause loss.

3. The director can be "deemed" to have been knowingly a party to the carrying on of any business of the company in a reckless manner where the director was

[36] Cox, Report of the Company Law Reform Committee (Dublin 1958), para.126
[37] S.297 Companies Act, 1963

> a party to the contracting of a debt by the company and did not honestly believe on reasonable grounds that the company would be able to pay that debt as well as its other debts when they fell due.

There is also an escape clause. Under subsection (8), where the court decides that the director has acted honestly and responsibly in relation to the affairs of the company, the director may be relieved by the court in whole or in part from personal liability. Finally, any compensation levied can be awarded to the company or a creditor or creditors.

**(iii) Difficulties with Section 610**

The section is complex. This creates many questions. Firstly, what exactly is 'reckless trading' and what are its parameters? Moreover, the apparent 'deeming' provisions within subsection (3) cause difficulties. Case law[38] has held that this subsection contains statutory fictions. Hence a director who would not be involved reckless trading under subsection (1) may well be deemed to be so involved under subsection (3). The apparent unfairness of this position has led the judiciary to seek escape routes thus complicating the application of the section. Further, there is the wider question as to whether these provisions contain statutory fictions at all.[39] Additionally, objective and subjective criteria may not integrate coherently. Moreover, an issue arises as to whether the defence in subsection (8) is helpful. While Ussher is quite strenuous as to the importance of not punishing honest optimists[40] a wider question here is whether a test of honesty and responsibility is beneficial.[41] All these issues arguably cause significant difficulties regarding the interpretation and application of the section. This will be explored in the next chapter.

**(iv) Legislative History of Section 610**

The difficulties within section 610 may have been caused in part at least by the lengthy passage of the legislation through the Dail and Seanad. The Companies Act, 1990

[38] Re. Hefferon Kearns Ltd. (No 2) [1993] 3 IR 191.
[39] Breen, 'Fictions or Guidelines? The Deeming Provisions in Section 610 of the Companies Act 2014' [2019] 26(9) CPL 168.
[40] Ussher, Company Law in Ireland, (Dublin: Sweet & Maxwell, 1986), p.534
[41] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7

began life as the Companies (No. 2) Bill 1987. The long passage of time can be attributed to successive change of government and thus changes of supporting Ministers.[42] However, it cannot be said that the lawmakers were not alive to the difficulties involved in satisfactorily drafting a section on reckless trading and many of the difficulties we grapple with today were recognised (even if only in passing) during the debates.

As initially drafted clause 107 Companies (No.2) Bill 1987 was relatively short and to the point. Reckless trading itself was described as it is currently as the carrying on of any business in a reckless manner.[43] The penalty was making the director personally responsible for some or all of the debts of the company.[44] Contracting a debt which the officer of the company did not honestly believe on reasonable grounds that the company would be able to repay when it fell due for payment also constituted reckless trading.[45] The draft section concluded by saying in subsection (4) that where the officer acted honestly and responsibly in relation to the affairs of the company, he or she may be relieved in whole or in part from personal liability.[46]

As the parliamentary debates ensued, distinct themes emerged. At Seanad committee stage, the section's lack of a definition of reckless trading was considered.[47] The requirement that there be a meticulous definition of reckless trading had been recommended by academic commentators such as McCormack.[48] Perhaps influenced by these commentators, ultimately an addition was made to the purposed section.[49] It introduced the concept of a director being knowingly a party to the carrying on of any business of the company in a reckless manner where having regard the level of knowledge, skill and experience of the director, he or she ought to have known that

[42] For a history of the Bill, see McCormack, The New Companies Legislation (Dublin: Roundhall Press 1991), p.1-14.
[43] Cl.107(2)(a) Companies (No. 2) Bill, 1987
[44] Cl.107(3) Companies (No. 2) Bill, 1987
[45] Cl.107(2)(b) Companies (No. 2) Bill, 1987
[46] See Albert Reynolds TD Minister for Industry and Commerce. 116(a) Seanad Deb Col.308 (20 May 1987)
[47] 116(a) Seanad Deb Cols. 1082 -1083 (17 June 1987). See also 120(b) Seanad Deb Col.2437 (12 July 1988)
[48] McCormack, 'Fraudulent Trading – New Wine in Old Bottles' [1988] 6 ILT 170
[49] 116(b) Seanad Deb Cols 2435-2437 (12 July 1988) Government Amendment No. 155.

the actions would cause loss, putting in place the categories of reckless trading we have today.

Interestingly, confusion between the subjective and objective approaches is evident. This is especially apparent during the Special Committee hearings. Deputies and Senators had difficulty determining which standard should be applied. The Minister for Industry and Commerce recognised the difficulties which could arise from mixing objective and subjective tests.[50] It is particularly interesting that different Deputies and Senators appear to have had different opinions on which particular test applied.[51]

Some Senators considered that the section as drafted did not adequately take into account the commercial necessity that a company participate in risky ventures. These may not work out and could involve the company in serious losses or even cause its demise. However, such ventures would not be either reckless or irresponsible.[52] While acknowledging the difficulty of capturing the historic intention of the legislators, here the Senators may be drawing a distinction between entrepreneurial risks (which company law supports) and operational mismanagement in the vicinity of insolvency[53] (which is not supported). The Minister's answer was that the purpose of the then subclause (4) containing the honestly and responsibly defence was to relieve a director in these circumstances.[54] If this is indeed the purpose behind the defence; a shield for the entrepreneurial risk taker, then this is not how it has been interpreted by the courts. Senator Ross in particular was unhappy with the Minister's reasoning regarding subsection (4) and warned presciently that the defences' subjectivity would cause problems in the future.[55]

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[50] Deputy O'Malley stated in relation to the proposed section *'The reason I say it is complicated is that it brings in and mixes together an objective and a subjective test'* Dail Eireann Companies (No. 2) Bill 1987 Special Committee Col 653 (6 March 1990)

[51] This led to some quite interesting exchanges. During the Special Committee Hearing, the Minister for Industry and Commerce explained that cl.(2)(a) is objective. He went on to describe cl.(2)(b) as being '*more subjective'.* Further clarifications were added by Deputy O'Malley as to the objective and subjective nature of these two limbs to which Deputy Bruton replied *'I must say I am lost'* Dail Eireann Companies (No. 2) Bill 1987 Special Committee Cols 653-657 (6 March 1990)

[52] 120(b) Seanad Deb Cols. 2440-2441 (12 July 1988)

[53] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7.

[54] 120(b) Seanad Deb Cols. 2443-2444 (12 July 1988). The Minister states concerning cl.(4) *'That makes it clear that it is not intended to take on the risk taker'.*

[55] 120(b) Seanad Deb Col. 2445 (12 July 1988).

Another notable issue in the debates is the lack of reference to effective remedies. There appears to be an implicit assumption that the errant director will always have sufficient personal funds to adequately recompense creditors. The question is not asked, at least directly, as to what would happen if the errant director turned out to be impecunious.[56] This would have been a sensible route of inquiry. In many cases if the company fails the director's sole source of income and wealth disappears. The director is therefore simply not in a financial position to take over the liabilities. The lack of recognition of the potential for such a possibility is a foreshadowing of problems to come.

Further, the lack of recognition of the importance of remedies is exacerbated by dismissal of any possible public enforcement of the provision. This point arose in the context of providing liquidators with sufficient public funds to pursue fraudulent directors.[57] It was suggested that this was a better approach than a reckless trading provision.[58] McCormack states that this idea was dismissed out of hand by the Minister and is unconvinced by this dismissal.[59] As will be demonstrated later, this refusal to consider public enforcement represents a missed opportunity.

## (IV) NEW ZEALAND

### (i) History of Provisions

Reckless trading provisions in New Zealand have a comparatively long history. A fraudulent trading provision existed as far back as 1933.[60] The next major Companies Act, that of 1955, while retaining fraudulent trading, did not contain any reckless trading provision. Reckless trading was in fact introduced by section 32 Companies Amendment Act, 1980 making New Zealand a relatively early mover in this area. This resulted from the recommendations of the Macarthur Report[61] which advocated

[56] There are instances of this issue being looked at in a somewhat elliptical manner. For example, Deputy S. Barrett ponders what would happen if a director died in financially straightened circumstances but his wife, a former passive director, later came into money. Could she be pursued? Dail Eireann Companies (No. 2) Bill 1987 Special Committee Col 655 (6 March 1990)
[57] 116(a) Seanad Deb Cols. 705-707 (4 June 1987).
[58] Ussher, Company Law in Ireland, (Dublin: Sweet & Maxwell, 1986), pgs.527-528
[59] McCormack, The New Companies Legislation (Dublin: Roundhall Press, 1991), p.216
[60] S.380 Companies Act, 1933
[61] Final Report of the Special Committee to Review the Companies Act (Wellington NZ 1973) ('The MacArthur Report')

following the Australian legislation as it existed at that time.[62] The Jenkins Committee Report was also influential.[63] The original section is worth quoting in full due to its striking similarities to part of the Irish reckless trading provision and is set out in Appendix Three.

As the 1980's progressed, however, the Companies Act, 1955 was viewed as outdated and it was considered that a general reform of New Zealand company law was required.[64] In 1986, the Law Commission was given the task of examining and reviewing the 1955 Act and preparing a report on the content of a new Companies Act. This resulted in the publication in 1989 of 'Law Commission Report No. 9: Company Law Reform and Restatement'. The Report had a number of recommendations to make in relation to reckless trading.

The Commission further concluded that section 320 Companies Act, 1955 had gone too far in inhibiting the use of the company form for a risky venture. Therefore, it was recommended that the new reckless trading provision only impose personal liability on directors where they unreasonably risked insolvency. The Commission concluded on this point by saying that whether or not insolvency has been unreasonably risked would depend on the circumstances of the case.[65] This test, however, was removed by the Department of Justice and, after some toing and froing between the Justice Department and the Law Reform Committee, the current test of 'substantial risk of serious loss' was introduced instead.[66] Hence there are significant differences in wording between section 320 Companies Act, 1955 and the current provision. Not all commentators approved. Farrar and Tennent for example considered that there were too many different sections concerning directors' action at or close to insolvency and that none of them were particularly well drafted.[67] Specifically, the drafting of the

[62] Watson and Taylor (General Editors), Corporate Law in New Zealand, (Wellington: Thomson Reuters, 2018), pgs. 605-606
[63] Watson and Taylor (General Editors), Corporate Law in New Zealand, (Wellington: Thomson Reuters, 2018), p.606
[64] Hon Justice D. Tompkins, Directing the Directors: The Duties of Directors Under the Companies Act, 1993 [1994] 2 Waikato Law Review 13
[65] Law Commission, Company Law: Reform and Restatement (R9) (Wellington NZ 1989), para.516
[66] Hon Justice D. Tompkins, Directing the Directors: The Duties of Directors Under the Companies Act, 1993 [1994] 2 Waikato Law Review 13 at 15.
[67] Farrar and Tennent, 'The Unfitness of Directors, Insolvency and the Consequences – Some Comparisons [2005] 11(1) Canterbury Law Review 239.

provisions was considered to be unclear.[68] Ultimately, the academic commentators proved to be correct, and the courts had to adopt a pragmatic approach to the interpretation of the sections.[69]

As currently drafted, Section 135 Companies Act, 1993 imposes a duty on directors to avoid reckless trading. Section 136 imposes a duty not to agree to the company incurring an obligation unless the director believes at the time on reasonable grounds that the company will be able to perform the obligation when called upon to do so. The sections are set out in Appendix Three. Of note also is that no general defence is available. There is a limited defence, however, under section 138 which applies to a director who obtained and followed professional advice.[70] There are other important hallmarks of the sections. Like Ireland, the court has the discretion as to the level of compensation awarded.[71] Importantly also, creditors have locus standi to take a case.

**(ii) Criminalisation**

Reckless trading type behaviour has been criminalised in New Zealand. Section 380(4) was added by the Companies Amendment Act, 2014 and creates the offense of dishonestly incurring a debt. The purpose of the amendment was to ensure that intentional breaches of the reckless trading provision would not go unpunished.[72] It was hoped that the introduction of the provision would sanction serious wrongdoing and improve accountability but, as Watson and Taylor point out, capturing these policy aims in legislative form was difficult to achieve.[73] To date, it appears that there have been no cases on this provision.[74]

[68] For an early critical commentary see Tefler, 'Risk and Insolvent Trading' in Grantham and Rickett (Eds), Corporate Personality in the 20th Century, (Oxford: Hart Publishing, 1998), p.127.
[69] Watson and Taylor (General Editors), Corporate Law in New Zealand, (Wellington: Thomson Reuters, 2018), para.22
[70] Please see Appendix Three
[71] S.301(1), Companies Act, 1993. See in particular Yan v Mainzeal Property and Construction Ltd. [2021] NZCA 99
[72] Watson and Taylor (General Editors), Corporate Law in New Zealand, (Wellington: Thomson Reuters, 2018), para.22.6
[73] Watson and Taylor (General Editors), Corporate Law in New Zealand, (Wellington: Thomson Reuters, 2018), para.22.6
[74] Watson and Taylor (General Editors), Corporate Law in New Zealand, (Wellington: Thomson Reuters, 2018), para. 22.6. The authors state that up to 2018 there were no reported cases. I could not locate any cases after that date.

## (V) CONCLUDING REMARKS

Corporate law as it evolved developed a disproportionate emphasis on directors' and shareholders' interests. This arose from the predominance of the characteristics of separate legal personality and limited liability. However, as the corporate form developed, its impact on other stakeholders was increasingly acknowledged. A developing acknowledgement that the interests of creditors in particular should be taken into account led to the introduction of fraudulent trading provisions. As the limitations within the concept of fraudulent trading became apparent, the less precise concept of reckless trading came into being to counteract these weaknesses.

It was hoped that reckless trading would counteract the limitations of fraudulent trading and improve corporate behaviour in the vicinity of insolvency.[75] Unfortunately, the reckless trading type provisions introduced in the jurisdictions under review and elsewhere have proven unsatisfactory. As can be seen from this chapter, particularly regarding Ireland, some of the weaknesses may be rooted in the origins of the provision. The most visible manifestation of this inadequacy is that the provisions appear little used and are often unsuccessful when they are. This leads to the first central research question of the thesis; why is this so? These inadequacies may arise from wider issues outside the framework of company law or from a narrower cause; flaws and lacuna within the drafting of the provisions themselves. The next two chapters will explore and analyse this issue in detail using both doctrinal and comparative methodologies and examine the potential legislative changes which might be made to section 610.

[75] Insolvency Law and Practice – Report of the Review Committee [1982] Cmnd 8558 paras.1777 and 1805

# CHAPTER THREE: A CRITICAL ANALYSIS OF SECTION 610 COMPANIES ACT, 2014

## (I) INTRODUCTION

Section 610 is sparsely used and, when it is invoked, is often unsuccessful. This is an Irish problem and is a problem in other jurisdictions as well. The first central research question of this thesis asks why this is the case. To provide an answer, this chapter will carry out a two-fold investigation; firstly, as to the possible external causes of this issue and, secondly, as to the problems caused by flawed drafting of the provision.

## (II) THE PAUCITY OF CASE LAW

### (i) The Different Jurisdictions

One of the most striking features of the Irish reckless trading provisions is the lack of case law. Since 1990, there have been four substantive reported cases dealing with this provision; Re. Hefferon Kearns (No. 2) Ltd.[1], Re. PSK Construction Ltd.,[2] Re. Appleyard Motors Ltd.[3] and Re. Kelly Trucks Ltd.[4] Further, despite applications being made against twelve directors in total only three of the applications were successful in monetary terms. [5] One was for a clear and admitted instance of deliberately preparing and filing false tax returns.[6] The second and third were for a deliberate and complex scheme to avoid paying two creditors of the company.[7] Moreover, there was only one other reported decision[8] concerning reckless trading during the twenty-five year period between the events in Hefferon Kearns and those is PSK Construction. This is despite Ireland suffering one of the worst fiscal contractions in modern times[9] and corporate insolvencies increasing over four-fold when 2006 (the final year of the boom) is

[1] [1993] 3 IR 191. For an early analysis of this case, see McCann, 'Reckless Trading Revisited' [1993] 11 ILT 31
[2] [2009] IEHC 538
[3] [2015] IEHC 28 and [2016] IECA 280
[4] [2019] IEHC 6
[5] Four directors in Hefferon Kearns, two directors in PSK Construction Ltd., four directors in Appleyard Motors Ltd and two directors in Re. Kelly Trucks Ltd. In Hefferon Kearns, it appears that three of the directors were found to have been involved in reckless trading but had their liabilities reduced to nil. The case against the fourth defendant was dismissed; [1993] 3 IR 191 at 225.
[6] Re. PSK Construction Ltd. [2009] IEHC 538
[7] In Re. Kelly Trucks Ltd. [2019] IEHC 6.
[8] Jones v Gunn [1997] 3 IR 1
[9] Honohan, What Went Wrong in Ireland, (Trinity College Dublin, May 2009). Four companies a day became insolvent in 2009.

compared to 2012 (the trough of the recession).[10] Moreover, there are quite a significant number of corporate insolvencies in Ireland on an annual basis. Deloitte reported 541 insolvencies in 2020 and 538 insolvencies in 2019.[11] Either businessmen and businesswomen in Ireland are careful in the extreme or there is a deeper issue.

That said, it must be kept in mind that the number of known cases may be too low. Evidence from the Office of the Director of Corporate Enforcement ('ODCE') may support this contention.[12] Further, other reckless trading cases do exist. Specifically, in Jones v Gunn[13] the application failed because section 610 was held not to have retrospective effect. Robinson v Forrest[14] mentions in passing proceedings in an earlier case under section 610 involving the same parties. That case was apparently compromised. Doherty Advertising Ltd; Stafford v Beggs is a case concerning the awarding of costs where a director is restricted. The decision in the case itself[15] mentions an earlier unreported case in 2003 wherein a finding of reckless trading was made against two of the company's directors. There also appears to be a further unreported case Re. Eastland Warehousing Ltd.[16] though it is unclear from available newspaper reports the precise basis on which personal liability was imposed.[17] Instances also exist of reckless trading applications being withdrawn by the liquidator prior to hearing.[18]

Moreover, there is the likelihood that reckless trading cases were settled before ever reaching court or personal funds were voluntarily produced under threat of a section 610 application.[19] For instance, Jay Bourke, a well-known publican and restauranteur

[10] McCormack et al Study on a new approach to business failure and insolvency Comparative legal analysis of the Member States' relevant provisions and practices Tender No JUST/2014/JCOO/PR/CIVI/0075 Appendix
[11] Deloitte, Marginal increase for corporate insolvencies in 2020 despite economic challenges. Deloitte headline figures include solvent liquidations.
[12] ODCE Annual Report 2018 (Dublin 2019), p.27 states that allegations of reckless trading (including fraudulent trading) made to it in 2017 numbered 35 and 34 in 2018. In 2019, the figure was 39.
[13] [1997] 3 IR 1
[14] [1999] IEHC 103 paras.1-2.
[15][2006] IEHC 258 para.2
[16] Unreported High Court May 2003.
[17] Keena, 'Former Directors of Firm in Liquidation Liable for Debts' Irish Times (2 May 2003)
[18] See for example 'Liquidator Withdraws Fraudulent Trading Claims' Irish Times (12 February 1999)
[19] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para. 12.87.

in Dublin was disqualified from acting as a director for seven years.[20] A reckless trading application was withdrawn by the liquidator. This could have been for a variety of reasons eg. the discovery of a weakness in the liquidator's case. In view of the seriousness of the misconduct allegations involved, it is possible that the matter was settled. This contention is supported by the fact that there is evidence of settlements in other jurisdictions.[21] However, even taking these facts into account, the incidence of use of the section is still extraordinarily low.

A similar problem exists in other jurisdictions. After the introduction of the wrongful trading provision in the UK, there were a number of initial successful cases. This appeared to bode well for the legislation. While the first successful wrongful trading case is unfortunately unreported,[22] this was followed by the influential Re. Produce Marketing Consortium Ltd.[23] Later important cases include Re. DKG Contractors Ltd.[24] and Re. Purpoint Ltd. [25] Each of these cases was successful in that the directors were obliged to contribute to the assets of the company. Successful invocations of the section can be found today with cases such as Re. Rod Gunner Organisation Ltd.,[26] Singla v Hedman[27] and Re. Robin Hood Centre Plc.[28] Therefore, at first blush, section 214 appears a vastly more useful provision than S.610. Further, the body of case law is far more developed than its Irish equivalent. For example, issues such as whether the section 214 right of action belongs to the company or the liquidator[29] and whether a section 214 application can be brought against the foreign directors of a foreign company liquidated in the UK[30] have been litigated.

That said, the question arises as to whether it has been sufficiently invoked. Empirical evidence suggests infrequent usage. Williams found twenty-nine reported decisions

[20] 'Jay Bourke has Disqualification Extended to 7 Years' Irish Times (17 July 2017)
[21] Steele and Ramsay, 'Insolvent Trading in Australia. A Study of Court Judgments from 2004 to 2017' [2019] 27 Insolvency Law Journal 156 at 165-177.
[22] Re. Fairmont Tours (Yorkshire) Ltd. (Unreported July 1996)
[23] [1989] 5 BCC 569.
[24] [1990] BCC 903
[25] [1991] BCC 121
[26] [2004] EWHC 216 Ch
[27] [2010] EWHC 902 Ch
[28] [2015] EWHC 2289
[29] Re. Oasis Marketing Services Ltd. [1998] Ch 170.
[30] Re. Howard Holdings Ltd. [1998] BCC 549.

between 1986 and September 2013 of which eleven were successful.[31] Mokal found few successful applications up to 2004.[32] This analysis was updated by Archer to 2017. He found that there had been four additional cases. One was procedural only; one was Scottish and in only one of the four cases did the liquidator succeed. As he states *"These are small numbers indeed."*[33] Keay has also noted (in 2005) that empirical evidence existed at that point for insufficient use.[34] Further, a government study found that around thirty wrongful trading cases had been taken between 1986 and 2014.[35] Konstantinov points out that very few directors who are disqualified face wrongful trading proceedings.[36] It can therefore be argued that taking into account the difference in populations and the fact that wrongful trading has been in existence somewhat longer, both provisions are similarly little used.

Invocations in New Zealand have been more frequent and more successful. As Taylor states *"Overall, however, reckless trading claims appear to be made more frequently in New Zealand than is the case in Australia and England."* [37] New Zealand is therefore the outlier when its population is taken into account.[38] Taylor undertook a comprehensive study in this regard. She found that during the 2008 to 2015 period 22,501 company liquidations were carried out[39] and that seventy-nine cases involving breaches of directors' duties occurred during the period 1994 to 2018.[40] Looking at figures for individual directors, she concluded that section 135 was invoked against ninety-three directors with a success rate of seventy-three percent and that section 136

[31] Williams, 'What We Can Expect to Gain From Reforming the Insolvent Trading Remedy' [2015] MLR 55 at 60.
[32] Mokal, Corporate Insolvency Law (Oxford: Oxford University Press, 2005), p.289-292.
[33] Archer, 'Directorial Liability in Insolvent Companies' PhD Thesis Lancaster University Law School (August 2017) para.4.17
[34] Keay, 'Wrongful Trading: Problems and Proposals' [2014] 65(10) NLQR 63
[35] Department of Skills and Enterprise, Transparency and Trust; enhancing the transparency of UK company ownership and increasing trust in UK business – Government Response (April 2014), para.260
[36] Konstantinov, Wrongful Trading: Comparative Approach (England and Wales, Russia and the USA) [2015] 2(1) BRICS LJ 100 at 116
[37] Taylor, 'Directors' Duties on Insolvency in New Zealand: An Empirical Study' [2018] 28(2) New Zealand Universities Law Review 172 at 187
[38] The New Zealand population was 4.886 million in 2018.
[39] Taylor, 'Directors' Duties on Insolvency in New Zealand: An Empirical Study' [2018] 28(2) New Zealand Universities Law Review 172 at 184
[40] Taylor, 'Directors' Duties on Insolvency in New Zealand: An Empirical Study' [2018] 28(2) New Zealand Universities Law Review 172 at 183

was invoked against seventy-five directors and had a forty-nine percent success rate.[41] It appears that in many cases a claim was taken under both section 135 and section 136,[42] hence the raw data makes the numbers appear far larger. That said, in comparison to the other jurisdictions more cases are being taken and a significant proportion of these are successful. However, though better than the UK and Ireland, the numbers are still not that encouraging when it is considered that a twenty-four year period is covered. Other commentators support this contention. Watson and Noonan note in 2005 that less than ten applications had been made under section 135.[43]

**(ii) The Possible Causes**

Based on the foregoing, it can be concluded that the reckless trading type provision in the UK and Ireland is under enforced. The New Zealand numbers are better, but not to a really significant degree. The first issue examined is the external factors which may be causing this lack of use. Unlike the UK, this issue has not been explored to any significant extent in Ireland.[44] There are a number of possibilities.

**(a) Absence of Reckless Trading Activity**

One possibility is that reckless trading type behaviour does not occur with much frequency. This was recently argued by Williams. He demonstrated that wrongful trading behaviour is rarely cited in successful disqualification cases.[45] This explanation certainly has the attraction of simplicity. The finding may, however, be caused by the narrow gauge of section 214; one is liable under the provision if there is no reasonable prospect of avoiding insolvency and every step was not taken to avoid loss to creditors. The disqualification condition: that the director is unfit to be involved in the management of a company[46] is much broader and encompasses a very wide range of behaviours. Looked at in this

[41] Taylor, 'Directors' Duties on Insolvency in New Zealand: An Empirical Study' [2018] 28(2) New Zealand Universities Law Review 172 at 186.
[42] Taylor, 'Directors' Duties on Insolvency in New Zealand: An Empirical Study' [2018] 28(2) New Zealand Universities Law Review 172 at 186
[43] Watson and Noonan, 'The Corporate Shield: What Happens to Directors When Companies Fail?' [Autumn 2005] Business Review 27 at 34
[44] The issue is explored by Irene Lynch Fannon. Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7
[45] Williams, 'Civil Recovery from Delinquent Directors' [2015] 15(2) Journal of Corporate Law Studies 311 at 331-332.
[46] S.842(d) Companies Act, 2014.

light, it may not be surprising that wrongful trading does not figure widely in the reported disqualification cases.

The analysis is difficult to support from an Irish perspective. The examination of the restriction and disqualification order regime in Chapter Five bears this out. Many Irish restriction order cases display typical reckless trading type behaviour. [47] That reckless trading type behaviour is not infrequent is also borne out by an examination of the ODCE Reports. Specifically, in 2017 fifteen percent of complaints made related to reckless trading. In the previous year, the figure was eleven percent. [48] Similar percentages are cited for 2018, 2019 and 2020 (fourteen percent, fifteen percent and sixteen percent respectively).[49] For the four-year period cited, one hundred and sixty allegations were made. Even accounting for the fact that some allegations must be groundless, reckless trading type behaviour is not infrequent in Ireland.

Further, other academics take a different view to Williams. Goode considers that in UK disqualification order cases, there is now less emphasis being placed on commercial morality. More consideration is being given to whether creditors' monies have been placed at risk through reckless, incompetent or negligent behaviour.[50] In effect, Goode's conclusion is the converse of Williams'; the UK disqualification order regime does display evidence of reckless trading behaviour in the wide sense of the concept. That Goode is correct is also borne out by creditors' support for the new Company Directors' Disqualification Act, 1986 compensation order regime.[51] Had creditors only infrequently incurred director induced losses this support would have been negligible.

[47] See Re Tailored Homes (Navan) Ltd. [2017] IEHC 76, Esmonde v Van Dessel [2014] IEHC 278 and Re SPH Ltd [2005] IEHC 152. This point is discussed in Chapter 6.
[48] ODCE Annual Report 2017 (Dublin 2018), p. 28. These figures include fraudulent trading as do figures for the later years.
[49] ODCE Annual Report 2019 (Dublin 2020), p.28. ODCE Annual Report 2020 (Dublin 2021), p.26
[50] Van Zwieten, Goode on Principles of Corporate Insolvency Law, 5th Edition (London: Thomson Reuters 2018), para.14-76
[51] Department of Business, Innovation and Skills, Transparency and Trust. Enhancing the Transparency of Company Ownership and Increasing Trust in Business. Government Response (April 2014), para.267

**(b) Funding Pressures**

A further possibility is that expensive legal fees or lack of company resources to engage in litigation either separately or in combination mean that section 610 applications are not pursued.[52] Irish liquidators are cost conscious and, especially where the directors do not have significant personal funds, would regard a reckless trading application as throwing good money after bad.[53] These are valid concerns; a liquidator would be unwilling to pursue a speculative application especially as he or she may be risking the company's remaining assets to fund perilous litigation to the real detriment of creditors. This is consistent with law and economic theorists' reasoning that in many situations enforcement is not advantageous; it will not maximise corporate wealth as the costs will exceed any possible benefit.[54]

Sanfey notes that sometimes the liquidator can persuade a major creditor such as the Revenue Commissioners (and, indeed, this may have occurred in the Re. PSK Construction Ltd. case) to fund the litigation or have all creditors contribute proportionately to a 'fighting fund.' The author observes, however, that in the majority of cases the liquidator's efforts in this regard are futile. Worryingly, he concludes that directors have a vested interest in leaving the company with as few assets as possible so that little will therefore remain to fund expensive litigation.[55]

Irish legal costs are generally regarded as high.[56] As the Review of the Administration of Civil Justice Report states *"International comparisons and*

[52] For a detailed discussion see Keay, 'Wrongful Trading: Problems and Proposals' [2014] 65(10) N.I.L.Q. 63 at 69–72 and Campbell, Wrongful Trading and Company Rescue, [1994] 25(1), Cambrian Law Review 69 at 77-80.
[53] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7
at 9
[54] Cheffins, 'Law, Economics and Morality: Contracting Out of Corporate Fiduciary Duties' [1991] 19 Canadian Business Law Journal 28 at 31.
[55] Sanfey 'Personal Liability of Directors Under Section 204 of the Companies Act, 1990' [1997] The Bar Review 50 at 51
[56] See for example the comments of former President of the High Court Judge Peter Kelly in 'Legal Costs to Face Cap under Justice Review' Irish Independent (16 February 2018) and 'Fear of Financial Ruin Deters Recourse to Courts – Kelly' Law Society Gazette (7 December 2020). See generally Review of the Administration of Civil Justice Report, Ch.9 (Dublin: October 2020)

*opinion expressed by persons or bodies involved in or concerned with civil litigation on a regular basis in this jurisdiction indicate that Ireland is a very high cost litigation jurisdiction, especially by European standards."*[57] Further, the CLRG notes that small companies often lack the funds to even appoint a liquidator. It is therefore hardly surprising that directors are not pursued.[58] The issue is also emphasised by the LRC which notes that high costs can be a bar to actions and that a major consideration for creditors and liquidators will be the costs of pursuing a claim.[59] Lynch Fannon notes that resource issues are often a reason why such section 610 actions are not initiated.[60] Finally, Steele and Ramsay mention that creditors' relative lack of success when they instigate insolvent trading cases arises in part from the financial constraints they are under.[61]

In the UK, the cost of taking a section 214 action does seem to be a particular factor.[62] In the recent Company Directors' Disqualification Act, 1986 compensation order case, Re. Noble Vintners Ltd.,[63] the judge noted that the liquidator simply did not have the funds to pursue the errant director.[64] Funding was an especially intransigent problem in the past when the liquidator could have to bear part of the costs of an unsuccessful action.[65] Though this type of litigation cost now forms part of the costs of the insolvency under Section 176ZA Insolvency Act, 1986, the time and expense of wrongful trading proceedings may discourage liquidators. Specifically, Re Continental Assurance Co. of London plc. involved a hearing lasting seventy-two days[66] and one non-

[57] Review Group Report, Review of the Administration of Civil Justice Report (Dublin: October 2020), para.9.1.2
[58] CLRG, Report on the Protection of Employees and Unsecured Creditors (Dublin June 2017), para.4.4
[59] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para.12.89
[60] Lynch Fannon, Reckless Trading: Good and Bad Risk-Taking in Irish Companies [2017] Commercial Law Practitioner, 24(1) 7 at 9.
[61] Steele and Ramsay, 'Insolvent Trading in Australia. A Study of Court Judgments from 2004 to 2017' [2019] 27 Insolvency Law Journal 156 at 18*8.*
[62] Arsalidou, 'The Impact of Section 214(4) of the Insolvency Act 1986 on Directors' Duties' [2001] 22(1) Company Lawyer 19 at 20-21.
[63] [2019] EWHC 2806.
[64] [2019] EWHC 2806 para.65
[65] Re MC Bacon (No2) [1990] BCLC 607
[66] [2007] 2 BCLC 287 at para.90 and 20.

executive director was cross-examined for four days. In effect, there may simply be a lack of resources to pursue such actions.

Similar problems exist in Australia. Steele and Ramsay have analysed the issue.[67] They note, in considering the role of litigation funders, that the low level of compensation in some cases may mean that due to cost and time factors initiating proceedings is simply not worthwhile. ASIC[68] also considers cost issues to be a factor. It notes that in deciding whether to mount actions for breaches of the civil insolvent trading provisions, the availability of assets to fund such a step is a key consideration.[69] Coburn agrees; liquidators will only institute proceedings for insolvent trading where there are sufficient funds to do so.[70] The issue has also arisen in Australian case law. Steele and Ramsay cite Re Origin Internet Solutions Pty Ltd. In that case, the liquidator discovered several causes of action against the remaining sole director which the company could pursue. However, as Finkelstein J. notes the liquidator did not take any action because *"he had no funds to cover his costs and any costs which might be ordered against him"* This was despite the fact that the insolvent trading claim could have yielded up to AUS$300,000. Although requested to do so by the liquidator, none of the creditors agreed to help fund the claims.[71] The same pattern appears in other case law.[72] In Hall v Poolman, the liquidator's costs in taking the proceedings exceeded AUS$2,000,000, the case ran for seventeen days, there were twenty-five volumes of exhibits and hundreds of pages of submissions all written to a very high standard. The judge stated that he was gravely concerned at the extent and the cost of the litigation.[73]

[67] Steele and Ramsay, 'Insolvent Trading in Australia. A Study of Court Judgments from 2004 to 2017' [2019] 27 Insolvency Law Journal 156 at 182-*183*
[68] For information on the role and origins of ASIC, see Chapter Nine.
[69] ASIC, Insolvency statistics: External administrators' reports (July 2015 to June 2016) (December 2016), p.15.
[70] Coburn, 'Insolvent Trading in Australia: The Legal Principles' in Ramsay Ed. 'Company Directors' Liability for Insolvent Trading' (North Ryde, NSW, CCH Australia Ltd., 2000), p.117
[71] [2004] 51 ACSR 163 paras.2-4.
[72] Steele and Ramsay, 'Insolvent Trading in Australia. A Study of Court Judgments from 2004 to 2017' [2019] 27 Insolvency Law Journal 156 at 182-18*3.*
[73] [2007] NSWSC 1330 para. 381.

Taylor notes that similar considerations exist in New Zealand. Liquidators may choose not to bring enforcement proceedings because the company has insufficient assets to fund same. A creditor can also pursue an action individually. The vast majority do not do either as the costs outweigh the potential benefits.[74] Liquidators can also be criticised for pursuing chancy cases. As Harrison J. stated in Grant v Johnston[75] *"The economic benefits of pursuing such claims are questionable — it must have been apparent to the liquidators, on a sober assessment of the case ... ... that the maximum amount of Mr Johnston's potential liability was very modest indeed. As a result, both parties have incurred costs which must exceed any potential benefits from this litigation."*

Thus, if the company does not have sufficient funds, the liquidator cannot take on an otherwise strong case. In Ireland, a creditor can mount a personal claim for a loss incurred directly by him or her due to directors' actions. However, many small creditors will be unwilling to take such a step as the risk of incurring large legal fees will outweigh the benefit of (possibly) recouping that which has been lost. Seen in this light, non-enforcement in this area is part of a continuum which bedevils Irish company law particularly in the area of directors' duties; private enforcement is infrequent and difficult[76] and costs are undoubtedly a major factor here. As Gustaffson notes the director disqualification regime in the UK is an undoubted success because it *"……is not weighed down by the exigencies of private actions*."[77]

**(c) Impecunious Directors**

A further consideration is that even where funding costs are not an issue, a reckless trading application may be pointless because the director is not worth pursuing due to an insufficiency of personal assets. While Keay considers that

[74] Taylor, 'Directors' Duties on Insolvency in New Zealand: An Empirical Study' [2018] 28(2) New Zealand Universities Law Review 172 at 179-180
[75] [2016] NZCA 157 at para. 97
[76] See for example Ahern, 'Directors' Duties: Broadening the Focus Beyond Content to Examine the Accountability Spectrum' [2011] 33(1) DULJ 116
[77] Gustaffson, 'Beating a Dead Horse: An Assessment of Wrongful Trading' [2017] 38(8) Company Law 239 at 247. One such exigency must be cost considerations.

the fault lies primarily in the drafting of the legislation,[78] other commentators support this view.[79] As Cheffins states *'Since the financial status of the individuals who run companies is usually closely tied to the fortunes of the business, directors of failed companies often do not have substantial personal assets.'*[80] Owner-managers will when financial peril strikes often inject personal assets into the company in an attempt to save it.[81] This is a particular weakness of the provision. The impecunious but reckless director will face no monetary sanction.

It is also important to note the prevalence of personal guarantees which again will diminish personal assets.[82] As the LRC notes directors are likely to be personally bankrupt particularly where they have given personal guarantees for the company's debts.[83] Indeed, Williams cites a 1994 study to the effect that over half the owners or directors of small companies surveyed had given personal guarantees. Directors also provide loans to their companies thus further diminishing their personal assets.[84] Even in situations where the director is not bankrupt, if the indebtedness of the company significantly exceeds the director's wealth the imposition of liability will not improve the creditors' situation.[85]

[78] Keay, 'Wrongful Trading: Problems and Proposals' [2014] 65(10) NLQR 63

[79] For example, Williams What We Can Expect to Gain From Reforming the Insolvent Trading Remedy 78 [2015] MLR 55 at 78, Hicks, 'Wrongful Trading, Has It Been a Failure?' [1993] 8(5) Insolvency Law and Practice 134 and Archer, Directorial Liability in Insolvent Companies' PhD Thesis Lancaster University Law School (August 2017), para.3.59. Nearly 12% of disqualified directors were bankrupt at the time of their disqualification.

[80] Cheffins, Company Law, Theory, Structure and Operation, (Oxford: Oxford University Press, 1997), p.544.

[81] Archer, Directorial Liability in Insolvent Companies' PhD Thesis Lancaster University Law School (August 2017), para.4.18

[82] Archer, Directorial Liability in Insolvent Companies' PhD Thesis Lancaster University Law School (August 2017), para.4.18 and Sanfey 'Personal Liability of Directors Under Section 204 of the Companies Act, 1990' [1997] The Bar Review 50 at 50.

[83] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para.12.90

[84] Williams, 'Civil Recovery from Delinquent Directors' [2015] 15(2) Journal of Corporate Law Studies 311 at 323

[85] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para. 12.90

Williams carried out an important survey investigating the solvency levels of disqualified directors.[86] His results are illuminating. Twenty-two percent of disqualified directors were declared bankrupt. The majority were declared bankrupt before their disqualification. The remainder was disqualified shortly thereafter. This result appears encouraging enough; only one in five directors were personally insolvent at or about the time a disqualification application would be made. However, that is not a complete picture. There are other personal insolvency arrangements the information on which is not publicly available. Williams, however, makes the reasonable assumption that the number of alternative insolvency arrangements entered into by directors at least equals the number of bankruptcies.[87] This indicates that, from an asset perspective alone, up to half of the directors of insolvent companies are not worth pursuing. Evidence of impecunious directors also arises in UK case law. In Paton v Ricky Martin (Racing) Ltd.,[88] two of the three directors were entitled to free legal aid, thus indicating that their assets could not be significant. In Re. Bright Future Software Ltd., the non-executive director was pursued because the executive director had no substantial assets and had been declared bankrupt.[89]

This analysis may also be bourn out by the Appleyard case. By the time the High Court judgment was delivered in that case, the application against two of the four respondents had been withdrawn.[90] No explanation is given but lack of personal funds may be the reason. By the time judgment was given in the Court of Appeal, another of the respondents had been withdrawn. The reason this time is given; the director had entered into a personal insolvency arrangement.[91] Further facts demonstrating the perilous financial situations of the directors can be gleaned from the judgments; the directors had given personal guarantees to Ulster Bank[92] and the second respondent was the company's largest unsecured creditor being owned a sum significantly in excess of the amount outstanding to Toomey

[86] Williams, 'Civil Recovery from Delinquent Directors' [2015] 15(2) Journal of Corporate Law Studies 311
[87] Williams, 'Civil Recovery from Delinquent Directors' [2015] 15(2) Journal of Corporate Law Studies 311 at 324-331.
[88] [2016] SC AIR 57 Postscript
[89] [2020] EWHC 1674 para.3
[90] [2016] IECA 280 para.2
[91] [2016] IECA 280 para.2
[92] [2016] IECA 280 para.12

Leasing.[93] That defendant has foregone his quite considerable salary for a number of months.[94]

This can however be contrasted with Re. PSK Construction Ltd.[95] Finlay Geoghegan J. made the executive director personally liable for debts of €1,600,000. It is unlikely that an experienced liquidator would have taken the case unless the director was 'good' for this sum. That said, that the more typical scenario is very likely that of the Appleyard directors and that the director in PSK Construction Ltd. is probably an outlier. We can see a similar issue arising in the unreported Re. Eastland Warehousing Ltd.[96] One of the directors informed the Irish Times that he had represented himself due to lack of funds and that the liquidators would get no money on foot of the order made due to his straightened circumstances.[97] Likewise, in Re. Hefferon Kearns Ltd.[98] two of the directors personally borrowed IR£45,000 (a very significant sum at the time) in order to indirectly provide funds to one of the companies involved. This must have had an effect on their own solvency.

Similar indications exist in other jurisdictions. Steele and Ramsay note that in Australia liquidators may find it difficult to recover funds in a successful case because the directors themselves are in personal financial difficulties. Specifically, in Hall v Poolman, the main director and his wife were both undischarged bankrupts.[99] Likewise, in Buzzle Operations Pty Ltd (in liq) v Apple Computer Australia Pty Ltd.,[100] the defendant was pursued on the basis that it was a shadow director because all the directors of Buzzle bar one were bankrupt.

Comparable conclusions have been reached in New Zealand. Taylor in 2018 examined eighty directors who were found to have breached their duties to the

[93] [2016] IECA 280 para.26.
[94] [2015] IEHC 28 para.31
[95] [2009] IEHC 538.
[96] Unreported High Court May 2003.
[97] Keena, 'Former Directors of Firm in Liquidation Liable for Debts' Irish Times (2 May 2003)
[98] [1993] 3 IR 191 at 201
[99] [2007] NSWSC 1330 para.5
[100] [2010] NSWSC 233.

company. Three had been adjudged bankrupt prior to the hearing. A further twenty-two were adjudged bankrupt afterwards.[101] With regard to bankruptcy alone, this finding is very similar to Williams; one quarter of directors were not worth pursuing. Taylor also notes that while claims against directors of listed companies are not unknown, few reach trial.[102] The predominance of cases is therefore against directors of closely held companies. The fortunes of such directors are much more likely to be tied to the company. This means that personal financial difficulties are to be expected as the company enters insolvency.

**(iii) Concluding Comments**

As we have seen from the above it seems unlikely that reckless trading behaviour is infrequent. Reported cases from the restriction and disqualification order regimes and the ODCE Reports indicate otherwise. There must therefore be other explanations for the dearth of case law across all jurisdictions reviewed. Two common themes emerge in all four jurisdictions: costs of litigation and impecunious directors. The evidence indicates that these two factors either in combination or separately are major contributors to the paucity of case law. Irish liquidators are cost conscious and the real possibility of incurring significant legal fees means they often regard a reckless trading application as throwing good money after bad.[103] These cost pressures are apparent in the other jurisdictions under review also. The financial status of directors is often closely tied the fortunes of their company. If that declines, their own wealth is severely impacted also. Personal guarantees are also prevalent often wiping out the personal wealth that did exist prior to the insolvency.[104] This factor poses a significant challenge as the truly impecunious director faces no sanction and both factors together may indicate the necessity for public enforcement in this area.

[101] Taylor, 'Directors' Duties on Insolvency in New Zealand: An Empirical Study' [2018] 28(2) New Zealand Universities Law Review 172 at 190.
[102] Taylor, 'Directors' Duties on Insolvency in New Zealand: An Empirical Study' [2018] 28(2) New Zealand Universities Law Review 172 at 189
[103] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7 at 9.
[104] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para.12.90

One of these two factors alone would curtail the invocation rate of the section; as both exist in combination, the curtailment is more severe. Moreover, while it is always possible that technology or government intervention will reduce legal fees "*The law …… cannot make assets where none exist."*[105] However, there is another ingredient as pointed out by Lynch Fannon.[106] The legislation may not be particularly well drafted. Importantly, this is an aspect which we can do something about.

## (III) A CRITICAL ANALYSIS OF SECTION 610

### (i) Introduction

Section 610 may have drafting weaknesses. These may stem in part from the difficult genesis of the section. From an analysis of the sparse case law and critical academic commentary, a number of themes emerge. Each will be discussed in turn. The section is set out in Appendix Two.

#### (a) Should "reckless trading" be defined?

The first issue is whether, as was originally suggested,[107] section 610(1) should contain a concrete definition of reckless trading. Put another way, does the phrase '*…carrying on any business of the company in a reckless manner …'* require further elaboration? Further, is the lack of clarity as to the ambit of reckless trading one of the reasons why so few cases have been taken?

What exactly is 'reckless trading' in the Irish context? Firstly, even the word 'trading' may be a misnomer. The section itself does not contain that word. Instead, it uses the phrase *'carrying on any business of the company'* arguably a lesser activity. That point aside, Lynch J in Hefferon Kearns has produced a description of what reckless trading under section 610(1) entails[108] *'…… the director is a party to carrying on the business in a manner which the director knows very well involves an obvious and serious risk of loss or damage to others, and yet ignores that risk, because he does not really care whether such others*

[105] Baird, 'A World Without Bankruptcy' [1982] 50 Law & Contemp. Probs 173 at 186
[106] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7
[107] Ussher, Company Law in Ireland, (Dublin: Sweet & Maxwell, 1986), pgs. 530-532. Ussher's arguments concerned a definition of 'recklessness.'
[108] [1993] 3 IR 191 at 222

*suffer loss or damage or because his selfish desire the keep his own company alive overrides any concern which he ought to have had for others'.*

Effectively what Lynch J. is saying is that the director must know that there is an obvious and serious risk of loss but continues on that path either because he or she does not care what happens or the director's sole consideration is the company's survival. This is a satisfactory description. It is re-emphasised by Finlay Geoghegan J. in PSK Construction[109] and is similar to HM Treasury's recent delineation of reckless behaviour in the banking industry; *"either disregarding a risk or acting unreasonably in taking on a risk."*[110] The description is confined to business principles. It concentrates on what the careful director would do to safeguard creditors when the company is approaching insolvency.

Aside from the Lynch description, what else do we know as to the parameters of reckless trading? We know that filing false tax returns for a company in severe financial difficulties constitutes reckless trading. In PSK Construction Ltd., Mr. Killeen had made a deliberate decision to prepare and file false tax returns for a considerable period of time. Finlay Geoghegan J. was satisfied that these actions constituted a serious risk of loss or damage to the Revenue.[111] In view of the perilous nature of the company's finances the judge could not have concluded otherwise. Put another way, if filing false tax returns for a company facing practically insurmountable financial difficulties is not reckless trading, then what is?[112] Beyond that point, little of concrete assistance can be gleaned. Re. Kelly Trucks Ltd.[113] is of scant assistance. A deliberate scheme to avoid paying two creditors must constitute reckless trading in so far as those particular creditors at least are concerned.

In considering this issue further, it is helpful to keep in mind Lynch Fannon's contention that the term 'reckless' should not have been used in the legislation at

[109] [2009] IEHC 538 paras.29-30.
[110] HM Treasury, Sanctions for the Directors of Failed Banks (July 2012), para.4.10
[111] [2009] IEHC 538 para.30
[112]As Lynch Fannon states *'This is a fairly straightforward conclusion'.* Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7 at 11
[113] [2019] IEHC 6

all. A more neutral term should perhaps have been used as it risks a confusing cross-fertilisation from other areas of law. [114] This has already happened; Lynch J. references the R. v Caldwell objective test of recklessness which was subsequently overruled.[115] As the LRC points out, the current definition of recklessness in Irish criminal law is quite different from Lynch J.'s iteration.[116] In any event, criminal tests of recklessness have little place in a civil setting concerning the correct assessment of risk in the commercial arena. It should also be noted that the later cases have resiled from Lynch J.'s approach. These do not emphasise criminal law. Thus, a second key point is evident. In determining what constitutes reckless trading behaviour, commercial considerations only should be used. Precepts imported from other legal areas are unhelpful.

Irish case law, aside from Lynch J.'s useful description, has cast little light on what the concept of reckless trading actually means and the issue of whether we need a detailed definition has not been addressed therein. We must therefore consider whether academic commentary provides the answer. O'Hanlon argues against a legislative definition of reckless trading on two grounds. Firstly, that whether or not a director has engaged in reckless trading is a question of fact and secondly cataloging the types of actions which constitute reckless trading risks compromising the provision entirely.[117] While Lynch Fannon points out correctly that there will be common instances of reckless activities,[118] overall there will be many different types of situations within the possible ambit. The lack of a definition is not for this reason a flaw within the section. It is simply a reflection of reality. The actions which may constitute reckless trading by their very nature take many forms. A comprehensive definition may be an impossibility. Not all commentators agree, however. Ussher has argued strenuously for a definition of

[114] However, as Lynch Fannon further points out the term has been so long used at this stage, the time may well have passed for its removal. Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7 at 12
[115] R v G. [2003] UKHL 50.
[116] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para12.10
[117] See also O'Hanlon, The Corporate Form and Reckless Trading: A Modern Pandora and Epimethus [2006] 28 DULG 254 at 290
[118] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7 at 12

recklessness.[119] He is supported in this regard by Kettle who argues that the legislature's failure to categorise and define reckless trading would ultimately frustrate the purpose of the section.[120]

The purpose of the reckless trading provision is arguably two-fold. Firstly, once the company nears insolvency, the provisions endeavour to realign the legally imposed duties of its directors. Shareholders are no longer the residuary claimants, creditors are. The second purpose is to incentivise those directors to act in the interests of creditors at the appropriate point in time.[121] The correct question may therefore be whether the section fulfils these aims. It may not be necessary for the provision to contain a detailed definition of reckless trading to do so. This is also in keeping with Easterbrook and Fischel's thesis that the legal system's reliance on case law is an economising device. (While the point is made in the context of private bargaining and not legislation that the same logic applies).[122] In effect court systems can apply solutions to problems that had not been considered at the time the legislation was drafted. Thus, rather than drafting a legislative provision setting out in great detail what constitutes reckless trading behaviour, and perhaps later finding that some actions are outside the scope of the definition, a general formulation is preferred. The courts can then develop the jurisprudence, as Lynch J. has done, as issues arise. Thus, once cross-fertilisations are avoided, the current phraseology in subsection (1)(a) is satisfactory.

**(b) The Deeming Provisions**

In the previous section, the argument was put forward that an undefined concept of 'reckless trading' is not, by itself, problematic. However, subsection (1)(a) does not stand alone. Two further iterations of reckless trading exist in subsections (3)(a) and (3)(b). The issue which arises is how this dual concept of reckless trading actually works.

[119] Ussher, Company Law in Ireland, (Dublin: Sweet & Maxwell, 1986), pgs.530-533.
[120] Kettle 'Improper Trading in Ireland and Britain' [1994] 12(4) ILT 91 at 93
[121] Mokal, Corporate Insolvency Law (Oxford: Oxford University Press, 2005), p.280.
[122] Easterbrook and Fischel, The Economic Structure of Corporate Law (Harvard: Harvard University Press 1991), p.35

Subsection 3(a) imposes personal liability when, having regard to the skill and knowledge a person in the director's position ought to have, the director ought to have realised that loss would be caused to creditors by his or her actions. The following subsection imposes personal liability where company incurs a debt without an honest and reasonable belief on the part of the director that the debt will be repaid. Case law has been clear that these are deeming provisions. Lynch J. concluded that subsection (3) is a deeming provision.[123] Finlay Geoghegan J. in Re. PSK Construction Ltd. provides a similar analysis.[124]

Moreover, these subsections are separate from section 610(1). This is apparent from Lynch J.'s analysis in Hefferon Kearns Ltd. wherein he states *"I now turn to s. 33, sub-section 2. Sub-section 2 does not affect or extend the meaning of sub-s. 1(a) but it extends the application of sub-s. 1(a) even though the director was not guilty of reckless trading within the meaning of sub-s. 1(a) itself, as interpreted by me above. Sub-section 2 deems a director to be guilty of reckless trading in the circumstances set out in paras. (a) and (b), and that presupposes that otherwise he would not be so guilty."*[125] Thus, a director who would not be involved reckless trading under subsection (1) may well be so involved under subsection (3) because of this extended application.

Hogan J.'s reiterates these points in Appleyard. He states that in relation to what is now section 610(3)(a)[126] *"It would be more accurate to say that the sub-section is concerned with a specified category of corporate conduct which is deemed to amount to reckless trading for the purpose of ascribing personal liability on the part of the corporate officers, even if such conduct would not otherwise come within the terms of s. 297A(1)'.* He goes on to state[127] *"The former category is concerned with what is in fact reckless trading, whereas the latter category is concerned with specified conduct which might not otherwise be regarded as*

[123] [1993] 3 IR 191 at 223
[124] Re. PSK Construction Ltd. [2009] IEHC 538 para.28
[125] [1993] 3 IR 191 at 222-223
[126] [2016] IECA 280 para.38
[127] [2016] IECA 280 para 39. It should also be noted that in considering whether to grant leave to appeal to the Supreme Court (this was refused) the Court stated that Hogan J.'s interpretation of section 610 was *'…a standard and thorough application of the principles of statutory construction…'*. Toomey Leasing Group Ltd. v Sedgwick & Others [2017] IESCDET 2 para.14.

*reckless trading at all, but is deemed to be such by the statute for the purposes of imposing personal liability: … …"*

The result of the above interpretation is that instead of simply having a concept of reckless trading, there are in effect two. The first, within subsection (1)(a) is actual reckless trading. The second category need not include 'recklessness' at all. It comprises of types of behaviour which can be deemed to constitute reckless trading. Put another way, per the case law, there is 'real' reckless trading within section 610(1)(a) and two more indeterminate types of conduct which are deemed to constitute reckless trading for the purposes of imposing personal liability.[128] Both categories must be considered separately. In this regard Hogan J. states quite clearly that case law on the first category is of limited assistance where the second category is under consideration.[129]

However, a strong argument can be made that the above interpretation is incorrect.[130] The two instances described in subsection (3) are simply examples of activities which may constitute reckless trading behaviour within subsection (1)(a). They are not neutral activities which are deemed to constitute reckless trading. This is supported by the Oireachtas debates when the reckless trading provision was initially drafted. At the time the provisions which are now contained in subsection (3) were added to the original clause,[131] there is no mention of deeming or statutory fictions in the debates. Specifically, Terry Leyden TD, stated during the Special Committee Debates on the Companies (No.2) Bill, 1987[132] *"The Committee will recall that section 279A was inserted in the Principal Act by section 116 of this Bill. Section 297A (1) (a) provides for the possibility that a director may be made personally liable for the debts of a company if he was knowingly a party to the carrying on of any business of the company in a reckless manner. Two <u>examples</u> of trading in a reckless manner are given in section 279A(2). One is the <u>example</u> quoted by the Deputies in their amendment, in other*

[128] [2016] IECA 280 paras.37-38
[129] [2016] IECA 280 para.39
[130] Breen, 'Fictions or Guidelines? The Deeming Provisions in Section 610 of the Companies Act 2014' [2019] 26(9) CPL 168.
[131] As clause section 107 Companies (No.2) Bill 1987
[132] Dail Eireann Companies (No. 2) Bill 1987 Special Committee Col 955 (24 May 1990)

*words paragraph (b), which cites the case of a person who was a party to the contracting of a debt by the company and did not honestly believe on reasonable grounds that the company would be able to pay the debt when it fell due for payment."* [Emphasis added][133] Thus it would appear that it was the intention of the Legislature to provide examples of behaviours which may constitute reckless trading and not to impose statutory fictions.

The original New Zealand provision also supports this view. Subsection (1) thereof is strikingly similar to the Irish reckless trading provision. In fact, subsection (1)(a) is linguistically the same as section 610(3)(b). It appears that the New Zealand provision may have been used a template.[134] However, there is one striking difference section 32 (1)(a) does not contain a statutory fiction. It contains a description of a type of activity which can constitute reckless trading.

There are other indicia that subsection (3) contains examples of reckless trading behaviour and not statutory fictions. For example, no fictional scenario is imposed. This is the hallmark of a deeming provision.[135] As Murphy J. stated in O'Connell v Keleghan[136] *'... legislation may and does from time to time deem acts or events to be what they are not ....'* The fiction must be imposed for a specific purpose.[137] It is however submitted that it is extremely difficult to determine the purpose of the fictions contained in section 610(3). This is because the scenarios imposed are in the majority of instances of reckless trading in any event. Moreover, that subsection (3) does not contain fictions is also supported by the deliberations of the Cork Committee.[138]

As will be argued below, the section more is coherent and comprehensible without the inclusion of the deeming provisions. Furthermore, absent a deeming element,

[133] Dessie O'Malley TD Minister for Industry and Commerce expressed similar sentiments. Dail Eireann Companies (No. 2) Bill 1987 Special Committee Col 653 (6 March 1990)
[134] An awareness of the New Zealand provision is very evident from the Oireachtas debates. See also Breen, 'Fictions or Guidelines? The Deeming Provisions in Section 610 of the Companies Act 2014' [2019] 26(9) CPL 168 at 173-174.
[135] Jenks v Dickinson [1997] STC 853 at 878
[136] [2001] 2 IR 490 at 501
[137] Murphy v Ingram [1974] Ch 363 at 370
[138] Breen, 'Fictions or Guidelines? The Deeming Provisions in Section 610 of the Companies Act 2014' [2019] 26(9) CPL 168 at 174.

a more sensible statutory scheme now exists in which section 610(1)(a) describes reckless trading as knowingly carrying on any business of the company in a reckless manner and subsection (3), without limiting the application of the first subsection, simply contains two examples of the types of activity which can constitute reckless trading. This reading in accordance with Lynch Fannon's suggested revision of the section.[139] Thus, for clarity purposes, it would be beneficial to amend the section so as to remove the phrase 'shall be deemed.'

The use of that phrase appears to have caused the judiciary to conclude that where the actions of the directors are within the ambit of subsection (3), a finding of reckless trading must inevitably follow.[140] This has led to the use of escape routes which both narrowed and complicated the application of the section; in Hefferon Kearns via the defence in subsection (8) and in Appleyard Motors by a restricted reading of subsection (3)(a).[141] The more straightforward scheme of interpretation set out above would have avoided these consequences and allowed for a more flexible dynamic under which the court could decide whether or not the director came within the ambit of subsection (3) based on normal judicial decision-making. Ultimately, Hogan J.'s comments in the Appleyard Motors case that this configuration has an artificiality which could be misleading must be endorsed.[142]

A final difficulty exists with regard to subsection (3)(b); it may make it impossible for a company to continue to trade while insolvent. [143] Continuing to incur debts while the company is insolvent can actually be a sensible course of action and beneficial to creditors in certain situations.[144] Moreover, this can be contrasted with the UK and New Zealand positions where insolvent trading can occur. However, as subsection (3)(b) is a deeming provision, there is no direct escape for

[139] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) C.L.P. 7 at 10-11.
[140] Re Hefferon Kearns Ltd. (No. 2) [1993] 3 IR 191 at 222-223 and Re. Appleyard Motors Ltd. [2016] IECA 280 paras.37-39
[141] These points are discussed below.
[142] [2016] IECA 280 at para. 38. See also Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7.
[143] Breen, 'Re Appleyard Motors Ltd; Toomey Leasing Group Ltd v Sedgwick: Another Nail in the Coffin for Reckless Trading?' [2018] 25(9) CPL 204 at 209. This is discussed in more detail below.
[144] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para.12.32

the sensible and responsible director. Incurring a debt, for good commercial reasons, constitutes reckless trading if the director does not believe it can be repaid when it falls due (that the director reasonably and honestly believes that it will be paid in full sometime after the due date is irrelevant). Likewise, subsection (3)(a) can catch one incorrect decision in a series of correct ones.[145]

Viewing subsection (3) as containing examples of reckless trading behaviour makes sense. The courts have the discretion to examine the merits of the director's conduct. For example, where a company trades beyond the point of obvious insolvency, that event must constitute reckless trading based on the current interpretation of subsection (3)(b).[146] On the other hand, if the subsection contains an example of the type of behaviour which can constitute reckless trading, the judge can come to his or her decision based on an objective analysis of whether the continued trading was warranted or not.[147]

**(c) Is the Bar Too High?**

The discussion in the preceding paragraphs leads us on to the next question; is the bar for reckless trading set too low or too high? Is it too difficult for an applicant to prove that a director has been involved in reckless trading thus discouraging liquidators and creditors from taking cases?

Overall, the section is weighted in favour of the director. This arises from the particularly strict construction applied to subsection (3)(a) and is evident from the Appleyard Motors case. Hogan J. focused on the use of the word *'would'* within subsection (2). He held that it was not sufficient that the director ought to have known that that his actions might or could cause a loss. The bar was far higher. The judge concluded[148] *"This suggests that the loss to the creditor must have been foreseeable to a high degree of certainty. On any review of the evidence there is little doubt but that, viewed objectively, a director in the position of Mr. Sedgwick must have known that there was a real risk that creditors might not be paid. The*

[145] As may have been the case in Re. Appleyard Motors Ltd. [2016] IECA 280
[146] As occurred in Re. Hefferon Kearns Ltd. [1993] 1 IR 191
[147] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), paras.12.33-12.34.
[148] [2016] IECA 280 paras.41-42

*company was, after all, in a perilous financial situation and every week involved a struggle to survive. That, however, is not the question which we are required to consider. The issue is rather whether, viewed objectively, a person in the position of Mr. Sedgwick ought to have known that his conduct (or that of Appleyard) would cause loss to this particular creditor."* [Emphasis added]

This has set the bar to a very lofty level indeed. As Hogan J. states, due to the use of the word *'would', '... the loss to the creditor must have been foreseeable to a high degree of certainty.'*[149] While the loss need not be a foregone conclusion, its realisation must be highly likely. This is a stringent requirement. It is not sufficient that the director ought to be aware in a general sense that the company may not be in a position to pay its creditors. The question instead is whether regarding the particular creditor, the director ought to have been aware that there would be a loss to that creditor.[150] In a large company this requires almost a micro analysis of the debt position in order to determine which, if any, creditor would not be repaid. Thus, the standard is particularly stringent and considerably constricts the operation of the subsection.

Re. PSK Construction Ltd. can also be interpreted as extending a high bar to the deeming provisions. Mr. Killeen liability under subsection (3)(a) was dismissed rapidly. As he had been found to have had been involved in reckless trading under subsection (1), the deeming provision was irrelevant.[151] The decision, however, that Ms. Higgins was not involved in reckless trading under subsection (3)(a) is more contentious. In arriving at this conclusion, Finlay Geoghegan J. appears to have been influenced by the fact that Ms. Higgins, while aware of Mr. Killeen's tax evasion, had no executive or managerial role in the company and acted at all times under the direction of Mr. Killeen.

[149] [2016] IECA 280 para. 52.
[150] As Hogan J. states *"What, then, is the evidence that from which it may be inferred that a responsible director ought to have known that his conduct (or that of the company) would have caused this particular loss in these circumstances?"* [2016] IECA 280 para. 43
[151] [2009] IEHC 538 para.28

With respect to the learned judge, this is a rather lenient decision (and is at odds with the decisions in Re. Hunting Lodges Ltd.[152] and Brian D. Pierson (Contractors) Ltd.[153]) and is another example of the high bar facing an applicant. Ms. Higgins had more than a modicum of business experience. She priced materials and stock for the company. She looked after office administration and related paperwork. She was a signatory on the bank account.[154] Anyone with a reasonable familiarity with the business world and a reasonable level of intelligence would be fully aware of the potentially serious consequences of filing incorrect tax returns for a significant length of time when the company was in very serious financial difficulties. It is perhaps unfortunate that Finlay Geoghegan J. did not expand on this analysis and set out how one determined what level of knowledge could be expected of a person in Ms. Higgin's role. This aspect of the judgement sets a high bar for an applicant to overcome.

**(d) Objective or Subjective?**

The next question is whether the section contains an objective or a subjective standard. There is a dual approach within the section which was noticed at an early stage.[155] The issue will be analysed in two stages. Firstly, there will be an examination of whether the categories of reckless trading carry objective or subjective tests. Secondly, the subjective defence will be analysed as will its interaction with the reckless trading categories.

Section 610(1)(a) contains a subjective test for reckless trading. This is based on the wording of the sub-section which states that an officer must be "*knowingly a party to the carrying on of any business of the company in a reckless manner*."[156] That said, this is not entirely clear from the wording.[157] The issue was first examined in Hefferon Kearns. After considering the objective test of 'recklessness' in R. v Caldwell,[158] Lynch J. held that, due to the use of the word

[152] [1985] ILRM 75
[153] [1999] BCC 26
[154] [2009] IEHC 538 para.19
[155] Flynn, 'Reckless Trading' [1991] 9(8) ILT 186 at 187. This issue was also noticed in Oireachtas debates – see Chapter Two.
[156]Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para.12.67
[157] 120(b) Seanad Deb. Cols.2437-2438 (12 July 1988).
[158] [1982] 1 AC 341

'knowingly,' the test must be a subjective one.[159] Courtney concludes that the judge's interpretation is, that while the subsection initially appears to carry an objective test, that test must be '*tempered with subjectivity'*.[160] Lynch Fannon[161] also considers the test to be subjective.

Subsection (3)(a) is clearly objective. This is demonstrated by the use of the phrase *'ought to have known'* in the subjection. Undoubtedly, what the person actually knew must be benchmarked against what the director ought objectively to have known.[162] But what of subsection (b)? Lynch Fannon[163] convincingly argues that this subsection carries an objective approach. This would appear to be correct due to the use of the words 'honestly' and 'on reasonable grounds' (both of which suggest an objective element). In effect, it is possible to conclude that subsection (3)(b) also contains an objective test overall. This approach is not coherent. Reckless trading within subsection (1) is subjective. The soi-disant fictions are objective. A unified approach would be preferable. This can be achieved by removing the word *'knowingly'* from subsection (1). This would, combined with a clarification that the fictions are in fact examples, result in a far more rational structure. The approach would be consistently objective.

A further and more difficult problem then arises; the two objective criteria must interact with the subjective defence within subsection (8). Subsection (8) is wholly subjective.[164] The issue examined is the whether the individual director acted in an honest and responsible manner. The first analysis of the defence was carried out by Lynch J. in Re. Hefferon Kearns Ltd. The judge concluded that the honestly and responsibly defence gave the judiciary wide powers to relieve directors from personal liability and in the circumstances, he was relieving the first three

[159] [1993] 3 IR 191 at 221-222
[160] Courtney, Company Law 4th Edition (Dublin: Bloomsbury Professional, 2016), para.16.172
[161] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7
[162] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7 at 10.
[163] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7 at 10
[164] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7
at 10. Lynch Fannon and Cuddihy, Corporations and Partnerships, 2nd Edition (The Netherlands: Wolters Kluwer 2016), para.107.

defendants on this basis.[165] Lynch J. was influenced by what he called the draconian nature of subsection (3)(b), the wide discretion conferred by subsection (8) and the factual honest and responsible behaviour of the directors. Lynch J's approach was arguably correct from a pragmatic standpoint correct.

Lynch Fannon has a convincing perspective on the Hefferon Kearns case. She considers that while the result in the case was correct, this was despite the difficulties with the provision's drafting and its alternation between objective and subjective standards. She agrees that there was considerable evidence to demonstrate that the Hefferon Kearns directors were not reckless in the usual sense of the word. They consulted with creditors and injected their own funds into the company in an effort to keep it going.[166] Therein lies the difficulty. The correct result may have arisen in the Hefferon Kearns case, but the judgment did nothing to solve the confusion which objective criteria and a subjective defence has engendered. As Lynch Fannon states *'Either the standard is objective or it is not'*.[167] This insight is correct. The standard cannot be both simultaneously. An objective test of recklessness cannot be paired with a subjective defence. This problem makes the defence unworkable. As Lynch Fannon states *'the provision allows the court an extensive discretion to revert to a consideration of the subjectively honest behaviour, and the subjectively viewed responsible actions, of the particular director.* [168]

This contention is supported by the decision in Re. Produce Marketing Consortium Ltd. (No.1).[169] The case concerned the jurisdiction of the court under section 727(1) of the Companies Act, 1985 to relieve a director from wrongful trading. Section 727(1) grants the court the discretion to excuse an officer of a company otherwise liable for negligence, default or breach of duty, if that officer acted honestly and responsibly. Knox J. refused the directors' application. The judge

[165] [1993] 3 IR 191 at 225.
[166] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7 at 10
[167] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7 at 10.
[168] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7 at 10
[169] [1989] 3 All ER 1

held that Parliament could not have intended that section 727(1) apply to section 214. There were three indications why this was the case. All these related to the largely objective nature of section 214 and the subjective outlook of section 727(1). As Knox J. states[170] *'Now that is an objective test which is very difficult indeed to marry with the essentially subjective approach that section 727 requires'.* Even more important is the judge's comments in relation to the issue of the skill, knowledge and experience which might reasonably be expected of an individual in the directors' position. Here Knox J. states that it is virtually impossible to determine whether the director has acted honestly and responsibly and simultaneously apply a different test imputing to the director a particular level of knowledge, skill and experience which he may not have.[171]

In conclusion, it is pertinent to repeat Lynch Fannon's summation at this point; *'Either the standard is objective or it is not.'*[172] It is an impossibility to have simultaneously an objective standard in subsection (3) and a subjective standard in subsection (8) and, indeed, in subsection (1)(a), yet that is what section 610 contains. Further, while not all commentators consider that section 727 is inapplicable where section 214 is concerned,[173] the logic of Knox J.'s analysis in Re. Produce Marketing Consortium Ltd. is compelling.

**(e) The Honestly and Responsibly Defence**

While the Cork Committee originally suggested a defence similar to section 610(8),[174] it is problematic for other reasons also. The first issue lies with the wording of the subsection; it only applies to those directors who have *'...acted honestly and responsibly ...'.* The issue of whether the director acted honestly should be confined to the fraudulent trading element of the section alone. Lack of

[170] [1989] 3 All ER 1 at 6
[171] [1989] 3 All ER 1 at 6
[172] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7 at 10
[173] Keay considers that case law post Produce Marketing indicates that section 727 can be applied to relieve a director from liability under section 214 in certain circumstances. See Keay, Company Directors' Responsibilities to Creditors (London: Routledge, 2007), p.121-123.
[174] Insolvency Law and Practice – Report of the Review Committee [1982] Cmnd 8558 paras.1793-1796

honesty is a concept associated with fraud.[175] O'Hanlon comments on this issue. He concludes that *'…the logic of the provisions of subsection (6)*[176] *is fundamentally flawed'.* He argues that as reckless trading is not fraudulent trading, honesty has no place in the defence. O'Hanlon is undoubtedly correct here.

Importantly also, there is another logical conundrum within subsection (8). There is an inherent inconsistency in finding that a director who engaged in reckless trading acted responsibly. [177] The existence of the former must exclude the latter. If one has acted recklessly then one cannot have acted responsibly. Yet, apparently, to invoke the defence, that is the finding required. Specifically, in Hefferon Kearns, to avoid what he viewed as an injustice caused by the deeming nature of subsection (3), Lynch J. without considering this logical inconsistency, applied the defence. [178]

A further question which must be asked is what the scope of the actual defence is? Is the errant director absolved from a finding of reckless trading in its entirety or is the subsection more limited in nature? Based on the wording of the subsection, this is difficult to ascertain. That said, as subsection (8) makes no reference to a finding of reckless trading within either subsection (1)(a) or subsection (3) and concentrates on the reduction of personal liability, the only reasonable conclusion is that the defence only becomes available once a finding of reckless trading is made. Thus, it merely reduces, either partially or entirely, the level of personal liability as occurred in the Hefferon Kearns case.

There is a further drafting inconsistency within the subsection. It is expressly stated to only be available where a declaration has been sought *"…on the grounds set out in subsection (1)(a) …"* There is no mention in the subsection of subsection (3). In effect, on a plain reading of the subsection, if we accept the analysis from case law that there are in effect two separate categories of reckless trading within the

[175] Keay, 'Fraudulent Trading: The Intent to Defraud Element.' [2006] 35(2) Comm L World Rev 121 at 122-124.
[176] Now section 610(8)
[177] O'Hanlon, The Corporate Form and Reckless Trading: A Modern Pandora and Epimetheus [2006] 28 DULG 254 at 285.
[178] For a detailed analysis of the difficulties with S.610(8) see Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) C.L.P. 7 at 7.

section, the defence is available to the former but not the latter. While this is what a plain reading of the subsection indicates, such an interpretation does not make sense; why limit the application of the defence in this manner? Further, it is contrary to Lynch J.'s decision in Hefferon Kearns[179] to allow the defence to a finding of reckless trading under subsection (3)(b). Likewise, the applicant's supporting documents requesting leave to appeal to the Supreme Court in the Appleyard case,[180] the applicant made the point that considerable argument had been made in the Court of Appeal regarding the availability of the defence. The Appleyard case centred on reckless trading within subsection (3)(a). The reference to the first subsection alone makes complete sense if that provision contains the only category of reckless trading and the behaviours described in subsection (3) are merely examples of actions which can constitute reckless trading within subsection (1)(a). This is a further indication that subsection (3) contains examples of reckless trading behaviour and not statutory fictions.

In light of the above confusion, a final question which arises is whether a subsection (8) type provision is necessary at all. As we have seen from Chapter One, the intention underpinning the drafting of the subsection may have been to shield the director who had engaged in entrepreneurial risk-taking. That is certainly a sensible aim. However, the awkward drafting means that this purpose is not achieved. Further, if this was indeed the aim, arguably that can still be achieved without recourse to a specific defence. Keay may provide the answer here. He argues that even in the absence of section 727, the judge still has a general power under section 214 to set the directors' contribution at nil.[181] In the context of the Irish provision, the court has precisely the same discretion under subsection (2). Arguably, this means that subsection (8) as well as being confusing may be redundant and a director with an answer to either sins of commission or omission is protected. This is an important point. In the absence entirely of subsection (8), judicial discretion still exists and can be used, for example, to absolve the director whose entrepreneurially risky venture did not come to fruition or the otherwise exemplary director who makes an unwise decision under pressure of the

[179] [1993] 3 IR 191
[180] [2017] IESCDET 2
[181] Keay, Company Directors' Responsibilities to Creditors (London: Routledge 2007), p.123.

company's financial difficulties. It could also be applied to a director whose company is in grave financial difficulties but is prevented from taking any remedial steps due to illness or a sudden family bereavement, thus rendering him or her involved in reckless trading in the eyes of section 610.[182] It is also important to note that the New Zealand provision operates successfully with a very limited defence.[183]

In conclusion, the defence in section 610(8) is flawed. It is inherently illogical that a director involved in reckless trading would have acted responsibly. Issues of honestly or moral blameworthiness have no place in a reckless trading provision. Finally, judicial discretion to reduce to nil or otherwise diminish the quantum of the contribution exists elsewhere in the section thus strengthening the case for the redundancy of subsection (8).

**(f) The Position of Creditors**

Under section 610(1), a number of possible applicants exist; the liquidator, an examiner, receiver, creditor or contributory. The question which therefore arises is whether the wide range of applicants envisaged by section 610 is problematic or beneficial. Specifically, should creditors be excluded as potential applicants? The UK confines section 214 applications to liquidators and administrators. This, arguably, is to avoid a multiplicity of actions.[184] On the other hand, the New Zealand provision has the same wide range of potential applicants as the Irish provision.[185] It is also interesting to note that the Australian position is that the creditor must obtain the consent of the liquidator in order to pursue an application or obtain reasons from the liquidator as to why the application should not be brought.[186]

What then are the advantages of barring creditors from making a section 610 application? While it is axiomatic that unsecured creditors *'get a raw deal'*[187] and

[182] Keay, Company Directors' Responsibilities to Creditors (London: Routledge, 2007), p.123.
[183] S.138 Companies Act, 1993.
[184] Keay, Company Directors' Responsibilities to Creditors (London: Routledge, 2007), p.826
[185] S.135 Companies Act, 1993
[186] S.588R and S.588S Corporations Act, 2001.
[187] Goode, Proprietary Rights and Unsecured Creditors, in The Realm of Company Law Rider (Ed) (London and Boston: Kluwer Law International 1998), p.197.

thus should have the maximum assistance possible made available to them, the wide range of possible applicants allowed by the section may be problematic. While it is impossible (and indeed dangerous) to extrapolate on the basis of only four reported cases, the fact that the two unsuccessful cases were taken by creditors may perhaps be indicative. This is particularly the situation in Hefferon Kearns[188] where it is argued later that the creditor itself should have taken more care with regard to the company structure and the management of the debt.

Steele and Ramsay's study of Australian insolvent trading cases found a very similar result. Liquidators won 84% of cases they brought. Creditor instigated cases were not successful 58% of the time. This is a striking disparity in numbers. As the authors state *"This finding suggests that creditors instigate less meritorious cases."*[189] They suggested that the reason for this lack of success is that creditors are less swayed by the legal merits of the case.[190]

Retaining creditors in the range of possible applicants may be problematic as creditors who have lost money may act in a less objective manner than a liquidator who will weigh more carefully the chances of success against the costs involved. This inadequate objectivity may have been a factor in Appleyard Motors. Importantly, the costs of the application (including a request for leave to appeal to the Supreme Court)[191] would have significantly exceeded the financial benefit (approximately €48,000)[192] which would have arisen from a successful outcome to the case. Moreover, the pursuit of at least one director was abandoned due to lack of assets. A second issue, as pointed out by Keay in the context of the UK provision, is that an expanded ability to prosecute might allow creditors to exert pressure on directors to have their own debts satisfied prior to insolvency.[193] He further points out that success by one or a small number of creditors could leave

[188] [1993] 3 IR 191
[189] Steele and Ramsay, 'Insolvent Trading in Australia. A Study of Court Judgments from 2004 to 2017' [2019] 27 Insolvency Law Journal 156 at 188.
[190] Steele and Ramsay, 'Insolvent Trading in Australia. A Study of Court Judgments from 2004 to 2017' [2019] 27 Insolvency Law Journal 156 at 188.
[191] [2017] IESCDET 2
[192] Re. Appleyard Motors Ltd. [2015] IEHC 28 para.1.
[193] Keay, Company Directors' Responsibilities to Creditors (London: Routledge, 2007), p.128. This view is supported by Hicks. Hicks, Advising on Wrongful Trading-Part 2 [1993] 14(3) Company Lawyer 55 at 59.

the directors destitute and thus unable to do anything for the remaining body of creditors. He concludes by saying that the creditors likely to be successful are the strong and well informed.[194] This is supported by McCormack's view that as a general body, creditors, especially where small companies are concerned, are unwilling to participate in the liquidation process. They often have too little at stake to justify active participation.[195]

That said, there are compelling counter arguments. Importantly, the Cork Report recommended that locus to apply should be available to creditors.[196] Further, some commentators argue in favour of creditor inclusion. Specifically, Campbell considers that amending section 214 to grant a judge the discretion to direct payments to particular creditors could encourage individual creditors, or a group of creditors, to fund actions. This effect can be seen in Ireland. Absent creditor locus standi two as opposed to four reported reckless trading cases would not exist. This is an important point as even unsuccessful cases will have a deterrent effect.

The inclusion of creditors as potential applicants when coupled with the courts' ability to make the director liable for specific debts or liabilities[197] is beneficial to the Irish reckless trading regime. Creditors' actions can be successful. The Australian statistic that creditors were unsuccessful fifty-eight percent of the time also demonstrates that they were successful in over forty percent of cases. Toomey Leasing Group Ltd. was successful in the High Court. Binchy J.'s judgment therein (while ultimately overturned) is cogent and persuasive.[198] This indicates that the applicant's case was far from being entirely without merit.

## (V) CONCLUSIONS

While reckless trading behaviour among directors of failing companies does not appear to be an outlier, it is clear across the jurisdictions examined that, to a lesser or greater extent, the provision is infrequently invoked. The first central research

[194] Keay, Company Directors' Responsibilities to Creditors (London: Routledge, 2007), p.128
[195] McCormack 'Rescuing Small Businesses: Designing an "Efficient" Legal Regime' [2009] 4 JBL 299 at 320.
[196] Insolvency Law and Practice – Report of the Review Committee [1982] Cmnd 8558 para.1797
[197] Section 610(2)
[198] [2016] IECA 280

question is why this is the case. Common themes emerge. Firstly, the cost of mounting a case can be significant. Generally, in Ireland, legal costs are high.[199] Specifically, due to evidential and other requirements, a reckless trading case can be expensive and time consuming.[200] Coupled with this is the fact that the financial wherewithal of directors is inextricably linked with the fortunes of their company. If that declines significantly so does their own affluence. Personal guarantees are also extremely prevalent.[201] These two factors feed off one another; a liquidator will be unwilling to risk large legal costs to pursue a director of limited means. However, these are not the only factors. As we have seen the section is awkwardly and confusingly drafted. This must have an impact on the invocation rate. Interpretational and application complexities mean that it is more difficult to mount a successful case.

Section 610 does contain beneficial features. The lack of a definition of reckless trading in subsection (1) is arguably helpful. While a more neutral term than 'reckless' may be preferable, the lack of definition has the advantage of not limiting the parameters of what may constitute reckless trading behaviour. From a normative standpoint, it is surely correct that a creditor who has suffered a loss should have the ability to act as the liquidator may not be in a position or unwilling to do so.

That said, there are a number of very significant problems. The arguably incorrect interpretation that subsection (3) contains deeming provisions results in an unwieldy section which is difficult to apply. Further, judicial efforts to avoid the harsher effects of the supposed statutory fictions has resulted in the section being construed in an artificial manner as both Hefferon Kearns and Appleyard illustrate. The honestly and responsibly defence is at best superfluous. At worst it infects the provision unnecessarily with moral issues and requires a court to consider a reckless director responsible. Its subjectivity is impossible to marry with the largely objective tests contained elsewhere. This means that as a defence it is arguably unworkable. These factors arguably mean that as far as potential applicants are concerned the section is seen as one which is very difficult to invoke successfully.

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[199] See Review of the Administration of Civil Justice Report, Ch.9 (Dublin: October 2020)
[200] For example, Re Continental Assurance Co. of London plc [2007] 2 BCLC 287.
[201] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para.12.90

A possible solution to the external factors will be developed in the latter part of this thesis. The internal factor is, however, quite solvable. If the section is to achieve its purpose, it needs to be significantly redrafted. To strengthen and improve the provision further, the following chapter will examine the UK and New Zealand equivalent provisions. The aim of this comparative analysis is to determine what can be learned from these provisions to further improve the effectiveness of section 610. The format of a revised provision will then be suggested.

# CHAPTER FOUR: THE UNITED KINGDOM AND NEW ZEALAND – A COMPARATIVE ANALYSIS

## (I) INTRODUCTION

In the last chapter we examined a number of aspects of section 610 and dissected the internal drafting problems. This chapter will examine the salient issues which have arisen with its UK and New Zealand counterparts. The examination will highlight the similarities and differences which exist between the Irish provision and the chosen comparators together with their strengths and weaknesses. This will further facilitate the development of proposals to improve the drafting of section 610.

## (II) THE UNITED KINGDOM

### (i) Features of Section 214

The relevant provisions of section 214 Insolvency Act, 1986 are set out in Appendix One. Section 214 is very different from its Irish counterpart despite the fact that both provisions had their genesis in the Cork Report. Specifically, section 214 is narrowly focused on a particular trading behaviour; not taking sufficient steps to minimise creditor losses once insolvent liquidation becomes unavoidable. Section 610 leaves 'reckless trading' undefined and is thus a much more expansive provision. Further, section 214 concentrates on the loss to the company. Section 610 is more broadly focused and can take into account the individual creditors' losses. These and other salient features of section 214 are discussed below.

#### (a) Timing Issues

Section 214 is very much focused on a particular temporal aspect of insolvencies. Under the section a liquidator must specify a point in time at which the director knew or ought to have concluded that there was no reasonable prospect of the company avoiding going into insolvent liquidation. While it is clear under UK company law what 'insolvent' means; a company's liabilities exceed its assets (a balance sheet test)[1] it can be very difficult for the liquidator, after the events in question, to pinpoint when precisely it was obvious that an insolvent liquidation was unavoidable. In many cases, while the liquidator does indeed

[1] S.214(6) Insolvency Act, 1986.

choose the correct point,[2] this requirement can limit his or her ability to maneuver as it can be impossible to make arguments in favour of other dates in the course of the hearing.[3] The courts have concluded that defendants in advance of the trial must know the case they have to meet[4] and it would be unfair if liquidators could specify new dates once the proceedings are underway.[5]

Keay considers that this rule may not have been enforced consistently across the board[6] and would appear to be correct in this regard. For example, in Re DKG Contractors Ltd.[7] the liquidator was allowed to argue for alternative dates.[8] This also occurred in Re. The Rod Gunner Organisation Ltd.[9] and Nicholson v Fielding.[10] Other cases, however, allow the liquidator one shot only at choosing a date.[11] Bachner points out that rather than risk being caught by *'this procedural snare'* liquidators will invariably chose a later date as the date on which the directors ought to have recognised that insolvency was inevitable.[12] This, however, will usually reduce the quantum of the contribution (and may exacerbate the problem encountered in Grant v Ralls,[13] discussed below). The alternative, to attempt to plead the case based on a choice of different dates, is unattractive due to the increased costs which such a strategy would entail.[14] Further, the court may resist such an attempt.

[2] In Re Purpoint Ltd. [1991] B.C.C. 121 liquidation was inevitable when the company could not pay its trading and Revenue debts and Re Bangla Television Ltd (in liquidation) [2010] B.C.C. 143 when the company had sold all its assets. See also Paton v Ricky Martin (Racing) Ltd. [2016] SC AIR 57 where a specific date, 23 March 2010, was used.
[3] Re Sherborne Associates Ltd. [1995] BCC 40. Re Continental Assurance Co. of London plc [2007] 2 BCLC 287 at para.99
[4] Re Robin Hood Centre Plc. [2017] BCC 99 para.9
[5] Re Sherborne Associates Ltd. [1995] BCC 40
[6] Keay, 'Wrongful Trading and the Point of Liability' [2006] 19 Insolvency Intelligence 132 at 132.
[7] [1990] B.C.C. 903
[8] An earlier point when a supplier refused to deliver or a later point when two important employees left the company. [1990] B.C.C. 903 at 912.
[9] [2004] EWHC 316 Ch
[10] [2017] All ER 156
[11] See Re Sherbourne Associates Ltd. [1995] BCC 40. Re Continental Assurance Co. of London plc [2007] 2 BCLC 287 and Re. Hawkes Hill Publishing [2007] BCC 937
[12] Bachner, Wrongful Trading - A New European Model For Creditor Protection? [2004] 5(2) EBOR 293 at 306.
[13] [2016] EWHC 243
[14] Bachner, Wrongful Trading - A New European Model For Creditor Protection? [2004] 5(2) EBOR 293 at 306

The converse also applies here. If the liquidator has the difficulty of pinpointing the moment when the director knew or ought to have realised that insolvent liquidation was unavoidable, the director will presumably encounter the same difficulty. The director must take action from this point, but how is it identified? This is a weakness of the section as it gives no guidance. Hannigan is of the opinion that this is the most difficult aspect of section 214.[15]

Further, the director must know (or ought to know) that there was no reasonable prospect of avoiding an insolvent liquidation.[16] Payne and Prentice consider that the meaning of the phrase '*no reasonable prospect'* is inherently elusive.[17] It is argued that the vagueness of the concept means that different outcomes will be produced depending on the preferences of the individual judge. A pro-business or pro-rescue judge will give the director the benefit of the doubt, whereas a pro-creditor judge will not.[18] Whether directors knew that the company had no reasonable prospect of avoiding an insolvent liquidation depends on their rational expectations of what the future might hold.[19] In this regard the court can take into account a broad range of factors such withdrawal of support by banks, loss of contracts or lack of new contracts, failure to pay taxes, and the loss of a major supplier. Keay draws attention to the fact that it is difficult for directors in many situations to see into the future and determine whether or not the company is doomed to insolvent liquidation.[20] Keay also points out that that the 'no reasonable prospect' requirement can put even a conscientious and competent director in difficulty. He or she must not be heedless but on the other hand an excessively cautious approach may result in the liquidation of a company which would otherwise have survived.[21]

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[15] Hannigan, Company Law 4th Edition (Oxford: Oxford University Press, 2015), para.15-22.
[16] S.214(2)(b) Insolvency Act, 1986
[17] Payne and Prentice, 'Company Directors' Liability for Company Debts Under English Law' in Ramsay (Ed.), Company Directors' Liability for Insolvent Trading (North Ryde, NSW, CCH Australia Ltd., 2000), p.206.
[18] Walters, 'Enforcing Wrongful Trading- Substantive Problems and Practical Disincentives' in Rider, The Corporate Dimension, (Bristol, Jordan Publishing Ltd., 1998), p.149
[19] Re. Hawkes Hill Publishing Company Ltd. [2007] BCC 937 para.41, Roberts v Frohlich [2011] EWHC 257 (Ch) paras.111-112 where the directors were led by willfully blind optimism.
[20] Keay, 'Wrongful Trading: Problems and Proposals' [2014] 65(10) NLQR 63 at 73
[21]Keay, McPherson's Law of Company Liquidation, 3rd Ed. (Sweet & Maxwell 2013), p.754.

Arguably, the more amorphous section 610 has the advantage here. In Ireland, the precise point at which insolvent liquidation became obvious or inevitable is a consideration[22] but not an overriding one. Thus, the broad ranging focus and undefined nature of the concept of reckless trading within section 610 allows the courts to concentrate on more important points; the nature of the directors' behaviour and its impact on creditors and the company.[23] The temporal nature of the test in section 214 can result, on the other hand, in an overemphasis on what is something of a tangential issue; identifying the precise point at which insolvency became inevitable. A liquidator must concentrate his or her resources on this temporal issue perhaps at the expense of other aspects of the case.

**(b) Entrepreneurial Risks Versus Operational Risks**

Section 214 may better distinguish between entrepreneurial risk-taking and operation risk-taking than section 610. The provision as drafted asks two questions: did the controllers realise on time that the company could not avoid an insolvent liquidation[24] and, having so realised, did they take every step to minimise losses to creditors.[25] These are operational issues only. No examination is to be carried out of previous entrepreneurial decisions of the directors. The cause of the liquidation is not in issue. The section is solely concerned with whether the directors realised that insolvency was inevitable and their conduct thereafter.[26] Section 214 is concerned with the controllers' actions once the point where no real prospect of avoiding insolvency has been reached.

Concentrating on operational risk-taking is the correct approach and, again, stems from the focused nature of the provision. While the wide drafting of section 610(1)(a) does have other advantages, it may not make such a distinction. A questionable entrepreneurial decision taken while the company was still robustly solvent could be the subject of a successful reckless trading application. An example may be investing in a physical compact disc business at the start of

[22] Re. Appleyard Motors Ltd. [2015] IEHC 28 para.67.
[23] Re. Appleyard Motors Ltd. [2015] IEHC 28 paras.63-67
[24] Section 214(2)(b)
[25] Section 214(3)
[26] Johnson v Beighton [2019] EWCH 895 para.29 for a discussion of the use and meaning of the word 'inevitable.'

the internet era on the assumption that downloading music would not catch on. If this business decision was a root cause of the company's ultimate demise, could that not constitute *'the carrying on of any business of the company in a reckless manner'*?[27]

Section 214 does not follow this approach. Only operational steps taken once insolvency is reached are relevant for the purposes of determining whether the director was involved in wrongful trading. Mokal reiterates this point. He stresses that the provision does not consider the cause of the insolvency. Instead, the provision concentrates solely on what happens once an insolvent liquidation becomes inevitable. This only issue is what happens once that point has been reached.[28] In this regard, section 214 is better drafted than section 610.

Lynch Fannon notes that, as a general principle of company law, in most cases it is operational risk-taking which is seen as harmful risk-taking. A risky entrepreneurial decision even where it later turns out to be misguided is rarely punished.[29] As she states *"Very rarely does the law seek to penalise entrepreneurial risk-taking, no matter how misguided such entrepreneurial or business decisions might seem in hindsight*."[30] Indeed, the Cork Committee in recommending a wrongful trading provision appear to emphasis the operational as opposed to the entrepreneurial.[31] This point is further emphasised by the LRC when it states *"Laws that apply to commercial decision-making must not deter or punish entrepreneurship or beneficial risk-taking"*[32] This principle is also evident in UK case law. Specifically, in Re Purpoint Ltd. Mr. Meredith's entrepreneurial decisions to allow the company to commence trading were very

[27] Section 610(1) Companies Act, 2014
[28] Mokal, Corporate Insolvency Law (Oxford: Oxford University Press, 2005), p.297
[29] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7 at 8.
[30] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7 at 8.
[31] Insolvency Law and Practice – Report of the Review Committee [1982] Cmnd 8558 paras.1781-1783
[32] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para.12.08

risky, but these did not attract culpability. The later failures to maintain financial records did. [33]

It is important to note that the CLRG favours an operational approach. Their view is that the purpose of the reckless trading provision is to ensure that the directors face up to the reality of insolvency and incur no further new debts. This is clearly an operational as opposed to an entrepreneurial concern[34] and contains an important point; insolvencies are a normal part of the business landscape and are inevitable. The purpose of the reckless trading provisions is not to prevent insolvencies from occurring. As Goode stated, if there were no insolvencies, this would mean that there were no entrepreneurial risk takers.[35] Further, good entrepreneurial decisions can be affected by unexpected or unfavorable circumstances, resulting in bad outcomes. That does not change the fact that the original decision was a good and correct one.[36] This view is also supported by the LRC.[37] It is in keeping with the purpose of separate legal personality; to facilitate entrepreneurial risk-taking even where the venture is chancy.[38] It is not, however, the function of separate legal personality to allow reckless or grossly incompetent operational actions especially when the company is in the vicinity of insolvency. Section 214 has managed to successfully delineate between the two concepts. This indicates that section 610 can and should do likewise.

**(c) The 'Every Step' Defence**

Liability under the wrongful trading provision may be avoided by availing of the safeguard contained in section 214(3). In order for the director to benefit from this defence, the court must be satisfied that he or she took *'every step with a view to minimising the potential loss to the company's creditors.'* Mayson,

[33] [1991] B.C.C. 121 at 127-128
[34] CLRG, Report on the Protection of Employees and Unsecured Creditors (Dublin June 2017), para.2.4.3
[35] Goode, Proprietary Rights and Unsecured Creditors, in The Realm of Company Law Rider (Ed) (London and Boston: Kluwer Law International 1998), p.196.
[36] Shopovski, Bezzina, Zammit 'The Disqualification of Company Directors and its Effect on Entrepreneurship' [2013] 9(7) European Scientific Journal 14 at 25
[37] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para.12.32.
[38] Many highly successful companies would have been considered extremely speculative when launched.

French and Ryan[39] criticise this defence on the basis that it is likely to cause considerable difficulty in application, especially the use of the word 'every.' Milman also criticises it on the basis that it is *'too vague.'*[40] Case law has concluded (perhaps unhelpfully) that what constitutes 'every step' depends on the facts of the case and that the burden of proof with regard to this defence is on the liquidator.[41] This leaves other questions outstanding; for example how many positive actions are required? Mayson, French and Ryan[42] ask whether the defence means that the director must demonstrate that he or she identified and took every possible step to minimize losses, no matter how negligible the particular step. As Griffin states that this defence sets a daunting standard which if construed literally could render its application to be improbable in all but the most exceptional of cases.[43] Keay concurs stating that it would except in rare cases be impossible to establish.[44] Practical difficulties also arise. The steps taken may minimise losses to some creditors but not to others.[45]

That said, the requirement may not be quite as onerous as it first appears. While Snowden J. states in Grant v Ralls that section 214(3) is intended to be a high hurdle for directors to surmount,[46] this may not actually be the case. Keay is able to provide a list of steps which the director should take,[47] though he and Murray point out that suggestions from commentators as only suggestions and nothing more.[48] Oditah on the other hand argues that following professional advice would absolve the director.[49] Indeed, Fletcher points out that even where the

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[39] Mayson, French and Ryan, Company Law 24th Edition (Oxford: Oxford University Press, 2007), p.669.
[40] Milman, 'Strategies for Regulating Managerial Performance in the 'Twilight Zone' – Familiar Dilemmas: New Considerations [2004] Journal of Business Law 493 at 498.
[41] Re Robin Hood Centre Plc. [2015] EWHC 2289 para.7
[42] Mayson, French and Ryan, Company Law 24th Edition (Oxford: Oxford University Press, 2007), p.669
[43] Griffin, Personal Liability and Disqualification of Company Directors (Oxford: Hart Publishing 1999), p.74.
[44] McPherson's Law of Company Liquidation, 3rd Ed. (Sweet & Maxwell 2013), p. 757
[45] See Re Robin Hood Centre Plc. [2015] EWHC 2289 para.292 where the registrar found that the unsecured creditors position had been improved but the position of other creditors (Tesco, HMRC and possibly Nottingham City Council) had disimproved.
[46] Grant v Ralls [2016] EWHC 243 para.245
[47] Keay, McPherson's Law of Company Liquidation, 3rd Ed. (Sweet & Maxwell 2013), p.754.
[48] Keay and Murray, 'Making Company Directors Liable: A Comparative Analysis of Wrongful Trading in the United Kingdom and Insolvent Trading in Australia' [2005] 14 Int. Insolv. Rev. 27 at 45
[49] Oditah, Wrongful Trading [1990] LMCLQ 205 at 208.

company is balance sheet and cashflow insolvent, the directors may escape liability if it can be shown that they sought and received professional advice.[50] Thus the UK position is similar to the legislative position in New Zealand.[51] Further, Goode concludes that 'every step' may mean no more than 'every reasonable step'; an obviously lower and achievable standard.[52]

Commentators may have been unduly fearful as the courts have ensured that the reality is that conscientious and responsible directors will not be found liable.[53] A case in point is Re Continental Assurance Co. of London plc.[54] The company was a small insurance company. In early 1992, it went into creditors' voluntary liquidation. Proceedings were brought by the liquidator against several of the company's former non-executives and the former managing director. The liquidators argued that the company should have ceased trading in the middle of 1991.[55] At that point, the directors knew or ought to have concluded that there was no reasonable prospect that the company would avoid an insolvent liquidation.

While Parke J. concluded that the company was not actually insolvent at the point in time contended by the liquidators, he held that even if he had come to the opposite conclusion, he would still not have found the directors' liable. When the losses first arose, the directors had carefully examined the issue of whether the company could properly continue to trade.[56] He held that the directors had acted reasonably in deciding that Continental could continue trading while a buyer for the business was sought.[57] The board had instructed both the auditors and the finance director to conduct a detailed examination of company's financial position. The directors were actively involved in keeping the company's

[50] Fletcher, The Law of Insolvency, 5th Edition (London: Sweet & Maxwell, 2017), para27-041
[51] S.138 Companies Act, 1993. This provision is discussed in the next section.
[52] Goode, Principles of Corporate Insolvency Law, 4th Edition (London: Sweet & Maxwell, 2011), para. 14.44
[53] Some commentators are not so pessimistic. Keay makes the point that while the section is initially very worrying for directors, the courts to not use hindsight and do not judge directors in light of subsequent developments. Keay, Company Directors' Responsibilities to Creditors (London: Routledge, 2007), p.120
[54] [2007] 2 BCLC 287.
[55] [2007] 2 BCLC 287 para.3
[56] [2007] 2 BCLC 287 para.107
[57] [2007] 2 BCLC 287 para.422

financial position under constant and careful review.[58] When it became clear in late 1991 that the company was indeed insolvent, the directors gave instructions that no new business should be taken on.[59] Advice was also obtained from insolvency practitioners.[60]

It is possible therefore to argue that despite the apparent stringent requirements of the defence, the reality is that the defence functions properly. Where the board of directors has performed correctly and made decisions on the basis of up-to-date evaluations of the company's financial position, baring other issues arising, it will be very difficult for a liquidator to bring a successful wrongful trading case.[61] As Keay states *'Rarely, where directors have made an effort to understand the position of their company, and where they have decided to continue doing business, will they be held liable*'.[62] The recent Nicholson v Fielding decision is also in point. The case emphasises the importance of accurate financial information and constant monitoring of the business environment.[63] This is echoed by Mallon J.'s comments on Roberts v Frolich[64] when he notes that a finding of wrongful trading will only be made where there is egregious disregard of creditors' interests.[65] Further, the UK courts appear to have held that the test in a wrongful trading case is the standard of the reasonable businessperson. Such a person will be temperamentally less cautious than the typical lawyer or accountant. The business approach of a director will involve risk and this must be factored in to any decision.[66]

This appears to be a sensible approach. Directors are not infallible. The world is complex and difficult judgments must often be made with necessarily incomplete information. A director of a financially troubled company who keeps abreast of the business' monetary position, obtains and follows professional

[58] [2007] 2 BCLC 287 para.34
[59] [2007] 2 BCLC 287 para.108
[60] [2007] 2 BCLC 287 para. 108
[61] Walters, 'Wrongful Trading Two Recent Cases' [2001] Insolvency Lawyer.211 at 214
[62] Keay, Company Directors' Responsibilities to Creditors (London: Routledge, 2007), pgs.95-139.
[63] [2017] All ER 156 para.106
[64] [2011] EWHC 257
[65] Mallon, 'The Onslow Ditchling Case: The Audacity of Hope' [2011] Insolvency Intelligence 95 at 96
[66] Re. Brian D. Pierson (Contractors) Ltd. [2001] BCLC 275 at 305

advice[67] and makes objective and considered judgments as to whether the company is placed in insolvency is not engaged in reckless or wrongful trading even if his or her ultimate decision turns out to be incorrect. Moreover, the emphasis is on operational and opposed to entrepreneurial missteps. What may in fact have occurred here is similar to the New Zealand position. The judiciary have placed a practical interpretation on the phrase 'every step' and have ignored its literal meaning. This has resulted in a safeguard that is, to a large extent, functional and applicable. In this regard it is superior to section 610(8) which, as we have seen, has a myriad of illogicalities and contradictions.

While, as has been argued in the previous chapter, section 610 may not need a formal defence at all due to the inherent discretion granted to the courts by subsection (2), if it were considered that one was necessary, then a defence similar to that used in the UK may be beneficial. The use of the phrase 'every step' should be avoided to prevent an overly literal application. However, that a defence which concentrated on whether directors, in the vicinity of insolvency, had sufficiently focused on creditors' interests from an operational standpoint would be effective. It would make the section more operationally focused and would avoid inappropriate concentration on honest behaviour. It would avoid treating a reckless director as responsible. It would also contain an objective test. If such a test was applied in the same manner as occurs in the UK it would absolve the conscientious director who seeks to achieve the best outcome for creditors.

**(d)The Quantum of the Contribution**

Another interesting issue has arisen in relation to the quantum of the contribution to be made by the errant director. This issue arises because section 214's function is to compensate the company for the loss caused to it by the failure to take every step to minimise potential losses.[68] A recent case in point is Grant v Ralls. Ralls Builders Ltd. was an insolvent building company. It was envisaged by the

[67] Milman, 'Strategies for Regulating Managerial Performance in the 'Twilight Zone' – Familiar Dilemmas: New Considerations' [2004] Journal of Business Law 493 at 499-500
[68] Van Zwieten, 'Director Liability in Insolvency and its Vicinity' [2018] 38(2) Oxford Journal of Legal Studies 382 at 383

directors in early 2010 that a Mr. James (a third-party investor) would inject funds into the company. He dragged his feet and ultimately did not invest. The company was placed in administration in October 2010 and went into liquidation in early 2011. The liquidator argued that by late summer 2010 the directors knew or ought to have known that the company could not have avoided insolvent liquidation.[69] Snowden J. considered that the company's sole survival hope lay in Mr. James' investment. The judge concluded that as of the end of July, it was reasonable to believe that monies from Mr. James might still be forthcoming[70] the situation had changed significantly by the end of August. Snowden J. held that any rational assessment of the company's prospects at the end of August would conclude that its situation was hopeless.[71] Thus, on this first point, the directors were indeed involved in wrongful trading.

The judge then considered the amount that the directors should contribute to the assets of the company. The directors argued that the calculation of their contribution must be by reference to the increased net deficiency of the company caused by the wrongful trading.[72] In effect, the court must take into account only losses caused by the period of wrongful trading and not losses caused by the insolvency generally.[73] There must be a causal link between the continued trading and the increase in the deficit.[74] As van Zwieten explains this is the difference between the net estate at the time the directors knew or ought to have known that the company was insolvent and the liquidation.[75] This interpretation arises because Section 214 is compensatory[76] and liability only runs (and this harks back to the section's concentration on operational and opposed to entrepreneurial issues) from the time that there was no reasonable prospect of the company avoiding an insolvent liquidation.[77] Snowden J. concluded that this

[69] [2016] EWHC 243 para.1
[70] [2016] EWHC 243 para.199
[71] [2016] EWHC 243 para.216
[72] [2016] EWHC 243 paras.221 -222 The directors relied on the decisions in Re Purpoint Ltd [1991] BCC 121 and Re Continental Assurance Co. of London plc [2007] 2 BCLC 287.
[73] [2016] EWHC 243 para.241.
[74] Briscoe v Milner [2021] UKHC 763 (Ch)
[75] Van Zwieten, 'Director Liability in Insolvency and its Vicinity' [2018] 38(2) Oxford Journal of Legal Studies 382 at 391
[76] Re Purpoint Ltd [1991] BCC 121.
[77] Oesterle, 'Corporate Directors' Personal Liability for "Insolvent Trading" in Australia, "Reckless Trading" in New Zealand and "Wrongful Trading" in England. A Recipe for Timid Directors,

was the correct approach to take. He stated *"I therefore conclude that the correct approach to determining whether the directors should be required to make a contribution under S.214 is, … …, to ascertain whether the company suffered loss which was caused by the continuation of trading by the company after 31 August 2010 until the company went into liquidation on 13 October 2010, and that as a starting point this should be approached by asking whether there was an increase or reduction in the net deficiency of the company as regards unsecured creditors between the two dates."*[78] The judge considered that *"… the real sin of the directors, … …, is the manner in which the continued trading facilitated the repayment of the bank and some existing creditors whilst leaving new creditors unpaid."* While the directors were at fault in allowing this to occur,[79] because of purpose of section 214 was not to remedy inequalities between creditors,[80] but to remedy the loss to the company, the directors' contribution was set at nil. The company's net deficiency had not increased during the period. In fact, it may have decreased.[81]

Interestingly, the UK courts in adopting this approach appear to ignore the discretion granted to them by the section to determine the size of the contribution the director is to make.[82] This is a significant point of divergence between the Irish and UK legislation (and, indeed to some extent, the New Zealand position which is discussed later). While the legislation in both jurisdictions is intended to be compensatory, the liquidator in Ralls Builders effectively lost the case because no loss to the company had resulted from the period of wrongful trading. The issue of the position of any individual creditors was not relevant because *"the purpose of S.214 is not to provide differential redress for individual creditors, …"*[83]

Hamstrung Controlling Shareholders and Skittish Lenders' in Ramsay (Ed.), Company Directors' Liability for Insolvent Trading (North Ryde, NSW, CCH Australia Ltd., 2000), p.35

[78] [2016] EWHC 243 para.241

[79] [2016] EWHC 243 para.246

[80] [2016] EWHC 243 para.251

[81] [2016] EWHC 243 para.268

[82] Davies, Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency' [2006] 7(1) EBOLR 301 at 325

[83] [2016] EWHC 243 para.236

The Ralls Builders type approach does prove a relatively straightforward defence for directors and one that is easier to prove evidentially than the 'every step' procedure. It has also been argued that it is a corporate rescue approach. The directors can involve the company in an excessively risky course of action in an effort to stave off insolvency. If it is not successful, the directors will not be penalised monetarily so long the company is no worse off.[84] This view does not take account of the fact that while the approach may be numerically neutral, new creditors will be exposed to the benefit of the old. It can allow a director to take on substantial new creditors who have no prospect of being repaid. As long as the director pays off earlier creditors and overall maintains and does not increase the company's deficit his contribution to the company on foot of a wrongful trading finding will be nil.[85] Thus the defence appears to be very problematic[86] and has been described as perplexing.[87] The merits of its relative simplicity may be outweighed by the fact that it is not in keeping with the purpose of the provision; to ensure that a company in financial difficulties is liquidated at the correct time.[88] It also, arguably, provides a safe harbour for the unscrupulous director. As long as he or she properly manages the company's balance sheet there is no financial danger to the director in not placing the company in liquidation.[89] A technical finding of wrongful trading may be made against the director, but no monetary sanction will be forthcoming.

The availability of this defence may be another reason for the paucity of cases in the UK; as well as proving wrongful trading, the liquidator must also demonstrate that the company's net deficiency increased. Archer considers that

[84] Davies, Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency' [2006] 7(1) EBOLR 301 at 325
[85] Moss, 'No Compensation for Wrongful Trading – Where Did It All Go Wrong' [2017] Insolvency Intelligence 49 at 53
[86] Milman has concluded that this aspect of the decision makes it significantly more difficult for liquidators to obtain redress under S.214. Milman, Company Directors: Maintaining the Balance Between Protecting Managerial Rights and Regulating Exposure to Liability in Law, [2016] Co. L.N 1 at 3
[87] Archer, Directorial Liability in Insolvent Companies' PhD Thesis Lancaster University Law School (December 2017), para.4.21
[88] Mokal, Corporate Insolvency Law (Oxford: Oxford University Press, 2005) at p. 302
[89] Moss, No Compensation for Wrongful Trading – Where Did It All Go Wrong [2017] Insolvency Intelligence 49 at 53.

this position is one reason why the provision is unattractive to liquidators.[90] If this approach is taken in Ireland, it will add an additional stratum to the already onerous requirements placed on a liquidator.

The Irish position is different. In particular, subsection (6) appears to allow the court wide discretion as to whom any award is paid, and subsection (2) contains considerable discretion as to quantum. However, there is an indication in the Hefferon Kearns case that an approach similar to Grant v Ralls may be applicable in Ireland as Lynch J. does reference the increased loss to the company caused by the extended period of trading. That said, ultimately it appears to be the loss to the applicant creditor which is emphasised.[91] This is clarified further in Re. Appleyard Motors Ltd. In that case, from an accounting standpoint, the crediting of the funds to the company's bank account without expenditure on the vehicles, actually improved the company's financial situation. No issue on that point was taken in either court. Further, the High Court awarded the compensation directly to Toomey Leasing Group Ltd.[92] indicating that it was the loss to the creditor and not the company's position which was important. Re. PSK Construction Ltd. appears to take a different approach, however. In calculating Mr. Killeen's personal liability, Finlay Geogheghan J. calculates the deficit caused to the company by its continuing to trade beyond the period in which it should have been wound up.[93] The differences in treatment in the Irish case law may, similar to the New Zealand approach,[94] stem from the applicant in the case. In PSK Construction, the applicant was the liquidator, hence a company focused

[90] Archer, Directorial Liability in Insolvent Companies' PhD Thesis Lancaster University Law School (December 2017), para.4.23

[91] [1993] 3 IR 191. Lynch J. states at 226 *"I do not overlook the fact that it might be argued that the increase of £11,760 in the debts of the company between the 28th September and the 11th October, 1990, could possibly diminish the dividends which creditors might get on their debts in the liquidation. If that be so, the diminution would be about 2 per cent: which, applied to the plaintiffs £4,500, would result in a diminution of £90. In my opinion that is such a trivial amount as not to be within the meaning of loss or damage as contemplated by s.33, sub-s.(3)(b), and neither was the case argued on that basis on behalf of the plaintiff."*

[92] [2015] IEHC 28 para.68

[93] [2009] IEHC 538 paras.41-44. The approach in the final case, Re. Kelly Trucks Ltd. [2019] IEHC 6 is more difficult to discern. Murphy J. imposes personal liability for *'the debts of Kelly Trucks Ltd.'* [at para. 164]. However, it is noted at para. 106 that this amounts to the sums owned to the two firms of solicitors as all other creditors of the company had seemingly been repaid.

[94] It should be noted that the New Zealand approach is directed by S.301 – the Irish approach under subsection (6) may grant the court more discretion in this area.

approach is appropriate. In the other two cases, the applicants were creditors, hence a creditor focused approach was appropriate.

The Irish position is superior. It seems illogical that directors in the UK escape on a technicality so to speak; creditors may have suffered real losses due to director misbehaviour yet, because the company's position can be netted off from an accounting standpoint, no compensation is due. While Moss's sentiments may be a little strong,[95] he is correct in his position that it was not the intention of the Cork Committee. It sought to compensate creditors where liabilities were taken on which could not be repaid.[96] His call for a return to this original idea of wrongful trading is likely to go unheeded, however. As Archer points out, the position is entrenched in the UK jurisprudence at this point and is here to stay.[97]

Van Zwieten is more sanguine with regard to the Grant v Ralls approach. She considers that a company will invariably pay off some creditors and incur new ones even during the period in which insolvency becomes inevitable. By itself, therefore, that this has occurred is not a good reason for imposing personal liability on directors. In other more malign situations (such as robbing Peter to pay Paul or paying off selected creditors in order to benefit the directors in some manner) she considers that fraudulent trading will provide an adequate remedy.[98] However, while she is undoubtedly correct that paying off some creditors at the expense of others is a fact of corporate life and should not by itself result in liability (as long as there was no preference involved),[99] in the more damaging situations, the remedy of fraudulent trading will be of little comfort to the liquidator given the problems with the concept and its very significant lack of success to date. She also points out that where a particular creditor has been

[95] He describes the matter as a disgrace to British jurisprudence. Moss, No Compensation for Wrongful Trading – Where Did It All Go Wrong [2017] Insolvency Intelligence 49 at 53
[96] Moss, No Compensation for Wrongful Trading – Where Did It All Go Wrong [2017] Insolvency Intelligence 49 at 53
[97] Archer, Directorial Liability in Insolvent Companies' PhD Thesis Lancaster University Law School (December 2017), para.4.22.
[98] Van Zwieten, 'Disciplining the Directors of Insolvent Companies' [2020] Insolvency Intelligence 1 at 4
[99] Van Zwieten, 'Disciplining the Directors of Insolvent Companies' [2020] Insolvency Intelligence 1 at 3

preferred at the expense of the others, section 214 is not available to the liquidator; the reason being that the company's financial position has not deteriorated. However, all is not lost because the liquidator can pursue the directors on the basis that they breached their duty to creditors. As we will see later, this may not be a suitable course currently in Ireland. For this and the other reasons cited, the discretion contained in section 610(6) and section 610(2) should be retained. This Irish position is superior.

**(e) Ability to Trade While Insolvent**

Case law in the UK has made it clear there is no statutory duty on directors not to trade while insolvent from a wrongful trading standpoint.[100] This arises from the statutory scheme of section 214. Trading while insolvent can occur as long as liquidation is not inevitable. The company may trade out of its difficulties. Even where liquidation is inevitable, directors may correctly take the view that it is in the best interests of both the company and the creditors to continue to trade for a period. As Davies states *'Trading whilst insolvent is not by itself either a criminal offence or a civil wrong'.*[101] Specifically, it is interesting to note that the company in Re. Sherborne Associates Ltd.[102] was loss making throughout its existence yet the directors in question were found not to have been involved in wrongful trading. Further, on occasion it may not be in creditors' interests to cease trading immediately and place the company in liquidation; there are situations when an immediate cessation increases losses to creditors.[103] For example, debtors, once they know that a company has been placed in liquidation, may take advantage of the situation and refuse to repay their debts. Thus, delaying liquidation and continuing to trade while insolvent for a period to collect outstanding debts may actually be beneficial and constitute one of the steps which must be taken to minimise creditor losses. By continuing to trade,

[100] See for example Re Purpoint Ltd [1991] BCC 121 where the company appeared to be balance sheet insolvent since inception.
[101] Davies, Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency' [2006] 7(1) EBOLR 301 at 314. Moss is even clearer when he states *"Moreover, as a matter of principle there is in English law nothing wrong per se with trading whilst insolvent. Depending on the circumstances, such trading may be necessary or desirable in the interests of creditors."* Moss, No Compensation for Wrongful Trading – Where Did It All Go Wrong [2017] Insolvency Intelligence 49 at 51
[102] [1995] BCC 40
[103] Campbell, Wrongful Trading and Company Rescue, [1994] 25(1), Cambrian Law Review 69 at 75

there is also the possibility of a voluntary work-out with creditors which avoids the costs of insolvency and may be more beneficial.[104]

This can be contrasted with the Irish position. As Lynch J. pointed out in Re. Hefferon Kearns, section 610(3)(b) due to its apparent deeming nature prevents the incurring of further debts once the company has become insolvent. This is despite the fact that it may be beneficial for the company to continue trading and thus incur further debts for a short period of time at least.[105] This view is reiterated by the LRC[106] and academics.[107] The Australian equivalent provision[108] contained a similar prohibition. This is now seen to be problematic and has been reformed.[109] The UK provision avoids this problem, and this is a strong point of the section.

As discussed in the previous chapter, the Irish difficulties with insolvent trading stem from the fact that subsection (3)(b) is construed as a deeming provision. Where the subsection redrafted along the lines suggested by Lynch Fannon,[110] so that it is clear that the subsection contains instead an example of actions which could constitute reckless trading behaviour, then the problem is ameliorated. In those circumstances the courts could, as in the UK, impose liability only where the continued trading was irrational and not of benefit to creditors.

Section 610 as currently drafted is well suited to deal with a situation where continuing to trade while insolvent was clearly damaging to creditors interests. A case in point is Re. PSK Construction Ltd. Finlay Geoghegan J. was able to make a clear finding that Mr. Killeen was involved in reckless trading under subsection (1) because the under-declarations of the tax liabilities allowed the

[104] Davies, Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency' [2006] 7(1) EBOLR 301 at 314.
[105] [1993] 3 IR 191 at 224-225
[106] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), paras 12.32-12.34.
[107] Ahern notes that in the context of restriction orders, directors are allowed to continue to trade for a short while at least post insolvency. Ahern, 'The Responsible Director in an Economic Downturn: Lessons from the Restriction Regime' [2009] 31(1) DULJ 183 at 190.
[108] S.588G Corporations Act, 2001
[109] S.588GA Corporations Act, 2001.
[110] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7 at 10

company to continue trading when it should have been wound up.[111] It does not, however, cope well with a situation where continuing to trade while insolvent was a rational and commercially based decision undertaken with creditors in mind (even if it was not ultimately the correct choice).

**(f) Objective and Subjective**

Like the Irish provision, the test for wrongful trading under section 214 contains both objective and subjective elements. However, these elements interact is a far more balanced and practicable way. Section 214 requires the court to firstly consider two objective matters:[112]

1. Whether the director realised or ought to have realised that there was no reasonable prospect of the company avoiding an insolvent liquidation, and
2. Once that point has been reached, whether the director took all necessary steps to minimise losses to creditors.

Where these objective elements are fulfilled, the director is then measured against an objective test with a subjective element – firstly, the level of general knowledge, skill and experience that may be reasonably expected of a person undertaking the same functions as the director,[113] and secondly, the level of skill, knowledge and experience which the director actually had.[114] This latter element is subjective because it looks to the specific skill, experience and knowledge which the particular director has.[115] The court will look at how the director behaved using the skills which he or she actually possesses and will then ask whether a reasonable man or woman with the attributes of the particular director would have followed the same course of action. If, combining these objective and subjective tests, the director knew or ought to have known that there was no reasonable prospect of avoiding insolvent liquidation and yet continues to trade, he or she will be liable. In effect where the director performs a special function

[111] [2009] IEHC 538 para.41
[112] Davies, Gower's Principles of Modern Company Law 6th Edition (Sweet & Maxwell 1997), p.153
[113] S.214(4)(a)
[114] S.214(4)(b)
[115] Keay, Directors Duties, 3rd Edition (Bristol: Jordan Publishing, 2016), p.227

then the director is benchmarked against the special skills expected of a person in that position.[116] That is not to say that it creates an escape route for the unskilled director. As Keay points out, the subjective element does not serve to reduce the standard of knowledge or skill required. It heightens the requirement for a skilled director but does not allow the unskilled director the excuse of ignorance.[117]

This is a more practical approach that the Irish methodology. The logical combination of an objective and a subjective element here allows a comparison of how the director should objectively have behaved with what the director actually did. Further the director's actual skills and experience can be taken into account. This indicates that a consistent approach within the Irish provision is also possible and should be adopted.

**(g) Moral Blameworthiness**

Another distinction between the UK and Irish provisions is that the former contains no provision for absolving a director from liability on the basis that he or she acted honestly. This means that it does not contain the inherent contradictions seen within section 610(8); a test of honesty where fraud is not in point.

The UK has expressly avoided the issue of honesty in wrongful trading provisions. This has two advantages. It firstly represents a far lower hurdle for the applicant to overcome as the court has no discretion on moral grounds to absolve an otherwise wrongful director. Unlike Ireland, the liquidator who demonstrates wrongful trading does not face the additional hurdle of demonstrating that the director was not honest and/or responsible. Secondly, it avoids the confusion which has been engendered when an objective test is coupled with a wholly subjective defence.

[116] Re. Brian D. Pierson (Contractors) Ltd. [1999] BCC 26 at 55
[117] Keay, McPherson's Law of Company Liquidation, 3rd Ed. (Sweet & Maxwell 2013), p.751.

By avoiding the inclusion of a judicial discretion to relieve based on honesty, lawmakers in the UK have made the procedure for the recovery of unfairly incurred losses more accessible. Given the difficulties already associated with bringing an Irish reckless trading action, the UK approach appears more beneficial and strengthens the argument for the removal or replacement of the subsection (8) defence from section 610.

In conclusion, the lack of a requirement to consider moral blameworthiness is a strong point of section 214. Moral considerations have no place in a reckless trading type provisions. Where they exist, they only serve to make the provision more difficult to apply.

**(h) Use of Hindsight**

An issue which arises with wrongful trading is that actions of the directors are invariably examined many years later. For example, in Re. Robin Hood Centre Plc (in liquidation) the events in question occurred between 2006 and 2009. However, the case was heard by the Registrar in mid-2015 and the appeal reached the High Court in October 2016.[118] An effect of such delays is that directors are in danger of being judged with hindsight. Humans are biased towards believing that because something actually happened that it was inevitable that it would happen.[119] Obviously, this is not the case. In reality, events are fluid and fast moving. Judges hearing wrongful trading cases appear to be very aware of the dangers of this bias.[120] This is obvious from UK case law.[121] Examples abound. [122] As Lewison J. stated in Re Hawkes Hill Publishing Co Ltd;[123] *'But directors are not clairvoyant and the fact that they fail to see what eventually comes to pass does not mean that they are guilty of wrongful trading'.* Further, Snowden J. stated in Grant v Ralls *"I caution myself against the application of hindsight, and remind myself that I should not too readily*

[118][2015] EWHC 2289 and [2017] BCC 99
[119] Roese and Vohs, 'Hindsight Bias' [2012] 7(5) Perspectives on Psychological Science 411.
[120] Keay, 'Wrongful Trading and the Liability of Company Directors: A Theoretical Perspective' [2005] 25(3) Legal Studies 431 at 440. This would also appear to be the case in Ireland. See Hogan J.'s comments in Appleyard Motors Ltd. [2016] IECA para.47
[121] See for example Jackson v Casey [2019] EWHC 1657 para.217
[122] Re Sherborne Associates Ltd. [1995] BCC 40 at 54 and Re Idessa Ltd (in liquidation) [2011] EWHC 804 para.113
[123] Re Hawkes Hill Publishing Co Ltd [2007] BCC 937 para.41.

*criticise the directors' contemporaneous actions from the comfort of a courtroom.* "[124]

That UK judges are aware of the dangers of hindsight is particularly important when the timing issues discussed below are considered.[125] The insolvent liquidation may look inevitable with hindsight but did not appear to be inevitable as the events were occurring. It is a strength of the UK wrongful trading code that this point is acknowledged and taken into account. The ability to discount hindsight may be particularly strong in the UK due to the focused nature of the provision. When two essential questions must be answered; whether the director ought to have realised that insolvency was unavoidable and whether all necessary steps to curtail losses to creditors were taken, hindsight can be removed from the considerations. It may be far more difficult to do so with the broad ranging and expansive Irish provision especially as historic entrepreneurial decisions may be in point. That said, there is a clear awareness of the dangers of hindsight in Ireland. Judges in restriction and disqualification order cases have long warned against its use.[126] There is also an awareness of the danger within the reckless trading case law.[127] Finlay Geoghegan J. states in Re. PSK Construction Ltd.[128] *'It is always dangerous for a Court to examine with the benefit of hindsight decisions taken by directors of a company at the relevant time.'* That said, limiting the Irish provision to operational issues only may be beneficial as such an amendment should limit the scope for hindsight bias.

**(ii) Concluding Comments**

As can be seen from the above, section 214 has many advantageous features. While the provision contains difficulties and ambiguities, it correctly focuses on operational as opposed to entrepreneurial risk-taking. There is an awareness of hindsight bias. Objective and subjective standards mesh seamlessly. Its defence is workable and

[124] [2016] EWHC 243 para.216
[125] See Johnson v Beighton [2019] EWCH 895 para.43 and Nicholson v Fielding [2017] All ER 156 para.39.
[126] See for example Re. USIT World Plc. [2005] IEHC 285 and Business Communications v Baxter & Parsons Unreported High Court 21 July 1995
[127] It should also be noted that the dangers of hindsight are mentioned in the defence submissions in Re. Hefferon Kearns (No. 2) Ltd. [1993] 3 IR 191 at 218
[128] [2009] IEHC 538 para.30

logical. Trading while insolvent is possible. Overall, valuable pointers are provided towards what a redrafted section 610 might look like.

## (III) NEW ZEALAND

### (i) History of the New Zealand Provisions

As set out in Chapter Two, reckless trading provisions were originally enacted in New Zealand by section 32 Companies Amendment Act, 1980.[129] The relevant legislation was amended by the Companies Act, 1993 as part of a wider review of the New Zealand company law provisions. In particular, the original 1955 Act was practically a direct copy of the UK Companies Act, 1948 and was no longer considered to be the correct model for New Zealand.[130] Watson states that the purpose behind the review was to solve clear faults within the system which became apparent post the 1987 Stock Market Crash: the penalties for misbehaviour by directors were not a sufficient deterrent. Simultaneously, many competent directors felt constrained by bureaucratic restrictions on their decision-making capacity under the existing legislation.[131]

The Companies Act 1993 addressed these concerns by giving directors wider powers with correspondingly greater obligations.[132] Unusually, the 1993 Act followed a North American model on the basis that this would create the flexibility needed by the modern business world.[133] Among these new provisions were revised reckless trading sections. These, however, did not find favour with a number of commentators.[134] Specifically, Farrar and Tennent's analysis has been previously mentioned.[135]

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[129] As S.320 Companies Act, 1955

[130] Hon Justice D. Tompkins, Directing the Directors: The Duties of Directors Under the Companies Act, 1993 [1994] 2 Waikato Law Review 13

[131] Watson, Directors' Duties in New Zealand [1998] JBL 495 at 495

[132] Watson, Directors' Duties in New Zealand [1998] JBL 495 at 495

[133] Ross, 'Evaluating New Zealand's Companies Law', [1994] 1(2) Agenda 189 at 189. See also Fitzsimons 'Australia and New Zealand on Different Corporate Paths' [1994] 8(2) Otago LR 267

[134] Tefler, 'Risk and Insolvent Trading' in Grantham and Rickett (Eds), Corporate Personality in the 20th Century, (Oxford: Hart Publishing, 1998), p.127, Dabner, 'Insolvent Trading. Recent Developments in Australia, New Zealand and South Africa' [1995] JBL 282 at p. 305 and Watson and Noonan, The Corporate Shield: What Happens to Directors When Companies Fail? [Autumn 2005] Business Review 27 at 34

[135] Farrar and Tennent, 'The Unfitness of Directors, Insolvency and the Consequences – Some Comparisons' [2005] 11(1) Canterbury Law Review 239 at 239. See Chapter Two.

**(ii) The Legislation**

The 1993 Act imposes substantial obligations on a director and extends their potential liability and, indeed, the reckless trading provision has been described as the most criticised provision in the entire Act.[136] The legislation uses a two-pronged approach. Section 135 imposes an obligation not to carry on business in a manner likely to create a substantial risk of serious loss to the company's creditors. Section 136 imposes an obligation on a director not to allow the company to incur an obligation unless he or she reasonably believes that the obligation can be performed.[137] While the word 'obligation' is obviously wider than the word 'debt', this provision is quite similar to section 610(3)(b). Section 136 appears to be directed at single transactions while section 135 is concerned with the totality of the company's operations.[138]

Moreover, the New Zealand provisions take a different approach to Ireland and the UK. The New Zealand reckless trading provisions form part of the coda of directors' duties set out in sections 131 to 135 and section 145 of the Companies Act, 1993. As directors' duties, these are obviously owed to the company. As such, the provisions can (theoretically at least) be imposed outside of the liquidation process. It is a management decision of the directors whether a director is pursued for a breach of duty. If the company is solvent and the directors in breach remain in control, it is highly unlikely that a reckless trading application would be taken against a fellow director. A derivative action is also theoretically possible, but very improbable. The reality therefore is that these particular duties are unlikely to be litigated outside the liquidation process. This possibility is increased by the structure of the provisions themselves. The reckless trading period runs from when a director *'agree[s]'*, *'cause[s],'*or *'allow[s]'* the business of the company to be carried on in a manner likely to create substantial risk of serious loss or when a director agrees to the company incurring an obligation when the director does not believe on reasonable grounds that the company will not be able to perform the obligation when called up to do so.[139]

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[136] Watson and Taylor (General Editors), Corporate Law in New Zealand, (Wellington: Thomson Reuters, 2018), para.22.2

[137] The provisions are set out in Appendix Three.

[138] Watson and Taylor (General Editors), Corporate Law in New Zealand, (Wellington: Thomson Reuters, 2018), para.22.3. It should be noted, however, that the Court of Appeal in Yan v Mainzeal Property and Construction Ltd. [2021] NZCA 99 para.279 appears to come to the opposite conclusion.

[139] Oesterle, 'Corporate Directors' Personal Liability for "Insolvent Trading" in Australia, "Reckless Trading" in New Zealand and "Wrongful Trading" in England. A Recipe for Timid Directors,

Section 301 Companies Act, 1993 allows the liquidator to take a case. For this section to apply, there needs to be a breach of one or more directors' duties and a liquidation in train. Specifically, under section 301 upon an application by a liquidator, creditor or shareholder, the court may order: (i) repayment or restoration of money or property with interest; or (ii) compensation as the court sees fit.[140] Thus, discretion is granted to the court in determining the amount of compensation payable by a director who is found to have breached his or her duties.

A question which does arise is whether adopting a similar approach to New Zealand and adding a reckless trading provision to the current list of directors' duties encapsulated within section 228 Companies Act, 2014 would be beneficial. It seems that it would not. If nothing else, it is doubtful that such a step would increase the invocation rate. Directors' duties are rarely enforced privately.[141] Thus the mechanism is still one of private enforcement with the attendant limitations of impecunious directors and costs. In fact, the rate is more likely to decline as creditors would not have the ability to enforce such a duty. If anything, this indicates that public enforcement has a role to pay in the future of reckless trading.

**(iii) The Salient Features**

Sections 135 and 136 are more similar to section 610 than the UK provision. This most likely arises from the fact that section 610 borrowed heavily from the original New Zealand provision and many elements of that provision still remain in the current iteration. That said, there are significant differences both in drafting and interpretation. These, as well as the salient aspects of the legislation, will be examined to enhance our understanding of section 610 and suggest features for its improvement.

Hamstrung Controlling Shareholders and Skittish Lenders' in Ramsay (Ed.), Company Directors' Liability for Insolvent Trading (North Ryde, NSW, CCH Australia Ltd., 2000), p. 35.

[140] Madsen-Ries v Cooper [2020] NZSC 100 para.156

[141] Nic Bhloscaidh 'The Concurrent Operation of Public and Private Enforcement of the Duties of Corporate Directors: Reinvigorating the Derivative Action and Refining the Public Enforcement Regime' [2018] CLP 132.

**(a) Entrepreneurial Risk-taking**

As directors' duties, sections 135 and 136 apply at all stages of a company's life. They are not confined to the directors' actions at or in the vicinity of insolvency.[142] As such they would appear to apply to equally to both entrepreneurial decisions and operational management issues. This appears to have been an important consideration in the original drafting of these sections. It was considered that the original reckless trading section unduly deterred risk-taking by directors. The new provision should impose liability only if the directors had unreasonably risked insolvency.[143] Thus, as Goddard states, the concept of risk-taking is integral to this approach.[144] As previously argued, the correctness of entrepreneurial decisions should not be the bailiwick of reckless trading type provisions.[145] Indeed, it has been pointed out that this may mean that in high-risk industries, the provision is potentially breached each time the directors make a significant investment decision and that the directors are thus exposed to having their entrepreneurial decisions second-guessed by the courts at a future date.[146]

However, while the intention was to allow entrepreneurial risk-taking, the revised section does not appear to have met its aims in this regard. As O'Regan J. stated in Fatupaito v Bates[147] the section *"...does not appear to allow for such risks to be incurred even in circumstances where the potential for great reward exists."* This is further emphasised by Watson and Taylor who note that contemporary commentators concluded that the specified degree of risk that directors must avoid under the provision would inhibit the use of the limited liability company. Further, the provision offered no guidance as to how to

[142] Davies, Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency' [2006] 7(1) EBOLR 301 at 333.
[143] Law Commission Report No. 9 Company Law Reform and Restatement (Wellington 1989) paras 515-516
[144] Goddard, 'Directors' Liability for Fraudulent Trading: A Critical Review of the New Zealand Regime' in Ramsay (Ed.), Company Directors' Liability for Insolvent Trading (North Ryde, NSW, CCH Australia Ltd., 2000), p.181
[145] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7
[146] Davies, Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency' [2006] 7(1) EBOLR 301 at 334.
[147] [2001] 3 NZLR 386 para.67

balance the risk/return ratio.[148] A final criticism was that it did not take into account the fact that high risk ventures should result in higher profits.[149]

These criticisms, it appears, were correct and a schism opened up between a literal construction of the section and a more figurative and practical interpretation of the section. It was ultimately concluded that the literal approach was not appropriate.[150] The pragmatic course is especially evident regarding section 135. That section, read literally, virtually gave a warranty of solvency and could operate harshly as the section applies before insolvency.[151]

Watson traces the development of this approach. It was first developed by Young J. in Re South Pacific Shipping Ltd.[152] who held that the most prudent approach to the section was not to apply it in its literal sense but instead to allow a balancing between legitimate and illegitimate risk. This balancing was approved by the Court of Appeal in Lower v Traveller[153] and in Mason v Lewis.[154] The test has since then been consistently used by the New Zealand courts.[155] Taylor summarised the position by concluding that the courts enlisted the academic criticism and rather than applying a close textual analysis of the section engaged instead with what the judiciary regarded as its essential points.[156] The judicial approach is now clear; the section does not apply to commercial and entrepreneurial decisions taken by directors on behalf of the company. As Cooke J. stated in Mainzeal Property and Construction Ltd (in liq) v Yan and Others [157] "*Section 135 is not intended to apply to the normal business risks taken by companies."* The judge also emphasised the importance of operational risks

[148] Watson and Taylor (General Editors), Corporate Law in New Zealand, (Wellington: Thomson Reuters, 2018), para.22.2
[149] Goddard, 'Directors' Liability for Trading While: A Critical Review of the New Zealand Regime' in Ramsay (Ed.), Company Directors' Liability for Insolvent Trading (North Ryde, NSW, CCH Australia Ltd., 2000), p.180
[150] Lower v Traveller [2005] NZCA 187. Mason v Lewis [2006] NZCA 55
[151] Mason v Lewis [2006] NZCA 55 para.46
[152] [2004] 9 NZCLC 263
[153] [2005] NZCA 187
[154] [2006] NZCA 55
[155] Watson, Corporate Law and Governance, [2015] New Zealand Law Review 239 at 242-243.
[156] Taylor, 'Directors' Duties on Insolvency in New Zealand: An Empirical Study' [2018] 28(2) New Zealand Universities Law Review 172 at 175
[157] [2019] NZHC 255 para.165

*"The conduct in issue is the manner in which the business is being carried on"*[158] The point is reiterated in Mason v Lewis[159] wherein Hammond J. stated in relation to section 135 "……*it focuses not on a director's belief but rather on the manner in which a company's business is carried on, and whether that modus operandi creates a substantial risk of serious loss."*

The New Zealand Law Commission[160] has an interesting perspective on this issue. The Commission considers that the debate as to how section 135 should be interpreted arose because the fact that financial loss is intrinsic to commercial endeavour was not taken into account. The Commission also concluded that the courts do not take a literal approach to the section. Instead, the question asked is whether the risks taken were legitimate.[161] In effect, a commercial approach which allows entrepreneurial risk-taking is being applied to the application of the section. A balance of risk and reward is allowed and this has been achieved by drawing a distinction between legitimate and illegitimate risks.[162] The judiciary's stance also seems to allow hindsight to be discounted, which is, as we have seen, a highly significant issue.[163] This demonstrates the importance of maintaining a distinction between entrepreneurial risk-taking on the one hand and operationally risky behaviour on the other. As Lynch Fannon states *"the … … reckless trading provisions are part of the legislative armoury used to curb harmful operational risk-taking which is considered to be at the unacceptable end of the spectrum."*[164]

Gellert provides an excellent summary of the factors which Young J. considered should be taken into account in determining whether the risk taken was

[158] [2019] NZHC 255 para.161(d). See also Goatlands Ltd. v Borrell and Borrell [2007] 23 NZTC 21 para.107 wherein Lang J. stated *"Mr and Mrs Borrell's actions also fell outside the scope of orthodox commercial behaviour, because an orthodox approach would have been to protect the company against the risk that Mr and Mrs Borrell had obviously identified."*
[159] Mason v Lewis [2006] NZCA 55 para.51 See also Jordan v O'Sullivan [2008] NZHC 2322
[160] Albeit in general terms as the report concerns incorporated societies.
[161] Law Commission Report R129 'A New Act for Incorporated Societies' [Wellington June 2013] para.6.59
[162] Watson, Corporate Law and Governance, [2015] New Zealand Law Review 239 at 242
[163] As Harrison J. states in Grant v Johnston [2016] NZCA 157 para.75 *"Mr Johnston's performance is not to be judged by the failure of his efforts but by the reasonableness of his actions* ……"
[164] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7 at 8.

legitimate or not.[165] Two important questions must be asked. Firstly, it must be determined whether the risks were understood by those whose funds were imperiled. Specifically, if creditors knew that they were lending to a high-risk venture, then the directors should not be liable. For example, every creditor should know that a new restaurant carries a high risk of failure. A creditor in such circumstances should know that he or she is dealing with a high-risk business and can decline credit if it is considered that the risk is too great.[166] Secondly, it must be asked whether the directors were acting in accordance with orthodox commercial practice. It is likely that directors whose practices were unorthodox would be involved in reckless trading. This point again harks back to Lynch Fannon's distinction between entrepreneurial risk-taking which should not be penalised and risky operational practices which should[167] and an emphasis on operational issues is evident from case law. Specifically, in Grant v Johnston, Mr. Andrews was found to have been involved in reckless trading in short order because he only discharged bills when pressurised by creditors, he did not provide his co-directors with adequate information, blatantly misled one as to the company's financial position and he rashly committed the company to various obligations without informing the other directors.[168] A further example is FXHT Fund Managers Ltd. v Oberholster.[169] In that case, it was the defendant allowing his co-director to have a free run over the running of the company which led Harrison J. to find that he had been involved in reckless trading under section 135. Again, lack of supervision or enquiry is an operational issue. Finally, in Mason v Lewis,[170] in holding that the directors had been involved in reckless trading, weight was placed on the fact that there were no proper financial accounts and that board meetings were ad hoc and not minuted.

In summary, the issue of risk-taking is the central weakness of the revised New Zealand provisions. That business genuinely entails risks does not appear to have

[165] Gellert, 'Re. South Pacific Shipping Ltd.' [1994] 10 Auckland U. L. Review 257 at 261-262
[166] Goddard, 'Directors' Liability for Fraudulent Trading: A Critical Review of the New Zealand Regime' in Ramsay (Ed.), Company Directors' Liability for Insolvent Trading (North Ryde, NSW, CCH Australia Ltd., 2000), p.185
[167] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7
[168] [2015] NZHC 611 paras.107-110
[169] [2010] NZCA 197
[170] Mason v Lewis [2006] NZCA 55

been appropriately taken into account. Likewise, consideration does not appear to have been given to the fact that even excellently run companies will sometimes fail due to extrinsic circumstances, bad luck or what with hindsight turn out to be errors of entrepreneurial judgment. In an example of legal outsourcing, the New Zealand judiciary has had to face these issues and in order to square the legislative circle has imposed a pragmatic methodology to the interpretation of the sections. It appears to be a beneficial approach. This is especially the case as, of the three reckless trading type provisions considered in this thesis, it is the only one which is invoked by applicants with any degree of consistency. Again, all the above points highlight the necessity, within the Irish provision, of confining its application to operational risk-taking.

**(b) Trading While Insolvent**

Sections 135 and 136 appear to have succeeded because the courts have taken a practical approach and have not applied a literal interpretation. While difficulties with the interpretation and application of phrase 'substantial risk of serious loss' still exist, these have been eased by alleviated by the New Zealand courts' pragmatic outlook. This has allowed companies to trade while insolvent in certain circumstances.

This practical approach is evident in the findings of the court in Mason v Lewis,[171] that where the company is facing insolvency, a 'sober assessment' of its financial situation is required. Very importantly, continuing to trade while insolvent is permissible and directors are allowed a margin of error[172] and, indeed, as Watson and Taylor point out, directors can be granted up to six months following insolvency to conduct the assessment and decide on the best course for the company.[173] This is an operational issue centering on whether the directors have sufficient financial information to make decisions properly.[174]

[171] [2006] NZCA 55 para.51
[172] Madsen-Ries v Greenhill [2016] NZHC 3188 para.70
[173] Watson and Taylor (General Editors), Corporate Law in New Zealand, (Wellington: Thomson Reuters, 2018), para.22.2.2 fn.96
[174] Watson and Taylor (General Editors), Corporate Law in New Zealand, (Wellington: Thomson Reuters, 2018) at para.22.2.2

Further, Young J. pointed out in Re. South Pacific Shipping Ltd.[175] that the company does not have to cease trading the moment it reaches the point of insolvency. Doing so may inflict even more losses on creditors and will prevent a salvageable company from being saved. He stated *'No one suggests that a company must cease trading the moment it becomes insolvent (in a balance sheet sense). Such a cessation of business may inflict serious losses on creditors ……'* This point was recently reiterated by the Court of Appeal in Yan v Mainzeal Property and Construction Ltd. Goddard J. stated *"It was reasonable for the directors to take some time to explore all realistic alternative courses of action and endeavour to avoid an insolvent liquidation. If they were actively engaged in seeking advice and attempting to address these issues, they could not be criticised."*[176]

This is not a carte blanche, however. For example, Madsen-Ries v Cooper held that trading while insolvent is prohibited where continuation might benefit some creditors but there would still be a shortfall overall. A company which is clearly cannot be saved cannot continue to trade even if some creditors' positions will be improved.[177] The Supreme Court was quite clear in this regard. Glazebrook J. stated *"If a company reaches a point where continued trading will result in shortfall to creditors and the company is not salvageable, then continued trading will be in breach of s 135 …"*[178]

The New Zealand position is stricter than that which exists in the UK. It is still superior, however, to the Irish provision which due to the apparent deeming nature of section 610(3)(b) means that such an option may not be open to directors of a troubled company where it is commercially rational to do so. The importance the New Zealand judiciary has placed on the ability to trade while insolvent further highlights the difficulties and limitations of the Irish position. It is again pertinent to point out that this could be easily solved by simply

[175] [2004] 9 NZCLC 263 para.125. See also Richard Geewiz Gee Consultants Ltd (In liquidation) v Gee [2014] NZHC 1483 para.99 and Madsen-Ries and Vance v Petera [2015] NZHC 538 para.97
[176] [2021] NZCA 99 para.452
[177] [2020] NZSC 100 paras.72 and 94. The Supreme Court's view may differ from that of the LRC. Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), paras.12.33-12.44
[178] [2020] NZSC 100 para.174

clarifying that the actions described in subsection (3)(b) are examples of reckless trading behaviour.

**(c) Defences**

As sections 135 and 136 are directors' duties, there is no general defence per se. This is an advantage of the New Zealand provisions when compared to section 610. The test here is clinical and objective; either the directors' duties were breached, or they were not. There is no requirement to investigate whether the director acted in an honest and responsible manner. Moral blameworthiness is not an issue. Indeed, even in the absence of a defence, the section produces satisfactory results. In Grant v Johnston, Mr. Johnston's liability, despite being found to be involved in reckless trading, was (discussed below) reduced to nil based on considerations of causation, fairness and culpability.[179]

There is, however, a defence of sorts in that directors may be able to rely on guidance from professional advisers.[180] The director must, however, demonstrate that such reliance was reasonable, and the section is not a carte blanche which allows the director to pass on all responsibility for decision-making to third parties.[181] Advice which is general in nature cannot be relied upon.[182] This defence is objective but contains a subjective element. While the director must subjectively believe that the advice received is reasonable and rational, he or she must also act in good faith and have objective grounds for such a belief. This is a far more sensible and functional defence than that currently contained within section 610. Importantly, it also extends to advice from competent employees and other directors (provided independence is maintained). Where a director obtains advice from well qualified professionals that the company can trade out of its difficulties or that a certain course of action will stave off insolvency and the director interrogates that advice and finds its objectively compelling, that director can be absolved from personal liability even where collapse ultimately occurs. Such a defence is eminently sensible and similar to the UK defence in its

[179] [2016] NZCA 157 para.89
[180] S.138 Companies Act, 1993. See Appendix Three.
[181] Goatlands Ltd. v Borrell and Borrell [2007] 23 NZTC 21
[182] Madsen-Ries v Cooper [2020] NZSC 100 paras.126-127

aims. It protects the conscientious director who does his or her best to protect creditors' positions in difficult circumstances.

The New Zealand position is superior to the Irish position. The New Zealand defence, though limited, is a model of clarity. It can be tested objectively. It avoids questions of moral culpability. The objective and subjective elements interact logically. It examines whether a sensible step, obtaining competent advice and information, was taken prior to liquidation. That said, the UK defence of taking every step to minimise losses to creditors may be superior. That defence is preferable as it can take into account the full range of actions which the director took (or indeed did not take) prior to insolvent liquidation and their effect on creditors. Ultimately, however, both the New Zealand and UK positions demonstrate that superior alternatives are available.

**(d) The Quantum of the Contribution**

While the UK may have found itself in a cul-de-sac as far as determining the quantum of the contribution, a similar issue has arisen in New Zealand. Historically, the New Zealand courts have held that a two-step approach is to be taken.

1. Firstly, the quantum of the deterioration in the company's financial position between the date that inadequate corporate governance first became evident and the date that the company was placed in liquidation must be calculated. This is obviously a factual matter and can be calculated by reference to the accounting evidence.[183]

2. The second element is discretionary. The court looks to the culpability of the director, the causation and the duration of trading.[184]

Grant v Johnston is a case in point. The High Court made Mr. Andrews who appeared to be the main culprit in the debacle personally liable for the full extent of the amounts outstanding to creditors at the date of the liquidation.[185] Mr.

[183] Mason v Lewis [2006] NZCA 55 para. 109
[184] Mason v Lewis [2006] NZCA 55 paras 110
[185] [2015] NZHC 611 para.140

Johnston, the non-executive director, had much lesser culpability and did not have to pay compensation based on issues of causation, culpability and fairness.[186] The second limb of the test takes into account extent of the director's responsibility for the insolvency of the company.[187] As Glazebrook J. stated in Peace and Glory Society Ltd. v. Samsa[188] *"……s 301 refers to a contribution by the director by way of compensation. This means that any contribution has to be equated with what was lost."*

That said, two recent cases have brought New Zealand closer to the UK approach. In Madsen-Ries v Cooper, the Supreme Court held that regarding a calculation of the quantum of liability under section 135, the appropriate starting point in most cases is the net deterioration in the company's financial position between the date trading should have ceased and the actual liquidation date. The court considered that this was the correct approach because section 135 looks at creditors and the business as a whole.[189] This is a company as opposed to an individual creditor approach. This analysis was recently applied by the Court of Appeal in Yan v Mainzeal Property and Construction Ltd. The directors were involved in reckless trading under section 135 because the company should have been liquidated in January 2011.[190] However, the continued trading had not resulted in a deterioration of the company's overall position.[191] In fact, similar to Grant v Ralls,[192] the financial position may actually have improved.[193] Hence, no personal liability could be imposed on the directors.[194] However, the New Zealand position under section 135 is not quite as narrow as that which exists in the UK. The court held that the directors could have been made liable for the entire deficiency of the company, had their actions been the cause of the company's insolvency.[195] Moreover, personal liability was imposed as section

[186] [2016] NZCA 157 paras. 89-93.
[187] See also Yan v Mainzeal Property and Construction Ltd. [2021] NZCA 99 paras.486 to 488.
[188] [2009] NZCA 396 para.75
[189] [2020] NZSC 100 para.164
[190] [2021] NZCA 99 para.541. A liquidator was not appointed until early 2013 (para.184).
[191] [2021] NZCA 99 para.542.
[192] [2016] EWHC 243
[193] [2021] NZCA 99 para.486
[194] [2021] NZCA 99 para.542.
[195] [2021] NZCA 99 para.503. It should be noted that one of the reasons for this finding was that this question had not been adequately argued by the defendants in the High Court.

136 had been breached. The directors caused the company to enter into new obligations after January 2011. While the directors believed that the company would meet those obligations, they did not have reasonable grounds for this belief.[196] Compensation was due to the company under the section. In effect, the Court of Appeal ruled that the directors were liable for the amount of new debt taken on by the company between January 2011 and the liquidation date.[197]

Commentators have questioned the correctness of the UK approach to quantum and this approach is applicable in New Zealand also. That said, due to the different wording of section 135 and the existence of section 136, the New Zealand courts are not narrowly confined to that approach. Importantly also it was acknowledged in Mainzeal that where a creditor brings a case, compensation can be awarded directly to that creditor under section 301(1)(c),[198] though how the quantum would be determined in these circumstances has not yet been judicially determined.

**(e) Objective and Subjective**

Under section 135, liability for reckless trading is based on an objective test.[199] The standard which is required is that of a reasonable and prudent director. What a director subjectively believes to be reasonable is not relevant. The test is whether a reasonable and prudent director would have seen that an unreasonable risk is involved.[200] As Hammond J. stated in Mason v Lewis *"the test is an objective one."*[201]

Section 136 is different in that it combines a subjective element and with an objective test. In order to establish a breach of this duty, the director must have agreed to the company incurring an obligation and not have believed (this is the subjective element) on reasonable grounds (this is the objective test) that the company would be able to perform that obligation when required to do so.[202]

[196] [2021] NZCA 99 para.544
[197] [2021] NZCA 99 para.519
[198] [2021] NZCA 99 para.255
[199] Mason v Lewis [2006] NZCA 55.
[200] Bos and Wiseman, 'Directors' Liabilities to Creditors' [2003] NZLJ 262 at 266
[201] Mason v Lewis [2006] NZCA 55 para.51
[202] Bos and Wiseman, 'Directors' Liabilities to Creditors' [2003] NZLJ 262 at 266

That said, some commentators consider that, in investigating liability under this section, the judiciary has placed more emphasis on the objective test rather than the subjective element. Watson and Noonan[203] use Fatupaito v Bates[204] as an example of this bias. In that case director the director had a genuine belief that continuing to trade would generate profits over and above the expenditure to be incurred. However, the judge found that the director had breached section 136 as the director did know that the company was insolvent.

The combination of objective and subjective standards within sections 135 and 136 is much more logical and effective than the combination contained in section 610. While some commentators decry the prevalence of the objective over the subjective, the New Zealand provisions have avoided the logical impossibility of combining an objective test of reckless trading with a subjective defence. A logical interaction between the objective and the subjective standards means that the sections, though very differently worded, are on par with the UK in this regard.

**(IV) A REDRAFTED SECTION 610**

Section 214 certainly has features which the Irish section would do well to adopt; it looks only to operational risks; the use of hindsight and moral blameworthiness are largely avoided as is the confusion between objective and subjective standards. Trading while insolvent is possible. The defence, when not interpreted literally, functions well. The UK judiciary appears to have been able to mitigate and soften the effects of the more severe requirements; 'every step' does not literally mean every possible step. The defence also avoids the illogicalities and contradictions of subsection (8). An Irish section which incorporated these strengths would encourage the use of the provision.

New Zealand is a more difficult proposition to judge. There are myriad difficulties with the drafting of the sections which have been ameliorated by the judiciary. Though

[203] Watson and Noonan, 'The Corporate Shield. What Happens to Directors When Companies Fail', [Autumn 2005] Business Review 27 at 34.
[204] [2001] 3 NZLR 386

more similar to the Irish provision because of a shared drafting history, sections 135 and 136 arguably provide less guidance on section 610. This is because of the judicial interpretation of the section is, in parts, quite divorced from what the sections themselves actually say. A practical rather than a literal interpretation has been invoked.

There are points to admire within the New Zealand regime. For example, the judiciary has successfully delineated entrepreneurial mistakes from operational ones. Further, the fact that the New Zealand provision operates effectively absent a general defence certainly contains food for thought regarding the necessity for and any possible redrafting of section 610(8). It indicates that the existence of a general defence is not of paramount of importance; the provisions operate well with section 138 alone. Moreover, objective and subjective criteria apply coherently and trading while insolvent is possible.

A redrafted section 610 should increase both the invocation rate and the success rate of the provision. Combining the insights gleaned from this Chapter and Chapter Three, it is recommended that there be a redrafting of the provision along the lines suggested by Lynch Fannon.[205] She convincingly argues that the section should contain:

1. The simple statement of reckless trading as already set out in subsection (1)(a)
2. A second statement as to what can amount to reckless trading derived from what is now subsection (3)(a)
3. A third statement as to what can amount to reckless trading derived from what is now subsection (3)(b)

This initial amendment results in a far more workable statutory scheme. The redrafted section would clarify that the new provisions derived from the current subsection (3) contain examples of what can constitute reckless trading behaviour. This should result in a more expansive interpretation of the provision as the judiciary is no longer circumscribed by statutory fictions. It will also allow a company to trade while

[205] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7at 10.

insolvent where doing so is commercially justified. The largely objective tests for what constitutes reckless trading can be retained especially if the word *'knowingly'* is removed from subsection (1). Redrafting along these lines also allows the retention of an existing beneficial aspect of the provision - no firm definition of reckless trading. Such an amendment also means that reckless trading will exist as a single concept. Currently, there are two entirely separate iterations of reckless trading – the first within subsection (1) and the second within subsection (3). This highly artificial[206] format will be abolished.

The current defence is unsatisfactory. The question of whether the director acted honestly is not relevant to reckless trading. Lack of honesty is a concept associated with fraud. Fraud is not within the ambit of reckless trading. Thus, honesty has no place in the defence. Secondly, the subsection contains a logical conundrum. It is inherently inconsistent to find that a director who engaged in reckless trading acted responsibly. The existence of the former must exclude the latter. Finally, a subjective defence is incompatible with objective criteria. Three possible ways of ameliorating this situation are suggested:

1. Subsection (8) could be deleted in its entirety. This is on the basis that the defence, as well as being confusing, is also unnecessary. The court already has sufficient discretion within subsections (2) and (6).
2. A limited defence, similar to that which exists in New Zealand, could be introduced.
3. A defence similar to that which exists in the UK could be introduced.

A UK style defence (without the emphasis on 'every step') is the preferred option. Such a defence would allow the court to concentrate on whether and what steps were taken to minimise losses to creditors. It would also allow trading while insolvent where such a course of action is reasonably considered to be beneficial. Moreover, such a defence would contain a wholly objective test. This would resolve the existing tension between objective criteria and a subjective defence. It is for these reasons that this suggestion is the preferred option.

[206] Re. Appleyard Motors Ltd [2016] IECA 280 para.38

The analysis of section 214 and sections 135 and 136 provides the following additional general guidance and hallmarks for a redrafted section 610;

1. As we have seen from section 214, a redrafted provision should seek to avoid an emphasis on narrow timing issues. The emphasis in the UK on when the directors should have realised that there was no reasonable prospect of avoiding an insolvent liquidation has become a *'procedural snare'*[207] that arguably deflects from the real purpose of a wrongful trading type provision; compensating creditors from the reckless actions of directors.[208] Hence retaining the existing subsections (1) and (3) in the manner suggested in by Lynch Fannon appears to be the optimal drafting solution.

2. The redrafted section should concentrate on operational failings. This is a clear strength of section 214 which largely avoids involving itself in entrepreneurial decision-making. The history of the New Zealand provision provides a warning in this area. If the section is not carefully redrafted, it may encroach on entrepreneurial risk-taking and may ultimately weaken the framework underpinning the separate legal personality of the company. Indeed, as has been pointed out, section 610(1)(a) may as currently drafted risks embroiling the judiciary in examinations of historic commercial decisions of the company. Indeed, New Zealand difficulties also indicate that section 214's emphasis on directors' operational actions is the preferred course.

3. It is important to allow directors the freedom to continue trading even though the company is insolvent. In many circumstances, this is commercially sensible and beneficial to creditors. Both the New Zealand and the UK provision allow this to occur and demonstrate the importance of this ability. Redrafting subsection (3)(b) as an example of an activity which may constitute reckless trading rather than a statutory fiction would solve this issue.

[207] Bachner, Wrongful Trading - A New European Model For Creditor Protection? [2004] 5(2) EBOR 293 at 306
[208] Insolvency Law and Practice – Report of the Review Committee [1982] Cmnd 8558 para.1776

4. Both the New Zealand and UK provisions are drafted to logically combine objective and subjective elements. An objective defence will achieve this as will the removal of the word *'knowingly'* from subsection (1)(a). This would ensure an entirely objective standard throughout the provision.

5. Creditors should retain locus standi to take a case. This has a normative basis; a creditor who has suffered a loss at the hands of an allegedly reckless director has an avenue to obtain recompense. It also increases the invocation rate. Moreover, subsections (2) and (6) should remain in the redrafted provision. Thus, the court will retain discretion as to the quantum and direction of any compensation awarded. This will avoid the straight jacket of the net deficiency approach now prevalent in the UK and seemingly gaining traction in New Zealand.

That said, it must be acknowledged that even a redrafted section combining what has been discovered in this and the previous chapter may not, by itself, be sufficient to override the systemic problems with invocation. It is therefore necessary to move on to the second central research question and ask whether a reckless trading type provision is necessary at all. In this regard, important legal theories will be applied in order to determine the light which they cast on the section. Further, the Irish restriction and disqualification regimes will be examined along with the directors' duty to act in the interests of creditors in order to determine whether these frameworks are suitable substitutes for section 610.

# CHAPTER FIVE: THEORETICAL APPROACHES TO RECKLESS TRADING

## (I) INTRODUCTION

In this chapter reckless trading will be examined from a theoretical perspective. Three important legal theories will be considered: contractarianism, stakeholder theory and judicial realism. Contractarianism has been chosen due to its seminal importance as a theory of company law. Stakeholder theory will be examined because of its significance as a contemporary philosophy which is playing an increasingly central role in corporate regulation. Thirdly, judicial realism is considered, but for different reasons. This theory has been chosen because it may provide an explanation for the lack of success of the current reckless trading provisions and liquidators and creditors unwillingness to engage with same. The chapter will consider the light these theories cast on the reckless trading provision. Irish case law will be examined taking into account the theoretical perspectives.

## (II) CONTRACTARIANISM

### (i) Contractarianism and Risk-Taking

Company law contains a number of fundamental concepts such as limited liability, separate legal personality and the division between ownership and control. The purpose of these concepts is to encourage and facilitate risk-taking. At its core, company law establishes rights among participants in companies and allocates risk among those participants.[1] Risk is intrinsic to economic enterprise[2] and risk-taking is an essential aspect of virtually any business venture.[3] Thus, traditionally the courts have been sanguine about the possibility of a company incurring losses[4] (as, indeed, are creditors themselves; bad debts are an inevitability in any business). A myriad of Irish case law supports this contention.[5] Against this background, the question to be

[1] Ramsay 'Models of Corporate Regulation: The Mandatory/Enabling Debate' in Grantham and Rickett (Eds), Corporate Personality in the 20th Century, (Oxford: Hart Publishing, 1998), p.220.
[2] O'Hanlon, The Corporate Form and Reckless Trading: A Modern Pandora and Epimethus [2006] 28 DULG 254 at 254-256
[3] Rosenberg, 'Supplying the Adverb: The Future of Corporate Risk-Taking and the Business Judgment Rule' [2009] 6(2) Berkeley Business Law Journal 216 at 217
[4] O'Hanlon, The Corporate Form and Reckless Trading: A Modern Pandora and Epimethus [2006] 28 DULG 254 at 256.
[5] Re. USIT World Plc. [2005] IEHC 285. Business Communications v Baxter & Parsons Unreported High Court 21 July 1995

asked is whether from a theoretical perspective company law should protect against risk at all. Put another way, the issue is whether a reckless trading provision interferes with the market and accordingly detracts from economic efficiency by protecting creditors in circumstances where creditors have not seen fit to protect themselves.[6] How creditors might create such protection is also considered below.

A legal theory which supports the above analysis is contractarianism. While this is a United States developed model[7] and concentrates on very large (and usually public) companies with a widely dispersed ownership, it can cast light on the issues examined in this thesis. A crucial question in company law is to whom is the corporation ultimately accountable? Contractarians believe that the company is simply a conglomeration of corporate constituents who act in concert.[8] The company is thus not accountable to anyone except shareholders and those who have voluntarily become associated with the company by entering into a contract with it.[9] This is known as the 'nexus of contracts' theory[10] and assumes that each third party will, as rational economic actors, attempt to maximise their own positions.[11] Contractarianism argues that market based interactions generate a spontaneous order. This results from each participant selecting the optimal mixture of efficient rules for themselves.[12] Thus non-shareholders are theoretically able to bargain for specific rights and obligations.[13] From a policy standpoint, private parties to a private contact should be free to order their affairs in the way that they see fit[14] and it is not the role of the legislature to interfere with that ordering.

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[6] O'Hanlon, The Corporate Form and Reckless Trading: A Modern Pandora and Epimethus [2006] 28 DULJ 254 at 287

[7] The model originally emanated from the Chicago School of Law and Economics legal jurisprudence.

[8] Bainbridge, 'Director Primacy: The Means and Ends of Corporate Governance' [2003] 97(2) Northwestern University Law Review 547 at 564-565.

[9] Bone, Legal Perspectives on Corporate Responsibility: Contractarian or Communitarian Thought?' [2011] 24(2) The Canadian Journal of Law and Jurisprudence 277 at 285.

[10] This theory has been criticised. See Blair and Stout, 'Specific Investment and Corporate Law' [2006] 7 EBOLR 473.

[11] See generally Fama, 'Agency Problems and the Theory of the Firm' [1998]' 88(2) Journal of Political Economy 288 and Easterbrook and Fischel, 'The Corporate Contract' [1989] 89(7) Columbia Law Review 1416

[12] Attenborough, 'Empirical Insights into Corporate Contractarian Theory' [2017] 37(2) Legal Studies 191 at 192

[13] Attenborough, 'Empirical Insights into Corporate Contractarian Theory' [2017] 37(2) Legal Studies 191 at 198.

[14] Butler and Ribstein, 'Opting out of Fiduciary Duties: A Response to the Anti-Contractarians', [1990] 65 Wash. L. Rev. 1 at 7-8

This leads to the model of shareholder primacy which argues that the sole purpose of the company is to advance owners' wealth.[15] The theory is based on the concept of private property. As shareholders own the company, their interests are primary. Thus, if the company is accountable to anyone, it must be the shareholders. In order to fulfill this wealth creation role, companies must be allowed to behave in a rational and efficient manner within the marketplace unobstructed by legislation.[16] Specifically, contractarians would not support the introduction of a reckless trading type provision as it alters the bargain between the creditors and the company.[17] Government intervention, they argue, is unnecessary.[18]

**(ii) Creditor Self Protection**

The argument arises that creditors must, and indeed are able to, manage their own credit risks.[19] As Tefler states *'[T]he creation of director liability assumes that creditors cannot take adequate steps to ensure their interests are protected.'*[20] Thus a reckless trading type provision in effect overcompensates creditors. This view has a long history; the perhaps most famous invocation being that of Lord Macnaghten in Salomon v Salomon.[21] To reiterate, on a contractarian analysis, creditors are overcompensated by legislative protections. This is on the basis that they can rely on a reckless trading provision in combination with, say, a personal guarantee or an increased interest rate. As Goddard states *"People who take a risk and are paid to take a risk should not complain when the risk materializes".*[22]

[15] Friedman, 'The Social Responsibility of Corporations is to Increase Wealth' [13 September 1970] NY Times Magazine 32.
[16] Bone, Legal Perspectives on Corporate Responsibility: Contractarian or Communitarian Thought?' [2011] 24(2) The Canadian Journal of Law and Jurisprudence 277 at 285
[17] Morrison, 'The Economic Necessity for the Australian Insolvent Trading Prohibition', [2003] International Insolvency Review 171 at 176-177
[18] Butler and Ribstein, 'Opting out of Fiduciary Duties: A Response to the Anti-Contractarians', [1990] 65 Wash. L. Rev. 1 at 53-56
[19] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para12.23
[20] Tefler, 'Risk and Insolvent Trading' in Grantham and Rickett (Eds), Corporate Personality in the 20th Century, (Oxford: Hart Publishing, 1998), p.129
[21] [1897] AC 22
[22] Goddard, 'Directors' Liability for Trading While Insolvent: A Critical Review of the New Zealand Regime' in Ramsay (Ed.), Company Directors' Liability for Insolvent Trading (North Ryde, NSW, CCH Australia Ltd., 2000), p.171

The arguments here are legion. A variety of devices are available to creditors.[23] Creditors are warned in advance that they are dealing with a limited liability entity. Creditors should spread their risk.[24] Creditors can monitor those to whom they extend credit. Where goods are sold, retention of title clauses are commonly available. Security can be demanded. Penalty clauses can be incorporated into the contract. Creditors can charge a higher interest rate on a loan to reflect a higher risk and/or restrictions can be placed on the activities of the company.[25] Even aside from this, creditors can structure their pricing to take into account the fact that a percentage of customers will default.[26] Banks certainly have a wide variety of avenues open to them. Specifically, they can demand personal guarantees from directors and also have expertise as to how to structure a particular transaction.[27] Indeed, a 1994 study[28] (and there is no reason to believe that the results would be significantly different today) demonstrates that banks and senior institutional lenders, via their lending conditions, were able to significantly influence the actions of corporate borrowers.[29]

**(iii) Are the Contractarians Correct?**

The above is the legal theory; an *"elegant theoretical framework".*[30] While shareholder primacy became near dogma due to its pervasiveness at the end of the last century[31] and has been described as a substantive intellectual accomplishment which has improved the coherence of academic corporate law,[32] the theory has now been somewhat discredited.[33]

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[23] Such as retention of title clauses and invoice factoring.
[24] Morrison, 'The Economic Necessity for the Australian Insolvent Trading Prohibition', [2003] International Insolvency Review 171 at 179
[25] Ramsay, 'An Overview of the Insolvent Trading Debate' in Ramsay (Ed.), Company Directors' Liability for Insolvent Trading (North Ryde, NSW, CCH Australia Ltd., 2000), p.10.
[26] Williams 'What We Can Expect to Gain From Reforming the Insolvent Trading Remedy' [2015] 78 MLR 55 at 58
[27] Keay, 'Wrongful Trading and the Liability of Company Directors: A Theoretical Perspective' [2005] 25(3) Legal Studies 431 at 452
[28] Gilson and Vetsuypens 'Creditor Control in Financially Distressed Firms: Empirical Evidence' [1994] 72 Wash ULQ 1005
[29] Gilson and Vetsuypens 'Creditor Control in Financially Distressed Firms: Empirical Evidence' [1994] 72 Wash ULQ 1005 at 1007.
[30] Blair and Stout, 'Specific Investment and Corporate Law' [2006] 7 EBOLR 473 at 480
[31] Stout, The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, and the Public (Oakland CA: Berrett-Koehler Publishers 2012), at p.21.
[32] Allen, 'Contracts and Communities' [1993] 50(4) Washington and Lee Law Review 1395 at 1399.
[33] Lynch Fannon, Working Within Two Kinds of Capitalism (Oxford and Portland Oregon: Hart Publications, 2003), p.125.

Corporate law does not require directors to maximise shareholder value.[34] Indeed, Stout argues that such belief is a fable.[35] It is difficult to find a supporting authority for the doctrine.[36] There is ample modern case law confirming that directors are free to divert assets and profits to other stakeholders.[37] The economic model of the principal/agent relationship underpinning the theory is also flawed as too simplistic. Simply put, it does not capture *"… the economic reality of a public corporation with thousands of shareholders, scores of executives, and a dozen or more directors"*[38] The primacy of contractual relationships means that the importance of social interactions within the company is ignored.[39] Shareholders, the soi-disant principals have little real power[40] and a rather weak claim to the company's assets and wealth.[41] From the lawyer's standpoint, shareholders' claims to ownership of the corporation are fragile.[42] The shareholder, who only wants value maximised, does not, in any event, exist.[43] Directors act in a manner which is contrary to the predictions of the model[44] and enjoy an extraordinary degree of discretion.[45] They are more akin to autonomous fiduciaries than agents.[46] Indeed, while the above points all concentrate on public companies, the reckless trading provision itself is an acknowledgement of this fact. It is the directors, and not the shareholders, who are pursued and made accountable. Finally, there is a

[34] For examples of situations where US corporate law allows for a contrary approach see Millon, 'Shareholder Primacy in the Classroom after the financial Crisis' [2013] 8 J. Bus. & Tech. L. 191 at 195

[35]Stout, The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, and the Public (Oakland CA: Berrett-Koehler Publishers 2012), pgs.21-26

[36] Millon, 'Shareholder Primacy in the Classroom after the Financial Crisis' [2013] 8 J. Bus. & Tech. L. 191 at 192.

[37]Blair and Stout, 'Specific Investment and Corporate Law' [2006] 7 EBOLR 473 at 487.

[38] Stout, The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, and the Public (Oakland CA: Berrett-Koehler Publishers 2012), p.36.

[39] Allen, 'Contracts and Communities' [1993] 50(4) Washington and Lee Law Review 1395 at 1401.

[40] Lynch Fannon, Working Within Two Kinds of Capitalism (Oxford and Portland Oregon: Hart Publications, 2003), p.124.

[41] Lynch Fannon, Working Within Two Kinds of Capitalism (Oxford and Portland Oregon: Hart Publications, 2003), p.80.

[42] Stout, 'Bad and Not-so-Bad Arguments for Shareholder Primacy' [2002] 75 Southern California Law Review 1189 at 1190-1192

[43] Stout, The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, and the Public (Oakland CA: Berrett-Koehler Publishers 2012), at 57-59 and 69.

[44] Blair and Stout, 'Specific Investment and Corporate Law' [2006] 7 EBOLR 473 at 495

[45] Blair and Stout, 'A Production Team Model of Corporate Law' [1999] 85(2) Virginia Law Review 247 at 252

[46] Blair and Stout, 'Director Accountability and the Mediating Role of the Corporate Board' [2001] 79(2) Washington University Law Review 403 at 423-426.

notable absence of evidence that shareholder value improves the financial results of companies.[47]

Contractarians argue that creditors can and should obtain the additional protections they need themselves. The question which arises is how feasible this analysis is for the typical small trader. (It should be noted that the concentration here is on the small trader. The case law, both in Ireland and elsewhere generally involves small companies and small creditors). Put another way, that creditors should bargain for and obtain protections of various types is, on the surface, a compelling theoretical solution. However, do we see evidence of this occurring in practice?

**(a) Can Creditors Protect Themselves?**

As we have seen banks, financial institutions and very large companies have little difficulty protecting themselves as creditors. A myriad of different devices is available. Likewise, some classes of involuntary creditors such employees can be in a strong position due to the statutory rights available to them. In this thesis, however, the concern is with the ordinary trade creditor and, in reality, small trade creditors cannot and do not obtain security. In any event, even if they could, precisely what would be available to them? The company will most likely have already granted a fixed and floating charge over all its assets to its financial institution.[48] Further, the legal system creates difficulties for those who take security in the vicinity of insolvency.[49] Oesterle lists a number of options open to trade creditors such as paying for independent credit reports, demanding financial information in contract negotiations and obtaining personal guarantees,[50] but the question must be asked as to how achievable such measures

[47] Stout, The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, and the Public (Oakland CA: Berrett-Koehler Publishers 2012), p.38
[48] Keay, Directors' Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors [2003] 66(5) Modern Law Review 665 at 688.
[49] Whincop, 'Taking the Corporate Contract More Seriously: The Economic Cases Against, and a Transaction Cost Rationale for, the Insolvent Trading Provisions' [1996] 5 Griffith Law Review 1 at 23.
[50] Oesterle, 'Corporate Directors' Personal Liability for "Insolvent Trading" in Australia, "Reckless Trading" in New Zealand and "Wrongful Trading" in England. A Recipe for Timid Directors, Hamstrung Controlling Shareholders and Skittish Lenders' in Ramsay (Ed.), Company Directors' Liability for Insolvent Trading (North Ryde, NSW, CCH Australia Ltd., 2000), pgs.32-33. Oesterle's list concerns US creditors, but the same options would be available here.

really are.[51] Traditional measures such as increased interest rates and restrictions on activities are simply not possible for the most part where such creditors are concerned.[52] Moreover, the creditor may only discover later that a higher interest rate should have been requested as the director's actions post the contract may make the transaction riskier.[53] If such creditors insist on more protection than their customers will bear, they will lose business[54] (and often their customers will bear very little protection). That, of course, depends on the market share and financial strength of the creditor vis-a-vis the customer.[55] Coca-Cola will be able to drive a far harder bargain with Tesco than a small local soft drink manufacturer.

In the real-world contractual arrangements are usually not made by equals,[56] and many contracts allow little room for negotiation.[57] Having such contracts prepared is, in any event, expensive as is the cost of monitoring such contracts.[58] Further, small creditors often extend credit for short periods so monitoring is pointless.[59] Informational asymmetries are ubiquitous,[60] but are particularly acute between the ordinary trade creditor and the company; directors will always know more about their firm than the outsider will. This is a point which appears to have been missed in contractarian thinking. The competitive nature of the business environment also mitigates against trade creditors in particular. A

[51] Keay 'A Theoretical Analysis of the Director's Duty to Consider Creditor Interests: The Progressive
School's Approach' [2004] 4 JCLS 307 at 320.
[52] Ramsay, 'An Overview of the Insolvent Trading Debate' in Ramsay (Ed.), Company Directors' Liability for Insolvent Trading (North Ryde, NSW, CCH Australia Ltd., 2000), p.10.
[53] Keay, Directors' Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors [2003] 66(5) Modern Law Review 665 at 689.
[54] Tefler, 'Risk and Insolvent Trading' in Grantham and Rickett (Eds), Corporate Personality in the 20th Century, (Oxford: Hart Publishing, 1998), p.131
[55] Keay, 'Wrongful Trading and the Liability of Company Directors: A Theoretical Perspective' [2005] 25(3) Legal Studies 431 at 453.
[56] See generally Attenborough, 'Empirical Insights into Corporate Contractarian Theory' [2017] 37(2) Legal Studies 191
[57] Keay, 'Stakeholder Theory in Corporate Law: Has it Got What it Takes?' [2010] 9(3) Richmond Journal of Global Law and Business 249 at 293.
[58] Keay, 'Wrongful Trading and the Liability of Company Directors: A Theoretical Perspective' [2005] 25(3) Legal Studies 431 at 443.
[59] Goddard, 'Directors' Liability for Trading While Insolvent: A Critical Review of the New Zealand Regime' in Ramsay (Ed.), Company Directors' Liability for Insolvent Trading (North Ryde, NSW, CCH Australia Ltd., 2000), p.172.
[60] Licht, 'Lord Eldon Redux: Information Asymmetry, Accountability and Fiduciary Loyalty' [2017] 27(4) Oxford Journal of Legal Studies 770 at 771

company will have little difficulty in finding another supplier who does not extract onerous concessions.[61] Morrison suggests that a large, diversified portfolio of lending contracts will protect the creditor.[62] While that is undoubtedly correct, the difficulty lies in obtaining such a portfolio in the first place. Spreading of risk in this manner is the bailiwick of banks and large financial institutions. As Keay states *'…many creditors extend credit to players in only one industry.'*[63] Sufficient diversification of risk, while possible for the financial institution, is unlikely in the extreme to be an option for the ordinary trade creditor.

This is not to say that protections do not exist or that creditors should be absolved from taking any care whatsoever. However, not all creditors are created equal. Hence, the overwhelming evidence is that unsecured trade creditors in particular have limited opportunities to protect themselves. Unlike larger creditors, they cannot supervise the company to which they extend credit.[64] Further, larger creditors, where a loss is concerned, can 'take the hit' so to speak as such companies have a myriad of customers and cash balances. In summary, many large creditors can and do protect themselves. That argument is, however, far less persuasive when applied to small trade creditors.[65]

Overall, it is difficult to accept the contractarians' analysis regarding the typical small trade creditor. The reality is that they obtain no protections for both the risks they willingly undertake (ordinary commercial failure of a customer) and those they do not (reckless trading type behavior). A reckless trading type provision is therefore justifiable in these circumstances. It may provide overcompensation to the large entity that is well able to look after itself. The same argument cannot, however, be made with regard to the ordinary creditor.

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[61] Keay, 'Wrongful Trading and the Liability of Company Directors: A Theoretical Perspective' [2005] 25(3) Legal Studies 431 at 453

[62] Morrison, 'The Economic Necessity for the Australian Insolvent Trading Prohibition' [2003] International Insolvency Review 171 at 182-188

[63] Keay, 'Wrongful Trading and the Liability of Company Directors: A Theoretical Perspective' [2005] 25(3) Legal Studies 431 at 452

[64] Posner and Scott, Economics of Corporation Law and Securities Regulation, (Boston MA, Little, Brown and Company Ltd., 1980), p.273.

[65] Watson and Taylor (General Editors), Corporate Law in New Zealand, (Wellington: Thomson Reuters, 2018), para.22.1.2

**(b) Limited Liability – The Perverse Incentive**

The inherently weak position of the small trade creditor is compounded by the fact that limited liability by its very nature creates incentives for the company to invest in higher risk projects than would its creditors.[66] In effect, it is the stakeholders and not the shareholders who are the bearers of the business risk. This is especially the case where the creditor is an individual. As Lynch Fannon states an individual's contract with a company is fundamentally weaker than the company's contract with the individual. The company in its contractual relationships benefits from limited liability and separate corporate personality. The individual does not.[67] Thus a structural asymmetry exists. An unsecured creditor's interest is in having the capital due paid to it at the end of the credit period. Directors will, on the other hand, have different motivations.[68] In theory, at least, they will wish to ultimately benefit the shareholders. This can make investment in a high-risk strategy particularly attractive when the company is in difficult financial circumstances.[69] The incentives intensify as the company approaches insolvency; risky behaviour becomes more attractive as the remote chance that it will prevent insolvency is pursued. This type of behaviour appears to be more prevalent where the director is also the shareholder[70] and less so where professional directors are involved[71] (that said this observation may simply arise from the fact that the majority of companies are small and close).[72] It is compounded by the fact that the business risk is being taken with creditors' funds, and not shareholders' funds, at the point of insolvency.

[66] Bainbridge and Henderson, Limited Liability; A Legal and Economic Analysis (Elgar Publishing 2016), p.49

[67] Lynch Fannon, Working Within Two Kinds of Capitalism (Oxford and Portland Oregon: Hart Publications, 2003), p.96.

[68] As Berle and Means state shareholding because it became dispersed meant that management and not the owners controlled the company. Berle and Means, The Modern Corporation and Private Property, (New York: The Macmillan Company, 1932)

[69] Mokal, An Agency Cost Analysis of the Wrongful Trading Provisions: Redistribution, Perverse Incentives and the Creditors' Bargain [2000] 59(2) Cambridge Law Journal 335 at 347

[70] Keay, 'Directors' Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors' [2003] 66(5) Modern Law Review 665 at 669.

[71] Watson and Taylor (General Editors), Corporate Law in New Zealand, (Wellington: Thomson Reuters, 2018), para.22.1.2

[72] I would like to thank Professor Lynch Fannon for pointing this out to me.

This is additional risk embedded in the nature of the company itself about which creditors can do nothing. On this analysis a reckless trading provision is not providing additional and unwarranted protection to creditors. It merely rebalances the inherently unfair situation which results from the incentive of limited liability. In this regard it can be argued that a reckless trading type provision actually returns efficiency to the market. Directorial misbehaviour which exacerbates losses is inefficient. A provision which prevents such events from occurring in the first place and, where they do occur, reverses the loss via personal liability in an efficacious one in the economic sense. This is because an economic system from which reckless trading behaviours have been largely purged must be worthwhile especially as such conduct can have a domino effect; the trader who is the victim of reckless trading is then not able to pay her own creditors.

**(c) Legislative Protection of Creditors**

A further question is whether it is the business of the legislature to protect creditors against losses. This issue is an old one. The Loreburn Report[73] stated in 1906 *"The Legislature cannot insure against such losses. It cannot, in the case of trading companies, secure skillful management or success in speculative enterprises. Those who choose to deal with limited companies must take the risk of doing so, must make their own enquiries and act on their own judgment".* It has thus been argued that enacting reckless trading type provisions is a legislative attempt to insure against trading losses.[74]

Easterbrook and Fischel's argument that company law should contain the terms which the parties would have negotiated were the costs of those negotiations sufficiently low.[75] Creditors are realistic and understand that some bad debts are inevitable. However, where directors' mismanagement in the vicinity of insolvency forces on them otherwise avoidable losses they would surely

[73] Report of the Company Law Amendment Committee (1906) Cd 3052 quoted in Cox, Report of the Company Law Reform Committee (Dublin 1958), para.47
[74] O'Hanlon, 'The Corporate Form and Reckless Trading: A Modern Pandora and Epimethus' [2006] 28 DULG 254 at 288-289.
[75] Easterbrook and Fischel, The Economic Structure of Corporate Law (Harvard: Harvard University Press 1991)

negotiate for personal liability in those circumstances. The authors further argue that the purpose of company law is to provide a set of off-the-peg rules so that parties to a contract can save the cost of contracting. Company law codes are in effect a set of rules provided to parties for free so that they can concentrate on negotiating items which are individual to their own contract.[76] There appears to be no good reason why reckless trading type rules (including the public enforcement thereof) should therefore not exist in company law. Insolvency and mismanagement as the company approaches insolvency are not specific risks, they apply to all companies. It is therefore likely that creditors contracting with a company would want individual terms in relation thereto. This is because it is reasonable for creditors to expect that while directors may suffer from misfortune or make ill-judged entrepreneurial decisions, they will not act in an operationally reckless manner with regard to their interests especially when the company is insolvent or in the vicinity thereof.[77] They are, after all, the residual claimants at that point.[78] It would also be rational and logical for creditors to expect, that if the directors do act in a reckless manner resulting in a loss which could otherwise have been avoided, recompense or sanction would follow.

Perhaps the ultimate answer is that if unsecured creditors could protect themselves against reckless trading, they would do so. A mechanism does exist; a personal guarantee from either the directors or the shareholders. These are easily obtained and invariably demanded by the stronger creditors such as financial institutions.[79] Stronger creditors will endeavour to obtain a personal guarantee if the company is small and/or cannot offer decent security.[80] However, a bank or financial institution will usually settle for security alone if the company is very large. The fact that these attractive instruments are obtained by the dominant creditors must arise because of the disparity in bargaining

[76] Easterbrook and Fischel, The Economic Structure of Corporate Law (Harvard: Harvard University Press 1991), p.34.
[77] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7
[78]Re. Frederick Inns Ltd. [1994] 1 ILRM 387.
[79] The restriction and disqualification order case law demonstrates the prevalence of such instruments; Club Tivioli Ltd. [2005] IEHC 468, Re. Mint Restaurant Ltd. [2014] IEHC 370 and Leahy v Doyle [2016] IEHC 177.
[80] For the prevalence of personal guarantees in small companies in particular see Williams, 'Civil Recovery from Delinquent Directors' [2015] 15(2) Journal of Corporate Law Studies 311 at 323

power. Had unsecured creditors a more robust negotiating position they would demand and obtain such guarantees for themselves.[81] As Whincop states *"A [personal] guarantee is conceptually akin to the insolvent trading provisions' effect."*[82]

Thus, the imposition of a section 610 type provision fits within Easterbrook and Fischel's positivist thesis as it grants small traders the reasonable protection they would demand had they been bargaining from a position of strength. Hence the argument may be that it is not reckless trading type provisions which overcompensate creditors; instead, strong creditors are already overcompensated because of their bargaining power. Asset backed security or a personal guarantee will, for example, protect the large creditor against mere bad luck, commercial mismanagement, reckless trading and everything in between. Conversely, the small trade creditor will have very little by way of protection and a reckless trading provision goes some way towards redressing this imbalance.

**(iv) A Contractarian Analysis of the Irish Case Law**

The argument so far has been that the contractarian position is unconvincing with regard to reckless trading. The existence of such a provision does not excessively protect creditors. It is the type of provision the small trade creditor would want had they the ability to obtain same. Further, such creditors are peculiarly at risk due to the perverse incentive of limited liability. The question which must be asked, however, is whether contractarian analysis is convincing in light of the Irish case law. Put another way, does evidence exist in the case law which demonstrates that the contractarians are correct, and a reckless trading provision is unwarranted?

[81] Keay 'A Theoretical Analysis of the Director's Duty to Consider Creditor Interests: The Progressive
School's Approach' (2004) 4 JCLS 307 at 324

[82] Whincop, 'Taking the Corporate Contract More Seriously: The Economic Cases Against, and a Transaction Cost Rationale for, the Insolvent Trading Provisions' [1996] 5 Griffith Law Review 1 at 23

**(a) Re. Hefferon Kearns Ltd.**

In this case,[83] the plaintiff was a creditor; a successful heating and plumbing sub-contracting company.[84] The company, Dublin Heating Company Ltd., was well run and its directors (who were also the sole shareholders) appeared to have been astute businessmen.[85] Nonetheless, the company encountered considerable difficulties in its dealings with Hefferon Kearns Ltd. That company had three building contracts, two of which were with companies, Senna Enterprises Ltd. and Darwood Builders Ltd., with which its own directors were connected. These companies owned the land upon which the houses being built and Hefferon Kearns Ltd.'s building contracts with them were, per Lynch J., keenly priced.[86] The directors of the plaintiff, Mahon and Mortell, however, concluded entirely incorrectly, that Hefferon Kearns itself was the owner of the lands in both cases. The belief that such substantial asset backing existed allowed Dublin Heating to follow a relaxed approach in its dealings with the company. Considerable credit was extended for long periods of time. At the time of the collapse, Dublin Heating Company was owed £41,694. This was a *"very severe blow"*[87] for a company of its size. This also appears to have been the reason for the section 610 application. As Lynch J. explains *"The plaintiff, in the persons of Messrs. Mahon and Mortell, was furious and extremely suspicious of the motivation behind the ownership of the sites by separate development companies rather than by the company. They were convinced that a fraud had been perpetrated on the plaintiff ..."*[88] Very importantly, however, as Lynch J. explained in detail, this type of structure, ownership of land in a separate company, was *"... the norm rather than the exception ..."*[89] in the building industry. Unchallenged evidence was produced to the court that banks would not lend to a building company which owns its own sites.[90]

[83] For a detailed summary of the facts and analysis of this case see McCann, 'Reckless Trading Revisited' [1993] 11 ILT 31
[84] [1993] 3 IR 191 at 198
[85] [1993] 3 IR 191 at 206
[86] [1993] 3 IR 191 at 207.
[87] [1993] 3 IR 191 at 206
[88] [1993] 3 IR 191 at 206
[89] [1993] 3 IR 191 at 209
[90] [1993] 3 IR 191at 209

Mahon and Mortell, who were astute and experienced operators in the building industry, for some unclear reason assumed that Hefferon Kearns Ltd. owned the Senna and Darwood lands. This was despite the fact that such a structure, had it existed, would have been highly unusual. It is reasonable to assume that Mahon and Mortell, after years of experience in the industry (they were plumbing and heating subcontractors to housing developers) would have been familiar with the modus operandi. Further, despite the fact that they should have known that land ownership by Hefferon Kearns would have been very rare, and a very large sum of money was involved, they did not have the matter investigated. A phone call or letter would have clarified matters. Failing that, the plaintiff could have requested its legal or financial advisors to investigate. This would have allowed Dublin Heating to begin pressing for collection and be much more careful about extending credit into the future. Further, a sensible commercial decision could have been taken as to whether continuing with the contract at all was worthwhile. Yet nothing of the sort was done. Instead, a very considerable amount of credit was extended on seemingly easy terms and Dublin Heating was relaxed about its collection. Finally, when matters came to a head and the bulk of the £41,694 owed was lost, a section 610 application was made in order to obtain recompense personally from the directors.

It can therefore be argued that the creditors here were using the legislative provision to 'repair' a mistake that was entirely their own. On this basis, the availability of section 610 does mean that overcompensation has occurred. Despite a very significant amount of money being involved and a belief in the existence of a structure which Mahon and Mortell either knew or should have known was unusual, no actions were taken. This is precisely the point which contractarian scholars make; creditors should take sensible precautions to protect themselves. A request to clarify the ownership would have been sufficient. Thereafter, Dublin Heating Company Ltd. could have simply placed more controls on its financial relationship with Hefferon Kearns Ltd.

While many small companies must do business when and where they can, there are indications that the creditor here was successful and could have been more

discerning.[91] The parties appear to have been of roughly equal bargaining power (indeed, the creditor may have been the stronger of the two entities), hence onerous terms were not being forced on an unwilling Dublin Heating. Once does get the sense that such considerations may have influenced Lynch J.'s thinking. The land holding structure, Mahon and Mortell's misinterpretation of same and the background to Dublin Heating are all described in considerable detail.[92] It is unlikely that the learned judge would have done so had he not considered these issues to be of importance in arriving at this decision that the directors should not be found liable as a result of the *'draconian'*[93] deeming provision and instead were honest and responsible in accordance with the defence in subsection (8).

Does this case indicate that the contractarians are correct and that a reckless trading provision overcompensates creditors? Not necessarily. The case certainly appears to acknowledge a central tenet of contractarianism; that the legal system should not intervene when the parties are of equal bargaining strength and are operating at arms-length. Thus, the fact that the creditor lost the case is of importance. No imbalance existed here, hence the law (correctly) declined to intervene. This does not detract from the fact that intervention may be necessary in other circumstances. The decision in the case may support contractarianism to a degree; it can be interpreted as an indication that the law should not intervene to compensate a party for its own misstep. Again, importantly, the court here did not intervene. It cannot, however, lead to a conclusion that a reckless trading type provision is never required in any circumstances.

**(b) The Remaining Case Law**

While the Hefferon Kearns case may lend credence to contractarian thinking, the remaining case law is different. In Re. PSK Construction Ltd. the main creditor appears to have been the Revenue Commissioners.[94] Moreover, Revenue was an involuntary creditor and, as such, may have been the driving force behind the

[91] [1993] 3 IR 191 at 206
[92] [1993] 3 IR 191 at 206-210
[93] [1993] 3 IR 191 at 224
[94] [2009] IEHC 538 para.16

liquidator's actions.[95] To apply a contractarian analysis, here, again, we may have an element of overcompensation. The Taxes Consolidation Act, 1997 contains an ever-increasing array of penalty and enforcement provisions dealing with non-payment of taxes.[96] Thus, it can certainly be argued that Revenue, as an arm of the state, is already amply provided for in so far as tax evaders are concerned. However, this picture is far too simplistic. Revenue, absent section 610, would have grave difficulty imposing personal liability in these circumstances.[97] There is also the situation of the unsecured creditors. That the executive director would falsify tax returns in order to allow the company to continue trading long past the point at which it should be placed in liquidation was not something which unsecured creditors could have protected themselves against by contract. Thus again, a central misconception of contractarianism is revealed; not all creditors have protective mechanisms as contractarians assume. Very large companies and financial institutions would have means to safeguard themselves, small trade creditors would not. Access to protective mechanisms is not evenly spread among the various creditor classes.

The same analysis can be applied to Re. Appleyard Motors Ltd.[98] Here there was a failure to protect the creditor's money.[99] Again, while the creditors could have asked for the monies to be placed in an escrow account, this would have been highly unusual.[100] More significantly, publicly available documentation would not have revealed to Toomey Leasing how truly dire the company's trading situation was in April and May of 2012. This was something which would have only been truly understood at director level. Hence, the availability of a reckless trading remedy does not smack of overcompensation. The potential availability of personal liability merely levels the playing field and addresses the informational asymmetry which contractarianism ignores.

[95] Sanfey 'Personal Liability of Directors Under Section 204 of the Companies Act, 1990' [1997] The Bar Review 50 at 51
[96] See for example Part 47 Taxes Consolidation Act, 1997.
[97] See in particular, Revenue Commissioners, Tax and Duty Manual, Collection Manual – Liquidation of Companies and Other Company Law Issues (Dublin, September 2019).
[98] [2015] IEHC 28 and [2016] IECA 280
[99] [2015] IEHC 28 paras. 5-6
[100] [2015] IEHC 28 para.32

Likewise, Kelly Trucks Ltd. Here only two creditors (both were firms of solicitors) were impacted by Mrs. Kelly's scheme. The remaining creditors were, it seems, taken care of by the replacement companies.[101] However, it would be difficult to argue that the solicitors should have considered the likelihood of such a scheme being put in place to avoid paying the fees owed to them and taken steps to protect themselves accordingly. Even if they had requested, say, a personal guarantee from the directors, this would have been resisted and it is very likely that Mrs. Kelly (regarding the company's own advisors) would have simply taken the company's business to a more amenable firm. Further, had the other unsecured creditors been similarly stranded (as occurred in the Pineroad Distribution Ltd. case,[102] for example), it is again highly improbable that they would have envisaged that Mrs. Kelly would have engaged in such actions and thus deemed it necessary to take steps to prevent themselves from such an eventuality.

Overall, creditors must accept the risk that liquidations will happen and money will be lost as a result of normal entrepreneurial misjudgment or simple bad luck. That is part and parcel of business life and the core reason for the existence of the corporate structure. Creditors must protect themselves as well as they can and, if that fails, bear the monetary loss. However, all the cases we have seen, save the Hefferon Kearns case which may have been a normal commercial collapse, had more so or less so[103] usual and unexpected operational features (in effect, reckless trading behaviour by directors). That typical trade creditors would be expected to both envisage these eventualities occurring and take steps to protect themselves is an argument that cannot be supported. Even if they had, the likely protection sought would be a personal guarantee; in effect the protection contained in the reckless trading provision.

[101] [2019] IEHC 6 para.106
[102] [2007] IEHC 55
[103] Even PSK is unusual. While unpaid taxes are common enough, falsifying tax returns for a very significant period of time is not.

**(iv) Contractarianism - Concluding Comments**

Contractarianism thus appears to be overly conjectural. It has been correctly described as *'rarefied*'[104] and *'idealized.*'[105] It does not take account of the realities of life as a small trade creditor. These are often far messier than the theories would suggest. As Lynch Fannon states, contractarians have ignored the existence inequalities in bargaining power.[106] The unsecured creditor does not have the benefit of equal bargaining power and it is a rare case where all necessary information is available in a full and timely manner. Singer reiterates this point *"Whatever bargain is agreed to by the parties will be a function of their relative bargaining power."*[107]

Proponents of contractarianism have argued that conventional regulatory approaches are a largely regressive force to be resisted in the interests of efficient profit making.[108] However, this ignores the reality that only the most powerful corporate actors have the actual freedom to choose whether or not to accept the terms of the bargain. Theoretically small creditors may be legally free to strike whatever contract they choose. In reality, however, no such freedom exists. Regarding contracts, self-interest is a fact of life.[109] The weaker of those constituents who interact with the company, can rarely choose, dissent or exit from it.[110] Further, a reckless trading provision may actually make credit contracts more efficient as the director will be encouraged to fully disclose information in order to avoid sanction.[111]

Moreover, it has been argued that contractarian scholars do accept the need for regulation so long as that regulation does not disrupt the arrangements entered into

[104] Lynch Fannon, Working Within Two Kinds of Capitalism (Oxford and Portland Oregon: Hart Publications, 2003), p.79.
[105] Allen, 'Contracts and Communities' [1993] 50(4) Washington and Lee Law Review 1395 at 1405
[106] Lynch Fannon, Working Within Two Kinds of Capitalism (Oxford and Portland Oregon: Hart Publications, 2003), p.83.
[107] Singer, 'The Reliance Interest in Property' [1988] 40 Stanford Law Review 611 at 649
[108] Attenborough, 'Empirical Insights into Corporate Contractarian Theory' [2017] 37(2) Legal Studies 191 at 212
[109] Thomas, The Judicial Process: Realism, Pragmatism, Practical Reasoning and Principles, (Cambridge: Cambridge University Press, 2005), p.382
[110] Attenborough, 'Empirical Insights into Corporate Contractarian Theory' [2017] 37(2) Legal Studies 191 at 201.
[111] Whincop, 'Taking the Corporate Contract More Seriously: The Economic Cases Against, and a Transaction Cost Rationale for, the Insolvent Trading Provisions' [1996] 5 Griffith Law Review 1 at 33.

between the company and its constituents.[112] A reckless trading provision does disrupt these arrangements as it grants unsecured creditors more rights than they bargained for. However, the real question here is whether such a provision grants such creditors more than they would have bargained for had there been an equality of position. The answer here is no. Banks and financial institutions bargain for and obtain personal guarantees which protect against all insolvency losses including those arising from reckless trading. These institutions obtain guarantees because of their dominant position within the business world. It follows that trade creditors would seek the same protections had they the bargaining strength to do so.

## (III) STAKEHOLDER THEORY

### (i) Introduction

Divergent from the above perspective is stakeholder/communitarian theory which has its roots in the Berle/Dodd debates of the 1930s. While still valuing the concepts of efficiency[113] and economic success,[114] this theory asks in whose interests the company should be governed. The theory argues that shareholders are not the only group which have a legal interest in the corporation; others include creditors, employees, customers and the public.[115] As all these groups contribute to the company, they should all benefit.[116] As Stout says, "*Shareholders alone cannot make a firm - creditors, employees, managers, and even local governments often must make contributions in order for an enterprise to succeed."*[117]

Stakeholder theory professes to bring together both capitalism and ethics[118] the purpose being to ensure that the interests of all stakeholders are taken into account by directors. Importantly, stakeholders are not to be seen as a means to maximise the

[112] Greenfield and Smith, 'Debate: Saving the World with Corporate Law' [2007] 57 Emory Law Journal 947 at 960.
[113] Keay, 'Stakeholder Theory in Corporate Law: Has it Got What it Takes?' [2010] 9(3) Richmond Journal of Global Law and Business 249 at 260
[114] Strand, Freeman, 'Scandinavian Cooperative Advantage: The Theory and Practice of Stakeholder Engagement in Scandinavia' [2015] 127(1) Journal of Business Ethics 65 at 73
[115] Bone, Legal Perspectives on Corporate Responsibility: Contractarian or Communitarian Thought?' [2011] 24(2) The Canadian Journal of Law and Jurisprudence 277 at 287.
[116] Lipton, Rosenblum, 'A New System of Corporate Governance: The Quiinquennial Election of Directors' [1991] 58(1) University of Chicago Law Review 187 at 192
[117] Stout, 'Bad and Not-so-Bad Arguments for Shareholder Primacy' [2002] 75 Southern California Law Review 1189 at 1195
[118] Parmar et al, 'Stakeholder Theory: The State of the Art', [2010] 4(1) Academy of Management Annals 403 at 404

wealth of shareholders. Instead considering stakeholder interests and benefiting such groups can be an end in itself[119] as it is rational not to act selfishly when exchange transactions are repeated.[120] As Blair and Stout state *"These scholars object to shareholder primacy on normative grounds, and argue that directors ought to be required to run corporations with due regard for the interests of other potential stakeholders such as employees, creditors, customers, suppliers, or the local community."*[121] This approach is common in European jurisdictions[122] such as Germany and also in Japan. While shareholder primacy is prevalent in Anglo American jurisdictions[123] there is evidence that stakeholder theory is gaining traction.[124]

The stakeholder approach has three elements, and is, to a certain extent a challenge to contractarian thinking. It questions the contractarian premise that all those dealing with the company can bargain for sufficient protection. It concludes that disparities in bargaining power prevent this. Finally, in contrast to the contractarian worldview, it considers the corporation to be a community of co-operative constituents rather than an aggregation of self-seeking individuals. As Allen states *"... corporations can be, indeed inevitably are, more than contracts."*[125]

The concept of reckless trading will be analysed in context of stakeholder theory; the purpose being to examine the light which this theory casts on the concept and the necessity for same. Unlike contractarianism, which is hostile to the concept, stakeholderism is supportive. Its concentration on relationships and its central tenet of fairness indicates a favourable alignment with reckless trading as creditors are a vital constituent of any company. Thus, a legislative provision which provides

[119] Keay, 'Stakeholder Theory in Corporate Law: Has it Got What it Takes?' [2010] 9(3) Richmond Journal of Global Law and Business 249 at 298
[120] Hodges, Law and Corporate Behaviour; Intergrating Theories of Regulation, Enforcement, Compliance and Ethics (Oxford and Portland, Oregon: Hart Publishing, 2015), p.677
[121] Blair and Stout, 'A Production Team Model of Corporate Law' [1999] 85(2) Virginia Law Review 247 at 287
[122] Lynch Fannon, Working Within Two Kinds of Capitalism (Oxford and Portland Oregon: Hart Publications, 2003), p.106.
[123] Keay, 'Stakeholder Theory in Corporate Law: Has it Got What it Takes?' [2010] 9(3) Richmond Journal of Global Law and Business 249 at 249.
[124] Dine, 'Private Property and Corporate Governance Part II: Content of Directors' Duties and Remedies' in Macmillian, Patfield, Perspectives on Company Law 1, (London, Boston MA: Kluwer Law International, 1995), p.115.
[125] Allen, 'Contracts and Communities' [1993] 50(4) Washington and Lee Law Review 1395 at 1402

compensation to these constituents in situations where director misbehaviour has occurred is likely to accord with this theory.[126] Further, and very importantly, stakeholder theory does not deny the importance of regulatory intervention in the corporate world. Indeed, while stakeholder theory does not mandate specific legislation change, it argues that facilitatory changes should be considered.[127]

**(ii) The Central Tenets of Stakeholder Theory**

Stakeholder theory has a number of core tenets, as follows:

**(a) The Importance of Relationships**

The company's relationship with its stakeholders is central to stakeholder theory and it has been argued that stakeholder relationships are even more important in small companies than in very large ones, although in a less formalised manner.[128] Smaller companies are reliant on their personal relationships with their stakeholders to obtain the resources necessary for growth. This is especially the case as they operate locally[129] and are embedded in the community.[130] Further, the limited research has found that in Europe in most family companies the stakeholder approach existed in an informal way long before the theory was formally developed.[131] Small companies prioritise dominant stakeholders such as employees, customers and suppliers (creditors).[132] If nothing else, absent creditors, who after all provide credit to the firm, few companies would thrive.

[126] Lynch Fannon argues in favour of public resolution of competing stakeholder claims. See Lynch Fannon, Working Within Two Kinds of Capitalism (Oxford and Portland Oregon: Hart Publications, 2003)

[127] Parmar et al, 'Stakeholder Theory: The State of the Art', [2010] 4(1) Academy of Management Annals 403 at 408

[128] Russo, Perrini, 'Investigating Stakeholder Theory and Social Capital: CSR in Large Firms and SMEs'[2010] 91 Journal of Business Ethics 207 at 217

[129] Schlierer et al, 'How do European SME Owner-Managers Make Sense of 'Stakeholder Management?: Insights from a Cross-National Study' [2012] 109(1) Journal of Business Ethics 39 at 40

[130] Ruffo et al 'Judgments of SMEs' Legitimacy and its Sources' [2018] Journal of Business Ethics 395 at 398

[131] Schlierer et al, 'How do European SME Owner-Managers Make Sense of 'Stakeholder Management?: Insights from a Cross-National Study' [2012] 109(1) Journal of Business Ethics 39 at 48

[132] Sen, Cowley, 'The Relevance of Stakeholder Theory and Social Capital Theory in the Context of CSR in SMEs: An Australian Perspective' [2013] 118 Journal of Business Ethics 413 at 418.

Stakeholder theory rejects the idea of maximising a single objective. From a normative standpoint, the theory argues that all claims on the corporation are legitimate.[133] Social goals should also be taken into account and not just narrow profitability.[134] In their decision-making, the directors must take into account all stakeholders and attempt to balance their interests. The communitarian school answers to a large extent the problems of asymmetry which exist within contractarianism. The associations between the various stakeholders in the corporation mean that their relationships can develop over time. Information initially lacking on one side can be incorporated later. If adaptations are necessary, the nature of the relationship can change over time. This is superior to contractarian reliance on the contract which is fixed at its inception[135] and, indeed, subject to asymmetries.

The model has instrumental support also in that the application of its norms and principles can allow a company to generate economic value.[136] This is a second aspect which underpins stakeholder theory is that, as well as being moral, it is beneficial to the corporation. A corporation will only thrive if all stakeholders are considered by the directors. This ensures that these constituents will remain committed to the company and support it should the need arise.[137] Collaboration is often as necessary as competition.[138]

**(b) The Concept of Fairness**

Stakeholder theory is underpinned by normative foundations.[139] As we have seen earlier, constituents such as creditors are not protected by contract due to, *inter alia*, their unequal bargaining position. Thus, stakeholderism attempts to ensure

[133] Keay, 'Stakeholder Theory in Corporate Law: Has it Got What it Takes?' [2010] 9(3) Richmond Journal of Global Law and Business 249 at 268
[134] Bainbridge, 'Director Primacy: The Means and Ends of Corporate Governance' [2003] 97(2) Northwestern University Law Review 547 at 549.
[135] Lynch Fannon, Working Within Two Kinds of Capitalism (Oxford and Portland Oregon: Hart Publications, 2003), p.92.
[136] Parmar et al, 'Stakeholder Theory: The State of the Art', [2010] 4(1) Academy of Management Annals 403 at 410. However, the evidence of this is debatable (at 416-417)
[137] Keay, 'Stakeholder Theory in Corporate Law: Has it Got What it Takes?' [2010] 9(3) Richmond Journal of Global Law and Business 249 at 265
[138] Freeman et al, Stakeholder Theory: The State of the Art, (Cambridge: Cambridge University Press, 2010), p.275
[139] Purnell, Freeman 'Stakeholder Theory, Fact/Value Dichotomy, and the Normative Core: How Wall Street Stops the Ethics Conversation' [2012] 109(1) Journal of Business Ethics 109

that directors will consider the interests of parties who become involved with the company; in effect, a social contract approach is applied to corporate relationships.[140] The existence of trust between the various constituents is central to stakeholder thinking.[141] This is where the concept of fairness arises.[142]

While, in the general sense, it is difficult to discern what exactly 'fairness' means,[143] it is arguable that it must incorporate taking into account creditors' legitimate expectations and such expectations would include the conviction that directors would not engage in reckless trading as the company approached insolvency. Small trade creditors cannot obtain increased protection such as personal guarantees should directors act in a reckless manner. This is the case even though it would be in their interest to obtain such protection and from a normative standpoint it would be fair for this to be provided. While fairness is a notoriously vague and imprecise concept, it is the fundamental purpose of insolvency law to provide a fair process for dealing with the affairs of insolvent companies. Specifically, it would not be fair if the directors caused a transfer of wealth from creditors by causing an increase in risk when the company is heading for insolvent liquidation.[144] Thus a reckless trading provision accords well with the idea of fairness as embedded with stakeholder theory.

**(c) Stakeholder Theory and Legislative Intervention**

Stakeholder theorists are more open to the idea of government regulation of corporations than contractarians. This may be because they are not wedded to the idea of an efficient market. As Hill and Jones state the idea that markets are invariably efficient is a *'...rather heroic assumption ...'*.[145] That said, stakeholder theorists are not blind to the limitations of government

[140] Keay, 'Stakeholder Theory in Corporate Law: Has it Got What it Takes?' [2010] 9(3) Richmond Journal of Global Law and Business 249 at 267
[141] Lynch Fannon, Working Within Two Kinds of Capitalism (Oxford and Portland Oregon: Hart Publications, 2003), pgs.94-97.
[142] Keay 'A Theoretical Analysis of the Director's Duty to Consider Creditor Interests: The Progressive School's Approach' (2004) 4 JCLS 307 at 327
[143] Mitchell, 'Fairness and Trust in Corporate Law' [1993] 43 De LJ 425 at 428
[144] Keay, 'Wrongful Trading and the Liability of Company Directors: A Theoretical Perspective' [2005] 25(3) Legal Studies 431 at 455
[145] Hill and Jones, 'Stakeholder-Agency Theory' [1992] 29(2) Journal of Management Studies 132 at 134

intervention[146] and it is recognised that legislation alone does not give stakeholder principles their true weight.[147] Conversely, while it has been argued that stakeholder theory is an alternative to regulation[148] and frameworks have been built to create a working system for stakeholder capitalism, we are in reality very far from such an eventuality.[149] The notion that stakeholder theory will evolve into a full blown operative system is arguably illusory.[150] Indeed, if stakeholder theory was universally adopted and applied, a reckless trading provision would be entirely redundant as such behaviour would no longer exist within the system. However, believing that such an outcome will occur appears both unrealistic and utopian. Hence governments must develop and pass enabling legislation to make stakeholder principles work in the real world.[151] For this reason also, stakeholder theory should be supportive of reckless trading type legislation.

While capitalism is the most effective way of organising an economy, controls are necessary and stakeholder theory accepts that governmental intervention is the most effective way of achieving such restraints.[152] Within stakeholder theory, governments may act as referees faced with contradictory social demands from various stakeholders.[153] Moreover, stakeholders divide into sub-groups thus disbursing their power. The government is often the only entity strong enough to act in a unified manner.[154] Indeed, in accordance with demands for stakeholder consideration, United States legislations have enacted 'constituency statutes'. This has occurred to a limited extent in the UK as well in the form of

[146] Freeman, Martin, Parmar, 'Stakeholder Capitalism'. [2007] 74(4) Journal of Business Ethics 303 at 310-311.
[147] Deskins, 'Benefit Corporation Legislation, Version 1.0 – a Breakthrough in Stakeholder Rights?' [2012] 15(4) Lewis & Clarke Law Review 148 at 160
[148] Buchholz, Rosenthal, 'Stakeholder Theory and Public Policy: How Governments Matter' [2004] 51(2) Journal of Business Ethics 143 at 144
[149] Freeman, Martin, Parmar, 'Stakeholder Capitalism'. [2007] 74(4) Journal of Business Ethics 303 at 311-312.
[150] Buchholz, Rosenthal, 'Stakeholder Theory and Public Policy: How Governments Matter' [2004] 51(2) Journal of Business Ethics 143 at 149
[151] Buchholz, Rosenthal, 'Stakeholder Theory and Public Policy: How Governments Matter' [2004] 51(2) Journal of Business Ethics 143 at 149
[152] Wood, 'Corporate Responsibility and Stakeholder Theory: Challenging the Neo-Classical Paradigm' [2008] 18 Business Ethics Quarterly 159 at 161
[153] Dahan, Doh, Raelin, 'Pivoting the Role of Government in the Business and Society Interface: A Stakeholder Perspective' [2015] 131(3) Journal of Business Ethics 665 at 669
[154] Dahan, Doh, Raelin, 'Pivoting the Role of Government in the Business and Society Interface: A Stakeholder Perspective' [2015] 131(3) Journal of Business Ethics 665 at 676

section 172 Companies Act, 2006 which requires directors to act in the interests of creditors in certain circumstances. It has also occurred to a more limited extent still in Ireland.[155] These enable directors to include stakeholder interests in the decision- making process. Their purpose is to allow companies to justify and possibly defend an action that they believe to be in the best interests of the corporation without violating the duties owed to shareholders.[156] This has a normative justification in that stakeholders can be categorised as those to whom the corporation has a moral responsibility[157] and indicates stakeholder theory support for a reckless trading type provision.

**(iii) Stakeholder Theory and Reckless Trading**

Another way of looking at this is that reckless trading behaviour is, in effect, a failure to apply the principles of stakeholder theory; had the tenets of stakeholderism been applied by the directors, the misconduct would not have occurred. As residual claimants on insolvency[158] and one of the remaining constituents at that point, creditors interests should be treated as of crucial importance. Instead, however, shareholder primacy prevails, and the shareholders are treated as paramount. When a failure to apply stakeholder principles such as this occurs, stakeholder theorists must be in favour of a reckless trading provision. It is fair, it redresses the balance, and it gives the relationship it proper weighting as it compensates the creditors for loss arising from the fact that their interests were significantly disregarded.

There is another argument also. As we have seen, limited liability itself has altered the balance between corporate debtor and creditor. Both limited liability and separate legal personality can act to the disadvantage of creditors. A reckless trading type provision is fair as it arguably rebalances this relationship as it encourages directors to have a closer regard to creditors' interests especially when the company is in financial difficulties. Thus a reckless trading provision chimes well with the central tenet of stakeholder theory. It also accords with the theory's concern for fairness.

[155] S. 224 Companies Act, 2014.
[156] Deskins, 'Benefit Corporation Legislation, Version 1.0 – a Breakthrough in Stakeholder Rights?' [2012] 15(4) Lewis & Clarke Law Review 1047 at 1059.
[157] Kaler, 'Differentiating Stakeholder Theory' [2006] 46(1) Journal of Business Ethics 71 at 74
[158] Re. Fredericks Inns Ltd. [1994] 1 ILRM 387.

**(iv) Criticisms of Stakeholder Theory**

While, as we have seen, the central tenets of stakeholder theory should be supportive of a reckless trading provision, it must be kept in mind that the entire framework has been criticised. As Lynch Fannon points out communitarians have differing aspirations and thus it is difficult to describe their work as a unified school of thought.[159] What exactly a stakeholder is can be a difficult concept to define and this problem appears to arise from its very flexibility.[160] This leads to the question of how to define who is a stakeholder in any particular company and who is not and whether these constituents be defined broadly or narrowly.[161] As Mitchell states *'What is needed is a theory of stakeholder identification that can reliably separate stakeholders from nonstakeholders.'*[162] This, it appears, has not yet been found and Fassin (writing in 2009) identified over one hundred groups and sub-groups of stakeholders in academic literature.[163] Further, the theory envisages that the directors will be able to balance the interests of all stakeholders. This is important as stakeholders will invariably have competing interests. In reality, however, these competing interests will make this an impossibly complex task.[164] The concept of balancing is meritorious, but it fails in practice.[165] That said, other commentators have different views on this point. Blair and Stout argue that directors do manage to balance the various competing interests. When the corporation is doing well, all constituents benefit. When the corporation is financially constrained, financial pain is distributed equitably among the stakeholders.[166]

Ultimately, however, that it is difficult to determine who the stakeholders are is irrelevant from the standpoint of reckless trading. Creditors are clearly stakeholders

[159] Lynch Fannon, Working Within Two Kinds of Capitalism (Oxford and Portland Oregon: Hart Publications, 2003), p.78
[160] Fassin, 'The Stakeholder Model Refined' [2009] 84(1) Journal of Business Ethics 113 at 117
[161] Mitchell, Agle, Wood, 'Toward a Theory of Stakeholder Identification and Salience: Defining the Principle of Who and What Really Counts' [1997] 22(4) Academy of Management Review 853 at 856
[162] Mitchell, Agle, Wood, 'Toward a Theory of Stakeholder Identification and Salience: Defining the Principle of Who and What Really Counts' [1997] 22(4) Academy of Management Review 853 at 854
[163] Fassin, 'The Stakeholder Model Refined' [2009] 84(1) Journal of Business Ethics 113 at 120
[164] Dahan, Doh, Raelin, 'Pivoting the Role of Government in the Business and Society Interface: A Stakeholder Perspective' [2015] 131(3) Journal of Business Ethics 665 at 675.
[165] Keay, 'Stakeholder Theory in Corporate Law: Has it Got What it Takes?' [2010] 9(3) Richmond Journal of Global Law and Business 249 at 283
[166] Blair and Stout, 'Specific Investment and Corporate Law' [2006] 7 EBOLR 473 at 494-495.

and, as residual claimants, their position becomes more important as the company reaches insolvency. Hence the fact that as a general proposition it may be impossible to categorically identify all stakeholders or that it may be impossible to perfectly balance the rights of all stakeholders does not detract from the theory in so far as reckless trading is concerned.

**(v) Stakeholder Theory and Irish Case Law**

The next issue is whether we see evidence of stakeholder thinking in the Irish case law. It is submitted that we do. This is hardly surprising as it can be argued that reckless trading behaviour is a failure to apply the tenets of stakeholderism and that section 610 is an attempt to correct that omission.

The first case to display stakeholder style reasoning is Hefferon Kearns Ltd. As we have previously seen, in order decide the case, Lynch J. had to determine what constitutes reckless trading under subsection (1)(a). His description is clearly in line with the position of the stakeholder theorists; *"……the director is party to carrying on the business in a manner which the director knows very well involves an obvious and serious risk of loss or damage to others, and yet ignores that risk because he really does not care whether such others suffer loss or damage or because his selfish desire to keep his company alive overrides any concern which he ought to have for others."*[167] The learned judges thinking here is clearly ad idem with stakeholderism; all constituents of the company should be considered, however, the director does not do this either because he is thoughtless or selfish and concentrates on the position of the shareholders alone. This is clear from his emphasis on the effect of directors' behaviour on 'others' and the fact that the director may, selfishly, only be thinking about the company.

Stakeholder theory considerations are also in evidence in Re. PSK Construction Ltd. Finlay Geoghegan J. concluded that Mr. Killeen was fully aware that his decision to falsify tax returns involved a serious risk that losses or damage would be caused to others. However, he decided to ignore that risk because of his desire to keep his company alive. Again, he is criticised for his failure to consider the other constituents

[167] [1993] 3 IR 191 at 222

of his company.[168] Likewise, Re. Kelly Trucks Ltd. concerned a plan to evade paying two stakeholders who were major creditors of the company. A similar argument can be made with regard to the Appleyard Motors Ltd. case. A failure to take special protective measure for a particular class of stakeholders in the company, its customers, per Binchy J. in the High Court[169] meant that the directors had engaged in reckless trading. In conclusion, if we accept that reckless trading type behaviour is a failure to implement the tenets of stakeholder theory with regard to creditors, then evidence of such thinking within the case law is unsurprising.

**(vi) Stakeholder Theory – Concluding Comments**

Stakeholder theory supports the concept of a legislative based reckless trading provision. Stakeholder theory is generally supportive of legislative intervention.[170] Even Freeman who considers that stakeholder principles will in time become the norms by which companies operate recognises that until then governments must legislate to constrain the interests of shareholders.[171] Hence it is no leap to argue that stakeholder theory would favour legislation to compensate creditors where directors' reckless actions have resulted in otherwise avoidable losses. Reckless trading behaviour can be classed as a failure to apply the tenets of stakeholderism. This is especially the case as small trade creditors have difficulty protecting themselves and are often at the mercy of company with which they do business. That situation does not give such creditors their true weight as stakeholders and does not treat creditors fairly.

When the company is thriving, creditors are a vital constituent. As Freeman states *'Supplier and company can rise and fall together'*.[172] Creditors become even more important as the company faces insolvency. At this point, the company is run for the benefit of creditors. Further, as Attenborough argues UK company law is shareholder

[168] [2009] IEHC 538 para.31
[169] [2015] IEHC 28 paras.64-65
[170] Stieb, 'Accessing Freeman's Stakeholder Theory' [2009] 87 Journal of Business Ethics 401
[171] Freeman, 'A Stakeholder Theory of the Modern Corporation' in Clarkson Ed 'The Corporation and its Stakeholders: Classic and Contemporary Readings' (Toronto: University of Toronto Press, 1988), p.125
[172] Freeman, 'A Stakeholder Theory of the Modern Corporation' in Clarkson Ed 'The Corporation and its Stakeholders: Classic and Contemporary Readings' (Toronto: University of Toronto Press, 1988), p.131

centric due to the historic influence of contractarian thinking.[173] The same logic can be applied to the Irish system. Hence, from a stakeholder perspective, a reckless trading provision is necessary as a counterweight to this emphasis. Ultimately, until such time (if ever) as the tenets of stakeholder theory are universally adopted, a reckless trading provision is necessary in order to ensure that proper weight is given to the interests of creditors especially when the company is in the vicinity of insolvency.

## (IV) JUDICIAL REALISM

### (i) Theoretical Underpinnings

The scholarly analysis of judicial decision-making has historically involved one central question; how much judicial decision-making actually depends on legal reasoning or as Llewellyn presents the question *"Do the judges find the law or do they make it?"*[174] The issue is whether, after determining the relevant facts, do judges consult the legal rules and then come to a decision or whether the opposite is the case?[175] Judicial realists, such as Jerome Frank,[176] argue that judges may do things in reverse; the decision is arrived at first and the legal rules are then used to justify that decision.[177] In effect, judges are using policy principles and not legal rules.[178] Judicial reasoning is not simply the unearthing of the previously existing laws.[179] This may be especially the case with reckless trading due to the amorphous nature of the concept and the anomalous drafting of the section. These factors may allow judges to decide cases based on personal preferences. This may manifest itself as a pro-director bias due to the fact that both judges and directors inhabit the same social milieu. This section will examine whether this is in fact the case.

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[173] Attenborough, 'Empirical Insights into Corporate Contractarian Theory' [2017] 37(2) Legal Studies 191 at 195-200

[174] Llewellyn Jurisprudence: Realism in Theory and Practice (University of Chicago 1962), p.361

[175] Frank, Law and the Modern Mind (New York: Brentano's Inc. 1930), p.109

[176] See Frank, Law and the Modern Mind (New York: Brentano's Inc. 1930) and Llewellyn, The Bramble Bush (New York: Oceana Publications, 1930).

[177] This theory developed in the US. For its history see Tumonis, 'Legal Realism and Judicial Decision-Making' [2012] 19(4) Jurisprudencija 1361 at 1367-1373 and Tamanaha, Realism' [2009] 87 Texas L. Rev. 371

[178] Tumonis, 'Legal Realism and Judicial Decision-Making' [2012] 19(4) Jurisprudencija 1361 at 1361.

[179] Thomas, The Judicial Process: Realism, Pragmatism, Practical Reasoning and Principles, (Cambridge: Cambridge University Press, 2005), p.52.

Judicial realists contend that the decision in a case does not exclusively derive from official law.[180] Instead the decision arises from the ideological or policy preferences of the particular judge or his or her biases and personal predilections.[181] In fact, judicial decision-making may be considerably influenced by intuition.[182] As Frank states "*But there is prevalent a gravely mistaken notion that legal rules control and cause decisions. This is partly due to the fact that the judges, when they are entering their judgments, sometimes publish little essays, called "opinions" in which they quote the rules and write as if their judgments had been produced by the rules, as if the rules had been the only influences affecting them. These opinions do not refer to the other kinds of stimuli which influenced them; but that does not mean that the other undisclosed factors were not as or more important in inducing their decisions."*[183]

However, the realist school does not maintain that formal legal rules do not matter at all. Legal rules are important,[184] only many of those rules are informal rules.[185] Further, the view that judges decide cases based on their own idiosyncrasies alone is surely taking the theory too far.[186] That said, an article by Patricia M. Wald on judicial writing does give humorous insights into what goes on behind the façade of formal decision-making.[187]

Arguably, judges do make law. This occurs not only when they expand a legal theory or extend a legal principle to a new situation within the common law. The developing doctrine of the directors' duty to creditors may be a case in point. It also occurs in the converse situation when a theory or a doctrine is constrained or restricted.[188] An apt

[180] Llewellyn, 'The Crafts of Law Re-Valued' 28 [1942] 28(12) American Bar Association Journal 801 at 802
[181] Frank, Law and the Modern Mind (New York: Brentano's Inc. 1930), pgs.114 and119-120. Schauer, "Legal Realism Untamed." [2013] 91 Texas Law Review 749 at 756
[182] Guthrie, Rachlinski, Wistrich, 'Blinking on the Bench. How Judges Decide Cases' [2007] 93(1) Cornell L. Rev. 1
[183] Frank, 'Are Judges Human? Part One', [1931] 80 U. Pa. L. Rev. 17 at 47.
[184] Frank, Law and the Modern Mind (New York: Brentano's Inc., 1930), pgs.141-142
[185] Tumonis, 'Legal Realism and Judicial Decision-Making' [2012] 19(4) Jurisprudencija 1361 at 1363
[186] Leiter, "Rethinking Legal Realism: Toward a Naturalized Jurisprudence," [1997] 76(2) Texas Law Review 267 at 279.
[187] Wald, 'The Rhetoric of Results and the Results of Rhetoric: Judicial Writings' [1995] 62 University of Chicago Law Review 1371.
[188] Thomas, The Judicial Process: Realism, Pragmatism, Practical Reasoning and Principles, (Cambridge: Cambridge University Press, 2005), p.3

example may be the constraint on veil piercing imposed by the UK Supreme Court in Prest v Petrodel Resources Ltd.[189]

If judges are lawmakers, the question which arises is what allows this to occur? It may be because the open texture of statutory language creates a large measure of discretion and is described by Frank as "…*the inescapable operation, of the personal element in court justice*".[190] Further, there are often multiple doctrinal materials potentially applicable in any given case.[191] In many cases it would not be possible to devise a rule which resolves all future questions or, if it was, it would involve endless detail and complexity.[192] This means that grey areas exist in which judicial discretion is paramount.[193] The restriction and disqualification legislation is a case in point due to the open nature of terms such as 'honestly and responsibly' and 'unfit to be concerned in the management of a company'.

**(ii) Limits to Judicial Realism**

Judicial realism is in contrast to legal formalism which sees law as a rational science. Here judges do not make law. They only apply the rules of logic. They discover and apply the rules of law which have always been there.[194] Realism is thus a claim about the unruliness of law[195] and the insufficiency of positive law to explain the mechanics of judicial decision-making.[196] Judges can use a wide variety of approaches to achieve the desired decision[197] and realists adhere to the view that there is a difference between 'law in books' and 'law in action'.[198]

[189] [2013] UKSC 34
[190] Frank, 'Are Judges Human? Part One', [1931] 80 U. Pa. L. Rev. 17 at 23
[191] Dagan, 'The Realist Conception of Law' [2007] 57(3) University of Toronto Law Journal 607 at 613
[192] Frank, Law and the Modern Mind (New York: Brentano's Inc., 1930), p.6
[193] Ratnapala, 'Jurisprudence' (Cambridge University Press 2009), p.26
[194] Tumonis, 'Legal Realism and Judicial Decision-Making' [2012] 19(4) Jurisprudencija 1361 at 1365
[195] Frank describes the law as an *'... unruly body of material'* 'Frank, 'Are Judges Human? Part Two As Through as Glass Darkly', [1931] 80 Univ Penn Law Rev 233 at 257
[196] Schauer, "Legal Realism Untamed." [2013] 91 Texas Law Review, 749 at 756.
[197] For details see Niblett, 'Do Judges Cherry Pick Precedents to Justify Extra-legal Decisions?: A Statistical Examination," [2010] 70 Maryland Law Review 234 at 236-237
[198] Stephenson, 'Legal Realism for Economists' [2009] 23 Journal of Economic Perspectives 191 at 198

However, there may be a bridge between the two views. If it is accepted that the law can be objectively applied, that may not deny that an individual judge's values can play an important role in the decision. Twinning, in fact argues, that at its core judicial realism is uncontroversial; its central tenet is that legal processes must be seen in the context of the totality of social processes.[199] The real answer must lie somewhere between two. Judges may rely on intuition and personal values (and may be unaware of their own prejudices),[200] but they must apply legal rules as well.[201] As Llewellyn argues the question as to whether judges find the law or make it may be meaningless. They do both at once in that they must *'[voice] what has not been voiced before."*[202] Furthermore, judges are required to make their decisions based either a statutory provision or precedent. This requirement plays an important part in ensuring that the decisions can in fact be justified by formal tenets[203] and is certainly a constraint. The requirement to produce and publish decisions which can be analysed by academics and practitioners is also a limitation.[204] However, the various interpretation and application difficulties which plague section 610 arguably means that the curtailment in this area may be a weak one.

Even if the judicial realists are correct, the effect of judicial law making may be limited. It is within the common law that judicial law-making largely occurs and a particular common law rule can always be overturned by the legislature through the enactment of a statute. Even when the common law rules are undisturbed by the legislative branch, because the common law evolves one case at a time, this tends to minimise the extent to which any one judge's policy preferences become law. A major change to the common law requires the sustained consensus of many judges over

[199] Twinning, Karl Llewellyn and the Realist Movement 2nd Ed. (Cambridge: Cambridge University Press, 2014), p.382
[200] Cohen, 'Field Theory and Judicial Logic' [1950] 59(2) Yale Law Journal 238 at 247.
[201] Guthrie, Rachlinski, Wistrich, 'Blinking on the Bench. How Judges Decide Cases' [2007] 93(1) Cornell L. Rev. 1 at 2-3.
[202] Llewellyn Jurisprudence: Realism in Theory and Practice (Chicago: University of Chicago, 1962), p.361
[203] Dorf, 'Prediction and the Rule of Law' [1995] 42(3) UCLA Law Review 651 at 686.
[204] Ashenfelter, Eisenberg and Schwab, 'Politics and the Judiciary: The Influence of Judicial Background on Case Outcomes' [1995] 24(2) The Journal of Legal Studies 257 at 264

time.[205] Moreover, many judges (including Irish judges) would reject any assertion that they make law and policy rather than simply interpreting law and policy.[206]

A further difficulty encountered by the judicial realism school of thought is that judges must use discretion when the law 'runs out' and make their decision based on other factors.[207] There is a limit which is inherent in the nature of language itself as to the level of guidance which the wording of a provision can provide.[208] The question for the judge is often which of two competing interpretations should be preferred. Statutory language is sometimes vague or ambiguous.[209] A further constraint is that the decision must be based on the arguments before the court. As reasonable people can disagree about the best interpretation of such a statute, there is no single right answer.[210] Hence, judicial realists may argue that certain decisions (particularly ones with which they do not agree) were arrived at for ideological reasons when in reality the factors outlined above meant that the judge had to use his or her discretion but did so on an objective and constrained basis.

Ultimately, not all decisions contain judges' policy preferences, and many decisions are not so influenced.[211] 'Hard cases' are where policy preferences have the most impact. This makes sense. If the issue is relatively straightforward it will be difficult for the judge to stray outside either the statutory wording or the body of precedent. In fact, if the issue is very clear the matter will very likely not interface with the court system at all. Thus, the determinate and predictable side of law is invisible to those who equate law with the field of litigated disputes. If the law applicable to a particular dispute is clear, then one side will expect to win and the other to lose. In such a scenario, the loser will settle or refrain from litigation as the courtroom battle will be

[205] Ware, 'Originalism, Balanced Legal Realism and Judicial Selection: A Case Study' [2013]22(2) The Kansas Journal of Law and Public Policy 165 at 176.
[206] See for example Neuberger, 'The Power of Judges in the UK' Prospect Magazine (1 November 2018)
[207] Lammon, 'What We Talk About When We Talk About Ideology: Judicial Politics Scholarship and Naïve Legal Realism' [2009] 83(1) St. John's Law Review 232 at 265
[208] Hart, The Concept of Law, 3rd Edition (Oxford: Oxford University Press, 2012), p.127
[209] Thomas, The Judicial Process: Realism, Pragmatism, Practical Reasoning and Principles, (Cambridge: Cambridge University Press, 2005), pgs.125-126
[210] Ware, 'Originalism, Balanced Legal Realism and Judicial Selection: A Case Study' [2013] 22(2) The Kansas Journal of Law and Public Policy 165 at 173-174
[211] Ware, 'Originalism, Balanced Legal Realism and Judicial Selection: A Case Study' [2013] 22(2) Kansas Journal of Law and Public Policy 165 at 178

costly but futile. Thus the disputes which do wind up in court are those in which two opposing parties hold mutually exclusive positions and normally this will only arise where the law (or indeed the facts) is unclear.[212] As Kahn-Freud states '*The reported cases are the cases of the most serious diseases, and the leading cases are often the worst, and least typical of all'.*[213] This means that many indicia of judicial pre-judgment are drawn from outliers which by their very nature are difficult to decide and require the exercise of judicial discretion.

**(iii) Interaction of Judicial Realism and Reckless Trading**

The question is whether because the reckless trading provision contains so many difficulties of interpretation and application, it will always contain too large a measure of judicial discretion. As Omar comments in relation to the French legal system it is possible that because judges come from the same milieu as the persons whose behaviour they are meant to assess, they show a certain reticence to apportion blame for management mistakes in those situations in which they might instinctively react in the same way.[214] There may be a tendency for judges towards in group favouritism to produce motivated reasoning.[215] Thus coming from the higher social and economic backgrounds,[216] judges may have sympathy with business people and such individuals may be treated more leniently. However, this reticence or leniency does not seem pronounced where the lesser sanction of restriction or disqualification is involved (as will be discussed in Chapter Six). As we will see, these provisions are often successfully invoked with regard to reckless trading type behaviour. That said, the judiciary may be more reticent where a real monetary sanction exists, and the nebulousness of the reckless trading concept allows such reluctance to flourish.

The question which arises is whether, even when the limitations of judicial realism are taken into account, the broad parameters and interpretational difficulties surrounding

[212] Schauer, "Legal Realism Untamed." [2013] 91 Texas Law Review, 749 at 756-757
[213] Kahn-Freud, Selected Writings, (London: Stevens & Sons, 1978), p.364
[214] Omar, France: The Regime Governing Directors' Liability in Insolvency and Reform Perspectives, [2004] Company Lawyer 378 at 383
[215] Wistrich, Rachlinski, Guthrie 'Head or Heart. Do Judges Follow the Law or Follow Their Feelings' [2015] 3 Texas Law Review 855
[216] Specifically, of the nineteen High Court judges on which I could find information (in December 2020), thirteen (nearly 70%) attended fee paying secondary schools. Of those who attended non-fee paying schools, most had rural backgrounds. That may be the explanation for school choice rather than economic circumstances. Fee paying schools are uncommon outside of Dublin.

the reckless trading concept means that the courts are not a suitable forum in which to decide whether a director is culpable or not. In effect, the drafting difficulties inherent in the section may mean that any reckless trading type provision will give a judge carte blanche to decide the case in accordance with their own world view. This means that different outcomes will be produced depending on the preferences of the individual judge. A pro-business or pro-rescue judge will give the director the benefit of the doubt, whereas a pro-creditor judge will not.[217] There may be some evidence of this in the case law. For example, it appears that judges even take into account the fact that businesspeople are by temperament less cautious than lawyers and accountants.[218]

As we have seen, judicial realism may be a generalisation about all applications of law from the set of litigated cases which is unrepresentative.[219] As Dorf states what the lawyer is attempting to do in consulting her law books is to predict whether or not her client will succeed.[220] If the prediction is negative then the case will not go ahead. In relation to reckless trading, it is hard to draw a firm conclusion. The paucity of Irish case law could mean that the provision works in the vast majority of cases (the case is settled with a payment because the director is clearly liable, or the matter is not pursued because it is clear that the applicant cannot succeed) and that the limited case law we see is a representation of an outlier minority where the facts or the application of the section to the facts is uncertain. On the other hand, it could that mean that deserving cases are not litigated at all due to the uncertainty surrounding the provision and a belief that judges are pro-director. Specifically, the limited reported case law can be set against the fact that thirty-nine allegations of reckless trading against directors were made by members of the public to the ODCE in 2019 and by percentage the second highest number of complaints in that year related to reckless trading. [221] For 2018, the number was thirty-four and was the highest number by percentage.[222] The 2020 Report shows similarly high figures.[223] This may indicate that reckless trading type behaviour is a larger problem than is indicated by reported case law.

[217] Walters, 'Enforcing Wrongful Trading- Substantive Problems and Practical Disincentives' in Rider, The Corporate Dimension, (Bristol, Jordan Publishing Ltd., 1998), pgs.149.
[218] Re. Brian D. Pierson (Contractors) Ltd. [1999] BCC 26 at 52.
[219] Schauer, "Legal Realism Untamed." [2013] 91 Texas Law Review, 749 at 758
[220] Dorf, "Prediction and the Rule of Law" [1995] 42(3) UCLA Law Review 651 at 656
[221] ODCE: Annual Report 2019 (Dublin 2020), p.28. This number includes fraudulent trading.
[222] ODCE: Annual Report 2019 (Dublin 2020), p.28. Again, fraudulent trading is included.
[223] ODCE Annual Report 2020 (Dublin 2021), p.26

**(iv) The Case Law**

There are four reckless trading cases in the public domain. From a creditor's standpoint, there has been a favourable result in two of the cases. This, at first blush, indicates a quite respectable fifty percent success rate and that judicial bias is not at work. However, a deeper analysis demonstrates that matters are not quite so straightforward. Both of the cases in question (Re. PSK Construction Ltd. and Re. Kelly Trucks Ltd.) were also successful fraudulent trading cases. This strongly suggests that the level of misbehaviour was so high that even the most pro-business judge would have grave difficulty avoiding a successful invocation of section 610. The PSK case involved significant tax evasion. Re. Kelly Trucks Ltd. concerned a deliberate, calculated and complex scheme to avoid paying two particular creditors.

The executive in the PSK case had left school at sixteen whereafter he commenced working on construction sites in the UK.[224] The two executive directors in Re. Kelly Trucks Ltd. were a mechanic and an office administrator respectively.[225] This could indicate that class bias was a factor in both cases. This possibility must be remote in the extreme. The misbehaviour in both cases was serious. That must have been the dominating factor in the decisions. Put another way, it would be impossible to argue that directors from similar socio-economic backgrounds to the judiciary would have been absolved from liability for the same actions.

Moreover, the treatment of the non-executive director in PSK does not support such a contention. As has been previously discussed, while the finding that the non-executive director in the PSK case was not involved in reckless trading is surprising, Ms. Higgins does not appear to have been a professional. Despite working in a financial type role, she had *"……no accounting expertise or qualifications"*[226] Had socio-economic considerations been an important factor in the determination that the executive directors in both cases were involved in reckless trading, it is unlikely that Ms. Higgins would have escaped such censure.

[224] [2009] IEHC 538 para.5
[225] [2019] IEHC 6 para.5
[226] [2009] IEHC 538 para.33

What then of two remaining cases where the directors succeeded? Here the directors are more likely to have been of similar social class to the judiciary. However, Re. Hefferon Kearns Ltd. has been described by two eminent academic commentators as a reasoned judgment. Lynch Fannon states[227] *"… there was considerable evidence of a lack of recklessness and convincing evidence of a consideration for the creditors."* Courtney agrees with Lynch Fannon. He states that the decision demonstrates an understanding of the rigours of commercial life.[228] Hence it appears that it was unlikely that class bias was involved in this decision.

The remaining case is Re. Appleyard Ltd. Certainly, the High Court decision cannot be cited as an example of judicial pro-director bias. Both directors were found to have been involved in reckless trading by Binchy J. The judge adopted a forensic and detailed approach in applying section 610. He considered that due to the company's perilous and deteriorating financial position[229] it was the duty of the directors to keep creditors' interests to the fore. They failed to do this especially with regard to the applicant who was a customer and not an ordinary trade creditor. In Binchy J.'s opinion, the company had by the end of May 2012 no future and it should have been placed in liquidation at that point. Had that occurred, Toomey Leasing would not have incurred the loss. Hence the directors had engaged in reckless trading behaviour.

This approach can, however, be contrasted with the perspective of Hogan J. in the Court of Appeal. Here the decision narrowly relies on the principles of statutory interpretation. As will be recalled, the central issue in the Court of Appeal decision in Appleyard was whether the sole remaining director was involved in reckless trading under subsection (3)(a). The approach of Hogan J. in the Court of Appeal was quite different to that of the High Court. While he reiterated the apparent deeming nature of the subsection[230] and its artificiality,[231] he then concentrated on the use of the word *'would'* within subsection (3). He held that it was not sufficient that the controller ought to have known that that his actions might or could cause a loss. Instead, the

[227] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7 at 10
[228] Courtney, Company Law 4th Edition (Dublin: Bloomsbury Professional, 2016), para.16.175
[229] [2015] IEHC 28 para.63
[230] [2016] IECA 280 paras.37
[231] [2016] IECA 280 para.38

director must have actually realised (or ought to have realised) that the loss was a practical or near certainty.[232] This is a surprising interpretation and certainly neither Lynch J. nor Finlay Geoghegan J. arrived at a similar conclusion in their reflections on the deeming provisions. Indeed, it is interesting to note that an argument foreshadowing Hogan J.'s ultimate interpretation was made in the Hefferon Kearns case,[233] yet little evidence can be gleaned from that case that the argument influenced Lynch J.'s thinking. Another surprising aspect of the decision is its implications for future reckless trading cases. In order for the plaintiff to be successful, the realisation of the loss must be highly certain. Thus, the categories of reckless trading within subsection (3) are closed off to an applicant unless it can be proven that the director knew or ought to have known that it was likely in the extreme that their actions would cause the particular loss. Pre Appleyard, section 610 was seen as a difficult provision under which to mount a successful case.[234] The Court of Appeal appears to have raised the level of difficulty even higher.

Is the Court of Appeal decision in Appleyard an example of in class solidarity? While the decision is surprising for its narrowness, it is difficult to classify it conclusively as such. There is no evidence in the judgments themselves that any of the directors were professionally qualified. That said, those who were the subject of the Court of Appeal hearing (Graham Sedgwick and Paul Farrell) were successful businesspeople for over thirty years.[235] Mr. Farrell's salary, for example, was €10,000 per month. This is a significant sum especially as it appears to be the after-tax figure.[236] Thus these two gentlemen may have inhabited a similar social stratum as the learned judge.

Likewise, Mr. Farrell faced personal insolvency which may have garnered sympathy.[237] Indeed, at the beginning of this judgment, Hogan J. emphasises the personal financial situation of the respondents.[238] Interestingly, here he places some

[232] [2016] IECA 280 paras.41-42
[233] [1993] 3 IR 191 at 218
[234] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7
[235] Appleyard Motors Ltd. v Commissioner of Valuation Appeal No. VA04/1/022 para.4
[236] [2016] IECA 280 para.31.
[237] [2016] IECA 280 para.2. It will be remembered that Mr. Farrell was released from the proceedings due to his personal insolvency at Court of Appeal level. Two other defendants has been released earlier for unexplained reasons.
[238] [2016] IECA 280 para.2

weight on the fact that the remaining director will be made liable for the entire debt. This may be the crux of the matter; similar socio-economic backgrounds could mean that while the judiciary is comfortable imposing restriction or disqualification orders, which have no direct financial impact, they are not comfortable imposing personal liability which does.

However, this possibility and the fact that the judgment appears lenient are insufficient to be conclusive either way. Dissatisfaction with the particular decision most likely stems from the fact that the artificial structure and unclear wording of the reckless trading provision results in the law 'running out' and that the judiciary was itself grappling with the limitations which are inherent in the open texture of language. Specifically, the judgment itself is confined to a recital of the facts and the evidence, the decision in the High Court and the interpretation of the section, in particular the 'deeming' provisions. It displays no awareness of the social class of the directors[239] or a sympathy deriving therefrom. It would be different if all four cases involved a combination of professional or wealthy directors and lenient judgments. Yet again, the lack of judicial decisions makes it impossible to draw a firm conclusion either way. While it can be said with some certainty that the Court of Appeal decision in Appleyard is sympathetic to the company's directors, why that is the case is far more difficult to answer.

**(v) Judicial Realism - Concluding Comments**

This section sought to answer a number of interconnected questions in relation to reckless trading. The first question is whether the concept is so nebulous that it allows too much judicial discretion, thus indicating that section 610 is superfluous to the company law canon. A further question is whether we see evidence of judicial realism at work in the reckless trading case law.

In relation to the first question, the issue of whether the law is certain or that it can be made certain is an illusion. If anything, as the world becomes more complex, law becomes more indeterminate.[240] Only so much guidance can be provided by the

[239] Albeit, as pointed out there appears to be an awareness of the directors' financial positions.
[240] Thomas, The Judicial Process: Realism, Pragmatism, Practical Reasoning and Principles, (Cambridge: Cambridge University Press, 2005), p.116

wording of a statutory provision.[241] The reckless trading provision, while poorly drafted, may still be an example of this imprecision; one where there is often a range of choices available to a judge in making a decision[242] and judges must weigh competing social policies in deciding issues.[243] Thus it is difficult to determine whether judges, in arriving at a decision, are exercising their policy preferences and then choosing particular legal rules to justify the result or whether judicial discretion is being used objectively in areas where the law has run out. In the absence of clear evidence for the former, it would be safer to assume that the latter is the case.

In relation to the remaining questions, the best conclusion which can be reached here is that judicial realism does not cast much light on the dynamics behind the limited invocation of section 610. Oliver Wendell Holmes pointed out that clients and their advisers will often seek to predict what courts will do and having made a prediction will then act in ways which reflect the prediction (ie. litigate or settle). Thus the influence of the law is two-fold; firstly on the basis of what courts actually decide and secondly on the fact that what courts decide influences primary behavior which never sees the inside of a courtroom.[244] Therefore, the influence of case law is both seen and unseen.[245] It is however difficult to determine the influence of judicial realism on the lack of case law and the success of the restriction and disqualification regimes argues against any general judicial bias in favour of directors. Thus, while a perception of partiality may be an element in the overall matrix of reasons for the limited invocation, the lack of any firm evidence in the case law of pro-director bias indicates that it could not be the primary one. Hence, the lack of invocation very likely derives from the factors which we have already seen; the difficult statutory language of section 610, high legal costs and that the fact that directors of insolvent companies often lack the personal means to make them worth pursuing rather than an acknowledged existence of judicial partiality to directors.

[241] Hart, The Concept of Law, 3rd Edition (Oxford: Oxford University Press, 2012), p.127
[242] Thomas, The Judicial Process: Realism, Pragmatism, Practical Reasoning and Principles, (Cambridge: Cambridge University Press, 2005), p.202
[243] Thomas, The Judicial Process: Realism, Pragmatism, Practical Reasoning and Principles, (Cambridge: Cambridge University Press, 2005), p.198
[244] Holmes, 'The Path of Law', [1897] 10 Harvard Law Review 457 at 458
[245] Schauer, "Legal Realism Untamed." [2013] 91 Texas Law Review, 749 at 779

## (V) CONCLUSIONS

While contractarianism is strongly against legislative interference in the marketplace; its main argument –that creditors can, and indeed should, be left to protect themselves[246] is unconvincing when examined it the context of the typical small to medium sized trade creditor. Financial institutions and companies with market control can obtain security and guarantees, ordinary suppliers cannot. Large entities are well able to negotiate and protect themselves. Small trade creditors in particular have limited opportunities to do so. They face excessive exposure to the perverse incentive of limited liability. Moreover, had they bargaining power equal to that of the stronger institutions such as banks, they would undoubtedly require similar type security such as personal guarantees. Further, the bulk of the case law demonstrates the necessity of a reckless trading provision. This shows that compulsory legislative rules are often necessary due to the fact that those dealing with companies often cannot protect themselves.[247] The protections such creditors can access are more illusory than real, and while creditors accept that debt write-offs are simply a cost of doing businesses (as entrepreneurial failures are inevitable) it is surely going too far to accept contractarian arguments and conclude that such entities deserve no protection at all from reckless trading behaviour.

Like contractarianism, stakeholder theory values commercial efficiency[248] and economic success.[249] However, the central tenet is that all groups which contribute to the company should benefit from the company. Communitarianism considers the corporation to be comprised of co-operative constituents and not a collection of self-seeking individuals.[250] This school also provides answers to the problem of asymmetry which exists within contractarianism. As such, it challenges contractarian thinking. This theory is gaining acceptance as shareholder primacy is increasingly discredited.

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[246] Mitchell, 'Groundwork of the Metaphysics of Corporate Law' [1993] Vol 50 No. 4 Washington and Lee Law Review 1476 at 1479

[247] Ramsay 'Models of Corporate Regulation: The Mandatory/Enabling Debate' in Grantham and Rickett (Eds), Corporate Personality in the 20th Century, (Oxford: Hart Publishing, 1998), p.221.

[248] Keay, 'Stakeholder Theory in Corporate Law: Has it Got What it Takes?' [2010] 9(3) Richmond Journal of Global Law and Business 249 at 260

[249] Strand, Freeman, 'Scandinavian Cooperative Advantage: The Theory and Practice of Stakeholder Engagement in Scandinavia' [2015] 127(1) Journal of Business Ethics 65 at 73

[250] Lynch Fannon, Working Within Two Kinds of Capitalism (Oxford and Portland Oregon: Hart Publications, 2003), p.93.

It is becoming increasingly obvious that shareholders in reality have little real power[251] and rather nebulous claims to the company's assets and wealth.[252]

Unlike contractarianism, stakeholder theory does not claim to have within itself an overarching concept such as market efficiency which solves all problems. It is acknowledged by theorists that the possibility that stakeholder theory will evolve into a full-blown operative system is largely illusory.[253] A reckless trading provision thus fits comfortably within this theoretical perspective. As we have seen from the case law especially, reckless trading behaviour can be classified as a failure to apply stakeholder principles. While small businesses certainly prioritise important stakeholders,[254] and the stakeholder approach is common in major European jurisdictions, expecting its universal adoption in the near term is undoubtedly unrealistic. Hence, especially when its central tenet of fairness is taken into account, the theory is supportive of a reckless trading type provision.

While judicial realism is an attractive theory in that it provides a straightforward answer to the question of why section 610 is infrequently and unsuccessfully invoked, it may be overly simplistic to lay the problem entirely at the feet of judicial bias. Judges tend to come from the same social class as many (but not all) directors[255] is undoubtedly correct, but were in-class solidarity active, it would be evident in the restriction and disqualification order regime case law. It is not. These regimes are regarded as successful in guiding and sanctioning director behaviour.[256] Hence, while the Court of Appeal decision in Appleyard Motors can be analysed as lenient and may have detrimental implications for future cases, it is difficult, for the reasons given, to classify it as an example of in group solidarity. Indeed, the infrequent use of the provision is far more likely to be caused by internal factors

[251] Lynch Fannon, Working Within Two Kinds of Capitalism (Oxford and Portland Oregon: Hart Publications, 2003), p.124.
[252] Lynch Fannon, Working Within Two Kinds of Capitalism (Oxford and Portland Oregon: Hart Publications, 2003), p.80 and pgs.81-82.
[253] Buchholz, Rosenthal, 'Stakeholder Theory and Public Policy: How Governments Matter' [2004] 51(2) Journal of Business Ethics 143 at 149
[254] Sen, Cowley, 'The Relevance of Stakeholder Theory and Social Capital Theory in the Context of CSR in SMEs: An Australian Perspective' [2013] 118 Journal of Business Ethics 413 at 418.
[255] Omar, France: The Regime Governing Directors' Liability in Insolvency and Reform Perspectives, [2004] Company Lawyer 378 at 383
[256] Ahern, Directors' Duties: Law and Practice, (Dublin: Thomson Reuters, 2009), para.15-03

such as poor drafting and external factors such as impecunious directors and the risk of high legal costs. If anything, the consideration of judicial realism indicates that a more robustly drafted provision would be beneficial. The judiciary would have less cause to grapple with the unclear wording and future decisions would be less subject to the limitations which are inherent in the open texture of language.

# CHAPTER SIX: THE RESTRICTION AND DISQUALIFICATION ORDER REGIMES

## (I) INTRODUCTION

From a UK perspective, one of the reasons cited for the lack of use of section 214 Insolvency Act, 1986 is the attractiveness of the other remedies.[1] While the evidence of this appears to be lacking in Ireland, the question is whether there are other remedies available to liquidators and creditors which constitute viable alternatives. The previous chapter examined whether a reckless trading type provision had theoretical support and the light shed on reckless trading by the selected theories. This chapter will examine whether, considering the difficulties highlighted in Chapter Three, section 610 is necessary at all as creditors may already be sufficiently well served by the restriction and disqualification order regimes. The following chapter will then examine the suitability of the directors' duty to creditors as an alternative.

## (II) THE RESTRICTION AND DISQUALIFICATION ORDER REGIMES

### (i) Restriction Orders – A Brief Background

The restriction order regime was introduced into Irish law by the Companies Act, 1990. The regime has a longer history and was first recommended by the Cork Committee. The primary aim of the system in Ireland was to put an end to the phoenix syndrome. Such was the level of concern surrounding phoenix activity that, as originally drafted, it was the intention of the legislation to automatically restrict all directors of insolvent companies.[2] This arose from the Cork Committee recommendation that disqualification be automatic on insolvency in all circumstances.[3] (Automatic restriction has, however, recently regained favour.)[4] As the Bill progressed this idea was tempered by the realisation that companies often fail

[1] Finch, Corporate Insolvency Law Perspectives and Principles, 2nd Edition (Cambridge: Cambridge University Press, 2009), p.700.
[2] Report of the Working Group on Company Law Compliance and Enforcement (Dublin November 1998) ('The McDowell Report), para. 6.3. See also CLRG, First Report 2000-01, (Dublin December 2001), para.7.2.
[3] Insolvency Law and Practice – Report of the Review Committee [1982] Cmnd 8558 para.1817
[4] CLRG, Report on the Protection of Employees and Unsecured Creditors (Dublin June 2017), para.4.4

despite the best efforts of their controllers. Such controllers who have acted sincerely and conscientiously should not be precluded from starting afresh.[5]

In order to avoid being restricted, the director must demonstrate that he or she acted *'honestly and responsibly in relation to the conduct of the affairs of the company*'.[6] The director must also demonstrate that there is no other reason why it would be just and equitable that he or she should be subject to a restriction order.[7] Moreover once the actual proceedings are underway, the onus of proof is very unusually on the director. Under section 819, when a director becomes the subject of a restriction order, he or she cannot for a period of five years become a director or a secretary of or become involved in the promotion or formation of a company unless it meets certain capitalisation requirements.[8] The director may still be involved in the management of companies, but only under the imposed conditions.

After an initially slow start, (up to April 1994 only eleven individuals had been restricted)[9] the restriction order regime has been very successful. In 2019, a total of ninety-four directors were restricted.[10] In 2018, the number was one hundred and fifty.[11]

**(ii) The Overlap Between Section 819 and Section 610**

The question is whether the restriction order regime is successfully addressing the behaviours which section 610 seeks to tackle. In order to provide an answer two issues will be considered;

1. Does the focus of section 819 make it a suitable provision for this task?
2. Secondly, is there evidence from case law that this is what is occurring?

[5] Report of the Working Group on Company Law Compliance and Enforcement (Dublin November 1998) ('The McDowell Report), para.6.4
[6] S.819(2)(a) Companies Act, 2014.
[7] S.819(2)(c). See also S.819(2)(b).
[8] S.819(3) Companies Act, 2014.
[9] Report of the Working Group on Company Law Compliance and Enforcement (Dublin November 1998) ('The McDowell Report), para.6.13.
[10] ODCE Annual Report 2019 (Dublin 2020), p.4. Restrictions in 2020 were lower due to Covid-19. See ODCE Annual Report 2020 (Dublin 2021), pgs.33-34
[11] ODCE Annual Report 2018 (Dublin 2019), p.7

The restriction order regime has a far broader focus than reckless trading. This may create an overlap, allowing section 819 to address reckless trading type misconduct. There are two aspects to this broader emphasis. Firstly, an application under section 819 can examine (but is not required to do so) the causal connection between the director's conduct and the demise of the company. Secondly, section 819, as part of its broad temporal remit, can examine events in the vicinity of the insolvency.

Section 610 addresses behaviours which directly led to losses to creditors as a result of the insolvency of the company. This is particularly evident with regard to section 610(3)(a) and (b). Under sub-paragraph (a) there is a causal link between the director's actions and the loss to the creditor. Likewise, in sub-paragraph (b), there must be a causal link; at the time of the contracting of the debt, the director must not honestly and reasonably believe that it will be repaid. Finally, the causal link within section 610(1)(a) is apparent from the statements of Lynch J. in Hefferon Kearns Ltd.;[12] the business of the company must be carried on in a manner which the director knows very well will involve a serious risk of loss or damage to creditors.

It is undoubtedly the case that one of the key issues in many restriction order applications is the behaviour of the directors in relation to the company's insolvency.[13] This is an important similarity between the two sections and stems from the fact that restriction only applies to directors of insolvent companies. Earlier case law indicates a significant overlap and holds that there must be a nexus between the director's conduct and the insolvency. Peart J. in Re. USIT World Plc. is robust on this point and drew a distinction between matters which may be the subject of criticism but are not causally linked to the insolvency and those which are so linked. Only the latter warrant restriction.[14] Likewise in Re. Mitek Holdings Ltd. more emphasis was placed on those failures which led to the insolvency of the company as opposed to those which did not.[15] Other such cases as Re Verit Hotel and Leisure (Ireland) Ltd.[16] and Re.

[12] [1993] 3 IR 191 at 222
[13]Ahern, 'The Responsible Director in an Economic Downturn: Lessons from the Restriction Regime', [2009] 31(1) DULJ 183 at 190
[14] [2005] IEHC 285 at 172.
[15] [2010] IESC 31
[16] [2001] 4 IR 550

Swanpool Ltd.[17] emphasise the necessity for a link as did Shanley J. in La Moselle Clothing Ltd. v Soualhi. Shanley J.'s criteria[18] include the requirement to consider the extent of the directors' responsibility for both the company's insolvency and the deficiency in its assets.

However, in other judicial decisions the division between behaviour which led to the insolvency and that which did not so lead is not entirely clear cut. Indeed, it appears that the need for a causal link has not been universally adopted in case law.[19] In Re. Tralee Beef and Lamb Ltd.[20] Finlay Geoghegan J. found the executive director, John Delaney, to have been irresponsible because he did not inform his co-directors of the appointment of a receiver, he purported to enter into a lease when he had no authority to do so and provided misleading financial information to a fellow director. While these actions are certainly not responsible, it is very unlikely that they contributed in any material sense to the insolvency of the company. More recently, in Re. Gingersnap Ltd. the company traded without a liquor license for 21 months.[21] In Re. Mint Restaurant Ltd. the non-executive director was restricted for using the company's credit card for personal expenditure. Due to the seriousness of the company's other problems[22] it is unlikely that this played a significant part in the insolvency. In Re. Tailored Homes (Navan) Ltd.[23] annual returns were not filed for two years. Those failings, while irresponsible could not have played a significant part in the insolvencies in question. Yet these are cited as a reason (among others) for the granting of the order. A further significant point is that section 819, on its wording, does not appear to require a connection between the insolvency and the behaviour in question. Thus, the emphasis on solvency in the legislation may simply hark back to the original purpose of the provision, the defeat of phoenix activity. This is also supported by the

[17] Re. Swanpool Ltd. [2005] IEHC 341. See also McCracken J.'s comments iin Re. Gasco Ltd. unreported High Court 5 February 2001
[18] [1998] 2 ILRM 345 at p 352. The five criteria are whether the director must comply with the duties imposed by the Companies Acts, the extent to which his or her conduct can be regarded as so incompetent as to amount to irresponsibility, the extent of the directors' responsibility for the insolvency, the extent of the director's responsibility for the net deficiency in assets and the extent to which the director exhibited want of commercial probity or proper standards.
[19] Ahern, 'The Responsible Director in an Economic Downturn: Lessons from the Restriction Regime', [2009] 31(1) DULJ 183 at 191
[20] [2004] IEHC 139
[21] [2016] IEHC 177 para.37
[22] [2014] IEHC 370 para.6.
[23] [2017] IEHC 76 para.37

fact that the section only applies to persons who were directors within twelve months of the winding up.[24] This is the period during which phoenix activity would occur.

The issue of whether the director's actions led to or caused the insolvency has acquired importance in case law. While other behaviours entirely unrelated to the insolvency can result in a restriction order, the importance which case law has placed on the link between the directors' actions and the insolvency creates an overlap between the regime and section 610. This means that section 819 is a suitable provision to address reckless trading type misconduct. The existence of the overlap may mean that the reckless trading provision is not actually necessary; directors can actually be made accountable for reckless trading behaviour under section 819.

A further example of the broader focus of the restriction order regime is that it provides for a retrospective review of a director's behaviour during the course of his or her tenure with the company.[25] This is despite the fact that section 819 only applies to an individual who has been a director within the twelve-month period prior to the insolvency. This could indicate that it is only behaviour during that final period which can be scrutinised. The courts, however, have taken a less restrictive view[26] and the entire period of the directorship is examined.[27] The reckless trading cases (while it is difficult to draw conclusions from such a small sample) appear to examine a far narrower temporal range of activities. Specifically, in Re. PSK Construction Ltd., the sole question for consideration was whether the filing of false tax returns and consequent underpayment of tax towards the end of the company's life constituted trading in a reckless manner. Likewise, in Re. Appleyard Motors Ltd. the issue was whether or not placing better protections on Toomey Leasing Ltd.'s funds (obtained shortly before the liquidator's appointment) constituted reckless trading. This narrower temporal focus arguably arises from the fact that section 610(3) in particular is aimed at specifically described actions which directly lead to loses to creditors. Finally, that there is a temporal focal point within section 610(1)(a) may be gleaned from Lynch J.'s description in Hefferon Kearns Ltd. of what reckless trading under

[24] Section 818(1) Companies Act, 2014
[25] Re. Squash Ireland Ltd. [2001] 3 IR 35 at 41.
[26] Ahern, 'The Responsible Director in an Economic Downturn: Lessons from the Restriction Regime', [2009] 31(1) DULJ 183 at 187
[27] Re Squash Ireland Ltd. [2001] 3 I.R. 31 at 40

that subsection entails; *"...the director is a party to carrying on the business in a manner which the director knows very well involves an obvious and serious risk of loss or damage to others, and yet ignores that risk."* [28] Actions which give rise to serious losses to creditors are far more likely to occur close to the end of the company's life.[29]

That said, from an examination of the restriction order case law, it does appear that there is a focus on the directors' actions towards the end of the life of the company. This is by no means an exclusive focus, and in many cases older transactions are taken into account,[30] nonetheless the focus is there and again this makes section 819 a suitable forum for addressing section 610 type misconduct. The restriction order regime does examine the events leading immediately up to the demise of the company. Again, examples abound. In Re. Mint Restaurant Ltd., an important issue was the failure to discharge tax liabilities close to the end of the company's life.[31] In Re. Mitek Holdings Ltd. it was the directors' actions in transferring funds to the companies' foreign parents which were in issue. A further issue was the granting of security in the period immediately prior to the liquidation.[32] Van Dessel v Esmonde[33] involved non-payment of Revenue liabilities in the period before the liquidation. As a final example, Cotter v Gilligan[34] involved allegations of unfair preference towards certain creditors and questionable transactions on the directors' loan account in the year before the winding up.

Section 819 can examine the causal connection between the director's actions and the insolvency. It can also examine directors' conduct in the vicinity of insolvency. Section 819 has, in effect, become a bellwether for judicial standard setting with regard to directorial behaviour and responsibilities making it a suitable conduit for the examination of reckless trading type misconduct. As a result, it has been argued that when determining the standards expected of directors, the courts have tended to give

[28] [1993] 3 IR 191 at 222
[29] Though, as has been previously pointed out, S.610 can examine director conduct at any point in time, the narrow range of case law has concentrated in actions in the vicinity of insolvency.
[30] See Re. Pineroad Distribution Ltd. [2007] IEHC 55 where the central events occurred in 2001 and the tax liabilities had been accruing since 1994.
[31] [2014] IEHC 370 para.5.
[32] [2010] IESC 31 para.18
[33] [2014] IEHC 278 para.14
[34] [2014] IEHC 305 paras.8-9. The directors were not restricted in this case (para.11)

the legislation a purposive interpretation.[35] This can be contrasted with the narrow interpretation applied to section 610. Section 610 is specifically tailored[36] to sanction a director whose reckless actions cause losses to creditors. As a general proposition, a statutory provision which is specifically designed to deal with a particular issue should yield better results that one which has a wide-ranging focus. However, the types of behaviours dealt with by the restriction order regime indicate that this general proposition does not appear to hold in these circumstances.

**(iii) Behaviours Addressed by the Restriction Order Regime**

The next question is whether the restriction order regime is successfully addressing reckless trading type behaviour. To determine whether this proposition is correct it is necessary to carry out a detailed examination of the types of behaviours which emerge within the restriction order case law. The purpose of this evaluation is to determine whether there is an overlap which allows the restriction order regime to address reckless trading type misconduct.

As issues of honesty rarely appear in restriction order case law,[37] it is the concept of irresponsibility which will be examined here. Further, this focus is appropriate as reckless trading type behaviour under section 610 does not encompass dishonest behaviour. As a restriction order can be made based on irresponsibility alone judicial focus has largely been aimed at what constitutes irresponsible behaviour.[38] Thus when section 819 is compared to section 610 a dichotomy is seen to exist. On a scale of misbehaviours dishonesty is far more serious than either recklessness or irresponsibility. Thus section 819 addresses a class of misbehaviour which is worse than that sanctioned by section 610 (dishonesty) and, also, a class of behaviour which is less blameworthy (irresponsibility).

The wide scope of the concept of irresponsibility is apparent from the comments of Fennelly J. in Re. Mitek Holdings Ltd.[39] In endorsing the classification set out by

[35] Brennan, 'Section 150 of the Companies Act 1990 – Restriction of Directors Reviewed (Part 1), [2002] 9(10) CLP 215 at 218.
[36] That was the intention at least. As set out in Chapter 2, it is open to question this aim is achieved.
[37] Ahern, Directors' Duties: Law and Practice, (Dublin: Thomson Reuters, 2009), para.15-130
[38] Ahern, Directors' Duties: Law and Practice, (Dublin: Thomson Reuters, 2009), para.15-130.
[39] [2010] IESC 31

Clarke J. in Re. Swanpool Ltd.[40] Fennelly J. confirmed that section 819 requires the consideration of the responsibilities of directors in the widest sense. The restriction order regime does not simply consider a director's statutory and equitable duties to his or her company. While encompassing such duties, the interests of any persons dealing with the company must also be taken into account. This will, obviously, also comprise creditors.[41] Thus section 819, as with section 610, is creditor focused and the restriction order regime's concern with director behaviour towards creditors is obvious from case law. This is apparent from such cases as Re. Swanpool Ltd. (preferential treatment of certain creditors)[42] Re. Pineroad Distribution Ltd. (abandonment of creditors of an insolvent company),[43] Re. Shemburn Ltd.[44] Cahill v O'Brien[45] and Re. Winning Ways Ltd.[46] (failure to liquidate in a timely fashion), and Re. DCS Ltd. (preferential treatment of certain creditors).[47] It is also acknowledged by the CLRG. In a recent Report, it recognised that where directors fail to take adequate and reasonable steps to minimise losses to creditors, they face the possibility of being made subject to restriction or disqualification orders.[48]

As with reckless trading, hindsight is not used to determine whether or not the director was irresponsible.[49] Further, responsible conduct must be judged against an objective standard.[50] In addition, irresponsibility is something more than committing errors of commercial judgment.[51] Some specific examples for irresponsibility can be drawn from the voluminous case law. Inadequate financial records and information are grounds for restriction[52] as is trading while insolvent,[53] not liquidating the company at

[40] [2006] 2 ILRM 217 para.3.7
[41] Re. Mitek Holdings Ltd. [2010] IESC 31 para.77
[42] [2006] 2 ILRM 217 para.3.7
[43] [2007] IEHC 55 para.18
[44] [2017] IEHC 475
[45] [2015] IEHC 817
[46] [2020] IEHC 264
[47] [2006] IEHC 179
[48] CLRG, Report on the Protection of Employees and Unsecured Creditors (Dublin June 2017), para.2.3.4
[49] Business Communications v Baxter Unreported High Court Murphy J. 21 July 1995.
[50] Re. Squash Ireland Ltd. [2001] 3 IR 35 at 39
[51] Re. Squash Ireland Ltd. [2001] 3 IR 35 at 39
[52] See Careca Investments Ltd. [2005] IEHC 62 where inadequacy of financial records featured as a reason for restriction.
[53] Re USIT World Plc [2005] IEHC 285

the appropriate time,[54] failure to pay taxes,[55] using tax monies to fund company operations,[56] and failing to prepare management accounts for a nineteen-month period while the company was insolvent.[57]

What is interesting here (and in must be stressed that the directors were not restricted in all the cases highlighted) is that from the above analysis an overlap becomes apparent in the case law between the failures addressed by the restriction order regime and section 610 under four subheadings. This answers our second question; there is evidence is case law that the restriction order regime is addressing reckless trading issues.

**(a) Trading While Insolvent**

In Re. Hefferon Kearns Ltd., the directors were found to have been involved in reckless trading because the company was not placed in liquidation at the correct time.[58] By way of comparison, the issue of continuing to trade while insolvent was specifically addressed in Re USIT World Plc. Peart J. acknowledged that trading while insolvent in an attempt to trade out of difficulties was not, in itself, an irresponsible act. What is interesting to note, however, is that it is the restriction order regime rather than section 610 which has fleshed out the criteria to determining whether continuing to trade during a period of insolvency is permissible or not. This is evident from case law. Directors are not required to cease trading immediately that the company becomes insolvent.[59] Trading may continue if there are reasonable grounds to believe that the company's fortunes will improve.[60] Leeway is given as the difficulties may be temporary. Reasonable steps in order to trade out of the difficulty should be taken (such as obtaining financial and legal advice).[61] Serious minded and bona fide efforts to trade through a period of difficulty are not precluded provided that the directors have regard to the interests of creditors.[62] Funding a loss making company

[54] Tailored Homes (Navan) Ltd. [2017] IEHC 76.
[55] Digital Channel Partners Ltd. [2004] 2 ILRM 35
[56] Re. Gingersnap Ltd. [2016] IEHC 177
[57] Re Fergus Haynes (Developments) Ltd [2013] IEHC 53
[58] [1993] 3 IR 191 at 224
[59] [2005] IEHC 285 para.205
[60] AMS I.T Consultants Ltd. [2006] IEHC 12
[61] Re. USIT World Plc [2005] IEHC 285 paras.205-206
[62] Arkins v Murphy [2015] IEHC 2 para.44

through continuous borrowing is permissible where experienced business people are involved.[63] That said, behaviour is viewed as irresponsible where the company continues to trade while insolvent over a protracted period. This is especially so where the directors continued to trade when the company's position was clearly hopeless.[64]

A similar correspondence arises in Re Tailored Homes (Navan) Ltd. This case involved an insolvent house builder which collapsed during the recession. While Barrett J. could not fault the directors for not spotting the imminent collapse of the housing market, he found that they had allowed the company to continue to trade long after it was known that collapse was inevitable.[65] The company could not pay PAYE and PRSI liabilities and was unable to file annual returns because funds to pay for their preparation were lacking.[66] Likewise, significant amounts of tax which accrued over a three year period were owing to the Revenue Commissioners. It is argued here that these are clearly reckless trading issues, yet the case was not litigated as such. The Tailored Homes case has similarities to Re. PSK Construction Ltd.[67] where monies due to Revenue were underpaid for a considerable period of time and the additional monies thus generated were used to fund operations at a point when the company should have been in liquidation. While Barrett J. was lukewarm in his endorsement of a restriction order[68] a clear finding was made that the company should have been liquidated far earlier. Yet it was section 819 which addressed the directors' misconduct.

**(b) Tax Failings**

The behaviours surrounding tax failings have a long history within the restriction order regime.[69] The prevalence of taxation related cases may arise from the fact that Revenue, when it petitions to have a company would up, will often agree to

[63] Re: First Class Toy Traders Ltd. Finlay Geoghegan J. Unreported 9th July 2004.
[64] Ahern, 'The Responsible Director in an Economic Downturn: Lessons from the Restriction Regime', [2009] 31(1) DULJ 183 at 190. Thus, the regime's position echoes that which exists in New Zealand under S.135 as set out in Chapter 4.
[65] [2017] IEHC 76 para.19
[66] [2017] IEHC 76 para.20
[67] [2009] IEHC 538 para.21
[68] [2017] IEHC 76 para.38
[69] See Re Verit Hotel and Leisure (Ireland) Ltd. [2001] 4 IR 550

fund the reasonable costs of a restriction order application.[70] Specifically, Finlay Geoghegan J. stated as long ago as 2004 in Digital Channel Partners Ltd. (In Voluntary Liquidation)[71] "*It appears to me that in relation to tax liabilities there must be something more than a limited failure over a period to indicate that the directors have acted irresponsibly. This has been put in a number of different ways and certainly in so far as there may be evidence that there either has been selective distribution or selective payment of liabilities of a company or indeed a total disregard of obligations to the Revenue or even a decision to effectively seek to use taxation liabilities for the purpose of financing a company, that of itself will normally be indicative of the fact that directors have been acting at least irresponsibly."*

More recently, similar events occurred in Esmonde v Van Dessel[72] where significant underpayment of PAYE and VAT were used to finance the continued trading of the company over a significant period. Another example is Re SPH Ltd. Here the company had an estimated deficit of approximately €1,700,000 of which €277,000 was due to the Revenue Commissioners. Finlay Geoghegan J held that the directors had either knowingly permitted significant Relevant Contractor's Tax liabilities to accrue without providing for their payment or that they were unaware of that these liabilities were accruing and hence they failed to put in place proper financial systems.[73] Either way, a restriction order was warranted.[74]

Other recent examples of tax failure cases are Re. Gingersnap Ltd.[75] (using tax monies to keep the company afloat) and Arkins v Murphy (non-payment of tax liabilities and questions as to whether the company was liquidated at the proper time). Indeed, the frequency with which unpaid tax liabilities are dealt with via the restriction order regime is best encapsulated by Barrett J.'s comments in

[70] See for example McDowell Purcell – Restriction of Directors; New Concern for Liquidators (22 March 2019)
[71] [2004] 2 ILRM 35
[72] [2014] IEHC 278
[73] [2005] IEHC 152 para.20
[74] [2005] IEHC 152 para.25
[75] [2016] IEHC 177.

Arkins v Murphy[76] *"- first, non-payment of tax is always a serious matter. In truth, a director who allows a company to stray into non-compliance on the tax front all but invites a later s.150 application if the company of which he or she is director later gets into difficulty"*

**(c) Reckless Behaviour**

In Re. Pineroad Distribution Ltd. is particularly illuminating. In this case, a commercial restructuring of the company (which was in the haulage business) carried out in 2001 resulted in its entire assets and business being transferred to a new company without any payment for goodwill. The commercial rationale for this was that a key employee had resigned from Pineroad. In order to ensure his services and that he did not set up in competition, the commercial restructuring was necessary. The key employee obtained a 10% shareholding in the new company.[77] However, this left Pineroad significantly insolvent and, in particular, it had large tax liabilities which had built up since 1994.[78] Payments from the new company were insufficient to discharge those liabilities.[79] While Hanna J. found that the restructuring itself did have a commercial rationale, the tax issues were another matter entirely.[80] He restricted all respondents. His description of their actions is particularly revealing. He described decision to strand the liabilities in Pineroad as "*recklessness of the highest order"*[81] He concluded that the respondents *"acted with gross recklessness and contrary to the interests of the creditors of the company."*[82]

It is telling that the judge uses the word 'reckless' to describe the directors' actions. Indeed, stranding Revenue liabilities in a company which could not discharge the amounts owing is an abuse of limited liability. It is highly likely that the arrangements constituted reckless trading either within section 610(1)(a) or within subsection (3)(a). However, there is no record of an action under section 610 being taken against any of the directors. This is despite the fact that

[76] [2015] IEHC 2 para.18
[77] [2007] IEHC 55 paras.3-4
[78] [2007] IEHC 55 para.17
[79] [2007] IEHC 55 para.4
[80] [2007] IEHC 55 para.17
[81] [2007] IEHC 55 para.17
[82] [2007] IEHC 55 para.18.

the executive director may have been a man of substantial means in that he personally discharged, on behalf of the company, sums totaling €1.1 million to Revenue in 2003 and 2004.[83]

**(d) Entrepreneurial and Operational Issues**

Another issue of central importance to reckless trading has had its parameters delineated within the restriction order canon of case law. A clear distinction has been drawn by the restriction order regime between entrepreneurial risk-taking and operation risk management.[84] Only the latter is sanctioned.

The restriction order regime has again developed central tenets in this area. Genuine commercial failure is not a target of the regime.[85] Commercial errors or misjudgments do not constitute irresponsible behaviour.[86] This is in keeping with the courts view that too close an examination of business decisions may not be advisable as it could inhibit legitimate risk-taking. Directors must maximise profits and that requirement will inevitably result in taking risks.[87] This must be divorced, however, from the question of whether suitable decision-making procedures were in place.[88] This is an advantageous approach for the judiciary to take as it should encourage the establishment of sensible decision-making procedures in companies without requiring the courts to punish business ventures which have simply failed for commercial reasons.[89]

There are numerous restriction cases where a combination or indeed all of the above behaviours are found. Specifically, older cases which form the bedrock of the restriction order canon display the overlap; Re. Newcastle Timber Ltd.[90] (where the company continued to trade for four years while insolvent and allowed significant

[83] [2007] IEHC 55 para.17
[84] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7.
[85] Ahern, 'The Responsible Director in an Economic Downturn: Lessons from the Restriction Regime', [2009] 31(1) DULJ 183 at 187
[86] Re. Squash (Ireland) Ltd. [2001] 3 IR 35 at 39
[87] Business Communications Ltd. v. Baxter Unreported High Court Murphy J. 21 July 1995
[88] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7.
[89] Parkinson, Corporate Power and Responsibility: Issues in the Theory of Company Law (Oxford: Clarendon Press, 1995), p.111
[90] [2001] 4 IR 586

Revenue debts to build up), La Moselle Clothing Ltd. v Soualhi[91] (continuing to trade while hopelessly insolvent and use of monies due to Revenue to finance trading activities and personal travel), and Business Communications v Baxter[92] (the company continued to trade for a significant period of time while insolvent). More recent examples are also plentiful; Re. Shemburn Ltd.[93] Re. Careca Investments Ltd.,[94] Re. Gilson Motors Ltd.,[95] Re Derbar Developments Ltd.,[96] Re Noxtad Ltd.,[97] Re Shellware Ltd., [98] and Murphy v O'Flynn.[99]

Likewise, restriction order cases may have begun to inform judicial thinking on the types of behaviour which should be sanctioned under section 610. This is particularly apparent from the High Court in Re. Appleyard Ltd.[100] In that case Re. USIT World Plc.,[101] Business Communications v Baxter and Parsons[102] and Re. Squash Ireland Ltd.[103] were of assistance to Binchy J. in arriving at his decision.

**(iv) Disqualification Orders – A Brief Background**

The disqualification order regime was originally created by the Companies Act 1990 and extended by Company Law Enforcement Act 2001. The provisions are now contained in Part 14 Companies Act 2014. The Irish regime is similar to that in the UK and Australia and has as its basis a recommendation of the Greene Committee.[104] Indeed, disqualification is an old concept having its genesis in the UK Companies Act, 1948. The core principle is that a disqualified director is debarred from acting as a director of a company again for a prescribed number of years. The thrust of the legislation is two-fold; firstly, conviction of certain indictable offenses results in automatic disqualification[105] and secondly under section 842, either on its own motion

[91] [1998] 2 ILRM 345
[92] Unreported High Court Murphy J. 21 July 1995
[93] [2017] IEHC 475 para.30 (trading while insolvent)
[94] [2005] IEHC 62 (trading while insolvent)
[95] [2015] IEHC 846 (inadequate books and records and outstanding taxes)
[96] [2012] IEHC 144 (failure to pay tax but no restriction order was made)
[97] [2014] IEHC 278 (non-payment of tax, using Revenue liabilities to fund operations and possible phoenix activity)
[98] [2014] IEHC 184 (non-payment of taxes, the director was not restricted)
[99] [2016] IEHC 197 (this company had significant unpaid capital gains tax, PAYE and PRSI)
[100][2015] IEHC 28
[101] [2005] IEHC 285 cited in Appleyard at paras.40-41.
[102] Unreported High Court Murphy J. 21 July 1995 cited in Appleyard at para.42.
[103] [2001] 3 IR 31 is cited in Appleyard at para.43
[104] Greene, Report of the Company Law Amendment Committee (1926) Cmnd 2657
[105] S.839 Companies Act, 2014.

or on the application of the specified person,[106] the court has the discretion in various circumstances to make a disqualification order for such period as it sees fit.[107] In all listed circumstances, the ODCE may apply for the disqualification order and has been pro-active in that regard.[108] Again, this is an example of the effectiveness of public enforcement and may indicate the future direction of reckless trading. Importantly, a restriction order is seen as a lesser sanction than disqualification.[109]

**(v) Managerial Unfitness**

The circumstance which has generated the most case law is section 842(d); the conduct of the director makes him or her unfit to be involved in the management of a company. Indeed, it is described by Milman as *'…the major entry point to the world of disqualification'*.[110] This subsection is also the closest conceptually to section 610. It is therefore this aspect which will be examined in this chapter. Whether this aspect of the disqualification order regime is sanctioning behaviour which is more properly within the bailiwick of reckless trading will be answered. The question to be asked here is whether, as with the restriction order regime, section 842 is addressing reckless trading type misconduct. There is evidence that this is occurring.

However, unlike section 819, the evidence is not as overwhelming. Disqualification orders in Ireland appear to be used (often, but not always) for the more unusual forms of misbehaviour; deliberate destruction of books and records,[111] carrying on unlicensed banking activities and evading tax,[112] setting up fictitious bank accounts in order to allow certain bank customers evade tax,[113] an offshore scheme to allow wealthy and well connected individuals to evade tax,[114] serious supervisory failures,[115]

[106] Set out in S.844 Companies Act, 2014
[107] These circumstances are set out in S.842(a) – (i).
[108] Specifically, the ODCE obtained 30 disqualification undertakings and 4 disqualification orders in 2019. ODCE Annual Report 2019 (Dublin 2020), p.8
[109] Report of the Working Group on Company Law Compliance and Enforcement (Dublin November 1998) ('The McDowell Report), para.6.9
[110] Milman, 'Disqualification of Directors: An Evaluation of Current Law, Policy and Practice in the UK' [2013] CLN 1 at 3.
[111] Re. CB Readymix Ltd.; Cahill v Grimes [2002] IESC 12
[112] ODCE v Collery [2006] IEHC 67.
[113] ODCE v D'Arcy [2005] IEHC 333 and ODCE v. Byrne [2009] 2 I.L.R.M. 3285
[114] ODCE v McCann [2010] IESC 59
[115] ODCE v. Brennan [2008] IEHC 132

misuse of client funds by an investment intermediary,[116] and tax fraud.[117] Hence, the regime may be being reserved for the more notable and high profile cases. Thus, there is not the overlap in behaviours seen in the restriction order regime canon of case law. This is surprising as the court has the discretion to make a disqualification order once a finding of reckless trading has been made against a director[118] and may arise from two particular facts. Firstly, the disqualification order regime applies to all companies whereas the restriction order regime only applies insolvent ones.[119] Further, there is an onus on the liquidator to pursue a restriction order unless relieved by the ODCE from doing so.[120]

This combination may direct the restriction order regime towards conduct which caused irretrievable losses to creditors. Secondly, the fact that uniquely there is a choice within the Irish system seems to have allowed for the creation of a two-tier approach. The more common types of misbehaviour (trading while insolvent, not paying taxes as opposed to organised and deliberate schemes of tax evasion) result in a restriction order. Section 842 is then left to deal with, as we have seen above, the atypical situations. This is not the case in the UK, however, where, as Griffin states, disqualifications order will be readily imposed where the misconduct is serious and prevents the repayment of corporate debts. This is especially the case where the misconduct caused the insolvency or significantly increased the outstanding liabilities.[121] In Ireland this statement is far more appropriate to the restriction order regime.

That said, an overlap can be found. In a recent case, Re. Wood Products (Longford) Ltd. the company continued to trade while insolvent and it appears that the company had been insolvent since 2003. Further, the company had outstanding taxation liabilities in the region of €1,100,000.[122] The second director also withdrew an unexplained sum of €10,000 from the company.[123] While this is not a large sum of

[116] Wallace v Cassidy [2016] IEHC 689
[117] Re. Bovale Developments Ltd. [2013] IEHC 561.
[118] S.842(1)(c) Companies Act, 2014
[119] S.819(1) Companies Act, 2014.
[120] S.682 Companies Act, 2014
[121] Griffin, 'The Disqualification of Unfit Directors and the Protection of the Public Interest' [2002] 53 NILQ 207 at 213
[122] [2017] IEHC 314 paras.11-20
[123] [2017] IEHC 314 paras.21-23.

money, this is undoubtedly an action which would cause losses to creditors. In another case, sums were diverted away from the main creditor.[124] A more recent case concerned preferential payments from an insolvent company.[125] Finally, Director of Corporate Enforcement v Rodgers,[126] involved among other serious matters insolvent trading for an extended period of time.

That disqualification orders are rarer and often deal with atypical situations is also evidenced by the Annual Reports of the ODCE; amongst the cases cited are non-payment of taxes in the sum of €2.5m, phoenix activity,[127] tax fraud identified during a Revenue audit, non-payment of wages to staff, the siphoning off by a director of nearly €1 million via a PayPal account,[128] tax defaults,[129] a Ponzi scheme, and the unexplained withdrawals and subsequent disappearance of over €500,000 from a company's bank account.[130] While the Reports do detail disqualification orders being granted for more mundane misconduct (non-cooperation with the liquidator, relatively small amounts of outstanding taxes) many cases contain at least one unusual feature. Indeed, restrictions are far more common than disqualifications. For example, in 2017, 103 directors were eligible for restriction undertakings whereas only 4 directors were eligible for disqualification undertakings. Further, 31 restriction orders were granted by the High Court against 9 disqualification orders.[131] This is borne out by Reports from later years.[132] This supports the contention that it is largely the restriction order regime which is addressing section 610 types of misconduct.

**(vi) Concluding Comments**

It appears therefore that types of conduct and issues which would be appropriate for section 610 actions are being successfully dealt with via the restriction route instead. In effect, commercial behaviour which could potentially be classed as reckless is instead being sanctioned on the basis that it is merely irresponsible. The same pattern

[124] Lennon v. Gilson [2015] IEHC 846
[125] Re. Alvonway Investments Ltd. [2020] IEHC 376.
[126] [2005] IEHC 443
[127] ODCE Annual Report 2017 (Dublin 2018), p.39
[128] ODCE Annual Report 2016 (Dublin 2017), p.37
[129] ODCE Annual Report 2019 (Dublin 2020), p.40 and ODCE Annual Report 2018 (Dublin 2019), p.39
[130] ODCE Annual Report 2015 (Dublin 2016), p.35
[131] ODCE Annual Report 2017 (Dublin 2018), pgs.37-38
[132] See for example ODCE Annual Report 2019 (Dublin 2020), p.37

can be discerned, albeit to a lesser extent, with regard to disqualification orders. While the broad focus of section 819, the wide meaning of the word 'responsible' and the provision's creditor focus allows encroachment to occur, that still begs the question as why it occurs. It goes without saying, however, that public enforcement of these regimes must play a major role. The restriction order regime was originally little used. This was because, due to unclear drafting within the original section, it was not specified who should actually take the application. While Murphy J. made a practice direction in Business Communications Ltd. v Baxter[133] and matters were further clarified by section 41(1)(c) Company Law Enforcement Act, 2001, it was actually section 56 of that Act which resulted in the robust enforcement of the restriction order regime which we have today. In effect, once the regime came within the bailiwick of the ODCE and became quasi-public, the number of cases rapidly increased. Likewise, the disclosure order regime has significant public involvement. This lends credence to the argument that adding a public enforcement aspect to reckless trading may be beneficial and is another example of the successful intrusion of public enforcement into the private sphere.[134]

The next question is whether this is a satisfactory state of affairs. Are the problems envisaged by section 610 sufficiently dealt with via sections 819 and 842? In order to answer that question, we must examine the purposes and policies behind the three provisions.

## (III) POLICY

### (i) Reckless Trading – Policy

Reckless trading arose from the need to remedy the failure of fraudulent trading to protect creditors in situations where the directors were not actually dishonest.[135] On foot of its examination of fraudulent trading, the Cork Committee concluded that it was appropriate to have criminal offense of carrying on a business dishonestly.[136] However, the Committee recognised that no adverse consequences attached to the

[133] Unreported High Court Murphy J. 21 July 1995.
[134] For a discussion of this intrusion generally see Ahern, 'Directors' Duties: Broadening the Focus Beyond Content to Examine the Accountability Spectrum, [2011] 33(1) DULJ 116.
[135] See comments of Minister of State at the Department of Industry and Commerce Seamus Brennan. 120(b) Seanad Deb. Col.2439 (12 July 1988)
[136] Insolvency Law and Practice – Report of the Review Committee [1982] Cmnd 8558 para.1777

commercially reckless director no matter how blameworthy his or her actions. The same considerations existed regarding the introduction of the Irish provision as is encapsulated in the Seanad Eireann Debates *"… section 107 also introduces the notion of "reckless trading", with the possibility of personal liability where this is proved. There have been many cases where directors have operated a company in a way which, while not actually fraudulent in intent, nevertheless completely disregarded the interests of its creditors, …"*[137]

Reckless trading is, while not phoenix orientated, a creditor protection measure and its underlying policy is to ensure that the directors face up to the reality of insolvency and incur no further new debts which they cannot repay.[138] That this is an underlying policy consideration is clear from the Cork Committee's deliberations.[139] Once the company nears insolvency, the provisions endeavour to realign the legally imposed duties of directors. The duties move from the shareholders to the creditors and the directors are incentivised to act in the interests of creditors.[140] There is also a deterrent element.[141] The threat of personal liability may deter directors from behaving in a commercially reckless manner in the first place.[142] A deterrent focus is also evident in the UK Parliamentary debates which preceded the introduction of wrongful trading.[143] Thus an alignment exists, to a certain extent, between restriction orders, disqualification orders and reckless trading from a policy standpoint.

However, very importantly, reckless trading has a final central policy element which is perhaps its raison d'etre. As the LRC recently stated the first aim of the reckless trading provision is to compensate creditors by the removal of limited liability.[144]

[137] 116(a) Seanad Deb. Col 464 (27 May 1987)
[138] CLRG, Report on the Protection of Employees and Unsecured Creditors (Dublin June 2017), para.2.4.3.
[139] Insolvency Law and Practice – Report of the Review Committee [1982] Cmnd 8558 para. 1784
[140] Mokal, Corporate Insolvency Law (Oxford: Oxford University Press, 2005), p.280.
[141] Bachner, 'Wrongful Trading - A New European Model For Creditor Protection?' [2004] 5(2) EBOR 293 at 297
[142] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para.12.52.
[143] Walters, 'Enforcing Wrongful Trading- Substantive Problems and Practical Disincentives' in Rider, The Corporate Dimension, (Bristol, Jordan Publishing Ltd., 1998), p.147.
[144] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para.12.52.

Restitution and compensation is described as the primary goal of the section.[145] That creditor recompense is a central policy consideration is also the view of a number of Irish commentators.[146] While it has been argued that Cork's response appears to have been driven more by a desire to deter reckless conduct than provide an effective remedy for creditors,[147] compensation is very much emphasised. The central recommendation was that a provision be added whereby compensation would be available to creditors who suffer foreseeable loss as a result of reckless and unreasonable behaviour by those in control of a company in an insolvency situation.[148]

**(iii) Restriction Orders - Policy**

It is of importance to trace the history of the policy behind the restriction order regime especially as this has changed as the regime progressed and different policy aspects were emphasised at different times. That said, creditor protection has always been within the ambit of the restriction order regime from a policy perspective as part of its overall public protection function.

**(a) Phoenix Activity**

The regime again has its genesis in the Cork Report. The original policy is clear. As McCormack states *'These provisions were obviously designed to make it more difficult for persons responsible for the failure of one company with limited liability immediately to recommence trading through the medium of another.'*[149] Thus from a policy standpoint, restriction orders as originally envisaged certainly carried an element of creditor protection.[150] That said, the main concern of the Irish legislators[151] during the progression of the Companies Act, 1991, while still creditor orientated, was much more specific; the phoenix syndrome. Indeed, the McDowell Report stated that combating phoenix activity is *'the sole*

[145] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para.12.86
[146] Flynn, 'Reckless Trading' [1991] 9(8) ILT 186 at 190. Kettle 'Improper Trading in Ireland and Britain' [1994] 12(4) ILT 91 at 91.
[147] Walters, 'Enforcing Wrongful Trading- Substantive Problems and Practical Disincentives' in Rider, The Corporate Dimension, (Bristol, Jordan Publishing Ltd., 1998), p.146.
[148]Insolvency Law and Practice – Report of the Review Committee [1982] Cmnd 8558 para.1777
[149] McCormack, The New Companies Legislation (Dublin: Roundhall Press 1991), p.139.
[150] McCormack, The New Companies Legislation (Dublin: Roundhall Press 1991), p.154.
[151] See Minister Albert Reynolds Dail 120(b) Deb. Col.601 (31 May 1988).

*purpose'* of what is now section 819.[152] Many TDs and Senators spoke effusively on this point.[153] A phoenix activity focus is further reiterated by the First Report of the CLRG in 1994 where the adverse impact of phoenix activity on the general business environment is discussed[154] and, indeed, the sanction and prevention of phoenix activity is still recognised today as an important aim of the regime.[155] Phoenix activity, although far from eradicated[156] does appear to have decreased significantly.[157] The restriction regime is credited, in part at least, with this success and demonstrates the effectiveness of public enforcement. Thus, if the original policy of the Irish legislation was narrowly to eradicate the phoenix company, then its bailiwick has certainty extended beyond this narrow focus.

**(b) Compliance with Statutory Duties**

Historically in Ireland, non-compliance with statutory obligations has been extremely common.[158] The McDowell Report noted that in 1997 only 13% of companies filed annual returns on time.[159] The Report stated that Irish company law was, at that time, characterised by a culture of non-compliance[160] and that penalties were not enforced even for serious breaches.[161] While the Report only provides filing levels for annual returns, compliance levels with regard to other Companies Registration Office documentation must have been similarly poor. Hence the regime's later emphasis with statutory compliance as a policy objective and McDowell's recommendation that liquidators enforce restriction

[152] Report of the Working Group on Company Law Compliance and Enforcement (Dublin November 1998) ('The McDowell Report), para.6.1.
[153] See for example comments by Senator Kennedy 127 Seanad Deb. Cols.280-283 (13 December 1990)
[154] CLRG, First Report 1994, (Dublin December 1994), para.7.7
[155] CLRG, Report on the Protection of Employees and Unsecured Creditors (Dublin June 2017), para.5.9.1
[156] See for example Re Fortwilliam Catering Ltd; Fitzpatrick v Sharma [2015] IEHC 3
[157] Lynch Fannon and Murphy, Corporate Insolvency and Rescue 2nd Edition (Dublin: Bloomsbury, 2012), para10.05
[158] McGrath, 'Twenty Years Since the McDowell Report: A Reflection on the Powers and Performance of the Office of the Director of Corporate Enforcement' [2018] 60(60) Irish Jurist 33 at 34.
[159] Report of the Working Group on Company Law Compliance and Enforcement (Dublin November 1998) ('The McDowell Report), p.9 and para.2.4.
[160] Report of the Working Group on Company Law Compliance and Enforcement (Dublin November 1998) ('The McDowell Report), p.(ii)
[161] Report of the Working Group on Company Law Compliance and Enforcement (Dublin November 1998) ('The McDowell Report), para.2.5

orders can be seen in context of policy to improve Ireland's woeful compliance levels.[162] Tentatively, this may explain the emphasis in the earlier restriction order case law on compliance with statutory duties. As compliance levels increased, that emphasis expanded resulting in Finlay Geoghegan's amplified criteria to include directors' common law and equitable duties in Re. Tralee Beef and Lamb Ltd.[163]

**(c) Regulation of Controller Behaviour**

Over time the regime has moved from a narrow policy concentration on phoenix activity to a wider focus on compliance with statutory duties and now concentrates on the standards of behaviour expected from directors in a general sense. The restriction order regime has become important in terms of judicial standard setting and the role played in conditioning societal expectations of directors.[164] Thus the regime has become a conduit for judicial consideration of directors' conduct and the standards of behaviour to be expected from them.[165] This has also been the experience in the UK.[166] It allows the judiciary to take into account the fact that the norms of the past may be of a lower or different standard to those of today[167] and to keep up with changing business mores which have become far less forgiving to directors over time. A further aspect is that the restriction regime case law has allowed the judiciary to specify what a director should or should not do where there is no legal standard which requires this behaviour ie. the director's behaviour, while lacking, was not actually irresponsible.[168]

**(d) Public Protection**

The fact that the policy emphasis of the restriction order regime has shifted over time does not take away from the fact that its central policy concern is that the

[162] Report of the Working Group on Company Law Compliance and Enforcement (Dublin November 1998) ('The McDowell Report), para.6.39
[163] [2004] IEHC 139 at 41.
[164] Ahern, Directors' Duties: Law and Practice, (Dublin: Thomson Reuters, 2009), para.15-04
[165] Ahern, Directors' Duties: Law and Practice, (Dublin: Thomson Reuters, 2009), para.15-04
[166] Walters, 'Directors Disqualification After the Insolvency Act 2000: The New Regime' [2001] Insolvency Lawyer 86 at 87
[167] See Director of Corporate Enforcement v McCann [2014] IESC 59.
[168] Lynch Fannon, 'The Dynamic Entrepreneur or the Totally Incompetent Fool? The Role of Norms in Identifying Legitimate Risk Taking under Irish Company Law' in Keane and O'Neill (Eds), Corporate Governance and Regulation, (Dublin: Round Hall Press, 2010), p.67

protection of the public from directors who have not acted honestly and/or responsibly (and this harks back to the Cork Report). The regime provides for the scrutiny of directors' conduct by the courts in order to determine whether they should be restricted in the public interest. The concern of the legislation has a purpose which is protective rather than punitive.[169] The primary aim of the regime is to protect those dealing with companies (including creditors) from a repeat performance by directors who, as past controllers of failed companies, have shown themselves to be a menace to others, particularly creditors.[170] Public protection also carries a deterrence element.

Finally, this policy objective is well reflected in case law and is well encapsulated by Finlay Geoghegan in Re Colm O'Neill Engineering Services Ltd.[171] wherein she stated *"In considering the matters raised by the liquidator in relation to the four respondent directors, I think it is necessary just briefly to consider the legal framework which has been established by s.150 and the authorities on the section. Firstly, it is well established that the purpose of the section is to protect the public against the future supervision and management of companies by persons whose past record as directors of insolvent companies have shown them to be a danger to creditors and others. It is also established that it is not the purpose of the section to punish the individuals concerned."*

**(iii) Disqualification Orders - Policy**

The policy underpinning the disqualification order regime is similar to that which underpins restriction orders. Like restriction orders, an important original guiding principle was combating phoenix activity.[172] Indeed, the CLRG considered disqualification the more suitable sanction.[173] There has always been a strong element of public protection.[174] There still is today; this is clear from the recent statements by

[169] Ahern, **'**The Responsible Director in an Economic Downturn: Lessons from the Restriction Regime', [2009] 31(1) DULJ 183 at 186.
[170] Clarke, 'Duty of Care, Skill and Diligence – From Warm Baths to Hot Water' [2016] 56 Irish Jurist 139 at 144.
[171] [2004] IEHC 83 para.3
[172] Report of the Working Group on Company Law Compliance and Enforcement (Dublin November 1998) ('The McDowell Report), paras.6.1-6.2. McDowell describes eradicating phoenix activity as one of the primary purposes of what is now S.842
[173] CLRG, First Report 1994, (Dublin December 1994), para.7.10
[174] CLRG, First Report 1994, (Dublin December 1994), 7.11.

the CLRG.[175] That the policy focus is primarily one of public protection is also well established in case law.[176] That protection extends, obviously, to creditors. Indeed, Haughton J. stated in Re. Wood Products (Longford) Ltd.,[177] '… *the primary purpose of the legislation is to safeguard the public and creditors'.* Creditor protection is also emphasised in the UK; Milman states that the regime is a valuable tool for protecting creditors and preventing the abuse of limited liability.[178]

That said, narrow public protection is by no means the sole policy consideration. As McDonnell J. stated in Director of Corporate Enforcement v McCann[179] *"…it is a significant error to characterise the section as having only a single purpose, that of protecting the public from the respondent in the future."* Deterrence is also an important policy consideration. Deterrence as a policy function is also supported by the CLRG[180] and case law.[181] Likewise, improving corporate governance is also an important policy point.[182] The policy considerations underpinning the disqualification order regime have been recently summarised in the Bovale case[183] as follows: *(i) A primary but not the only purpose of an order of disqualification is to protect the public against future conduct of companies by persons whose past record has shown them to be a danger to creditors and others. (ii) It is also a purpose of an order of disqualification to improve corporate governance ……(iii) A further purpose of an order of disqualification is that it acts as a deterrent, both in respect of the respondent director and other directors of companies."*

The policy rationale underpinning disqualification orders does not contain a punitive element.[184] Indeed as Browne Wilkinson VC stated in Re. Lo Line Motors Ltd.[185] *'The primary purpose … is not to punish the individual but to protect the public against the*

[175] CLRG, Report on the Protection of Employees and Unsecured Creditors (Dublin June 2017), para.2.1
[176] Director of Corporate Enforcement v McCann [2010] IESC 59
[177] [2017] IEHC 314 para.38
[178] Milman, 'Disqualification of Directors: An Evaluation of Current Law, Policy and Practice in the UK' [2013] CLN 1 at 1.
[179][2010] IESC 59
[180] CLRG, First Report 2000-01, (Dublin December 2001), para.8.3.8
[181] See ODCE v Collery [2006] IEHC 67 para.32 and OCDE v D'Arcy [2005] IEHC 333 para.74
[182] ODCE v McCann [2010] IESC 59
[183] Re. Bovale Developments Ltd. [2013] IEHC 561 para.26
[184] ODCE v McCann [2010] IESC 59
[185] [1988] Ch 477 at 487-488

*future conduct of companies by persons whose past records as directors of insolvent companies have shown them to be a danger to creditors and other.'* This makes sense. Encouraging compliance rather than punishment is seen as more effective in the company law area.[186] This is an important policy similarity to section 610 as the latter section is compensatory and not punitive.[187]

Thus, it can be seen that the disqualification order regime has a policy focus which does not entirely align with that of section 819. Both focus on public protection and this obviously encompasses creditor protection.[188] Post McCann[189] however, the former regime appears to place equal weight on public protection, deterrence and corporate governance while section 819 remains centred on public protection. Thus the latter regime has the closer policy alignment with section 610. Hence it is not surprising that we see from case law reckless trading type misconduct being dealt with largely via the restriction order regime and not via disqualification orders.

**(iv) Concluding Comments**

To conclude, there is an alignment between the policy considerations underpinning the three sections. All three are creditor protection orientated, though there are divergences in emphasis. This can especially be seen from the initial prominence of phoenix activity within the restriction order regime. However, it is suggested that that alignment is not so strong as to allow reckless trading misconduct to be properly dealt with via the other two mechanisms.

While creditor protection is an important policy element of reckless trading, it is very much centred on creditor compensation. The restriction order regime has a broader public protection role. This can be seen from its historic concerns regarding phoenix activity and regulatory compliance. Its function is to protect creditors but only as one class amongst other stakeholders. Like the disqualification order regime which is also underpinned by public protection policy considerations, section 819 has no compensatory role. Thus, while there is certainly a policy overlap; all three are focused

[186] Braithwaite and Geis, 'On Theory and Action for Corporate Crime' [1982] 28(2) Crime & Delinquency 292 at 302
[187] Flynn, Reckless Trading, [1991] 9(8) ILT 186 at 190
[188] See Director of Corporate Enforcement v Collery [2006] IEHC 67 para.32
[189] [2010] IESC 59

to a lesser or a greater extent on creditor protection, that alignment is not sufficient to warrant reckless trading type misconduct being dealt with via the restriction and disqualification order regimes; the reason being that creditor compensation only exists as a policy consideration with regard to the former and not the latter. This lacuna is also reflected in the different sanctions which apply under each section.

## (IV) SANCTIONS

### (i) Restriction Orders

Vastly different sanctions exist when the restriction order regime is compared to section 610. The section 610 sanction is the imposition of personal liability for part or all of the debts of the company. This can have very significant financial repercussions. For example, in Re. PSK Construction Ltd., the executive director was made personally liable for liabilities of €1,600,000.[190] Similar results have been obtained in the UK[191] and New Zealand.[192] A director may become liable for more than any benefit accruing to him or her from the reckless behaviour.[193]

When a restriction order is imposed on a director, he or she cannot for a period of five years become a director or otherwise be involved in a company unless it meets certain capitalisation requirements. The capitalisation requirement is set at €100,000 for a private company.[194] This is a very different type of sanction and arguably a lesser one than the imposition of personal liability. As Lynch Fannon has pointed out, there have been considerable variations in opinion as to whether the minimum capital requirement is onerous or not.[195] Case law generally considers it lenient. The original capitalisation requirement of £20,000 was considered in Re. Costello Doors Ltd. to be '*a very modest sum'*.[196] The Supreme Court described the requirement as *'largely symbolic'* and of little practical effect because the capitalisation level was low.[197]

[190] [2009] IEHC 538
[191] See Re. Indessa Ltd [2011] EWHC 804
[192] In Re. South Pacific Shipping Ltd. [2009] 9 NZCLC 263
[193] O'Keeffe v Ferris [1997] 2 ILRM 161. While this is a fraudulent trading case, the same principle applies to reckless trading.
[194] S.819(3) Companies Act, 2014.
[195] Lynch Fannon, 'The Dynamic Entrepreneur or the Totally Incompetent Fool? The Role of Norms in Identifying Legitimate Risk Taking under Irish Company Law' in Keane and O'Neill (Eds), Corporate Governance and Regulation, (Dublin: Round Hall Press, 2010), p.85
[196] unreported High Court 21 July 1995
[197] Re. Tralee Beef and Lamb Ltd, [2008] IESC 1

Likewise, the McDowell Report describes restriction as *'a lesser sanction'.*[198] Indeed, for the wealthy individual or one with wealthy connections, the requirement may not be that onerous. Further, it is possible for the restricted person to recommence the business in unincorporated form,[199] albeit without the benefit of limited liability.

Thus, the main impact of the sanction may be elsewhere. Specifically, a major negative aspect of the regime may be reputational. A stigma is attached to being the subject of an order.[200] Again, this view finds support in case law. Murphy J. stated in Baxter[201] "*It would seem that the more serious penalty which the restraining order imposes is the stigma which attaches as a result of the making of the order ….''* This analysis has been reiterated in later case law.[202] Further, the stigma effect will be worse for the professional director. As Hicks states in relation to disqualification orders a professional director of a large private company or a public company will be unable to obtain employment of a similar nature in the future.[203] Thus for directors of that class, the effect can be career ending and catastrophic.

This leads on to another important aspect of the sanction. Being the subject of a restriction order undoubtedly may prevent the director from setting up in business again (either in incorporated or unincorporated form). This may not arise because of the capitalisation requirement or reputational damage. Banks simply do not extend credit to restricted persons. As the CLRG state *''… the public disclosure of the restriction is probably a greater obstacle to the establishment of a new business because of the reluctance of 3rd parties, especially banks, to extend credit to individuals who have been restricted.''*[204] This sentiment is echoed by Barrett J. in Arkins v Murphy:[205] *''For example, it may impact on his or her ability to raise*

[198] Report of the Working Group on Company Law Compliance and Enforcement (Dublin November 1998) ('The McDowell Report), para.6.10
[199] Ahern, 'The Responsible Director in an Economic Downturn: Lessons from the Restriction Regime', [2009] 31(1) DULJ 183 at 183
[200] Ahern, 'The Responsible Director in an Economic Downturn: Lessons from the Restriction Regime', [2009] 31(1) DULJ 183 at 183. In effect, a restriction order is a shaming penalty as defined by Posner. Posner, Law and Social Norms, (Cambridge Mass.: Harvard University Press, 2002) pgs.94-97
[201] Business Communications Ltd. v Baxter Unreported High Court Murphy J. 21 July 1995
[202] See In the Matter of Tralee Beef and Lamb Ltd [2008] IESC 1
[203] Hicks, 'Director Disqualification: Can It Deliver?' [2001] JBL 433 at 442.
[204] CLRG Report 2011 (Dublin 2011) para.5.1.3
[205] [2015] IEHC 2 para.45

*borrowings from a credit institution regardless of whether the restriction is later lifted,"* and indeed by Paul Appleby (former Director of Corporate Enforcement).[206] This aspect, it is argued, is the real sanction. A director with sufficient funds available to meet the capitalisation requirement and who is impervious to reputational damage will still find it very difficult to run a company successfully without access to bank lending. Certainly, absent very significant personal funding, expansion and new investment may be impossible and the business will undoubtedly suffer cashflow problems. Even the restricted director who cannot meet the capitalisation requirement and decides to trade in unincorporated form, if he or she cannot obtain bank funding, it is likely that he or she will not be able to recommence operations of any scale at all.

No evidence has been found of a similar lending policy with regard to reckless trading despite the fact that reckless behaviour as opposed to that which is irresponsible must represent a greater lending risk to financial institutions. Considering, however, the fact that section 610 is so infrequently invoked, this gap is hardly surprising.

A further interesting aspect of the restriction order regime is that the sanction is fixed. This, obviously, differs from a disqualification order where the court has discretion as to the disqualification period.[207] It does not change no matter how large (or indeed small) the loss to creditors caused by the irresponsible director. Specifically, in Tailored Homes (Navan) Ltd., the restricted directors allowed liabilities to the Revenue Commissioners to accrue to nearly €100,000.[208] The unsecured creditors, had, however been substantially paid on foot of an earlier settlement.[209] In Re. Pineroad Distribution Ltd., the tax authorities were owed a sum in the region of close to €1,000,000.[210] The respondent directors were restricted and their actions were described by the judge as grossly reckless and contrary to the interests of the creditors of the company.[211] In Re. Gingersnap Ltd., the amount owed to unsecured creditors was an astonishing €6,000,000.[212] Despite the significant differences in the monetary

[206] Appleby, 'Corporate Regulation in Ireland' in O'Brien, Governing the Corporation: Regulation and Corporate Governance in an Age of Scandal and Global Markets (Oxford: Wylie, 2005), p.268.
[207] S.842 Companies Act, 2014.
[208] [2017] IEHC 76 para.34.
[209] [2017] IEHC 76 para.18
[210] [2007] IEHC 55 para.5.
[211] [2007] IEHC 55 para.18
[212] [2016] IEHC 177 para.6.

amounts, due to the nature of the sanction, each set of directors suffered precisely the same consequence.

Two principles can be gathered from the above. Firstly, the restriction order regime sanctions the delinquent director by making it far more difficult, if not impossible, for him or her to set up in business again. While capitalisation and reputational damage are barriers, the real impediment appears to be the inability to access bank finance. This, however, does not benefit existing creditors who have suffered losses. Possible future creditors are protected (if the director is not in business at all, such future creditors cannot be at risk). Secondly, the sanction is unsuitable as it is fixed. It cannot be varied depending on the amount of the losses to creditors. Further, the sanction is precisely the same whether the behaviour is irresponsible, but only marginally so[213] or grossly reckless.[214]

**(ii) Disqualification orders**

A disqualification order is a severe sanction. It prohibits the affected person from having any involvement whatsoever in the promotion, formation or management of any company for the duration of the disqualification period.[215] Indeed Finlay Geoghegan J. described disqualification as compared to restriction as being "*in its terms more restrictive."*[216] As set out above, a wealthy or well-connected individual may be able to either form or join a sufficiently capitalised company thus negating one sanction of the restriction order regime. That cannot happen where the individual is the subject of a disqualification order.

Importantly, a restriction order is seen as a lesser than disqualification.[217] This is despite that fact that from case law it appears that reckless trading type behaviour is far more likely to be dealt with and thus sanctioned via the restriction order regime. If nothing else, there are far more restriction order applications than disqualification order applications[218] and disqualification orders appear to be used for the more unusual

[213] Tailored Homes (Navan) Ltd. [2017] IEHC 76 para.38
[214] Re. Pineroad Distribution Ltd. [2007] IEHC 55
[215] S. 838 Companies Act, 2014
[216] Re: Clawhammer Ltd. [2005] IEHC 85
[217] Report of the Working Group on Company Law Compliance and Enforcement (Dublin November 1998) ('The McDowell Report), para.6.9
[218] See the annual Reports of the Office of the Director of Corporate Enforcement in this regard.

forms of corporate misbehaviour.[219] Thus, of the two available sanctions restriction or disqualification, arguably the lesser sanction is being applied. More surprisingly, the court has the discretion to make a disqualification order once a finding of reckless trading has been made against a director.[220] This indicates that disqualification, the more serious sanction, is the more appropriate penalty where reckless trading is found. Yet it appears that the less suitable restriction order regime is the one which is most frequently invoked.

Ultimately, however, disqualification protects the future creditor only. The director is debarred from involving himself or herself in business endeavours via the corporate form. The regime does nothing to assist the current creditor who has lost money as a result of director misconduct.

### (iii) Concluding Comments

In effect, while obviously better than no enforcement at all, the nature of the sanction means that neither the restriction order nor the disqualification regime is a suitable conduit for policing reckless trading behaviour. Neither benefits the existing creditors who have incurred losses as a result of the director's behaviour. It must be cold comfort for those creditors that a mere order is now in place while the monetary losses go unremedied.

## (V) THE UNDERTAKING PROCEDURE

A new process was introduced in Ireland by Companies Act, 2014.[221] On foot of this process, the director can consent to being restricted or disqualified by giving an undertaking to that effect to the ODCE. No court proceedings are involved. It thus allows the director to avoid the costs of a finding against him. While a new departure in Ireland, something similar has been in place in the UK for nearly two decades.

[219] Such as corporate fraud; Wallace v Cassidy [2016] IEHC 689 and bank tax evasion schemes; ODCE v D'Arcy [2005] IEHC 333.
[220] S.842(c) Companies Act, 2014
[221] The relevant sections are S.849 to S.854.

Academic commentators have criticised the undertaking procedure. A supervisory/ investigative role is combined with a quasi-judicial one.[222] The decision to request an undertaking is based on allegations and beliefs found in the liquidator's report.[223] Further, the director has no capacity to agree some allegations and refute others. The undertaking must be accepted in its entirety or not at all.[224] This can be contrasted with the UK position where an agreed factual basis for the undertaking can be reached by the director and the Secretary of State.[225] Finally, where the vast majority of restrictions and disqualifications are carried out via the undertaking procedure, the process can become invisible. Public awareness of the regimes is reduced as there are fewer cases reported in the media.[226] Visibility may be weakened, and the two mechanisms may be treated as things apart from company law.[227] The deterrent aspect of the regime may decline and the courts have less chance to provide guidance on directorial standards.

Overall, however, the procedure appears beneficial. It reduces legal costs and avoids taking up court resources for what are often relatively mundane issues. It avoids delays and provides better public protection because those warranting restriction or disqualification orders are dealt with expeditiously.[228] Again, the strengths of public enforcement are demonstrated. The undertaking procedure is very helpful to individuals who no longer want to be directors or do not plan to become involved in the management of a company again for a number of years.[229] The potency of the regimes is also increased in the fight against corporate irresponsibility. The ODCE can obtain an order easily because in the majority of cases the director accepts the

[222] Murphy, Restriction and Disqualification of Directors under the Company's Act, 2014, [2016] CLP 228 at 230
[223] Murphy, Restriction and Disqualification of Directors under the Company's Act, 2014, [2016] CLP 228 at 230
[224] Murphy, Restriction and Disqualification of Directors under the Company's Act, 2014, [2016] CLP 228 at 231
[225] Murphy, Restriction and Disqualification of Directors under the Company's Act, 2014, [2016] CLP 228 at 232
[226] Fletcher, 'Out of Sight, Out of Mind? The Progressive Dematerialisation of our Insolvency Procedures' [2017] 30(5) Insolv. Int. 81 at 82. See also Griffin, "The Disqualification of Unfit Directors and the Protection of the Public Interest" [2002] 53 *NILQ* 207 at 222-223.
[227] Walters, 'Directors Disqualification After the Insolvency Act 2000: the New Regime' [2001] Insolvency Lawyer 86 at 88
[228] Murphy, Restriction and Disqualification of Directors under the Company's Act, 2014, [2016] C.L.P 228 at 231.
[229] See Walters, 'Directors Disqualification After the Insolvency Act 2000: A New Regime' [2001] Insolvency Lawyer 86 at 95.

undertaking.[230] All these advantages serve to highlight the underlying policy differences between the restriction and disqualification order regimes and reckless trading. The undertaking procedure efficiently removes errant directors from circulation, thus protecting the public. It does nothing, however, to compensate creditors.

## (VI) CONCLUSIONS

A number of interesting inferences can be drawn from the above review of the restriction and disqualification order regimes. Firstly, the regimes have proved extremely successful. It is important to note however that the restriction order regime's success only occurred once the ODCE was given a role in the process. In effect a sophisticated regulatory regime is useless without enforcement.[231] Indeed, regarding directors' duties generally, public enforcement is considerably more extensive than private enforcement[232] and it is increasingly common for company law to be enforced publicly.[233] As Parkinson states *"... the creation and refinement of standards of conduct and performance, have the quality of 'public goods' which private enforcers, pursuing only private gain are liable to under-produce."*[234] This gives a clear indication of the optimal future direction of reckless trading.

Secondly, the restriction order regime copes well with new factual situations and developing societal expectations of what is required of a director. Due to its ample case law, the failures necessary to restrict a director are relatively well understood. The same cannot be said of section 610. This is a missed opportunity as can be seen from the sparse and narrow jurisprudence which has emerged from the reckless trading provision.

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[230] In 2019, 112 restriction undertaking offers were made and 83 were accepted. In 2018, 172 restriction undertaking offers were made and 127 were accepted. ODCE Annual Report 2019 (Dublin 2020), p.39.

[231] Corbett, 'Directors' Disqualifications – Has Enforcement Legislation Changed Practice in Ireland? [2009] 16(9) CPL 197 at 204

[232] Nic Bhloscaidh 'The Concurrent Operation of Public and Private Enforcement of the Duties of Corporate Directors: Reinvigorating the Derivative Action and Refining the Public Enforcement Regime' [2018] CLP 132.

[233] Ahern, Directors' Duties: Law and Practice, (Dublin: Thomson Reuters, 2009), para.8.01.

[234] Parkinson, Corporate Power and Responsibility: Issues in the Theory of Company Law (Oxford: Clarendon Press, 1995), p.238

Thirdly, while the success of the regimes has significantly improved directorial standards, from a creditors' standpoint the benefit is intangible. Creditors are protected from such directors going forward, but it does nothing to reimburse the losses caused by reckless trading. Thus, while the creditor may take comfort from the fact that the director's freedom to act in the corporate sphere has been curtailed, the central concern, that the amounts due had to be written off, is not addressed. The sanction has no bearing on the loss. This harks back to a central issue in this chapter; that neither section 819 nor section 842 has an underlying compensation policy.

While the above inferences are relevant to the issues under consideration, we cannot lose sight of the fact that reckless trading type misconduct is being sanctioned via the restriction order regime (and to a lesser extent the disqualification order regime). We can easily see how this has occurred. Section 610 is in abeyance. Something else, likely because of the public nature of the enforcement, has filled the gap. The real question, however, is whether this is a satisfactory state of affairs. This is the question posed at the start of this chapter; are creditors already sufficiently well served by the restriction and disqualification order regimes? The answer is that while it is better than nothing it is not satisfactory. This is because there is a policy misalignment; neither section 819 nor section 842 is creditor compensation orientated. There is a sanction misalignment for the same reason. This leads to the question to be posed in the next chapter; is the directors' duty to creditors instead the suitable alternative?

# CHAPTER SEVEN: THE DIRECTORS' DUTY TO CREDITORS

## (I) INTRODUCTION

### (i) The Directors' Duty to Creditors

As we saw in the previous chapter, reckless trading behaviour is being sanctioned via the restriction and disqualification order regimes. This is far from ideal as there are considerable misalignments with regard to both policy and sanctions. In this chapter, the directors' duty to creditors is examined. It is an important concept as it may provide a suitable alternative mechanism to impose personal liability where reckless trading type behaviour has occurred. As Van Zwieten states with regard to wrongful trading and the duty *'... both rules could be understood to perform a similar function.'*[1] The chapter will deal with the history and scope of the duty to creditors. It will examine the parameters of the duty, especially from an Irish perspective as the extent and application in this jurisdiction is uncertain. Special emphasis will, due to this, be placed on the work of the CLRG. Comparisons will also be made between the duty and section 610. The ultimate purpose is to determine whether or not the duty may constitute a viable alternative to a reckless trading provision.

Over time case law has slowly recognised that in particular circumstances directors may also have obligations to creditors in addition to the consideration which is normally due to shareholders[2] (in the sense that the director must promote the success of the company for the benefit of the members as a whole) and these days the duty is well established.[3] Indeed, in many jurisdictions the concept of creditors' rights has taken statutory form, though in Ireland it remains, to date, a common law duty (despite the CLRG's recent recommendation of a codified provision the full text of which is set out in Appendix Four.)[4] Thus the question which arises is whether in these circumstances a reckless trading provision is necessary at all. With increased and strengthening recognition of the rights of creditors, statutory regulation of reckless

[1] Van Zwieten, 'Director Liability in Insolvency and its Vicinity' [2018] 38(2) Oxford Journal of Legal Studies 382 at 383
[2] Walker v Wimbourne [1976] 50 ALJR 446. Nicholson v Permakraft (NZ) Ltd. [1985] 1 NLZR 242.
[3] Though it has been argued that the duty is without pedigree. Watts, 'Why as a Matter of English-Law Principle Directors Do Not Owe a Duty of Loyalty to Creditors on Insolvency' [2021] 2 JBL 103
[4] CLRG, Report on the Protection of Employees and Unsecured Creditors (Dublin June 2017), para.2.3.4

trading may simply be obsolete. Importantly also, breach of the duty to creditors can in certain circumstances impose personal liability on directors.[5]

**(ii) A Brief History of the Duty**

Recognition of the rights of creditors first occurred in case law. It was initiated by an obiter statement by Mason J in the Australian case Walker v Wimborne[6] in 1976. Indeed, the duty has been described by one judge as being *'remarkably recent'*[7] and its adoption was from the outset recognised as requiring " ... ... *a difficult amalgam of principle, policy, precedent and pragmatism".*[8] However, by the mid-1980s it had developed into a legal concept which was accepted in other common law jurisdictions such as in New Zealand in Nicholson v Permakraft (NZ) Ltd.,[9] the UK in West Mercia Safetywear Ltd. v Dodd,[10] the United States in Revlon Inc v MacAndrews and Forbes Holdings Inc[11] and later in Ireland in Re Frederick Inns Ltd. wherein Lardner J. in the High Court stated that the existence of the duty is consonant with company law.[12] Indeed, at the date of writing the principle is firmly entrenched in these jurisdictions and in Irish common law.

That said, the duty does not meet with universal approval.[13] For example, the law and economics brand of contractarianism is firmly opposed to the imposition of a duty to creditors.[14] It arises ex-post and is outside of the terms of the contract entered into between the company and the creditor.[15] Contractarian scholars consider that directors' functioning as agents of the shareholders would become less efficient as maximising profits will no longer be their sole consideration.[16] Further, creditors are

[5] West Mercia Safetywear Ltd. v Dodd [1988] 4 BCC 30.
[6] [1976] 50 ALJR 446
[7] BTI 2014 LLC v Sequana SA [2019] EWCA Civ 112 [2019] BCC 631 para.129.
[8] Nicholson v Permakraft [1985] 1 NLZR 242 at 255
[9] [1985] 1 NLZR 242.
[10] [1988] 4 BCC 30.
[11] 506 A 2d 173, 179 [Del 1986].
[12] [1991] ILRM 582 at 590.
[13] Worthington, 'Directors' Duties, Creditors' Rights and Shareholder Intervention' [1991] 18(1) Melbourne University Law Review 121 at 142.
[14] Keay, Directors' 'Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors' [2003] 66(5) Modern Law Review 665 at 666.
[15] Keay, 'A Theoretical Analysis of the Director's Duty to Consider Creditor Interests: The Progressive School's Approach' [2004] 4(2) Journal of Corporate Law Studies 307 at 312-313
[16] Glasbeek, "More Direct Director Responsibility: Much Ado About What?" [1995] 25(3) Canadian Business Law Journal 416 at 441.

less likely to take steps to protect themselves where such a duty exists.[17] Other commentators are not supportive for practical reasons; the nebulous nature of the duty and its unanswered questions.[18] Other theorists support the imposition of such a duty. It may reduce monitoring costs and the length and complexity of documentation. Deterrent effects may also be produced.[19] Creditors may also be protected from unreasonable director risk-taking.[20]

## (II) THE SCOPE OF THE DUTY

### (i) Theoretical Underpinnings of the Duty

The duty can be summarised succinctly. Construed narrowly, when the company is insolvent or approaches insolvency the directors are under a duty to take into account the interests of the creditors. Construed broadly, when the company is insolvent or approaches insolvency, the interests of the creditors become paramount. The legal theory underpinning the concept is straightforward; shareholders no longer have an interest in the assets of an insolvent company.[21] Thus the duty has a normative foundation as the creditors are now the residual claimants.[22] This is best encapsulated by Blayney J. in Re. Fredericks Inns Ltd.[23] wherein he stated *'... as soon as the winding up order has been made the company ceases to be the beneficial owner of its assets, with the result that the directors no longer have the power to dispose of them'.*

Goode's analysis also provides guidance; when the company is insolvent or approaching insolvency, the directors' allegiance must change. Their duties are now owed to the creditors who now have the primary interest in the company's assets.[24] In effect, the theory matches the reality that the creditors supplant the shareholders.[25] As

[17] Spindler, 'Trading in the Vicinity of Insolvency' [2006] 7 European Business Organization Law Review 339 at 343-344
[18] See Hargovan, Todd 'Financial Twilight Re-Appraisal: Ending the Judicially Created Quagmire of Fiduciary Duties to Creditors' [2016] 78(2) U Pitt. L. Rev 135.
[19] Keay, 'A Theoretical Analysis of the Director's Duty to Consider Creditor Interests: The Progressive School's Approach' [2004] 4(2) Journal of Corporate Law Studies 307 at 341
[20] Keay, 'A Theoretical Analysis of the Director's Duty to Consider Creditor Interests: The Progressive School's Approach' [2004] 4(2) Journal of Corporate Law Studies 307 at 343.
[21] Ayerst (Inspector of Taxes) v C&K Construction Ltd. [1976] AC 167
[22] Davies, 'Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency' [2006] 7(1) EBOLR 301 at 337.
[23] [1994] 1 ILRM 387 at 396
[24] Goode, Principles of Corporate Insolvency Law, 4th Edition (London: Sweet & Maxwell, 2011), para.14-20
[25] Keay, 'A Theoretical Analysis of the Director's Duty to Consider Creditor Interests: The Progressive School's Approach' [2004] 4(2) Journal of Corporate Law Studies 307 at 330

Nourse J. stated in Brady v Brady[26] "…*where the company is insolvent, or even doubtfully solvent, the interests of the company are in reality the interests of existing creditors alone*." Recent UK case law supports this contention[27] as does Re. Fredericks Inns Ltd.[28] and, indeed, the analysis is in line with the older Kinsella v Russell Kinsela Pty Ltd[29] formulation. In effect, an exchange of allegiances takes place.[30]

The traditional analysis of this switch in allegiance is that it is to avoid the moral hazard problem. The directors are accountable to shareholders but as the company approaches insolvency the shareholders may encourage the directors to take increasingly risky bets with the company's assets in the hope of saving the company.[31] These bets are likely to be to the detriment of creditors.[32] Interestingly, a similar analysis can be applied to section 610. However, as Van Zwieten[33] discovered, a review of the cases reveals few examples of the duty being invoked in response to the taking of unacceptable risks. Indeed, most UK breach of duty cases involve something quite different such as preferential payments,[34] the repayment of debts due to a director,[35] the sale of stock to a company connected with the directors,[36] the sale of an asset at an undervalue to a director,[37] or a challenge to a resolution of directors to settle legal proceedings.[38] There are limited outliers, of course. Roberts v. Frohlich[39] is a case in point and it is not surprising that the behaviour in question was also the subject of a section 214 application**.** Paton v Ricky Martin (Racing) Ltd.[40] is another instance.

[26] [1987] 3 BCC 535 at 552
[27]Re. HLC Environmental Projects Ltd. [2013] EWHC 2876 para.89.
[28] [1994] 1 ILRM 387
[29] [1986] 4 NSWLR 722 at 730
[30] CLRG, Report on the Protection of Employees and Unsecured Creditors (Dublin June 2017), para.2.3.2
[31] Keay, Directors' Duties 3rd Edition (Lexis Nexis 2016), para.13.12.
[32] Hargovan, Harris, 'For Whom the Bell Tolls: Directors' Duties to Creditors after Bell' [2013] 35(2) Sydney L. Rev. 433 at 436
[33] Van Zwieten, 'Director Liability in Insolvency and its Vicinity' [2018] 38(2) Oxford Journal of Legal Studies 382 at 391
[34] See for example, Knight v Frost [1999] BCC 819 and Re. Micra Contracts Ltd. [2016] BCC 153.
[35] E-Clear plc v Elia [2013] 2 BCLC 455.
[36] GHLM Trading Ltd v Maroo [2012] EWHC 61.
[37] Re. System Building Services Group Ltd. [2020] EWHC 54.
[38] Colin Gwyer & Associates Ltd. v London Wharf (Limehouse) Ltd. [2003] BCC 885
[39] [2012] BCC 407.
[40] [2016] SC AIR 57.

Australian cases follow a similar pattern. Kalls Enterprises Pty Ltd. v Baloglow[41] involved discharge by a company of a personal liability of its director, Walker v Wimbourne[42] involved lending by one insolvent company to another insolvent company and Westpac Banking Corporation v The Bell Group Ltd. (No. 3)[43] was a preference type transaction; the refinancing of bank debt arguably breached the duty because it benefited the group's bankers at the expense of other creditors. Importantly, we appear to be encountering again an important issue considered in previous chapters. The duty is invoked where misplaced operational risk-taking or mismanagement occurs.[44] Entrepreneurial risk-taking is not in point.

The same pattern also exists in Ireland and, again, indicates that it is not unacceptable risk-taking**,** in the entrepreneurial sense, which causes the duty to be breached. The duty is largely invoked in preference type cases again often involving operational mismanagement. In Re. Swanpool Ltd.,[45] Business Expansion Scheme creditors were preferred at the expense of the companies' other creditors. John C. Parkes & Sons Ltd. v Hong Kong and Shanghai Banking Corporation[46] is a fraudulent preference case. Re. Fredericks Inns[47] also involved preference type transactions; three companies within an insolvent group sold their assets and allowed the proceeds to be used to reduce liabilities owed by other group companies to Revenue at the expense of the other creditors. DCS Ltd.,[48] a restriction case in which the duty was considered, also concerns issues of preference. Jones v Gunn[49] is another preference case. Very interestingly, however, the plaintiffs in that case sought to invoke section 610 (they failed on a retrospectivity issue).

[41] [2007] NSWCA 191
[42] [1975-1976] CLR 1
[43] [2012] WASCA 157
[44] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7
[45] [2005] IEHC 341
[46] [1990] ILRM 341
[47] [1994] 1 ILRM 387
[48] [2006] IEHC 179 para.42
[49] [1997] 3 IR 1

### (ii) Interaction with Section 610

The occasional outlier such as Roberts v Frolich[50] does not detract from Van Zwieten's analysis. In the UK duty cases predominantly involve preference issues. Wrongful trading rarely intrudes. This is arguably because section 214 is very narrow; it only applies where a director who knew or ought to have known that insolvency was imminent did not take sufficient steps to protect creditors. Very importantly, personal liability for wrongful trading cannot be imposed where the reduction in assets is matched by a reduction in liabilities.[51] It is a hallmark of preference cases that this occurs. Hence the duty and wrongful trading tend to follow divergent paths.

The Irish situation is different. There is an overlap. Due to the broad parameters of section 610 (specifically where the director ought to have known that his or her action would cause loss to any of the creditors), a traditional breach of duty type case (such as preference) could be taken under section 610 as we have seen in Jones v Gunn.[52] Preferring one creditor in an insolvency situation invariably causes a loss to the remainder. This demonstrates the extremely broad reach of the section and, again, highlights a difference between section 610 and section 214. The latter, it appears, may not be useful in preference type actions due to the fact that wrongful trading cannot occur where the reduction in assets is matched by a reduction in liabilities. That issue is irrelevant regarding section 610 with its focus on the loss to creditors.

## (III) THE DUTY TO CREDITORS

### (i) The Issues

Many questions remain as to the parameters and application of the duty. These are set out below. Each will then be examined in turn. These issues are important. The duty's role as a viable alternative or parallel to a reckless trading provision is more robust if its parameters are certain. Further, its application must be enforceable and effective.

[50] [2012] BCC 407
[51] Grant v Ralls [2016] EWHC 243
[52] Please see Chapter 2 in this regard.

These issues are:

(a) Does the duty to creditors flow from directors' fiduciary duty to act in the best interests of the company or is there another separate duty to take creditors interests into account?

(b) What must directors do to comply with the duty?

(c) At which point do creditors' rights come into existence?

(d) How does one balance the interests of the various classes of creditors and indeed creditors and shareholders?

(e) How is the duty enforced and discharged?

**(a) Where does the Duty Flow From?**

The first question is as to the nature of the duty itself. There was initial confusion as to whether the directors' failure to consider the interests of creditors is a breach of a duty to the company or whether directors owe a separate and distinct duty to creditors.[53] Indeed, some limited case law outside Ireland has found that a separate duty exists.[54] The current judicial view internationally, however, is that this is an indirect duty and arises to the creditors via the company.[55] This can be seen from pre-codification case law in the UK[56] and Australia. In Australia, in particular, Spies v The Queen[57] is a very clear rejection of the direct duty proposition. Thus, from a judicial standpoint elsewhere, it appears to be settled law at this point. As Barber J. stated in Re. System Building Services Group Ltd.[58] *'Where the company is insolvent or likely to become insolvent ……the interests of the company are regarded as the interests of the creditors alone.*' This will have important implications regarding enforcement which will be discussed in greater detail below.

[53] CLRG, Report on the Protection of Employees and Unsecured Creditors (Dublin June 2017), para.2.3.2.
[54] Winkworth v Edward Baron Development Co. Ltd. [1987] 1 All ER 114
[55] Keay, 'A Theoretical Analysis of the Director's Duty to Consider Creditor Interests: The Progressive School's Approach' [2004] 4(2) Journal of Corporate Law Studies 307 at 310-311.
[56] Vivendi SA v Richards [2013] BCC 771 para.148, Colin Gwyer & Associates Ltd. v London Wharf (Limehouse) Ltd. [2003] BCC 885 para.74 and Yukong Line Ltd. of Korea v Rendsburg Investments Corp of Liberia (No. 2) [1998] BCC 870
[57] [2000] 173 ALR 529. See also Berkahn, 'Directors' Duties to 'The Company' and to Creditors: Spies v The Queen' [2001] 6(2) Deakin Law Review 360
[58] [2020] EWHC 54 para.35.

As highlighted by the CLRG,[59] the Irish position may be different. There are certainly strong indications that this is so in the Irish case law with its emphasis on preserving the assets of the company for correct distribution to creditors. As put by McGovern J. in Harlequin Property (SVG) Ltd. v O'Halloran[60] the duty may only extend *"to the preservation of the corporate structure"* Jones v Gunn is a case in point.[61] There McGuinness J. states *"I consider that the various authorities opened to me by counsel for the plaintiffs are persuasive and, of course, in the case of the Supreme Court, binding on me, in establishing that where a company is clearly insolvent, even if not in liquidation, the directors owe a fiduciary duty to the general creditors and may not make payments which benefit either closely connected companies or themselves personally to the detriment of the general and independent creditors."* A fiduciary duty to creditors is also indicated in the seminal Re. Fredericks Inns case[62] wherein Lardner J. states *"... the payments to the revenue which are in question were made by the authority of the directors of the respective companies in breach of the duty which the company and the directors owed to the general creditors of these insolvent companies."* Similar sentiments are expressed in the more recent Hughes v Hitachi Koki Imaging Solutions Europe[63] and in Re. Winning Ways Ltd.[64] The uncertainty of the Irish position was recently discussed by McGovern J. in the High Court in Harlequin Property (SVG) Ltd. v O'Halloran[65] wherein, after a review of the authorities, the learned judge concluded with regard to creditors *"Accordingly, it seems that there is some uncertainty as to the whether a director's duty to creditors in circumstances of clear insolvency may give rise to a direct cause of action."* Unfortunately, as the judge was able to decide the case on another issue, no further guidance was provided on the cause of action point.

The CLRG, however, in advocating codification, recommend that the duty be owed to the company.[66] The proposed provision, section 224A(2), states as follows; *"(2) The*

[59] CLRG, Report on the Protection of Employees and Unsecured Creditors (Dublin June 2017), para.2.3.1
[60] [2013] IEHC 362 para.94.
[61] Jones v Gunn [1997] 3 IR 1 at 21-22
[62] [1991] ILRM 582 at 589.
[63] [2006] IEHC 223 paras.3.7-3.9.
[64] [2020] IEHC 264 para.54
[65] [2013] IEHC 362 para.97
[66] CLRG, Report on the Protection of Employees and Unsecured Creditors (Dublin June 2017), para.2.3.4

*duty in subsection (1) shall be owed to the company (and the company alone) and shall be enforceable in the same way as any other fiduciary duty owed to a company by its directors."* This would appear to be the correct approach. It follows what is now the norm in other common law jurisdictions. Further, as discussed previously, it has theoretical justification. This is a clear indication that the non-inclusion of the duty in Companies Act, 2014 was a missed opportunity as this important aspect would have been settled for once and for all. As it stands, the Irish position is unclear. In any event, if the duty were to contain a direct right of action for creditors, that would place creditors in a superior position to shareholders.[67]

From an academic standpoint, the issue is also largely a settled one.[68] Finch and Milman conclude that, while there are occasional indications to the contrary in case law, there is no direct fiduciary duty to creditors.[69] The relationship is not one of agent and principal. The duty to creditors forms part of the directors' overall duty to act in the interests of the company.[70] Keay agrees.[71] Ahern is of the same view.[72] Van Zwieten arguably has the last word on the matter when she states *"……the rule does not work by imposing on directors a new duty owed directly to creditors. Nor does it work by imposing a new duty owed to the company. Rather, the content of the duties that directors already* o*we to the company is altered so as to require enhanced regard for creditors, viewed as a class or as a whole."*[73]

**(b) What Must The Directors Do In Order To Comply With The Duty?**

Usually, the duty is expressed as requiring the directors to act in 'the interests of creditors' or treat creditors' interests as 'paramount'. It is difficult to describe what these phrases actually mean in a practical sense. The contours of the duty are

[67] Gavin, 'Jumping the Gun: Codifying the Duty to Consider the Interests of Creditors in the Companies Act, 2014' [2021] 65 Irish Jurist 138 at 150
[68] Keay, Directors' Duties 3rd Edition (Lexis Nexis 2016) para.13.101
[69] Finch and Milman Corporate Insolvency Law Perspectives and Principles 3rd Edition (Cambridge: University Press Cambridge 2017), p.586.
[70] Finch and Milman Corporate Insolvency Law Perspectives and Principles 3rd Edition (Cambridge: University Press Cambridge 2017), p.586.
[71] Keay, Directors' 'Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors' [2003] 66(5) Modern Law Review 665 at 669.
[72] Ahern, Directors' Duties: Law and Practice, (Dublin: Thomson Reuters, 2009), para.5-39
[73] Van Zwieten, 'Disciplining the Directors of Insolvent Companies' [2020] 33 Insolvency Intelligence 2 at 5

nebulous[74] and, thus, it is difficult to determine what its parameters actually are. As Teele Langford and Ramsay[75] state *"Debate still exists, however, as to what the duty, once triggered, requires."* A large number of open questions remain and most case law does not address the relevant issues. [76] Hargovan and Todd summarise the possible positions "*What, then, is the duty? Several options emerge. First is the narrow formulation, which prohibits self-dealing and preferential treatment. Second is the intermediate view, which mandates a duty to minimize losses. Third is the expansive view, which mandates a duty to maximize long-term corporate wealth creating capacity, including a subordination of shareholder interests to creditor interests."*[77] Ultimately, the authors conclude *"... the current jurisprudence provides no answer ..."*[78]

An aspect of this issue arises in BT1 2014 LLC v Sequana SA. This case asks whether once the duty is triggered are creditors' interests paramount[79] or are their interests instead simply to be considered.[80] The UK case law appears to use these phrases interchangeably without any significant consideration being given to their effect. The former formulation is used in Roberts v Frohlich,[81] Re. HLC Environmental Projects Ltd.,[82] Colin Gwyer & Associates Ltd. v London Wharf (Limehouse) Ltd.[83] and Re. System Building Services Group Ltd.[84] Other cases, however, use a different formulation. In Bilta (UK) Ltd. v Nazir, the duty was described by Lords Toulson and Hodge as requiring the director to have proper regard for the interests of the company's creditors and prospective creditors.[85] In MDA Investment Management Ltd.[86] Park J said that the director *'...ought to have taken account of the interests of creditors ....'*

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[74] Teele Langford and Ramsay, 'The "Creditors' Interests Duty": When Does it Arise and What Does it Require? [2019] 135 LQR 385 at 385
[75] Teele Langford and Ramsay, 'The "Creditors' Interests Duty": When Does it Arise and What Does it Require? [2019] 135 LQR 385 at 389
[76] Keay, 'The Shifting of Directors' Duties in the Vicinity of Insolvency' [2015] 24(2) International Insolvency Review 140 at 156
[77] Hargovan, Todd 'Financial Twilight Re-Appraisal: Ending the Judicially Created Quagmire of Fiduciary Duties to Creditors' [2016] 78(2) U Pitt. L. Rev 135 at 158
[78] Hargovan, Todd 'Financial Twilight Re-Appraisal: Ending the Judicially Created Quagmire of Fiduciary Duties to Creditors' [2016] 78(2) U Pitt. L. Rev 135 at 159.
[79] [2019] BCC 631 para.169
[80] [2019] BCC 631 para.222
[81] [2012] BCC 407 para.94
[82] [2013] EWHC 2876 para.92
[83] [2003] BCC 885 para.74
[84] [2020] EWCH 54 para.35.
[85] [2015] BCC 343 para.123
[86] [2005] BCC 783 para.24

A similar formulation is used in Facia Footwear Ltd. v Hinchcliffe,[87] Ultraframe Ltd. v Fielding[88] and Burden Holdings Ltd. v Fielding[89] The Australian position appears to be different. A paramount duty to creditors could mean that the directors' duties were to the creditors alone.[90] Hence the particular circumstances would indicate what the duty requires.[91]

This is further aggravated by the fact patterns in the case law. While, as we have seen previously, there is a preponderance of preference type issues, a wide variety of behaviours are in issue. In Vivendi SA v Richards, a series of payments made by an obviously insolvent company to other entities (which in some instances were connected with a particular director) was in breach of the duty to creditors.[92] In particular, the directors in seeking to extract the company's remaining cash breached the duty.[93] Likewise, in Re. HLC Environmental Projects Ltd.[94] the payment of certain creditors in preference to others was held to be in breach of the duty. Similar transactions occurred in Re Cosy Seal Insulation Ltd.[95] where, in particular, payments were made to a company controlled by the sole director-shareholder's wife. In Roberts v Frohlich[96] allowing an inadequately funded company to proceed with a property development was held to be a breach of the duty. Re. MDA Investment Managers Ltd.[97] held that an incorrect split of the consideration for the sale of an asset between the company and a partnership connected with the director constituted a breach. The shear variety of directorial misbehaviours makes it difficult to outline the parameters.

The Irish case law likewise provides no clear answers, though as we have seen previously the reported cases largely involve preference type transactions. That said, the emphasis of the Irish courts is different and, to some extent, narrower than that which exists in other jurisdictions. The preservation of assets for proper distribution

[87] [1988] 1 BCLC 218
[88] [2005] EWHC 1638 para.1304.
[89] [2016] EWCA 557 para.18
[90] Bell Group Ltd v Westpac Banking Corporation [No 9] [2008] WASC 239 para.4439
[91] Teele Langford and Ramsay, 'The Contours and Content of the Creditors' Interests Duty' [2021] 21(1) JCLS 1 at 15.
[92] [2013] BCC 771 paras.165 and 178
[93] [2013] BCC 771 para.165
[94] [2013] EWHC 2876.
[95] [2016] 2 BCLC 319
[96] [2012] BCC 407.
[97] [2005] BCC 783

to creditors is prominent (and, indeed, indicates, as previously discussed, that there may be a separate duty owed directly to creditors in the Irish common law). Specifically, in Re. Fredericks Inn,[98] Blayney J. in the Supreme Court considered that the insolvent company ceasing to be the beneficial owner of its assets meant that the directors have a duty to preserve the assets so that they can be distributed in accordance with insolvency rules. This emphasis, absent in the UK, on maintaining the assets so that the liquidation can be carried out in accordance with Companies Act requirements continues in later case law. In Re. Swanpool Ltd., Clarke J. indicated that the purpose of the duty is to ensure that the assets of the company are dealt with in accordance with the insolvency rules contained in the Companies Acts.[99] The judge applies the same analysis in Hughes v Hitachi Koki Imaging Solutions Europe.[100]

That said, this emphasis may be a point of semantics only. While the UK case law does not deal with the issue, it is surely encompassed in any statement that the directors must act in the interests of creditors or that creditors' interests are paramount that assets must be preserved to allow proper distribution to creditors. It should also be noted that the other Irish cases provide a much more limited analysis still. In John C. Parkes & Sons Ltd. v Hong Kong and Shanghai Banking Corporation,[101] the Mercia Safetyware case[102] was cited with approval. However, Blayney J. concluded that he did not have to consider the ambit of the duty in the case because the real question was whether the transactions in question were ultra vires the company.[103] Likewise, in both the High Court and the Supreme Court in Harlequin Property (SVG) Ltd. v O'Halloran[104] judicial consideration is limited and obiter.

If the Irish duty is limited in aspect to failure to preserve assets for correct distribution, this may explain the preponderance of preference type cases; obviously if one creditor is paid in priority to the others proper distribution among all creditors is impossible. However, this would be a significant limitation of the duty and would indicate that the duty is not a suitable substitute for the reckless trading provision. Directors' actions

[98] [1994] 1 ILRM 387 at 396
[99] [2005] IEHC 341 para.3.1
[100] [2006] IEHC 223 para.3.9
[101] [1990] ILRM 341
[102] [1988] 4 BCC 30
[103] [1990] 1 ILRM 341 at 349
[104] [2013] IEHC 362 and [2019] IESC 76

causing a devaluation or loss of assets may not be covered, for example. In that situation, proper distribution in accordance with the Companies Acts will still occur. A diminution in value of the company's assets has no impact on the procedure involved; there are simply less assets to distribute.

This conclusion is hardly correct. It does not seem reasonable or logical that the Irish duty should be limited in this manner. More likely, the emphasis on preservation has arisen from the prevalence of preference type cases (and, indeed, restriction order cases[105] where, again, the emphasis is on compliance with the Companies Acts) and not the other way around. That said, the matter is not beyond doubt and, again, the adoption of the CLRG draft provision would have settled the issue conclusively in favour of a broad application similar to the UK and Australian experiences. The draft specifies that the directors shall, firstly, have regard to the interests of the company's creditors and, secondly, shall preserve the company's assets. [106] Expressed in this manner, the parameters of the Irish duty and the requirements placed on directors is clear.

Other questions also arise. Is it a requirement of the duty that the company cease trading and be placed in liquidation? Again, there are no clear answers. Logically, in some instances this may be the best course while in others it may not. An insolvent company may recover or a continuation of trade, even for a short while, may actually benefit creditors.[107] Further, to which creditors is the duty owed as creditors can be current, future or prospective?[108] Attempts have been made to distinguish the interests of existing creditors and future creditors. However here, inconsistent approaches are encountered.[109] These result from a dicta of Templeman J. in Winkworth v Edward Baron Development Ltd.[110] wherein the learned judge suggested that the duty was to

[105] Re. Swanpool Ltd. [2005] IEHC 341 and DCS Ltd. [2006] IEHC 179
[106] CLRG, Report on the Protection of Employees and Unsecured Creditors (Dublin June 2017), para.2.3.4
[107] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para.12.31
[108] Hayne, 'Director's Duties and a Company's Creditors' [2014] 38(2) Melbourne University Law Review 795 at 807
[109] Finch and Milman Corporate Insolvency Law Perspectives and Principles 3rd Edition (Cambridge: University Press Cambridge 2017), p.587
[110] [1987] 1 All ER 114.

present and future creditors. Keay, however, convincingly argues that there is no requirement to consider the interests of future creditors.[111]

**(c) When Does The Duty Come Into Existence**

As Hargovan states *"To be effective, a duty must have a clear triggering point."*[112] That said, while there is significant agreement amongst judges both on the need for a duty to creditors and the fact that the duty should not arise until the company is suffering some degree of financial difficulty, there is no unanimity on the question of when the duty is triggered. As Keay states *"The lack of precision in delineating the point at which directors are to have regard for creditor interests, and may potentially become liable, is highly unsatisfactory."*[113] Clearly the duty will arise when the company is insolvent.[114] The possibilities which therefore require examination are, firstly, whether the duty exists when the company is approaching insolvency and, secondly, can the duty apply to directors of a solvent company.

Overall, it seems logical that the duty does not arise when the company is solvent. This makes sense. At that point, creditors are well protected as the company has significant funds. While imposing creditor related duties during solvency might give the creditors an even higher level of protection, it is not necessarily in the public interest to do so as it could generate incentives for directors to engage only in excessively low-risk activities.[115] Thus if the duty was to apply when the company is clearly solvent, then it could unreasonably interfere with the decision-making of directors, hamper the business of the company, and discourage the directors from taking appropriate risks.[116] Further, in this scenario the issue would arise as to how the directors balance their duty to the shareholders with their duty to creditors.

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[111] Keay, 'Directors' Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors' [2003] 66(5) Modern Law Review 665 at 699

[112] Hargovan, Todd 'Financial Twilight Re-Appraisal: Ending the Judicially Created Quagmire of Fiduciary Duties to Creditors' [2016] 78(2) U Pitt. L. Rev 135 at 151

[113] Keay, 'The Director's Duty to Take into Account the Interests of Company Creditors: When Is It Triggered?' [2001] 25(2) Melbourne University Law Review 315 at 316

[114] Keay, Directors' Duties 3rd Edition (Lexis Nexis 2016), para.13.28

[115] Davies, 'Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency' [2006] 7(1) EBOLR 301 at 304

[116] Keay, 'The Director's Duty to Take into Account the Interests of Company Creditors: When Is It Triggered?' [2001] 25(2) Melbourne University Law Review 315 at 329

That said, case law in the UK and Australia indicates that the duty could arise in a solvent company in certain circumstances. Specifically in Re. HLC Environmental Projects Ltd., per John Randall QC (sitting as a judge of the High Court), actions by the directors while the company was solvent were sufficient to trigger the duty as long as these carried a real risk to the company's ability to repay its creditors.[117] However, clarification has recently been provided in the UK at least in BT1 2014 LLC v Sequana SA. The facts of that case meant that the judge, David Richards LJ, had to determine whether the duty only came into existence once the company was insolvent or whether it could also exist at an earlier time. The factual background was, briefly, that a subsidiary paid a dividend to its parent, Sequana SA. It later became apparent that this was not a wise decision financially. The company was solvent at the point of payment. The essential question was whether the duty was triggered when the company, though solvent at the time, faced a real as opposed to a remote risk of insolvency from the director's actions. David Richards LJ concluded that this was not the position. He states *"In my judgement, the test of a real, as opposed to a remote risk, of insolvency is not part of the present law as regards the creditors' interest duty, ...*[118] This conclusion does not garner universal support, however. As Hannigan states, moving away from the real but not remote triggering point to something closer to actual insolvency may weaken the effectiveness of the duty as a remedy.[119] Further, in Australia, Kalls Enterprises Pyt Ltd. v Baloglow[120] sets out the existence of a real but not remote possibility that the directors' actions will prejudice creditors as a triggering point. This view was accepted in the recent Termite Resources NL v Meadows.[121] Overall, therefore, while there has been no consideration of this issue in Ireland, it appears that in the UK at least the duty cannot be triggered while the company is solvent.[122]

[117] [2013] EWHC 2876 at para. 89
[118] [2019] BCC 631 para.215
[119] Hannigan, Company Law 5th Edition (Oxford: Oxford University Press 2018), para.10.49.
[120] [2007] NSWCA 191 para.174
[121] [2019] FCA 354, [2019] 135 ACSR 45 The case is under appeal. For a discussion see Teele Langford and Ramsay, 'The Contours and Content of the Creditors' Interests Duty' [2021] 21(1) JCLS 1
[122] It is interesting to note that Teele Langford and Ramsay argue that the UK position is superior to the Australian one. Teele Langford and Ramsay, 'The Contours and Content of the Creditors' Interests Duty' [2021] 21(1) JCLS 1

Therefore, the outstanding question is whether the duty applies to a company in the vicinity of insolvency. Put another way, what degree of financial distress is required before the duty is triggered? Case law internationally has not been helpful. In both Kinsela[123] and West Mercia,[124] the companies concerned were clearly insolvent. Later cases are more expansive. For example, in Vivendi SA v Richards, Newey J. clearly states that the interests of creditors intrude even when the company may not be strictly insolvent.[125] Leslie Kosmin QC (sitting as a judge of the High Court) expresses similar sentiments in Colin Gwyer & Associates v London Wharf (Limehouse) Ltd.[126] Registrar Barber speaks of insolvency being *'reasonably foreseeable'* in Re. Micra Contracts Ltd.[127]

David Richards LJ analysis in Sequana is interesting and enlightening. He concluded that in all previously reported cases where the issue arose, the company in question was insolvent and the duty was clearly in existence at that point.[128] He further concluded that it was also in existence at an earlier point. Something less than actual insolvency was a sufficient trigger; *'I have, however, concluded that the duty may be triggered when a company's circumstances fall short of actual, established insolvency'*[129] The weight of previous judicial opinion indicated that this was the case; *"…the number of times that judges, many of them of considerable experience in this field, have assumed that something less than actual insolvency will trigger the duty carries weight"*[130] While this judgment is under appeal to the Supreme Court and is obviously extra jurisdictional in so far as Ireland is concerned, Richard LJ's conclusions that probable insolvency is sufficient is compelling for the very practical reason that *"The precise moment at which a company becomes insolvent is often difficult to pinpoint. Insolvency may occur suddenly but equally the descent into insolvency may be more gradual.*"[131]

[123] [1986] 4 NSWLR 722 at 730
[124] [1988] 4 BCC 30
[125] [2013] BCC 771 para.149
[126] [2003] BCC 885 para.74
[127] [2016] BCC 153 para.23.
[128] [2019] BCC 631 para.195.
[129] [2019] BCC 631 para.216.
[130] [2019] BCC 631 para.195
[131] [2019] BCC 631 para.218

Hence, the conclusion at this stage in so far as the UK position is concerned is that only actual insolvency itself or something close to it will trigger the duty. How close is the next question? David Richards LJ concludes "... *that the duty arises when the directors know or should know that the company is or is likely to become insolvent accurately encapsulates the trigger. In this context, "likely" means probable, not some lower test ..."*[132] Thus actual or probable insolvency appears to be the trigger and, indeed, this was the test which was recently applied by Barber J. in Re. System Building Services Group Ltd.[133]

The position in Ireland may, however, be different; the duty may only come into existence on actual insolvency itself. All reported Irish cases appear to involve insolvent companies. The first Irish case on this issue, Re. Fredericks Inns,[134] involved a group of companies which were hopelessly insolvent when the actions in question were undertaken. In John C. Parkes & Sons Ltd. v Hong Kong and Shanghai Banking Corporation the company in question was insolvent at the time of the transaction, thought the director does not appear to have been aware of this.[135] Likewise in Re. Swanpool Ltd.,[136] both companies were insolvent as was the company in the Hitachi Koki case.[137] Jones v Gunn[138] also involved a clearly insolvent company. Finally, in DCS Ltd.,[139] the company appears to have been insolvent at the time in question. Harlequin Property (SVG) Ltd. v O'Halloran[140] also concerned an insolvent company.

It is also extremely interesting to note that in only one of the above cited Irish cases did the judge consider the duty in the context of a company which was approaching insolvency but not yet insolvent. In Re. Fredericks Inns[141] Lardner J. states that the West Mercia formulation is *"……appropriate and applicable to insolvent companies in Irish law."* Similar sentiments are expressed by McGuinness J. in Jones v Gunn[142]

[132] [2019] BCC 631 para.220
[133] [2020] EWCH 54 para.35
[134] [1994] 1 ILRM 387
[135] [1990] ILRM 341
[136] [2005] IEHC 341.
[137] [2006] IEHC 223 para.2.5
[138] [1997] 3 IR 1
[139] [2006] IEHC 179
[140] [2013] IEHC 362. McGovern J. uses the phrase '*clear insolvency'* (para.97)
[141] [1991] ILRM 582 at 590
[142] [1997] 3 IR 1 at 22

where she states that the duty applies to directors of *'clearly insolvent'* companies and the Harlequin case where a similar expression *'clear insolvency'* is used.[143] MacMenamin J in DCS Ltd. is also makes it clear that the duty applies to the directors of an insolvent company when he states *"There can be little doubt therefore that amongst the important duties of directors is one to ensure that when it becomes clear that a company is insolvent, the assets are preserved and dealt with in accordance with the requirements of the Companies Acts.*"[144] In Re. Swanpool Ltd.[145] the duty is also expressed to exist in the context of an insolvent company.

Indeed, that an earlier triggering point may exist in Irish law is only mentioned in the recent Supreme court case Harlequin Property (SVG) Ltd. v O'Halloran wherein MacMenamin J. stated obiter[146] "*Given his conclusion on this primary issue on fraudulent misrepresentation giving rise to deceit, the judge did not consider it necessary to consider any alternative claim made on behalf of the respondents that Mr. O'Halloran could be held liable simply by reference to the duty owed to creditors by directors in circumstances where the latter are aware that the company is insolvent, or nearly so* " [Emphasis added].

The fact that the preponderance of Irish case law appears to require actual insolvency or something very close to insolvency weakens the effectiveness of the duty. If the duty is imposed only on or very close to actual insolvency, then creditors will not be protected from inappropriate actions by directors prior to that point. This may be too late as it is before that point that the incentive to engage in excessively risky projects manifests itself.[147] Conversely, it significantly increases the potency of section 610 as it allows creditors and liquidators to challenge actions taken while the company was still solvent. The section's triggering point is very arguably closer to the real and not remote risk that the action would prejudice creditors set out in Kalls Enterprises Pyt Ltd. v Baloglow[148] and dismissed in Sequana[149] because the section looks to whether

[143] [2013] IEHC 362 para.97
[144] [2006] IEHC 179 para.35
[145] [2005] IEHC 341 para.3.1
[146] [2019] IESC 76 para.120
[147] Davies, 'Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency' [2006] 7(1) EBOLR 301 at 313.
[148] [2007] NSWCA 191
[149] [2019] BCC 631

the directors' actions caused a loss to creditors and not when those actions occurred. In summary, under Irish law as currently stated, the reckless trading provision may be superior as it provides a remedy to creditors where director misbehaviour has occurred prior to actual insolvency. With the duty, the timeframe is much shorter; actual insolvency and, based on the two Supreme Court decisions, something very close to it.

On the alternate assumption that David Richards LJ's conclusions are largely correct and would be followed in this jurisdiction, the reckless trading provision still appears to be of greater assistance to creditors that the duty from a timing perspective. Although the company must be insolvent to invoke section 610, there is nothing in the section to indicate that the action complained of must take place while the company is insolvent or likely to be insolvent. Actions taken by directors of a perfectly solvent company can be examined. Hence Irish creditors with the same fact pattern as Sequana would not have been precluded from taking a reckless trading case based on the timing issue alone. This again emphasises the importance of delineating entrepreneurial missteps from operational ones.[150] The Irish position can be contrasted with the UK one where both the duty to creditors and section 214 has a similar triggering point.[151]

Indeed, the recent Re. Kelly Trucks Ltd. may be a case in point. It appears that the company itself was successful and profitable at the time of the actions in question. For example, the company's accounts (albeit unaudited) for the year before the events in question showed shareholders' funds in excess of €750,000.[152] Mrs. Kelly's asset stripping resulted in its demise. At the time the director began to remove assets, the company was not insolvent. Hence no action for breach of duty may have accrued to the company's liquidator despite the fact that the director's actions carried a real risk of causing detriment. However, the liquidator's claim was successful under section 610 and no timing issues arose in the case.

[150] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7
[151] Hannigan, Company Law 5th Edition (Oxford University Press 2018), para.10.48.
[152] [2019] IEHC 6 para.26.

Even where there is a clear consensus that the duty is triggered when the company becomes insolvent or is probably insolvent, that is not the end of the difficulties. It is hard to identify the precise point of insolvency.[153] Actual insolvency can be difficult to establish as detailed accounting analysis is often required and is not one that directors can easily judge when making commercial decisions, particularly during times of financial distress.[154] Accounting rules and definitions are notoriously opaque. Some companies may wander in and out of insolvency as their financial circumstances change.[155] Often directors may not know nor could they be expected to know that the company is insolvent until sometime after the insolvency has occurred.[156] Ultimately, it may only be possible to pinpoint when a company reached 'true' insolvency with hindsight. Determining when a company is of doubtful solvency may be even more difficult than determining when it is actually insolvent.[157] Hence even the current conviction that the duty is triggered on insolvency or probable insolvency only takes us so far. This again demonstrates the superiority of section 610 in this area. The directors' actions and their effects on creditors are in issue and not the company's financial state when the behaviour occurred.

Finally, it must be noted that in any event, a vigorous early application of the duty could undermine the purpose of the corporate form, allowing and encouraging risk-taking. The scenario described by David Richards LJ in Sequana is an example of this. A perfectly solvent company has cash resources available to meet a liability due to mature in two years' time. Obviously, in this case the interests of creditors are best served by retaining the cash on hand until the liability matures or investing it in risk-free assets. The company however has the opportunity to invest the funds in a business venture that carries significant risks and rewards. This is not a reckless investment, but it does carry a real risk of failure. The directors in such a scenario may well be advised that they should not invest the monies in the venture as it is the creditors who will lose

[153] Teele Langford and Ramsay, 'The Contours and Content of the Creditors' Interests Duty' [2021] 21(1) JCLS 1 at 7
[154] Hargovan, Harris, 'For Whom the Bell Tolls: Directors' Duties to Creditors after Bell' [2013] 35(2) Sydney L. Rev. 433 at 437.
[155] Sealy, 'Directors' "Wider" Responsibilities - Problems Conceptual, Practical and Procedural' [1987] 13 Monash University Law Review 164 at 179. Hannigan, Company Law 5th Edition (Oxford: Oxford University Press 2018), para.10.45.
[156] BTI 2014 LLC v Sequana SA [2019] BCC 631 para.218
[157] Keay, 'The Director's Duty to Take into Account the Interests of Company Creditors: When Is It Triggered?' [2001] 25(2) Melbourne University Law Review 315 at 327

out if it fails and they may be held liable for breach of duty. The directors may decide not to court this personal risk. An imposition of the duty where a purely commercial decision is in issue may well have *"a chilling effect on entrepreneurial activity"*[158] This again indicates the importance of delineating operational and entrepreneurial risk-taking.

**(d) The Balancing of Interests**

On the assumption that the creditor centered duty comes into existence as the company declines into insolvency, the issue which firstly arises is whether those interests are paramount, equal to or subservient to the shareholders' interests during that period. Finch and Milman acknowledge that at a certain point in time creditors' interests and shareholders' interests may conflict[159] as debt and equity can have opposing priorities.[160] Secondly, how are the directors to balance the interests of the various classes of creditors who may have competing rights and motivations?

It would seem apparent that once the company is clearly insolvent, then creditors' interests must be paramount as the creditors are the residual claimants at that point.[161] At that juncture, the duty of the directors is to ensure that creditors receive the maximum repayment possible and risky ventures which will reduce that potential must be avoided.[162] As David Richards LJ stated obiter in BTI 2014 LLC v Sequana SA *"……where the directors know or ought to know that the company is presently and actually insolvent, it is hard to see that creditors' interests could be anything but paramount."*[163]

The next question which arises is how the duty is to be applied when the company is in the vicinity of insolvency. David Richards LJ in Sequana SA[164] indicates that creditors' interests are paramount from the point of probable insolvency. This,

[158] BTI 2014 LLC v Sequana SA [2019] BCC 631 para.200
[159] Finch and Milman Corporate Insolvency Law Perspectives and Principles 3rd Edition (Cambridge: University Press Cambridge 2017), p.588
[160] Hargovan, "Directors' Duties to Creditors: A Doctrinal Mess" [2015] 3 NIBLeJ 135 at 140
[161] Keay, 'A Theoretical Analysis of the Director's Duty to Consider Creditor Interests: The Progressive School's Approach' [2004] 4(2) Journal of Corporate Law Studies 307 at 313.
[162] Keay, 'Formulating a Framework for Directors' Duties to Creditors: An Entity Maximisation' [2005] 64(3) Cambridge Law Journal, 614 at 620-621
[163] [2019] BCC 631 para.222
[164] [2019] BCC 631 paras.198-199.

however, may be in the context of the codified UK provision and so is of scant assistance in Ireland. Here if the duty is triggered when the company is not insolvent, there may be a co-existing duty to act in the interests of the shareholders. Thus the question arises as to how the directors balance these duties? For example, if there is a forty percent chance of disaster and a sixty percent chance of success which duty takes priority? Keay suggests that the circumstances across the board of each individual company be taken into account.[165] It is respectfully suggested that this is unhelpful. The test would be nebulous in the extreme and may deter directors from engaging in any course of action which carries even the slightest potential to render the company insolvent. Indeed, as Keay later points out, if the directors switch their emphasis to the creditors at too early a point, they may face a derivative action from the shareholders.[166] He also stresses the difficulties which directors may face in deciding whether they should be fulfilling their duty to promote the success of the company or their duty under section 172(3)[167] and that balancing the interests of shareholders and creditors can be challenging.[168]

It is further suggested that this is not an issue as directors are well used to balancing interests in any event and that even when determining what is in the best interests of shareholders may have to balance various competing elements and choices.[169] While these points are undoubtedly correct, the complexity of the directors' role has been significantly increased. Previously, the directors had a duty to shareholders and had to balance their interests. Now directors must balance the often-competing interests[170] of shareholders and creditors and must also balance the competing interests within these two classes. Further, all this must be carried out at a time when the company's financial situation is deteriorating. Overall, however, Keay concludes that within the current company law paradigm *"The idea of balancing the interests of the shareholder and creditor constituencies seems meritorious, but in practice it would be very difficult for*

[165] Keay, 'The Director's Duty to Take into Account the Interests of Company Creditors: When Is It Triggered?' [2001] 25(2) Melbourne University Law Review 315 at 334
[166] Keay, 'The Shifting of Directors' Duties in the Vicinity of Insolvency' [2015] 24(2) International Insolvency Review 140 at 151.
[167] Keay, Directors' Duties 3rd Edition (Lexis Nexis 2016) paras.13.52-13.53.
[168] Keay, Directors' Duties 3rd Edition (Lexis Nexis 2016) para.13.80
[169] Keay, 'Formulating a Framework for Directors' Duties to Creditors: An Entity Maximisation' [2005] 64(3) Cambridge Law Journal, 614 at 623-629.
[170] Keay, 'Formulating a Framework for Directors' Duties to Creditors: An Entity Maximisation' [2005] 64(3) Cambridge Law Journal, 614 at 622-623.

*a director, in many situations, to know what to do."*[171] This conclusion, applied to insolvency situations, appears to be correct.

Further, where the duty applies to creditors with competing interests, it fragments.[172] In contrast with shareholders,[173] there is no single class of creditors. Some are secured, others are unsecured. Some have preferential rights. Creditors can be contingent, prospective and future.[174] Judges have tended to treat creditors as a single, homogeneous group but have not stated clearly whether directors owe a duty to creditors generally, to individual creditors, or to a particular class of creditors.[175] Directors, as a matter of business judgment, may have to choose between competing creditors, preferring some to others.[176] Indeed it has been argued that remedies should be focused on the unsecured creditor.[177] That said, this particular issue may be overblown. No such difficulty has arisen in the UK case law of which there is a significant body at this point.

**(e) Enforcement and Remedies**

Applying the position that the duty is mediated via the company, then there is no universal remedy for a breach of the duty to creditors. This is entirely logical; as a breach of duty to the company the standard common law and equitable remedies apply.[178] This can be seen from the UK case law. While there is a preponderance of preference type issues,[179] a myriad of different fact patterns arise. Taking a short sample of UK case law Roberts v Frohlich[180] concerned continued involvement in a building project which had scant chance of success. Re. System Building Group Ltd.[181]

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[171] Keay, 'Formulating a Framework for Directors' Duties to Creditors: An Entity Maximisation' [2005] 64(3) Cambridge Law Journal, 614 at 633.
[172] Sealy, 'Directors' "Wider" Responsibilities - Problems Conceptual, Practical and Procedural' [1987] 13 Monash University Law Review 164 at 175
[173] There may, of course, sometimes be different classes of shareholders.
[174] Keay, Directors' Duties 3rd Edition (Lexis Nexis 2016) para.13.103
[175] Finch and Milman Corporate Insolvency Law Perspectives and Principles 3rd Edition (Cambridge: University Press Cambridge 2017), p.588
[176] Sealy, 'Directors' "Wider" Responsibilities - Problems Conceptual, Practical and Procedural' [1987] 13 Monash University Law Review 164 at 178.
[177] Davies, 'Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency' [2006] 7(1) EBOLR 301 at 30.
[178] Teele Langford, Directors' Duties: Principles and Application (NSW, Federation Press 2014) p.165
[179] West Mercia Safetywear Ltd. v Dodd [1988] 4 BCC 30**,** Knight v Frost [1999] BCC 819 and Re. Micra Contracts Ltd. [2016] BCC 153
[180] [2012] BCC 407
[181] [2020] EWHC 54

involved the purchase of a company asset by its director at an undervalue as well as preference type payments to connected companies. MDA Investment Management Ltd.[182] concerned the incorrect splitting of sale consideration between the company and a partnership connected with its director. Yukong Line Ltd. of Korea v Rendsburg Investment Corp. of Liberia[183] entailed the removal of funds from the defendant's bank account when it had probable liabilities to the plaintiff vastly in excess of its assets. Hence the different fact patterns required different remedies. Like reckless trading, personal liability has been imposed on directors.[184] Directors have been required to repay to the company the sums which he or she caused to be unlawfully paid out. This occurred, for example, in Re. HLC Environmental Projects Ltd.,[185] Re Cityspan Ltd.,[186] Re Cosy Seal Insulation Ltd.[187] and Re Micra Contracts Ltd.[188] Likewise in West Mercia,[189] the director who had authorised the payment by the subsidiary to the parent was ordered to pay the subsidiary the amount involved.

In Ireland, even leaving aside the issue of whether the duty is owed to the company or to the creditors directly, we have little idea of the remedies involved as the fact pattern is less diverse due to the predominance of preference type actions. Moreover, much of the Irish case law does not involve enforcement of the duty or remedies at all. Re. Swanpool Ltd.[190] is a restriction order as is DCS Ltd.[191] case. Duties to creditors are also briefly mentioned in another restriction order case; Re. Usit World Plc.[192] Hughes v Hitachi Koki Imaging Solutions Europe[193] concerned an application for a Mareva injunction. In the recent Harlequin case,[194] no enforcement or remedial decision in relation to the duty was made as the case was decided on another point entirely, though the plaintiff did request that the first named defendant be made personally liable.[195] In

[182] [2005] BCC 783
[183] [1988] BCC 870
[184] See Re. Micra Contracts Ltd. [2016] BCC 153 at para.115
[185] [2013] EWHC 2876
[186] [2008] BCC 60
[187] [2016] 2 BCLC 319
[188] [2016] BCC 153
[189] [1988] 4 BCC 30
[190] [2005] IEHC 341
[191] [2006] IEHC 179
[192] [2005] IEHC 285. See paras.163 and 205.
[193] [2006] IEHC 223 para.3.9.
[194] [2013] IEHC 362
[195] [2013] IEHC 362 para.93.

John C. Parkes,[196] the West Mercia decision was distinguished and in Jones v Gunn,[197] we do not appear to have a report of the second case at which the remedy may have been decided. The remaining case is Re. Fredericks Inns[198] where the transactions were effectively reversed. The Revenue Commissioners were required to return to the companies the amount which they had paid out of their own assets in excess of their own liabilities. Revenue held the monies in a fiduciary capacity and was constructive trustee for the payor companies. Hence in Ireland, due to the paucity of case law, it is impossible describe with any certainty what the enforcement and remedy landscape might be. Logically, of course, it could be the imposition of personal liability but we cannot point to a reported case where this occurred. In this regard, section 610 is more attractive due to the certainty of its remedy. It is narrowly compensatory and clearly imposes personal liability. The judge can order payment by the director to the creditor or to the company.

Thus, again, section 610 appears to be the more beneficial section for creditors. Where a director's actions cause a loss to even one creditor a clear compensatory remedy is available. Where such an event has occurred, the existence of a loss to the company or indeed even other creditors is irrelevant. Re. Appleyard[199] is a case in point as the applicant creditor could not have taken a duty case here. Its loss arose from an action which was specific to it alone. Further, the company and, hence, the general pool of creditors benefited from the transaction; an additional €48,000 had been lodged to and remained in its bank account.

This leads to the question of how the duty is to be effectively enforced. Sealy states *"A supposed legal duty which is not matched by a remedy is a nonsense"*[200] The issue is also recognised in case law. Lords Toulson and Hodge state in Bilta (UK) Ltd. v Nazir *"Such protection would be empty if it could not be enforced."* [201] There appear to be significant challenges. The CLRG concludes that creditors may encounter some

[196] [1990] ILRM 341 at 348
[197] [1997] 3 IR 27 at 22
[198] [1994] 1 ILRM 387
[199] [2015] IEHC 28 and [2016] IECA 280
[200] Sealy, 'Directors' "Wider" Responsibilities - Problems Conceptual, Practical and Procedural' [1987] 13 Monash University Law Review 164 at 177
[201] [2015] BCC 343 para.127

difficulties in this regard in Ireland.[202] This view is echoed by Finch and Milman who state that *"The judges have tended to see directors' duty to creditor in exhortatory terms and so have failed to grasp the enforcement nettle"*[203]

If the duty is mediated via the company as it is in the UK, then enforcement is more straightforward. It cannot be enforced by an individual creditor or group of creditors. The duty is enforceable only by the creditors collectively via the liquidator.[204] We have a myriad of examples from that jurisdiction of liquidators taking enforcement actions. Van Zwieten[205] does point out a logical inconsistency in many of the preference type cases such as West Mercia where the payment to the preferred creditor reduced both assets and liabilities by an equal amount meaning that there was no loss to the company. As she states, if it is accepted that the duty is to the company, then there cannot have been a breach in those circumstances as the company (as opposed to the creditors) suffered no loss.[206] Hence, while the enforcement route is clear, a remedy may not be available in all circumstances and the duty may suffer from a similar lacuna to that contained within section 214.

If the Irish position is that a direct fiduciary duty arises to creditors, then the question of both enforcement and remedy arises. As we have seen, the reported Irish case law gives little guidance in this matter. While any direct duty to creditors in Ireland would appear to be a fiduciary one,[207] and thus all the equitable remedies would be available, the mechanism under which such a duty would be enforced is unclear. The CLRG note the misfeasance mechanism under section 612 Companies Act, 2014 may be available, but that the matter is not without doubt. The Group ultimately concludes "…*creditors may encounter some difficulties in seeking to enforce remedies where they consider*

[202] CLRG, Report on the Protection of Employees and Unsecured Creditors (Dublin June 2017), para.2.3.2
[203] Finch and Milman Corporate Insolvency Law Perspectives and Principles 3rd Edition (Cambridge: University Press Cambridge 2017), p.606
[204] Davies, Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency' [2006] 7(1) EBOLR 301 at 328-329
[205] Van Zwieten, 'Director Liability in Insolvency and its Vicinity' [2018] 38(2) Oxford Journal of Legal Studies 382 at 400
[206] Keay as referenced by Van Zwieten (at p. 400) argues that the duty is focused on creditors. Keay, 'Directors' Duties and Creditors' Interests' [2014] 130 LQR 443 at 466-469
[207] Jones v Gunn [1997] 3 IR 1 at 22

*that the directors have not properly discharged their duty to the creditors."*[208] It is also unlikely that all creditors would unite to pursue a claim. Again, this points to the superiority of section 610 regarding both enforcement and remedies. While section 610 is not often, as we have seen, enforced, the path to do so is clear. It should also be noted that the CLRG's draft codified duty provides both a clear enforcement mechanism and clear remedy. It is again submitted that not incorporating same into the Companies Act, 2014 was a missed opportunity.

Where the duty is mediated via the company, Davies points out another disadvantage which he contends is significant; the proceeds appear not to go to the unsecured creditors. As the company's cause of action against the directors exists at the point the company goes into liquidation, the proceeds of the enforcement of the duty will be caught by any security interests granted by the company.[209] This is a significant disadvantage and one which does not exist with regard to section 610. Regarding the Irish reckless trading provision, the director can be made personally liable for a specific debt of the company and ordered to pay a specific amount to a particular creditor. The status of other creditors is not relevant.

As the LRC concludes "*The common law duty owed to creditors, while focused on protecting creditors when a company enters insolvency, arguably has insufficient penalties to adequately correct for the powerful incentive that exists to engage in reckless risk-taking."*[210] In effect the wheel comes full circle. Per the Commission, the enforcement weaknesses of the duty have led many jurisdictions to introduce legislation prohibiting reckless trading.[211] These have then proved unsatisfactory. This in turn leads to an examination of whether directors' duty to creditors (in particular a codified duty) provides a viable alternative to such provisions.

[208] CLRG, Report on the Protection of Employees and Unsecured Creditors (Dublin June 2017), para.2.3.2

[209] Davies, Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency' [2006] 7(1) EBOLR 301 at 317.

[210] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para.12.48

[211] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para 12.48

## (IV) WOULD CODIFICATION BE OF ASSISTANCE?

The parameters of the duty as developed in common law, particularly in Ireland, are far from clear. It is therefore hardly surprising that it has been argued that the codification of the duty would be beneficial. However, as Hargovan and Todd state *"… any legislative remedy needs to be crafted carefully and clearly…"*[212]

The CLRG has strongly argued in favour of a codified directors' duty to creditors both in its first report in 2000-2001[213] and in 2017.[214] The originally suggested provision was brief; *"A director must have regard to the interests of the company's employees in general and to those of its members, and where the company is insolvent, its creditors."* In contrast, the 2017 recommendation is far more detailed and robust (See Appendix Four).

It is also interesting to speculate as to why the draft provision changed so much between 2001 and 2017. It is likely that this is because of the lack of development in the Irish common law as to the parameters and triggering point of the duty. Unlike the UK, where a codified common law position would contain sufficient guidance for future cases, that is not the case here.

The scope of the Irish duty is quite unclear and there are many unanswered questions. The CLRG draft provision clarifies the vast majority of these issues. Specifically, the duty is owed to the company. There is no direct fiduciary duty to the creditors. This is a sensible position as it is in line with common law and statute elsewhere. It also clarifies the enforcement position. The duty is enforceable in the same way as any other owed to the company. Hence it is the liquidator who would pursue the claim under the statutory scheme. As the CLRG state *"It is not proposed that creditors, as a group would be able to take an action against the directors for failing to take their interests into account in the period approaching insolvency."*[215] This is, however, a

[212] Hargovan, Todd 'Financial Twilight Re-Appraisal: Ending the Judicially Created Quagmire of Fiduciary Duties to Creditors' [2016] 78(2) U Pitt. L. Rev 135 at 179
[213] CLRG, First Report 2000-01, (Dublin December 2001), para.11.3.7.
[214] CLRG, Report on the Protection of Employees and Unsecured Creditors (Dublin June 2017), para.2.3.4
[215] CLRG, Report on the Protection of Employees and Unsecured Creditors (Dublin June 2017), para.2.3.4

limitation on the draft provision as compared to section 610. Under that section, creditors do have a direct right of action.

The duty is triggered when the company is insolvent or likely to be insolvent. This follows the position in the UK rather than the seemingly more restrictive Irish position. Further, the draft usefully clarifies that the test for insolvency is appropriately cash-flow.[216] The CLRG have also sought to clarify the remedial position which is, as we have seen, a significant issue. This has been done in a two-fold manner. Firstly, it is confirmed that the duty is enforceable in the same way as any other fiduciary duty. Secondly, and more importantly, it imposes a species of personal liability. Where the duty has been breached, the director must indemnify the company for any loss. Subsection (4) goes on to state that the company shall be taken to have incurred a loss where creditors do not recover sums which they would otherwise have received had there been no breach of the duty. It thus provides a practical approach to establishing and quantifying the loss. The onus of proof will be on the liquidator to demonstrate, firstly, a breach of duty and, secondly, that the breach resulted in loss or damage to the company. Once these aspects are established, the loss is then quantified by reference to the creditors' shortfall, and it is that for shortfall that the director must indemnify the company. This methodology would prove beneficial in the preference type situations which typically arise in the Irish case law. However, it should also prove applicable should a more varied situation arise similar to those which we find in the UK and Australian case law. It is also interesting to note that the provision requires the directors' to *"...preserve the company's property ..."* Undoubtedly, this arises from the aspect of the duty which is only articulated in the Irish case law; the requirement to maintain the company's assets for proper distribution to the creditors in accordance with legislation.

A codified duty in clear terms in line with the CLRG model would also be beneficial for another reason. A liquidator could have the option in many circumstances of taking alternate claims under both the reckless trading provision and the duty. This would increase the creditors' chances of obtaining a remedy. If the reckless trading claim

[216] Gavin, 'Jumping the Gun: Codifying the Duty to Consider the Interests of Creditors in the Companies Act, 2014' [2021] 65 Irish Jurist 138 at 159

failed due to the specific wording of the section, the more generally worded codified provision may still be available.

Finally, the possible lacuna which Van Zwieten highlighted[217] is remedied by the draft provision. In preference type cases, on the basis that the duty is owed to the company, no remedy may arise as the company has not suffered a loss. Both its assets and its liabilities are equally diminished. The CLRG draft avoids this problem because subsection (4) thereof treats a loss as occurring to the company where creditors do not recover sums which they would otherwise have received had the breach not occurred. This is an important point as it would significantly strengthen the reach of the duty.

Aside from addressing the specific questions which arise in Irish law in this area, there are other benefits from codification; monies recovered from the directors would accrue to the benefit of the general pool of creditors. It may also encourage directors to better monitor the company's financial situation so as to minimise any losses to creditors. While the Group does have a concern that care must be taken to ensure that companies are not liquidated at the first hint of trouble, overall, its view is that the inclusion of such a duty in the Companies Act would be beneficial.[218] It is, in any event, unlikely that what is essentially a clarified legal position in statutory form would cause a wave of premature liquidations.

Indeed, the post-codification UK case law would support the argument that codification is beneficial for another reason. When the analysis of the duty in, for example, Re. Building Systems Group Ltd.,[219] Bilta Ltd. v Nazir[220] and Sequana SA[221] is compared with previously mentioned pre-codification case law,[222] the difference is stark. Post codification, the duty is analysed and applied in a much more detailed and considered manner. The duty is given prominence in the case law. Codification

[217] Van Zwieten, 'Director Liability in Insolvency and its Vicinity' [2018] 38(2) Oxford Journal of Legal Studies 382
[218] CLRG, Report on the Protection of Employees and Unsecured Creditors (Dublin June 2017), para.2.3.4
[219] [2020] EWHC 54.
[220] [2015] EWSC 23
[221] [2019] BCC 631.
[222] See Knight v Frost [1999] BCC 819 and Yukong Line Ltd. of Korea v Rendsburg Investments Corp of Liberia (No. 2) [1998] BCC 870.

appears to give more definition to the duty than previously existed.[223] It allows the duty to be placed in its correct context; directors in fulfilling their duties to the company must focus on creditors as opposed to members as insolvency approaches and the duty is analysed as such. A particularly pertinent example is Re. System Building Services Group Ltd.[224]

## (V) CONCLUSIONS

In conclusion, the duty is not a suitable alternative to a reckless trading claim. From an Irish standpoint, the duty is shrouded in uncertainty. It is difficult to ascertain when precisely the duty comes into existence. It is not easy to ascertain its parameters. It may be limited to a duty to preserve the company's assets for proper distribution. As, it seems, the duty is owed directly to creditors, its enforcement mechanism and remedies are unclear. This is entirely unsatisfactory. Creditors should have certainty in this area, as should directors. Neither cohort does. As Keay states it is necessary that *"……that directors can be confident that when they act they are taking into account the appropriate interests and that their action is safe from attack."*[225] Creditors should have certainty also. A codified duty could have answered these questions. This is the first point here. Absent codification, due to the paucity of case law, the duty in Ireland is simply too vague and uncertain to comprise a viable alternative to section 610.

That said, even assuming the adoption of the codified duty at some point or, indeed, a new Irish case which significantly clarifies the legal position, there are still likely to be a number of areas where section 610 is superior. Specifically, the temporal application of the duty is more limited than that of section 610. As set out previously, the current legal position appears to be that the duty is only triggered when the company is insolvent or nearly so. While the CLRG[226] confirmation that the duty also applies in the vicinity of insolvency would have significantly increased its potency, it

[223] Gavin, 'Jumping the Gun: Codifying the Duty to Consider the Interests of Creditors in the Companies Act, 2014' [2021] 65 Irish Jurist 138 at 141
[224] [2020] EWHC 54 paras. 31-35. For a discussion of this case see Wood, 'Directors' Duties Post Insolvency' [2021] 32(7) ICCLR 371
[225] Keay, 'The Director's Duty to Take into Account the Interests of Company Creditors: When Is It Triggered?' [2001] 25(2) Melbourne University Law Review 315 at 316
[226] CLRG, Report on the Protection of Employees and Unsecured Creditors (Dublin June 2017), para.2.3.4

would still be a less beneficial provision to creditors than section 610. By contrast, the reckless trading provision can, it seems, apply to acts occurring while the company is either solvent, approaching insolvency or actually insolvent.

Irish case law currently indicates that the duty is a fiduciary one owed directly to creditors. As the CLRG have pointed out, this poses serious questions concerning its enforceability and remedies.[227] This also indicates a limitation as compared to section 610. Further, under proposed codification, the duty is mediated via the company. While this creates a clear enforcement and remedial mechanism, it means that the duty will be less beneficial to some creditors than section 610. An individual creditor or a group of creditors will be debarred from taking a claim.

Perhaps Davies views on the matter (commenting on the UK position) are the most apropos. He considers that the duty can play a useful supplementary role to the wrongful trading provision.[228] It may allow the courts to impose a liability in appropriate cases where section 214 itself does not for some reason apply. However, that conclusion cannot be applied in Ireland absent codification. The common law directors' duty to creditors has too many unanswered questions to allow it to position itself as a viable alternative. A statutory directors' duty to creditors is a solution, but in its absence section 610 must stand alone.

[227] CLRG, Report on the Protection of Employees and Unsecured Creditors (Dublin June 2017), para.2.3.2

[228] Davies, 'Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency' [2006] 7(1) EBOLR 301 at 329.

# CHAPTER EIGHT: CRIMINALISING RECKLESS TRADING

## (I) INTRODUCTION

As we have seen in Chapters Three and Four, the lack of invocation of section 610 has been caused by a mixture of internal and external factors. The internal factors can be solved by a redrafting of the section along the lines suggested. The external factors are more intransigent and neither the restriction and disqualification order regimes or the directors' duties to creditors provide suitable alternatives. Generally, private enforcement of section 610 is unsatisfactory.

It is notable, however, that public sanction of director misbehaviour via the quasi-public restriction and disqualification order regimes has been very successful. As the relevant chapter concluded, reckless trading behaviour is in effect sanctioned via these regimes. This may indicate that 610 should come within the bailiwick of public enforcement. Such enforcement would not be an outlier. Public enforcement exists elsewhere, and reckless trading behaviour has been criminalised in other jurisdictions. A new public civil recovery regime has been introduced in the UK. Further, there has been a policy shift in Ireland to a public enforcement type model[1] and it can be argued that Irish company law is becoming increasingly public in nature. Public enforcement has many advantageous features. It actually occurs as we can see from the work of the ODCE. Regulatory agencies have also been found to be generally efficient.[2] This can be contrasted with private enforcement which tends to be patchy and ad hoc. As the McDowell Report stated relying on private parties to entirely enforce companies' legislation is unrealistic.[3] The issue which arises is whether reckless trading should be publicly enforced and what shape enforcement should take. There are a number of options; enforcement could be criminal or civil and civil enforcement could take a number of different forms. This chapter will examine whether criminalising reckless

[1] Ahern, 'Directors' Duties. Broadening the Focus Beyond Content to Examine the Accountability Spectrum' [2011] 33(1) DULJ 116 at 140. See also Armour, 'Enforcement Strategies in Corporate Governance: A Roadmap and Empirical Assessment' in Armour and Payne, Rationality in Company Law. Essays in Honour of DD Prentice, (Oxford: Hart Publishing, 2009)
[2] Posner, 'Theories of Economic Regulation' [1974] 5(2) Bell Journal of Economics 335 at 337-339
[3] Report of the Working Group on Company Law Compliance and Enforcement (Dublin November 1998) ('The McDowell Report), para.2.25

trading behaviour is a suitable solution. The next chapter will examine the various civil enforcement routes.

## (II) IS RECKLESS TRADING A CRIME?

### (i) The Nature of Crime

The initial question is whether engaging in reckless trading constitutes an activity which is criminal in nature. This is difficult to answer as it is necessary to define the concept of criminal activity. As Kingsmill Moore J. stated in 1963 '*a comprehensive definition [is] almost impossible to frame.*'[4] That observation still holds true today.[5] The starting position is that while it has been argued that there is no 'essence' which makes a particular act criminal[6] most theorists consider that conduct should be criminalised only if it is inherently wrongful.[7] In effect, the conduct must be morally wrong.[8] This wrongness constraint arguably exists because criminal sanctions are, distinctively, condemnatory and punitive.[9] Specifically, a criminal record will both express strong societal disapproval of the conduct and have a penal effect.[10] Such a record can significantly impact on employment prospects and social standing. Thus, due to the stringency of the penalties, only a limited number of acts warrant classification as crimes. The punitive aspect of company law derives from the wrongness constraint. The action can be punished because it was wrong and thus the punishment is deserved.[11] This is in effect the harm principle approach of Mills.[12] It exists in two forms. Firstly, conduct should be criminalised if it causes harm to others. Secondly, conduct should be criminalised if such action will prevent harm to others.[13]

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[4] Melling v O Mathghamhna [1963] 97 ILTR 60 at 71

[5] See for example Campbell et al, Criminal Law in Ireland: Cases and Commentary (Dublin; Clarus Press, 2010), paras.1.04-1.06

[6] McCullagh, 'Two-Tier Society, Two-Tier Crime, Two-Tier Justice' in Kilcommins and Kilkelly (Eds), Regulatory Crime in Ireland, (Dublin: First Law/Lonsdale Law Publishing Dublin 2010, p.145

[7] Ashworth, Principles of Criminal Law, 5th Edition (Oxford: Oxford University Press, 2006), p.31. Cornford, 'Rethinking the Wrongness Constraint on Criminalisation" [2017] 36(6) Law and Philosophy 615 at 615.

[8] Ashworth, 'Positive Duties, Regulation and the Criminal Sanction' [2017] 133 LQR 606 at 612.

[9] Cornford, 'Rethinking the Wrongness Constraint on Criminalisation" [2017] 36(6) Law and Philosophy 615 at 616

[10] Cornford, 'Rethinking the Wrongness Constraint on Criminalisation" [2017] 36(6) Law and Philosophy 615 at 619

[11] Cornford, 'Rethinking the Wrongness Constraint on Criminalisation" [2017] 36(6) Law and Philosophy 615 at 624

[12] Mills, On Liberty (1859). Feinberg, Harm to Others (Oxford: Oxford University Press: 1987)

[13] Ashworth, 'Positive Duties, Regulation and the Criminal Sanction' [2017] 133 LQR 606 at pgs.611-612.

It should also be kept in mind, however, that there are many offences where criminal liability is imposed by the state in order to regulate a particular activity.[14] Much of modern criminal law punishes conduct which is wrong only in a technical sense; the terms of the prohibition have been breached (mala prohibita).[15] In such instances such offences may lack the 'wrongness' of traditional crime.[16] Many regulatory crimes fall into this category. Indeed, as Ashworth points out many apparently 'criminal activities' such as riding a bicycle without lights are, in reality, trivial in the extreme.[17]

Bowles et al develop this idea further and conclude that, while there is no universal legal definition of a criminal act, it is one which does public harm, possibly on a substantial scale, repetition of the act causes citizens to incur costs or damage and criminalisation prevents deviations from behaviour judged to be consistent with the smooth functioning of society. It is also intended to reflect societal disapproval.[18] Overall, however, the authors conclude that using a legal approach there is no satisfactory and complete answer as to why certain acts are criminalised.

**(ii) Crimes Under Irish Law**

The Irish legal position casts little light on the issue. The seminal case is Melling v O'Mathghamhna[19] which adopted a rather circular reasoning and held that conduct is criminal in nature if the procedures attaching thereto are also criminal in nature.[20] The judgment has a focus on arrest, state prosecution, culpability requirements and punitive elements as hallmarks of a crime[21] and does not examine the question of whether the action is morally wrong. Such a course can possibly be criticised on the basis that importance is laid on the procedural aspects as a definitional element while the rationale behind the existence of the rule is dismissed.[22] That said, the judgement

[14] Ashworth, Principles of Criminal Law, 5th Edition (Oxford: Oxford University Press, 2006), p.1.
[15] Simester, Sullivan et al, Simester and Sullivan's Criminal Law: Theory and Doctrine 7th Edition (Oxford: Hart Publishing 2020), pgs.2-3
[16] Ormerod, Smith and Hogan Criminal Law 8th Edition (Oxford: Oxford University Press, 2008), pgs.12-14
[17] Ashworth, Principles of Criminal Law, 5th Edition (Oxford: Oxford University Press, 2006), p.1.
[18] Bowles, Faure and Garoupa, 'The Scope of Criminal Law and Criminal Sanctions: An Economic View and Policy Implications' [2008] 35(3) Journal of Law and Society 389 at 392-393
[19] [1963] 97 ILTR 60
[20] This reasoning is in line with Glanville Williams definition of a crime. Williams, "The Definition of a Crime" [1955] C.L.P. 107.
[21] McGrath, 'The Colonisation of Real Crime in the Name of All Crime' in Kilcommins and Kilkelly (Eds), Regulatory Crime in Ireland, (Dublin: First Law/Lonsdale Law Publishing Dublin, 2010), p.36
[22] Dine, 'Punishing Directors' [1994] JBL 325 at 327

has been approved in subsequent Supreme Court decisions and its reasoning applies today.[23] Indeed, the ratio of the case may stem from the inherent difficulty of defining the intrinsic qualities that make certain conduct a crime.[24]

Similar reasoning can also be seen in the fraudulent trading case O'Keeffe v Ferris.[25] Here again, the Melling reasoning was unequivocally followed. The Supreme Court held that the offence was not criminal in nature due to the lack of criminal procedures. While the decision has been criticised,[26] it is convincing due to the particular hallmarks of the provision. As Murphy J. stated in the High Court,[27] the party injured is not the state, but the company's creditors, and proceedings may only be instituted when the company is in liquidation and not at any other time. Indeed, the decision was contemporaneously well received[28] and the matter is now settled law.[29] That said, Melling[30] and O'Keeffe v Ferris by themselves are of little assistance in determining whether reckless trading type behaviour merits criminal sanction. Per Melling, an offence is a crime if it carries the procedural indicia of one. However, that begs the question – what warrants the offence carrying these indicia in the first place?

**(iii) Criminalisation in Other Jurisdictions**

That reckless trading behaviour warrants criminalisation may be supported by the fact that other jurisdictions have introduced a criminal offence. As we will see, however, the type of behaviour to which the sanction applies has been limited in most jurisdictions under review. This indicates that a scale exists; not all manifestations of reckless trading behaviour are either inherently wrongful or require criminal regulation.

[23] This case was approved in subsequent Supreme Court judgements such as McLoughlin v Tuite [1989] IR 82.
[24] Ormerod, Smith and Hogan Criminal Law 8th Edition (Oxford: Oxford University Press, 2008), p.15
[25] [1994] 1 ILRM 425, [1997] 2 ILRM 161.
[26] McGrath, Corporate and White-Collar Crime in Ireland. A New Architecture of Regulatory Enforcement (Manchester: Manchester University Press, 2015), p.20.
**[27]** [1994] 1 ILRM 425 at 431
[28] Foy, 'Accountability, Trustee, Corporate and Personal Liability' [1997] 4(5) CLP 115
[29] Lynch Fannon and Murphy, Corporate Insolvency and Rescue 2nd Edition (Dublin: Bloomsbury, 2012), para.10.59
[30] [1963] 97 ILTR 60

Two new criminal offences were introduced in New Zealand by the Companies Amendment Act, 2014. These caused much consternation at the time.[31] It was considered that legislation could have significant adverse effects on normal risk-taking which is part and parcel of running a business and thus have a chilling effect on the decision-making process.[32] The first applies to a director who exercises powers or carries out duties in bad faith and does not believe his or her actions to be in the best interests of the company. The director must also know that such conduct would cause loss to the company.[33] The second is the relevant provision here and applies when a director dishonestly allows an insolvent company to incur debts.[34] Section 380(4) Companies Act, 1993 is set out in Appendix Three.

The requirements of this offence are based on the duty which exists under section 135 Companies Act, 1993 not to allow or cause the company's business to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors. Interestingly, the offence is not committed if the creditors concerned consented to the business being carried on in that manner. The policy underlying the defence is to allow a company approaching insolvency to enter into arrangements with its creditors to potentially save the company without the directors facing a risk of prosecution.[35] A director convicted under section 380 is liable to a term of imprisonment of up to five years or a fine of up to NZ$200,000. [36] It was hoped that the introduction of the provision would sanction serious wrongdoing and improve accountability. To date, it appears that there have been no cases.[37]

Australia's more robust approach to corporate misbehaviour stems from corporate and regulatory failures in the 1960's, 1970's and again in the 1990's.[38] The Australian

[31] Keay and Welsh, 'Enforcing Breaches of Directors' Duties by a Public Body and Antipodean Experiences' [2015] 15(2) Journal of Corporate Law Studies 255 at 269
[32] Business New Zealand 'Submission to the Commerce Select Committee on the Companies and Limited Partnerships Amendment Bill 2011'
[33] S.138A Companies Act, 1993.
[34] S.380(4) Companies Act, 1993 as inserted by S.7(2) Companies Amendment Act, 2014.
[35] Quo, 'Criminalisation of Breach of Directors' Duties: An Analysis of the Insolvent Trading Offence in New Zealand and Australia and the Requirement to Prove Dishonesty' [2015] 36(12) The Company Lawyer 371 at 373
[36] under section 373(4) Companies Act, 1993
[37] See Watson and Taylor (General Editors), Corporate Law in New Zealand, (Wellington: Thomson Reuters, 2018) at para. 22.6. The authors state that as at 2018 there were no reported cases.
[38] Fitzsimons "Australia and New Zealand on Different Corporate Paths" [1994] 8(2) Otago LR 267 at 268

provision, section 588G(3) Corporations Act, 2001, has a different focus; directors are under a positive duty not to engage in insolvent trading. This provision is set out in Appendix Five. Under the Australian section it is sufficient if the director suspects that the company is insolvent.[39] Under the New Zealand equivalent actual knowledge of insolvency is required.[40] Thus while the Australian provision is similar to the New Zealand provision, it has a lower threshold. Quo states in 2015 that based on her research only seven insolvent trading cases were criminally prosecuted between 2000 and 2014 and in all cases the defendants pleaded guilty. ASIC[41] has acknowledged the difficulty in successfully prosecuting such offences and in only one case was a defendant imprisoned.[42] Indeed, by the mid-1990's the enforcement of director's duties by criminal law had proved unsatisfactory.[43] As a result, the civil penalty regime was introduced.[44]

It is important to note that both provisions are, however, significantly different to the Irish reckless trading provision. Importantly, both section 380(4) and section 588G(3) require the director's failure to prevent the company incurring the debt to be dishonest.[45] This appears to have caused difficulty, however, as there are a number of different tests of dishonesty which could be used but is in keeping with Keay and Welsh's thesis that courts are, in any event, unlikely to convict in the absence of dishonesty.[46] That said, this is a recognition that this is not simply the criminalisation of straightforward reckless trading type behaviour. Dishonest behaviour is required. This is arguably a sensible and fair approach. The honest director will not be penalised for decisions made in good faith which did not work out. However, the introduction

[39] S.588G(1)(c) Corporations Act, 2001
[40] Quo, 'Criminalisation of Breach of Directors' Duties: An Analysis of the Insolvent Trading Offence in New Zealand and Australia and the Requirement to Prove Dishonesty' [2015] 36(12) The Company Lawyer 371 at 374
[41] For details of the role and origins of ASIC, see Chapter Nine.
[42] Quo, 'Criminalisation of Breach of Directors' Duties: An Analysis of the Insolvent Trading Offence in New Zealand and Australia and the Requirement to Prove Dishonesty' [2015] 36(12) The Company Lawyer 371 at fn.8
[43] Hedges et al, 'The Policy and Practice of Enforcement of Directors' Duties by Statutory Agencies in Australia: An Empirical Analysis' [2017] 40(3) Melbourne University Law Review 905 at 925
[44] Comino, 'Effective Regulation by the Australian Securities and Investments Commission: The Civil Penalty Problem' [2009] 33(3) Melb. U. L. Rev. 802 at 805.
[45] Quo, 'Criminalisation of Breach of Directors' Duties: An Analysis of the Insolvent Trading Offence in New Zealand and Australia and the Requirement to Prove Dishonesty' [2015] 36(12) The Company Lawyer 371 at 374.
[46] Keay and Welsh, 'Enforcing Breaches of Directors' Duties by a Public Body and Antipodean Experiences' [2015] 15(2) Journal of Corporate Law Studies 255 at 281

of a dishonesty requirement in an Irish criminalised reckless trading provision may well risk a repetition of the difficulties encountered with fraudulent trading. Regarding the latter concept, the court imposed *"actual dishonesty"* requirement[47] meant that the provision fell into abeyance because of the improbability of a successful outcome. Fletcher argues that this requirement has become embedded in the fabric of judicial thought processes in the area.[48] As a thought process, it may be hard to dislodge and hence could infect judicial interpretation of a criminalised reckless trading provision, even if that provision does not contain a direct dishonesty condition.

Moreover, a criminalised reckless trading may be an oxymoron.[49] Reckless trading as a concept emanated from the deliberations of the Cork Committee which concluded that it was appropriate to have a provision which targeted the carrying on of a business dishonestly.[50] Nevertheless, the Committee did recognise that this created a problem. Where creditors suffered a financial loss in an insolvency situation, the dishonesty requirement set the bar too high. A new provision; reckless trading, was therefore required to target honest but *'unreasonable behaviour'* in the commercial sphere,[51] in effect, stripping out the dishonestly element. Reinserting that requirement into a new criminalised provision undermines the core rationale of reckless trading as one of its central tenets is an absence of dishonesty.

It is also interesting to note that neither jurisdiction simply criminalised its existing reckless or insolvent trading provision. Only limited instances of reckless trading behaviour have been criminalised. Compared to section 610, there are other differences. The sections are narrowly concerned with the incurring of debts (interestingly largely an operational as opposed to an entrepreneurial activity). Other activities which can constitute reckless trading behaviour are not in issue. Moreover, in both instances, the company must be insolvent or close to insolvency. As has been previously discussed, this may not necessarily be the case with the Irish provision.

[47] Re. William C. Leitch Bros Ltd. [1932] 2 Ch 271. Re. Patrick and Lyon Ltd. [1933] Ch 786.
[48] Fletcher, The Law of Insolvency, 5th Edition (London: Sweet & Maxwell 2017), para.27-027
[49] I would like to thank Professor Lynch Fannon for pointing this out.
[50] Insolvency Law and Practice – Report of the Review Committee [1982] Cmnd 8558 para.1777
[51] Insolvency Law and Practice – Report of the Review Committee [1982] Cmnd 8558 para.1777

Finally, both provisions require actual knowledge of insolvency or impending insolvency[52] or, at least, suspicion of insolvency.[53]

There has been little or no impetus in the UK to criminalise wrongful trading. However, a new offence of reckless misconduct in the management of a bank was introduced in Financial Services (Banking Reform) Act 2013.[54] This provision was introduced on foot of the recommendation of the Parliamentary Commission on Banking Standards. Prosecution would, however, be limited to only the most serious of failings, in effect, failings similar to those that were seen during the financial crisis.[55]

**(iv) The Irish Case Law**

In determining whether or not reckless trading should be criminalised, it may be instructive to examine the existing Irish case law in the area and ask whether the directors involved deserved criminal sanction. In the two successful cases, Re. Kelly Trucks Ltd. and Re. PSK Construction Ltd., one does instinctively feel that criminal sanction would not have been inappropriate for the behaviours involved. It soon becomes obvious why this is the case, however. The two Kelly directors and the executive director in PSK were found to have been involved in fraudulent trading under section 610.[56] That provision has a criminal counterpart; section 722 Companies Act, 2014. Hence criminal prosecution and liability was a possibility in both of those cases.

What then of the remaining case law where the directors were found not to have been involved in reckless trading? In the PSK case, the non-executive director escaped sanction. She was, per Finlay Geoghegan J., a financially naïve woman who believed Mr. Killeen that the tax evasion was a temporary measure which would be reversed when the company's cash flow problems were resolved. [57] The decision that she was not involved in reckless trading does appear lenient; she was, after all, disqualified for

[52] Section 380(4) Companies Act, 1993
[53] Section 588G(3) Corporations Act, 2001
[54] S.36 Financial Services (Banking Reform) Act 2013.
[55] Parliamentary Commission on Banking Standard, Changing Banking for the Good Volume II (London June 2013), para.1183
[56] [2019] IEHC 6 at para.152. [2009] IEHC 538 para.38
[57] [2009] IEHC 538 para.33

a period of five years.[58] Thus a different judge could have arrived at the opposite conclusion. Therefore, had a criminal reckless trading provision existed in the mid-2000's, there is at least the possibility of a successful prosecution. A level of culpability certainly exists. However, this was a sin of omission. Ms. Higgins, of course, have questioned Mr. Killeen more closely and challenged his plan. She should have contacted Revenue if he persisted with the scheme. That she did not do so arose perhaps from the fact that she was in a relationship with the executive director. Overall, however, criminal liability and the possibility of imprisonment do seem unduly harsh in the circumstances.

The same can be said in the remaining two cases. The Appleyard directors ran a very successful business for over thirty years.[59] The company's real downfall was the recession coupled with excessive borrowing during the boom.[60] As found by Binchy J. in a convincing judgment (although it was later overturned), the directors were involved in reckless trading because they did not place sufficient protections on the applicant's funds[61] and they did not liquidate the company in time.[62] Again, while the consequences for Toomey Leasing Group Ltd. were significant, it is difficult to argue that the directors should have faced the possibility of imprisonment for their omissions. The same analysis can be applied to Re. Hefferon Kearns Ltd. While the company was not liquidated on time,[63] the directors did seem overall to take sensible precautionary steps. Weekly directors' meetings were held,[64] bi-monthly financial statements were prepared,[65] the directors borrowed personally to support the company,[66] the company concentrated on its most profitable contract[67] and there were meetings with creditors.[68] To some extent the company's ultimate collapse can be blamed on the recession of the early 1990's.[69] Further, as was previously discussed, the applicant's loss was somewhat its own fault. It misunderstood the corporate

[58] [2009] IEHC 538 para.59
[59] Appleyard Motors Ltd. v Commissioner of Valuation Appeal No. VA04/1/022 para.4
[60] Re. Appleyard Motors Ltd. [2015] IEHC 28 paras. 9
[61] [2015] IEHC 28 para. 64-67
[62] [2015] IEHC 28 para.67
[63] [1993] 3 IR 191 at 224
[64] [1993] 3 IR 191 at 202
[65] [1993] 3 IR 191 at 200
[66] [1993] 3 IR 191 at 201
[67] [1993] 3 IR 191 at 202-203
[68] [1993] 3 IR 191 at 204-205
[69] [1993] 3 IR 191 at 208

structure, and a result was blasé about extending credit. Again, it is difficult to accept that the directors should have faced possible imprisonment in these circumstances.

What is also evident from the case law is that reckless trading behaviour often involves an omission as opposed to a positive action ie. omitting to liquidate the company in a timely manner, omitting to be sufficiently careful with customer's money or omitting to question more closely the executive director's actions. The criminal law has always been wary of imposing punishment for omissions,[70] though duties to take positive actions are currently increasing.[71] There are three reasons for this. Firstly, the offence will be one of vague terms; it will be impossible to proscribe what should and should not be done. Secondly, this creates too much discretion at prosecution level. The prosecutor in effect defines the scope of the law. The final objection is philosophical. Certain acts are morally reprehensible, omissions less so.[72]

**(v) Conclusions**

The question which arises is whether engaging in reckless trading is inherently wrongful. As Husak points out conduct should not be criminalised unless the state can justify punishing those who engage in the particular conduct[73] and, as we have seen, actions are criminal in nature if they are inherently wrong. This appears to mean that such acts are harmful[74] and thus deserve punishment.[75] Ultimately, however, whether conduct is criminalised or not is a question of degree[76] and the test at this stage may consist of a series of indications rather than a robust definition.[77]

Are those who engage in reckless trading in effect criminals? Reckless trading does, arguably, carry some of the hallmarks of a criminal activity. It is harmful. It is

[70] Ashworth, Principles of Criminal Law, 5th Edition (Oxford: Oxford University Press, 2006), p.44-47
[71] Ashworth, 'Positive Duties, Regulation and the Criminal Sanction' [2017] 133 LQR 606
[72] Ashworth, Principles of Criminal Law, 5th Edition (Oxford: Oxford University Press, 2006), p.45
[73] Husak, 'Malum Prohibitum and Retributivism' in Defining Crimes; Essays on the Special Part of the Criminal Law, Duff and Green (Eds). (Oxford: Oxford University Press 2005), p.68
[74] Ashworth, Principles of Criminal Law 5th Edition (Oxford: Oxford University Press, 2006), p.30
[75] Cornford, 'Rethinking the Wrongness Constraint on Criminalisation" [2017] 36(6) Law and Philosophy 615 at 624
[76] The Law Commission, Consultation Paper No. 195, Criminal Liability in Regulatory Contexts A Consultation Paper (August 2010), *para.3.5.* Ashworth, Principles of Criminal Law, 5th Edition (Oxford: Oxford University Press, 2006), p.25
[77] Dine, 'Punishing Directors' [1994] JBL 325 at 328.

detrimental to creditors and ultimately can be detrimental to the entire economy and financial system.[78] Even small-scale collapses can cause huge damage at community level. This is especially the case when the insolvent company has many creditors based in the local economy who are heavily reliant on it for business.[79] Alternatively, if inherent wrongfulness cannot be assigned to reckless trading, then the harm it causes may arguably require it to be criminally regulated as an activity which should be prohibited.

However, the LRC points out that the fact that reckless trading causes specific harm cannot by itself be a justification for criminalisation.[80] Creditors voluntarily accept the risk that they will not always be paid in full.[81] The risk to creditors is an inherent aspect of both company law and the corporate structure itself. It is also worthwhile remembering that the Australia and New Zealand both require dishonesty. This indicates that reckless trading exists in many hues not all of which are morally reprehensible. We see this is the case law too. The Kelly's deliberate plan to thwart two creditors is on a different scale to that of the directors in Re. Hefferon Kearns Ltd. whose main 'crime' may have derived from a lack of astuteness or luck as businessmen.

In summary, no clear conclusion can be arrived at. There are certainly some firm indications that reckless trading behaviour warrants criminalisation; specifically, it is harmful and it has been criminalised elsewhere. Moreover, director behaviour does require regulation. On the other hand, criminalisation abroad has been limited and relatively unsuccessful to date and, as we have seen from the case law, misjudgment of risk (Hefferon Kearns), incompetence (Appleyard) or naivety (Ms. Higgins in PSK Construction) may end up being criminally sanctioned as opposed to behaviour that is truly morally reprehensible or cannot be regulated by another means.

[78] Dabor, 'The Directors' Disqualification Compensation Order Regime: The Panacea for Preventing Corporate Abuse? [2018] 39(8) Comp. Law 243 at 243
[79] Konstantinov, Wrongful Trading: Comparative Approach (England and Wales, Russia and the USA) [2015] 2(1) BRICS LJ 100 at 106
[80] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para.12.123
[81] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para.12.23.

## (III) BENEFITS OF CRIMINALISATION

### (i) Introduction

Thus, while reckless trading does carry some of the indicia of an activity which warrants criminal prohibition, it is impossible to conclude that this is certainly the case. Therefore, examining the possible benefits of criminalisation may cast light on whether a criminal provision should be enacted. There are a number of possible benefits.

### (ii) Beneficial Aspects

#### (a) Impecunious Directors

As has been established previously, one major reason for the lack of invocation of the Irish reckless trading provision is that the directors of the failed company are impecunious. Indeed, impecunious directors are an oft-cited reason for the lack of reckless/wrongful trading applications in the UK and in other jurisdictions. The threat of being made personally liable for the debts of the company is no deterrent if the director is a 'man of straw'. The individual can behave as he or she chooses safe in the knowledge that the liquidator will not consider a section 610 action worthwhile. A director with limited personal resources will now face a real consequence, the possibility of incarceration or a fine. More importantly even a minor criminal conviction carries a social stigma and will impact on future economic prospects.[82] In summary, as well as sending a moral message, the effect of criminalisation, especially where the director concerned has no significant personal assets, may be significant. The possibility of criminal prosecution would mean that the misconduct now has consequences.

#### (b) Deterrence

It has been argued that criminal sanction works better to deter corporate actors than other individuals convicted of crimes. Corporate actors have more at stake such as status, reputation and possessions which can be lost through a criminal

[82] O'Malley, 'Sentencing White-Collar and Corporate Crime' in McGrath (Ed), White-Collar Crime in Ireland Law and Policy (Dublin: Clarus Press, 2019), pgs.182-183.

conviction.[83] As Feinberg states with regard to the criminally convicted "*The punishments themselves brand him with society's most powerful stigma and undermine his life projects, in career or family, disastrously*."[84] Further, corporate actions are usually not spur of the moment. Instead they are calculated risks taken by rational actors[85] who will over a period of time weigh up the potential benefits against the potential consequences.[86] Also, as the Parliamentary Commission on Banking Standards has stated that the existence of a criminal penalty would concentrate minds.[87] The Australian Senate Economics References Committee has taken a similar view regarding white collar crime.[88] In effect, the harsher penalties and the social stigma attaching to a criminal conviction are powerful deterrents.[89] This chimes well with the policy of deterrence underpinning reckless trading.[90]

The above is the theory. The practical outcomes must now be examined. While the evidence overall appears to be inconclusive, there are anecdotal indications at least that punitive regulatory action does in a general sense have a deterrent effect.[91] In particular, Quo argues that the very indistinctiveness of the dishonesty requirement in New Zealand law may encourage compliance. She states that the use of dishonesty may promote ethical conduct because there is often a cognitive dissonance between what the public sees as morally wrong and what existing laws proscribe as unlawful.[92] Thus as well as the potential deterrent

[83] Braithwaite and Geis, 'On Theory and Action for Corporate Crime' [1982] 28(2) Crime & Delinquency 292 at 302
[84] Feinberg, Harm to Others (Oxford: Oxford University Press, 1987), p.4
[85] Braithwaite and Geis, 'On Theory and Action for Corporate Crime' [1982] 28(2) Crime & Delinquency 292 at 302
[86] Reich, Saving Capitalism; For the Many, Not the Few, (London: Icon Books Ltd., 2015), pgs.74-75.
[87] Parliamentary Commission on Banking Standards, Changing Banking for the Good: Vol 1 Summary, and Conclusions and Recommendations' (London June 2013), para.243. See also HM Treasury, The Government's Response to the Parliamentary Commission on Banking Standards (London July 2013) Cmnd 8661 para.3.26.
[88] Senate Economics References Committee, Lifting the fear and suppressing the greed': Penalties for white-collar crime and corporate and financial misconduct in Australia, (Canberra March 2017), para.4.65.
[89] Ashworth, Principles of Criminal Law, 5th Edition (Oxford: Oxford University Press, 2006), p.16.
[90] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para.12.52.
[91] Baldwin, 'The New Punitive Regulation' [2004] 67(3) MLR 351 at 361.
[92] Quo, 'Criminalisation of Breach of Directors' Duties: An Analysis of the Insolvent Trading Offence in New Zealand and Australia and the Requirement to Prove Dishonesty' [2015] 36(12) The Company Lawyer 371 at 380

effect, criminalisation of breaches of directors' duty to prevent insolvent trading in Australia and New Zealand is part of a trend to foster ethical behaviour in the corporate sphere. It has also been found that the increasing regulatory burden on businesses generally has not deterred new entrants to the market.[93] As Glasbeek states the imposition of criminal liabilities on directors is not new and does not appear to have deterred suitable candidates from coming forward.[94] Therefore, criminalisation may well bring the twin benefits of deterring unacceptable trading behaviour and improving business ethics.

**(c) Improving Standards of Behaviour**

Criminal law has played an educative role by informing and shaping society's perceptions of moral standards. Coffee considers that criminal law can be a system for moral education and can shape societal preferences.[95] There is arguably a close link between criminal law and behaviour deemed morally culpable by the general community. Criminal legislation can reinforce societal pressures.[96] Quo argues that recognising the moral dimension of the New Zealand criminal provisions will provide public, political and institutional support for the regime and lead to its effective enforcement. She argues that it should also boost the deterrence value of the section by facilitating the internalisation of relevant moral norms in the business community in order to secure long-term compliance.[97] Thus a potential benefit of criminalising reckless trading may be an increased public perception that corporate behaviour has a moral element and can be inherently wrong. However, legislation may not be the best way to achieve commercial morality as it tends to be results based and is often accessed by those affected on the basis of costs and tends to encourage a minimum response.[98] That said, while this may well be the case, even a limited

[93] The Law Commission, Consultation Paper No. 195, Criminal Liability in Regulatory Contexts A Consultation Paper (London, August 2010) para.7.14.
[94] Glasbeek, 'More Direct Director Responsibility: Much Ado About..What?.' [1997] 25(3) Canadian Business Law Journal 416 at 447
[95] Coffee, 'Paradigms Lost: The Blurring of the Criminal and Civil Law Models-And What Can Be Done About It' [1992] 101(8) Yale Law Journal 1875 at 1877
[96] Feinberg, Harm to Others (Oxford: Oxford University Press, 1987), p.4
[97] Quo, 'Criminalisation of Breach of Directors' Duties: An Analysis of the Insolvent Trading Offence in New Zealand and Australia and the Requirement to Prove Dishonesty' [2015] 36(12) The Company Lawyer 371 at 381
[98] Commonwealth of Australia, Company Directors' Duties. Report by Senate Standing Committee on Legal and Constitutional Affairs (November 1989) ('The Cooney Report'), para.10.10

response will have beneficial effects. Further, the level of the response may increase as the particular value (avoidance of reckless trading type behaviours) becomes embedded in the corporate sphere as a result of criminalisation.

**(d) The Influence of Elites**

A question which follows from the above issues is that of the influence of elites. Does the fact that corporate misbehaviour has not traditionally been criminalised arise because such behaviour is not actually morally wrong or does this situation stem from the influence of powerful interests who create a perception that such actions are not actually criminal in nature?[99] If the reason is the influence of elites, then a potential benefit of criminal enforcement of reckless trading is a weakening of that impact. The same question can be applied to the lack of enforcement where criminal legislation exists. It has been argued that criminal law is a social product which is inordinately influenced by powerful social elites.[100] Due to this domination, white collar criminals are less likely to be punished than those from the lower strata of society. Thus white-collar criminals avoid the full reach of the Irish criminal justice system, whereas the poorer classes do not.[101]

Moreover, vested interests can work to influence the formulation of regulatory legislation in order to subvert or dilute the provisions.[102] Specifically, Quo states, with regard to the New Zealand legislation criminalising breaches of directors' duties that the final provisions bore little resemblance to the original proposals owing to criticism by politically powerful interest groups.[103] It must therefore be asked whether in arguing against criminalisation of reckless trading, are we

[99] McGrath, 'The Colonisation of Real Crime in the Name of All Crime' in Kilcommins and Kilkelly (Eds), Regulatory Crime in Ireland, (Dublin: First Law/Lonsdale Law Publishing Dublin, 2010), p.58
[100] McCullagh, 'Two-Tier Society, Two-Tier Crime, Two-Tier Justice' in Kilcommins and Kilkelly (Eds), Regulatory Crime in Ireland, (Dublin: First Law/Lonsdale Law Publishing Dublin, 2010), p.143
[101] Kilcommins and Vaughan, 'The Rise of the Regulatory Irish State: A Response to Colin Scott' in Kilcommins and Kilkelly (Eds), Regulatory Crime in Ireland, (Dublin: First Law/Lonsdale Law Publishing Dublin, 2010), p.91
[102] MacKenzie and Green, 'Performative Regulation. A Case Study in How Powerful People Avoid Criminal Labels' [2008] 48(2) Brit. J. Criminol 138 at 141.
[103] Quo, 'Criminalisation of Breach of Directors' Duties: An Analysis of the Insolvent Trading Offence in New Zealand and Australia and the Requirement to Prove Dishonesty' [2015] 36(12) The Company Lawyer 371 at 372

simply prey to social prejudices? Is there any reason why a director who causes avoidable losses of €100,000 to creditors should be treated more leniently than a drug addict who steals €1,000?[104] Thus a potential benefit of criminalisation is that this divergence in treatment may be reduced.

However, this is likely to be an overly simplistic and trite approach. The vast majority of companies are small affairs and thus, as a matter of statistical probability, do not consist of powerful individuals comprising an influential economic elite. Moreover, the Law Commission has noted that *"... ... much modern criminal legislation is in practice likely to have a great deal of its primary impact on small business activity."*[105]

Indeed, in arguments in favour of criminalising corporate behaviour there may be an implicit and incorrect assumption that companies are *'powerful'*[106] and thus criminalisation levels the playing field in some manner. As became obvious during the financial collapse, many small companies lead a precarious existence and are creditors themselves, dependent on timely payment by their own customers. This is illustrated by case law. Even though it is highly unlikely that PSK Construction would have survived the recession, it was significantly weakened by the fact that a major client was underpaying it by up to €40,000 per fortnight.[107] While Ireland undoubtedly has a number of large and influential companies, classifying all corporate actors as members of a powerful elite does not stand up to scrutiny.

In reality, most white-collar criminals may be from the middle rather than the upper strata of society.[108] The reckless trading case law also appears to bear this

[104] O'Malley poses this question in the context of white-collar crime. O'Malley, 'Sentencing White-Collar and Corporate Crime' in McGrath (Ed), White-Collar Crime in Ireland Law and Policy (Dublin: Clarus Press, 2019), p.184.
[105] The Law Commission, Consultation Paper No. 195, Criminal Liability in Regulatory Contexts A Consultation Paper (London, August 2010) para.7.17
[106] McCullagh, 'Two-Tier Society, Two-Tier Crime, Two-Tier Justice' in Kilcommins and Kilkelly (Eds), Regulatory Crime in Ireland, (Dublin: First Law/Lonsdale Law Publishing Dublin, 2010), p.143.
[107] [2009] IEHC 538 para.30
[108] Weisburd and Schlegel, 'Returning to the Main-Stream Reflections on Past and Future White Collar Crime Study' in Schlegel and Weisburd (Eds), White Collar Crime Reconsidered (Boston, MA: North Eastern University Press, 1992), p.355

point out. Indeed, it is interesting to note, that the directors found to have been involved in reckless trading were of a lower socio-economic status; a mechanic, an office administrator and a construction worker respectively. While the Appleyard[109] directors appear to have been relatively wealthy individuals prior to the recession, none of the directors in the cases present themselves as members of a privileged and influential elite. Likewise, the large body of case law involving restriction and disqualification orders also bears this point out.[110]

Finally, Horan notes the widely held perception that there is a reluctance to imprison white collar criminals. This perception may be misplaced. She goes onto explain that this may arise from the fact that such individuals usually have no previous convictions, have a record of good character, are unlikely to reoffend and, in some instances (tax crimes, for example) will already have made financial settlements.[111]

## (IV) LIMITATIONS OF CRIMINALISATION

### (i) Introduction

Having established that reckless trading has hallmarks of behaviour warranting criminal sanction and that its criminalisation would undoubtedly carry some benefits, we must now examine the difficulties, in a general sense, which have been encountered when actions become the focus of criminal sanction. Criminalisation is not a panacea. Indeed, it has many acknowledged weaknesses. O'Malley cautions against a rush to legislation. The need for a measure must be carefully assessed having regard to the nature of the misbehaviour, the environment and circumstances in which it occurs and evidence-based projections about the nature of the problems likely to be experienced in the particular area in the future.[112]

[109] [2015] IEHC 28 and [2016] IECA 280

[110] Specifically, restaurant owners **(**Re. Mint Restaurant Ltd. [2014] IEHC 370) a shopkeeper (La Moselle Clothing Ltd. v Soualhi [1998] 2 ILRM 345) a public house and nightclub operator (Re. Gingersnap Ltd. [2016] IEHC 177) the directors of company was involved in the contract painting of aluminium (Cahill v O'Brien [2015] IEHC 817) and a general convenience store keeper (Re. DCS Ltd. [2006] IEHC 179)

[111] Horan, Corporate Crime (Bloomsbury Professional 2011), paras.7.107-7.109

[112] O'Malley, 'Sentencing White-Collar and Corporate Crime' in McGrath (Ed), White-Collar Crime in Ireland Law and Policy (Dublin: Clarus Press, 2019), p.194.

### (ii) Limitations

#### (a) Lack of Enforcement

While complete enforcement of any crime is a chimera,[113] that laws in the corporate field fail not through a deficiency in the provision itself but through lack of enforcement has a long history.[114] The Cooney Report identified this as an issue as long ago as 1989.[115] This is a significant issue as laws 'on the books' have little value if they are not supported by effective enforcement.[116] Likewise, the Report found that where legislation provides for imprisonment, the judiciary appears reluctant to impose such sanctions.[117] Indeed, matters may not be significantly different today. In 2017 Hedges et al concluded that disqualification orders are the dominant mode by which company law is enforced in Australia.[118] Steele et al noted that directors trading insolvently were rarely criminally prosecuted.[119] This issue has been identified in Ireland also; we are unwilling to incarcerate white collar criminals.[120] That said jurisdictions differ. The United States authorities, for example, regularly use the criminal justice system in the corporate world.[121] Canada has had a similar experience to Ireland; Snider states that examples of leniency abound.[122]

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[113] Packer, The Limits of the Criminal Sanction (Stanford: Stanford University Press, 1968), p.286
[114] For a history of inertia in Ireland see McGrath, Corporate and White-Collar Crime in Ireland. A New Architecture of Regulatory Enforcement (Manchester: Manchester University Press, 2015), pgs. 30-46 and pgs.67-85.
[115] Commonwealth of Australia, Company Directors' Duties. Report by Senate Standing Committee on Legal and Constitutional Affairs (November 1989) ('The Cooney Report'), para.10.21-10.24
[116] Packer, The Limits of the Criminal Sanction (Stanford: Stanford University Press, 1968), p.287.
[117] Commonwealth of Australia, Company Directors' Duties. Report by Senate Standing Committee on Legal and Constitutional Affairs (November 1989) ('The Cooney Report'), para.13.6
[118] Hedges et al, 'Banning Orders: An Empirical Analysis of the Dominant Mode of Corporate Law Enforcement in Australia' [2017] 39 Sydney L. Rev 501. The types of orders considered are described at 507.
[119] Steele et al 'Insolvency Reform in Australia and Singapore. Directors' Liability for Insolvent Trading and Wrongful Trading' [2019] 28 Int. Insolv. Rev. 363 at 388
[120] Lynch Fannon, 'Controlling Risk Taking: Whose Job Iss It Anyway?' in Kilcommins and Kilkelly (Eds), Regulatory Crime in Ireland, (Dublin: First Law/Lonsdale Law Publishing Dublin, 2010), p.116. That said, as have been mentioned previously, Horan has a different explanation for this phenomenon. Horan, Corporate Crime (Bloomsbury Professional 2011), paras.7.107-7.109
[121] Coffee, 'Law and the Market. The Impact of Enforcement' [2007] 156 University of Pennsylvania Law Review 229 at 274-276
[122] Snider, The Criminological Lens in O'Brien, Governing the Corporation: Regulation and Corporate Governance in an Age of Scandal and Global Markets (Oxford: Wylie, 2005), p.177. See previous comments, however. Per Horan this may not be leniency.

If corporate enforcers fail to pull the trigger on criminal sanctions, this undermines the credibility of the regulatory architecture.[123] The regulator must demonstrate activity as opposed to passivity.[124] If regulators do not punish, then corporate actors have no reason to adopt a compliance orientated approach.[125] As Scott argues a regulatory regime which is based on draconian punishment measures alone will struggle to establish credibility as the sanctions can only be used for the worst breaches. Thus, those involved in lesser breaches will probably correctly conclude that they will not be sanctioned at all.[126]

Pontell and Calavita indicate that enforcement agencies may only invoke criminal sanctions for cases they know that they will win.[127] This can be a sensible policy as it makes the enforcement agency appear invincible thus encouraging those considering non-compliance to comply.[128] However, on the other hand it could exacerbate the non-enforcement issues that bedevil company law in Ireland. The clever or well-advised director will thus be fully aware that all but the most audacious forms of corporate misbehaviour will escape criminal sanction entirely.

Indeed, limited enforcement of the criminal parts of the company law code already appears to be occurring in Ireland. The ODCE's own recent report states *"As has been set out in detail in previous Annual Reports, in recent years the Office has made a conscious policy decision to devote less resources towards pursuing criminality on the less serious end of the spectrum in favour of concentrating its resources on investigating more serious indications of*

[123] Hodges, Law and Corporate Behaviour; Integrating Theories of Regulation, Enforcement, Compliance and Ethics (Oxford and Portland, Oregon: Hart Publishing, 2015), p.1637.
[124] Hawkins, Law as Last Resort. Prosecution Decision-Making in a Regulatory Agency (Oxford: Oxford University Press, 2002), pgs.229-230
[125] McGrath, Corporate and White-Collar Crime in Ireland. A New Architecture of Regulatory Enforcement (Manchester: Manchester University Press, 2015), p.169
[126] Scott, 'The Regulatory State and Beyond' in Drahos (ed) Regulatory Theory Foundations and Applications (ANU Press 2017), p.272.
[127] Pontell and Calavita, 'Bilking Bankers and Bad Debts White Collar Crime and the Savings and Loan Crisis' in Schlegel and Weisburd (Eds), White Collar Crime Reconsidered, (Boston, MA: North Eastern University Press, 1992), p.197.
[128] Hawkins, Law as Last Resort. Prosecution Decision-Making in a Regulatory Agency (Oxford: Oxford University Press, 2002), p.233

*wrongdoing."*[129] Further, the ODCE's historic prosecution record is limited to a very narrow range of offences. While there are four hundred criminal offences in the Companies Act, only three types of offence are actively pursued.[130] In 2018 no summary prosecutions were initiated by the ODCE. Only two indictable prosecutions were forwarded to the DPP; one on foot of the Criminal Justice (Theft and Fraud Offences) Act 2001 and the Criminal Justice (Money Laundering and Terrorist Financing) Act 2010 and the other for criminal fraudulent trading.[131] Heretofore, the ODCE had largely prosecuted summarily in the District Court. Its first indictable prosecution was in 2011.[132] Further, the number of convictions being sought by the Director has declined over[133] and this policy has continued in recent years.[134] The ODCE Annual Report 2019 indicates that only one summary prosecution was initiated in that year.[135] There were three confirmed indictable prosecutions; two under the Criminal Justice (Theft and Fraud Offences) Act, 2001 and one involving a charity.[136] The ODCE Annual Report 2020 shows similarly low figures.[137]

The UK Law Commission also has views on the under-enforcement issue. It considers that criminalisation may mean that prosecutions will only be brought for offences which are clearly defined and have a visible result. Complex cases involving less well delineated concepts may be only partially enforced.[138] Armour states that in the UK four categories of misbehaviour are frequently prosecuted. A range of other regulatory offences are, however, barely prosecuted

[129] ODCE Annual Report 2018 (Dublin 2019) p.46. This issue may be ameliorated by the passing of the Companies (Corporate Enforcement Agency) Bill 2018.
[130] McGrath, Corporate and White-Collar Crime in Ireland. A New Architecture of Regulatory Enforcement (Manchester: Manchester University Press, 2015), p.167
[131] ODCE Annual Report 2018 (Dublin 2019), p.47
[132] McGrath, 'Twenty Years Since the McDowell Report: A Reflection on the Powers and Performance of the Office of the Director of Corporate Enforcement' [2018] 60(60) Irish Jurist 33 at 52
[133] McGrath, 'Twenty Years Since the McDowell Report: A Reflection on the Powers and Performance of the Office of the Director of Corporate Enforcement' [2018] 60(60) Irish Jurist 33 at 53
[134] ODCE Annual Report 2018 (Dublin 2019), p.47
[135] ODCE Annual Report 2019 (Dublin 2020), p.46
[136] ODCE Annual Report 2019 (Dublin 2020), p.47
[137] ODCE Annual Report 2020 (Dublin 2021), p.39
[138] The Law Commission, Consultation Paper No. 195, Criminal Liability in Regulatory Contexts A Consultation Paper (London, August 2010) para.A.21

at all.[139] There is evidence that this trend is occurring in Australia.[140] Some breaches of directors' duties could be criminally sanctioned in Australia since 1958,[141] however, ASIC did not become active in enforcement until a civil penalty regime was introduced.[142] Indeed, the Australian courts' attitude towards the imprisonment of business people has been described as cautious and conversative.[143] For criminal sanctions to be effective, the regulator must be prepared to use the provisions at its disposal.[144] Thus while there have been instances in Australia of imprisonment for insolvent trading,[145] as Steele and Ramsay state ASIC typically relies on other sanctions rather than criminal enforcement. Indeed, allegations of civil insolvent trading by insolvency practitioners vastly exceed allegations of criminal insolvent trading. [146]

In conclusion, the previously discussed lack of criminal prosecution by the ODCE does not bode well for the enforcement of a criminalised reckless trading offence. If limited prosecutions occur, we could end up with a situation where private civil proceedings are abolished (or remain in their current abeyance) but criminal prosecutions are not pursued either except on indictment for rare egregious examples of reckless trading type behaviour. Very arguably, creditors are better served on foot of the current position. As Hodge states a system based on deterrence only works if there is a high level of detection and enforcement.[147]

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[139] Armour, 'Enforcement Strategies in Corporate Governance: A Roadmap and Empirical Assessment' in Armour and Payne, Rationality in Company Law. Essays in Honour of DD Prentice, (Oxford: Hart Publishing, 2009)
[140] Quo, 'Criminalisation of Breach of Directors' Duties: An Analysis of the Insolvent Trading Offence in New Zealand and Australia and the Requirement to Prove Dishonesty' [2015] 36(12) The Company Lawyer 371 at fn.8
[141] Keay and Welsh, 'Enforcing Breaches of Directors' Duties by a Public Body and Antipodean Experiences' [2015] 15(2) Journal of Corporate Law Studies 255 at 257.
[142] Welsh, 'Realising the Public Potential of Corporate Law: Twenty Years of Civil Penalty Enforcement in Australia' [2014] 42 (1) Federal Law Review 217 at 233
[143] Gilligan et al, 'Penalties Regimes to Counter Corporate and Financial Wrongdoing in Australia – Views of Governance Professionals' [2017] 11(1) Law and Financial Markets Review 4 at 7.
[144] The Law Commission, Consultation Paper No. 195, Criminal Liability in Regulatory Contexts A Consultation Paper (London, August 2010) para.A.23
[145] Steele and Ramsay, 'Insolvent Trading in Australia. A Study of Court Judgments from 2004 to 2017' [2019] 27 Insolvency Law Journal 156 at p. 176.
[146] Steele and Ramsay, 'Insolvent Trading in Australia. A Study of Court Judgments from 2004 to 2017' [2019] 27 Insolvency Law Journal 156 at 167
[147] Hodges, Law and Corporate Behaviour; Integrating Theories of Regulation, Enforcement, Compliance and Ethics (Oxford and Portland, Oregon: Hart Publishing, 2015), p.132

Further, the ODCE currently uses the pyramidal model of enforcement.[148] Criminal sanction is seen as a last resort.[149] Hence not criminalising reckless trading is more in keeping with the ODCE's own enforcement methodology; criminal sanction should be used only against the most serious of company law breaches or serial misbehaviour. This view is also endorsed by the LRC.[150]

**(b) The Director of Corporate Enforcement**

There is the further issue that the ODCE may expend significant resources pursuing unsuccessful criminal prosecutions. The agency has had only mixed success in obtaining civil disqualification orders against high-profile company executives.[151] It does to some extent lack expertise.[152] Further, if we accept that reckless trading is motivated by fear of financial loss, it will be more prevalent during periods of economic crisis. However, it may be that state regulatory activity is reduced during such periods so as to encourage economic growth[153] or, indeed, as part of a government cost saving exercise, the resources provided to the regulator may be cut, thus limiting its effectiveness.

Ultimately resource constraints mean that many breaches are either not detected in the first place or, if they are, are not fully investigated and prosecuted. Information asymmetries can be a problem.[154] Enforcement activity may only be initiated in a small percentage of cases. The regulator must exercise discretion as to which apparent breaches are investigated and, of the ones investigated,

[148] Appleby, 'Compliance and Enforcement – the ODCE Perspective' in Regulatory Crime in Ireland Kilcommins and Kilkelly (Eds) (First Law/Lonsdale Law Publishing Dublin 2010). This model was developed by Ayres and Braithwaite. Ayres and Braithwaite, Responsive Regulation: Transcending the Deregulation Debate, (Oxford: Oxford University Press, 1992).
[149] Gethings, 'Corporate Enforcement 'Ominshambles' or Alternative Regulatory Mechanism: An Objective Analysis of the ODCE' [2018] 36(19) ILT 294 at 296
[150] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para.12.142
[151] McGrath, 'Twenty Years Since the McDowell Report: A Reflection on the Powers and Performance of the Office of the Director of Corporate Enforcement' [2018] 60(60) Irish Jurist 33 at 51
[152] McGrath, 'Twenty Years Since the McDowell Report: A Reflection on the Powers and Performance of the Office of the Director of Corporate Enforcement' [2018] 60(60) Irish Jurist 33 at 61.
[153] Benson, Cullen, Maakestad, 'Community Context and the Prosecution of Corporate Crime' in Schlegel and Weisburd (Eds) White Collar Crime Reconsidered (Boston MA: North-Eastern University Press 1992), p.281.
[154] Gilchrist, 'Accountability Lost and the Problem of Asymmetry' [2019] 50(3) Loyola University of Chicago Law Journal 599

which ones are formally enforced.[155] Thus the complexity of criminal prosecution may lead to only a limited number of investigations and an even more limited number of cases.[156] Ultimately, criminal sanctions in the area of corporate regulation may prove inadequate because detection, prosecution and conviction rates prove to be too low.[157] This general principle could easily apply to reckless trading.

The ODCE itself has examined the issue of whether reckless trading should be a criminal offence.[158] The agency considered that not enough research has been undertaken to allow it form a definitive view and stated that criminalisation of reckless trading is unusual internationally.[159] Further, these considerations were also made against the background of the banking collapse[160] and may perhaps be viewed in light of the office's need to examine this issue as reckless trading risks would have been amplified by the media during and post the financial crisis.[161] Thus, the endorsement of an expert body with practical experience in the area is lukewarm at best.

**(c) Weaknesses within the ODCE**

It must be acknowledged that events in the wake of the financial crisis have exposed serious short comings in the ability of the ODCE to successfully prosecute criminal offences. The high-profile trial of Sean Fitzpatrick, the former chairman of Anglo-Irish Bank plc. collapsed due to very serious procedural failures at regulatory level.[162] This demonstrates the difficulties which even a generally efficacious body such as the ODCE can encounter in the criminal field. The issues were legion. Highly important statements of two key witnesses were drafted and prepared as if they were civil affidavits. The ODCE

[155] Welsh, 'Realising the Public Potential of Corporate Law: Twenty Years of Civil Penalty Enforcement in Australia' [2014] 42 (1) Federal Law Review 217 at 232
[156] Indeed, as previously pointed out, this may be happening already.
[157] Keay and Welsh, 'Enforcing Breaches of Directors' Duties by a Public Body and Antipodean Experiences' [2015] 15(2) Journal of Corporate Law Studies 255 at 261
[158] ODCE, Submission on White Collar Crime (Dublin 2010), paras. 13-14
[159] ODCE, Submission on White Collar Crime (Dublin 2010), fn.11.
[160] ODCE, Submission on White Collar Crime (Dublin 2010), para.14
[161] Baldwin, Black, 'Driving Priorities in Risk Based Regulation: What's the Problem?' [2016] 43(4) Journal of Law and Society 265 at 279
[162] See Gethings, 'Corporate Enforcement 'Ominshambles' or Alternative Regulatory Mechanism: An Objective Analysis of the ODCE' [2018] 36(19) ILT 294

negotiated with witnesses' solicitors as to what should be contained in statements. Moreover, the witnesses were coached, and evidence was scripted. As a result, it was not obvious to the ODCE that there was very little or no actual evidence to support many of the charges. More astonishingly, important documents were shredded by the lead investigator. Overall, the ODCE's approach was biased and partisan. They regarded themselves as 'building a case' against Mr. Fitzpatrick and not objectively determining whether or not laws had been breached. [163] A lack of coordination within the Office was also identified as a cause of its failings.[164] Important issues were not fully investigated. Speaking about the lead investigator, Judge John Aylmer stated *"Unfortunately, he had no previous experience relevant to the proper investigation of indictable offences. As a consequence of that inexperience, he has admitted in evidence before me and before the jury that he made many fundamental errors in the investigation"*[165]

While the reasons for the failures have been fully investigated and understood and steps taken to ensure that the ODCE is equipped to undertake complex criminal investigations in the future,[166] the Fitzpatrick case does nevertheless clearly demonstrate the significant challenges which may be faced by a public body in this area. Indeed, as the LRC stated the ruling in Fitzpatrick begs the question as to *"…. whether the current system is capable of taking effective action when serious corporate offending is discovered and when a criminal prosecution on indictment (as opposed to regulatory enforcement or summary prosecution) is the appropriate enforcement route."*[167]

[163] The People (DPP) v Fitzpatrick. Unreported judgment. Circuit Criminal Court (Judge Aylmer), unreported 23 May 2017
[164] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 1: Regulatory Powers (Dublin 2018), para.1.55 and paras.6.03-6.04
[165] The People (DPP) v Fitzpatrick. Unreported judgment Circuit Criminal Court (Judge Aylmer), 23 May 2017.
[166] Department of Business, Enterprise and Innovation. 'An account of the shortcomings identified by Judge Aylmer of the Circuit Court concerning an investigation by the Office of the Director of Corporate Enforcement' (Dublin December 2018).
[167] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 1: Regulatory Powers (Dublin 2018), para.1.56

A key proposal to increase the efficacy of the ODCE in the criminal sphere is to reestablish it as a statutory agency. Such a step would "*provide greater autonomy to the Agency in relation to staff resources and ensure it is better equipped to investigate increasingly complex breaches of company law."*[168] Legislation, in the form of the Companies (Corporate Enforcement Agency) Bill 2018 was published and it is expected that this Bill will be enacted shortly. The new Agency would have the authority to appoint its own staff. The Agency would also have more discretion as to its use of resources. The question also arises as to whether these steps will, by themselves, be sufficient. Overall, the weaknesses highlighted by the Fitzpatrick case combined with government inaction to date concerning reform raises questions on the efficacy of criminal prosecution.

**(d) Criminalisation and Risk-Taking**

It must also be recognised that reckless trading as a concept is different from most other provisions within the corporate code which carries criminal sanction (such as section 247 or section 286). Reckless trading involves corporate risk-taking which is the raison d'etre of company law. The purpose of the corporate structure is to facilitate risk-taking. In light of this, should reckless trading be criminalised? The risk of failure is inevitable and unavoidable. It is something which all corporate actors accept. Therefore, the question which must be asked is whether embedding a criminal sanction within section 610 will criminalise ordinary business failure. It must also be asked what the consequences of this might be.

Indeed, the LRC's deliberations with regard to criminalisation are limited to a narrow category of negative risk-taking;[169] situations where a director consciously disregards substantial and unjustifiable operational risk-taking that actually and culpably results in harm to creditors.[170] This is similar to the path

[168] Department of Business, Enterprise and Innovation. 'An account of the shortcomings identified by Judge Aylmer of the Circuit Court concerning an investigation by the Office of the Director of Corporate Enforcement' (Dublin December 2018), p.10.
[169] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para.12.04
[170] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para.12.10

taken in the UK. It was recommended that a criminal offence based on excessive risk-taking or recklessness be introduced but only in the context of banking operations.[171] HM Treasury considered that defining excessive risk within a financial institution would require a clear idea of what constitutes normal risk-taking. The business of banking inevitably involves taking risks.

The LRC's deliberations did not favour a specific offence of reckless trading.[172] In contrast to New Zealand, it was considered that there was too high a chance that such a step would have a chilling effect on commercial endeavour[173] and be *"…very detrimental to the proper functioning of corporate life in Ireland."*[174] As an alternative it is suggested that further investigations be made as to whether existing fraud offences might cover the same set of facts.[175] Ultimately, the Commission considered that a specific reckless trading offence would be too difficult to make workable. There are essentially two reasons for this; firstly, there are practical difficulties such as from which creditor's perspective do you determine the substance and lack of justification of the risk. Secondly, and of more fundamental significance, a criminal offence would have a dampening effect on corporate risk-taking. The Commission concluded that it would prove too difficult to preserve fully the ability of directors to engage in beneficial (albeit risky) activities while adequately restricting their scope to engage in irresponsible risk-taking to the detriment of creditors.[176]

The LRC highlights the practical issues which arise with regard to the interface between commercial risk-taking and the criminalisation of reckless trading. Specifically, how are the positive forms of commercial risk-taking to be

[171] HM Treasury, The Government's Response to the Parliamentary Commission on Banking Standards (July 2013) Cmnd 8661 para.3.26
[172] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para.12.140.
[173] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para.12.134.
[174] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para.12.135
[175] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para.12.135
[176] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para.12.140

supported within the context of a criminalised provision?[177] A business decision may represent an obvious and serious risk to creditors, but the risk may be fully justified within its commercial context. The taking of an entrepreneurial risk that has a potentially extremely high benefit to the company may be justifiable, even if it, at the same time, poses a significant or serious risk to creditors.[178] It is significant to note that the courts in New Zealand grappled with this precise issue in the context of sections 135 and 136 Companies Act, 1993.

Arguably behaviours should not be criminalised because controllers have simply misjudged risk as this would result in directors who have merely overestimated the firm's prospects or financial position in what was a fast moving and perhaps fraught environment being criminally sanctioned. Effectively, those who keep going because they could not care less and those who simply misjudge the risks are equally punished. The latter hardly warrants imprisonment at worst or a fine and a criminal record (with the consequent impacts on social standing and future employment) at best. The Cooney Reports analysis appears correct and prescient in this regard. Criminal sanctions should exist for directors' behaviour which is truly criminal in nature.[179]

Importantly, the LRC recognises the difficulty in separating unacceptable risk-taking from acceptable risk-taking. The standard is context-sensitive in nature.[180] This is indeed correct. Within a range, there will be outliers on either side; risk-taking that was clearly acceptable or unacceptable (for example continuing to trade for a short time while clearly insolvent in order to complete a lucrative order as compared to preparing fraudulent tax returns and trading with the proceeds). However, there will inevitably be a large context driven mid-range where it will be difficult to determine where considered and judged decision-making as to risk ends and culpability begins. It is directors within that gamut

[177] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para.12.113
[178] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para.12.115
[179] Commonwealth of Australia, Company Directors' Duties. Report by Senate Standing Committee on Legal and Constitutional Affairs (November 1989) ('The Cooney Report'), para.13.5
[180] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para.12.33

who will be exposed to the possibility of criminal conviction. This may be a strong argument as to why reckless trading should not be criminalised; it is simply impossible to identify with any precision the boundary between acceptable and unacceptable risk-taking. This lack of precision, while unsatisfactory in a civil context, is perilous where criminal liability is in issue.

**(e) The Standard of Proof**

Lynch Fannon provides further cogent and practical criticism on this issue. Her concern is that the difficulties inherent with regard to the criminalisation of reckless trading would be compounded by the higher standard of proof.[181] Beyond reasonable doubt is far more difficult standard especially in the commercial sphere. Considerations of natural justice and fair procedures are far more acute in criminal law. The Supreme Court's warnings in Re. Tralee Beef and Lamb Ltd.[182] which involved a straightforward restriction order may be a harbinger of the complexities which will be encountered regarding to a criminalised reckless trading provision.[183] Thus the intricacies of the law or the intricacies of the company's books may mean that it is difficult to prove the case beyond a reasonable doubt.[184] This stems from the nature of risk-taking itself and the previously discussed difficulties which exist in mapping the parameters of acceptable risk. As Igoe states, *"The onus of proof in criminal cases has been sufficient to discourage prosecutions in unknown numbers of commercial cases"*[185] It might also be necessary to prove causation. This could be difficult as there may be a considerable time lapse between the taking of a decision and its adverse impact. A great many things could have happened in the meantime which would have affected the outcome. Further, hindsight bias would have to be discounted.

[181] Lynch-Fannon, 'Reckless Trading: Good and Bad Risk-taking in Irish Companies' [2017] 24(1) CLP 7, at 12.
[182] [2008] IESC 1
[183] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7 at 12.
[184] Braithwaite and Geis, 'On Theory and Action for Corporate Crime' [1982] 28(2) Crime & Delinquency 292 at 298
[185] Igoe, 'Use of Civil Law Remedies to Combat Corporate Fraud' [1997] 15 ILT 94 at 95

**(f) Costs and Time**

There are further practical difficulties with regard to the criminalisation of reckless trading. Specifically, it has been mentioned previously that the time and expense of reckless trading civil proceedings may be a reason why so few cases are taken. For example, in Re Continental Assurance Co. of London plc., where one non-executive director was cross-examined for four days,[186] the hearing itself lasted an astonishing seventy-two days.[187] These problems can be compounded in criminal trials. As the government's recent report Measures to Enhance Ireland's Corporate, Economic and Regulatory Framework[188] states court hearings in relation to complex financial transactions tend to be protracted. Indeed, that criminal prosecution entails significant costs from the state's standpoint and that these are rarely recouped was pointed out as long ago as 2001 by the CLRG.[189] Specifically, the Fitzpatrick case[190] became bogged down in weeks of legal argument prior to its collapse.[191] A difficulty which arises from this is that if the offence is an indictable one the jury must make themselves available for long periods. Technology and concluding pre-trial legal issues in advance of empanelling are suggested as possible solutions.[192] However, these proposals do not detract from the fact that protracted enforcement is also problematical as it impedes the prospect of success and meaningful sanction.[193] Further, lay people may simply not be suited to answering what is often the essential question here; whether the company was liquidated in time. Judging the profitability of even a simple business is complex.[194] Without a thorough understanding of accounting concepts and a sense for what it is like to make business judgments in real time, leaving this essential question to a jury may

[186] [2007] 2 BCLC 287 para.20
[187] [2007] 2 BCLC 287 para.90.
[188]Department of Business, Enterprise and Innovation, Measures to Enhance Ireland's Corporate, Economic and Regulatory Framework, Ireland combatting 'white-collar' crime (Dublin 2017), para.2.4
[189] CLRG, First Report 2000-01, (Dublin December 2001), *para.8.3.8.*
[190] The People (DPP) v Fitzpatrick. Unreported judgment Circuit Criminal Court (Judge Aylmer), 23 May 2017
[191] Brennan, 'Sean Fitzpatrick acquitted on all counts at the direction of the trial judge' Irish Independent (23 May 2017)
[192] Department of Business, Enterprise and Innovation, Measures to Enhance Ireland's Corporate, Economic and Regulatory Framework, Ireland combatting 'white-collar' crime (Dublin 2017), para2.4.
[193] Parliamentary Commission on Banking Standards, Changing Banking for the Good: Vol 1 Summary, and Conclusions and Recommendations' (London June 2013), para.233.
[194] Kay, The Truth About Markets (London: Allen Lane, Penguin Books, 2004), p.343

simply not be safe.[195] With hindsight, collapse may have look inevitable. In reality however, rationally judged, the company may have had real prospects of survival. This leads us back to a point made earlier. The ultimate result of a criminalised section 610 may be that misjudgments of risk are now subject to criminal sanction.

Lynch Fannon makes the point that one oft cited and indeed correct reason for the lack of reckless trading litigation is liquidators' unwillingness to risk scarce resources in what might well prove to be a pointless exercise.[196] Hence criminal prosecution may appear to be a panacea. While introducing criminal prosecution would certainly add resources beyond that which exists in the current enforcement model, the ODCE's resources are not themselves limitless[197] and will not become so even when the Companies (Corporate Enforcement Agency) Bill 2018 is passed. Another way of phrasing the issue is to ask whether, on a cost-benefit analysis, would this be the best use of the available (or indeed) the additional resources.[198] The ODCE has had many deserved successes in obtaining restriction and disqualification orders. However, many applications are strongly contested, and the courts' approach can vary. Considering the severe sanctions which attach to a criminal conviction, full defence of a criminal prosecution can be expected. This is especially the case as criminal legal aid may well be available. Legal aid in the civil sphere is far more difficult to obtain. Likewise, the ODCE may face a wealthy and well-resourced defendant against whom its own resources will be constrained[199] thus having a further impact on its financial situation.

[195] Fitzgerald and McFadden make this point in relation to competition law. Fitzgerald and McFadden, 'Filling a Gap in Irish Competition Law Enforcement: The Need for a Civil Fines Sanction' (The Competition Authority June 2011)
[196] Lynch-Fannon, 'Reckless Trading: Good and Bad Risk-taking in Irish Companies' [2017] 24(1) CLP 7 at 9
[197] Lynch-Fannon, 'Reckless Trading: Good and Bad Risk-taking in Irish Companies' [2017] 24(1) CLP 7 at 9
[198] For a general discussion of the strengths and weaknesses of cost-benefit analysis in the regulatory field see Black, The Role of Risk in Regulatory Processes, in Baldwin, Cave, Lodge (Eds) The Oxford Handbook of Regulation (Oxford: Oxford University Press 2010), pgs.321-323
[199] Lynch Fannon, 'Controlling Risk Taking: Whose Job Is It Anyway?' in Kilcommins and Kilkelly (Eds), Regulatory Crime in Ireland, (Dublin: First Law/Lonsdale Law Publishing Dublin, 2010), p.115.

**(g) Impact on Small Businesses**

Further, a criminalised reckless trading provision may place smaller companies at a particular disadvantage. They are less well placed than larger firms to obtain and make efficient use of legal advice.[200] This contention is supported by research from New Zealand in this area.[201] Reckless trading is often simply a case of not placing the company in liquidation at the right time. That said, in real time it is often difficult to judge when precisely a company has reached such point that insolvency is now inevitable. Larger companies can call on specialist, sophisticated advice, or indeed may have their own in-house experts, thus reducing the likelihood that their directors will be exposed to a criminal trial.[202] The director of the small company may have to judge the issue largely on his or her own, thus making exposure to criminal sanction more likely. Indeed, it has been found that the vast majority of wrongful trading applications in the UK were taken against small, closely held companies.[203] (This finding may, of course, only be correct because the majority of companies are small and closely held). Furthermore, this may not be because directors of small companies are more likely to engage in reckless trading. The likelihood may be the same whether the company is large or small. Directors of large companies may simply have fast access to top class financial and legal advice.

Indeed, the New Zealand research demonstrates that while breach of directors' duty cases (which includes reckless trading) are sometimes initiated against public companies, very few reach trial. One reason for this is that such directors will often carry insurance making settlement more likely. However, another reason is that such directors are professionally advised.[204] If this hypothesis is correct, the same scenario will play out with regard to a criminalised reckless trading provision. Less well-advised directors of small companies will bear the

[200] The Law Commission, Consultation Paper No. 195, Criminal Liability in Regulatory Contexts A Consultation Paper (London, August 2010) para.7.8
[201] Taylor 'Directors' Duties on Insolvency in New Zealand: An Empirical Study' [2018] 28(2) New Zealand Universities Law Review 172 at 193
[202] That said, this is not always the case – see Yan v Mainzeal Property and Construction Ltd. [2021] NZCA 99.
[203] Keay, Company Directors' Responsibilities to Creditors (London: Routledge 2007), p.99
[204] Taylor 'Directors' Duties on Insolvency in New Zealand: An Empirical Study' [2018] 28(2) New Zealand Universities Law Review 172 at 189

brunt of the sanction. As the LRC has noted, criminal legislation tends to impact primarily on the activities of small businesses.[205]

**(h) Consequences of a Criminal Conviction**

Unlike the imposition of personal liability which involves monetary loss a criminal conviction carries extremely serious consequences. Aside from the risk of imprisonment itself, convicted offenders are viewed as societal outcasts subject to social scorn and deprived of the rights and benefits accorded to others such as employment opportunities.[206] Thus due to the moral gravity of a guilty verdict and the unparalleled consequences that flow therefrom, criminal liability should be sparingly used. Coffee argues that the scope of criminal law must be limited because our capacity to focus censure and blame is a scarce resource.[207] The Law Commission also expresses concern regarding the use of criminal law in a regulatory capacity in specialised areas of activity.[208]

The policy underpinning reckless trading is creditor compensatory. Criminal law, on the other hand, is condemnatory and punitive.[209] Criminalisation of reckless trading must thus indicate the existence of a significant policy shift. As Coffee states *"……characteristically the criminal law prohibits, while the civil prices."*[210] Lynch Fannon states that one of the main purposes of reckless trading is to pursue the errant director for recompense. The goal is to recoup amounts owned to creditors. Sanctions in criminal law have different aims entirely and the creditor would not gain from a criminal prosecution. That is unless, as Lynch Fannon states,[211] we follow the Australian example where an order can be made to include payment to the affected creditor. The policy point is reiterated by the

[205] The Law Commission, Consultation Paper No. 195, Criminal Liability in Regulatory Contexts A Consultation Paper (London, August 2010) para.7.17
[206] O'Malley, 'Sentencing White-Collar and Corporate Crime' in McGrath (Ed), White-Collar Crime in Ireland Law and Policy (Dublin: Clarus Press, 2019), pgs.182-183.
[207] Coffee, 'Paradigms Lost: The Blurring of the Criminal and Civil Law Models-And What Can Be Done About It' [1992] 101(8) Yale Law Journal 1875 at 1877.
[208] The Law Commission, Consultation Paper No. 195, Criminal Liability in Regulatory Contexts A Consultation Paper (London, August 2010)
[209] Cornford, 'Rethinking the Wrongness Constraint on Criminalisation" [2017] 36(6) Law and Philosophy 615 at 619.
[210] Coffee, 'Paradigms Lost: The Blurring of the Criminal and Civil Law Models-And What Can Be Done About It' [1992] 101 Yale Law Journal 1875 at 1884
[211] Lynch-Fannon, "Reckless Trading: Good and Bad Risk-taking in Irish Companies (2017) 24(1) CLP 7 at 12.

LRC which emphasises the compensatory purpose of the reckless trading provision.[212] The Commission notes that restitution is not a primary aim of criminal law. Criminal law seeks to deter, punish, and publicly censure certain types of culpable conduct.[213]

**(i) Regulatory Ritualism**

It can be argued that legislatures expand criminal law, not on the basis of rational reasoning, but because it is expedient to do so.[214] As Ashworth states *"Creating a new criminal offence may often be regarded as an instantly satisfying political response to public worries about a form of conduct that has been given publicity by the newspapers and television."*[215] Criminal law has been overused as a regulatory device.[216] Indeed, criminal sanction in the company law sphere has been increasing and may be falling foul of the concept of 'over-criminalisation'.[217] The Law Commission states that the Companies Act, 2006 added an additional twenty new criminal offences to the sixty-nine offences carried forward from earlier legislation.[218] Gethings points out that in the late 1990's there were two hundred and eighty criminal offences within the Irish Companies Acts. By 2001, this had increased to four hundred.[219] Horan notes a similar pattern[220] and, indeed, that the level of statutory fines has also increased.[221] The general approach in Ireland has been to provide for an obligation and then enforce that obligation via the creation of a criminal

[212] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para.12.52
[213] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para.12.53
[214] Coffee, 'Paradigms Lost: The Blurring of the Criminal and Civil Law Models-And What Can Be Done About It' [1992] 101 Yale Law Journal 1875 at 1881.
[215] Ashworth, Principles of Criminal Law, 5th Edition (Oxford: Oxford University Press, 2006), p.23
[216] Simester, Sullivan et al, Simester and Sullivan's Criminal Law: Theory and Doctrine 7th Edition (Oxford: Hart Publishing 2020), p.3
[217] This term appears to have been coined by Erik Luna. See Luna, 'The Overcriminalisation Phenomena' [2005] 54(3) Am U L Rev 703.
[218] The Law Commission, Consultation Paper No. 195, Criminal Liability in Regulatory Contexts A Consultation Paper (London, August 2010) para.7.16
[219] Gethings, 'Corporate Enforcement 'Ominshambles' or Alternative Regulatory Mechanism: An Objective Analysis of the ODCE' [2018] 36(19) ILT 294 at 298
[220] Horan, Corporate Crime (Bloomsbury Professional, 2011), para.1.48
[221] Horan, Corporate Crime (Bloomsbury Professional, 2011), para.7.76.

offence.[222] Criminalising of reckless trading may for this reason be seen to be a favourable approach – it is a habitual response.

It must also be kept in mind that drives to criminalise certain types of activity can often simply stem from a moral panic of some kind ie. an incident or series of incidents which results in a strong societal reaction and calls for new enforcement powers.[223] These may stem from a public perception that company directors are not called to account for misbehaviours.[224] Indeed, laws are often a produce of history rather than rationality[225] and the New Zealand criminalisation of insolvent trading has been described as a reaction to the global financial collapse and not a considered enactment of an objectively required measure.[226] While it is axiomatic that criminal sanctions are only appropriate where the offence is actually criminal in character,[227] there is arguably a modern trend towards the criminalisation of actions which are not genuinely criminal. In effect, what we would have here is a species of 'regulatory ritualism' as defined by Braithwaite. Unwilling politicians are forced by the public to increase regulation. The new regulatory regime is 'ritualistic'. It has the appearance of robustness, but in reality, there is no substantive change.[228] This can also be dangerous. As Simester and Sullivan argue criminal law as a regulatory device is bluntly coercive and morally loaded. It should be used sparingly and with care.[229]

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[222] Hamilton, 'Do We Need a System of Administrative Sanctions in Ireland' in Kilcommins and Kilkelly (Eds), Regulatory Crime in Ireland, (Dublin: First Law/Lonsdale Law Publishing, 2010), p.27.
[223] Coffee, 'Paradigms Lost: The Blurring of the Criminal and Civil Law Models-And What Can Be Done About It' [1992] 101 Yale Law Journal 1875 at 1881.
[224] Keay and Welsh, 'Enforcing Breaches of Directors' Duties by a Public Body and Antipodean Experiences' [2015] 15(2) Journal of Corporate Law Studies 255 at 277.
[225] Macrory, 'Sanctions and Safeguards: The Brave New World of Regulatory Enforcement' [2013] 66(1) Current Legal Problems 233 at 239
[226] Watson and Hirsch, 'The Unintended Consequences of the Criminalisation of Directors' Duties' [2011] 17 NZBLQ 303 at 303.
[227] Commonwealth of Australia, Company Directors' Duties. Report by Senate Standing Committee on Legal and Constitutional Affairs (November 1989) ('The Cooney Report'), para.13.5
[228] Braithwaite, Regulatory Capitalism: How it Works and Ideas for Making it Work Better, (Cheltenham: Edward Elgar, 2009), p.142
[229] Simester, Sullivan et al, Simester and Sullivan's Criminal Law: Theory and Doctrine 7th Edition (Oxford: Hart Publishing 2020), p.685

Criminal sanction should be reserved for behaviors that are so wrongful and harmful to victims or the general public that the official condemnation and denial of freedom that flow from a guilty verdict is justified.[230] As the Law Commission observes the criminal law should only be used to deal with wrongdoers who have engaged in seriously reprehensible conduct and thus deserve the stigma which is associated with a criminal conviction.[231] Imposing criminal sanctions against acts which are not wrong in themselves can undermine the signals of moral condemnation which the criminal law is meant to convey.[232] The moral authority of the criminal law can be eroded.[233] As Simester and von Hirsch state *"Morally speaking, those whose conduct is not reprehensible ought not to be convicted and made punishable."*[234] Thus if we accept that while reckless trading behaviour may, in certain circumstances, carry some indicia of criminal activity, the conduct overall is not seriously reprehensible, its criminalisation may simply be 'regulatory ritualism' and nothing more.

## (V) CONCLUSIONS

Reckless trading is part and parcel of the overall fault line which runs through company law; the use of the separate legal personality of the company to encourage risk-taking on the one hand while curtailing its use to prevent abusive mismanagement on the other. While reckless trading behaviour has an ability to cause harm to both individuals and to the wider community from the foregoing analysis, criminalisation is too blunt an instrument to balance these competing considerations. A balanced framework of company law must exist to facilitate enterprise and not impede it.[235] As the LRC warns; a business that has failed is not by any means proof of wrongdoing.[236] Criminal law should not be invoked unless other methods of enforcement are

[230] Luna, 'The Overcriminalisation Phenomena' [2005] 54(3) Am U L Rev 703 at 713
[231] The Law Commission, Consultation Paper No. 195, Criminal Liability in Regulatory Contexts A Consultation Paper (London, August 2010) para.3.137.
[232] The Concurrent Operation of Public and Private Enforcement of the Duties of Corporate Directors: Reinvigorating the Derivative Action and Refining the Public Enforcement Regime para. A.21
[233] Cornford, 'Rethinking the Wrongness Constraint on Criminalisation" [2017] 36(6) Law and Philosophy 615 at 632.
[234] Simester and von Hirsch, Crimes, Harms and Wrongs On Principles of Criminalisation (Oxford: Hart Publishing, 2011), p.19
[235] Appleby, 'Compliance and Enforcement – the ODCE Perspective' in Regulatory Crime in Ireland Kilcommins and Kilkelly (Eds) (First Law/Lonsdale Law Publishing Dublin 2010), p.189
[236] Law Reform Commission Report Regulatory Powers and Corporate Offences (Dublin 2018), para.12.19

inappropriate. [237] This is because criminal law is a powerful tool to address wrongdoing, but it may not be the only potential legal response. The Law Commission agrees. The criminal law should only be used against wrongdoers who have engaged in seriously reprehensible conduct and deserve the stigma associated with criminal conviction. This is also in accordance with the thinking of the Cork Committee which considered that criminal sanction should be reserved for fraudulent trading. Conversely, compensation of losses is the bailiwick of wrongful trading.[238]

The primary policy purpose of reckless trading is to compensate creditors who have suffered as a result of the misbehaviour of directors. This strongly indicates that regulatory as opposed to criminal enforcement is more appropriate in these circumstances. As Lynch Fannon states *"Sanctions in criminal matters may lead to incarceration, which is a different goal, or to a fine, and the question then arises as to whether the creditors gain from this action at all."*[239] Further, other routes such as educational approaches rather than formal criminal enforcement may lead to better results.

Criminal enforcement of reckless trading is, at first blush, attractive concerning the external problem which bedevils section 610; many directors are impecunious and pursuing them for compensation is pointless. However, enforcement is the key. As Walters states if the state is serious about using wrongful trading as a deterrent, then visible enforcement is necessary.[240] As we have seen, there is little evidence that this will occur in Ireland. Lack of enforcement of corporate criminal sanctions here is well documented. The limited number of prosecutions may not be successful and resource constraints will exist.[241] The failed Fitzpatrick trial is an example of such an occurrence. In fact, the issue is more serious than that. If additional stringent sanctions are introduced but not enforced, then, invoking the consequentialist approach, the role of reckless trading as a tool for controlling corporate misbehaviour will be weakened

[237] Ashworth and Horder, Principles of Criminal Law (7th Ed) (Oxford University Press 2013), p.31
[238] Insolvency Law and Practice – Report of the Review Committee [1982] Cmnd 8558 para.1777
[239] Lynch-Fannon, "Reckless Trading: Good and Bad Risk-taking in Irish Companies [2017] 24(1) CLP 7 at 12
[240] Walters, 'Enforcing Wrongful Trading- Substantive Problems and Practical Disincentives' in Rider, The Corporate Dimension, (Bristol, Jordan Publishing Ltd., 1998), p.159
[241] Lynch-Fannon, "Reckless Trading: Good and Bad Risk-taking in Irish Companies [2017] 24(1) CLP 7 at 9

rather than strengthened. Ultimately, the most insightful conclusion is that criminalisation may prove to be a distraction which does nothing to solve the underlying problems of the provision.[242]

[242] Lynch-Fannon, "Reckless Trading: Good and Bad Risk-taking in Irish Companies [2017] 24(1) CLP 7 at 12

# CHAPTER NINE: PUBLIC CIVIL ENFORCEMENT OF RECKLESS TRADING

## (I) INTRODUCTION

The previous chapter asked whether public sanction of reckless trading via criminalisation is a viable option. The conclusion reached is that this is unlikely to be the case. In this part we will ask whether a civil public enforcement regime would be beneficial. As Lynch Fannon and Murphy point out, in the area of directors' duties generally, the extent of public enforcement as compared to private enforcement is striking.[1] Public enforcement occurs far more frequently than private enforcement. The publicly enforced restriction and disqualification regimes have been highly successful. In fact, to the extent that reckless trading behaviour is significantly sanctioned at all, it is sanctioned via these regimes. That reality clearly indicates that some form of public enforcement may be beneficial. It would also be in keeping with the increasing tendency in Ireland towards public enforcement in the company law area.[2] In this regard, Nic Bhloscaidh correctly points out that it is unfortunate that public enforcement mechanisms have not to date been used to impose personal liability on errant directors.[3] Overall, the enforcement mechanism required is one which retains the advantages of criminal enforcement; deterrence, ability to improve standards of behaviour and an effective sanction but avoids its drawbacks.

## (II) CIVIL ENFORCEMENT IN IRELAND

### (i) Introduction

To determine whether public enforcement would be beneficial, initially two Irish regimes will be examined. These involve financial sanctions whereby a 'fine' is imposed in a civil context. Using international comparisons, the question of whether the ODCE could be added to the list of those who can invoke section 610 in order to obtain compensation for creditors will then be examined.

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[1] Lynch Fannon and Cuddihy, Corporations and Partnerships, 2nd Edition (The Netherlands: Wolters Kluwer 2016), para.11.02. This is the position in the UK also – see Armour, 'Enforcement Strategies in Corporate Governance: A Roadmap and Empirical Assessment' in Armour and Payne, Rationality in Company Law. Essays in Honour of DD Prentice, (Oxford: Hart Publishing, 2009)

[2] Ahern, 'Directors' Duties: Broadening the Focus Beyond Content to Examine the Accountability Spectrum' [2011] 33(1) DULJ 116

[3] Nic Bhloscaidh 'The Concurrent Operation of Public and Private Enforcement of the Duties of Corporate Directors: Reinvigorating the Derivative Action and Refining the Public Enforcement Regime' [2018] CLP 132 at 136.

Civil sanction regimes, often with a robust appeals system, [4] have become popular for sanctioning corporate misconduct. Such fines can be imposed either by a court or by a regulator (often with court supervision). There are two types; firstly fines which are imposed at the end of a court hearing using the civil balance of probabilities standard of proof.[5] Secondly, sanctions imposed by a body other than a court, though usually subject to a formal appeal, review or approval by a court.[6] This recently occurred when the Central Bank sanctioned Davys Stockbrokers for involving itself in a conflict of interest regarding a bond deal.[7] Moreover, the body imposing the sanction may also have an investigative role.[8] In order to distinguish between the two and maintain clarity, the former will be called 'civil penalties' and the latter 'administrative fines' or 'administrative sanctions'. When both are being referred to the term used will be 'civil sanctions.'

Both types of sanction will be discussed here. At present, neither are part of our company law system and the ODCE, as a public enforcement body, has no power to administratively fine directors. Breaches of Irish company law are sanctioned criminally or have other legal consequences. That said, an analysis of civil sanction regimes is useful. An examination of the hallmarks of these systems will demonstrate the strengths and advantages of the public enforcement model. Further, a discussion of the models' advantages will cast light on the benefits of the application of such a system to reckless trading and demonstrate that such a system could be used to significantly improve the use and accessibility of the provision.

[4] See for example the recommendations of The Law Commission, Consultation Paper No. 195, Criminal Liability in Regulatory Contexts A Consultation Paper (London, August 2010) paras.3.159-3.170

[5] McFadden, 'Two Tiers Equals Full Suite: Civil Fines Complement Criminal Enforcement' in Kilcommins and Kilkelly (Eds), Regulatory Crime in Ireland, (Dublin: First Law/Lonsdale Law Publishing Dublin, 2010), p.193.

[6] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 1: Regulatory Powers (Dublin 2018), para.3.03

[7] 'Davy Fined Record €4.1m for 'Serious Conflict of Interest' Failures in Bond-Dealing Case' Irish Independent (2 March 2021). See also Central Bank, Enforcement Action Notice: J&E Davy fined €4,130,000 and reprimanded by the Central Bank for regulatory breaches arising from personal account dealing. Press Release (2 March 2021)

[8] McFadden, 'Two Tiers Equals Full Suite: Civil Fines Complement Criminal Enforcement' in Kilcommins and Kilkelly (Eds), Regulatory Crime in Ireland, (Dublin: First Law/Lonsdale Law Publishing Dublin, 2010), p.193.

Comparisons will also be made to the different forms of corporate public enforcement in the UK and Australia. Under the British compensation order regime, the Secretary of State for Business, Energy and Industrial Strategy can obtain a court order whereunder a disqualified director must compensate creditors. The test is whether the director has caused loss to one or more creditors of an insolvent company. ASIC is an independent authority set up under the Australian Securities and Investments Commission Act, 2001.[9] It began operations in 1991[10] and it is an integrated corporate, markets, consumer and finance regulator. It administers the Corporations Act, 2001.[11] Where insolvent trading occurs, ASIC can apply to court to have the director responsible made personally liable for part or all of the company's debts or fined.[12] Any compensation awarded is due to the company.[13]

**(ii) Advantages of Public Enforcement Regimes**

Administrative sanction regimes involve non-judicially decided fines, orders and remedies that can be applied without the application thereof having to be decided through a hearing in a criminal court.[14] These have been described as a *"...an enforcement mechanism of intermediate severity between civil proceedings for compensation and criminal proceedings that could lead to criminal sanctions."*[15]

Administrative fines are easy to implement and less resource intensive than civil or criminal sanctions.[16] Such a regime can also be speedy and flexible.[17] Further, an expert company law regulatory body is already in existence in Ireland; the ODCE. Where the administrative fine is set at an appropriate level, they can effectively deter non-compliance.[18] Moreover, administrative fine regimes carry an important hallmark

[9] Earlier iterations of ASIC existed under precursor legislation such as the Australian Securities and Investment Commission Act, 1989.
[10] Replacing the earlier National Companies and Securities Commission.
[11] S.5B Corporations Act, 2001
[12] S.1317G and S.1317H Corporations Act, 2001
[13] S.588M(2) Corporations Act, 2001
[14] The Law Commission, Consultation Paper No. 195, Criminal Liability in Regulatory Contexts A Consultation Paper (London, August 2010), para.3.23
[15] Morley v ASIC [2010] 274 ALR 205 at para.692
[16] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 1: Regulatory Powers (Dublin 2018), para.3.11
[17] The Law Commission, Consultation Paper No. 195, Criminal Liability in Regulatory Contexts A Consultation Paper (London, August 2010) para.A.39
[18] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 1: Regulatory Powers (Dublin 2018), para.3.08

of public enforcement; sanctioning actually occurs. Numerous such regimes exist in Ireland.[19]

A civil penalty regime is a hybrid.[20] Despite being within sphere of the civil courts, it carries punitive sanctions. As with administrative fines, these can be 'disgorgement' type measures in that the economic benefit of the breach is removed. A civil penalty regime can be advantageous especially when compared to criminal enforcement. The procedural complexities of a criminal trial are avoided and the burden of proof is lower. This means that there is less pressure on scarce resources.[21]

Both regimes are said to be cost effective. Further, there can be a real deterrent effect.[22] On the other hand, we have seen that criminal sanctions do not pose a realistic threat as participants will know that the regulator is under-resourced and only the most heinous examples will be pursued. A civil sanction regime represents a more realistic deterrent and regulated entities recognise the increased possibility that the regulator will use its enforcement tools.[23] Further, publicising the regulator's decisions can have a stigmatising effect, hence increasing deterrence.[24] Also, the publication of decisions can be educational. Others can learn from previous contraventions and improve their own compliance.[25] Concurrence is also increased by the fact that those whose commitment to obeying the law is governed by whether the cost of doing so outweighs the benefits are persuaded to do so by active civil sanction regimes.[26]

[19] Irish bodies that can levy administrate fines include the Revenue Commissioners, the Central Bank, the Broadcasting Authority of Ireland, the Property Services Regulatory Authority and the Commission for Energy Regulation.
[20] Comino, 'Effective Regulation by the Australian Securities and Investments Commission: The Civil Penalty Problem' [2009] 33(3) Melb. U. L. Rev. 802 at 810
[21] Keay and Welsh, 'Enforcing Breaches of Directors' Duties by a Public Body and Antipodean Experiences' [2015] 15(2) Journal of Corporate Law Studies 255 at 262-263.
[22] Welsh, 'New Sanctions and Increased Enforcement Activity in Australian Corporate Law: Impact and Implications' [2012] Comm. L. World. Rev. 134
[23] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 1: Regulatory Powers (Dublin 2018), para.3.12
[24] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 1: Regulatory Powers (Dublin 2018), para.3.159
[25] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 1: Regulatory Powers (Dublin 2018), para.3.156. These and the above cited points are made by the LRC in the context of administrative sanction. It is submitted that they equally apply to civil penalty regimes.
[26] Welsh, 'New Sanctions and Increased Enforcement Activity in Australian Corporate Law: Impact and Implications' [2012] Comm. L. World. Rev. 134 at 142.

A public enforcement regime also allows the regulator to enforce strategically to obtain maximum voluntary compliance.[27] Such regimes can encourage the regulator to be proactive. For example, ASIC has created a national insolvency training program which intervenes to deal with possible insolvent trading before it occurs.[28] Moreover, there can be a norm setting effect.[29] Settlements can be reached and early co-operation can also be taken into account.[30] In this context such a public enforcement regime has the further advantage of not criminalising behaviours that were traditionally outside of the remit of criminal law and which do not carry the same moral stigma.[31]

**(iii) Public Enforcement Regimes and Reckless Trading**

The above examination of administrative fines and civil penalties illustrates the advantages which accrue to public enforcement regimes generally. It is therefore worth examining whether an administrative fine regime or a civil penalties regime would be suitable regarding reckless trading. There are some difficulties.

The requirement under Article 34 of the Constitution that justice must be administered by judges in courts established by law has been construed, as a general principle, as limiting judicial administration to the courts.[32] The provision has had a chilling effect on the legislature's willingness to grant to administrative bodies sanctioning powers which might be regarded as judicial. This is despite the fact that Article 37 grants limited judicial power to administrative bodies in civil cases.[33] Thus, administrative fines potentially have constitutional implications.[34]

[27] Welsh and Morabito, 'Public v Private Enforcement of Securities Laws: An Australian Empirical Study' [2014] 14 JCLS 39 at 51
[28] Australian Securities and Investments Commission, REP 213 National Insolvent Trading Program Report (October 2010)
[29] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 1: Regulatory Powers (Dublin 2018), para.3.157
[30] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 1: Regulatory Powers (Dublin 2018), paras.3.12-3.13
[31] Hamilton, 'Do We Need a System of Administrative Sanctions in Ireland' in Kilcommins and Kilkelly (Eds), Regulatory Crime in Ireland, (Dublin: First Law/Lonsdale Law Publishing, 2010), p.17.
[32] This was confirmed in McDonald v Bord na gCon [1965] IR 217.
[33] Lucey, 'Corporate Wrongdoing: The Civil Enforcement Tool Kit' in McGrath (Ed), White-Collar Crime in Ireland Law and Policy (Dublin: Clarus Press Dublin, 2019), p.127.
[34] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 1: Regulatory Powers (Dublin 2018), para.3.16

Differing views on whether such regimes were susceptible to constitutional challenge have been expressed. This is not helped by the fact that it has proven difficult to determine what the phrase 'administration of justice' means precisely.[35] Hamilton considered that a constitutional challenge would be successful.[36] McDowell, on the other hand, took the opposite view regarding certain legal areas.[37]

The Central Bank of Ireland has considerable sanctioning powers and can accept settlements and impose administrative fines.[38] These fines are significant and, in the past, received little judicial scrutiny.[39] Importantly, the Central Bank's powers were found not to be contrary to Article 34 in Purcell v Central Bank of Ireland.[40] In that case the plaintiff challenged the jurisdiction of the defendant to hold an inquiry into his actions as a building society director and to impose administrative sanctions. Hedigan J. relied on the five criteria set out in MacDonald v Bord na gCon[41] to determine that the Central Bank's powers did not breach Article 34. As stated by Kenny J. in that case, the administration of justice occurs if the matter concerns a dispute as to the existence of legal rights or a legal violation, rights of parties are ascertained or a penalty is inflicted, legal rights or the imposition of a penalty is finally determined, the rights determined, or the penalty imposed can be enforced and a characteristic order is made by the court. The Central Bank was not administering justice because its power was to hold inquiries, not to settle disputes. There was no determination of the rights of parties. The inquiry was not a final determination. The Central Bank could not enforce any penalty imposed. Any such imposition was a matter for a court of competent jurisdiction.[42] An appeal process existed.[43] A similar

[35] See in particular Hogan et al, Kelly: The Irish Constitution 5th Edition (Dublin: Bloomsbury Professional, 2018), paras.6.1.13-6.1.55.
[36] Hamilton, 'Do We Need a System of Administrative Sanctions in Ireland' in Kilcommins and Kilkelly (Eds), Regulatory Crime in Ireland, (Dublin: First Law/Lonsdale Law Publishing, 2010), p.28.
[37] McDowell, 'Non-Criminal Penalties and Criminal Sanctions in Irish Regulatory Law' in Kilcommins and Kilkelly (Eds), Regulatory Crime in Ireland, (Dublin: First Law/Lonsdale Law Publishing Dublin, 2010), pgs.129
[38] See Horan, Corporate Crime (Bloomsbury Professional, 2011), paras.15.46-15.55.
[39] O'Malley, 'Sentencing White-Collar and Corporate Crime' in McGrath (Ed), White-Collar Crime in Ireland Law and Policy (Dublin: Clarus Press, 2019), p.161.
[40] [2016] IEHC 514
[41] [1965] IR 217 as recently confirmed by the Supreme Court in O'Connell v The Turf Club [2015] IESC 57.
[42] [2016] IEHC 514 para.8.7
[43] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 1: Regulatory Powers (Dublin 2018), paras.3.64-65

analysis could be applied if inquiry and sanctioning powers were granted to the ODCE. All five criteria must be complied with. Hence a system similar to that of the Central Bank could be imposed. An inquiry process coupled with court oversight should not breach Article 34. The recent Zalewski v Workplace Relations Commission[44] is also instructive. O'Donnell J. held that where the court's discretion is confined to largely rubberstamping the tribunal's decision, Kenny J.'s fourth limb is complied with as the regulatory body in effect determines the penalty. However, it is envisaged that the High Court here would have more extensive oversight powers, thus the ODCE would not be administering justice.

As a wider issue, the primary policy underpinning reckless trading is that of compensation to creditors. A fine does not achieve that policy function. Where fines are imposed, the monetary penalty paid is for the benefit of the state. Administrative fines are, in effect, 'disgorgement' type measures in that the economic benefit of the breach is removed from the company. The LRC sees power to remove the benefit of a contravention as being an important regulatory tool.[45] Hence disgorgement measures prevent the regulated entity from benefiting from the breach and place the entity back in the position it would have been in had the contravention not been committed.[46] Analysed in this light, administrative fines (and civil penalties) might not be suitable in a reckless trading context. The errant director in many circumstances will have obtained no direct personal benefit from his or her behaviour.[47] That said, this is not true in all cases. Had the scheme in Re. Kelly Trucks Ltd.[48] succeeded in evading the company's liabilities to the solicitors, as shareholders, the directors would have benefited indirectly. Moreover, where the director did not benefit, the disgorgement issue declines in importance. This is because, from the director's standpoint, it is irrelevant whether the fine benefits the creditors, the company or the state. Which entity benefits is ultimately only of importance to creditors.

[44] [2021] IESC 24 at para.88.
[45] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 1: Regulatory Powers (Dublin 2018), para.3.177
[46] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 1: Regulatory Powers (Dublin 2018), para.3.121
[47] See Re. Appleyard Motors Ltd. [2015] IEHC 28.
[48] [2019] IEHC 6

Importantly, however, as we have seen, the major fault line in section 610 is that an impecunious director faces no penalty whatsoever and is immune from monetary sanction. The imposition of a civil sanction regime therefore makes sense in this context (as it is always possible to levy an affordable fine) and is a straightforward solution to this problem. Moreover, reckless trading is also underpinned by a policy of deterrence.[49] While a fine will not compensate, the possibility of one will certainly deter.

**(iv) Concluding Comments**

Public enforcement systems have numerous advantages and strengths. Public enforcement actually occurs, as such there is a significant deterrent value. Such regimes can be speedy and flexible.[50] They can be easy to implement and resource efficient.[51] Settlements can be made,[52] adding to flexibility. Expert bodies are in place. Public enforcement tends to be cost effective.[53] Cases can be chosen for maximum deterrence and public impact. The public interest can be pursued and enforcement can be strategically directed to obtain maximum voluntary compliance.[54] Action by the regulator can have a stigmatising effect.[55] Educational benefits accrue.[56] This is particularly important in the area of company law where many directors are not professionally qualified. Further, there is a modern tendency to publicly enforce company law.[57] Moreover, there can be a norm setting effect.[58] A civil sanction regime can deliver a message that a certain type of behaviour is egregious. This makes

[49] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para.12.52
[50] The Law Commission, Consultation Paper No. 195, Criminal Liability in Regulatory Contexts A Consultation Paper (London, August 2010) para.A.39
[51] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 1: Regulatory Powers (Dublin 2018), paras.4.86-4.87
[52] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 1: Regulatory Powers (Dublin 2018), para.3.13
[53] The ODCE's budget in 2019 was €6m. ODCE Annual Report 2019 (Dublin 2020), p.8
[54] Welsh and Morabito, 'Public v Private Enforcement of Securities Laws: An Australian Empirical Study' [2014] 14 JCLS 39 at 51
[55] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 1: Regulatory Powers (Dublin 2018), para.3.159
[56] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 1: Regulatory Powers (Dublin 2018), para.3.156. It should be noted that this and earlier citations are made by the LRC in the context of administrative fines. It is submitted that the same advantages accrue to civil penalty regimes.
[57] Ahern, 'Directors' Duties: Broadening the Focus Beyond Content to Examine the Accountability Spectrum' [2011] 33(1) DULJ 116
[58] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 1: Regulatory Powers (Dublin 2018), para.3.157

individuals unwilling to engage in such behaviour. A financial sanction will also mean that an impecunious director will face a consequence. Finally, a public enforcement regime, properly designed, should be able to handle the complex questions involving risk which can arise in reckless trading cases. That is not to say that private enforcement should be abandoned altogether. As occurs in Australia, one system can complement the other.[59]

Administrative fine and civil penalty regimes have their limitations. Academics have questioned whether civil penalty regimes are merely criminal sanctions without the safeguards.[60] Civil sanctions regimes are not creditor compensatory. Constitutional issues exist; hence judicial oversight would be necessary. On the whole, however, these difficulties are far from insurmountable.

## (III) PUBLIC ENFORCEMENT

### (i) Other Jurisdictions

Public enforcement orders for reckless trading type behaviour exist in other jurisdictions; the UK and Australia being the notable examples. Each jurisdiction has taken a different route. Thus, it is instructive to examine both to see what might work from an Irish perspective while keeping in mind Kahn-Freud's insight that legal transplantation can be difficult.[61] In the UK, the Secretary of State for Industry and Commerce can apply for what is called a compensation order for the benefit of creditors as an adjunct to a director disqualification application. This is a standalone regime[62] which is completely decoupled from the wrongful trading provision. In Australia, ASIC has simply been given locus to enforce directors' duties (including the duty not to engage in insolvent trading) and seek a civil fine, a disqualification or compensation for the benefit of the company.

[59]Jones and Welsh, 'Toward a Public Enforcement Model for Directors' Duties of Oversight' [2012] 45(2) Vand. J. Transnat'l L. 343 at 377-379

[60] Keay and Welsh, 'Enforcing Breaches of Directors' Duties by a Public Body and Antipodean Experiences' [2015] 15(2) Journal of Corporate Law Studies 255 at 264

[61] Kahn-Freud, 'On Uses and Misuses of Comparative Law', [1974] 37(1) MLR 1 at 6.

[62] Re. Noble Vintners Ltd. [2019] EWHC 2806 para.25

**(ii) The United Kingdom Experience**

Compensation orders (described as a novel solution)[63] were introduced in the UK as sections 15A-15C Company Directors' Disqualification Act, 1986 and came into force on 1 October, 2015.[64] The court may make a compensation order against a disqualified director whose conduct has caused loss to one or more creditors of an insolvent company.[65] The Secretary of State must make an application[66] within two years from the date the disqualification order is granted.[67] As such, civil recovery is placed in the hands of the state.[68] The compensation order regime in the UK is seen as strengthening the efficacy of disqualification orders.[69] Its purpose is decoupled from section 214. Indeed, it is seen as an independent and free-standing regime in its own right.[70] This may reflect a view of policymakers that the existing powers of civil recovery, including wrongful trading, are insufficient.[71]

Compensation orders were introduced with little fanfare. As Prentiss J. commented in Re. Noble Vintners Ltd. [72] there were no parliamentary debates. The regime was proposed in a July 2013 Discussion Paper called 'Transparency & Trust: enhancing the transparency of company ownership and increasing trust in business'.[73] This was followed by a government response to the paper.[74] Shortly thereafter the legislation was enacted. That such an innovative and far-reaching provision was brought in which such little analysis is surprising.[75]

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[63] Williams, 'Civil Recovery from Delinquent Directors' [2015] 15(2) Journal of Corporate Law Studies 311 at 312.
[64] Small Business, Enterprise and Employment Act, 2015 (Commencement No. 2 and Transitional Provisions) Regulations 2015 SI 2015/1689
[65] S.15A(3) Company Directors' Disqualification Act, 1986
[66] S.15A(1) Company Directors' Disqualification Act, 1986
[67] S.15A(5) Company Directors' Disqualification Act, 1986
[68] Williams, 'Civil Recovery from Delinquent Directors' [2015] 15(2) Journal of Corporate Law Studies 311 at 312
[69] Re. Noble Vintners Ltd. [2019] EWHC 2806 para.19
[70] Re. Noble Vintners Ltd. [2019] EWHC 2806 para.25
[71] Williams, 'Civil Recovery from Delinquent Directors' [2015] 15(2) Journal of Corporate Law Studies 311 at 312
[72] [2019] EWHC 2806 paras.14-15

[73] Department for Business, Innovation and Skills, Transparency & Trust: enhancing the transparency of company ownership and increasing trust in business' (July 2013)
[74] Department of Skills and Enterprise, Transparency and Trust; enhancing the transparency of UK company ownership and increasing trust in UK business – Government Response (April 2014)
[75] [2019] EWHC 2806 paras 14-15

From a policy standpoint, the new regime appears to have arisen from the fact that creditors rarely receive recompense for losses caused by culpable directors' misconduct.[76] This was seen to be a lacuna in the disqualification order regime[77] (and not, it seems, wrongful trading). Further, directors who have fallen short of the requisite standards should be held accountable where their actions have caused loss to creditors.[78] Hence the policy overall is aligned with the policy underpinning reckless trading; the compensation of creditors.

The Discussion Paper outlines considerable potential benefits. In the general sense, such orders are advantageous as they provide reparation to those who have suffered loss.[79] Hence such provisions are likely to be advocated by creditors who (naturally) would prefer robust recovery methods to regulatory procedures.[80] There are other advantages. Compensation orders avoid the need for those affected to pursue chancy and potentially expensive private actions.[81] Stakeholder confidence in the insolvency regime may be improved.[82] The longstanding complaint of creditors that while a director can be prevented from holding such office for the future, the director does not suffer financially, may be settled.[83] Moreover, there is a good chance that the compensation will be used by creditors to grow their own businesses, thus supporting enterprise.[84] Such orders should have a deterrent effect[85] and creditors' and directors'

[76] Department for Business, Innovation and Skills, Transparency & Trust: enhancing the transparency of company ownership and increasing trust in business. Government Response (April 2014), para.259
[77] Department for Business, Innovation and Skills, Transparency & Trust: enhancing the transparency of company ownership and increasing trust in business' Government Response (April 2014), para.260
[78] Department for Business, Innovation and Skills, Transparency & Trust: enhancing the transparency of company ownership and increasing trust in business' Government Response (April 2014), para.273.
[79] Department of Business, Innovation and Skills, 'Transparency and Trust. Enhancing the Transparency of Company Ownership and Increasing Trust in Business. Discussion Paper (July 2013), para. 55.
[80] Archer, Directorial Liability in Insolvent Companies' PhD Thesis Lancaster University Law School (December 2017), para.2.39
[81] The Law Commission, Consultation Paper No. 195, Criminal Liability in Regulatory Contexts A Consultation Paper (London August 2010), para.A.67
[82] Department of Business, Innovation and Skills, 'Transparency and Trust. Enhancing the Transparency of Company Ownership and Increasing Trust in Business. Government Response (April 2014), para.262.
[83] Department for Business Innovation and Skills, 'Impact Assessment – Giving the court and Secretary of State (SoS) a power to make a compensatory award against a director' *(June 2014),* para.2.
[84] Department for Business Innovation and Skills, 'Impact Assessment – Giving the court and Secretary of State (SoS) a power to make a compensatory award against a director' (June 2014), paras.17 and 64
[85] Welsh, 'Realising the Public Potential of Corporate Law: Twenty Years of Civil Penalty Enforcement in Australia' [2014] 42 (1) Federal Law Review 217 at 231-232

interests would be better aligned.[86] It is also important to note that two thirds of respondents to the government's Trust and Transparency Discussion paper were in favour of compensation.[87] This can be compared with the consternation that greeted the proposed criminalisation of directors' duties in New Zealand.[88] A regime of this type also has a normative basis; it improves the position of creditors who have suffered due to reckless behaviour.[89] All these advantages would apply to public enforcement of reckless trading.

**(iii) Compensation Order - Features**

Important safeguards are built into the legislation. For example, causation must be proved;[90] there must be a causal link between the misconduct and the creditors' loss. The burden of proof here rests on the Secretary of State.[91] This ensures that the director's loss is not unlimited.[92] While Williams considers that this will limit the effectiveness of the remedy as correlation between the director's behaviour and the loss must be proved,[93] a review of the restriction order case law in Ireland provides ample evidence of applicants being able to demonstrate a causal nexus between the misconduct and the loss.[94] Directions are also given in section 15C regarding the issues which the court must take into account in determining the amount of compensation to award. The court must have regard to the amount of the loss and the nature of the conduct which caused the loss. Whether financial recompense has already been made by the director can also be taken into account.

[86] Department for Business Innovation and Skills, 'Impact Assessment – Giving the court and Secretary of State (SoS) a power to make a compensatory award against a director' (June 2014), para.15.
[87] Department of Business, Innovation and Skills, Transparency and Trust. Enhancing the Transparency of Company Ownership and Increasing Trust in Business. Government Response (April 2014), para.267
[88] Keay and Welsh, 'Enforcing Breaches of Directors' Duties by a Public Body and Antipodean Experiences' [2015] 15(2) Journal of Corporate Law Studies 255 at 269
[89] Keay and Welsh, 'Enforcing Breaches of Directors' Duties by a Public Body and Antipodean Experiences' [2015] 15(2) Journal of Corporate Law Studies 255 at 283
[90] Re. Noble Vintners Ltd. [2019] EWHC 2806 para.37
[91] S.15A Company Directors' Disqualification Act, 1986
[92] Archer, Directorial Liability in Insolvent Companies' PhD Thesis Lancaster University Law School (December 2017), para.2.36
[93] Williams, 'Civil Recovery from Delinquent Directors' [2015] 15(2) Journal of Corporate Law Studies 311
[94] See for example La Moselle Clothing Ltd. v Soualhi [1998] 2 ILRM 345.

Keay and Welsh worry that creditors will only benefit where the director is disqualified. In effect, there may be cases where disqualification is not warranted but compensation is.[95] This does, however, seem unlikely. If the director has caused loss to creditors in such circumstances that compensation must be paid, then it is highly likely that the director is also unfit to be involved in the management of a company. That said, to protect creditors in the limited circumstances where a director has caused a loss but disqualification is not warranted, decoupling the two requirements appears to be the better course. This issue is further discussed in more detail below.

Further, unlike the Australian provision, the remedy is very flexible, in that the court may order compensation to be paid to one or more creditors, a class or classes of creditors or as a contribution to the general assets of the company.[96] Thus its flexibility is equal to that contained in section 610(6) and overcomes the difficulty that compensation which accrues to the company may not necessarily significantly benefit the creditor most directly affected by the director's misconduct. Further, there is no indication that each type of allocation is mutually exclusive.[97]

**(iv) Re. Noble Vintners Ltd.**

The Noble Vintners case is the first reported case on the compensation order regime.[98] The Secretary of State successfully obtained direct compensation for twenty-eight specific creditors of the company.[99] It involved a Mr. Kevin Eagling, a disqualified director of a company called Noble Vintners Ltd. which was placed in creditors' voluntary liquidation in 2017.[100] Mr. Eagling had misappropriated in excess of Stg.£500,000 from the company by transferring these funds to another company. The transfers had no discernible business purpose[101] and it appears that the funds were entirely lost to Noble Vintners' creditors. Interestingly, the fact pattern is somewhat similar to that which occurred in a number of directors' duty to creditors cases such as

[95] Keay and Welsh, 'Enforcing Breaches of Directors' Duties by a Public Body and Antipodean Experiences' [2015] 15(2) Journal of Corporate Law Studies 255 at 282
[96] Re. Noble Vintners Ltd. [2019] EWHC 2806 para.24
[97] Archer, Directorial Liability in Insolvent Companies' PhD Thesis Lancaster University Law School (December 2017), para.2.37
[98] For a general discussion of this case see Bailey, 'Noble Vintners Ltd.- Compensation Orders Following Disqualification: Why, What and Where Next?' [2020] 33(4) Insolv. Int 124
[99] [2019] EWHC 2806 paras.69-70
[100] [2019] EWHC 2806 para.6
[101] [2019] EWHC 2806 para.12

such as Vivendi SA v Richards[102] and Re. MDA Investment Managers Ltd.[103] Importantly, Prentis J. stated that the application would be beneficial to the creditors as the liquidator himself did not have the funds to pursue Mr. Eagling.[104] Hence, had only private enforcement been available Mr. Eagling would have avoided monetary sanction.[105]

Helpfully, Prentis J. clarified a number of aspects of the legislation. The provisions are radical (from a UK perspective) as liability is not based on the loss to the company but on the loss to an individual creditor or creditors.[106] Obviously, this position would not be as far-reaching in Ireland due to the provisions of section 610(6). Importantly, however, the judge stated that a compensation order can be made where no loss has actually been caused to the company or where the loss is problematic.[107] This does overcome the difficulty which has arisen in the UK from case law such as Grant v Ralls[108] where personal liability cannot be imposed on directors found to have been involved in wrongful trading if the loss to the company has not been increased.

A further aspect which the judge examined was the issue of 'double recovery';[109] in effect whether the compensation order regime and other claims within a liquidation context could allow the same funds to be recovered twice from the same person. The judge considered, however, that this would not happen as there were checks and balances in place.[110] He also considered the effects of the regime on director disqualifications.[111] As only disqualified directors can be the subject of a compensation order, it is likely that fewer disqualification cases will settle. The relevant literature on the regime warns that a claim for compensation may follow one for disqualification.

[102] [2013] BCC 771
[103] [2005] BCC 783.
[104] [2019] EWHC 2806 para.65.
[105] Collecting the compensation many prove difficult as Mr. Eagling had moved to Northern Cyprus. [2019] EWHC 2806 at para. 9.
[106] [2019] EWHC 2806 para.24.
[107] [2019] EWHC 2806 para.65
[108] [2016] EWHC 243
[109] [2019] EWHC 2806 paras 46-51
[110] [2019] EWHC 2806 para.50
[111] [2019] EWHC 2806 paras 53-54

**(v) The Australian Experience**

Australia has a long-established compensation order regime. It is very different from that which exists in the UK. It forms part of its civil penalty regime. Where instances of insolvent trading occur, ASIC can seek to have the director fined, disqualified or made personally liable. The aim in imposing personal liability is to obtain compensation for a company that has suffered a loss as a result of the director's breach of duty. In effect, the court may order compensation where a civil penalty provision has been breached and damage results to the company. As part of that regime, ASIC (along with liquidators and creditors) can apply for compensation.[112] There are provisions in place to ensure that multiple applications are not taken. Specifically, a creditor can only pursue a claim with the consent of the liquidator.[113] If the liquidator does not respond within a certain time frame, the creditor can apply to the court for leave to proceed with the case.[114] If the liquidator makes the application, then the amount awarded is due to the company.[115] If the application is made by a creditor, then the amount is due to the creditor.[116]

The number of compensation orders sought and applied for by ASIC has been relatively low.[117] Recent research by Welsh indicates that, since 1993, a compensation order has only been sought in eleven cases. Encouragingly, nine out of the eleven were successful,[118] a success rate of nearly eighty-two percent. This demonstrates a clear strength of the regime. Further, a compensation order has never been the sole order sought. Steele and Ramsay found similar results. In their study, they found an additional two reported cases in which ASIC sought a compensation order.[119] In Welsh's view this reflects the fact that ASIC does not see its primary role as one of obtaining compensation for companies and their shareholders.[120] This exposes

[112] Liquidators and creditors can apply under S.588M Corporations Act, 2001. ASIC can apply under S.1317G and S.1317H.
[113] S.588R Corporations Act, 2001
[114] S.588S and S.588T Corporations Act, 2001.
[115] S.588M(2) Corporations Act, 2001
[116] S.588M(3) Corporations Act, 2001
[117] Steele and Ramsay, 'Insolvent Trading in Australia. A Study of Court Judgments from 2004 to 2017' [2019] 27 Insolvency Law Journal 156 at *172*
[118] Welsh, 'Realising the Public Potential of Corporate Law: Twenty Years of Civil Penalty Enforcement in Australia' [2014] 42 (1) Federal Law Review 217 at 238
[119] Steele and Ramsay, 'Insolvent Trading in Australia. A Study of Court Judgments from 2004 to 2017' [2019] 27 Insolvency Law Journal 156 at 185.
[120] Welsh, 'Realising the Public Potential of Corporate Law: Twenty Years of Civil Penalty Enforcement in Australia' [2014] 42 (1) Federal Law Review 217

potential fault line in the area. When a regulator seeks compensation for a creditor, is the regulator exercising a public or a private function?

The Australian corporate civil penalties regime is well established and hence its operation is instructive.[121] ASIC can apply to the court to have a pecuniary penalty imposed if the director's behaviour has prejudiced the company's ability to pay its creditors.[122] Penalty levels are specified.[123] It works alongside private enforcement to great effect[124] and has been highly successful.[125] It is a regime which is vigorously pursued.[126] Interestingly, in recent years most Australian civil penalty applications have been in relation to public as opposed to private companies and are often used in high profile cases. This appears to be an astute approach as it highlights both the role of ASIC and the consequences of company law breaches. It sends a strong deterrent message to the market.[127] This is a significant advantage of a public regime over a private regime. The regulator can choose cases to take with the maximum public and deterrent impact in mind. Policy considerations can to some extent determine which cases to take. Private enforcement on the other hand is ad hoc. It cannot be focused as it is subject to the vagrancies of the participants as to whether a case is taken or not. This can result in published cases of dubious deterrent value. Specifically, Re. Appleyard Motors Ltd.[128] and Re. Kelly Trucks Ltd.[129] have such unusual facts and are so fact specific that, while their very existence means that there is a deterrent value, it cannot be that strong.

[121] The regime has been in place since 1993. Welsh, 'Realising the Public Potential of Corporate Law: Twenty Years of Civil Penalty Enforcement in Australia' [2014] 42 (1) Federal Law Review 217 at 225.
[122] S.1317G Corporations Act, 2001. There are other grounds also.
[123] S.1317GAD Corporations Act, 2001.
[124] Nic Bhloscaidh 'The Concurrent Operation of Public and Private Enforcement of the Duties of Corporate Directors: Reinvigorating the Derivative Action and Refining the Public Enforcement Regime' [2018] CLP 132 at 136.
[125] Jones and Welsh, 'Toward a Public Enforcement Model for Directors' Duties of Oversight' [2012] 45(2) Vand. J. Transnat'l L. 343 at 386
[126] Keay and Welsh, 'Enforcing Breaches of Directors' Duties by a Public Body and Antipodean Experiences' [2015] 15(2) Journal of Corporate Law Studies 255 at 270
[127] Welsh, 'Realising the Public Potential of Corporate Law: Twenty Years of Civil Penalty Enforcement in Australia' [2014] 42 (1) Federal Law Review 217 at 234
[128] [2015] IEHC 28 and [2016] IECA 280
[129] [2019] IEHC 6

**(iv) Concluding Comments**

Public enforcement can be very effective. While the UK achieved this via a new section, the entity tasked with obtaining disqualification orders, the Department of the Secretary of State for Business, Energy and Industrial Strategy, was also tasked with obtaining compensation orders. Hence the structure is simple; an existing expert body was given an additional power as part of its overall role. The Australian system is even more straightforward. ASIC is simply one of the entities, along with the liquidator and creditors, who can apply to court for compensation on behalf of the company or to have a civil penalty imposed.[130] Both systems appear to work. The first compensation order case taken in the UK was successful.[131] ASIC, when it sought compensation orders, was even more successful. As we have seen the success rate was 82%.[132] Civil penalties are also successfully obtained. Thus, it appears from an Irish standpoint that a similar approach should be taken.

The next question is what form Irish public enforcement of reckless trading should take. It is obvious that the already effective and expert ODCE should be granted enforcement jurisdiction. This is especially the case as its prestige, role and resources will be greatly enhanced when the Companies Corporate Enforcement Authority Bill, 2018 is enacted. However, more difficult questions arise as to how exactly this role should be structured and organised. It is simply not a straightforward case of copying either regime wholesale and using it here. Secondly, we must ask whether the ODCE will view its task as one of obtaining compensation for private entities. This is an important question. As we have seen from the Australian experience, this may pose a significant obstruction to the efficacious fulfillment of its role. Finally, we must ask how we can prevent public enforcement falling foul of one of the problems which has hindered the invocation of section 610 to date, impecunious directors. Is there a solution to this issue within a civil sanction type regime?

[130] Only ASIC may apply to have a civil penalty imposed.
[131] Noble Vintners Ltd. [2019] EWHC 2806
[132] Welsh, 'Realising the Public Potential of Corporate Law: Twenty Years of Civil Penalty Enforcement in Australia' [2014] 42 (1) Federal Law Review 217 at 238.

## (IV) THE FORM OF IRISH PUBLIC ENFORCEMENT

### (i) Introduction

We can draw from the above analysis the features required for a public enforcement system for reckless trading. Such a regime must have a deterrent effect. It must be constitutionally robust. It should, if possible, compensate creditors financially damaged by director misbehaviour. It must effectively sanction directors where compensation is not possible. It must be a system which is easy to put in place; in effect it must avoid the constitutional issues which arise with administrative sanctions. Finally, any new system must be one which can handle the complex risk-based questions which arise on insolvency and in its vicinity. Having now examined the two different regimes which exist in the UK and Australia, one or other of these (or a combination thereof) could be adopted as a public enforcement mechanism in Ireland.

On this basis, it is recommended that the new Irish public enforcement regime for reckless trading should have the following features:

1. The ODCE should be granted the ability to invoke section 610
2. The existing successful restriction order liquidator reporting system should be extended to reckless trading.
3. The OCDE should be granted the power to impose an administrative fine in certain circumstances.
4. The restriction and disqualification undertaking system should be leveraged to increase the use of section 610.

### (ii) The ODCE

The first hallmark of the regime is to adopt a system similar to that which exists in Australia. ASIC has locus standi to take a case where the director has caused the company to trade while insolvent in order to obtain compensation. The ODCE would be added to the list of those who have locus standi to pursue a claim under section 610. The purpose of this addition would be to allow the ODCE to independently pursue a director where reckless trading occurs. Its role, in part, would thus be on par with ASIC.

Such a step would have many advantages. In particular, the ODCE could pursue a reckless trading claim in tandem with an application for disqualification.[133] Behaviour for which a director is disqualified often encompasses reckless trading behaviour. Thus, reckless trading is sanctioned via the disqualification regime. This is demonstrated both by case law and ODCE Reports as we have seen in Chapter Six (though the restriction order regime is the prevalent mode of enforcement). Moreover, the Insolvency Unit of the ODCE targets dissolved companies with significant liabilities to determine whether disqualification may be appropriate.[134] Some of these cases indicate reckless trading behaviour. Specifically, the Report details the fact pattern in one case where "*The liquidator found that the directors' decision to continue trading was one of the key reasons for the liquidation and contributed to the extent of the deficit to the creditors"* [135] In another instance *"The liquidator found that the company's directors failed to wind up the company in a timely manner, failed to maintain proper books and records and that a phoenix company was operated by the directors, which took over the trade, business and assets of the company, whilst the company was left insolvent with substantial debts."*[136] Similar behaviour in listed in the most recently published Report.[137] The above indicates that because of this information conduit and its role as a driver of disqualification applications, the ODCE is extremely well placed to police this area.

Importantly also, the court has the discretion to impose a disqualification order on a director who has been found to be involved in reckless trading.[138] This demonstrates the relationship between the two provisions. If a finding of reckless trading can result in a disqualification order, the converse can also apply; there may be issues regarding the disqualification which indicate that the director was involved in reckless trading. It is a lacuna in the system that where such behaviour involves reckless trading, the ODCE is limited (unlike ASIC) to a section 642 application alone.

[133] The ODCE would not be confined to invoking S.610 in conjunction with a disqualification order application. Compensation could be the sole order sought.
[134] ODCE Annual Report 2019 (Dublin 2020), p.14
[135] ODCE Annual Report 2019 (Dublin 2020), p.41
[136] ODCE Annual Report 2019 (Dublin 2020), p.41.
[137] ODCE Annual Report 2020 (Dublin 2021), p.35
[138] S.842(c) Companies Act, 2014

The Australian precedent is a strong one. Where a director has engaged in insolvent trading, ASIC has a choice. It can seek to obtain compensation for the company, a civil penalty,[139] disqualification[140] or a combination of the foregoing. While the Australian grounds for disqualification differ from those in Ireland, that jurisdiction's successful system clearly indicates that increasing the links between the two remedies would be beneficial. Specifically, also, in Australia, whether or not the director did his or her best to avoid insolvent trading[141] and whether tax liabilities were discharged[142] are considerations in determining whether or not a director should be disqualified.

The intention of this proposal is not to make the ODCE the litigant of first recourse with regard to reckless trading. The ODCE even when reconstituted as an Authority[143] will still have to marshal its resources. That said, a discretionary ability to invoke section 610 in tandem with a disqualification application will considerably add to the potency of the section and increase its effectiveness as a deterrent. As we have seen, disqualified directors engage in what is very likely reckless trading behaviour but escape financial sanction. Granting locus to the ODCE should help to close this lacuna.

**(iii) The ODCE and the Restriction Order Regime**

The above points are also evident in the restriction order regime. Restriction is a far more common sanction than disqualification.[144] This is evident from the ODCE Annual Reports. What may constitute reckless trading behaviour is frequently cited by the ODCE as a reason for the restriction as the following extracts from the 2019 Report attest; *"The directors allowed the company to trade for a protracted period while insolvent, to the detriment of creditors."* and *"The remaining director allowed the company to continue to trade for a protracted period when he knew, or ought to have known, that the company was insolvent."*[145] Further, as we saw in Chapter Six, reckless trading behaviour is very common in reported restriction order cases. Case law

[139] S.1317G and S.1317H Corporations Act, 2001
[140] S.206C Corporations Act, 2001
[141] Re Delonga and ASIC [1994] 15 ACSR 450 para.29
[142] Healey v ASIC [2000] AATA 9
[143] Companies Corporate Enforcement Authority Bill, 2018
[144] ODCE Annual Report 2019 (Dublin 2020), pgs.39-40.
[145] ODCE Annual Report 2019 (Dublin 2020), p.42. See also ODCE Annual Report 2020 (Dublin 2021), pgs.36-37

examples of trading while insolvent,[146] non-payment of taxes[147] and reckless operational behaviour[148] abound.

There is currently significant interaction between liquidators and the ODCE under the restriction order regime. The liquidator must complete a detailed form setting out whether he or she considers that the director should be restricted.[149] This gives the ODCE clear information on any issues or problems in the company. A relatively straightforward step could, therefore, be to require the liquidator complete a form setting out whether he or she considers that section 610 has been breached. As with restriction orders, the ODCE could agree or disagree with the liquidator's view of the situation and, if necessary, instruct the liquidator to invoke section 610. Such a structure must increase the invocation rate of the section. The restriction order regime had an initial very slow start. It was not until section 56 of the Company Law Enforcement Act, 2001 granted the ODCE the power to instruct a liquidator to either commence or refrain from commencing a restriction application under what is now section 683 that the robust regime we have now came into existence. The same result will emanate from the implementation of a similar system for section 610.

The above suggestion is, in effect, utilising an important aspect of the restriction order regime; the liquidator is best placed to uncover misbehaviour. The restriction order regime has harnessed that fact by requiring the liquidator to bring an application under unless relieved of this obligation by the Director of Corporate Enforcement. In effect, the liquidator has a quasi-public role.[150] Though best placed to uncover misbehaviour in a potential reckless trading situation, section 610 does not currently exploit that ability. ASIC follows a similar strategy, and the benefits are clear. It has a wealth of information available to it based insolvency practitioners' reports.

Of course, the reality may be that the liquidator does not have sufficient funds to pursue the claim or that the director is impecunious. This information could be

[146] See Re Tailored Homes (Navan) Ltd. [2017] IEHC 7, Re. Winning Ways Ltd [2020] IEHC 264 and Re. Adalbert Ltd. [2020] IEHC 194
[147] Van Dessel v Esmonde [2014] IEHC 278, and Luby v Logan. [2019] IEHC 260.
[148] Re. Pineroad Distribution Ltd. [2007] IEHC 55
[149] S.863 Companies Act, 2014
[150] Ahern, 'Directors' Duties: Broadening the Focus Beyond Content to Examine the Accountability Spectrum' [2011] 33(1) DULJ 116 at 141.

included in the report also. The ODCE would then be in a position to make a judgement both as to whether the director has a case to answer with regard to reckless trading and whether it is practical to instruct the liquidator to institute proceedings. A case in point here is Re. Noble Vintners Ltd. The Secretary of State in that case had knowledge of the liquidator's financial position.[151] Moreover, from an efficiency standpoint, the restriction order High Court hearing and the reckless trading case could both be heard at the same time. This is cost efficient and would avoid the necessity of a two-stage process as occurs in the UK. Thus, it may often be possible to pursue a director for reckless trading at little additional cost.

Where the liquidator could not afford to invoke section 610, the ODCE would have the option to pursue the case itself. Obviously, due to resource constrains, the ODCE would not be in a position to pursue every deserving case or even a meaningful percentage of such cases. That said, there will be situations where such interventions are warranted. This would occur where the liquidator cannot afford to the take the case but the director is financially solid and worth pursuing. In other very occasional situations, the ODCE could pursue an impecunious director whose behaviour was egregious. Invocation by the ODCE would be beneficial in such circumstances. The potency and deterrent effect of the section would be significantly increased. ASIC uses its powers in an astute and targeted manner.[152] The ODCE would be clearly able to use a similar approach.

Furthermore, restriction (or, indeed, disqualification) would not be a prerequisite for a successful reckless trading award. While an unlikely event, it should be possible to find that a director should not be restricted but that he or she was involved in reckless trading. Making compensation conditional on disqualification has been criticised by Keay and Welsh[153] and is described as a lacuna in the UK compensation order legislation. A creditor would not receive compensation where either the Secretary of State does not consider that a disqualification application is warranted, or a judge decides not to disqualify. Keay and Welsh's point is that there may well be cases where

[151] [2019] EWHC 2806 para.65
[152] Welsh, 'Realising the Public Potential of Corporate Law: Twenty Years of Civil Penalty Enforcement in Australia' [2014] 42 (1) Federal Law Review 217 at 234.
[153] Keay and Welsh, 'Enforcing Breaches of Directors' Duties by a Public Body and Antipodean Experiences' [2015] 15(2) Journal of Corporate Law Studies 255 at 282

the application for disqualification is not justified, or the application fails but this does not mean that the creditor is not entitled to compensation. The Appleyard case is in point here. The conduct of the directors may have warranted compensation. However, it is unlikely that due to the very specific nature of what occurred, that, if that was the only instance of misconduct, the directors would have been disqualified or restricted. Indeed, even without the Appleyard example, it is possible to envisage many cases where a director's isolated action was reckless only in so far as a specific creditor was concerned. Keay and Welsh are therefore correct. The UK legislation is too narrow. That fact that a director is not disqualified does not necessarily mean that reckless trading behaviour has not occurred. It would therefore be preferable to allow public enforcement of section 610 in the absence of an application for or the imposition of a restriction or disqualification order. The preference is an Australian style system where compensation and disqualification are independent of one another.

**(iv) Impecunious Directors**

There is the long-standing issue regarding reckless trading generally; it is pointless invoking section 610 if the director concerned has no private assets.[154] Public enforcement will not solve this problem. If it is futile for a liquidator to pursue a director because he or she has scant resources, it will be equally futile for the ODCE to do so in the vast majority of circumstances.[155] This issue has been well documented from a UK perspective by Williams[156] who found using a sample survey that twenty two percent of disqualified directors became bankrupt.[157] However, an important point to draw from this analysis is that seventy eight percent (in effect nearly four out over every five directors) were not declared bankrupt. A significant proportion of this cohort must have at least some assets worth pursuing. However, this is not the end of the matter as Williams was unable to study other personal insolvency arrangements as information is not publicly available.[158] He makes the reasonable assumption that the

[154] The Law Commission, Consultation Paper No. 195, Criminal Liability in Regulatory Contexts A Consultation Paper (London August 2010), para.A.68.
[155] In a minority of cases, the ODCE might decide to proceed anyway if the behaviour was very egregious.
[156] Williams, 'Civil Recovery from Delinquent Directors' [2015] 15(2) Journal of Corporate Law Studies 311
[157] Williams, 'Civil Recovery from Delinquent Directors' [2015] 15(2) Journal of Corporate Law Studies 311 at 326.
[158] Williams, 'Civil Recovery from Delinquent Directors' [2015] 15(2) Journal of Corporate Law Studies 311 at 329

number of alternative insolvency arrangements at least equals the number of bankruptcies.[159] Thus, while not all directors are impecunious, this issue will limit the effectiveness of a public ability invoke section 610

That said, even the combined UK bankruptcy and alternative insolvency arrangement figures would indicate that somewhere in the region of fifty to sixty percent of disqualified directors escape all types of personal insolvency arrangements.[160] Again, even within this more limited cohort, there must be a significant number of individuals worth pursuing either privately or publicly.

Likewise, in Australia, Steele and Ramsay determined that thirty-nine insolvent trading cases were taken between 2004 and 2017. The authors were able to determine the monetary amount awarded in twenty-one of those cases. It averaged AUS$846,739. The median was AUS$410,593. The highest award was AUS$3,422,900 and the lowest AUS$$53,504. Most awards were for less than AUS$500,000. However, one third were for more than AUS$1,000,000.[161] Again, this is evidence that not all directors of insolvent companies are hopelessly impecunious. Many directors will be worth pursuing either by the liquidator on ODCE instructions or by the ODCE itself. This is, of course, subject to the ODCE's resource constraints. It cannot be expected to pursue any significant percentage of deserving cases. That said, targeted and occasional invocations would significantly improve the potency and effectiveness of section 610.

While some directors will be worth pursuing, many will not be from a compensation standpoint. As we have seen, a significant difficulty facing the enforcement of reckless trading is that, as currently structured, impecunious directors face no sanction. Thus, such individuals can engage in reckless trading with impunity. It carries no financial consequences. Granting the ODCE an invocation and oversight role will only take us so far where such directors are concerned. This means that something more is

[159] Williams, 'Civil Recovery from Delinquent Directors' [2015] 15(2) Journal of Corporate Law Studies 311 at 330.
[160] Williams, 'Civil Recovery from Delinquent Directors' [2015] 15(2) Journal of Corporate Law Studies 311 at 330
[161] Steele and Ramsay, 'Insolvent Trading in Australia. A Study of Court Judgments from 2004 to 2017' [2019] 27 Insolvency Law Journal 156 at 171.

needed. The reality must be that even a relatively small civil sanction would have a significant deterrent effect.[162] Impecunious directors who engaged in reckless trading behaviour would finally face a real financial consequence. The next question is what form such sanctioning should take.

A civil penalty regime would not be suitable. Many academics question such a system. It can be interpreted as a means by which the state achieves its regulatory goals while by passing the high standard of proof and procedural requirements of the criminal system.[163] Importantly, the civil penalty regime in Australia has suffered some difficulties. Judges have treated civil penalty cases as quasi-criminal. Defendants have sometimes been granted procedural protections similar to defendants in criminal trials.[164] This treatment appears to have a long history.[165] Issues around the burden of proof have also arisen.[166] Similar concerns have been expressed in the UK.[167] Civil penalty cases have also proven to be expensive in Australia. In Forrest v ASIC[168] the Commission apparently engaged seven senior counsels and spent AUS$30 million pursuing the plaintiff.[169] Forrest was a high-profile case.[170] ASIC's budget in 2011-12 was AUS$304 million,[171] thus the Forrest costs equalled nearly 10% of ASIC's funding in that year.

[162] Welsh, 'New Sanctions and Increased Enforcement Activity in Australian Corporate Law: Impact and Implications' [2012] Comm. L. World. Rev. 134
[163] Keay and Welsh, 'Enforcing Breaches of Directors' Duties by a Public Body and Antipodean Experiences' [2015] 15(2) Journal of Corporate Law Studies 255 at 264
[164] Keay and Welsh, 'Enforcing Breaches of Directors' Duties by a Public Body and Antipodean Experiences' [2015] 15(2) Journal of Corporate Law Studies 255 at 274.
[165] Gilligan et al, Regulating Directors' Duties. How Effective Are the Civil Penalties Sanctions in the Australian Corporations Law (University of Melbourne Legal Studies Research Paper No. 156), p.43
[166] Comino, 'James Hardie and the Problems of the Australian Civil Penalties Regime' [2014] 37(1) University of NSW Law Journal 195 at 225.
[167] Macrory, 'Sanctions and Safeguards: The Brave New World of Regulatory Enforcement' [2013] 66(1) Current Legal Problems 233 at 249.
[168] [2012] 247 CLR 486. This case involved a company called Fortescue Metals Group Ltd and its director Andrew Forrest. ASIC's argument was the Mr. Forrest had contravened S.1041H Corporations Act, 2001 by misleading the public as to the effect of various agreements the company had entered into with Chinese companies. Such a contravention gave rise to civil liability under S.1041I. ASIC argued that Forrest has represented that the agreements were legally enforceable under Australian law when, in fact, it was merely the intention of the parties that they would be bound by them. The High Court of Australia held that factually no misrepresentation had been made.
[169] Comino, 'James Hardie and the Problems of the Australian Civil Penalties Regime' [2014] 37(1) University of NSW Law Journal 195 at 200
[170] The company involved, Fortescue Metals Group Ltd. is a major public company in Australia and fourth largest iron ore producer in the world.
[171] ASIC Annual Report 2011-12 (Sydney 2012), p.16

It is therefore recommended that the ODCE be granted the ability, similar to the Central Bank to impose an administrative fine where reckless trading behaviour has occurred. Such an ability would be very beneficial. Hearing of this type should be relatively informal. Thus, it should not result in the high legal costs which court applications entail. Moreover, even the most financially constrained will have the wherewithal to pay a small fine. The ODCE would have the expertise to levy such fines in an impartial and unbiased manner. Cases can be chosen with the maximum public and deterrent impact in mind. Such an ability would allow strategic enforcement to obtain maximum voluntary compliance.[172] The regulator can be proactive. Coupled with a redrafted section 610, its personnel would be capable of making apposite judgments on whether inappropriate risks were taken with creditors' money. This will especially be the case when the Companies Corporate Enforcement Authority Bill, 2018 is enacted. It will have autonomy regarding the hiring of staff[173] and will therefore be in a position to hire additional expertise if required.

The Constitutional constraints still exist, however. That said, these should be solvable. In Purcell v Central Bank of Ireland, the High Court held that the Central Bank's levying of an administrative sanction did not breach Article 34. The financial penalty had to be confirmed by a court of competent jurisdiction.[174] The vast majority of reckless trading fines would be imposed in tandem with a disqualification or restriction order application. Thus, the High Court could simultaneously confirm or otherwise the levying of the sanction. This would be more than mere rubberstamping. The system would be efficient and not run up additional significant costs for liquidator, the ODCE or the director. Situations where only an administrative fine was imposed would be outliers. Confirmatory standalone proceedings would be rare.

Many other benefits would accrue from such a step. Publicising a regulator's decisions can have a stigmatising effect, thus deterrence is increased.[175] The imposition of sanctions would be published in the ODCE's Annual Reports. Likewise, judicial

[172] Welsh and Morabito, 'Public v Private Enforcement of Securities Laws: An Australian Empirical Study' [2014] 14 JCLS 39 at 51
[173] Head 11 Companies Corporate Enforcement Authority Bill, 2018
[174] [2016] IEHC 514 para.8.7.
[175] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 1: Regulatory Powers (Dublin 2018), para.3.159

guidance would also be available. This would have both an educative and norm setting effect. Moreover, the fact that sanctioning is happening would not languish unseen on some specialist database. Maximum voluntary compliance can also be achieved by strategic enforcement on behalf of the regulator.[176] The ODCE could target via the new administrative fine regime the categories of reckless trading behaviour which frequently occur within the restriction order regime such as protracted insolvent trading and tax defaults. This would further enforce the message that behaviour of this type will not be tolerated. As it currently stands, instances of insolvent trading and significant tax accruals appear with depressing regularity when section 819 is invoked. Restriction may in many circumstances be an inadequate penalty by itself.

Furthermore, such a step would not adversely impact of the policy underpinning reckless trading; that of creditor compensation. The first port of call would always an invocation of section 610 by a liquidator, a creditor, or, occasionally, the ODCE in order to obtain compensation. An administrative fine could be levied where the director is clearly impecunious and seeking compensation would be pointless or the behaviour is particularly egregious. Directors who can make at least some contribution to the creditors could be pursued privately (or publicly in more limited circumstances) as even a small contribution is better than none at all.

Applications in these circumstances would form part and parcel of the role of the regulator is to use its enforcement powers strategically to increase compliance and deter harmful behaviour. As Ni Bhloscaidh points out successful high-profile cases can create adverse publicity which deters other directors from engaging in similar activities. The ODCE could follow ASIC's approach and use careful decision-making processes to ensure that "maximum regulatory impact" is achieved.[177] An administrative sanction regime would send a strong message to directors that wrongdoings concerning creditors are taken seriously,[178] thus increasing the deterrent

[176] Welsh and Morabito, 'Public v Private Enforcement of Securities Laws: An Australian Empirical Study' [2014] 14 JCLS 39 at 51
[177] Nic Bhloscaidh 'The Concurrent Operation of Public and Private Enforcement of the Duties of Corporate Directors: Reinvigorating the Derivative Action and Refining the Public Enforcement Regime' [2018] CLP 132 at 137. The author comments are in the context of directors' duties.
[178] Keay, 'Wrongful Trading and the Liability of Company Directors: A Theoretical Perspective' [2005] 25(3) Legal Studies 432 at 454-455

effect of the section. Such actions taken by the ODCE in such circumstances would align well with the deterrence rationale underpinning section 610.[179]

Further, both the report from the liquidator and the ability to invoke section 610 will have an added advantage regarding the ODCE's educative role. In order to fulfill its function of encouraging compliance with the Companies Acts,[180] directors could be educated as to how reckless trading behaviour can be avoided. The higher volume of information available to it will embed within the organisation a deeper understanding of when and why reckless trading occurs, its parameters and effects. This information can then be disseminated to stakeholders via annual reports and, indeed, the judicial decisions themselves. The ODCE already has an admirable record in its educational function. Such knowledge should allow it to enhance this reputation further. ASIC's national insolvency training program is cited in this regard.[181]

**(v) The Undertaking Procedure**

In the UK, the Secretary of State may accept a compensation undertaking.[182] This is important as it saves both sides the expense and time costs of court proceedings. As we have seen, one of the reasons for the dearth of invocation of section 610 is the issue of legal costs. An undertaking procedure goes some way to overcoming this difficulty. That said, general criticisms which apply to the restriction and disqualification regime undertaking procedure must be kept in mind. Transparency is important in any regulatory process[183] and this may be lacking where an undertaking procedure is used. Further, the result may depend on the strength of each sides' negotiating skills rather than an objective measurement of the merits of the case. Finally, as Williams points out, some directors, due to cost constraints, may feel obliged to comply with the undertaking for that reason alone.[184]

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[179] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para.12.52.
[180] S. 949(1)(a) Companies Act, 2014
[181] Australian Securities and Investments Commission, REP 213 National Insolvent Trading Program Report (October 2010)
[182] S.15A(2) Company Directors' Disqualification Act, 1986
[183] Macrory, 'Regulatory Justice: Making Sanctions Effective' (Better Regulation Executive, UK Cabinet Office 2006). See Chapter 5 on the importance generally of transparency.
[184] Williams, 'Civil Recovery from Delinquent Directors' [2015] 15(2) Journal of Corporate Law Studies 311 at 338

It is, however, submitted that some trade off must occur and the use of undertakings, if compensation is obtained for creditors, it is the lesser of two evils. Further, as a safeguard, compensation should be decoupled from disqualification and restriction; for example, a director could accept a compensation undertaking while challenging a disqualification application or vice versa. Likewise, a director could accept some aspects of a suggested compensation undertaking and challenge others. Finally, a built in safe-guard which exists in the UK legislation could also be introduced here; if the director has given a compensation order undertaking he or she can apply to the court to have the compensation undertaking varied or cancelled.[185] This is a sensible provision; the individual could, for example, have entered into to undertaking in the absence of legal or financial advice or the advice given may have been wrong. Likewise, a director's financial position could unexpectedly deteriorate. A provision whereby the undertaking can be revisited is therefore warranted and sensible.

**(vi) The Creditor's Position**

The next issue which arises is whether creditors should retain the ability to invoke section 610. As we saw in Chapter Two, there are sound reasons for the current position. However, that leaves open the possibility that a wealthy creditor may decide to simply stand back and allow the ODCE to pursue the miscreant directors. If successful, the creditor or company would benefit at the expense of the public purse. If the ODCE is unsuccessful, the creditor has lost nothing. There is precedent for such an occurrence. In Re. Aventine Resources Ltd.,[186] while the shareholders complained the directors' behaviour to the ODCE, they did not make the disqualification application themselves. Instead, the ODCE made the application. As Williams states public enforcement may simply serve to shift the costs of civil recovery on to the state.[187]

That said, it is doubtful that this is a real risk. The ODCE's main role in this area will be akin to its role regarding restriction orders; to instruct the liquidator to institute proceedings where the invocation of section 610 is warranted or impose an

[185] S.15C Directors Disqualification Act, 1986.
[186] [2010] IESC 59
[187] Williams, 'Civil Recovery from Delinquent Directors' [2015] 15(2) Journal of Corporate Law Studies 311 at 322.

administrative fine. On rare occasions, resources allowing, the ODCE will pursue directors for compensation itself possibly in tandem with a disclosure order application. Its function, therefore, will be as a litigator of last rather than first resort. Its personnel are astute, and their expertise will increase when the Companies Corporate Enforcement Authority Bill, 2018 is enacted. It is therefore highly unlikely that it would unwittingly pursue a case where a creditor is well placed to do so.

Another solution may be to allow creditors who believe that they have a case but do not have the funds to make the application themselves (and cannot persuade the liquidator to do so) to petition the ODCE to act on their behalf. The ODCE could then obtain its own assurances as to the financial wherewithal of the creditor and the strength of its case. In effect, a system would be in place to direct creditors towards enforcing the section themselves in the first place. Where funds are not available, then the ODCE could step in if it considered that action was warranted. Due to resource constraints, this would only occur where private funding was not available and the director's behaviour was particularly egregious or the director was particularly financially strong. Even if section 610 is not ultimately invoked, receiving information from creditors as to alleged director misbehaviour could inform policy and may be useful in an educative capacity. Creditors who were previously discouraged by legal costs would now have a fresh avenue open to them. Directors who engaged in reckless trading on the basis that neither the company nor the creditors would have funds to pursue them and perhaps pursued a 'scorched earth' policy[188] with this end in mind would now face a real deterrent; the ODCE.

**(vii) Policy Issues**

It has been argued that the purpose of regulation is not to compensate those who have suffered losses, but instead to encourage increased levels of compliance.[189] Thus the argument runs that public resources should not be expended for the purpose of securing compensation for private individuals or entities.[190] As we have already seen

[188] Report of the Working Group on Company Law Compliance and Enforcement (Dublin November 1998) ('The McDowell Report), para.4.42.
[189] Welsh, 'Realising the Public Potential of Corporate Law: Twenty Years of Civil Penalty Enforcement in Australia' [2014] 42 (1) Federal Law Review 217 at 230.
[190] Welsh, 'Realising the Public Potential of Corporate Law: Twenty Years of Civil Penalty Enforcement in Australia' [2014] 42 (1) Federal Law Review 217 at 231. Moreover, a lack of enthusiasm for pursuing compensation order applications in noted by Bailey. Bailey, 'Noble Vintners

ASIC does not seem to regard its role as obtaining compensation for private individuals. This is also a risk if public enforcement is introduced in Ireland. The ODCE's primary function is to improve compliance by encouraging adherence to the requirements of the Companies Acts.[191] It also sees its role as investigative[192] and enforcement orientated. Arguably that mission does not include obtaining compensation for private parties. That may also be a consideration with the ODCE especially considering its resource constraints.[193] The ODCE may take the view that it is taking over a role which should be carried out by the liquidator or the creditors themselves. It may, for this reason, place a primary focus on the imposition of administrative fines.

However, while due to resource constraints, the ODCE could never be the litigant of first resort, it could and should regard this quasi-private role as being within its ambit. As Welsh argues regarding ASIC, the role of the regulator is to use its enforcement powers strategically to increase compliance and deter harmful behaviour.[194] The fact that compensation for creditors is sought and obtained should have a deterrent effect,[195] thus improving corporate behaviour as a whole. This is an important issue overall. If the ODCE's public enforcement powers in this area are not used with regard to public enforcement, then this power will go the way of current private enforcement and the deterrent effect will be minimal.

Secondly, reckless trading has a wider societal impact. Creditor businesses who suffer as a result of reckless trading do not exist in a vacuum. The fact that a business has not been paid may have a significant impact on its own viability. This is turn will adversely

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Ltd.- Compensation Orders Following Disqualification: Why, What and Where Next?' [2020] 33(4) Insolv. Int 124 at 128

[191] ODCE Customer Charter. Appleby, 'Compliance and Enforcement – the ODCE Perspective' in Regulatory Crime in Ireland Kilcommins and Kilkelly (Eds) (First Law/Lonsdale Law Publishing Dublin 2010), p.180

[192] Appleby, 'Compliance and Enforcement – the ODCE Perspective' in Regulatory Crime in Ireland Kilcommins and Kilkelly (Eds) (First Law/Lonsdale Law Publishing Dublin 2010), pgs.180-181

[193] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7 at 9

[194] Welsh, 'Realising the Public Potential of Corporate Law: Twenty Years of Civil Penalty Enforcement in Australia' [2014] 42 (1) Federal Law Review 217 at 233.

[195] Department for Business Innovation and Skills, 'Impact Assessment – Giving the court and Secretary of State (SoS) a power to make a compensatory award against a director' (June 2014), paras. 61

impact on its own employees and creditors.[196] Ultimately the success of any public enforcement regime will be dependent on the ODCE's policy in deciding which and how many cases to pursue. Indeed, it is probably not possible to classify claims against directors to recover money for creditors as either a solely public or solely private function.[197] Further, as has been found, reckless trading type behaviour is being dealt with via the restriction order regime. That must be an indication that it has a significant public importance and thus that it is suitable for a system of publicly obtained compensation.

Moreover, assisting creditors who have irrevocably lost money due to director misbehaviour has a normative foundation and aligns well with the body's public interest function. The ODCE may correctly argue that it is carrying out work which should be done by others. Where those others cannot do so, public enforcement must step into the breach. Keay points out that the very granting to the Secretary for State for Trade and Industry the power to bring section 214 proceedings would be a powerful signal that wrongful trading is public law.[198] Precisely the same point can be made regarding section 610. Welsh argues that the primary role of the regulator is to enforce is a strategic manner to encourage the non-compliant to comply.[199] The same analysis can be applied to reckless trading. Welsh asks, in the context of the public enforcement of directors' duties in Australia, whether the function of public enforcement in that jurisdiction is to obtain compensation for companies who have suffered a loss or to act in the public interest by encouraging those individuals inclined towards non-compliance to observe the statutory requirements.[200] In effect, her question is what is the purpose of public enforcement of directors' duties? Is it to obtain compensation for the company involved or is it for the benefit of the wider community? While the issue is narrower because reckless trading alone is under examination, the same question arises here. The answer must be that while it is

[196] Keay, 'A Theoretical Analysis of the Director's Duty to Consider Creditor Interests: The Progressive School's Approach', [2004] 4(2) Journal of Corporate Law Studies, 307 at 328
[197] Law Commission, Study Paper 11. Insolvency Law Reform: Promoting Trust and Confidence. An Advisory Report to the Ministry of Economic Development (Wellington NZ 2001), para.111
[198] Keay, 'Wrongful Trading and the Liability of Company Directors: A Theoretical Perspective' [2005] 25(3) Legal Studies 432 at 454-455.
[199] Welsh, 'Realising the Public Potential of Corporate Law: Twenty Years of Civil Penalty Enforcement in Australia' [2014] 42 (1) Federal Law Review 217 at 231
[200] Welsh, 'Realising the Public Potential of Corporate Law: Twenty Years of Civil Penalty Enforcement in Australia' [2014] 42 (1) Federal Law Review 217

undeniable that the enforcement of the reckless trading provision has a significant private benefit, the public benefits of deterrence and increased compliance, not to mention the educational benefits, are undeniable. Further, the UK Department for Business Innovation and Skills considers that as well as monetary recompense, compensation orders will have a deterrent effect, improve standards in business and encourage appropriate risk-taking.[201] These, again, all have public implications.

Hence, we can apply the following analysis to a public enforcement regime for reckless trading, as a purely private enforcement mechanism the policy underpinning section 610 can be confined to the compensation of creditors who have suffered otherwise avoidable losses. However, once the enforcement moves to the public sphere, the policy can widen to deterrence and the encouragement of those who consider engaging in reckless trading type behaviour to desist. This overcomes any difficulties which the ODCE might otherwise have had with regard to its role. The fact that the ODCE can obtain a compensation order will deter the behaviour in question. Moreover, the receipt by the creditor still has a community benefit as it is likely the compensation will be used in the creditor's own business.[202] Indeed, the New Zealand data demonstrates that the majority of the beneficiaries of successful reckless trading cases there have been small enterprises.[203]

That obtaining compensation for private parties such as creditors is within the bailiwick of a body with a public role is supported by the UK situation. In Noble Vintners, the Secretary of State sought and obtained direct compensation for twenty-eight specific creditors of the company.[204] No issue appears to have arisen in the UK that a public body was expending resources in obtaining recompense for private entities. As has previously been noted, the proposed enactment of section 15C generally met with approval. Thus, while it is obvious that, due to resource constraints, the OCDE will never pursue a significant number of reckless trading cases in its own

[201] Department for Business Innovation and Skills, 'Impact Assessment – Giving the court and Secretary of State (SoS) a power to make a compensatory award against a director' (June 2014) paras.61-63.
[202] Department for Business Innovation and Skills, 'Impact Assessment – Giving the court and Secretary of State (SoS) a power to make a compensatory award against a director' (June 2014), paras.17 and 64
[203] Taylor 'Directors' Duties on Insolvency in New Zealand: An Empirical Study' [2018] 28(2) New Zealand Universities Law Review 172 at 188.
[204] [2019] EWHC 2806 paras.69-70

right, an ability to invoke section 610 on an occasional and selective basis will be beneficial in the extreme.

## (V) CONCLUSIONS

Bringing public enforcement to bear on reckless trading via a power to administratively sanction would have significant benefits. These proposals avoid the difficulties of criminalisation, yet retain the benefits of such a step. It is also likely to be a better use of the ODCE's scarce resources than criminal enforcement. In particular, an administrative sanctions regime is flexible, easy to implement[205] and cost effective. Likewise granting the ODCE locus to obtain compensation for creditors under section 610 will be beneficial.

From the foregoing, we can propose the features of an Irish enforcement regime for reckless trading. We would not necessarily follow either the UK or the Australian system. Instead, elements of both would be combined to produce the optimal solution for Irish circumstances. The regime would be similar to Australia in that the ODCE is now one of the parties who can invoke section 610. Private enforcement should be encouraged where the parties have the financial wherewithal to mount a case. Like Australia, the ODCE would draw on reports from liquidators in order to make its decisions. The hallmarks of the new regime would be dissimilar to the UK in that no new standalone provision would be added to the Companies Acts. An undertaking system would be used, with safeguards.

Granting the ODCE locus standi, combined with an administrative sanctions regime, would also be a powerful signal to directors that reckless trading behaviour has public implications and is taken seriously by the Oireachtas. Obtaining compensation for private entities can be beneficial to society as a whole and falls within the ambit of the ODCE's role of improving compliance with the Companies Acts.[206] A regime which combines both public and private models of enforcement must result in increased invocation of section 610 and an increased number of successful cases. An administrative sanctions regime, subject to court confirmation, avoids constitutional

[205] This is especially the case if the Companies Corporate Enforcement Authority Bill, 2018 is enacted.
[206] S.949 Companies Act, 2014.

difficulties. It ensures that all directors who involve themselves in reckless trading type conduct face a real possibility of sanction.

Public enforcement is not a panacea. Many deserving cases will still not be taken due to resource constraints within the ODCE.[207] Lack of assets among culpable directors will also, as Williams states, place limits on the benefits of a civil regime.[208] That said, it will be of assistance where the case is meritorious, but funding is not available either at company or creditor level. It will also be beneficial in situations where the amount the director can contribute is perhaps small (but nonetheless beneficial to a creditor). ODCE resources would be well used in this regard; compensation obtained will very likely be used to grow or sustain the creditors' own business to the benefit of the entire community. Significant assistance will also accrue where invoking section 610 is likely to be in the public interest. Moreover, there must be many directors who know that private action is unlikely and consider that they can act as they please. The possibility of an administrative fine would have a considerable deterrent impact. Public enforcement also sends, via an administrative fine, a strong message that reckless trading behaviour is taken seriously by the legislature and is a public policy issue.[209] An educational impact will also be produced.

In conclusion, a better drafted section combined with both public oversight and administrative sanctions should ensure increased successful invocations of the section and improve generally the efficacy of section 610. As was pointed out in the first chapter to this thesis, a balance must be struck. Creditors cannot be overly favoured as this will have a chilling effect on entrepreneurial endeavours.[210] Conversely, where companies are overly favoured, irresponsible trading will be encouraged. The lack of invocation of the section and the dearth of case law indicates that currently directors are excessively favoured at the expense of creditors. The suggested measure of public enforcement will serve, in large measure, to correct this imbalance.

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[207] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7at 9.
[208] Williams, 'Civil Recovery from Delinquent Directors' [2015] 15(2) Journal of Corporate Law Studies 311 at 335.
[209] Keay, 'Wrongful Trading and the Liability of Company Directors: A Theoretical Perspective' [2005] 25(3) Legal Studies 432 at 454-455
[210] Law Reform Commission Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para.12.135

# CHAPTER TEN: CONCLUSIONS

## (I)INTRODUCTION

Finding the correct balance between supporting commercial risk-taking on the one hand and encouraging financial responsibility towards creditors on the other is a crucial issue in company law. Too much emphasis on the former can ultimately result in financial and economic crises. Too much emphasis on the latter can stultify economic activity. That the concepts of limited liability and separate legal personality can be abused has presented a difficulty since the inception of the corporate structure. The recurrent question is whether the company law system, as structured, is capable of preventing the misuse of these core concepts especially in the vicinity of insolvency. Indeed, the recent financial crisis has shown a real requirement for reform in this area.

Reckless trading can thus be understood as part of a progression. Corporate law developed a (perhaps) undue concentration on members' and controllers' interests. This arose from the inherent characteristics of limited liability and separate legal personality. Kahn-Freud[1] and Dodd,[2] with their emphasis on wider stakeholders, were for many years isolated voices. However, as the corporate form became more established and better understood, its impact on other stakeholders was increasingly acknowledged. The optimistic introduction[3] of the Irish reckless trading provision can be understood as forming part of this continuum. Section 610 was expected to be an important weapon in an armoury of measures introduced to control director misbehaviour and it was hoped that it would significantly improve corporate behaviour in the vicinity of insolvency.[4]

## (II)THE FIRST CENTRAL RESEARCH QUESTION

Unfortunately, section 610 itself and reckless trading type provisions in the jurisdictions under review have proven unsatisfactory. The most visible manifestation of this inadequacy is lack of use. While reckless trading behaviour among directors of

[1] Kahn-Freund, 'Some Reflections on Company Law Reform' [1944] 7 MLR 54.
[2] Dodd, 'For Whom Are Corporate Managers Trustees?' [1932] 45(7) Harvard Law Review 1145
[3] Duffy, 'Fraudulent Trading and the Decision in O'Keeffe v Ferris' [1994] 1(10) CLP 251
[4] Insolvency Law and Practice – Report of the Review Committee [1982] Cmnd 8558 paras.1777 and 1805

failing companies does not appear to be an outlier,[5] it is clear across all jurisdictions examined that, to a lesser or greater extent, the provision is infrequently invoked. Ireland has had five reported cases in thirty years. The UK's position, adjusted for population, does not impress.[6] New Zealand is somewhat better, though not significantly so. Australia is also an improvement, but this is likely a result of public enforcement. Moreover, the success rate in Ireland and the UK is unimpressive. This issue is important. It would be pointless suggesting improvements to the provision to increase its invocation and success rates without a comprehensive understanding of the origins of these problems in the first place.

Concerning the low invocation rate, common themes do emerge across the jurisdictions. Firstly, the cost of mounting a case can be significant. Generally, in Ireland, legal costs are high.[7] Specifically, a reckless trading application can be expensive and time consuming.[8] Coupled with this is the fact that the financial wherewithal of directors is often inextricably linked with the fortunes of their companies. If that declines significantly so can their own affluence. Academic studies point in this direction.[9] Personal guarantees are also extremely prevalent.[10] The two factors are connected; a liquidator will be unwilling to risk large legal costs to pursue a director of limited means. There are no simple solutions here. Legal costs are too high but solving that requires an overhaul of the entire charging structure. Moreover, legal rules cannot transform paupers into millionaires so that creditors can be compensated.

However, these are not the only factors. The section is awkwardly and confusingly drafted. This must have an impact on the invocation rate. Interpretational and application complexities mean that it is more difficult to mount a successful case. Many of these were recognised in the original Oireachtas debates. That the section contained a confusing mixture of subjective and objective approaches was evident

[5] See the ODCE Annual Reports. The annual level of complaints significantly exceeds reported cases.
[6] Gustafsson, 'Beating a Dead Horse? An Assessment of Wrongful Trading' [2017] 38(8) Comp. Law 239
[7] Review Group Report, Review of the Administration of Civil Justice Report (Dublin: October 2020)
[8] For example, Re. Continental Assurance Co. of London plc. [2007] 2 BCLC 287
[9] Williams What We Can Expect to Gain From Reforming the Insolvent Trading Remedy 78 [2015] MLR 55. Keay, 'Wrongful Trading: Problems and Proposals' [2014] 65(10) NLQR 63
[10] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), para.12.90

from the beginning.[11] The need to protect the ability of directors to enter entrepreneurially risky ventures was also recognised,[12] though not legislated for. Importantly, possible public enforcement was discussed and preemptively dismissed.[13]

However, other difficulties only became apparent later. The arguably incorrect interpretation that subsection (3) contains deeming provisions results in an unwieldy section which is difficult to apply.[14] A perusal of the original Oireachtas debates indicates that, when originally drafted, the subsection was intended to contain guidelines as to the type of activities which might constitute reckless trading behaviour.[15] Statutory fictions are invariably introduced for a purpose which is generally reasonably easy to ascertain. In these circumstances however, it is very difficult to determine why the legislature would designate as fictions actions which constitute, in the majority of circumstances, reckless trading behaviours in any event. The original New Zealand provision, on which section 610 may well be based, makes no reference to deeming. Judicial efforts to avoid the harsher effects of the supposed fictions have undoubtedly resulted in the section being construed in an artificial and narrow manner, as both Hefferon Kearns[16] and Appleyard[17] illustrate. Importantly also, trading while insolvent in circumstances beneficial to creditors is proscribed by the deeming provisions.

The honestly and responsibly defence is at best superfluous. It infects the provision unnecessarily with moral issues; the honesty or otherwise of a director has no bearing on whether or not he or she engaged in reckless trading behaviour. Moreover, the defence requires a court to find that a director who had acted in a reckless manner was nonetheless a responsible individual. Additionally, the subjectivity of the defence is impossible to marry with the objective tests contained elsewhere. All these factors

[11] For example, Deputy Desmond O'Malley Dail Eireann Companies (No. 2) Bill 1987 Special Committee Cols 653-654 (6 March 1990)
[12] 120(b) Seanad Deb. Cols.2440-2441 (12 July 1988)
[13] McCormack, The New Companies Legislation (Dublin: Roundhall Press, 1991), p.216
[14] Breen, 'Fictions or Guidelines? The Deeming Provisions in Section 610 of the Companies Act 2014' [2019] 26(9) CPL 168.
[15] Dail Eireann Companies (No. 2) Bill 1987 Special Committee Col 653 (6 March 1990)
[16] [1993] 3 IR 191
[17] [2016] IECA 280

arguably mean that as far as potential applicants are concerned the section is seen as one which is difficult to navigate and invoke successfully.

That is not to say that the section does not contain some beneficial features. What constitutes reckless trading is undefined. This is arguably helpful. While as Lynch Fannon explains more a neutral term than 'reckless' may be preferable to avoid dangerous cross-fertilisations from other legal fields,[18] the lack of definition has the advantage of not limiting the parameters of what may constitute reckless trading behaviour. Indeed, it would be nigh impossible to draft a definition which encompassed the full range of possible behaviours. An overly specific definition has its dangers. Arguably, one of the failings of section 214 is that it is too narrow in scope. This may have led the UK to implement a separate provision entirely; sections 15A and 15B Directors Disqualification Act, 1986 which mirrors to some extent the broader nature of section 610. Further, it is important to retain the ability of creditors to invoke the section and to retain the court's ability to award compensation directly to the applicant creditor. From a normative standpoint, it is surely correct that a creditor, who has suffered a loss and has the funds to do so, should have the ability to act where the liquidator is unwilling or unable to do so. It is also correct that, in those circumstances, such a creditor should reap the rewards of a successful case.

A comparative analysis of the UK and New Zealand provisions casts further light on amendments which could be made to section 610. Each of these jurisdictions has conceptualised reckless trading in a different manner. The core purpose of section 214 is to encourage directors to tackle an approaching insolvency in a timely manner and reduce losses to creditors.[19] That said, the section may not have achieved its aims. A considerable bulk of the case law is centred on timing issues. The emphasis in the UK on when the directors should have realised that there was no reasonable prospect of avoiding an insolvent liquidation has become a *'procedural snare'*[20] that arguably deflects from the real purpose of a wrongful trading type provision; compensating and

[18] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7 at 12
[19] Arsalidou, 'The Impact of Section 214(4) of the Insolvency Act 1986 on Directors' Duties' [2001] 22(1) Company Lawyer 19
[20] Bachner, Wrongful Trading - A New European Model For Creditor Protection? [2004] 5(2) EBOR 293 at 306

protecting creditors from the wrongful actions of directors.[21] Moreover, the ability of directors, despite misbehaviour, to avoid personal liability where their actions do not impact on the company's overall financial position is worrying.[22] As long as the company's balance sheet position remains neutral, that creditors may have suffered severe financial repercussions is not taken into account. This is a considerable lacuna.

That said, section 214 does have significant strengths. These can provide us with guidance. Section 214 confines itself to operational risks. Unlike the Irish provision, there is little scope for an examination of entrepreneurial decision-making. The expansive scope of section 610(1)(a), while otherwise beneficial, appears to invite such analysis. The UK judiciary have been careful to limit the use of hindsight.[23] Trading while insolvent, if a sensible approach, can occur. Moral blameworthiness is largely avoided. Objective and subjective standards do not conflict. A practical rather than a literal interpretation of the defence means that it generally functions well. While the section itself requires that 'every step' be taken to minimise losses to creditors, the UK judiciary, like their New Zealand compatriots in similar circumstances, appear to have applied a pragmatic approach; 'every step' appears to encompass only those which are practicable. The defence also avoids the illogicalities and contradictions of subsection (8). An Irish section which incorporated these strengths would be beneficial.

The New Zealand provisions are more difficult to evaluate. The invocation rate is higher than that of the UK or Ireland as is the success rate.[24] Yet, when the provision was redrafted in 1993, its application was beset by significant difficulties. In an attempt to avoid penalising entrepreneurial risk-taking, the legislature drafted a provision which, when applied literally, had the opposite effect.[25] Not enough consideration appears to have been given to the fact that risk-taking is pivotal in business life and that companies must have the freedom to undertake legitimate

[21] Insolvency Law and Practice – Report of the Review Committee [1982] Cmnd 8558 para.1777 and para.1805
[22] Grant v Ralls [2016] EWHC 243
[23] Re Hawkes Hill Publishing Co Ltd [2007] BCC 937
[24] Taylor, 'Directors' Duties on Insolvency in New Zealand: An Empirical Study' [2018] 28(2) New Zealand Universities Law Review 172 at 187
[25] Watson and Taylor (General Editors), Corporate Law in New Zealand, (Wellington: Thomson Reuters, 2018), para.22.2

business projects even if very risky. This lack of demarcation between entrepreneurial and operational risks is a timely warning for the Irish provision which may contain the same flaw. Indeed, this lacuna had near catastrophic consequences for the functionality of the section as it meant that, in high-risk industries, the legislation was potentially breached any time a director made a significant investment decision. In effect, entrepreneurial decision-making could be second guessed by a court at a later stage.[26] It rapidly became obvious that a schism existed between the literal construction of the section and a more practical approach. Ultimately, the judiciary concluded that a literal approach was not workable.[27]

The New Zealand provisions provide guidance on other issues as well. The sections operate effectively without a general defence. This leads us to consider whether section 610 could also flourish with such an absence. A limited defence (similar to section 138 Companies Act, 1993) or a straightforward application of judicial discretion, as also occurs in New Zealand,[28] may be sufficient. Moreover, the combination of objective and subjective standards within sections 135 and 136 is much more logical and effective than the combination contained in section 610. Further, while the net deficiency approach has recently gained traction, flexibility as to remedy still exists. [29]

Thus, the first central research question has been answered. The external causes of the lack of invocation of the section and its disappointing success rate have been identified, lack of financial wherewithal among many directors and high legal costs. Moreover, it has been determined with relative accuracy the drafting amendments which section 610 requires to improve its invocation and success rates. First and foremost, what is required is a redrafting of the provision along the lines suggested by Lynch Fannon.[30] The drafted section should contain the statement of reckless trading as already set out in subsection (1)(a). It should go on to state that the activities set out

[26] Davies, Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency' [2006] 7(1) EBOLR 301 at 334.

[27] Lower v Traveller [2005] NZCA 187. Mason v Lewis [2006] NZCA 55

[28] See Grant v Johnston [2015] NZHC 611.

[29] Madsen-Ries v Cooper [2020] NZSC 100 and Yan v Mainzeal Property and Construction Ltd. [2021] NZCA 99

[30] Lynch Fannon, 'Reckless Trading: Good and Bad Risk-Taking in Irish Companies' [2017] 24(1) CPL 7 at 10-11

in subsections (3)(a) and (3)(b) are examples of actions which may constitute reckless trading. This should result in a more expansive interpretation of the provision as the judiciary is no longer circumscribed by the 'statutory fictions.' It would also better allow a company to trade while insolvent when doing so is commercially justified. The objective tests of reckless trading can be retained, and subsection (1) redrafted in this regard by the removal of the word '*knowingly'*. Revisions along these lines also allows the retention of the existing beneficial aspects of the provision, such as no firm definition of reckless trading, without the difficulties caused by the 'deeming' provisions. Importantly also the narrow timing issues contained within the UK provision would be avoided.

Moreover, a number of additional recommendations can also be made. The current subsection (8) defence be removed in its entirely. The option of a New Zealand type defence, a UK style defence (the preferred option) or indeed no express defence at all could then be considered. Care should be taken to ensure that the redrafted section limits its bailiwick to operational risk-taking. We have seen the importance, especially in New Zealand, of ensuring that entrepreneurial risk-taking is not inhibited.

The ability of creditors to both invoke the section and directly reap the rewards of a successful case should be retained. This recommendation has two benefits. It has a normative basis and increases the invocation rate of the section. For example, a creditor with funds, who has suffered a direct loss, can make his or her own decision as to whether to pursue a case.

Directors should be able to trade while insolvent in circumstances where it may be reasonably considered that it would be beneficial to creditors to do so. Continuing to trade while insolvent may be the correct commercial decision and may be actually beneficial to creditors.[31] This would follow the path taken in the UK and to a more limited extent New Zealand. After a period of 'sober assessment'[32] directors should have the ability to continue trading if that appeared to be the correct commercial course.

[31] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), paras.12.32-12.34.
[32] Described in Mason v Lewis [2006] NZCA 55 para.51

## (III)THE SECOND CENTRAL RESEARCH QUESTION

That said, it must be acknowledged that even a redrafted section may not, by itself, be sufficient to override the external limitations to invocation. This indicated a second research question; is a reckless trading type provision necessary at all. To explore this question, three important legal theories were examined. Contractarianism's proponents are strongly against legislative interference in the marketplace. They argue that creditors have the ability to protect themselves.[33] Hence a reckless trading type provision over-compensates creditors. They obtain the protections they bargained for[34] and legislative protection to boot.[35] This contention is, however, unconvincing when examined through the lens of anything other than a large, sophisticated creditor such as a bank, financial institution or other large enterprise. Financial institutions and companies with market control can obtain security and guarantees.[36] Small to medium sized trade creditors cannot. Such entities have limited opportunities to protect themselves because their bargaining power is minimal. Contractarianism does not take account of the realities of life as a small trade creditor and is today somewhat discredited. The large creditor, via security and personal guarantees, obtains protection from misfortune, entrepreneurial misadventures and (amongst many other possibilities) reckless trading. The trade creditor is unprotected, and a reckless trading provision merely goes some way towards redressing this imbalance. This demonstrates that compulsory legislative rules are necessary due to the illusory nature of the protections available to the small creditor. While trade creditors will certainly accept losses caused by entrepreneurial misadventures, it is surely an overstatement to accept contractarian arguments that such entities deserve no protection at all from reckless trading behaviour which they could not have reasonably foreseen. Unsecured creditors do obtain more rights than those they bargained for. However, the real answer to the question is that such regulation only grants them the rights which they would have bargained for and obtained had they had the ability to do so.

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[33] Mitchell, 'Groundwork Of The Metaphysics Of Corporate Law' [1993] Vol 50 No. 4 Washington and Lee Law Review 1476 at 1479

[34] Attenborough, 'Empirical Insights into Corporate Contractarian Theory' [2017] 37(2) Legal Studies 191 at 198

[35] Morrison, 'The Economic Necessity for the Australian Insolvent Trading Prohibition', [2003] International Insolvency Review 171 at 176-177

[36] Keay, 'Wrongful Trading and the Liability of Company Directors: A Theoretical Perspective' 25(3) [2005] Legal Studies 431 at 451-452

Stakeholder theory holds that the corporation is a public actor and as such should be regulated by the state to achieve societal goals. Thus, the theory supports the concept of a legislative based reckless trading provision. As a concept, it is supportive of legislative intervention.[37] Absent legislation, small trade creditors will have difficulty protecting themselves and are dependent on the bona fides of the directors with which they do business. Indeed, reckless trading behaviour can be classed as a failure to apply the tenets of stakeholderism and legislative intervention merely redresses this imbalance. Creditors' importance as stakeholders is acknowledged and the overemphasis on shareholder concerns, due to historic influence of contractarian thinking,[38] is reduced. True weight is given to the importance of creditors as constituents of the company. Aspects of the theory may be problematical in that there are numerous unanswered questions as to its parameters and operation. That does not, however, detract from the fact that it is broadly supportive of legislative regulation to support stakeholders. A reckless trading provision can thus form part of the theoretical framework of stakeholderism as reckless trading behaviour itself is arguably a failure to apply stakeholder principles. This is evident from the Irish case law, in particular Lynch J.'s description of reckless trading in Hefferon Kearns with its emphasis on the director's overconcentration on his own and the company's position and his concomitant failure to consider the other constituents.

The final theory examined was that of judicial realism. The question posed was whether a reckless trading provision could ever be successful. The hypothesis tested is that, as judges come from same social class as directors, they are reluctant to apportion blame for mistakes in situations in which they might have reacted in the same way. Judges are drawn from a social class which understands and is sympathetic to industry and commerce.[39] The questionable drafting of the section, coupled with the undefined nature of reckless trading itself, may allow bias to occur. In effect, the reckless trading concept is so nebulous that it allows too much judicial discretion. An

[37] Stieb, 'Accessing Freeman's Stakeholder Theory' [2009] 87 Journal of Business Ethics 401 at 407
[38] Attenborough, 'Empirical Insights into Corporate Contractarian Theory' [2017] 37(2) Legal Studies 191 at 195-200
[39] Omar, France: The Regime Governing Directors' Liability in Insolvency and Reform Perspectives, [2004] Company Lawyer 378 at 383

allied question then was whether we see evidence of judicial realism at work in the reckless trading case law.

However, this conclusion is arguably too simplistic for a number of reasons. Judges do tend to come from the same social class as many directors but were class solidarity active, it would be evident in the restriction and disqualification order regime case law. It is not. Ultimately, unlimited guidance cannot be provided by the wording of a statutory provision.[40] The reckless trading provision may simply be an example of an imprecise provision which leaves a range of possible decisions available to a judge.[41] Put another way, simply because the provision is imprecise, bias does not inevitably follows.

Thus, judicial realism has a surface level attraction. It provides a straightforward answer to the question of why section 610 is infrequently and unsuccessfully invoked. That said, it would be lazy reasoning to assume that directors and judges inhabit the same social milieu and that this must be one explanation for the provision's lack of success. Evidence is required and case law does not provide clear confirmation one way or the other. In the absence of a strong signal, it would be dangerous make assumptions. Indeed, the limited success of the provision is far more likely to be caused solely by internal factors such as poor drafting and external factors such as impecunious directors and the risk of high legal costs rather than a fear by possible claimants that they will not succeed due to judicial class solidarity. On that basis, the exploration of this theory supports the thesis' call for a more robustly drafted provision and public enforcement.

Both the disqualification order and the restriction order regimes have proved extremely successful. However, the success of the restriction order regime only occurred once the ODCE was given a role in the process. That fact is strongly suggestive of the future direction enforcement of section 610 should take. A regulatory regime is useless without enforcement.[42] More importantly, a key insight obtained is

[40] Hart, The Concept of Law, 3rd Edition (Oxford: Oxford University Press, 2012), p.127
[41] Thomas, The Judicial Process: Realism, Pragmatism, Practical Reasoning and Principles (Cambridge: Cambridge University Press 2005), p.202
[42] Corbett, 'Directors' Disqualifications – Has Enforcement Legislation Changed Practice in Ireland?' [2009] 16(9) CPL 197 at 204

that reckless trading type misconduct is being sanctioned via the restriction order regime (and to a lesser extent via disqualification). Specifically, case law examples of reckless trading type behaviour abound. The wider question considered in the relevant chapter, however, is whether this is a suitable state of affairs. Directorial misbehaviour is being sanctioned. At a superficial level, this may be satisfactory. Indeed, when the sparse and narrow jurisprudence of the reckless trading provision is compared with the expansive restriction order regime, the contrast is stark. The latter regime copes well with new factual situations and, more importantly, shapes societal expectations of the directors' role. These facts aside, however, it must be concluded that neither regime is a suitable substitute. This is because of significant and unbridgeable differences concerning policy and sanction. The regimes' focus is on deterrence and public protection. While such elements also exist in the policy considerations underpinning reckless trading, these are of lesser importance. Section 610's primary focus is compensating creditors for losses caused by director misbehaviour.[43] Neither regime is so orientated. Moreover, the regimes' sanctions are not compensatory.

The second area examined as a possible suitable substitute was the common law directors' duty to creditors. Unfortunately, numerous difficulties were uncovered. The duty is shrouded in uncertainty. It is difficult to ascertain when precisely it comes into existence. Its parameters are nebulous. As the Irish common law duty is, it seems, owed directly to creditors,[44] its enforcement mechanism and remedies are difficult to determine. As such, it is not a suitable alternative to reckless trading. Indeed, section 610, even in its current unsatisfactory iteration, is a superior option for a creditor. The path to enforcement is clear. The remedy is certain.

A further issue is that the impact of the duty would be stronger had the CLRG's codified provision been exacted as part of the Companies Act, 2014.[45] The suggested provision would have provided clear answers to many of the difficulties which bedevil the duty at Irish common law. Moreover, the draft contained clear enforcement and

[43] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), paras 12.52
[44] CLRG, Report on the Protection of Employees and Unsecured Creditors (Dublin June 2017), para.2.3.1
[45] CLRG, Report on the Protection of Employees and Unsecured Creditors (Dublin June 2017), para.2.3.4

remedial mechanisms. This represents a missed opportunity and is the most important point. Absent codification, due to the paucity of case law, the duty in Ireland is simply too vague and uncertain to comprise a viable alternative to section 610.

## (IV)THE THIRD CENTRAL RESEARCH QUESTION

The thesis thus established that a reckless trading provision is necessary. Additionally, neither the restriction and disqualification order regimes nor the directors duty to creditors provide viable alternatives. The amendments suggested should increase the functionality and efficacy of the section. However, even well-designed changes may not be sufficient. For this reason, the thesis explored whether some form of public enforcement of reckless trading would be beneficial.

Criminal enforcement of reckless trading has initial attractions. Firstly, reckless trading behaviour does carry some of the hallmarks of crime. Reckless trading behaviour has a significant ability to cause harm to others and to the wider community. Thus punishment can be deserved. Moreover, many directors are impecunious and pursuing such individuals for compensation is pointless. A criminalised provision means that such individuals will suffer real sanction and section 610 will be a real threat. At present, the provision is of no danger to a truly impecunious director. Thus, criminalisation should also have an increased deterrent effect.[46] Standards of behaviour would, very likely, improve.

Overall, however, it was concluded that criminalisation is too blunt an instrument to deal with this complex issue. Central to the concept of reckless trading is risk-taking in the economic sphere. It may well prove impossible to support positive forms of commercial risk-taking within the context of a criminalised provision. Those who take unacceptable risks because they could not care less and those who simply misjudge the risks are equally punished. It is also important to note that the LRC appears to favour a minimalist approach to criminalisation.[47] Ultimately criminal law should not be invoked unless other methods of enforcement are inappropriate. [48]

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[46] Ashworth, Principles of Criminal Law 5th Edition (Oxford: Oxford University Press, 2006), p.16.
[47] Law Reform Commission, 119-2018, Report on Regulatory Powers and Corporate Offences Volume 2: Corporate Offences (Dublin 2018), paras. 12.03 and 12.08
[48] Ashworth and Horder, Principles of Criminal Law (7th Ed) (Oxford University Press 2013), p.31

This brings up another very important point. Enforcement is crucial. While there is evidence (albeit inconclusive) that criminalisation does deter, that will not happen without visible enforcement.[49] There is scant evidence that this will occur in Ireland. Prosecution of existing corporate criminal provisions is limited.[50] Those which have occurred, have on occasion been unsuccessful. Overall, lack of enforcement of corporate criminal sanctions here is well documented. Resource constraints within the ODCE also exist.[51] Moreover, if additional penal sanctions are introduced but not enforced, then the role of reckless trading as a tool for controlling corporate behaviour may be weakened rather than strengthened. Directors will know that only the most egregious will be pursued meaning that the more mundane examples of reckless trading behaviour can be engaged in without fear of consequences. Moreover, cost issues, time constraints, the severity of the sanction and regulatory ritualism all indicate the unsuitability of criminalisation.

Ultimately a key finding of this thesis is that bringing civil public enforcement to bear on reckless trading would have significant benefits. A four-pronged approach is recommended. Locus standi would be granted to the ODCE to invoke section 610 and obtain compensation for creditors perhaps in conjunction with a disqualification order. The existing successful restriction order liquidator reporting system would be extended to reckless trading. Thus, the ODCE could, where appropriate, direct the liquidator to invoke the section. The restriction and disqualification undertaking system would be leveraged to increase the use of section 610. However, these three steps would be insufficient in themselves. It is pointless invoke the reckless trading provision where the director concerned has no private assets.[52] This is an external problem and cannot be solved by public enforcement. If it would be fruitless for a liquidator to pursue a director with scant resources, it will be equally fruitless for the ODCE to do so. Thus, the regulator should be granted the power to impose an administrative fine in certain circumstances. This would solve the significant difficulty facing the enforcement of reckless trading; impecunious directors face no sanction.

[49] Walters, 'Enforcing Wrongful Trading- Substantive Problems and Practical Disincentives' in Rider, The Corporate Dimension, (Bristol, Jordan Publishing Ltd., 1998), p.159
[50] ODCE Annual Report 2018 (Dublin 2019), p.47.
[51] Lynch-Fannon, "Reckless Trading: Good and Bad Risk-taking in Irish Companies [2017] 24(1) CLP 7 at 9
[52] Williams, 'Civil Recovery from Delinquent Directors' [2015] 15(2) Journal of Corporate Law Studies 311 at 335.

Such individuals would no longer be able to engage in reckless trading with impunity. The misbehaviour would now be sanctioned and carry financial consequences.

Combining the granting of locus standi to the ODCE with an administrative fine regime will be a successful approach. The difficulties of criminalisation are avoided while the benefits of public enforcement are preserved. In effect, in proposing such measures, the stronger hallmarks of civil penalty regimes, such as the fact that civil enforcement actually occurs and the benefits of an expert regulatory body, are retained. The proposed regime also borrows from the best aspects of administrative sanction regimes; flexibility, settlements can be agreed and a deterrence value. It should also be possible to design a robust regime which avoids constitutional weaknesses.

Beneficially for the Irish position, guidance can be obtained from other jurisdictions under review. As we have seen, Australia has a long-established compensation order regime forming part of its civil penalty system. A wide range of remedies are available to ASIC. There have been significant notable successes.[53] Thus our new proposed regime is shaped by two aspects of the Australian experience; the ability of the regulator to seek a financial sanction and locus standi to obtain compensation. The UK's compensation order regime is of much more recent vintage. Central to the regime is the court's ability, on foot of an application by the Secretary of State for Industry and Commerce, to obtain a compensation order against a disqualified director whose actions have caused loss to creditors of an insolvent company. To date, there has been one successful case.[54] Again, the proposed Irish regime is influenced by the UK experience.

Thus, the mechanism designed for public enforcement should prove both functional and effective as the best features of the UK and Australian systems are combined. Like Australia, the ODCE would be added as an additional party who can invoke section 610. Safeguards would exist to ensure that private claims are not outsourced unnecessarily to public enforcement. The OCDE will, however, have the ability to

[53] Welsh, 'Realising the Public Potential of Corporate Law: Twenty Years of Civil Penalty Enforcement in Australia' [2014] 42 (1) Federal Law Review 217 at 238.
[54] Re. Noble Vintners Ltd. [2019] EWHC 2806

take a case where, for example, the financial circumstances of the company or the creditor mean that private invocation is unaffordable. This is an efficient mechanism. In addition, while drawing on the innovative features of the UK's compensation regime, public enforcement would not be conditional of the director having already been disqualified. The undertaking procedure would also be available. Calibrating the Irish regime in this manner avoids additional and unnecessary complications for directors, creditors and liquidators.

Public enforcement sends a strong message that reckless trading behaviour is taken seriously by the legislature and is a public policy issue. Granting the ODCE locus standi and a sanctioning role would send a powerful signal to directors that reckless trading behaviour has public implications[55] and will not be tolerated. Corporate behaviour should improve. Educational benefits may also follow. There should also be a significant deterrent effect. Currently, this must be minimal as the chances of pursuit for even egregious reckless trading behaviour is remote.

## (V) CLOSING OBSERVATIONS

This thesis does not pretend to produce a panacea. The thesis isolates the two primary external causes of the under-invocation of section 610; high legal costs and impecunious directors who are not worth pursuing. While costs may well be reformed in the future, the legal system cannot transform the financial situation of an impoverished director. There are also internal difficulties. The section is beset by drafting difficulties and anomalies.

Solutions have been developed for these problems; civil public enforcement combined with a robustly redrafted section 610. While these solutions cannot entirely banish or sanction all director misbehaviour or ensure that all deserving creditors and companies are compensated, nonetheless this combination of measures should insure a significant increase in both the invocation rates and the success rates of the provision. Section 610 will then finally take its correct place as an important provision policing the fault line in company law between acceptable and unacceptable risk-taking.

[55] Keay, 'Wrongful Trading and the Liability of Company Directors: A Theoretical Perspective' [2005] 25(3) Legal Studies 432 at 454-455.

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# APPENDICES

## APPENDIX ONE

## SECTION 214 INSOLVENCY ACT, 1986

(1) Subject to subsection (3) below, if in the course of the winding up of a company it appears that subsection (2) of this section applies in relation to a person who is or has been a director of the company, the court, on the application of the liquidator, may declare that that person is to be liable to make such contribution (if any) to the company's assets as the court thinks proper.

(2) This subsection applies in relation to a person if—

(a) the company has gone into insolvent liquidation,

(b) at some time before the commencement of the winding up of the company, that person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation, and

(c) that person was a director of the company at that time;

but the court shall not make a declaration under this section in any case where the time mentioned in paragraph (b) above was before 28th April 1986

(3) The court shall not make a declaration under this section with respect to any person if it is satisfied that after the condition specified in subsection (2)(b) was first satisfied in relation to him that person took every step with a view to minimising the potential loss to the company's creditors as (assuming him to have known that there was no reasonable prospect that the company would avoid going into insolvent liquidation) he ought to have taken.

(4) For the purposes of subsections (2) and (3), the facts which a director of a company ought to know or ascertain, the conclusions which he ought to reach and the steps which he ought to take are those which would be known or ascertained, or reached or taken, by a reasonably diligent person having both—

(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 that director in relation to the company, and

(b) the general knowledge, skill and experience that that director has.

(5) The reference in subsection (4) to the functions carried out in relation to a company by a director of the company includes any functions which he does not carry out but which have been entrusted to him.

(6) For the purposes of this section a company goes into insolvent liquidation if it goes into liquidation at a time when its assets are insufficient for the payment of its debts and other liabilities and the expenses of the winding up.

(7) In this section “director” includes a shadow director.

(8) This section is without prejudice to section 213.

**APPENDIX TWO**

**SECTION 610 COMPANIES ACT, 2014**

(1) If in the course of the winding up of a company or in the course of proceedings under Part 10 in relation to a company, it appears that-

(a) any person was, while an officer of the company, knowingly a party to the carrying on of any business of the company in a reckless manner, …

(b) any person was knowingly a party to the carrying on of any business of the company with intent to defraud creditors of the company, or creditors of any other person or for any fraudulent purpose,

the court, on the application of the liquidator or the examiner of the company, a receiver of property of the company or any creditor or contributory of it, has the following power.

(2)That power of the court is to declare, if it thinks proper to do so, that the person first mentioned in paragraph (a) … of subsection (1) shall be personally responsible, without any limitation of liability, for all or any part of the debts or other liabilities of the company as the court may direct.

(3) Without prejudice to the generality of subsection (1)(a), an officer of the company shall be deemed to have been knowingly a party to the carrying on of any business of the company in reckless manner if –

(a) the person was a party to the carrying on of such business and, having regard to the general knowledge, skill and experience that may reasonably be expected of a person in his or her position, the person ought to have known that his or her actions or those of the company would cause loss to the creditors of the company, or any of them, or

(b) the person was a party to the contracting of a debt by the company and did not honestly believe on reasonable grounds that the company would be able to pay the debt when it fell due for payment as well as its other debts (taking into account the contingent and prospective liabilities)

(4) Notwithstanding anything contained in subsection (2), the court may grant a declaration on the grounds set out in subsection (1)(a) only if –

(a) paragraphs (a), (b), (c) or (d) of section 570 applies to the company concerned, and

(b) an applicant for such a declaration, being a creditor or contributory or any person on whose behalf such application is made, suffered loss or damage as a consequence of any behaviour mentioned in subsection (1)

(5) In deciding whether it is proper to make a declaration on the ground set out in subsection (3)(b), the court may have regard to whether the creditor in question was, at the time the debt was incurred, aware of the company's financial state of affairs and notwithstanding such awareness, nevertheless assented to the incurring of the debt.

(6) Where the court makes a declaration under this section, it may provide that sums recovered under this section shall be paid to such person or classes of persons, for such purposes, in such amounts or proportions at such time or times and in such respective priorities among themselves as such declaration may specify.

(7) On the hearing of an application under this section, the applicant may himself or herself give evidence or call witnesses.

(8) Where it appears to the court that any person in respect of whom a declaration has been sought on the grounds set out in subsection (1)(a) has acted honestly and responsibly in relation to the conduct of the affairs of the company or any matter or matters on the ground of which such declaration is sought to be made, the court may, having regard to all the circumstances of the case, relieve him or her either wholly or in part from, personal liability on such terms as it may think fit.

**APPENDIX THREE**

**SECTION 320 COMPANIES ACT, 1955 AS AMENDED BY SECTION 32 COMPANIES AMENDMENT ACT, 1980**

(1) If in the course of the winding up of a company it appears that-

(a) Any person was, while an officer of the company, knowingly a party to the contracting of a debt by the company and did not, at the time the debt was contracted, honestly believe on reasonable grounds that the company would be able to pay the debt when it fell due for payment as well as all its other debts, (including future and contingent debts); or

(b) Any person was while an officer of the company, knowingly a party to the carrying on of any business of the company in a reckless manner; or

(c) Any person was knowingly a party to the carrying on of any business of the company with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose,-

the Court, on the application of the Official Assignee or the liquidator or any creditor or contributory of the company, may, if it thinks it proper to do so, declare that the person shall be personally responsible, without any limitation of liability, for all or any part of the debts and other liabilities of the company as the Court may direct. On the hearing of an application under this subsection the Official Assignee or the liquidator, as the case may be, may himself give evidence or call witnesses.

(2) Section 320 (3) of the principal Act is hereby repealed.

**SECTION 135 COMPANIES ACT, 1993**

A director of a company must not—

(a) agree to the business of the company being carried on in a manner likely to create a substantial risk of serious loss to the company's creditors; or

(b) cause or allow the business of the company to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors.

**SECTION 136 COMPANIES ACT, 1993**

A director of a company must not agree to the company incurring an obligation unless the director believes at that time on reasonable grounds that the company will be able to perform the obligation when it is required to do so.

**SECTION 138 COMPANIES ACT, 1993**

(1) Subject to subsection (2), a director of a company, when exercising powers or performing duties as a director, may rely on reports, statements, and financial data and other information prepared or supplied, and on professional or expert advice given, by any of the following persons:

(a)an employee of the company whom the director believes on reasonable grounds to be reliable and competent in relation to the matters concerned:

(b)a professional adviser or expert in relation to matters which the director believes on reasonable grounds to be within the person's professional or expert competence:

(c)any other director or committee of directors upon which the director did not serve in relation to matters within the director's or committee's designated authority.

(2) Subsection (1) applies to a director only if the director—

(a)acts in good faith; and

(b)makes proper inquiry where the need for inquiry is indicated by the circumstances; and

(c) has no knowledge that such reliance is unwarranted.

**SECTION 380(4) COMPANIES ACT, 1993**

(4) Every director of a company commits an offence and is liable on conviction to the penalties set out in section 373(4) if—

(a) the company incurs a debt (the debt); and

(b) the company—

(i) is insolvent at the time that it incurs the debt; or

(ii) becomes insolvent by incurring the debt; or

(iii) is insolvent at the time that it incurs debts that include the debt; or

(iv) becomes insolvent by incurring debts that include the debt; and

(c) the director knows, at the time when the company incurs the debt, that the company is insolvent or will become insolvent as a result of incurring the debt or other debts that include the debt; and

(d) the director's failure to prevent the company incurring the debt is dishonest.

**APPENDIX FOUR**

**CLRG DRAFT CLAUSE – 224A COMPANIES ACT, 2014**
224A Directors of insolvent company to have regard to interests of creditors

(1) The directors of a company who believe, or who have reasonable cause to believe, that a company is unable or likely to be unable to pay its debts as they fall due, shall–

(a) have regard to the interests of the company's creditors; and

(b) preserve the company's property.

(2) The duty in subsection (1) shall be owed to the company (and the company alone) and shall be enforceable in the same way as any other fiduciary duty owed to a company by its directors.

(3) Where a director of a company acts in breach of his or her duty under subsection (1) and the company goes into insolvent liquidation then the director shall be liable to indemnify the company for any loss or damage resulting from that breach.

(4) For the purposes of subsection (3), a company shall be taken to have suffered loss or damage where, upon its insolvent liquidation, its creditors do not recover the sums which they would have received had there been no breach of the duty in subsection (1).

**APPENDIX FIVE**

**SECTION 588G(3) CORPORATIONS ACT, 2001**

(3) A person commits an offence if:

(a) a company incurs a debt at a particular time; and

(aa) at that time, a person is a director of the company; and

(b) the company is insolvent at that time, or becomes insolvent by incurring that debt, or by incurring at that time debts including that debt; and

(c) the person suspected at the time when the company incurred the debt that the company was insolvent or would become insolvent as a result of incurring that debt or other debts (as in paragraph (1)(b)); and

(d) the person's failure to prevent the company incurring the debt was dishonest.