

THE HIGH COURT

[2019/148 COS]

IN THE MATTER OF AN APPLICATION PURSUANT TO SECTION 631 OF THE COMPANIES
ACT 2014

AND IN THE MATTER OF SECTION 602 OF THE COMPANIES ACT 2014
AND IN THE MATTER OF CHURCHBORO BUILDING CONTRACTORS LIMITED (IN
LIQUIDATION)

BETWEEN

DAVID VAN DESSEL, AS LIQUIDATOR OF CHURCHBORO BUILDING CONTRACTORS
LIMITED (IN LIQUIDATION)

APPLICANT

AND

ALAN CONNOLLY AND SANDRA CLARKE

RESPONDENTS

JUDGMENT of Ms. Justice Reynolds delivered on the 16th day of December 2020

Introduction

1. The applicant ("the liquidator") has brought the within application pursuant to s.631 of the Companies Act 2014 seeking directions, *inter alia*, from the Court as to whether the mortgage dated the 23rd of November, 2017, executed in favour of the respondents over the property of Churchboro Building Contractors Limited ("the company") known as 17B Ardmacha, Old Bawn, Tallaght, Dublin 24, is void together with other ancillary relief.

Factual Background

2. The liquidator was appointed by Order of the High Court (Mr. Justice Keane) made on the 4th December, 2017. That Order was granted on foot of a petition jointly presented to the High Court by two creditors of the company on the 20th November, 2017.
3. Prior to the company entering liquidation, it carried on the business of construction and civil engineering works.
4. The respondents are partners in BCC Accountants and Registered Auditors Limited, the company's former auditors/accountants.
5. Following his appointment, the liquidator took steps to establish the full extent and nature of the assets and liabilities of the company and became aware that a purported fixed mortgage/charge ("the Connolly charge") was created on the 23rd November, 2017 (three days after the presentation of the winding-up petition), in favour of the respondents over the property. The charge was registered in the Companies Registration Office on the 30th November, 2017.
6. There is no suggestion that either the liquidator consented to the Connolly charge being entered into, or that the directors retained the power to enter into the debenture pursuant to s.677(3) of the Companies Act.
7. Previously on the 23rd May, 2016 the company had entered into a debenture in favour of Allied Irish Banks, plc ("the AIB charge") which created, *inter alia*:

"a floating charge over the Company's book debts and other debts and its undertaking and all its other property, assets and rights whatsoever, and wheresoever both present and future".

8. Clause 7(k) of the AIB charge ("the negative pledge clause") required the company:

"Not without the prior consent in writing of the Bank to create any mortgage or charge ranking in priority to or *pari passu* with this mortgage debenture."

9. The AIB charge was registered in the Company's Registration Office on the 26th May, 2016.

10. The company is indebted to AIB to the sum of €224,749.83.

11. In the Directors' Estimated Statement of Affairs exhibited by the liquidator, the directors have indicated that the company has preferential debts in the sum of €130,517. Of this sum, €60,000 is admitted to be due and owing to Revenue in relation to unpaid PAYE/PRSI. Revenue's own estimate of its indebtedness in this liquidation is €77,106.75.

12. The liquidator is satisfied that a significant deficit of funds will arise at the conclusion of the liquidation.

The Connolly Charge

13. By loan agreement dated the 16th September, 2016, the respondents agreed to provide the company with a loan in the sum of €150,000 at an interest rate of 0.5% per month for a period of six months.

14. The agreement provided that the company was to grant a first charge in favour of the respondents over the land and buildings at 17B Ardmacha, Old Bawn, Tallaght, Dublin 24 ("the property") as security for the loan provided. The funds in respect of the loan agreement were transferred to the company's solicitor, John C. Walsh Solicitors on the 20th September, 2016, by electronic transfer.

15. In further consideration of the loan agreement, by letter dated the 16th September, 2016, the company's solicitor provided an undertaking to the respondents to pay the outstanding loan balance from the proceeds of sale of the property on completion of the build. However, it is common case that no charge was put in place over the property at that time.

16. In August 2017, the respondents became aware of the fact that no charge had been put in place in respect of the property. In September 2017, the respondents attended at the offices of the company's solicitors in order to begin the process of putting in place the charge as per the terms of the loan agreement. Ultimately, the charge dated the 23rd November, 2017 was executed by the company.

17. However, a petition to wind up the company was presented to the High Court on the 20th November, 2017 and listed for hearing on the 4th December, 2017.

18. For ease of reference, a chronology of relevant dates is annexed to the judgment.

Issues

19. In circumstances where the Connolly charge was created after the deemed date of the commencement of the company's liquidation, the Court is required to determine the following issues: -

- (1) Whether or not the Connolly charge is void pursuant to s.602(2) of the Companies Act 2014 ("the 2014 Act").
- (2) In the event that the Court validates the charge in favour of the respondents, the Court is required to consider the application of priorities between the charge granted in favour of the respondents and the charge granted in favour of AIB.

Statutory Provisions

20. Pursuant to s.589(1) of the 2014 Act, the winding-up of a company by the court is deemed to commence at the time of the presentation of the winding-up petition. The commencement date, therefore, in the instant case is the 20th November 2017.

21. Section 602 of the Companies Act 2014 further provides:

- "(1) This section applies to each of the following acts in any winding-up of a company;
- (a) any disposition of the property of the company;
 - (b) any transfer of shares in the company; or
 - (c) any alteration in the status of the members of the company, made after the commencement of the winding-up.
- (2) Without prejudice to subsection (3), an act to which this section applies that is done without the sanction of -
- (a) the liquidator of the company, or
 - (b) a director of the company who has, by virtue of section 677(3) retained the power to do such act, shall, unless the court otherwise orders, be void".

Post - liquidation Dispositions

22. The liquidator contends that the Connolly charge is void and ineffective by virtue of s.602(2) of the Companies Act 2014 insofar as it was created after the deemed date of commencement of the company's liquidation.

23. The respondents firstly contend that the Connolly charge is not a disposition for the purpose of s.602 in circumstances where it submits that the company had entered into an unconditional contract before the presentation of the petition to wind-up. Alternatively, the respondents contend that the court retains the discretion to validate the disposition notwithstanding the fact that the execution of the charge occurred after the presentation of the petition.

24. In *Principles of Corporate Insolvency Law, 4th Edition, 2011*, Professor Goode states:

"The word 'disposition'...must be given a wide meaning if the purpose of the section [being the equivalent provisions in the UK] is to be achieved, particularly in view of the fact that there is no exception in favour of transfers for full value".

Professor Goode continues:

"This position should therefore be considered to include not only dealing with the company's ...assets by sale, exchange, lease, charge, gift or loan, but also any other act which in reducing or extinguishing the company's rights and/or assets, transfers value to another person." (Emphasis added).

25. Forde et al state (The Law of Company Insolvency, 3rd Ed. At 11-05):

"The term 'disposition of the property' has been given a wide meaning in this context and includes virtually all transaction that involve the company parting with anything of value. It therefore includes all sales of property, charges given over assets (see Re Stean's Bournemouth Ltd [1950] 1 All E.R. 21), and all payments of company money, whether by the company or by a third party, and whether directly or indirectly. But the disposition by a receiver of property which is subject to a charge is not caught because that property beneficially belongs to the debenture-holder (see Sowman v. David Samuel Trust Ltd [1978] 1 All E.R. 616 at 624".

In Re Motor Racing Circuits Limited (Supreme Court, Unreported, 31 January 1997), Blayney J. rejected an argument to the effect that the appointment of a receiver after the presentation of a winding-up petition breached Section 218 of the Companies Act 1963 (being the equivalent of Section 602), stating:

'The position is that the appointment of a receiver does not in any way come within section 218. It does not in any way represent any disposition of the property of the company; this disposition had taken place when the debenture was executed'. (Emphasis added).

Power to apply to court for determination of questions

26. Section 631 of the Companies Act 2014 provides that the liquidator may apply to the court to determine any questions arising in the winding-up of a company.

27. Section 631(2) further provides as follows:

"The court, if satisfied that the determination of the question will be just and beneficial, may accede wholly or partially to such an application on such terms and conditions as it thinks fit or may make such other order on the application as it thinks just."

28. After the original hearing of the application, the Court directed that the Revenue Commissioners be put on notice of the application as they had a legitimate interest in the outcome of same.

29. At the resumed hearing, an agreed position was adopted by all parties insofar as it is now acknowledged that AIB's debt ranks behind the preferential debt owed to the Revenue Commissioners but ahead of the unsecured creditors.
30. Based on valuations obtained by the liquidator, it is readily apparent that in the event of the Connolly charge being upheld, any dividend for the preferential creditors is likely to be far below the full amount of preferential debt owed, and no dividend is likely to be available to AIB.
31. The Revenue Commissioners are supportive of the liquidator's application to have the Connolly charge declared invalid.

The evidence

32. In his affidavits, the liquidator refers to the Estimated Statement of Affairs furnished by the directors which estimates the total deficiency of funds available to creditors in the sum of €440,000 approximately. Whilst the liquidator confirms that he is not in a position to estimate the likely deficit of funds at the end of the liquidation, he is satisfied that a significant deficiency will arise.
33. In respect of the AIB mortgage, he highlights the negative pledge clause whereby the company covenanted that it would "not without the prior consent in writing of the Bank create any mortgage or charge ranking in priority to or *pari passu*" with the AIB mortgage.
34. Whilst he accepts that no special legal charge was immediately created over the property by way of the AIB mortgage, he avers to his understanding that the commencement of the company's liquidation caused the floating charge in the AIB debenture to crystallise. However, at the resumed hearing after the Revenue was put on notice of the application, the liquidator's position changed in circumstances where he now concedes that there was no such crystallisation.
35. Further, he avers that the consent of AIB to the creation of the Connolly charge was neither sought nor procured.
36. The liquidator sought details from the respondents' solicitors, Baily Homan Smyth McVeigh ('BHSM') of what debt the respondents claimed to be due from the company and was advised that they had provided a loan in September 2016 in the sum of €150,000 to the company at an interest rate of .5% per month and that the amount due was €165,000. The respondents claimed that the loan was documented in a written loan agreement dated the 16th September, 2016 which provided for security to be furnished in the form of a first charge over the property.
37. In further correspondence, BHSM stated that at the time of execution of the Connolly charge the respondents had been advised by the company's solicitors that the previous charge granted in favour of AIB had been discharged in full and contended that the Connolly charge had priority over the AIB charge. The respondents stated that they did

not engage any legal representation or take any legal advice in relation to the execution of the loan agreement.

38. In response, the liquidator pointed out that it was clear that both the respondents and BHSM were aware of the existence of the AIB mortgage prior to the execution of the Connolly charge and of the negative pledge clause therein and further called upon BHSM to outline what steps had been taken by them to confirm the existence or otherwise of prior ranking charges before the execution of the Connolly charge. No response was ever received in that regard.
39. The liquidator again called upon the respondents to confirm that the charge was invalid in circumstances where it had been executed on the 23rd November, 2017, three days after the petition to appoint him had been presented and noted the failure of the respondents to explain how a period of over a year had elapsed from the time the purported debt had been incurred to the execution of the charge.
40. After protracted correspondence, BHSM in March 2019 furnished the liquidator with copies of a "bank record of the payment of loan monies by our clients to the Company" together with a copy of the loan agreement dated the 16th September, 2016.
41. The liquidator responded advising that the documents did not fundamentally alter the position i.e. that the Connolly charge was void under s.602(2) of the Companies Act 2014.
42. Further, it was noted that if any equitable charge was created pursuant to the loan agreement dated the 16th September, 2016, it was void as against the liquidator because particulars of same had not been registered in the Companies Registration Office within 21 days after its creation as required pursuant to the Companies Act 2014.
43. Thereafter, the motion issued in May 2019. AIB has furnished an affidavit in support of the liquidator's application.
44. Mr. Alan Connolly, in his replying affidavits on behalf of the respondents, confirms that they were the accountants for the company up to the date of the winding-up. He outlines the circumstances in which the respondents provided the company with the loan which was for the purpose of providing financial assistance to complete the development of the property at Old Bawn in Tallaght.
45. Clause 3 of the loan provided as follows:

"3.1 Security is provided by way of a first charge of the unencumbered land and buildings at 17B Ardmacha, Old Bawn, Tallaght, Dublin 24.
46. The loan was to be repaid within a period of six months from the date of drawdown unless otherwise agreed in writing between the parties. The loan was drawn down on the 20th September, 2016.

47. In further consideration of the loan agreement, the company's solicitors provided by letter dated the 16th September, 2016 an undertaking to the respondents to pay the outstanding loan balance from the proceeds of sale of the property on completion of the development.
48. Mr. Connolly asserts that at the time of entering the loan agreement, it was agreed with the company's directors that the company's solicitor would put in place the relevant charge to secure the loan against the property.
49. Mr. Connolly avers to the untimely death of the contracts manager within the company in June 2017 which resulted in difficulties and disputes in relation to the main contracts held by the company. This precipitated steps being taken by the respondents to ensure that their position was secure in circumstances where the loan was overdue and sought to be furnished with a copy of the charge. At a meeting on the 11th of September, 2017 they were advised by the company's solicitor that he could not put the charge in place as he had acted for the company in respect of the loan agreement. Thereafter, the respondents instructed BHSM to put the charge in place.
50. In the course of this process, BHSM received a letter from the company's solicitors dated the 8th November, 2017 advising that it was their understanding that the AIB charge had been discharged in full and confirming that the company was prepared to execute a charge in favour of Mr. Connolly.
51. Ultimately, the charge was executed on the 23rd November, 2017 and registered with the Companies Registration Office on the 30th November, 2017.
52. Mr. Connolly avers that he was aware that the company was experiencing cash flow difficulties and that a 21-day warning letter had been received from one of its creditors. However, he advises that in his experience as an auditor, companies experiencing cash flow difficulties frequently receive threats by creditors to issue winding-up proceedings 'many of which never materialise'.
53. At the resumed hearing, affidavit evidence was adduced from Mr. Patrick Behan, administrative officer, on behalf of the Revenue Commissioners, a creditor of the company. He avers that Revenue's estimate of its indebtedness in the liquidation is €77,106.75.
54. Further, he expresses surprise that the Revenue, as a *legitimus contradictor* affected by the outcome of the within application, was not put on notice of the application at the very outset.
55. Thereafter, he avers to Revenue's support for the liquidator's contention that the Connolly charge is void pursuant to s. 602(2) of the Companies Act 2014.
56. In relation to the respondent's contention that the loan itself entered into in September 2016 is the key agreement for the purposes of s. 602, as distinct from the charge, the Revenue posits that this is simply not correct. It is contended that if the respondents'

right to the charged asset was preserved by the September 2016 loan agreement, there would be no need for the Connolly charge created on the 23rd November, 2017.

57. In all the circumstances, Mr. Behan contends that the charge is incapable of validation pursuant to s.602 of the Companies Act 2014.

Discretion to validate post-liquidation dispositions

58. As already stated above, the term 'disposition of the property' has been given a wide meaning to include all transactions that involve the company being divested of anything of value, and includes charges given over assets. It is incumbent on the applicant, as liquidator, to take such steps as are necessary to protect the assets of the company and to ensure that they are preserved intact for the benefit for those who will be entitled to them.

59. Forde et al (The Law of Company Insolvency, 3rd Edition, 2015, para. 11-10) note as follows:

"Where the company is insolvent, the proposed disposition will be considered very carefully by the court, and will only be sanctioned where clearly it will benefit the creditors or there is some other very good reason for doing so." (Emphasis added)

60. The relevant part of s.602 of the Companies Act is a critical safeguard for creditors of an insolvent company. The legislation provides that the debts and assets of a company are effectively frozen at the commencement of the winding-up and the assets are to be distributed to the creditors in accordance with the statutory scheme. The underlying principle is that at the date of commencement of a winding-up, the assets of an insolvent company shall be realised to meet the claims of its creditors- who will not otherwise have their debts paid- subject to the costs of those realisations.

61. In *Re A.I. Levy (Holdings) Limited* [1963] 2A11 ER 85, the company sold its interest in a leasehold property for market value after the petition was presented because the lease could be forfeited if the company was wound up. The court validated the disposition as being clearly in the interests of all the creditors.

62. In *Gray's Inn Construction Company* [1980] 1 A11 E.R. 814 at 821, the court determined as follows:

"The court should not validate any transaction or series of transactions which might result in one or more pre-liquidation creditors being paid in full at the expense of other creditors, who will only receive a dividend, in the absence of special circumstances making such a course desirable in the interests of the unsecured creditors as a body."

63. In *Re Lynch, Monaghan & O'Brien Ltd* (High Court, Unreported, 9 June 1989), Costello J. observed that the discretionary validation jurisdiction conferred on the courts is intended primarily for dispositions to creditors whose debts arise after the presentation of the petition. Clearly, this is not the case in this instance, where the respondents claim that

the debts at issue arose approximately 18 months prior to the presentation of the petition.

64. In *Re Ashmark Ltd (No. 1)* [1990] ILRM 330, fees were discharged to a solicitor in respect of services provided prior to the presentation of the winding-up petition. O'Hanlon J. refused to validate the disposition, notwithstanding that it was argued that the solicitor was unaware that the payment was made after the commencement of the winding-up, and held that the solicitor had constructive notice that the petition had been presented. O'Hanlon J. further held that special circumstances must exist for a post-liquidation to be validated and stated as follows:

"I find it hard to envisage a situation where the court would validate a payment in full made after the commencement of a winding-up, in respect of services rendered, or goods sold, or other obligations incurred by the company prior to the winding-up, and when similar treatment could not be accorded to the general body of unsecured creditors."

65. In *Re French's Wine Bar* [1987] B.C.L.C. 449, the High Court in England and Wales in considering the equivalent English provision to s.602, held that where the company has made an unconditional contract for the sale of property, which it duly completes after the liquidation commenced, the transaction is not void. However, it was held that if the contract was conditional or if its terms were varied, it depended on the circumstances whether or to what extent the transaction was invalidated.

Legal submissions

66. Counsel on behalf of the liquidator submits that the principles applicable to the validation of post-liquidation dispositions militate against the transaction being validated in circumstances where the effect of such validation would be to grant priority to the respondents over the preferential and/or unsecured creditors and would reduce the dividend payable to them.
67. Further, it is submitted that whether by themselves or through their solicitors, the respondents should be held to have been on constructive notice of the presentation of the winding-up petition prior to the execution of the charge and reliance is placed on the Ashmark decision in support of this proposition.
68. In addition, the Court's attention is drawn to the unique position of the respondents as auditors/accountants to the company in circumstances where it has been acknowledged by the respondents on affidavit that they were well aware of the company's difficult financial circumstances. It is submitted that the charge was for the purpose of seeking priority for the respondents over the company's unsecured and preferential creditors.
69. Counsel on behalf of the respondents contends that the Connolly charge was created in circumstances where the obligation on the part of the company to grant the charge in favour of the respondents arose as a result of the loan agreement entered into on the 16th September, 2016. It is submitted, therefore, that as and from that date there was

an enforceable agreement between the company and the respondents that a first fixed charge would be put in place over the subject property.

70. Counsel relies on the *French's Wine Bar* decision in submitting that the requirement in the loan agreement to execute a first fixed charge in favour of the respondents was an unconditional contractual term and that the execution of that aspect of the loan agreement post-presentation of the petition should not be deemed to be a disposition to which s.602 can apply.
71. However, it must be noted that the facts of that case are clearly distinguishable from those at issue here. It involved a situation where the company had entered into an unconditional contract to sell a property to a third party sometime prior to the commencement of its liquidation. Under English law, the entire beneficial interest in the property had passed to the purchaser prior to the liquidation, and all that remained was the completion of the contract (this is also the position in Irish law under s.52 of the Land and Conveyancing Law Reform Act 2009).
72. Unsurprisingly, the court held that the completion of the contract did not engage the equivalent provision to s.602, because the company had no beneficial interest in the property prior to the liquidation and so would not have been free to deal with the property or to realise same for the benefit of its creditors afterwards. Accordingly, there was no disposition of the property because the beneficial interest had already transferred. The purchaser of the property would have been entitled to an order for specific performance completing the transaction.
73. An alternative argument is put forward by the respondents in contending that even if the execution of the charge on the 23rd November, 2017 is deemed to be a disposition within the meaning of s.602, it is submitted that the court should exercise its discretion in favour of the respondents and validate the charge.
74. Counsel contends that the respondents entered into a *bona fide* loan agreement with the company in September 2016 and the clear terms of the loan agreement required the putting in place of a first fixed charge in favour of the respondents. In the circumstances, counsel posits that the delay on the part of the company in complying with its contractual obligation to execute the charge should not operate against the respondents as *bona fide* creditors of the company.
75. The Revenue supports the submissions made on behalf of the liquidator in asserting that the directors of the company sought to convey the property of the company in favour of the respondents at a time when the company was insolvent. It is submitted that the assets were subject at that point to the statutory scheme for insolvent companies, and the constructive trust issue recognised at common law.
76. Counsel cites the decision In *Re. Frederick Inns Limited* [1994] 1 ILRM 387 in support of this proposition wherein the Supreme Court held that when a winding-up order is made a company ceases to be the beneficial owner of its assets and the directors no longer have

the power to dispose of them. It further held that the directors owed a duty to the creditors to preserve the assets to enable them to be applied *pro tanto* in discharge of the company's liabilities.

Conclusions

77. Firstly, I am satisfied having regard to the decision in *Re Motor Racing Circuits Limited* that the execution of the Connolly Charge on the 23rd November, 2017 was a post liquidation disposition for the purpose of s.602 of the Companies Act, in circumstances where it was executed some three days after the winding up petition was presented.
78. I simply cannot accept the respondents' proposition that the Connolly Charge is not a disposition for the purpose of the section in circumstances where it submits that the company entered into an unconditional contract before the presentation of the petition. It is clear that the loan agreement entered into on the 16th of September, 2016 did not legally effect a charge over the secured property. The debenture dated the 23rd of November, 2019 was required to do this. If it wasn't, there would have been no necessity for it at all.
79. The fundamental issue, therefore, for determination by the Court is whether the Connolly charge is void pursuant to s.602(2) of the Companies Act 2014 because it was created after the deemed date of commencement of the company's liquidation.
80. Clearly, the purpose of s.602 is to freeze the affairs of the company upon the presentation of the winding-up petition, so that the directors cannot thereafter choose to take steps to place certain creditors in a better position than others as regards payment of debts.
81. In *Re. World Port Ireland Limited* [2005] IEHC 189, Clarke J. in the High Court stated as follows:
- "It seems to me that the primary purpose of the section is to ensure, insofar as it may be possible, that the Company is 'frozen' as of the date of the presentation of the winding-up petition. Where it is sought to wind-up a company on the basis of insolvency it will, save in the most exceptional cases, be the case that the company will end up being unable to pay all of its debts."*
82. The court further held as follows: -
- "The Companies Acts provide an elaborate code for determining where the burden of not being paid should lie. The primary purpose of the section, it seems to me, is to ensure that the court has ample power to prevent any adjustment occurring subsequent to the presentation of the petition, which would disturb that elaborate balance."*
83. It is readily apparent that in the instant case the directors of the company sought to convey the property in favour of certain creditors ie. the respondents, at a time when the

company was insolvent. The assets of the company were at that time subject to the statutory scheme for insolvent companies and were effectively 'frozen'.

84. Further, it is clear that the loan transaction was not carried out in the ordinary course of the company's business as it related to a once-off loan advanced some eighteen months previously by the respondents, being the company's accountants. The respondents were in a unique position whereby they were at all times aware or ought to have been aware of the financial position of the company. Indeed, it is notable that the respondents have never denied that they were aware of the petition.
85. Further, they have conceded that they were aware that a s.570 demand had been served on the company. In the circumstances, I can only conclude on the basis of the *Ashmark* decision that the respondents – whether by themselves and/or through their solicitors – had constructive notice of the presentation of the winding-up petition prior to the execution of the charge.
86. Indeed, it may well be that the charge was for the very purpose of granting the respondents priority over the company's unsecured and preferential creditors.
87. For all the reasons foregoing, and having carefully considered the disposition, I am satisfied that the charge is void pursuant to s.602(2) of the Companies Act 2014.
88. Further, I am satisfied that there are no 'special circumstances' which could justify the Court exercising its discretion to validate the charge. To do so would undermine the statutory scheme and would be to the detriment of the company's creditors.

Appendix: Chronology of relevant dates

23 May 2016	AIB Charge is created
26 May 2016	AIB Charge is registered
16 September 2016	Loan Agreement between Respondents and Company allegedly executed
30 September 2016	Sum of €150,000 loaned by Respondents to the Company
21 September 2017	Two Section 570 notices served on the Company by different creditors
20 November 2017	Winding-up Petition against the Company is presented
23 November 2017	Connolly Charge is created

30 November 2017	Connolly Charge is registered
4 December 2017	Company is placed in liquidation by Order of the High Court