MAPLES GROUP

UPDATE

Directors Personally Liable for the Fraud of a Company

In a landmark decision[1], the Irish High Court ("High Court") recently held directors and shadow directors personally liable for funds misappropriated by a company as part of a fraudulent investment scheme worth €186 million. This represents the first time that an Irish court has pierced the corporate veil to hold directors personally liable, notwithstanding the well-established company law principle that a company has a separate legal personality to its members and directors. The judgment serves as a stark reminder of the importance of directors' duties and, in particular, the potential consequences for their dereliction by passive directors.

Background

The judgment arose from an application by a plaintiff 'investor' against two directors and two shadow directors of an Irish registered company called Greymountain Management Limited ("Greymountain") which was in liquidation. Greymountain acted as a key middleman in a supposed binary option trading enterprise that defrauded unsuspecting members of the public, primarily based in the US, with the assistance of 'brokers' from a call centre in Israel. The use of an Irish company was said to have provided a 'veneer of legitimacy' in that 'investors' understood they were investing in an entity which was registered and regulated in Ireland and the European Union.

Greymountain was beneficially owned by Mr David Cartu who, together with his brother Mr Jonathon Cartu (the "Cartu Brothers"), were deemed to be shadow directors of Greymountain and to be the controlling minds behind its use as an instrument of fraud.

The directors of Greymountain during the period of the fraud were both Irish. The first director was a consultant to a firm of accountants and an experienced company director who maintained that his role was purely administrative. The second director was a college student who maintained that he became a director in name only and because the owners 'needed a local person'.

The Test for Piercing the Corporate Veil

The High Court concluded that, while lifting the corporate veil is not to be done lightly, the Irish courts will contemplate finding directors personally liable for the acts or omissions of a company, if:

- it is a case of fraud or the misapplication of monies or misrepresentation, on the part of the directors;
- a case of the directors syphoning off large sums of money out of the company so as to leave the company unable to fulfil its obligations; or
- there is negligence or impropriety on the part of the directors in the conduct of the affairs of the company.

Personal Liability of the Shadow Directors

The High Court saw no reason in principle to distinguish between shadow directors and directors when applying the above principles.

[1] *Powers v Greymountain Management Ltd (In Liquidation)* [2022] IEHC 599.

Having found that the Cartu Brothers had syphoned off considerable sums of money from Greymountain for their own benefit such that it was unable to repay investors, the High Court considered that as shadow directors they could not evade legal liability by hiding behind the veil of incorporation and held them personally liable for the plaintiff investor's losses.

Personal Liability of the Irish Directors

As the High Court could not conclude on the evidence before it that the Irish directors were aware of the fraud, it considered that their acts and omissions were of a completely different character to those of the Cartu Brothers (who orchestrated and benefitted directly from the fraud). Such acts and omissions included signing payment processing agreements with acquiring banks without investigating their terms, granting a power of attorney to the owner of Greymountain without any oversight of its purpose and signing bank withdrawals and company accounts without acquiring sufficient knowledge of Greymountain's business.

The High Court concluded that the Irish directors were 'unwittingly involved' in facilitating the fraud and that they failed to observe the basic duties of a director in that they failed to:

- inform themselves about the nature of their duties (or they ignored those duties);
- acquaint themselves sufficiently with the affairs of Greymountain; and
- exercise appropriate supervision at a board level in respect of task or functions delegated to others.

While the High Court expressed some sympathy for the position of the Irish directors, it concluded that the impropriety and dereliction of duties on their part was of such a degree as to justify holding both directors personally liable to the plaintiff for the return of his losses.

Key Learnings for Directors of Irish Companies

- Directors should not 'hand over the keys' to a company to shadow directors and should exercise caution and diligence when dealing with third parties.
- Regardless of their level of experience, directors must be sufficiently informed of the company's operations and business in order to discharge their legal duties.
- The granting of a power of attorney by a director to another individual does not discharge the director's duty to oversee actions taken on behalf of the company by an attorney.
- The level of activity of a director in a company's operations (for example, signing agreements) as well as their level of experience may be factors in determining the extent of a director's liability in cases of fraud or negligence.

Conclusion

While it remains a high bar for a court to pierce the corporate veil and find directors or members as legally responsible for a company's liabilities, this case serves as a stark reminder that directors may be made personally liable for losses suffered as a result of a company's fraudulent activities and where the interests of justice require it.

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